State of Idaho
DEPARTMENT OF INSURANCE

DIRK KEMPTHORNE
Governor

700 West State Street, 3rd Floor
P.O. Box 83720
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Phone (208)334-4250
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MARY L. HARTUNG
Director

ORDER ADOPTING REPORT OF EXAMINATION

AS OF DECEMBER 31, 2002

OF THE

UNITED HERITAGE PROPERTY & CASUALTY COMPANY

The above Report was completed by examiners of the Idaho Department of Insurance.

The findings and conclusions of the Department regarding the status of the Company result from consideration of the review of the Report, relevant examiner workpapers, and any written submissions or rebuttals of the Company.

IT IS HEREBY ORDERED that the examination report be adopted and filed as an official record of the Department.

Mary L. Hartung
Director of the Department of Insurance
State of Idaho

BY: Georgia Hill
Georgia Hill, CFE, CPA
Chief Examiner/Bureau Chief
Idaho Department of Insurance

DATED THIS 3rd day of July, 2003.

DEPARTMENT OF INSURANCE

STATE OF IDAHO

REPORT OF EXAMINATION

of

UNITED HERITAGE PROPERTY & CASUALTY COMPANY

(a domestic stock insurer)

as of

December 31, 2002

FILED
7/3/03
DATE
STATE OF IDAHO
Dept. of Insurance

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MARY L. HARTUNG
Director

Meridian, Idaho
June 13, 2003

The Honorable Mary L. Hartung
Director of Insurance
700 West State Street
Boise, Idaho 83720

Madame:

Pursuant to your instructions and in conformity with the provisions of the Insurance Laws and Rules of the State of Idaho, an examination has been made of the administrative affairs, books, records and financial condition of

United Heritage Property & Casualty Company
707 East United Heritage Court
Meridian, Idaho 83642

hereinafter referred to as the "Company," at its offices in Meridian, Idaho.

The following Report of Examination is respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period January 1, 1998, through December 31, 2002, and included such prior transactions and any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

The examination was conducted in accordance with generally accepted examination procedures and accounting guidelines. Verification and valuation of assets, determination of liabilities, and an analysis and review of such other accounts and records appropriate to the examination were also performed. There was some reliance upon the independent auditor's and the consulting actuary's work in this examination.

A letter of representation attesting to the Company's ownership of all assets and to the nonexistence of unrecorded liabilities or contingent liabilities was signed by and received from management.

PRIOR EXAMINATION

The prior financial examination was conducted by the Idaho Department of Insurance covering the period January 1, 1995 through December 31, 1997. Recommendations contained in the prior examination report/management letter and management's responses to those recommendations were as follows:

1. It appears that Canyon Agency, Inc. was an active corporation and that the Company may be subject to Chapter 38, Title 41, Idaho Code, Holding Company Systems.

   A waiver regarding Chapter 38 was granted to the Company on November 2, 1999.

2. It was recommended that placement of the Company's commercial business policy through an agency owned by a director of the Company be disclosed in the conflict of interest statement.

   In a letter to the Department dated October 19, 1999, the Company indicated that ownership of the agency was disclosed in the February 16, 1999 minutes and the 1999 Conflict of Interest Statement.

3. It was recommended that the custodial agreement be amended to include satisfactory safeguards and controls specified in the NAIC *Financial Condition Examiners Handbook, Volume I.*

   The Company requested that Wells Fargo Bank (formerly First Security Bank) provide a custodial agreement, which included the safeguards and controls specified by the NAIC.

4. It was recommended that the Company comply with the investment limitations required by Section 41-706(1), Idaho Code.

   The Company stated it would comply with the requirement of 41-706 and watch carefully to be sure that no one institution holds more than ten percent of its assets.

5. It was recommended that the Company implement a reasonable method of estimating loss and LAE reserves.

   The Company has sought the services of David Misner, actuary; Joseph Shirts, certified public accountant; Tom Jones, certified public accountant; and Judy Nielsen, computer programmer to provide the most accurate data possible to establish a reasonable method of estimating loss and LAE reserves. The Company would continue to strive for the most accurate reserving possible for a small company.

6. It was recommended that the Company track all ALAE payments by claim to ensure that payments are included in the correct accident year in Schedule P.

   The Company initiated a program to track all ALAE payments by claim to be sure that they are included in the correct accident year in Schedule P.

7. It was recommended that the Company correctly complete Schedule P, including restating historical data, in future annual statements.

   The Company would correctly complete Schedule P, including restating historical data in future statements beginning with the 12-31-99 statement.

8. It was recommended that the consulting actuary prepare workpapers that support the opinion regarding current year gross and net loss reserves.

9. It was recommended that the consulting actuary review ALAE and unallocated loss adjustment expense reserves in conjunction with future reserve opinions.

10. It was recommended that the consulting actuary include the required wording in future reserve opinions.

    The Company's consulting actuary agreed to comply with the above three items.

11. It was recommended that the Company develop reports that summarize claims by line of business and by accident year.

    Currently, the Company had two separate reports, which summarize claims by line of business and by accident year. In the future this information will be combined into one report.

12. It was recommended that the Company investigate and correct any problems with the programming logic of its claims data reports.

    The Company has investigated and corrected problems with the programming logic of its claims data reports and can now provide information in ASC11 form regarding files from 1998 and for future reports.

The recommendations contained in the prior examination report and management letter were addressed by the Company, except that related to the custodial agreement. Additional comments in this regard are included under Note 1 to the Financial Statements.

HISTORY AND DESCRIPTION

General

The Company was organized and incorporated as a domestic county mutual fire insurance company on June 10, 1907 under the laws of the State of Idaho. The Company commenced business on April 2, 1908 as Canyon County Farmers Mutual Fire Insurance Company.

Effective July 15, 1992, the Company was converted to a domestic mutual insurance company, and its name was changed to Idaho Mutual Insurance Company. As of July l, 1997, Latah County Farmers' Mutual Insurance Company merged with the Company. As discussed in the following sub-captions, the Company demutualized and was subsequently acquired by United Heritage Financial Group, Inc. (formerly United Heritage Holdings, Inc.) in 2000.

Demutualization

Effective November 7, 2000, the Company demutualized pursuant to the Plan of Reorganization adopted by the Board of Directors on June 12, 2000. The Plan provided for the conversion from a mutual insurance company to a stock insurance company in accordance with Section 41-2855, Idaho Code. The principal purposes of the reorganization were to demutualize the Company to improve its access to capital through becoming an affiliate of United Heritage Life Insurance Company (formerly United Heritage Mutual Life Insurance Company), and to provide eligible policyholders economic value from their membership interests in the Company that would otherwise be unavailable.

The Plan was approved by the State of Idaho Departments of Finance and Insurance pursuant to a preliminary order dated October 3, 2000. The Order became final on November 7, 2000. The Plan was subsequently approved by the policyholders of the Company at a Special Policyholders' Meeting held on November 7, 2000.

Upon the effective date of the Plan, the Company became a stock insurance company and its name was changed to United Heritage Property & Casualty Company. All membership interests were extinguished and eligible policyholders were entitled to receive the value of their allocable equity. The policyholders' collective equity under the Plan was determined as follows:

Unassigned funds per Quarterly Statement as of June 30, 2000		$2,180,643
Home Office Property:		
Appraised value at November 22, 1999, less 6 percent commission	$474,700	
Less book value per 1999 Annual Statement	441,243	33,457
Reasonable equity in reserves using case basis approach		0
Rounding		400
Eligible policyholders' collective equity		$2,214,500

Pursuant to the Plan, the policyholders of record were entitled to receive their allocable equity in stock, cash, or as a credit on their policy. Sixteen policyholders received their equity in the form of stock, while the majority elected to receive a cash distribution. The fractional shares held by the former policyholders were subsequently redeemed due to a reverse stock split, which is discussed under the sub-caption, "Capital Stock". A liability for future payoffs to the former mutual policyholders was established in the financial statements. The balance of this obligation at December 31, 2002 was $467,745.

Acquisition by United Heritage Financial Group, Inc.

The Plan of Reorganization also contemplated an investment in the Company by United Heritage Financial Group, Inc. in exchange for majority ownership. Under the terms of a Stock Purchase Plan, United Heritage Financial Group, Inc. paid the Company $2,214,500 for 4,429 shares of stock on November 7, 2000.

In a letter dated September 18, 2000, the Department of Insurance stated that the Form A Filing regarding the acquisition of control of the Company by United Heritage Financial Group, Inc. was reviewed and based on documents submitted, the Department had no objection to the proposed acquisition.

At the time of acquisition, United Heritage Financial Group, Inc. was wholly owned by United Heritage Life Insurance Company. In 2001, United Heritage Life Insurance Company converted to a mutual insurance holding company structure. Pursuant to this conversion, the name of the life company was changed from United Heritage Mutual Life Insurance Company. As a result of this conversion, United Heritage Mutual Holding Company replaced United Heritage Life Insurance Company as the ultimate controlling person within the holding company system.

United Heritage Mutual Holding Company was first incorporated in August of 2001 pursuant to Section 41-3821, Idaho Code. On or about the same date, United Heritage Holdings, Inc. was renamed United Heritage Financial Group, Inc. At that time, United Heritage Life Insurance Company became a 100 percent stock subsidiary of United Heritage Financial Group, Inc. On the same date, United Heritage Financial Group, Inc. became a 100 percent stock subsidiary of United Heritage Mutual Holding Company.

As previously stated, all fractional shares owned by the former mutual policyholders were redeemed due to a reverse stock split on February 19, 2001. Consequently, United Heritage Financial Group, Inc. became the 100 percent shareholder of the Company, exclusive of Directors' shares as of December 31, 2002.

Capital Stock

As previously reported, the Company demutualized on November 7, 2000, and became a stock insurance company. In this connection, the Articles of Incorporation, as amended, provided for authorized capital of $3,092,500, consisting of 1,237 shares of common stock each with a par value of $2,500. The shares are of one class of common stock with uniform rights.

As of the examination date, the Company had 551 shares of capital stock issued and outstanding with a par value of $2,500 per share for a total capital of $1,377,500. The issued and outstanding shares were reconciled to Company capital stock records without exception. The Company's paid in and contributed surplus at December 31, 2002 was $1,377,500.

The following exhibit reflects the activity in the capital structure of the Company since its conversion to a stock insurance Company on November 7, 2000 through December 31, 2002:

Year	Shares Issued/ (Redeemed)	Common Capital Stock	Gross Paid In & Contributed Surplus	Total Capital & Paid in and Contributed
2000 (1) *	4,454	$1,113,500	$1,113,500	$2,227,000
2001 (2) *	(4,454)	(1,113,500)	(1,113,500)	(2,227,000)
2001 (3) *	451	1,127,500	1,127,500	2,255,000
2001 (4) *	(442)	(1,105,000)	(1,105,000)	(2,210,000)
2001 (4) *	442	1,105,000	1,105,000	2,210,000
2001 (5) *	100	250,000	250,000	500,000
Totals	551	$1,377,500	$1,377,500	$2,755,000

* See next page for detailed explanation.

(1) A resolution authorizing the sale and issue of 4,454 shares of $250 par value common stock for $500 per share was approved by the Board of Directors on November 7, 2000. Sixteen shares were issued to former mutual policyholders and 4,429 shares were issued to United Heritage Financial Group, Inc. (then United Heritage Holdings, Inc.) Nine shares were issued to each Director of the Company in compliance with Section 41-2835, Idaho Code. In consideration for the nine shares issued, promissory notes were executed between the Directors and the Company.

(2) The Articles of Incorporation were amended February 27, 2001 to effectuate a ten to one stock reversal. Consequently, the number of shares authorized was decreased from 12,369 to 1,237 shares. Each share of common stock with $250 par value previously issued and outstanding was converted into 1/10th share of $2,500 par value common stock.

(3) The shares previously issued to United Heritage Financial Group, Inc. on November 7, 2000 were transferred to another stock certificate to reflect the reverse stock split of 442 shares. The fractional shares of the former mutual policyholders and the shares issued to the Directors were redeemed on February 26, 2001. Nine shares were then issued to Directors of the Company under new certificates. New promissory notes dated February 26, 2001 were also executed between the Directors and the Company.

(4) On August 28, 2001, the certificate representing 442 shares issued to United Heritage Financial Group, Inc. under its former name was cancelled and a certificate was issued to the majority owner under its new name.

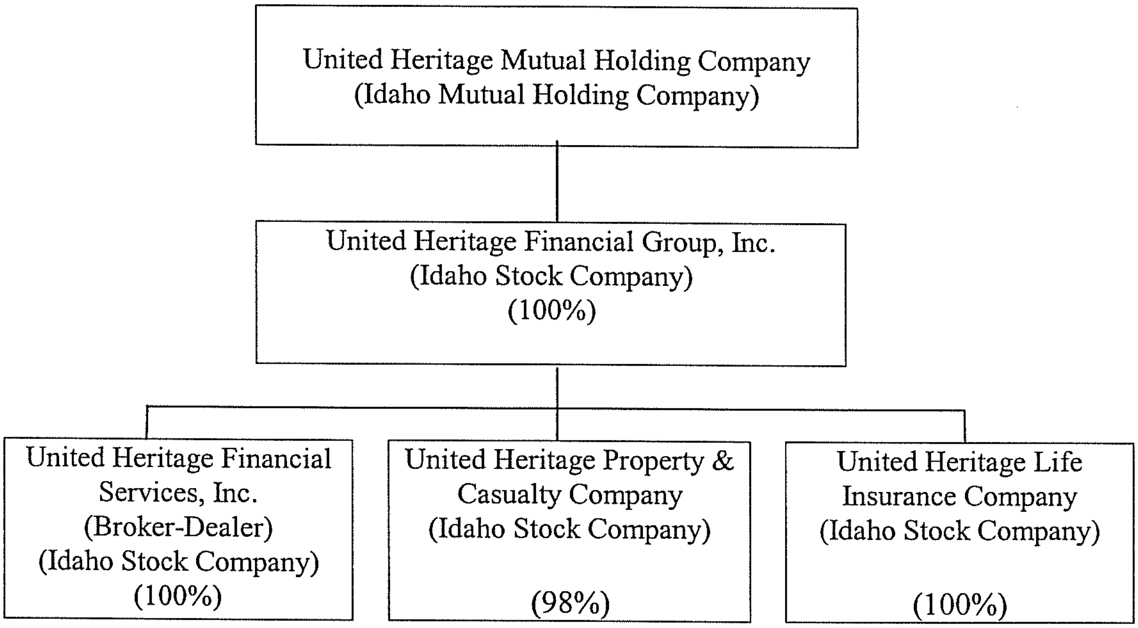
(5) In December 2001, the Board of Directors authorized the sale of 100 shares of stock to United Heritage Financial Group, Inc. for $5,000 per share.

MANAGEMENT AND CONTROL

Insurance Holding Company System

The Company converted from a mutual insurance company to a stock insurer effective November 7, 2000. Prior to that time, the Company, as a mutual insurer, was owned by its policyholders and members and was managed by its Board of Directors.

On November 7, 2000, the majority of the Company's stock was acquired by United Heritage Financial Group, Inc. At that time, the Company became a member of an insurance holding company system as defined in Section 41-3801, Idaho Code. The "Ultimate Controlling Person" within the holding company system was United Heritage Mutual Holding Company as shown in the following organizational chart:



United Heritage Mutual Holding Company is owned by the policyholders of United Heritage Life Insurance Company.

As of December 31, 2002, United Heritage Financial Group, Inc. owned 98 percent of United Heritage Property & Casualty Company's outstanding shares. The remaining outstanding shares were held by the Directors of United Heritage Property & Casualty Company in compliance with Section 41-2835, Idaho Code.

Company records indicated that no one person or entity had the power to direct the management of the ultimate controlling person noted in the chart above.

In December of 2002, United Heritage Mutual Holding Company began negotiations to affiliate with Sublimity Insurance Company (a mutual insurer), Sublimity, Oregon. Sublimity markets primarily homeowners and automobile insurance in Oregon and Idaho.

The Plan of Merger (Form A) of Sublimity Insurance Company and United Heritage Mutual Holding Company dated January 17, 2003, and subsequently amended and designated the Amended Plan of Reorganization and Merger (the Plan) dated March 19, 2003, was filed with the State of Oregon Department of Consumer and Business Services and was approved by Oregon on April 15, 2003.

A Form E Pre-Acquisition Notification Form Regarding the Potential Competitive Impact of a Proposed Merger or Acquisition by a Non-Domiciliary Insurer Doing Business in this State or by a Domestic Insurer was filed with the State of Idaho Department of Insurance on April 8, 2003.

In a letter dated April 18, 2003 from the Idaho Department of Insurance to United Heritage, the Department indicated that it had reviewed the Plan, and generally had no objections to it. However, the Idaho Department determined that approval of the Plan by the Director was not required; the Department also concluded that the Form E Pre-Acquisition Notification satisfied the requirements of Title 41, Idaho Code.

The effective date of the Plan is May 23, 2003, subject to other conditions specified in the Order. Specifically, the Plan must be approved by the eligible members of United Heritage Mutual Holding Company and Sublimity. In this connection, a Special Members' Meeting for United Heritage Mutual Holding Company is scheduled for May 19, 2003.

Prior to the effective date of the Plan, Sublimity Mutual Holding Company will be organized. On the effective date of the Plan, the reorganization shall occur; Sublimity Insurance Company will be converted to a stock insurer and will become a wholly owned subsidiary of Sublimity Mutual Holding Company. The membership interests of the Sublimity members will become membership interests in Sublimity Mutual Holding Company. Also on the effective date, immediately after the reorganization has been completed, the merger will occur. In the merger, the Sublimity members will become members of United Heritage Mutual Holding Company. Immediately after the merger, United Heritage Mutual Holding Company will exchange all outstanding shares of common stock of Sublimity for additional shares of United Heritage Financial Group, Inc. common stock. As a result of this exchange, Sublimity will become a wholly owned subsidiary of United Heritage Financial Group, Inc.

Affiliated Transactions

The Company's home office property located in Nampa, Idaho was acquired by United Heritage Life Insurance Company in 2001. The Department of Insurance was not notified in writing of the Company's intention to enter into this affiliated transaction pursuant to Section 41-3807, Idaho Code. Therefore, it is recommended that in the future, the Company notify the Director prior to entering into transactions set forth in Section 41-3807, Idaho Code.

In 2001, the Company began participating in a 401(k) plan sponsored by United Heritage Financial Group, Inc. Also in 2001, certain employee benefits offered by United Heritage Life Insurance Company were integrated with those offered by the Company. During 2002, the Company adopted United Heritage Life Insurance Company's accident and health insurance, dental insurance, and other miscellaneous employee benefits.

A cost sharing and allocation arrangement between and among the subsidiary companies of United Heritage Financial Group, Inc., was executed by the Company. The agreement was effective January 1, 2002 through January 1, 2003 and provided for rent, and the allocation of employee benefit and various operating expenses, among other things. The agreement was renewed for the period January 1, 2003 through January 2004. Additional comments regarding this arrangement are included under the sub-caption, "Contracts and Agreements".

The Company acquired mortgage loans from its affiliate, United Heritage Life Insurance Company, during the period under examination. In addition, the loan servicing function for the Company's mortgage portfolio was provided by United Heritage Life Insurance Company. Additional comments in this regard are included in Note 2 to the Financial Statements.

A review of the latest Form B Holding Company System Registration Statement (for the year ended December 31, 2001), filed by United Heritage Life Insurance Company, showed that it had been submitted to the Idaho Department of Insurance on May 31, 2002, and appeared to be current and valid.

The Year 2002 Form B had not been finalized at the close of the examination fieldwork (May 16, 2003).

Members

Prior to demutualization, each policyholder, other than a holder of a reinsurance contract, was a member of the Company. Any person, government, or governmental agency, state or political subdivision thereof, public or private corporation, board, association, estate, trustee, or fiduciary was also eligible to be a member of the Company.

Directors

The following persons were the duly elected members of the Board of Directors at December 31, 2002:

Name and Business Address	Principal Occupation
George Rudolph Banta Jr.	Retired – Chief Master Sergeant, United States Air Force
Richard Henry Chipman	Retired – Commercial Field Underwriter – Farm Bureau Mutual Insurance Company of Idaho
James Russell Nall, Jr. 917 2nd Street South, Nampa, ID	Agent/Owner, W. W. Deal Agency
Glenn Smith	Retired – Manager of Idaho Surveying & Rating Bureau
Jack Jay Winderl 707 United Heritage Court, Meridian, ID	Executive Vice President, Investments and Treasurer, United Heritage Life Insurance Company; President/Chief Executive Officer United Heritage Financial Services, Inc.
James Edwin Burke	Retired – Vice President of Sales – Farm Bureau Mutual Insurance Company of Idaho
Brian Edward Henman 707 United Heritage Court, Meridian, ID	President and Chief Executive Officer, United Heritage Property & Casualty Company
Glenn Sylvester Osborn	Retired – City of Wilder Fire Chief
Perry Cecil Sutton	Rancher

Officers:

The following persons were serving as officers at December 31, 2002:

Brian Edward Henman	President/Chief Executive Officer
Sharon Lee Locke	Vice President/Secretary
Glenn Sylvester Osborn	Vice Chairman/Treasurer
George Rudolph Banta Jr.	Chairman of the Board
Kent Michael Delana	Vice President
Robert Dean Robertson	Vice President
Jack Jay Winderl	Vice President

Subsequent to the examination date, Anne Aschenbrener was appointed Vice President of Human Resources and Assistant Corporate Secretary.

Committees

The following persons were appointed to special or standing committees at December 31, 2002:

Executive Committee
George Rudolph Banta, Jr.
Brian Edward Henman
Jack Jay Winderl

Claims Committee
George Russell Banta, Jr.
Glenn Sylvester Osborn
Perry Cecil Sutton

Underwriting Committee
Richard Henry Chipman
James Russell Nall, Jr.
Glenn Smith

Conflict of Interest

The Company had a conflict of interest policy in place that required the directors, officers, and management employees to complete a disclosure statement of any conflicts or possible conflicts with the performance of their duties and responsibilities. The statements completed during the period January 1, 1998 through December 31, 2002 appeared to appropriately disclose any possible conflicts of interest.

The disclosure statements were completed by directors and officers of the Company, but were not completed by management employees as specified in the policy adopted by the Board of Directors. Therefore, it is recommended that management employees execute conflict of interest statements annually. It is also recommended that the Board of Directors document their review of the executed conflict of interest statements in the corporate minutes.

Contracts and Agreements

The Company had the following agreements in effect at December 31, 2002:

Agent Appointment Agreements

Independent agents and agencies produced business on behalf of the Company under terms of Agent Appointment Agreements. These agreements were effective on a continuous basis and commissions were paid in relation to territory and business written. The agreements terminate upon the death or retirement of the agent or immediately by written notice from the agent or the Company.

Agency Contingent Bonus Agreements

In addition to commissions paid to agents and agencies under the Agent Appointment Agreements, the Company may pay bonuses when certain conditions are met. To qualify for a contingent bonus, the agent or agency must meet the minimum premium requirements during the calendar year and show an increase of at least 10 percent in current premiums over the past calendar year. In addition, the agent or agency must also have a qualifying loss ratio during the same time period. Effective January 1, 1999, the requirement to show an increase of at least 10 percent in current premiums over the past calendar year was eliminated for agents or agencies appointed more than two years.

Computer Programmer Agreement

The Company retained the services of a computer programmer for its information systems and data processing needs. Under the terms of the 2002 letter of agreement, programming services were provided at the rate of $25 per hour, for a total of $30,000. Additional hours were at the rate of $30 per hour.

The agreement was renewed in 2003 for a two-year term, renewable for another two years at the end of each year. The contract rate was increased to $35 per hour, for a total of approximately $59,500. Additional hours were also at the rate of $35 per hour.

Cost Sharing and Allocation Agreement

A cost sharing and allocation arrangement between and among the subsidiary companies of United Heritage Financial Group, Inc. was executed by the Company. The agreement was effective January 1, 2002 through January 1, 2003. The following provisions were applicable to the Company:

- Employee benefit costs were allocated to and paid by each respective company in proportion to their share of the cost of the benefit without markup or overhead charges.

- Transaction processing and clearing services were provided by United Heritage Financial Services, Inc. Charges were based upon usage of the services.

- The Company rented space from United Heritage Life Insurance Company. No formal rental agreement existed and the occupancy was month-to-month. Total rents paid during 2001 and 2002 totaled $18,090 and $43,417, respectively.

- United Heritage Life Insurance Company paid various operating expenses, including telephone and postage, for the Company. Those expenses were charged to the Company based upon its share of usage. The Company's share of operating expenses was $12,306 and $106,814 for 2001 and 2002, respectively.

In a letter dated December 11, 2001, the Department of Insurance stated that the cost sharing and allocation agreement was reviewed pursuant to Section 41-3807, Idaho Code and IDAPA 18.01.23.023, and that it had no objections to the proposed agreement.

Subsequent to the examination date, the cost sharing and allocation agreement was renewed for the term January 1, 2003 through January 1, 2004.

CORPORATE RECORDS

Articles of Incorporation and Bylaws

The Company's records indicated that the Articles of Incorporation and the Bylaws were amended twice during the period under examination.

As previously reported, the Company converted from a mutual insurance company to a stock insurer effective November 7, 2000. In this connection, the Articles of Incorporation were amended to authorize 12,369 shares of stock at $250 par value. The amended articles also established the number of directors between five and fifteen and required each to be a shareholder of the Company. The amended articles of incorporation were approved by the Board of Directors and the Department of Insurance on November 7, 2000.

The Articles of Incorporation were again amended effective February 27, 2001 to reflect a ten to one reverse stock split. In this regard, authorized stock was changed to 1,237 shares with a $2,500 par value. The Board of Directors and the Shareholders approved this amendment to the Articles of Incorporation on December 5, 2000 and February 19, 2001, respectively. The amended Articles of Incorporation were approved by the Department of Insurance on February 26, 2001.

Prior to demutualization, the Bylaws were amended to change the principle office location to Nampa, Idaho and to set forth places of Members' and Board of Directors' meetings. The amended Bylaws were approved by the Members on February 16, 1999 and by the Board of Directors on March 2, 1999. The Department of Insurance approved the amended Bylaws on April 12, 1999.

In connection with the demutualization, the Bylaws were amended and restated to change the annual meeting of the shareholders to the third Monday in May and to establish the number of directors between five and fifteen. The amended and restated Bylaws were adopted by the Board of Directors and approved by the Department of Insurance on November 7, 2000.

Minutes of Meetings

A review of the minutes of the meetings of the Members and/or the Shareholders, the Board of Directors, and the various committees for the period January 1, 1998 through December 31, 2002, and subsequent thereto, indicated compliance with the Articles of Incorporation and Bylaws with respect to annual Membership and/or Shareholder and Board meeting dates, the election of the Board of Directors and Officers, and the appointment of Committee members.

This review of the minutes also indicated that a quorum was present at all Board of Directors' meetings held during the examination period and that Company transactions and events were properly authorized. Specifically, the Plan of Reorganization; salaries and Board compensation; and the sale of capital stock, among other things, were approved. In addition, investments of the Company were authorized by the Board of Directors as required by Section 41-704, Idaho Code.

The Minutes of the Board of Directors' meeting held August 3, 1999 indicated that the Examination Report as of December 31, 1997, conducted by the Idaho Department of Insurance was reviewed and accepted.

FIDELITY BOND AND OTHER INSURANCE

Insurance coverage for the protection of the Company was maintained through the period under examination. Coverages in effect as of December 31, 2002 included insurance company professional liability; directors' and officers' liability; business owners' property and commercial automobile; workers' compensation and employers' liability; and financial institution bond insurance.

The Company was included as a named insured under the financial institution bond maintained by affiliate, United Heritage Life Insurance Company. The protection of the financial institution bond met the suggested minimum limits recommended by the NAIC *Financial Condition Examiners Handbook* for United Heritage Life Insurance Company and the Company.

The insurance companies providing coverage to the Company and to United Heritage Life Insurance Company were licensed or otherwise authorized in the State of Idaho. Insurance company professional liability coverage was written on a surplus lines basis.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company provided a Simplified Employee Pension (SEP) plan for all employees who were at least 21 years of age and who had one year of service. Under terms of the plan, the Company provided discretionary contributions to the individual retirement accounts or annuities of all eligible employees. During the period under examination, the Company contributed 4.3 percent of an employee's annual compensation. According to management, the SEP plan was terminated in 2002 and no further contributions were made.

Three former employees of the Company received pension benefits under a non-qualified retirement plan previously in use. Reserves for pension benefits under this plan were based on annuity factors provided by the Idaho Department of Insurance. At December 31, 2002, a liability of $13,573 associated with future pension payments was established in the balance sheet under the caption, "Other expenses".

For the years 1998 through 2001, all full-time employees and their eligible dependents received health care, vision care, and hospitalization coverage under terms of a group health plan. Dental care insurance was provided under a separate plan. The Company paid premiums for these health care benefits, and in addition, reimbursed the employees for a portion of their health care deductibles. In 2002, the Company adopted United Heritage Life Insurance Company's accident and health insurance, dental insurance, and other miscellaneous employee benefits.

In 2001, certain employee benefits offered by the Company's affiliate, United Heritage Life Insurance Company, were integrated with those offered by the Company. Those benefits included group accident, group life, and group long-term disability insurance coverages.

Employees of the Company were allowed to participate in the United Heritage Financial Group 401(k) Plan in 2001. The Company matched the first 3 percent of employee contributions. In 2002, the Company matched the first 4 percent of employee contributions. Also in 2002, a discretionary amount based on profit may be paid by the Company to the 401(k) plan. At December 31, 2002, a liability of $14,853 for profit sharing accruals was established in the balance sheet under the caption, "Other expenses".

TERRITORY AND PLAN OF OPERATION

Effective November 7, 2000, the Company was licensed in the State of Idaho as a domestic stock insurance company and was authorized to write casualty and property business, excluding workers compensation. Previous to that, the Company was licensed as a domestic mutual insurance company. The Company became licensed to write property and casualty, excluding worker's compensation, insurance in the State of Oregon on March 18, 2002. The Company subsequently commenced business in Oregon in July of 2002.

Operations of the Company were conducted from its main administrative office located in Meridian, Idaho.

The Company offered standard fire, homeowners, farmowners, landlord, and commercial lines of insurance coverages. During 2002, approximately 40 percent of net premiums written were attributed to homeowners' coverages, while 34 percent and 21 percent were comprised of fire and farmowners' business, respectively. The remaining 5 percent of premiums written in 2002 were related to commercial multiple peril business.

The Company marketed its insurance products through independent agencies located throughout the States of Idaho and Oregon. At December 31, 2002, the Company had appointed approximately 94 licensed agencies, and/or agents to solicit business on its behalf.

STATUTORY AND SPECIAL DEPOSITS

As of December 31, 2002, the Company had provided the following deposits in trust for the protection of all its policyholders and/or creditors through the office of the Director of Insurance, in compliance with Section 41-316A, Idaho Code.

Description	Par Value	Statement Value	Market Value
Statutory:			
U. S. Treasury Strip, Due 11/15/11	$ 284,000	$ 160,121	$ 160,121
U. S. Treasury Strip, Due 11/15/12	300,000	161,614	161,614
Federal Home Loan Mortgage Corporation, 8%, due 11/15/21	33,955	33,984	33,984
Idaho Housing Agency, 6.8%, due 7/1/25	20,000	20,000	20,000
Idaho Falls Electric Company, due 4/1/03	160,000	158,063	158,064
Southern Idaho Solid Waste, 5%, due 11/1/06	50,000	50,000	50,000
Inter American Development Bank, 7.125%, due 3/15/23	250,000	261,411	260,390
Associates Corp. of North America, 8.15%, due 8/1/09	125,000	143,512	145,474
Cash	23,569	23,569	23,569
Totals	$1,246,524	$1,012,274	$1,013,216

GROWTH OF THE COMPANY

The Company's growth for the years indicated, as taken from the prior examination report and its Annual Statements, is shown in the following schedule:

Year	Admitted Assets	Liabilities	Capital & Surplus	Net Income(Loss)
1997*	$3,762,695	$2,224,849	$1,537,846	($100,789)
1998	4,476,973	2,337,727	2,139,246	363,454
1999	4,706,130	2,466,811	2,239,329	131,508
2000	6,551,979	3,767,874	2,784,105	92,023
2001	6,769,932	3,475,462	3,294,470	(141,468)
2002*	7,559,714	4,245,711	3,314,003	(26,368)

*As determined by Examination.

Capital and surplus increases were due primarily to net income for the years 1997 through 2000. In 2001 and 2002, increases were due to cumulative effects of changes in accounting principles, paid in capital and surplus changes/adjustments, and a decrease in the obligation to former mutual policyholders. Net income for the years 1997 through 2000 was due principally to net investment income. However, in 2001 and 2002, the Company experienced net losses as a result of decreased net investment income and increased incurred losses.

LOSS EXPERIENCE

The ratios of benefits and expenses to written premium shown in the following schedule were derived from amounts reported in the Company's Annual Statements:

Year	Net Premiums Written	Net Losses Paid	Underwriting Expenses	Ratio of Benefits and Expenses to Written Premium
1997*	$2,923,548	$1,497,358	$1,473,543	101.62%
1998	3,123,494	1,261,450	1,540,639	89.71%
1999	3,246,118	1,492,862	1,756,714	100.11%
2000	3,391,268	1,439,634	1,927,985	99.31%
2001	3,438,164	1,653,465	1,953,533	104.91%
2002*	4,459,907	1,884,847	2,089,386	89.11%

*As determined by Examination.

REINSURANCE

Assumed

The Company did not assume any reinsurance business during the period January 1, 1998 through December 31, 2002 and subsequent thereto.

Ceded

During the examination period, the Company maintained surplus share reinsurance for certain property risks, excess of loss reinsurance for property and casualty risks, and aggregate reinsurance for property risks with losses in excess of a specified loss ratio.

The reinsurance contracts were written and administered by reinsurance intermediary, Benfield Blanch, Inc. (formerly E. W. Blanch Co., Reinsurance Services), Minneapolis, Minnesota. The contracts contained the standard insolvency clause, right of offset, arbitration, access to records, and errors and omissions provisions.

The reinsurers participating in the reinsurance contracts executed Interests and Liabilities Agreements, which specified the participating reinsurers' percentage share in the interests and liabilities set forth in the subject reinsurance contracts. At December 31, 2002, the reinsurer participating in the Company's reinsurance program was authorized by the State of Idaho.

Significant terms of the reinsurance coverages in effect as of December 31, 2002 and subsequent thereto are summarized below:

1. Multiple Line Excess Reinsurance

   Property business classified as fire and allied lines and casualty business classified as farmowners/homeowners multiple peril was ceded under this contract. The Company's retention and reinsurer's liability are illustrated in the following table:

Business Ceded	Company Retention	Reinsurer's Liability	
Property Business	\$60,000	\$440,000, one risk, each loss	\$880,000, all risks, one occurrence
Casualty Business	\$50,000	\$950,000	each insured/occurrence
Property/Casualty per occurrence	\$60,000	\$50,000	one occurrence
Loss in excess of policy limits & extra contractual obligations	\$1,000,000	\$250,000	one occurrence

Property and casualty loss adjustment expenses were shared by the Company and the reinsurer in proportion to the ultimate net loss paid/payable borne by the reinsurer to the total loss paid/payable by the Company.

The reinsurance premium was based on a percentage of net earned premium for the contract year. Annual deposit premiums, payable in four equal installments, were also required. In addition, the Company received a ceding commission of 35 percent of all premiums ceded under the contract.

A one-time contingent or profit commission was made part of the contract through Addendum No. 1, effective January 1, 1998. Under this addendum, the Company received a contingent commission equal to 50 percent of the net profit accruing to the reinsurer.

The contract was amended effective January 1, 2001 to again provide for a contingent commission. The commission was equal to 50 percent of the net profit accruing to the reinsurer from the period January 1, 2001 through December 31, 2003 and each subsequent thirty-six month period. The contingency period was changed to January 1, 2002 through December 31, 2004 for the contract effective January 1, 2002.

The Multiple Line Excess contract was effective January 1, 1998 and continued in force until terminated on January 1, 2002. Effective January 1, 2002, the Company entered into a multiple line excess reinsurance contract with similar terms and conditions.

2. <u>Alternative Excess Catastrophe and Aggregate Excess Loss Ratio Reinsurance</u>

Business classified as Business Insurance Policy Section I Perils and Fire and Allied Lines was ceded under this contract. The Company's retention was determined by election of either of the following:

A. <u>First Excess Catastrophe:</u> The Company retained the first $200,000 of ultimate net loss arising out of each loss occurrence. The Company was required to retain at least 5 percent of the excess ultimate net loss under the contract. The reinsurer was liable for 95 percent of the amount exceeding the Company's retention, but not in excess of 95 percent of $1,500,000, any loss occurrence, or $3,000,000, all loss occurrences commenced during the contract term.

B. <u>First Aggregate Excess Loss Ratio:</u> The Company retained 70 percent of net written premium for the contract term. The reinsurer was liable for 95 percent of the amount exceeding the Company's retention, not to exceed 95 percent of $2,000,000. For the contract effective January 1, 2002, the reinsurer's limit was decreased to 95 percent of $1,500,000.

In consideration for coverage provided, the Company paid a percentage of net written premium, subject to minimum premium. Annual deposit premiums paid on a quarterly basis were also required.

The contract was renewable on an annual basis, subject to termination provisions contained therein.

3. Property Excess of Loss Reinsurance

The excess liability under policies classified as property business was ceded under this contract. The Company retained $500,000 any risk, each loss and the reinsurer's limit was $500,000 one risk, each loss and $1,000,000 all risks, one loss. The reinsurer was also liable for its proportionate share of loss adjustment expenses. The contract was effective January 1, 2002 until terminated, with 60 days prior written notice.

INSURANCE PRODUCTS AND RELATED PRACTICES

A limited scope Market Conduct Examination was conducted in conjunction with the examination of the administrative affairs, books, records, and financial condition of the Company. Underlying data was also validated during the limited scope Market Conduct Examination.

Policy Forms and Underwriting Practices

The Company offered various coverages on homeowners, farmowners, landlord, commercial and standard fire policies. Coverages included dwellings, garages, mobile homes, farm structures, business structures, personal property, loss of use and other related risks. Premium rates and underwriting guidelines, along with other general information related to policy forms and underwriting were contained in the Company's underwriting manual.

A limited review of selected policies indicated compliance with underwriting guidelines and policy forms. Rates, in general, were filed with the Department of Insurance within 30 days after the effective date. However, effective June 1, 2001, personal liability rates increased $15.00 on farmowner policies. This rate increase was not filed within 30 days after the effective date as set forth in the Department of Insurance Bulletin 91-1. Therefore, it is recommended that the Company file all future rates in accordance with Bulletin 91-1.

Under the excess of loss reinsurance contract, the Company retained $60,000 for property and $25,000 for casualty business. For the alternative catastrophe/aggregate excess of loss reinsurance contract, the retention was $200,000 or 70 percent of annual subject net written premium. The Company retained $500,000, any risk, each loss under the property excess of loss reinsurance contract. Premiums in excess of the retentions were ceded through various reinsurance coverages as described in the previous section of the examination report.

Treatment of Policyholders

Claims

Samples of partially paid, paid, and released claims incurred during the examination period were reviewed. This review indicated that, in general, claims were being settled properly and payments were being made in a timely manner.

The Company reported suspected fraudulent claims to the Department of Insurance as required by Section 41-290, Idaho Code during and subsequent to the examination period.

Complaints

The Company maintained a complaint register containing a complete record of all the written complaints it had received during 1998 through December 31, 2002 as required by Section 41-1330, Idaho Code.

Advertising and Sales Material

The Company distributes an annual review brochure to its agents and/or agencies. The brochures contain historical and financial information extracted from the Company's Annual Statements. Otherwise, the Company does not advertise to the general public.

Information about the Company and its products is available on United Heritage Financial Group, Inc.'s website at www.unitedheritage.com. The information available on the website was reviewed and nothing deceptive or misleading was noted.

ACCOUNTS AND RECORDS

General Accounting

During the examination period, the Company utilized a custom developed property and casualty administration, billings, claims, and accounting system. The system was converted from an NCR midrange computer to an Intel/Microsoft Windows network platform to address year 2000 issues. Workstation computers running Microsoft Windows 98 were used to access data stored on a server running Microsoft Windows NT. The new hardware platform was implemented on January 1, 2000.

In 2002, the Company purchased new IBM personal computers, running Microsoft Windows XP to use as workstations. The server, however, was not changed. During the fourth quarter of 2002, the accounting portion of the custom developed system was converted to SunGard's Enterprise Accounting System (EAS), a PC based system running on an IBM Netfinity Server utilizing a Microsoft SQL Server database. This system was implemented on January 1, 2003.

As previously reported, information systems and data processing services were provided to the Company by an outside programmer. Additional comments are included under the caption, "MANAGEMENT AND CONTROL".

An outside accountant compiled the financial statements and prepared the NAIC annual and quarterly statements, among other things, during and subsequent to the examination period.

Independent Accountants

The annual independent audits of the Company for the years 1998 through 2001 were performed by Jones, Spackman, Basterrechea, & France, Chtd., Gooding, Idaho. The financial statements in each report were on a statutory basis. There was some reliance on the 2001 audit report and workpapers in this examination of the Company.

The 2002 statutory audit by the independent auditors had not been finalized at the close of the Idaho Department of Insurance's examination fieldwork (May 16, 2003).

Actuarial Opinion

The policy reserves and related actuarial items were calculated by the Company and reviewed by David T. Misner, A.S.A., M.A.A.A., of Decision Support Solutions, LLC. The December 31, 2002 statement of opinion issued stated that the amounts carried in the balance sheet: (a) meet the requirements of the insurance laws of Idaho; (b) are computed in accordance with accepted loss reserving standards and principles; and (c) make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The identified actuarial items in the Annual Statement were as follows:

Reserve for unpaid losses (Page 3, Line 1)	$599,661
Reserve for unpaid loss adjustment expenses (Page, 3 Line 2)	128,529
Reserve for unpaid losses - direct and assumed	
(Schedule P, Part 1, Column 13 total)	809,000
(Schedule P, Part 1, Column 15 total)	99,000
Reserve for unpaid loss adjustment expenses - direct and assumed	
(Schedule P, Part 1, Column 17 total)	55,000
(Schedule P, Part 1, Column 19 total)	78,000
(Schedule P, Part 1, Column 21 total)	151,000

Anticipated salvage and subrogation were included as a reduction to loss reserves shown above. As of December 31, 2002, there was no reduction. There was no discount for the time value of money reflected in the above and as reported in Schedule P.

The Company did not participate in any voluntary or involuntary pooling arrangements, and, therefore, did not have any liabilities arising from these sources.

The net reserves for losses and loss adjustment expenses that the Company carried for asbestos liabilities and environmental liabilities were zero. The total reserves for losses and loss adjustment expenses that the Company carried for the extended loss and expense reserve and which were reported in the Schedule P Interrogatories were also zero.

COMMITMENTS AND CONTINGENT LIABILITIES

In 2000, the Company executed a Letter of Agreement in connection with its acquisition by United Heritage Financial Group, Inc. Under terms of this agreement, certain officers of the Company would be entitled to five years salary if their employment with the Company were involuntary terminated. As of December 31, 2002, the contingent liability for the salary guarantee was $505,600. The salary guarantee shall be terminated in its entirety in the year 2010.

FINANCIAL STATEMENTS

The financial section of this report contains the following statements:

Balance Sheet as of December 31, 2002

Underwriting and Investment Exhibit, Year 2002

Capital and Surplus Account, Year 2002

Reconciliation of Capital and Surplus Account, December 31, 1997, to December 31, 2002.

Balance Sheet
As of December 31, 2002

ASSETS

	Assets	Nonadmitted Assets	Net Admitted
Bonds (Note 1)	$4,224,690	$ 0	$4,224,690
Stocks:			
Preferred stocks (Note 1)	173,770	0	173,770
Common stocks (Note 1)	363,433	0	363,433
Mortgage loans on real estate: First liens (Note 2)	1,415,781	0	1,415,781
Cash and short-term investments (Notes 1 and 3)	700,440	0	700,440
Reinsurance recoverables on loss and loss adjustment expense payments	283,883	0	283,883
Federal income tax recoverable and interest (includes $227,041 net deferred tax asset)	227,041	0	227,041
Electronic data processing equipment and software (Note 4)	34,934	0	34,934
Interest, dividends and real estate income due and accrued	95,795	0	95,795
Aggregate write-ins for other than invested assets:			
Idaho Code Section 41-601(12):			
Equipment & Automobile	39,947	0	39,947
Stock subscriptions receivable (Note 5)	45,000	45,000	0
Totals	$7,604,714	$ 45,000	$7,559,714

Balance Sheet
As of December 31, 2002 (Continued)

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses (Note 6)	$ 599,661
Loss adjustment expenses (Note 6)	128,529
Commissions payable, contingent commissions and other similar charges	80,213
Other expenses	93,611
Taxes, licenses and fees (Note 3)	30,165
Federal and foreign income taxes	29,984
Unearned premiums	2,700,321
Ceded reinsurance premiums payable (net of ceding commissions)	115,482
Distribution due to mutual policyholders (Note 7)	467,745
Total liabilities	$4,245,711
Common capital stock	$1,377,500
Gross paid in and contributed surplus	1,377,500
Unassigned funds (surplus)	559,003
Surplus as regards policyholders	$3,314,003
Totals	$7,559,714

UNDERWRITING AND INVESTMENT EXHIBIT

For the Year Ending December 31, 2002

STATEMENT OF INCOME

UNDERWRITING INCOME	Per Company and Examination
Premiums earned	$ 3,722,767
Deductions:	
Losses incurred	$ 1,926,890
Loss expenses incurred	443,991
Other underwriting expenses incurred	1,729,340
Depreciation on equipment and vehicle	9,884
Total underwriting deductions	$ 4,110,105
Net underwriting gain (loss)	$ (387,338)
INVESTMENT INCOME	
Net investment income earned	$ 436,452
Net realized capital losses	(12,447)
Net investment gain (loss)	$ 424,005
OTHER INCOME	
Loss on sale of equipment	$(6,953)
Total other income	$(6,953)
Net income after dividends to policyholders and before federal and foreign income taxes	$ 29,714
Federal and foreign income taxes incurred	$ 56,082
Net income (loss)	$ (26,368)

CAPITAL AND SURPLUS ACCOUNT

For the Year Ending December 31, 2002

	Per Company	Examination Changes	Per Examination
Surplus as regards policyholders, December 31, 2001	$3,294,470	$ 0	$3,294,470
GAINS AND (LOSSES) IN SURPLUS			
Net income (loss)	$ (26,368)	$ 0	$ (26,368)
Net unrealized capital gains or (losses)	(25,771)	0	(25,771)
Change in net deferred income tax	52,042	0	52,042
Change in nonadmitted assets	0	0	0
Distribution due to mutual policyholders	40,630	0	40,630
Accrued directors' fees	(21,000)	0	(21,000)
Change in surplus as regards policyholders for the year	$ 19,533	$ 0	$ 19,533
Surplus as regards policyholders, December 31, 2002	$3,314,003	$ 0	$3,314,003

RECONCILIATION OF RESERVES AND UNASSIGNED FUNDS

December 31, 1997 Through December 31, 2002

	1998	1999	2000	2001	2002
Surplus as regards policyholders, December 31, previous year	$1,537,846	$2,139,246	$2,239,319	$2,784,105	$3,294,470
Net income (loss)	363,454	131,508	92,023	(141,468)	(26,368)
Net unrealized capital gains or (losses)	64,913	(31,435)	(150,907)	(40,078)	(25,771)
Change in net deferred income tax	0	0	0	27,103	52,042
Change in nonadmitted assets	70,275	0	0	(45,000)	0
Self-correction of 1997 examination report changes – losses and loss adjustment expenses	102,758				
Cumulative effect of changes in accounting principles	0	0	0	136,558	0
Capital changes: Paid in	0	0	2,219,156	267,922	0
Surplus adjustments: Paid in	0	0	0	267,922	0
Transferred from capital	0	0	(1,615,486)	0	0
Distribution due to mutual policyholders	0	0	0	37,406	40,630
Accrued directors' fees	0	0	0	0	(21,000)
Change in surplus as regards policyholders for the year	$ 601,400	$ 100,073	$ 544,786	$ 510,365	$ 19,533
Surplus as regards policyholders, December 31, current year	$2,139,246	$2,239,319	$2,784,105	$3,294,470	$3,314,003

NOTES TO THE FINANCIAL STATEMENTS

Note (1) – Bonds	$4,224,690
Preferred Stocks	173,770
Common Stocks	363,433
Cash and short-term investments	700,440

Certain bonds and short-term investments and all of the Company's stocks were held by Wells Fargo Bank (formerly First Security Bank, N.A., of Boise, Idaho), pursuant to a custodial agreement. The custodial agreement included satisfactory safeguards and controls specified in the NAIC *Financial Condition Examiners Handbook, Volume I*, except for the following:

a. The Bank is not obligated to indemnify the Company for any loss of securities in the Bank's custody occasioned by the negligence or dishonesty of the Bank's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.

b. In the event of a loss of the securities, there was no provision in the custodial agreement requiring the Bank to promptly replace the securities, or the value of the securities, and the value of any loss of rights or privileges resulting from such loss.

The previous examination report recommended that this custodial agreement be amended to include the above safeguards and controls specified by the NAIC. However, the custodial agreement provided for the current examination also did not include the safeguards stated above.

Subsequent to the examination date, a custodial account agreement including the above-recommended safeguards was executed between the Company and Wells Fargo Bank.

Note (2) – Mortgage loans $1,415,781

The following were noted in the examination of mortgage loans:

1. Year 2001 was the first year the Company invested in mortgage loans. The initial investment was $1,351,988 (original principal) with an amortized balance of $1,055,572 at December 31, 2001. Additional mortgages of $417,630 (original principal) were acquired in 2002. The mortgages were acquired from affiliate, United Heritage Life Insurance Company.

The mortgages acquired in both 2001 and 2002 exceeded 3 percent of admitted assets for each respective year and triggered Section 41-3807, Idaho Code, regarding investment transactions with a person in a domestic insurers' holding company system. The Company did not notify the Director of its intention to enter into these transactions at least 30 days prior thereto. Therefore, it is recommended that the Company notify the Director prior to entering into transactions set forth in Section 41-3807, Idaho Code.

2. United Heritage Life Insurance Company provided a loan servicing function for the Company's mortgage loan portfolio. It is recommended that the Company file an agreement or amend the existing cost sharing arrangement to formalize the service function pursuant to Section 41-3807, Idaho Code.

3. Four of the five mortgages acquired in 2001 and all of the mortgages acquired in 2002 did not have the requisite appraisal performed at the time of acquisition (i.e. at the time title transferred to the Company) as specified in Section 41-723(1), Idaho Code. Therefore, it is recommended that all mortgage loans have current appraisals performed at the time of purchase or acquisition as prescribed by Section 41-723(1), Idaho Code.

Note (3) – Cash and short-term investments $700,440

The following were noted in the examination of cash and short-term investments:

1. The Cash Management portion of the commercial checking account represented securities purchased under the Repurchase Agreement with Idaho Independent Bank. At December 31, 2002, the amount paid for securities under the Repurchase Agreement was $864,484. Pursuant to SSAP No. 45, Paragraph 4, the amount paid for the securities shall be reported as a short-term investment. Therefore, it is recommended that the Company classify investments purchased under repurchase agreements in compliance with SSAP No. 45 in future financial statements.

2. Furthermore, the Company did not disclose its policy for requiring collateral/other security or describe the securities underlying the agreements as required by SSAP No. 45 in Notes to the Financial Statements. Therefore, it is also recommended that the Company report the disclosures required by SSAP No. 45 in future financial statements.

3. The Company included the book balance of Idaho Independent Bank in its total of qualified Idaho investments for the reduced premium tax rate. Review of the Repurchase Agreement Confirmation Notice dated January 1, 2003, however, indicated that the Company owned undivided interests in Federal Home Loan Bank and Federal Farm Credit Bank securities. These securities were not of the type designated in Section 41-403, Idaho Code, and, therefore were not qualified Idaho investments.

4. The ratios of qualified Idaho investments to total investments, excluding the Idaho Independent book balance, were re-calculated for the years 2001 and 2002. The results indicated compliance with Section 41-403, Idaho Code for these years. However, it is recommended that in the future, the Company exclude securities purchased under the Repurchase Agreement from the total of qualified Idaho investments.

5. Funds of $47,543 held in the non-statutory deposit account were invested in the Wells Fargo Cash Investment Money Market Fund. This fund was not included in the list of money market funds filed with the NAIC's Securities Valuation Office (SVO). Therefore, it is recommended the balance be reported as common stock in Schedule D – Part 2 – Section 2 pursuant to instructions set forth the SVO manual.

Note (4) – Electronic data processing equipment $34,934

The Company included the depreciated cost of non-operating, application software valued at $3,194 in Electronic Data Processing Equipment. Non-operating, application software is not admitted under Section 41-601(11), Idaho Code. However, application software, at the option of the insurer, may be admissible under Section 41-601(12), Idaho Code. The total amount admissible under Section 41-601(12) cannot exceed 1 percent of the other assets of the insurer. Therefore, it is recommended that application software be reclassified to furniture and equipment in future financial statements.

Allowing application software as an admitted asset differs from guidance set forth in SSAP No. 16. If the Company opts to include non-operating, application software with furniture and equipment, this permitted practice should be disclosed in the Notes to the Financial Statements.

Under Section 41-601(11), Idaho Code, the cost of electronic data processing equipment shall be amortized in full over a period not to exceed ten calendar years. This depreciation period differs from guidance set forth in SSAP No. 79. Therefore, this prescribed practice should also be disclosed in the Notes to the Financial Statements.

Note (5) – Stock subscriptions receivable $ 0

On November 7, 2000, the Company demutualized and became a stock insurance company. Subsequently, nine shares of stock were issued to each Director in consideration for promissory notes executed between the Directors and the Company. The stock was sold for $500 per share for a total of $4,500.

The Articles of Incorporation were amended February 27, 2001 to effectuate a ten to one stock reversal. The Directors' fractional shares were redeemed and the related promissory notes were cancelled. New promissory notes of $5,000 each were executed on February 26, 2001 and new stock certificates were issued to the Directors.

The promissory notes were over 90 days past due at December 31, 2002; therefore, the balance was properly not admitted in the 2002 Annual Statement.

Note (6) – Losses $599,661
Loss adjustment expenses $128,529

Losses and loss adjustment expenses, as of December 31, 2002, were examined by Taylor-Walker & Associates, Inc. Taylor-Walker considered the reserves booked by the Company to be within a reasonable range and did not recommend an adjustment to reserves in this examination report.

The actuarial examination recommended that in the future, the Company's opining actuary ensure that the source data reconciles with Schedule P before proceeding with further analysis of loss and allocated loss adjustment expense development in the calculation of reserves.

Note (7) - Distribution due to mutual policyholders $467,745

As previously reported, the Company demutualized on November 7, 2000. As part of the demutualization process, the Company established a liability to former mutual policyholders. This liability was paid in cash or in future credits against premiums and will be paid off during 2006. Additional comments relating to the demutualization are included under the caption, "HISTORY AND DESCRIPTION".

SUMMARY, COMMENTS AND RECOMMENDATIONS

Summary

The results of this examination disclosed that as of December 31, 2002, the Company had admitted assets of $7,559,714, liabilities of $4,245,711, and total capital and surplus of $3,314,003. Therefore, the Company's total capital and surplus exceeded the $2,000,000 minimum prescribed by Section 41-313, Idaho Code.

Comments and Recommendations

Page

10, 31 It is recommended that in the future, the Company notify the Director prior to entering into affiliated transactions set forth in Section 41-3807, Idaho Code.

12 It is recommended that management employees execute conflict of interest statements annually. It is also recommended that the Board of Directors document their review of the executed conflict of interest statements in the corporate minutes.

21 It is recommended that the Company file all future rates in accordance with Idaho Department of Insurance Bulletin 91-1.

32 It is recommended that the Company file an agreement or amend the existing cost sharing arrangement to formalize the mortgage loan servicing function pursuant to Section 41-3807, Idaho Code.

32 It is recommended that all mortgage loans have current appraisals performed at the time of purchase or acquisition as prescribed by Section 41-723(1), Idaho Code.

32 It is recommended that the Company classify investments purchased under repurchase agreements in compliance with SSAP No. 45 in future financial statements. It is also recommended that in the future, the Company report the disclosures required by SSAP No. 45.

32 It is recommended that in the future, the Company exclude securities purchased under the Repurchase Agreement from qualified Idaho investments.

32 It is recommended the Wells Fargo Cash Investment Money Market Fund be reported as common stock in Schedule D – Part 2 – Section 2 pursuant to instructions set forth the SVO manual.

33 It is recommended that application software be reclassified to furniture and equipment in future financial statements. Prescribed practices should be disclosed in the Notes to the Financial Statements of future financial statements.

34 It is recommended that in the future, the Company's opining actuary ensure that the source data reconciles with Schedule P before proceeding with further analysis of loss and allocated loss adjustment expense development in the calculation of reserves.

Items not considered material to the examination as a whole were reported to the Company in the Management Letter dated June 13, 2003.

CONCLUSION

The undersigned acknowledges the assistance and cooperation of the Company's officers and employees, the outside accountant, the computer programmer, and the consulting actuary in conducting the examination.

In addition to the undersigned, Bill Michels, MBA, CFE of the Idaho Department of Insurance, participated in the examination. Taylor-Walker & Associates, Inc. conducted the actuarial portion of the examination.

Respectfully submitted,

Lois Haley

Lois Haley, CFE
Senior Insurance Examiner
State of Idaho
Department of Insurance

AFFIDAVIT OF EXAMINER

State of Idaho: Idaho
County of : Ada

Lois Haley being duly sworn, deposes and says that she is a duly appointed Examiner for the Department of Insurance of the State of Idaho, that she has made an examination of the affairs and financial condition of **United Heritage Property & Casualty Company** period from January 1, 1999, through December 31, 2002, that the information contained in the report consisting of the foregoing pages is true and correct to the best of her knowledge and belief; and that any conclusions and recommendations contained in this report are based on the facts disclosed in the examination.

Lois Haley

Lois Haley, CPA, CFE
Senior Insurance Examiner
Department of Insurance
State of Idaho

Subscribed and sworn to before me the 13th day of June, 2003, at Boise, Idaho.

ROBERT E. MEUNIER JR. NOTARY PUBLIC STATE OF IDAHO

R.E. Meunier
Notary Public

My Commission Expires: 11/10/2004