

REPORT ON EXAMINATION
OF
ARCHITECTS & ENGINEERS INSURANCE COMPANY,
A RISK RETENTION GROUP
AS OF
DECEMBER 31, 2013

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT OF EXAMINATION, made as of December 31, 2013 of the

ARCHITECTS AND ENGINEERS INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

Attest By: Brandi Biddle

Date: July 8, 2014



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 8th day of July, 2014.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart".

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT OF EXAMINATION
OF THE
ARCHITECTS AND ENGINEERS INSURANCE COMPANY
AS OF
DECEMBER 31, 2013

The above-captioned report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the company as reflected in the report.

This report is hereby accepted, adopted and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart".

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 8th day of July, 2014

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SALUTATION

May 1, 2014

Honorable Karen Weldin Stewart, CIR-ML
Commissioner
Delaware Department of Insurance
Rodney Building
841 Silver Lake Blvd.
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in the Certificate of Authority No. 14.017, dated March 5, 2014, an examination has been made of the affairs, financial condition and management of

ARCHITECTS & ENGINEERS INSURANCE COMPANY, RISK RETENTION GROUP, hereinafter referred to as the "Company" or "AEIC" and incorporated under the laws of the State of Delaware. The Company's registered office in the State of Delaware is located at 1209 Orange Street, Wilmington, Delaware 19807. The examination was conducted at the administrative office of the Company located at 2056 Westings Avenue, Suite 20, Naperville, Illinois. The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2010 by the Delaware Insurance Department. This examination covered the period of January 1, 2011 through December 31, 2013, and encompasses a general review of transactions during the period, the Company's business policies and practices, as well as management and relevant corporate matters, with a

determination of the financial condition of the Company at December 31, 2013. Transactions subsequent to the examination date were reviewed where deemed necessary.

We conducted our examination in accordance with the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook* (Handbook) and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. The NAIC Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. The examination also included 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. The examination report addresses regulatory issues reviewed during the examination process.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, Strohm Ballweg, LLP, for the prior year, 2012. Certain auditor work papers have been incorporated into the work papers of the examiners and have been utilized in determining the scope, areas of emphasis in conducting the examination and in understanding of controls.

In addition to items noted in this Report on Examination, the following topics were reviewed without material exception and are included in the work papers of this examination:

Conflict of Interest
Custodial Agreements
NAIC Ratios
Legal Actions
Regulatory Agency Correspondence
All other Assets and Liabilities not mentioned
Pensions, Stock Ownership and Insurance Plans

SUMMARY OF SIGNIFICANT FINDINGS

The following finding was identified during the examination:

Investments Not Approved or Ratified

The Board of Directors did not approve, authorize or ratify investment transactions during the examination period pursuant to 18 Del.C. § 1304, “Authorization; Record of Investments”.

SUBSEQUENT EVENTS

There were no material subsequent events for the Company requiring disclosure.

COMPANY HISTORY

The Company was organized and incorporated as a stock insurance company under the captive insurance laws of the State of Delaware 18 Del. C. § 6902, with a designation as a “Risk Retention Group” as described under the insurance laws of the State of Delaware 18 Del. C. Ch. 80 and under the Federal Risk Retention Act of 1986. The Company’s Certificate of Incorporation was filed on July 8, 1987. The Certificate of Authority issued January 4, 1988, authorizes the Company to transact the business of liability insurance as a Risk Retention Group. AEIC commenced business on April 29, 1988.

The Company offers professional liability insurance policies to architectural and engineering consulting firms on a claims-made basis. AEIC does not have any subsidiaries and is a member of a Holding Company with Architects and Engineers Loss Control, Incorporated (“AELC”).

CAPITALIZATION

The Company is required to maintain a minimum capital and surplus of \$1,000,000, which is the minimum amount required of a Risk Retention Group under the insurance laws of the State of Delaware 18 Del. C. §6905(a). As of December 31, 2013, the Company's capital and surplus levels exceeded \$10 million.

Chapter 65, 15 USCS Section 3901(4) (E) of the Federal Statutes indicate that a "Risk Retention Group" must have "as its owners only persons who comprise the membership of the Risk Retention Group and who are provided insurance by such group." Therefore, ownership is necessary to obtain liability coverage from the Company. Ownership is obtained through the purchase of the Company's capital stock by those firms seeking liability coverage. The Company enters into a shareholders' agreement with each policyholder they insure.

The Company was initially capitalized through the sale of common stock to prospective policyholders as a condition of obtaining coverage. This common stock was issued to policyholders in exchange for cash and promissory notes (notes receivable). The notes receivable are backed by irrevocable letters of credit. After initial capitalization and prior to 1998, the shareholders' subscription agreement required a minimum capital investment equal to 3.0% of gross revenues for the year in which the stock purchase plan was selected. The minimum investment varied depending upon which stock purchase plan was selected. Effective in 1998, the Company required that new shareholders/policyholders purchase only one (1) share of common stock. The stock originally was issued by the Company for \$100.00 per share. The issue price was increased to \$120.00 per share in 1990, and increased again in 1992 to the current \$140.00 per share. Currently, the Company's amended Certificate of Incorporation authorizes the issuance of 500,000 shares of common

stock with a par value of \$5.00 per share. As the number of insureds has decreased slightly over the examination period, the common capital stock has decreased slightly as well over the examination period.

CORPORATE RECORDS

The Board of Directors (Board) and Committee meeting minutes were reviewed for the examination period. Attendance at meetings and election of Directors and Officers were evidenced. Investment transactions were not formally ratified or approved by the Board for the examination period in compliance with 18 Del.C. §1304, “Authorization; Record of Investments”. Therefore,

It is recommended that the Board approve, authorize or ratify investments pursuant to 18 Del.C. §1304, Authorization; Record of Investments.

MANAGEMENT AND CONTROL

Pursuant to the Company’s Certificate of Incorporation and bylaws, all corporate powers and its business property and affairs are managed by, or under the direction of the Board. The Board shall consist of not less than three (3) and no more than seven (7) Directors. The Directors need not be residents of the State of Delaware. One (1) Director is to be designated as a representative of AELC. Board Directors are elected for a one year term. The following persons were elected and serving as Directors of the Company at December 31, 2013:

Directors	Primary Business Affiliation
Harold A. Dombeck Woodstock, Georgia	Board Chairman Dombeck Associates
George X. Cannon Fishers, Indiana	Board Director and Audit Committee Chairman Consultant
Jason A. Peterson Naperville, Illinois	Board Director AELC
Robert M. Pratzel St. Louis, Missouri	Board Director HOK Group, Inc.

Pradeep R. Patel Philadelphia, Pennsylvania	Board Director EwingCole
James G. Beittenmiller Houston, Texas	Board Director HOK Group, Inc.

The Officers of the Company are elected by the Board. The following Officers served as of December 31, 2013:

Officers	Title
Mitchell A. Sellett	President and CEO
George X. Cannon	Vice President and Treasurer
Jason A. Peterson	Secretary

The ultimate controlling entity is AELC, the Holding Company.

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of an insurance holding company system as defined pursuant to 18 Del. C. Chapter 50 “Insurance Holding Company System Registration”. The Holding Company, AELC, has a controlling interest of 56.2% of the Company.

AELC serves as the management firm, performing the day-to-day operational activities for the Company through a Management Services Agreement. All employees are employed through AELC. A review was performed of the Company’s most recently filed Form B, Insurance Holding Company Registration Statement, for accurate disclosures and filings of Intercompany Agreements with the Delaware Insurance Department.

INTERCOMPANY / MANAGEMENT AGREEMENTS

Management Service Agreement

Effective April 16, 2011, the Company revised the Management Services Agreement (Management Agreement) with AELC. The Management Agreement authorizes AELC to handle all management functions, operational and administrative services for the Company with the exception of investments. The Management Agreement was revised during the examination

period to include claims services, a service formerly performed by a Third Party Administrator, C.R. Vince & Associates, Inc.

Intermediary Agreement

Effective January 1, 2009, the Company and Beach & Associates, LTD., entered into a Reinsurance Intermediary Agreement, with Beach & Associates as the Company's broker of record for the reinsurance programs. Pursuant to the Reinsurance Intermediary Agreement, Beach & Associates is granted authority to prepare submissions, solicit markets, negotiate terms and conditions, and services AEIC's reinsurance, subject to final approval by the Company.

Investment Advisory Agreements

Effective November 2, 1990, the Company has utilized Alpha Advisors Inc. (Alpha Advisors), as the Company's investment manager. Pursuant to the Investment Advisory Agreement, Alpha Advisors is authorized to buy and sell fixed income investments on behalf of the Company in accordance with AEIC's fixed income Investment Guidelines.

Effective November 9, 2012, the Company entered into an Investment Advisory Agreement with Harris Associates L.P. (Harris Associates), for investment management services performed over the equity portfolio. The Company began investing in stocks for the first time during 2013. Harris and Associates is authorized to buy and sell all equity securities on behalf of the Company in accordance with the Company's equity Investment Guidelines.

FIDELITY BONDS AND OTHER INSURANCE

The Company has fidelity coverage under a Directors and Officers policy issued by Great American Insurance Company with coverage of \$1 million any one claim and \$1 million in aggregate. The Fidelity Bond exceeds the suggested minimum amount of coverage for the Company as recommended by the NAIC.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2013, the Company was licensed to transact business in the State of Delaware, and registered as a Foreign RRG in an additional thirty-nine (39) states and the District of Columbia. The Company writes professional liability insurance policies to architects and engineers. Professional Liability coverage offered by AEIC includes: Professional, Directors and Officers, Employment Practices, and Benefit and Trust Liability. Coverage is offered on a claims-made basis, to firms that are members of the RRG.

Direct policies are offered by AEIC with limits up to \$10 million in coverage. The Company offers either one year or three year term policies. During 2013, multi-year policies encompassed about 85% of all policies. At year-end 2013, the Company had 91 insureds. The Company began writing policies on a direct basis at the beginning of 1998. Product distribution is through independent and wholesale agencies.

GROWTH OF THE COMPANY

The following chart represents the growth of the Company since the last examination period:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Policyholders' Surplus</u>	<u>Net Written Premium</u>	<u>Net Income</u>
2010	\$20,406,619	\$11,312,530	\$9,094,089	\$2,617,623	\$199,511
2011	\$20,825,286	\$11,613,374	\$9,211,912	\$1,946,057	\$95,926
2012	\$21,710,546	\$12,135,490	\$9,575,056	\$661,936	\$238,856
2013	\$22,903,534	\$12,637,645	\$10,265,889	\$1,169,559	\$443,923

Since the last examination, the Company has reported a reduction of net premiums written of \$1,448,064 between 2010 and 2013. A majority of policies written by the Company are on a three year term. The multi-year policy term results in fluctuations to the direct premium written. Policyholder count has decreased and overall aggregate premium volume has been reduced by 15% from peak years reported by AEIC during mid-2008 and softening market conditions thereafter.

Admitted assets have consistently increased. An equity portfolio was added for the first time since the Company's inception during 2013. During 2013, invested assets rose 8.2%. In addition to an increase in investment income, additional contributing factors to an overall increase in admitted assets were increased cash reserves and improved liquidity metrics. During 2013, capital and surplus exceeded \$10 million for the Company's first time.

REINSURANCE

The Company is protected from risk over-exposure through the use of reinsurance. AEIC's net maximum retention was \$150,000 per insured risk for the 2013 policy effective year. The following is a summary of net premiums as of December 31, 2013:

Direct	\$6,991,052
Ceded	<u>5,821,493</u>
Net	<u>\$1,169,559</u>
Net Percentage	16.7%

Assumed Reinsurance:

AEIC did not assume any reinsurance during the examination period.

Ceded Reinsurance:

As of December 31, 2013, the Company had an Excess of Loss, Excess of Cessions and a Quota Share Reinsurance Agreement in force. The Professional Liability Quota Share Reinsurance Treaty (the Quota Share Agreement) is between the Company and Transatlantic Reinsurance Company and Partner Reinsurance Company with an effective date of January 1, 2013 through December 31, 2013. The Quota Share Agreement is 40% placed with each reinsurer assuming a 20% share of the interests and liabilities. The policy limit for the Quota Share Agreement is \$10 million.

Effective January 1, 2012 through December 31, 2014, the Company has an Excess of Loss Agreement in force between AEIC, American Safety Reinsurance, LTD and Hannover Re. The

Excess of Loss treaty is 60% placed with each reinsurer assuming a 30% share of the interests and liabilities. The policy limit of the Excess of Loss treaty is \$750,000 in excess of \$250,000.

Effective January 1, 2013 through December 31, 2013, the Company had an Excess of Cessions Agreement in force between AEIC, Lloyds of London Syndicates, Hannover Reinsurance, Catlin Bermuda and Advent. The Excess of Cessions Agreement is 60% placed with Lloyds of London Syndicates assuming 44.5%, Hannover Reinsurance assuming 5%, Catlin Bermuda assuming 7% and Advent assuming 3.5%. The policy limit of the Excess of Cessions treaty is \$9 million in excess of \$1 million.

ACCOUNTS AND RECORDS

The statutory-basis financial statements of the Company have been audited annually by the external accounting firm, Strohm Ballweg, LLP and Actuarial firm, EVP Advisors, Inc. Strohm Ballweg, LLP opined that the December 31, 2012 financial statements were presented fairly in all material respects. The 2013 audit had not been finalized during the examination as of December 31, 2013.

The accounts and records review included an assessment of the Company's risk management process in identifying and controlling risks in the key operational areas of the Company. In making the assessment in each key area, processes were reviewed, risks were identified and operational and organizational controls were identified and substantive testing performed for determination of risk mitigation.

Based on the examination review of the Annual Statement classifications and subsequent discussion with management, the accounting system and procedures conformed to insurance accounting standard practices and requirements.

STATUTORY DEPOSITS

The Company’s state statutory deposit is comprised of two municipal bonds held in escrow by Wilmington Trust, Wilmington, Delaware. The following statutory deposit was on file with the Delaware Insurance Department:

STATE	Deposits For The Benefit of ALL Policyholders		All Other Special Deposits	
	Book/Adjusted Carrying Value	Fair Value	Book/Adjusted Carrying Value	Fair Value
Delaware	\$ 200,000	\$ 207,254	-	-
TOTAL DEPOSITS	\$ 200,000	\$ 207,254	-	-

FINANCIAL STATEMENTS

The following pages contain the Company’s Financial Statements for the year ending December 31, 2013, as determined by this examination, with supporting exhibits as detailed below:

- Assets
- Liabilities, Surplus and Other Funds
- Summary of Operations
- Reconciliation of Capital and Surplus

ARCHITECTS & ENGINEERS INSURANCE COMPANY, a RRG
ASSETS

DECEMBER 31, 2013

	<u>Assets</u>	Non-Admitted <u>Assets</u>	Admitted <u>Assets</u>	<u>Notes</u>
Bonds	\$ 9,512,921	\$ 0	\$ 9,512,921	(1)
Stocks	1,730,765	0	1,730,765	(2)
Cash	<u>2,087,295</u>	<u>0</u>	<u>2,087,295</u>	
Subtotals, cash and invested assets	13,330,981	0	13,330,981	
Investment income due and accrued	141,495	0	141,495	
Premiums and Considerations:				
Uncollected premiums and agents' balances in the course of collection	2,650,277	0	2,650,277	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	4,515,872	0	4,515,872	
Amounts recoverable from reinsurers	184,474	0	184,474	
Net deferred tax asset	127,104	0	127,104	
Aggregate write-ins for other than invested assets	<u>1,971,893</u>	<u>18,562</u>	<u>1,953,331</u>	(3)
Totals	<u>\$ 22,922,096</u>	<u>\$ 18,562</u>	<u>\$ 22,903,534</u>	

ARCHITECTS & ENGINEERS INSURANCE COMPANY, a RRG
LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 20113

			<u>Notes</u>
Loss	\$ 3,641,023		(4)
Loss Adjustment Expenses	358,839		(4)
Commissions payable, contingent commissions and other similar charges	16,790		
Other Expenses	114,152		
Taxes, licenses and fees	13,983		
Current federal and foreign income taxes	87,121		
Unearned premiums	2,069,974		
Ceded reinsurance premiums payable	<u>6,335,763</u>		
Total Liabilities	12,637,645		
Common capital stock	\$ 318,191		
Aggregate write-ins for other than special surplus funds	\$ 2,226,399		(5)
Gross paid-in and contributed surplus	4,642,148		
Unassigned funds (surplus)	<u>3,079,151</u>		
Surplus	<u>9,947,698</u>		
Surplus as regards policyholders	<u>10,265,889</u>		
Total Liabilities, Capital and Surplus	<u>\$ 22,903,534</u>		

ARCHITECTS & ENGINEERS INSURANCE COMPANY, a RRG
SUMMARY OF OPERATIONS
DECEMBER 31, 2013

Underwriting Income

Premiums earned	\$	1,778,386	
Losses incurred		(1,040,356)	
Loss adjustment expenses		(115,595)	
Aggregate write-ins for underwriting deductions		<u>(358,121)</u>	
Net underwriting gain	\$		264,314

Investment Income

Net investment income earned	\$	260,210	
Net realized capital gains or (losses)		<u>18,006</u>	
Net investment gain or (loss)	\$		278,216

Other Income

Net income before federal income taxes		542,530	
Federal income taxes incurred		<u>98,607</u>	
Net income	\$		<u><u>443,923</u></u>

ARCHITECTS & ENGINEERS INSURANCE COMPANY, a RRG
RECONCILIATION OF CAPITAL AND SURPLUS
DECEMBER 31, 2013

Surplus as regards policyholders, December 31, 2012	\$ 9,575,056
<u>Gains and (losses) in surplus</u>	
Net income	443,923
Change in surplus as regards policyholders for the year	<u>690,833</u>
Surplus as regards policyholders, December 31, 2013	<u><u>\$ 10,265,889</u></u>

SCHEDULE OF EXAMINATION ADJUSTMENTS

There were no financial statement adjustments as a result of the examination conducted.

NOTES TO FINANCIAL STATEMENTS

Note 1 - Bonds \$9,512,921

Investments in bonds are reported at values (amortized cost) adopted and approved by the Securities Valuation Office (SVO) of the NAIC. The bond portfolio was diversified among 31 separate holdings, ranging in size between par amounts of \$100,000 to \$500,000. The bond portfolio is comprised of 41.5% of the Company's total admitted assets. All of the Company's bonds were rated a SVO class 1 by the NAIC.

Note 2 – Common Stock \$1,730,765

The Company established a stock portfolio for the first time during 2013. The stock portfolio encompasses 7.5% of the Company's total admitted assets. The stock portfolio generated \$18,000 in realized gains and \$367,000 in unrealized gains in 2013.

Note 3 – Aggregate write-ins for other-than-invested assets \$1,953,331

The Company reports notes receivable of \$1.953 million at the end of 2013. The notes receivable represent commitments by certain shareholders for their initial purchase of the Company's common stock. The notes are secured by irrevocable letters of credit callable upon demand by the Company. The notes receivable neither have a maturity date nor stated interest rate. The letters of credit were approved by the Delaware Insurance Department during the Company's formation.

Note 4 – Loss and Loss Adjustment Expense \$ 3,999,862

The Company reported net loss reserves of \$3.641 million and unpaid loss adjustment expense reserves of \$358,000. Losses have decreased over the examination period in relation to

modest decreases in insured's during the examination period. INS Consultants, Inc. reviewed the Company's reserving methodologies and estimated net loss and loss adjustment expenses in an amount not materially different than that reported by the Company as of December 31, 2013.

Note 5 – Aggregate Write-in Special Surplus

\$ 2,226,399

The Company reports a liability for provision for redeemable capital stock, for terminating shareholder/policyholder coverage. Pursuant to a requirement of the Delaware Insurance Department, the Company must maintain \$15 million in capital and surplus before issuing any distributions. The liability is valued for terminated shareholders/policyholders at acquisition cost and classified as a provision of redeemable capital stock, as part of the aggregate write-in for other special surplus funds. The shares are payable upon demand of the former insured upon attainment of applicable statutory requirements for AEIC, Board and Delaware Insurance Department approval.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

There were no prior examination recommendations.

SUMMARY OF RECOMMENDATIONS

It is recommended that the Board approve, authorize or ratify investments pursuant to 18 Del.C. §1304, Authorization; Record of Investments.

CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

Architects & Engineers Insurance Company, a Risk Retention Group

<u>Description</u>	<u>December 31, 2010</u>	<u>December 31, 2013</u>	<u>Increase (Decrease)</u>
Assets	\$ 20,406,619	\$ 22,903,534	\$ 2,496,915
Liabilities	\$ 11,312,530	\$ 12,637,645	\$ 1,325,115
Common Capital Stock	323,206	318,191	(5,015)
Aggregate write-ins	2,089,258	2,226,399	137,141
Gross Paid In and Contributed Surplus	4,773,014	4,642,148	(130,866)
Unassigned Funds (Surplus)	1,908,611	3,079,151	1,170,540
Total Surplus	\$ 9,094,089	\$ 10,265,889	\$ 1,171,800
Totals	\$ 20,406,619	\$ 22,903,534	\$ 2,496,915

In addition to the undersigned, Bob Gardner, ACAS, MAAA, Actuary with INS Consultants, Inc. and Gregg Bealuk, CFE, Delaware Supervising Examiner, participated in the examination. The assistance and cooperation of the Company's outside audit firm, Strohm Ballweg, LLP and the Company's management and staff was appreciated and acknowledged.

Respectfully submitted,



Natalie Davis, CFE
Examiner-In-Charge
State of Delaware