

**North Carolina Mutual
Employers Fund**

Financial Statements
Years Ended December 31, 2007 and 2006

North Carolina Mutual Employers Fund

Table of Contents

	Page
Report of Independent Auditors.....	3
Balance Sheets	4
Statements of Income	5
Statements of Members' Equity.....	6
Statements of Cash Flows.....	7
Notes to Financial Statements.....	8-16



Report of Independent Auditors

Board of Directors
North Carolina Mutual Employers Fund
High Point, North Carolina

We have audited the accompanying balance sheet of the North Carolina Mutual Employers Fund (the "Fund") as of December 31, 2007 and the related statements of income, members' equity and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the North Carolina Mutual Employers Fund as of December 31, 2006 were audited by others auditors whose report dated February 12, 2007, expressed an unqualified opinion of those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2007 financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina Mutual Employers Fund at December 31, 2007, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Cherry, Bekaert & Holland, L.L.P.

Charlotte, North Carolina
March 25, 2008

NORTH CAROLINA MUTUAL EMPLOYERS FUND

**Balance Sheets
December 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u>
Assets		
Investments	\$ 38,861,770	\$ 35,709,636
Cash and cash equivalents	7,872,806	7,269,087
Accrued investment income	514,513	447,060
Premiums receivable	6,901,981	7,010,683
Reinsurance recoverable on paid and unpaid losses	9,999,000	8,936,000
Prepaid expenses	629,453	374,117
Deferred income taxes	<u>1,136,000</u>	<u>610,000</u>
Total assets	<u>\$ 65,915,523</u>	<u>\$ 60,356,583</u>
 Liabilities and Members' Equity		
Liabilities		
Insurance losses and loss adjustment expenses	\$ 36,752,000	\$ 33,568,859
Unearned premiums	9,746,213	10,026,095
Accounts payable and accrued expenses	200,150	416,888
Due to third party administrator	474,751	566,982
Federal income taxes payable	<u>533,014</u>	<u>832,694</u>
Total liabilities	<u>47,706,128</u>	<u>45,411,518</u>
 Members' equity		
Unassigned surplus	<u>18,209,395</u>	<u>14,945,065</u>
Total members' equity	<u>18,209,395</u>	<u>14,945,065</u>
Total liabilities and members' equity	<u>\$ 65,915,523</u>	<u>\$ 60,356,583</u>

See accompanying notes to financial statements.

NORTH CAROLINA MUTUAL EMPLOYERS FUND

**Statements of Income
Years Ended December 31, 2007 and 2006**

	2007	2006
Revenues		
Premiums earned	\$ 25,185,573	\$ 23,590,933
Ceded reinsurance premiums	(1,707,611)	(2,329,892)
Net premiums earned	23,477,962	21,261,041
Net investment income	1,943,038	1,524,704
Realized losses on the sale of investments	(3,601)	(25,130)
Total revenues	25,417,399	22,760,615
Expenses		
Losses and loss adjustment expenses	16,959,670	13,059,205
Policy acquisition and underwriting expenses	3,729,399	3,981,273
Total expenses	20,689,069	17,040,478
Income before taxes on income	4,728,330	5,720,137
Taxes on income	1,464,000	1,948,000
Net income	\$ 3,264,330	\$ 3,772,137

NORTH CAROLINA MUTUAL EMPLOYERS FUND

Statements of Members' Equity

	<u>Unassigned Surplus</u>
Balance, December 31, 2005	\$ 11,172,928
Net income	<u>3,772,137</u>
Balance, December 31, 2006	14,945,065
Net income	<u>3,264,330</u>
Balance, December 31, 2007	<u><u>\$ 18,209,395</u></u>

NORTH CAROLINA MUTUAL EMPLOYERS FUND

Statements of Cash Flows
Years Ended December 31, 2007 and 2006

	2007	2006
Cash flows from operating activities		
Net income	\$ 3,264,330	\$ 3,772,137
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
Deferred taxes	(526,000)	(97,000)
Amortization of bond premiums and discounts	(71,629)	(50,172)
Realized loss on sale of investments - net	3,601	25,130
Decrease (increase) in operating assets:		
Accrued investment income	(67,453)	(153,862)
Premiums receivable	108,702	(408,707)
Prepaid expenses	(255,336)	(46,255)
Reinsurance recoverable on unpaid losses	(1,063,000)	(2,218,000)
Increase (decrease) in operating liabilities:		
Insurance losses and loss adjustment expenses	3,183,141	3,906,803
Unearned premiums	(279,882)	1,247,600
Accounts payable and accrued expenses	(216,738)	5,812
Due to third party administrator	(92,231)	49,872
Accrued federal income taxes	(299,680)	763,000
	<u>3,687,825</u>	<u>6,796,358</u>
Net cash provided by operating activities		
Cash flows from investing activities		
Purchase of investments	(9,436,985)	(12,569,586)
Proceeds from sale and redemption of investments	6,352,879	6,447,767
	<u>(3,084,106)</u>	<u>(6,121,819)</u>
Net cash used in investing activities		
Net increase in cash and cash equivalents	603,719	674,539
Cash and cash equivalents, beginning of year	<u>7,269,087</u>	<u>6,594,548</u>
Cash and cash equivalents, end of year	<u>\$ 7,872,806</u>	<u>\$ 7,269,087</u>
Cash paid during the year for:		
Income taxes	<u>\$ 1,764,000</u>	<u>\$ 1,282,000</u>

See accompanying notes to financial statements.

North Carolina Mutual Employers Fund

Notes to Financial Statements
December 31, 2007 and 2006

Note 1 – Summary of Significant Accounting Policies

Business – The North Carolina Mutual Employers Fund (the Fund) was organized on December 13, 1993. The Fund provides workers' compensation insurance coverage to member organizations located in North Carolina. The Fund is subject to the rules and regulations of the North Carolina Department of Insurance and the North Carolina Industrial Commission.

Basis of Presentation – The accompanying financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America which differ from statutory accounting practices prescribed or permitted for insurance companies by regulatory authorities.

Uses of Estimates – The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investments – Investments consist of obligations issued by the U.S. government, mortgage-backed securities and corporate bonds. FASB No. 115, "Accounting for Certain Investments in Debt and Equity Securities," requires that all applicable investments be classified as trading, available-for-sale or held-to-maturity securities. The Fund determines the appropriate classification of its investments in debt and equity securities at the time of purchase and revalues such determinations at each balance sheet date.

Debt securities are classified as held-to-maturity as the Fund has the positive intent and ability to hold the securities to maturity and are stated at amortized cost. The fair value of substantially all securities is determined by quoted market prices.

Net investment income, consisting of interest and dividends, net of investment expense, is recognized when earned. Realized gains and losses on investments are recognized when investments are sold or redeemed on a specific identification basis.

Cash Equivalents – For purposes of the statements of cash flows, cash equivalents are cash on deposit, money market funds, and highly liquid debt instruments that mature within 90 days of purchase. Cash equivalents are carried at cost which approximates fair market value.

To conform with statutory requirements, U.S. treasury notes and cash equivalents totaling \$1,585,604 and \$1,588,043 were on deposit with the North Carolina Department of Insurance at December 31, 2007 and 2006, respectively. *These funds are not used to pay*

North Carolina Mutual Employers Fund

Notes to Financial Statements (continued)
December 31, 2007 and 2006

Note 1– Summary of Significant Accounting Policies (continued)

Prepaid Policy Acquisition Costs – Commissions, premium taxes, and other costs of acquiring new and renewal business are deferred, subject to ultimate recoverability from future income, and amortized on a straight-line basis over the term of the policies (12 months) to which they relate.

Premium Revenue and Credit Risk – Premiums from participants are recognized as earned on a pro rata basis over the policy term. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums. Premiums earned as a result of payroll audits performed at the end of the policy term are recorded at the completion of audit and subsequent receipt. The Fund performs ongoing risk and credit evaluations of its insured members and generally does not require collateral.

Insurance Losses and Loss Adjustment Expense – The liability for losses and loss adjustment expense includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in current earnings. Insurance losses and loss adjustment expenses expected to be paid after one year are discounted a discount rate of 3.98% at December 31, 2007 and 2006, commensurate with the risk involved. The reserve for loss and loss adjustment expenses is reported net of receivables for subrogation of approximately \$776,000 and \$399,000 at December 31, 2007 and 2006, respectively.

Reinsurance – In the normal course of business, the Fund seeks to reduce the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying reinsurance policy. Prepaid expenses include prepaid reinsurance premiums of approximately \$267,000 and \$0 at December 31, 2007 and 2006, respectively.

Income Taxes – Income taxes are calculated using the asset and liability method specified by Statement of Accounting Standards No. 109, "Accounting for Income Taxes." Deferred income taxes reflect the impact of temporary differences between the amount of assets and liabilities for financial reporting purposes and such amounts as measured for income tax purposes.

The Fund is subject to a state premium tax, in lieu of a state income tax.

Fair Value of Financial Instruments – Financial instruments of the Fund include premiums receivable, unearned premiums and accounts payable. Due to short term nature of the premiums receivable, unearned premiums and accounts payable, the estimated fair value of these financial instruments approximate their recorded carrying amounts.

North Carolina Mutual Employers Fund

Notes to Financial Statements (continued)
December 31, 2007 and 2006

Note 2 – Investments

The amortized cost and estimated fair value of investments by major type at December 31, 2007 and 2006 are as follows:

December 31, 2007	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to Maturity Securities:				
U.S. government obligations	\$ 33,679,519	\$ 872,023	\$ (30,134)	\$ 34,521,408
Mortgage-backed securities	322,184	-	(4,879)	317,305
Corporate Bonds	4,860,067	37,040	(41,197)	4,855,910
Total Investments	\$ 38,861,770	\$ 909,063	\$ (76,210)	\$ 39,694,623

December 31, 2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to Maturity Securities:				
U.S. government obligations	\$ 29,980,597	\$ 92,060	\$ (416,602)	\$ 29,656,055
Mortgage-backed securities	386,341	-	(12,959)	373,382
Corporate Bonds	5,342,698	18,193	(113,546)	5,247,345
Total Investments	\$ 35,709,636	\$ 110,253	\$ (543,107)	\$ 35,276,782

The scheduled maturities of the above investments at December 31, 2007 were as follows:

	Amortized Cost	Fair Value
Due in one year or less	\$ 11,539,499	\$ 11,548,002
Due after one year through five years	17,483,255	18,000,499
Due after five years through ten years	9,516,832	9,828,817
Due after ten years	322,184	317,305
	\$ 38,861,770	\$ 39,694,623

Other than Temporary Impairments of Securities and Unrealized Losses on Investments – As of December 31, 2007, the Fund had nine securities deemed to be temporarily impaired. These investments had aggregate unrealized losses of less than 6.78% and no single security loss exceeded \$52,916.

North Carolina Mutual Employers Fund

Notes to Financial Statements (continued)
December 31, 2007 and 2006

Note 2 – Investments (continued)

In concluding that investments with unrealized losses are not other-than-temporarily impaired, positive evidence consisted of: 1) no specific events related to credit risk of the issuer caused concern; 2) interest payments are current; 3) market prices have risen; 4) changes in market value are normal relative to fluctuations in overall interest rates; and 5) the Fund has the positive intent and ability to hold the security until the anticipated recovery in value occurs.

The fair value and amount of unrealized losses segregated by the time period for which the investment has been in an unrealized loss position is as follows:

December 31, 2007:	Less than 12 months		Greater than 12 months	
	Fair Value of Investments with Unrealized Losses (000)	Gross Unrealized Losses (000)	Fair Value of Investments with Unrealized Losses (000)	Gross Unrealized Losses (000)
Debt securities:				
U.S. government obligations	\$ 4,414	\$ (28)	\$ 596	\$ (2)
Mortgage-backed securities	-	-	317	(5)
Corporate Bonds	598	(2)	2,544	(39)
Totals	\$ 5,012	\$ (30)	\$ 3,457	\$ (46)

December 31, 2006:	Less than 12 months		Greater than 12 months	
	Fair Value of Investments with Unrealized Losses (000)	Gross Unrealized Losses (000)	Fair Value of Investments with Unrealized Losses (000)	Gross Unrealized Losses (000)
Debt securities:				
U.S. government obligations	\$ 2,643	\$ (4)	\$ 16,994	\$ (412)
Mortgage-backed securities	586	(6)	3,562	(108)
Corporate Bonds	-	-	373	(13)
Totals	\$ 3,229	\$ (10)	\$ 20,929	\$ (533)

North Carolina Mutual Employers Fund

Notes to Financial Statements (continued)
December 31, 2007 and 2006

Note 2 – Investments (continued)

Major categories of net investment income are summarized as follows:

	2007	2006
Held-to-maturity securities	\$ 1,700,262	\$ 1,348,384
Cash & cash equivalents	328,380	265,364
	<u>2,028,642</u>	<u>1,613,748</u>
Investment expenses	(85,604)	(89,044)
Net investment income	\$ 1,943,038	\$ 1,524,704

Proceeds from the sale of bonds were \$2,352,879 and \$3,547,767 in 2007 and 2006, respectively, on which gross gains of \$2,315 and \$121 and gross losses of \$5,916 and \$22,251 were realized on those sales in 2007 and 2006, respectively. The carrying amount at the date of sale of the bond sold was \$2,356,480 and \$3,569,897 in 2007 and 2006, respectively.

Note 3 – Prepaid Insurance

Prepaid expenses consist of the following:

	2007	2006
Prepaid reinsurance expense	\$ 267,009	\$ -
Prepaid policy acquisition costs	362,444	374,117
	<u>\$ 629,453</u>	<u>\$ 374,117</u>

North Carolina Mutual Employers Fund

Notes to Financial Statements (continued)
December 31, 2007 and 2006

Note 4 – Insurance Losses and Loss Adjustment Expenses

The incurred and paid activity in the liability for insurance losses and loss adjustment expenses is as follows:

	2007	2006
Balance at January 1	\$ 33,568,859	\$ 29,662,056
Less reinsurance recoverable at January 1	8,936,000	6,718,000
Net balance at January 1	24,632,859	22,944,056
Incurred related to:		
Current year	19,963,670	17,953,205
Prior years	(3,004,000)	(4,894,000)
Total incurred	16,959,670	13,059,205
Paid related to:		
Current year	7,204,637	5,688,402
Prior years	7,634,892	5,682,000
Total paid	14,839,529	11,370,402
Gross balance at December 31	26,753,000	24,632,859
Plus reinsurance recoverable at December 31	9,999,000	8,936,000
Balance at December 31	\$ 36,752,000	\$ 33,568,859

Insurance losses and loss adjustment expenses expected to be paid after one year are discounted at a discount rate of 3.98% at December 31, 2007 and 2006, commensurate with the risks involved. Insurance losses and loss adjustment expense reserves are recorded net of present value discounts of \$3,475,000 and \$2,595,000 in 2007 and 2006, respectively.

The Fund's estimation of reserves for insurance losses and loss adjustment expenses as of December 31, 2007 and 2006 were decreased by \$3,004,000 and \$4,894,000, respectively for claims that occurred in prior years. This favorable development during 2007 and 2006 was attributable to additional information that has become available that provides a better approximation of the amounts expected to be paid.

North Carolina Mutual Employers Fund

Notes to Financial Statements (continued)
December 31, 2007 and 2006

Note 5 – Reinsurance

The Fund was party to non-proportional reinsurance agreements in 2007 and 2006, primarily to protect it against catastrophic losses but also to limit losses on individual claims for benefit payments and certain other risks.

Reinsurance contracts do not relieve the Fund from its primary obligation to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Fund; consequently, allowances may be established for amounts deemed uncollectible. The Fund evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. Based on the financial condition of the Fund's reinsurers and collections history, the Fund did not record an allowance for uncollectible reinsurance recoverable on unpaid losses as of December 31, 2007 and 2006.

At December 31, 2007 and 2006, the Fund had reinsurance recoverable on unpaid losses of approximately \$9,999,000 and \$8,936,000 with three reinsurers, none of which was in dispute as of December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, prepaid reinsurance premiums were \$ 267,009 and \$0, respectively. The Fund does not hold collateral under their reinsurance agreements.

For the years ended December 31, 2007 and 2006, the Fund recognized ceded reinsurance premiums of \$1,707,611 and \$2,329,892, respectively. These amounts have been reflected as a reduction of premiums earned on the statements of income. In addition, the Fund has reduced its losses and loss adjustment expenses incurred by approximately \$287,000 and \$9,000 as of December 31, 2007 and 2006 for losses ceded to its reinsurers.

Note 6 – Income Taxes

Provisions for income taxes in the statements of income consisted of the following components:

	2007	2006
Current - federal	\$ 1,990,000	\$ 1,851,000
Deferred - federal	(526,000)	97,000
Total taxes on income - federal	\$ 1,464,000	\$ 1,948,000

The U.S. federal statutory income tax applicable to ordinary income is 34 percent for 2007 and 2006. The Fund's effective federal income tax rate differs from the statutory rate in 2007 due to a true up of deferred income taxes, of \$144,000, related to loss reserves. The Fund's effective federal income tax rate approximated the statutory rate during 2006.

North Carolina Mutual Employers Fund

Notes to Financial Statements (continued)
December 31, 2007 and 2006

Note 6 – Income Taxes (continued)

The components of the temporary differences and their effect on deferred taxes are as follows:

	2007	2006
Loss reserves	\$ 580,000	\$ 38,000
Unearned premiums	663,000	682,000
Deferred policy acquisition costs	(123,000)	(127,000)
Capital loss carryforward	16,000	17,000
Total deferred federal tax asset	\$ 1,136,000	\$ 610,000

For the years ended 2007 and 2006, no valuation allowance was necessary for deferred tax assets since it is more likely than not the deferred tax assets will be fully realized in the future.

Note 7 – Statutory Net Income and Members' Equity

The Fund, which is domiciled in North Carolina, prepares its statutory financial statements in accordance with accounting principles and practices prescribed or permitted by the North Carolina Department of Insurance, which North Carolina recognizes for determining solvency under North Carolina Insurance Law. The commissioner of the North Carolina Department of Insurance has the right to permit other practices that may deviate from prescribed practices required by the National Association of Insurance Commissioners (NAIC). Prescribed statutory accounting practices (SAP) are those practices that are incorporated directly or by reference in state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in North Carolina. Permitted SAP encompass all accounting practices that are not prescribed, such practices differ from state-to-state, may differ from company-to-company within a state, and may change in the future. The Fund has not adopted any accounting practices that differ from those required by the NAIC.

Generally accepted accounting principles differ in certain respects from the accounting practices prescribed or permitted by insurance regulatory authorities (statutory basis). Statutory net income was approximately \$2,540,000 and \$3,727,000 in 2007 and 2006, respectively, and statutory members' equity was approximately \$14,956,000 and \$12,416,000 at December 31, 2007 and 2006, respectively.

The maximum amount of dividends which can be paid by the State of North Carolina insurance companies to policyholders without prior approval of the Insurance Commissioner is the lesser of 10 percent of statutory surplus or defined net income of the previous twelve-month period ended December 31. The State of North Carolina requires the Fund to maintain a minimum statutory surplus balance of \$300,000. No dividends were paid to policyholders for the year ending December 31, 2007 and 2006.

North Carolina Mutual Employers Fund

Notes to Financial Statements (continued)
December 31, 2007 and 2006

Note 8 – Commitments and Contingencies

The Fund has entered into a contractual arrangement with a servicing agent to provide various administrative and management services on behalf of the Fund. This agreement may be terminated in accordance with certain provisions as stipulated in the agreement. In the event this contract is terminated, the Fund would become responsible for claims administration on all unsettled claims incurred during the period the servicing agent's contract was in effect.

In the normal course of business, the Fund may become involved in workers' compensation related litigation. In the opinion of management disposition of such litigation will not have a material impact on the financial position of the Fund.

Note 9 – Concentration of Credit Risk

The Fund is exposed to credit risk in the area of cash and cash equivalents, certificates of deposit, and investments. The Fund places its cash and cash equivalents, certificates of deposit, and investments on deposit with a North Carolina financial institution. The Fund maintains balances in these accounts that are in excess of the \$100,000 insured amount covered by the Federal Deposit Insurance Corporation.

Note 10 – Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48") and interpretation of FASB Statement No. 109 ("SFAS 109"). This interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS 109. "Accounting for Income Taxes." FIN 48 details how companies should recognize, measure, present, and disclose uncertain tax positions that have been or expect to be taken. As such, financial statements will reflect expected future tax consequences of uncertain tax positions presuming the taxing authorities' full knowledge of the position and all relevant facts. This statement is effective for fiscal years beginning after December 15, 2006. Management does not expect the adoption of FIN 48 to have a material impact on its financial position or results of its operations.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157. "Fair Value Measurements" ("SFAS No. 157"). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions