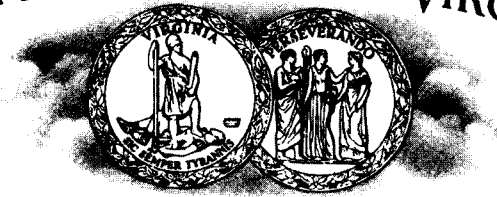


EXAMINATION REPORT
on
AUGUSTA MUTUAL INSURANCE COMPANY
Staunton, Virginia
as of
December 31, 2009

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE



P.O. BOX 1157
RICHMOND, VIRGINIA 23218
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I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Augusta Mutual Insurance Company as of December 31, 2009, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand
and affixed to the original the seal of the Bureau at the City
of Richmond, Virginia this 22nd day of December, 2010

Alfred W. Gross
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
October 8, 2010

Honorable Alfred W. Gross
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by authority of § 38.2-1317 of the Code of Virginia, an examination of the records and affairs of the

AUGUSTA MUTUAL INSURANCE COMPANY
Staunton, Virginia

hereinafter referred to as the Company, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Company is a mutual assessment property and casualty insurer licensed under Chapter 25 of Title 38.2 of the Code of Virginia. The last examination made by representatives of the State Corporation Commission Bureau of Insurance (Bureau) was as of December 31, 2006. This examination covers the three-year period from January 1, 2007 through December 31, 2009.

HISTORY

The Company was organized on June 4, 1870, and was first granted a charter by the Circuit Court of Augusta County on August 14, 1871. On September 22, 1906, the Company was granted a new charter with the name East Augusta Mutual Fire Insurance Company, Incorporated. This charter was amended on June 6, 1933, May 1, 1953 and January 24, 1964 to enlarge the territory of operations and to permit the insurance of more types of risks. The latter amendment also restated the articles of incorporation. The Company's name was changed to Augusta Mutual Insurance Company by charter amendment on December 6, 1977.

The purposes and powers of the Company according to the charter, as amended, are as follows:

The conduct of a mutual assessment fire insurance business, within the widest definition of Section 38.1-659, Code of Virginia of 1950, as amended from time to time.

The powers of this corporation are those permitted to a mutual assessment fire insurance company under Chapter 2 of Title 13.1 of the Code of Virginia, as amended from time to time.

On January 27, 1982, The Nelson County Mutual Fire Insurance Company (Nelson) merged into the Company, leaving the Company as the surviving corporation. All Nelson policies in good standing became policies of the Company. The State Corporation Commission (Commission) approved the merger effective January 27, 1982.

On February 25, 1993, Bedford Mutual Insurance Company, Inc. (Bedford Mutual) merged into the Company, leaving the Company as the surviving corporation. All Bedford Mutual policies in good standing became policies of the Company upon renewal. The Commission approved the merger effective March 4, 1993.

On January 1, 1999, Albemarle Home Mutual Fire Insurance Company (Albemarle) merged into the Company, leaving the Company as the surviving corporation. All Albemarle policies in good standing became policies of the Company upon renewal. The Commission approved the merger effective January 1, 1999.

MANAGEMENT AND CONTROL

Management of the Company is vested in a board of not less than nine and not more than fifteen directors, including the president and vice president, each of whom must be a member of the Company. All of the directors are elected by the members at the annual meeting, with at least three directors elected each year. A quorum at any meeting shall consist of a majority of the members of the board.

The board may by resolution designate three or more of their members to constitute an executive committee which, to the extent provided in the resolution, has all powers of the board except for the power to levy assessments.

The bylaws of the Company provide that the officers shall be a president, a vice president, an executive vice president, one or more vice presidents, a secretary, a treasurer and, at the option of the board, such other officers as the board may designate. Their term of office is one year.

The Company's directors, officers and members of selective committees at December 31, 2009 were as follows:

<u>Directors</u>	<u>Principal Occupation</u>
Richard P. Chaffin	Developer Forest, Virginia
George A. Coyner, II	Supervisor McKee Foods Corporation Stuarts Draft, Virginia
Rebecca L. Earhart	Senior Planner Augusta County Verona, Virginia
Carl L. Freed, Jr.	Farmer Crimora, Virginia
David B. Hewitt	Farmer Swoope, Virginia
Keith W. Holland	Contractor Lexington, Virginia
W. Dan Maupin	Farmer Charlottesville, Virginia
Samuel F. McClure	Real Estate Appraiser Stonewall Appraisal Company Staunton, Virginia
Dale C. Smith	Retired Staunton, Virginia
Robert D. Thompson	Banker Planters Bank and Trust Company Stuarts Draft, Virginia
Joseph F. Williams	Farmer Greenville, Virginia

Officers:

George A. Coyner, II	President
James V. Gynn	Executive Vice President
David B. Johnson	Vice President Underwriting
Mary R. Taylor	Vice President Claims
Fred A. Shultz	Secretary and Treasurer

Executive Committee

George A. Coyner, II
David B. Hewitt
Samuel F. McClure
Robert D. Thompson

Audit Committee

George A. Coyner, II
Dale C. Smith
Mary R. Taylor
Robert D. Thompson

Investment Committee

James V. Gynn
Samuel F. McClure
Fred A. Shultz
Robert D. Thompson
Joseph F. Williams
Keith W. Holland
Rebecca L. Earhart

RELATED PARTY TRANSACTIONS

One officer of the Company is a director and shareholder of Augusta Insurance Agency, Inc. (Agency). The Agency markets various lines of insurance through other insurance companies, and is also an appointed agent of the Company. In 2007, 2008, and 2009, respectively, the Company paid the Agency commissions of \$207,343, \$190,870 and \$190,079 and insurance premiums for its property, workers' compensation and commercial auto coverages of \$12,478, \$12,397 and \$12,294.

FIDELITY BOND AND OTHER INSURANCE

The Company had insurance in force at December 31, 2009, providing coverage in the amount of \$265,000 to insure against losses arising from dishonest acts of its officers and employees. The Company had a directors' and officers' liability policy in force at December 31, 2009. The coverage was for \$1,000,000 with a retention of \$10,000 on each director or officer for each loss event. In addition, the Company had business owners, commercial auto, workers compensation, employers liability coverages, and commercial umbrella liability in force at December 31, 2009.

TERRITORY AND PLAN OF OPERATION

The Company is currently licensed as a mutual assessment property and casualty insurer under Chapter 25 of Title 38.2 of the Code of Virginia and may operate throughout Virginia. The Company is licensed to write the following business:

Fire	Inland Marine
Miscellaneous Property	Liability Other Than Auto
Farm Multiple Peril	Automobile Liability
Homeowners Multiple Peril	Automobile Physical Damage
Commercial Multiple Peril	

Business is solicited by 313 agents and 67 corporate agencies. Commissions paid range from 15 to 25% of assessments, depending upon the type of services rendered.

All applications for insurance are submitted to the Company's underwriter and if the risk is accepted, a term type of policy is issued. The usual term for a homeowners, mobile homeowners, farmowners or commercial policy is one year. Some short-term policies are issued (usually six months or less) on livestock and builders' risks. Additional coverages are available to the Company's members by endorsement to fire or homeowners policies containing the standard provisions provided for by the Code of Virginia.

Assessments are generally levied and payable annually in advance. An installment plan is available for premiums in excess of \$200 (payable on a semi-annual basis) and those in excess of \$500 (payable on a quarterly basis). Assessments rates vary according to classification of risks, subject however, to a minimum charge of \$100 on personal policies and \$200 to \$400 on commercial policies.

Losses are adjusted in the Staunton area by salaried personnel of the Company and by independent adjusters. An independent adjuster is employed to adjust claims outside of the Staunton area.

GROWTH OF THE COMPANY

The following data, obtained from annual statements filed with the Bureau and from examination reports, reflect the growth of the Company in the ten-year period ending December 31, 2009:

<u>Year</u>	<u>Admitted</u> <u>Assets</u>	<u>Liabilities</u>	<u>Surplus</u>
2000	\$12,662,645	\$3,995,339	\$8,667,306
2001	13,884,119	4,666,989	9,217,130
2002	14,426,686	5,911,865	8,514,821
2003	16,503,083	7,143,181	9,359,902
2004	18,258,303	7,180,104	11,078,199
2005	20,845,068	7,803,451	13,041,617
2006	22,383,744	7,463,348	14,920,396
2007	23,797,970	7,217,368	16,580,602
2008	23,292,833	7,065,218	16,227,615
2009	24,797,419	7,235,411	17,562,008

<u>Year</u>	<u>Premiums</u> <u>Earned</u>	<u>Loss and Loss</u> <u>Adjustment Expenses</u>	<u>Other</u> <u>Underwriting</u> <u>Expenses</u>	<u>Net</u> <u>Underwriting</u> <u>Gains or (Losses)</u>
2000	\$4,725,144	\$2,472,355	\$1,848,754	\$404,035
2001	5,276,293	2,555,645	2,358,486	362,162
2002	5,987,790	3,691,967	2,839,280	(543,457)
2003	7,259,175	4,231,935	2,919,080	108,160
2004	7,940,780	2,968,971	3,213,277	1,758,532
2005	8,405,173	2,854,116	3,407,649	2,143,408
2006	8,912,944	3,766,070	3,511,626	1,635,248
2007	8,463,233	3,602,452	3,191,414	1,669,367
2008	8,126,063	4,125,540	3,257,472	743,051
2009	7,891,456	4,194,696	3,227,635	469,125

REINSURANCE

As of December 31, 2009, the Company was reinsured under the following excess of loss reinsurance agreements through the reinsurance intermediary, Axiom Intermediaries, LLC. These agreements are described briefly as follows:

<u>Type of Agreement</u>	<u>Business Covered</u>	<u>Company's Retention</u>	<u>Reinsurers' Limit of Liability</u>
First Excess of Loss (Section A)	Property	\$70,000	\$430,000 in excess of \$70,000, each and every loss, any one risk; subject to an occurrence limitation of \$860,000
First Excess of Loss (Section B)	Casualty	\$70,000	\$430,000 in excess of \$70,000, each and every loss occurrence
First Excess of Loss (Section C)	Property and Casualty	\$70,000	\$70,000 each and every loss occurrence in excess of \$70,000 each and every loss occurrence
Second Excess of Loss	Property	\$500,000	\$500,000 each and every loss, any one risk, excess of \$500,000 each and every loss, any one risk; subject to an occurrence limitation of \$1,000,000
Second Excess of Loss	Casualty	\$500,000	\$500,000 in excess of \$500,000, each and every loss occurrence
First Property Surplus	Property	\$1,000,000 subject to underlying excess of loss coverage	\$1,000,000 each loss, each and every risk, excess of \$1,000,000 each loss, each and every risk; subject to an occurrence limit of \$2,000,000

<u>Type of Agreement</u>	<u>Business Covered</u>	<u>Company's Retention</u>	<u>Reinsurers' Limit of Liability</u>
First Property Catastrophe Excess of Loss	Property per Occurrence	\$500,000	\$500,000 ultimate net loss each and every loss occurrence in excess of \$500,000 ultimate net loss each and every loss occurrence; subject to a limit of liability of \$500,000 in respect of any one loss occurrence
Second Property Catastrophe Excess of Loss	Property per Occurrence	\$1,000,000 subject to underlying excess of loss coverage	\$3,000,000 ultimate net loss each and every loss occurrence in excess of \$1,000,000 ultimate net loss each and every loss occurrence; subject to a limit of liability of \$3,000,000 in respect of any one loss occurrence
Third Property Catastrophe Excess of Loss	Property per Occurrence	\$4,000,000 subject to underlying excess of loss coverage	\$9,000,000 ultimate net loss each and every loss occurrence in excess of \$4,000,000 ultimate net loss each and every loss occurrence; subject to a limit of liability of \$9,000,000 in respect of any one loss occurrence
Umbrella Quota Share	Personal, Farm and Commercial Umbrella	5% of the first \$1,000,000 subject only to excess of loss reinsurance	95% of the Company's net liability of the first \$1,000,000 and 100% of \$1,000,000 in excess of \$1,000,000 for each policy

All of the above agreements contain an insolvency clause and a guarantee of the intermediary's credit.

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2007 through December 31, 2009. Assets were verified and liabilities were established at December 31, 2009.

This examination was conducted in accordance with the NAIC *Financial Condition Examiners' Handbook* (Handbook). The Handbook requires that the Bureau plan and perform the examination to evaluate the Company's financial condition and identify prospective risks of the Company, assess corporate governance, identify and assess inherent risks within the Company and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles, and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2009, a statement of income for the period ending December 31, 2009, a reconciliation of surplus for the period under review, and a statement of cash flow as of December 31, 2009. The financial statements are presented in accordance with Statutory Accounting Principles.

ASSETS

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$6,743,751		\$6,743,751
Common stocks	4,772,940		4,772,940
Property occupied by the company	896,153		896,153
Cash and short-term investments	11,026,344		11,026,344
Investment income due and accrued	97,864		97,864
Uncollected premiums and agents' balances in the course of collection	37,944		37,944
Deferred premiums, agents' balances and installments booked but deferred and not yet due	503,924		503,924
Amounts recoverable from reinsurers	79,684		79,684
Funds held by or deposited with reinsured companies	56,325		56,325
Current federal income tax recoverable	178,907		178,907
Net deferred tax asset	403,583		403,583
Totals	<u>\$24,797,419</u>	<u>\$0</u>	<u>\$24,797,419</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		\$1,575,462
Loss adjustment expenses		81,332
Commissions payable, contingent commissions and other similar charges		249,143
Other expenses		142,076
Taxes, licenses and fees		99,835
Unearned premiums		4,919,800
Advance premium		<u>167,763</u>
Total liabilities		\$7,235,411
Unassigned funds (surplus)	<u>17,562,008</u>	
Surplus as regards policyholders		<u>17,562,008</u>
Totals		<u><u>\$24,797,419</u></u>

UNDERWRITING AND INVESTMENT EXHIBIT
STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned	<u>\$7,891,456</u>
Deductions:	
Losses incurred	\$3,111,657
Loss expenses incurred	1,083,039
Other underwriting expenses incurred	<u>3,227,635</u>
Total underwriting deductions	<u>\$7,422,331</u>
Net underwriting gain	<u>\$469,125</u>

INVESTMENT INCOME

Net investment income earned	\$368,960
Net realized capital gains	<u>23,276</u>
Net investment gain	<u>\$392,236</u>
Net income before federal income taxes	\$861,361
Federal income taxes incurred	<u>134,544</u>
Net income	<u><u>\$726,817</u></u>

RECONCILIATION OF CAPITAL AND SURPLUS
FOR PERIOD UNDER REVIEW

	<u>2007</u>	<u>2008</u>	<u>2009</u>
Surplus as regards policyholders, December 31, previous year	<u>\$14,920,396</u>	<u>\$16,580,602</u>	<u>\$16,227,615</u>
Net income	\$1,719,819	\$779,902	\$726,817
Change in net unrealized capital gains or (losses)	(136,480)	(1,913,599)	992,873
Change in net deferred income tax	36,673	748,847	(388,677)
Change in nonadmitted assets	<u>40,194</u>	<u>31,863</u>	<u>3,380</u>
Change in surplus as regards policyholders for the year	<u>\$1,660,206</u>	<u>(\$352,987)</u>	<u>\$1,334,393</u>
Surplus as regards policyholders, December 31, current year	<u><u>\$16,580,602</u></u>	<u><u>\$16,227,615</u></u>	<u><u>\$17,562,008</u></u>

CASH FLOW**Cash From Operations**

Premiums collected net of reinsurance	\$7,939,427
Net investment income	442,552
Total	<u>\$8,381,979</u>
Benefit and loss related payments	\$3,646,640
Commissions, expenses paid and aggregate write-ins for deductions	3,226,180
Federal income taxes paid	250,000
Total	<u>\$7,122,820</u>
Net cash from operations	<u>\$1,259,159</u>

Cash From Investments

Proceeds from investments sold, matured or repaid:	
Bonds	\$1,838,349
Stocks	1,506,567
Net gains or (losses) on cash, cash equivalents and short-term investments	443,532
Total investment proceeds	<u>\$3,788,448</u>
Cost of investments acquired (long-term only):	
Bonds	\$1,808,707
Stocks	1,979,741
Miscellaneous applications	39,420
Total investments acquired	<u>\$3,827,868</u>
Net cash from investments	<u>(\$39,420)</u>

Cash From Financing and Miscellaneous Sources

Cash provided (applied):	
Other cash provided	\$443,976
Net cash from financing and miscellaneous sources	<u>\$443,976</u>
Net change in cash and short-term investments	<u>\$1,663,715</u>

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Cash and short-term investments:	
Beginning of year	\$9,362,629
End of year	11,026,344
Net change in cash and short-term investments	<u>\$1,663,715</u>

RECOMMENDATIONS FOR CORRECTIVE ACTION**Management and Control**

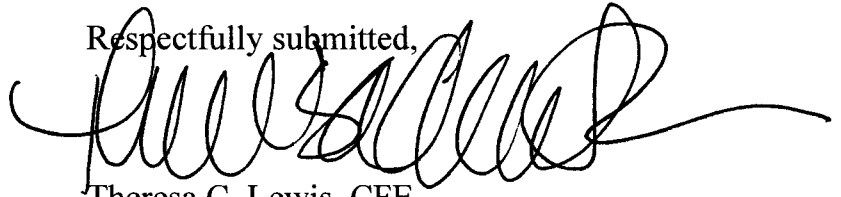
1. During the Examiners' review of the premium controls, it was noted that the controls over the premium collections process did not appear adequate. The Examiners became aware that one employee receives, posts, and deposits all premium receipts. The Examiners recommend that the Company utilize proper segregation of duties in order to mitigate the risk of misappropriation of assets.
2. The Company's general ledger is maintained using an accounting software package installed on a single computer in the Treasurer's office. Additionally there is only one login used to access the software. Any person who needs to make changes or post entries to the general ledger must use the single login. It is recommended that the Company install its accounting software on at least one other computer and create separate logins for all individuals who need access to the accounting software. A similar recommendation was made in the previous examination report.

CONCLUSION

The courteous cooperation extended by the Company's officers and employees during the course of the examination is hereby gratefully acknowledged.

In addition to the undersigned, Mario A. Cuellar, CFE, Jennifer K. Blizzard, CFE, and T. Bradford Earley, CFE, CPCU, AIAF, of the Bureau participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Theresa C. Lewis', with a long horizontal flourish extending to the right.

Theresa C. Lewis, CFE
Senior Insurance Examiner



AUGUSTA MUTUAL INSURANCE COMPANY

BU 13 Idlewood Blvd
Staunton, VA 24401-9355

10 DEC 15 AM 9:11

December 10, 2010

Mr. David H. Smith:
Bureau of Insurance
P O Box 1157
Richmond, VA 23218

Dear David:

We acknowledge receipt of your December 3, 2010, letter with first draft of the examination report. Corrective action has been taken on the two recommendations as follows listed on page 15 of report.

1) Controls for premium collections – Please be advised the Company has implemented additional steps to strengthen control. One employee is opening premium payment and producing control balance for all premium payments. A second employee processes these payments into the computer system and balances to the control total with any reconciling item noted. This control total is then balanced to the bank deposit. Each of these steps is documented on a control sheet and initialed by each employee completing their individual tasks.

2) Software Accounting – The accounting package has been loaded on an additional employee's computer with a separate sign on. This employee is responsible for loading the receipts and disbursement journal entries on a monthly basis.

Thank you in advance for your attention to the above recommendations and responses. Should you have any additional questions, please do not hesitate to contact me. I will need 15 copies of your report.

Sincerely,

A handwritten signature in black ink, appearing to read "Fred A. Shultz".

Fred A. Shultz, Treasurer

daw