HEARTLAND INSURANCE RISK POOL

JUNE 30, 2008

HEARTLAND INSURANCE RISK POOL

FINANCIAL STATEMENTS
with
REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

YEARS ENDED JUNE 30, 2008 AND 2007

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CONNER ASH P.C.

Certified Public Accountants
and Business Consultants

An independent member of BKR International

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Heartland Insurance Risk Pool
Tama, Iowa

We have audited the accompanying statutory statements of admitted assets, liabilities, and surplus of Heartland Insurance Risk Pool (the Pool) as of June 30, 2008 and 2007, and the related statutory statements of income and surplus and cash flows for the years then ended. These statutory financial statements are the responsibility of the Pool's management. Our responsibility is to express an opinion on these statutory financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in Note 1 to the financial statements, the Pool prepared these financial statements using accounting practices prescribed or permitted by Iowa Department of Commerce, Insurance Division, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of the Pool as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2008 on our consideration of the Pool's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

This report is intended solely for the information and use of the board of trustees of Heartland Insurance Risk Pool, the State of Iowa, the reinsurers of the Pool, and the Iowa Department of Commerce, Insurance Division and is not intended to be and should not be used by anyone other than these specified parties.

Conner Ash P.C

St. Louis, Missouri
October 31, 2008

HEARTLAND INSURANCE RISK POOL

STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND SURPLUS

June 30,	2008	2007
ADMITTED ASSETS		
Investments	**$ 6,651,458**	$ 5,609,763
Cash	**930,614**	970,922
Total cash and investments	**7,582,072**	6,580,685
Prepaid service	**24,344**	-
Accrued interest receivable	**69,027**	91,029
	$ 7,675,443	$ 6,671,714
LIABILITIES AND SURPLUS		
LIABILITIES		
Reserve for losses and loss adjustment expenses (notes 3 and 4)	**$ 2,450,000**	$ 2,461,611
Other liabilities	**23,700**	22,925
TOTAL LIABILITIES	**2,473,700**	2,484,536
SURPLUS	**5,201,743**	4,187,178
	$ 7,675,443	$ 6,671,714

See accompanying notes and accountants' report.

HEARTLAND INSURANCE RISK POOL

STATUTORY STATEMENTS OF INCOME AND SURPLUS

Years Ended June 30,	2008	2007
UNDERWRITING OPERATIONS (notes 2, 3, and 4):		
Premiums earned, net of reinsurance	**$ 2,350,035**	$ 2,360,900
Losses and loss expenses incurred, net of reinsurance	**1,319,728**	1,773,127
Underwriting expenses	**410,064**	429,838
	1,729,792	2,202,965
NET UNDERWRITING INCOME	**620,243**	157,935
INVESTMENT INCOME	**394,322**	307,978
NET INCOME	**1,014,565**	465,913
SURPLUS at beginning of year	**4,187,178**	3,721,265
SURPLUS at end of year	**$ 5,201,743**	$ 4,187,178

See accompanying notes and accountants' report.

HEARTLAND INSURANCE RISK POOL

STATUTORY STATEMENTS OF CASH FLOWS

Years Ended June 30,	2008	2007
CASH FROM OPERATIONS		
Net premiums collected	**$ 2,350,035**	$ 2,360,900
Net losses and loss adjustment expenses paid	**(1,331,339)**	(1,278,103)
Underwriting expenses paid	**(433,633)**	(429,413)
Cash provided by operations	**585,063**	653,384
Net investment income received	**416,324**	282,505
Net cash provided by operations	**1,001,387**	935,889
CASH FROM INVESTMENTS		
Proceeds from investments sold or matured	**3,891,382**	3,143,483
Cost of investments acquired	**(4,933,077)**	(3,608,100)
Net cash used in investing activities	**(1,041,695)**	(464,617)
NET CHANGE IN CASH	**(40,308)**	471,272
CASH AT BEGINNING OF YEAR	**970,922**	499,650
CASH AT END OF YEAR	**$ 930,614**	$ 970,922

See accompanying notes and accountants' report.

HEARTLAND INSURANCE RISK POOL

NOTES TO STATUTORY FINANCIAL STATEMENTS

June 30, 2008 and 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company operations

Heartland Insurance Risk Pool (the Pool) operates as a self-insured risk pool. The Pool was formed July 1, 1987 and provides insurance coverage to ten rural counties in Iowa.

The Pool self-insures workers' compensation, automobile liability, automobile physical damage, crime, and property lines of business on an occurrence basis. General liability, law enforcement, and public official errors and omissions coverage is written on a claims-made basis.

Basis of presentation

The Pool prepares its statutory financial statements in conformity with accounting practices prescribed or permitted by the Iowa Department of Commerce, Insurance Division. The statutory accounting financial statements are in accordance with the National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual*, subject to any deviations prescribed or permitted by the State of Iowa insurance commissioner. The Pool is currently applying only prescribed accounting practices. Statutory accounting practices, in accordance with NAIC *Accounting Practices and Procedures Manual*, vary in some respects from accounting principles generally accepted in the United States of America (GAAP) and include the following: (1) reinsurance recoverables on unpaid losses are netted rather than presented gross, (2) the statutory financial statements do not include a statement of comprehensive income, and (3) the statement of cash flows does not include classifications consistent with GAAP, and a reconciliation of net income to net cash provided by operating activities is not provided.

Use of estimates

The preparation of statutory financial statements in conformity with accounting practices prescribed or permitted by the Iowa Department of Commerce, Insurance Division, requires management to make estimates and assumptions that affect the reported amounts of admitted assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Valuation of investments

Investments are comprised of certificates of deposit with varying maturities and are carried at cost, which approximates fair value. The cost of securities sold is based upon the specific identification method. Maturities were as follows at June 30:

	2008	2007
Less than 1 year	**$4,544,272**	$4,030,850
One to two years	**2,107,186**	1,578,913
	$6,651,458	$5,609,763

Premium income recognition

All policies have a twelve-month term and expire on June 30. As a result, all premiums are earned by the June 30 year-end and are reported net of applicable reinsurance.

Reserve for losses and loss adjustment expenses

The Pool provides liabilities for losses based upon undiscounted aggregate case basis estimates for losses reported; estimates of unreported losses based upon past experience, modified for current trends; and deductions of amounts for reinsurance placed with reinsurers. Losses are reported net of amounts recoverable from salvage and subrogation.

Income taxes

The Pool was formed under Chapter 28E of the Iowa Code and is tax-exempt under Section 115 of the Internal Revenue Code.

2. SERVICE AGREEMENTS

The Pool has agreements with Risk Management Solutions of Iowa, Inc., and Arthur J. Gallagher & Co. to act as a service agent for the self-insured lines of business and provides administrative and loss control services. The Pool has another agreement with Alternative Risk Services, LLC to provide claims services. The service fees for the years ended June 30, 2008 and 2007 were as follows:

2. SERVICE AGREEMENTS – CONTINUED

	2008	2007
Claims services	**$105,000**	$105,000
Administrative services	**96,188**	123,117
Brokerage services	**98,501**	98,501
Loss control services	**72,764**	72,764
	$372,453	$399,382

3. REINSURANCE

The Pool cedes insurance to other insurers in order to limit its maximum loss through risk diversification. Insurance ceded by the Pool does not relieve its primary liability as the originating insurer. The amounts deducted for reinsurance ceded were as follows:

	Direct	Ceded	Net
2008:			
Premiums written and earned	$3,346,481	$ 996,446	$2,350,035
Losses and loss adjustment expenses incurred	$1,324,448	$ 4,720	$1,319,728
Reserve for losses and loss adjustment expenses	$3,536,590	$1,086,590	$2,450,000
2007:			
Premiums written and earned	$3,485,855	$1,124,955	$2,360,900
Losses and loss adjustment expenses incurred	$1,953,127	$ 180,000	$1,773,127
Reserve for losses and loss adjustment expenses	$3,543,481	$1,081,870	$2,461,611

The basic ceded reinsurance treaties benefiting the Pool apply to risks on an excess basis. The base per occurrence retention levels of the Pool are as follows:

Policy period ended	Workers' compensation	Auto, law enforcement, public official and general liability	Property
Through June 30, 2002	$350,000	$250,000	$ 50,000
June 30, 2003	$350,000	$350,000	$100,000
June 30, 2004	$500,000	$350,000	$100,000
June 30, 2005 - 2008	$750,000	$400,000	$100,000

3. REINSURANCE – CONTINUED

The Pool does not have aggregate reinsurance for periods after June 30, 2002. The workers' compensation reinsurance policy periods ending June 30, 2008 and 2007 have $250,000 corridors; this means that the Pool must pay an additional $250,000 on its first loss exceeding the retention level before the reinsurer becomes liable.

4. RESERVE FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

Activity in reserve for losses and loss adjustment expenses is summarized as follows:

	2008	2007
Balance as of July 1, net of reinsurance recoverable of $1,081,870 in 2007 and $901,870 in 2006.	**$2,461,611**	$1,966,587
Incurred related to:		
Current year	**1,380,157**	1,673,656
Prior years	**(60,429)**	99,471
Total incurred	**1,319,728**	1,773,127
Paid related to:		
Current year	**327,679**	366,033
Prior years	**1,003,660**	912,070
Total paid	**1,331,339**	1,278,103
Balance as of June 30, net of reinsurance recoverable of $1,086,590 in 2008 and $1,081,870 in 2007	**$2,450,000**	$2,461,611

The reserving process relies on the basic assumption that past experience, adjusted for the effect of current developments and likely trends, is an appropriate basis for predicting future events. Reserve amounts are necessary based on management's informed estimates. As other data becomes available and is reviewed, these estimates and judgments are revised, resulting in increases and decreases to existing reserves. As a result of changes in estimates of ultimate losses on insured occurrences in prior years, the Pool had favorable development of $60,429 in 2008 and unfavorable development of $99,471 for 2007. Development for losses and loss adjustment expenses on prior years could vary significantly due to the small size of the Pool. As of June 30, 2008, the Pool expects reinsurance recoveries of $1,086,590 from General Reinsurance Corporation.

5. CONTINGENCIES

The Pool is subject to numerous lawsuits arising in the normal course of the insurance business. The Pool believes that the resolution of these lawsuits will not have a material adverse effect on its financial condition or its results of operations. The Pool has reserves which are believed adequate to cover any potential liabilities arising out of all such pending or threatened proceedings.