

2012 Annual Report



THE MUTUAL FIRE
INSURANCE COMPANY
OF BRITISH COLUMBIA

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Chairman Report

Jake Bredenhof

Chairman

This year has shown that The Mutual Fire Insurance Company of British Columbia is resilient in the face of adversity. The company withstood both frequent and severe losses, above those previously experienced. The board along with management have identified a number of strategic areas that will be a focus as we move forward. It's satisfying to know that as a company we were able to remain competitive and financially strong during this challenging year. However, claims are unpredictable and it is this unpredictability that reminds us why we are in this business in the first place. To look after our policyholders when a fortuitous event gives rise to financial hardship.

It is a rare year when Mutual Fire has to rely on our investment income to keep us profitable, but thankfully our investments did remarkably well as you will see in the presentation of the financial statements. Our conservative investment approach to preserve capital for our members ensures that capital is there to pay for your claims when needed.

As we move forward, we realize our most valued assets are people. Mutual Fire has a tremendous, capable and forward thinking staff and management along with a vibrant broker network. Much effort is made to keep a good line of communication with our brokers.

This past year significant effort was utilized in enhancing our information systems. In a competitive industry we cannot be complacent with regard to technology as it changes so rapidly.

To our management and staff at Mutual Fire Insurance, I thank you on behalf of the board for your dedication and determination to Mutual Fire. It is our hope that we continue to thrive and grow across western Canada.

To the board, thank you for your dedication and commitment to improved board governance.



President & Chief Executive Officer Report

Darin Lord Nessel, CIP

President & Chief Executive Officer

The Mutual Fire Insurance Company of British Columbia had another solid year of growth, as we continued to underwrite business throughout Western Canada. This is a remarkable testimony indeed for a Company of our size to service such a large geographical area. Current and future challenges will keep us focused, such as exercising underwriting discipline, combined with adequate rate for risk return, not to mention low interest rates on government bonds continuing to place more importance on underwriting performance as opposed to investment income.

Overall, the Canadian insurance industry remains well capitalized, although worldwide influences such as the fragile global economy, Europe in recession and slow growth in Canada, USA and Japan will continue to challenge our ability and that of the entire insurance industry to grow and stay financially strong.

On the heels of the earthquake catastrophe losses of Japan and New Zealand, earthquake became one of the main topics of discussion, amongst reinsurers, Insurers and regulators alike. This topic is of critical importance for us in British Columbia, which is a well-known earthquake exposed region. Our underwriting of business into the prairie provinces helps to spread the earthquake risk of the company, so eventually a much smaller proportion of the overall gross written premiums, will be in high earthquake exposure areas.

Several developments have recently high-lighted the risks and costs of a major earthquake, including increased property values, increased loss estimates from modeling, increased reinsurance costs from recent global earthquakes, and anticipated increased reinsurance requirements as a result of regulatory changes.

I want to assure the policyholders of The Mutual Fire Insurance Company of British Columbia, that the management and Board are vigilant in working with regulators and reinsurers to ensure proper compliance and accurate data assembly of our earthquake exposure risk.

Mutual Fire endured a challenging year with respect to claims. There was an increase not only in severity of losses but also in frequency. In part, the severity in losses can be

attributed to the underwriting of a relatively new line of business to the Company, commercial lines. We entered into the commercial market six years ago, or year three, of now eight consecutive years of soft market rating. We continue to make internal changes to groom our commercial portfolio in order to become profitable. Industry-wide, especially in British Columbia we have seen some improvement on the commercial rating front and we anticipate seeing some continuation of this trend as we look ahead.

Further exacerbating our difficult claims year was an increase in our frequency of losses. Since our foray into the provinces of Alberta, Saskatchewan and Manitoba we have seen severe weather activity resulting in increased claims. The majority of these claims resulting from hail losses. We are watching this severe weather phenomenon closely and are making the appropriate changes to our underwriting guidelines.

As the company enters into new jurisdictions of underwriting, we are realizing that it could take several more years within those jurisdictions until we see consistent profitable results. We do remain thankful that our strong, overall farm portfolio which stands at 52% of our overall gross written premiums continues to be profitable. We completed the year with a favorable 46.48% farm gross loss ratio.

The management has worked diligently to reduce our expense ratio this past year and was successful in doing so. We will continue to do the same during 2013.

Our bottom line was not as profitable as previous years. However, we were able to operate as a true Mutual, in other words "offering Insurance products at cost." We did this while maintaining our AM Best rating of A- (Excellent) with a continued 'stable' outlook. As an organization we are very proud of this rating.

In conclusion, I observe the recent business placed on our books and as it matures, combined with increased rates, fewer broker appointments and internal strengthening of the company, I forecast a much stronger year for The Mutual Fire Insurance Company of British Columbia in 2013.



Underwriting Report

Pina Dorey

Personal Lines Manager

Our main focus was to increase the business we underwrite in the Prairie Provinces, while continuing with our strong presence in British Columbia. Our targets of increasing the volume in each of the Personal lines, Commercial lines and our Farm portfolio were also met. We feel it is extremely important that while spreading the risk of the company across Western Canada, we also maintain balance among our lines of business.

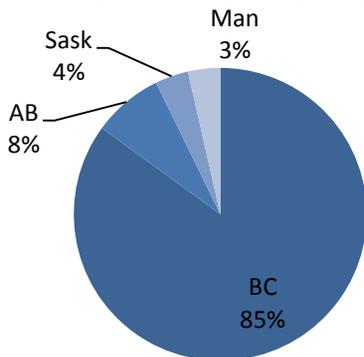
Each of our three underwriting teams are highly attentive to the pressures within the insurance industry. Each team displays the responsibility and vision required to advance the proficiency of a successful underwriting organization. Underwriting for the losses that we see today, is an ever evolving, ever changing landscape. At one time our underwriters assessed a risk for fire, water and theft among other perils. In today's environment, our underwriters face challenges like assessing earthquake risk, location of a risk

with respect to potential forest fires, which in terms of frequency and severity are now an annual event, and today we are faced with severe weather patterns in the prairies. As you can begin to appreciate, our underwriters are making "by the minute" decisions, accurately and utilizing fair assessments of risk in doing so.

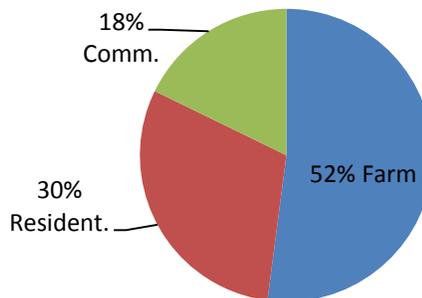
At this time, I would like to extend my gratitude to the Personal, Farm and Commercial teams and support staff for their dedication and hard work. We have bigger and better things to accomplish in 2013, including continuing to improve our processes, workflows and ultimately a more timely distribution of our products to our network of brokers and policyholders.

Our company is supported by approximately 575 broker branches throughout Western Canada, and it is our commitment to continue to remain loyal to the distribution network. We would like to thank each of our broker's for their continued partnership.

2012 Premiums



Premiums by Policy



The total of in force policies grew from 21,548 in 2011 to 29,556 in 2012 a 37% increase



Claims Department Report

Pamala Louttit, CIP Claims Manager

2012 was a busy year for the Claims Department. Our Team processed 964 new claims, including 14 Excess losses. Our total number of claims handled increased by 48%. We worked together to ensure that our policyholders were given the best possible service, and I am pleased to say that the response received from our Policyholders and Brokers was most positive.

It was also a year for unusual losses. Losses that seasoned adjusters rarely come across. For instance, losses that involved significant contents, “hoarding” as it has become known, are increasing in regularity. We are also beginning to see this type of loss at the forefront of many discussions and industry publications. Whether societal and economic influences are coming forward remains to be seen. Nonetheless, these types of losses are most difficult to settle—we must recognize that all property is important to its owner.

There were significant changes to the Insurance Acts effective July 1, 2012. Previously, Statutory Conditions were only required to be included in every fire policy; now they are included in every multi-peril property policy. The limitation period for property losses in BC was increased to two years from the date the insured “knew or ought to have known the loss or damage occurred”. The Insurance Act of Alberta was also amended to provide for a two year limitation period, in effect harmonizing all Western Provinces. We must also provide a reminder notice of the proscription date on the one year anniversary date for open claims. This procedure of reminding the policyholder of a pending proscription date is not new to MFI.

Further, and in an effort to strengthen consumer protection, the regulations set out the requirement for an insurer to give written notice of Alternate Dispute Resolutions to the insured within 10 days of the Insurer becoming aware of a disagreement. We are now registered with the General Insurance Ombudservice (GIO) – an independent resolution service for helping consumers resolve disputes with their home, auto and business insurance. I am pleased to say that we have received no complaints to date. Our Claims Team is very cognizant of good customer service and work diligently to that end.

Gross Incurred Losses for 2012 were \$28.5 million compared to \$19.5 million in 2011. Excess Losses in 2012 were 14 compared to 13 in 2011 and accounted for \$10.0 million in gross claims. We define an excess loss as any claim that exceed our per risk retention. For property our retention is \$300,000 per risk and liability is \$350,000. Our property retention under our reinsurance treaty will increase by \$50,000 in 2013.

We invite our policyholders to respond to our Customer Satisfaction Survey sent out on all claims. We are always open to the introduction of new ideas and suggestions as this is where improvements are generated from.

As a Claims Team, we look forward to continuing our high standard of customer service and our focus to settle claims promptly, efficiently and fairly remains.



Finance Department Report

Jason Christopherson, CGA, BAccSc
Chief Financial Officer

With 2012 coming to a close The Mutual Fire Insurance Company of British Columbia completed its 110th year of providing peace of mind with a regional perspective. While maintain or regional approach we have become the only British Columbia based insurer that insures risks in all of the western provinces. We have always believed that success can be achieved in a manner that is consistent with our principles and ideas that unit us as mutual. This sets us apart from our competitors, and allows us to know we always do the right thing for our members.

We have come a long way from 1902 with premiums of \$550, salaries of \$125, and agents' commissions of \$45. We now write more premium in less than one month than we wrote in our first 50 years. In 2012, our premiums growth of \$6,924,096 represents an increase of 18% over last year. Net premiums earned increased 20% to \$35,548,713. Increased claims levels this year resulted in a loss ratio of 62.50% and a combined ratio of 103.06% representing a \$1,091,713 in underwriting loss. A respectable increase of 14% in investment income to \$1,481,821 helped contribute to a net income after tax of \$336,261.

With our conservative investment approach Mutual Fire Insurance ensures only high quality investments are maintained in our investment portfolio. Our investment portfolio consists of accumulated unrealized gains in 2012 of \$1,107,667. Significantly higher than 2011, which was \$375,220. A \$732,457 increase. Added to net income our after taxes Comprehensive income for the year was \$1,108,682.

The insurance industry continues to face the challenges of the past few years. Low investment returns and soft underwriting profits continue to put pressure on results. The Mutual Fire Insurance Company of British Columbia has not been immune to these pressures as evidenced by our underwriting loss in 2012. However, these challenges experienced by all insurers have created opportunities for Mutual Fire as other insurers reallocate their capital and move away from some markets and into others. By strategically taking advantage of opportunities we have been able to grow the business and provide greater value to our members. We are well positioned to meet the challenges of 2013.

Insurance Regulators over the past year have continued to make significant changes to how we as an insurer manage our capital. The changes made by the regulators required Mutual Fire to apply a more risk based measurement of our minimum capital requirements calculated each quarter. The new guidelines required Mutual Fire to include interest rate risk and credit rate risk of investments in our calculations. The result was increased minimum capital requirements. I am pleased to say that even with these increased requirements The Mutual Fire Insurance Company of British Columbia continues to maintain capital levels that exceed the minimum by 352% and surpasses most insurance companies in the industry. We are well capitalized and remain strong.

Although 2012 was a challenging year the determination and passion of our employees, brokers and partners will ensure we continue to build on our strengths in 2013.

Company Profile

HEAD OFFICE

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Langley, BC Canada
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Phone: 604- 881-1250
Toll Free: 1-866-417-2272

AUDITORS

KPMG Enterprise
1827 West 5th Avenue
Vancouver, BC Canada
V6J 1P5

ACTUARY

Baron Insurance Services Inc.
206 Laird Dr. East
York, ON Canada
M4G 3W4

Board of Directors



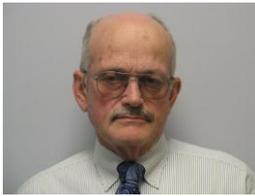
Jake Bredenhof
Chairman



Don Hooge
Vice Chairman



Bill Adams
Treasurer



Darryl Cherry
Director



Mike Bose
Director



Ralph Terpstra
Director



Jeff Regier
Director



John Pruim
Director

AUDIT COMMITTEE

Bill Adams (Chair), Jake Bredenhof, Ralph Terpstra

CONDUCT REVIEW COMMITTEE

Jake Bredenhof (Chair), John Pruim, Daryl Cherry, Bill Adams

INVESTMENT COMMITTEE

Don Hooge (Chair), Jeff Regier, Mike Bose

Management Statement

The Mutual Fire Insurance Company of British Columbia • Years Ended December 31, 2012 and December 31, 2011

The financial statements are the responsibility of management and have been prepared in conformity with Canadian Generally Accepted Accounting Principles including the accounting requirements of the Insurance Act of British Columbia and the Financial Institutions Act. In the opinion of management, the financial statements fairly reflect the financial position, results of operations and cash flows of The Mutual Fire Insurance Company of British Columbia within reasonable bounds of materiality.

Preparation of financial information is an integral part of management's broader responsibilities for the ongoing operations of the Company. Management maintains an extensive system of internal accounting controls to ensure that transactions are accurately recorded on a timely basis, are properly approved and result in reliable financial statements. The adequacy of operation of the control systems is monitored on an ongoing basis by management.

The Board of Directors is responsible for approving the financial statements. It has established an Audit Committee, comprised of directors who are neither officers nor employees of the Company who meet with management, the actuary and external auditors, all of whom have unrestricted access and the opportunity to have private meetings with the Audit Committee, to review the financial statements. The Audit Committee then submits its report to the Board of Directors recommending approval of the financial statements.

The Financial Institutions Commission makes a bi annual examination and inquiry into the affairs of the Company as deemed necessary to ensure that the Company is in sound financial condition and that the interests of the policyholders are protected under the provisions of the Insurance Act of British Columbia and the Financial Institutions Act.

The actuary has been appointed by the Board of Directors. The actuary is required to carry out a valuation of the policy liabilities recorded by the Company in its financial statements and report thereon to the shareholder. Policy liabilities consist of the provisions for and reinsurance recovery of unpaid claims and adjustment expenses on insurance policies in force, including provisions for salvage and subrogation, and future obligations on the unearned portion of insurance policies in force, including deferred policy acquisition costs. The valuation is made in accordance with accepted actuarial practice, as well as any other matter specified in any direction that may be made by regulatory authorities. The actuary, in his verification of the management information provided by the Company used in the valuation, also makes use of the work of the external auditors. The actuary's report outlines the scope of his work and opinion.

The Company's external auditors have been appointed by the members to conduct an independent and objective audit of the financial statements of the Company in accordance with Canadian generally accepted auditing standards and report thereon to the members. In carrying out their audit, the auditors also make use of the actuary and his report on the Company's policy liabilities. The auditors' report outlines the scope of their audit and their opinion.



Darin Nessel, CIP
President & Chief Executive Officer



Jason Christopherson, CGA, BAccSc
Chief Financial Officer

Report of the Actuary

The Mutual Fire Insurance Company of British Columbia • Years Ended December 31, 2012 and December 31, 2011

The actuary is appointed by the Board of Directors of The Mutual Fire Insurance Company of British Columbia pursuant to the Insurance Act. The actuary is responsible for ensuring that the assumptions and methods used in the valuation of policyholder liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives. The actuary is also required to provide an opinion regarding the appropriateness of the policyholder liabilities at the balance sheet date to meet all policyholder obligations of the company. Examination of supporting data for accuracy and completeness and consideration of the company's assets are important elements of the work required to form this opinion.

Policyholder liabilities include unearned premiums, unpaid claims and adjustment expenses, the reinsurers' share of unearned premiums and unpaid claims and adjustment expenses, deferred premium acquisition costs, premium deficiency and retrospective adjustments. The actuary uses the work of the external auditors in verifying data used for valuation purposes.

APPOINTED ACTUARY'S REPORT

To the Members of The Mutual Fire Insurance Company of British Columbia

I have valued the policyholder liabilities and the reinsurance recoverables of The Mutual Fire Insurance Company of British Columbia for its statement of financial position at December 31, 2012 and their change in the statement of comprehensive income for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of policyholder liabilities, net of reinsurance recoverables, makes appropriate provision for all policyholder obligations, and the financial statements fairly present the results of the valuation.



Toronto, Ontario
February 21, 2013

Barb Addie
Fellow, Canadian Institute of Actuaries

Independent Auditors' Report

The Mutual Fire Insurance Company of British Columbia • Years Ended December 31, 2012 and December 31, 2011

To the Members of The Mutual Fire Insurance Company of British Columbia

We have audited the accompanying financial statements of The Mutual Fire Insurance Company of British Columbia, which comprise the statement of financial position as at December 31, 2012, the statements of comprehensive income, changes in members' surplus and reserves, and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of The Mutual Fire Insurance Company of British Columbia as at December 31, 2012 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

The image shows a handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, slightly slanted style. Below the signature, there is a single horizontal line that starts under the 'K' and extends to the right, ending under the 'P'.

Chartered Accountants
February 25, 2013
Vancouver, Canada

Statements of Financial Position

The Mutual Fire Insurance Company of British Columbia • as at December 31, 2012 and December 31, 2011

	Notes	2012	2011
Assets			
Cash and cash equivalents		\$ 5,399,485	\$ 4,961,447
Investments	4	51,087,568	41,911,937
Accrued investment income		198,844	127,545
Premiums receivable		5,315,760	5,439,242
Due from reinsurers		817,080	937,935
Reinsurers' share of provision for:			
Unpaid claims and adjustment expenses	5	8,957,000	6,800,100
Deferred policy acquisition costs	6	4,589,763	3,864,316
Income taxes receivable	7	38,272	366,160
Deferred income tax asset		24,833	15,650
Property and equipment	8	1,761,175	1,877,902
Intangible assets	9	372,907	394,584
		\$ 78,562,687	\$ 66,696,818
Liabilities and Members' Surplus and Reserves			
Amounts payable and accrued liabilities	10	\$ 1,202,781	\$ 1,105,277
Due to reinsurers		1,536,285	1,249,230
Unearned reinsurance commissions		6,071	1,245
Unearned premiums	5	21,533,526	18,746,043
Provision for unpaid claims and adjustment expenses	5	24,959,000	17,316,100
Loans		16,646	39,263
		49,254,309	38,457,158
Members' surplus and reserves:			
Reserves	11	500,000	500,000
Accumulated other comprehensive income		1,107,677	375,220
Unappropriated members' surplus		27,700,701	27,364,440
		29,308,378	28,239,660
Commitments	12		
Contingencies	13		
		\$78,562,687	\$66,696,818

See accompanying notes to financial statements.

Approved on behalf of the Board:



President



Treasurer

Statements of Comprehensive Income

The Mutual Fire Insurance Company of British Columbia • Years Ended December 31, 2012 and December 31, 2011

	Notes	2012	2011
Premium written:			
Gross premium written		\$ 46,366,300	\$ 39,442,204
Less: Reinsurance premiums ceded		(8,030,104)	(6,640,038)
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Net premiums written		38,336,196	32,802,166
Less: Increase in unearned premiums		(2,787,483)	(3,240,707)
<hr/>			
Net premiums earned		35,548,713	29,561,459
Commission income		43,637	57,105
Service fees		31,018	14,499
Membership fees		31,187	33,326
<hr/>			
		35,654,555	29,666,389
Claims and expenses incurred:			
Claims and adjustment expenses		22,285,070	15,862,139
Commissions		10,014,604	8,309,967
Salaries and benefits	14	2,680,583	2,456,330
Administration		1,330,604	1,109,649
Amortization		310,816	245,902
Premium taxes		124,591	148,976
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		36,746,268	28,132,963
<hr/>			
Net underwriting income (loss)		(1,091,713)	1,533,426
Net investment income	15	1,481,821	1,295,182
Other income (expenses):			
Other operating income		13,342	6,914
Patronage recovery (expense)		(3,169)	30,326
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		10,173	37,240
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Earnings before income taxes		400,281	2,865,848
Income tax expense (benefit)	7		
Current		73,203	29,371
Deferred		(9,183)	(72,960)
<hr/>			
		64,020	(43,589)
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Net earnings for the year		336,261	2,909,437
Other comprehensive income:			
Net unrealized gains (losses) on available-for-sale assets, net of tax of \$169,184 (2011 - \$23,454)		732,457	(8,921)
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Total comprehensive income, end of year		\$ 1,068,718	\$ 2,900,516

See accompanying notes to financial statements.

Statements of Changes in Members' Surplus and Reserves

The Mutual Fire Insurance Company of British Columbia • Years Ended December 31, 2012 and December 31, 2011

	Unappropriated members' surplus	Accumulated other comprehensive income	Reserves	Total members' surplus and reserves
Balance, December 31, 2010	\$ 23,601,743	\$ 384,141	\$ 1,353,260	\$ 25,339,144
Total comprehensive income	2,909,437	(8,921)	-	2,900,516
Decrease in reserves	853,260	-	(853,260)	-
Balance, December 31, 2011	27,364,440	375,220	500,000	28,239,660
Total comprehensive income	336,261	732,457	-	1,068,718
Balance, December 31, 2012	\$ 27,700,701	\$ 1,107,677	\$ 500,000	\$ 29,308,378

See accompanying notes to financial statements.

Statements of Cash Flows

The Mutual Fire Insurance Company of British Columbia • Years Ended December 31, 2012 and December 31, 2011

	2012	2011
Cash provided by (used in):		
Operations:		
Total comprehensive income	\$ 1,068,718	\$ 2,900,516
Items not involving cash:		
Depreciation and amortization	310,816	245,902
Unrealized losses (gains) on available-for-sale investments	(732,457)	8,921
Realized losses (gains) on available-for-sale investments	25,010	(55,590)
Amortization of investment income	(513,188)	(580,476)
Deferred income tax expense (recovery)	(9,183)	(49,506)
Changes in non-cash operating working capital:		
Accrued investment income	(71,299)	9,822
Premiums receivable	123,482	(1,346,276)
Due from reinsurers	120,855	1,670
Deferred acquisition costs	(725,447)	(686,491)
Reinsurers' share of unpaid claims and adjustment expenses	(2,156,900)	3,356,968
Provision for unpaid claims and adjustment expenses	7,642,900	1,087,820
Unearned premiums	2,787,483	3,240,707
Unearned reinsurance commission	4,826	(2,439)
Due to reinsurers	287,055	366,055
Income taxes	327,888	(1,104,677)
Amounts payable and accrued liabilities	97,594	(590,191)
	8,588,063	6,802,735
Financing:		
Proceeds from loans	-	16,030
Repayment of loan	(22,617)	-
	(22,617)	16,030
Investments:		
Purchase of investments	(15,652,871)	(18,967,159)
Proceeds on sale of investments	7,697,875	11,470,239
Purchase of property, plant, and equipment	(41,113)	(128,719)
Purchase of intangible assets	(131,299)	(5,939)
	(8,127,408)	(7,631,578)
Increase (decrease) in cash and cash equivalents	438,038	(812,813)
Cash and cash equivalents, beginning of year	4,961,447	5,774,260
Cash and cash equivalents, end of year	\$ 5,399,485	\$ 4,961,447

See accompanying notes to financial statements