CUMBERLAND TECHNOLOGIES INC
Form 10-K
May 06, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

[Mark One]

[x] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2002

or

[] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____________ to _____________.

Commission File No. 0-19727

CUMBERLAND TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Florida | 59-3094503 |
| (State or other jurisdiction of incorporation) | (I.R.S. Employer Identification No.) |
| 4311 West Waters Avenue, Suite 501<br>Tampa, Florida | 33614 |
| (Address of principal executive offices) | (Zip Code) |

(813) 885-2112
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each Class | Name of each exchange on which registered |
|---|---|
| Common Stock | The Over The Counter Bulletin Board |

Securities registered pursuant to Section12(g) of the Act:

Common Stock
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [x] No [ ]

Indicate by a check mark if disclosure of delinquent files pursuant to Item 405 Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this form 10-K. [x]

$216,120

Aggregate market value of voting stock (Common Stock) held by nonaffiliates of the Registrant as of March 6, 2003

5,597,244 shares of Common Stock $.001 par value

Number of shares of Common Stock outstanding as of March 6, 2003

Documents incorporated by reference: NONE

# PART I

## Item 1. Business

### General

Cumberland Technologies, Inc. ("CTI" or "the Company"), (f/k/a Cumberland Holdings, Inc.) a Florida corporation, was formed on November 18, 1991, to be a holding company and a wholly-owned subsidiary of Kimmins Corp. ("KC"). Effective October 1, 1992, KC contributed all of the outstanding common stock of two of its wholly-owned subsidiaries, Cumberland Casualty & Surety Company ("CCS") and Surety Specialists, Inc. ("SSI") to CTI. KC then distributed to its stockholders CTI's common stock on the basis of one share of common stock of CTI for each five shares of KC common stock and Class B common stock owned (the "Distribution"). Cumberland Technologies, Inc., ("the Company") is a holding company engaged through its subsidiaries, Cumberland Casualty & Surety Company ("CCS"), Surety Specialists, Inc. ("SSI"), The Surety Group, Inc. ("SG"), Associates Acquisition Corp. d/b/a Surety Associates ("SA") and Qualex Consulting Group, Inc. ("Qualex") in the delivery of specialty surety and insurance services. Surety services include underwriting surety bonds on a direct and assumed basis, surety consulting and the development of surety software. Insurance services include the underwriting of specialty and other liability insurance products. In addition, the Company conducts its business through a number of independent agencies which focus on selling and delivering surety insurance products to consumers. Because the need to advance technologically in the delivery of insurance products, the Company developed a software product called Bond-Pro(R). This patented surety issuance system increases the speed that surety agents deliver their products to the customer and financially report those transactions to the carrier, while reducing operating costs. The Company's business strategy is to continue the underwriting focus of each of its operating subsidiaries and to achieve growth through the expanded licensing of Bond-Pro(R).

CCS is a property and casualty insurance company that was incorporated in

Texas on May 4, 1988 and redomesticated in Florida, on September 2, 1994. CCS is licensed in twenty-seven states, the District of Columbia, and Guam. It holds a certificate of authority from the United States Department of the Treasury, which qualifies CCS as an acceptable surety on Federal bonds. CCS is rated "B+" (Very Good) by A.M. Best.

CCS currently has applications for admission pending in various states. Most of these states have a lengthy applications process in which the admission filing must be updated with certain financial and nonfinancial information until the insurance department decides to approve an application. The insurance department is not restricted as to the amount of time it may take to approve an application. All applications are updated as new information becomes available and CCS is waiting for inquiries or actions by these pending states. Those states in which CCS has not yet applied for licensing generally require additional years of operating history or additional capital and surplus. Once CCS has met these requirements, it is anticipated that the applications for admission will be submitted accordingly. CCS is currently attempting to obtain additional state licenses in order to spread its risk of loss geographically and to increase its sales of direct surety and insurance products. Management believes that CCS can function profitability selling direct surety and insurance products in the states in which it is currently licensed.

SSI, a Florida corporation, formed in August 1988, SG, a Georgia corporation, and SA, a South Carolina corporation purchased by the Company in February and July 1995, respectively, are specialized surety agencies which operate as independent agencies. Each secures surety risks for small to medium size contractors as an agent and for other agents as a broker. SG and SA are also general lines insurance agencies. When acting as an agent, SSI, SG and SA receive a commission from the various insurance companies it represents, one of which is CCS. Agency commissions are based upon a percentage of premiums paid by the consumer. The commissions paid by CCS to SSI, SG and SA range from 35 to 40 percent.

In addition, SSI generates additional revenues through joint partnering agreements to pursue small to medium size contract and commercial surety business on a countrywide basis. The agreements allow SSI to solicit surety business in states in which CCS is not licensed thereby significantly increasing the Company's ability to geographically spread risk. CCS participates in both agreements underwriting risk through a retrocession treaty.

Qualex, a Florida corporation, formed in November 1994, provides claim and contracting consulting services to the surety and construction industries. CCS purchases claim consulting services from Qualex on a contract basis.

The percentages of gross revenue generated by the Company's subsidiaries for the year ended December 31, 2002 are as follows:

| Subsidiary | Revenue Percentage |
|---|---|
| CCS.......................... | 87% |
| Qualex....................... | 10% |
| SA........................... | 1% |
| SG........................... | 2% |
| | 100% |

The term "the Company" unless the context otherwise requires, refers to

Cumberland Technologies, Inc. and its subsidiaries. The principal executive offices of the Company are located at 4311 West Waters Avenue, Suite 401, Tampa, Florida 33614. The Company's telephone number is (813) 885-2112, its facsimile number is (813) 885-6734 and its web site is www.cumberlandtech.com.

### Surety Products

CCS underwrites a wide variety of surety bonds for small to medium size surety accounts. CCS also assumes underwriting risk from other surety companies under various reinsurance arrangements. Contract surety bonds center primarily on performance and payment bonds issued for the construction industry. The bonds guarantee that a contractor will fulfill their obligations, with respect to performing the scope of work defined in the contract and fulfilling their financial obligations. CCS's typical bond is less than $200,000 with aggregate ongoing work of $500,000. These bonds are marketed through independent insurance agencies specializing in this type of coverage to general contractors, sub-contractors and specialty contractors.

Commercial surety bonds, which includes all non-contract surety bonds, numerous types of license and permit, miscellaneous and judicial bonds. The scope of each bond varies according to the law, locality, the nature of the guarantee, and the parties who have a right of action under the bond. The typical bond penalty ranges from $5,000 to $50,000 and is usually written on a volume basis.

### Insurance Products

The Company's other liability insurance products include Registered Investment Advisors professional liability insurance and Notary Public Errors and Omission liability insurance. Both coverages are occurrence liability coverages, that insure against specific liability risks. Under the Registered Investment Advisors professional liability coverage, each endorsed account is limited to a maximum liability coverage of $500,000. Due to the volatility in the marketplace, the Company suspended marketing of this product effective September 2001. The Notary Public Errors and Omissions liability coverage is written with liability limits of $7,500 to $30,000 per policy.

On surety or insurance products sold directly by CCS, exposure to loss would be the penal amount of the bond, less any portion for which CCS has obtained reinsurance. On reinsurance, CCS's exposure to loss would be limited by the amount of reinsurance provided. Reinsurance does not relieve an insurer of its liability to the policyholder for the full amount of the policy, however, the reinsurer is obligated to the insurer for the portion assumed by the reinsurer.

### Technology Product

On October 1, 1996, CTI launched the development of a surety bond issuance system "Bond-Pro(R)." The Company received its federal copyright registration #TX4-542-729 effective March 29, 1997. The Company sees the implementation of the system as an integral part of its unique service affording it the ability to capture a larger share of the marketplace. This program encompasses the required functions an agency needs to run a full scale bond desk when implemented inside the agency structure. The software is designed to reduce the labor required to provide improved service. CCS offers its Bond-Pro(R) program to small and medium size agencies in order to produce premiums. The efficiencies gained in using the Bond-Pro(R) system enhances CCS's ability to increase premiums and to develop relationships which may not otherwise be possible due to competition for this class of business. While a small percentage of the industry offers issue and reporting systems for bonds, no other provider offers a fully integrated, multi-carrier production and processing system including management reporting.

## Underwriting

For the contract and commercial surety lines of business, the Company's underwriting philosophy provides for an individual analysis of the risk associated with each application, except for specific categories of miscellaneous bonds. In underwriting contract bonds, its approach focuses on the financial strength, experience and operating capacity of the contractor. In underwriting commercial surety, this approach focuses on the credit history and financial resources of the applicant.

The Company maintains control of the contract and commercial surety underwriting process through the use of authority limits for each underwriter and committee underwriting of larger risks. The Company may require collateral on contract bonds and occasionally, on other types of bonds based upon an assessment of the risk characteristics. The risk assessment includes evaluation of the financial strength of the contractor, the credit history of the contractor, work in progress and successful work experience. Collateral can consist of irrevocable letters of credit, certificates of deposit, cash, savings accounts and publicly traded securities. Both corporate and personal indemnification may be required in order to mitigate liability risk. The Company also targets various products in the commercial surety market which are characterized by relatively low risk exposure in small penal amounts. The underwriting criteria, including the extent of bonding authority granted to independent agents, will vary depending on the class of business and the type of bond. For example, relatively little underwriting information is typically required of certain low exposure risk such as notary bonds.

Other liability insurance applications are individually evaluated and the decision to write a particular risk is made by the Company's underwriting department. The underwriting department determines whether to write a particular risk after evaluating a number of factors based upon detailed objective underwriting standards relating to each class of business.

## Reinsurance

CCS assumes reinsurance premiums through a program whereby its subsidiary, SSI has contracted through two joint partnering agreements (St. Paul Fire and Marine Group, f/k/a United States Fidelity and Guaranty Company and Peerless Insurance Company) to pursue small to medium size contract and commercial surety business in states in which CCS is not licensed. Effective July 1, 2002, these programs were discontinued. CCS participates in the underwriting risk through a retrocession treaty with Transatlantic Reinsurance Company.

Effective October 1, 1996, CCS entered into a quota share agreement with First Indemnity of America Insurance Company ("FIA") whereby all of the premiums written through a shared underwriting office are subject to this treaty. The Company assumes 50% of the premiums written by FIA and cedes 50% of the premiums written by CCS.

The Company's insurance subsidiary, in the ordinary course of business, cedes insurance to other insurance companies, to limit its exposure to loss, provide greater diversification of risk, and minimize aggregate exposures. Because the ceding of insurance does not discharge the primary liability of the original insurer, CCS places reinsurance with qualified carriers after conducting a detailed review of the nature of the obligation and a thorough assessment of the reinsurers credit qualifications and claims settlement performance and capabilities. The reinsurance coverage terms are tailored to the specific risk characteristics of the underlining products of the company.

For contract and commercial surety business, CCS entered into an excess of loss reinsurance agreement with Transatlantic Reinsurance Company (Transatlantic Treaty), which is rated A+ (Superior) by A.M. Best. Excess of loss reinsurance is a form of reinsurance, which indemnifies the ceding insurer up to an agreed amount against all or a portion of the amount of loss in excess of a specified retention. The Company cedes risk insured to Transatlantic Reinsurance Company on an excess of loss treaty 95% of the risk insured with a maximum exposure to the Company of $235,000 per principal prior to June 30, 2001 and a maximum exposure of $300,000 per principal effective July 1, 2001 through June 30, 2002. Effective July 1, 2002, net exposure, is limited to $250,000 through its reinsurance program after a $1.4 million annual aggregate deductible, limited to $350,000 per principal, is satisfied. Under the Transatlantic Treaty, the reinsurer automatically assumes the risk of losses on all contract surety bonds written and classified as surety in CCS's statutory annual statement and all miscellaneous surety bonds with penal sums over $100,000 written and classified as surety in CCS's statutory annual statement.

Effective July 1, 2002, CCS entered into a quota share agreement with Transatlantic Reinsurance Company whereby CCS cedes 35% of the premiums, net of commissions, on its commercial surety bonds with penal sums less than $100,000. The quota share treaty is renegotiated annually.

For its liability line of registered investment advisor insurance, the Company has reduced its exposure on any one risk, through the purchase of a quota share agreement with Dorinco Reinsurance (Dorinco Treaty) which is rated A (Excellent) by A.M. Best. Under the Dorinco Treaty, CCS cedes 50% of its liability on all Registered Investment Advisor policies.

## Reserves

Reserves for losses and loss adjustment expenses are established based upon reported claims and historical industry loss development. The amount of liability for case loss reserves for reported claims is based on a case by case evaluation of the claim. Historical industry data is reviewed and consideration is given to the anticipated impact of various factors such as legal developments, economic conditions and the effects of inflation. Amounts are adjusted periodically to reflect these factors.

Reserve for losses and loss adjustment expenses are actuarial estimates of losses, including the related settlement costs. Management believes that the reserves for losses and loss adjustment expenses are adequate to cover the losses and loss adjustment expenses, including the cost of incurred but not reported losses. During 2002, there were no material changes in the mix of business or types of risk assumed.

Current fluctuations in inflation have not had a material effect on the consolidated financial statements and there are no explicit provisions in the consolidated financial statements for the effects of inflation that may cause future changes in claim severity.

Other than certain classification differences, there are no material differences between statutory reserves and Generally Accepted Accounting Principle ("GAAP") reserves. CCS does not discount its loss reserves for financial reporting purposes.

Derivative Instruments
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The Company adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" effective January 1, 2001. As a result, the Company identified one product that meets the definition of a derivative instrument as defined in SFAS No. 133. The policy is issued to registered investment advisors ("Advisors"), and insures losses suffered by the Advisors as a result of market declines on covered investment principal, provided that the Advisors have followed the investment guidelines required by the policy. The identified derivative was formerly accounted for as an insurance contract within the policy liabilities for loss and loss adjustment expenses account in the consolidated balance sheet for periods prior to January 1, 2001. Due to the volatility in the marketplace, the Company suspended marketing of this product effective September 2001.

Environmental Claims
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The Company bonds several accounts that have incidental environmental exposure, with respect to which the Company provides limited contract bonding programs. In the commercial surety market, the Company provides bonds to corporations that are in the business of mining various minerals, establishing mitigation banks, or operating environmental facilities, and that are obligated to post financial assurance bonds that guarantee that property can be managed according to regulatory guidelines. While no environmental responsibility is overtly provided by commercial or contract bonds, some risk of environmental exposure may exist if the surety were to assume certain rights of ownership of the property in the completion of a defaulted project or through salvage recovery. To date, the Company has not received any environmental claim notices, nor is management aware of any potential environmental claims.

Investments
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Insurance company investment practices must comply with insurance laws and regulations. Generally, insurance laws and regulations prescribe the nature and quality of, and set limits on, various types of investments, which may be made by CCS.

CCS's investment portfolios generally are managed to maximize any tax advantages to the extent available while minimizing credit risk with investments concentrated in high quality, fixed income securities. CCS's portfolios are managed to provide diversification by limiting exposures to any one issue or issuer and to provide liquidity by investing in the public securities markets. Portfolios are structured to support CCS's operations and in consideration of the expected duration of liabilities and short-term cash needs.

An Investment Committee of CCS's Board of Directors establishes investment policy and oversees the management of the portfolios.

Marketing

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CCS principally markets its products in twenty-seven states, the District of Columbia and Guam in which it is licensed. Its products are marketed primarily through SSI, SG, SA and independent agents and producers, including multi-line agents and brokers that specialize as surety specialists, many of whom are members of the National Association of Surety Bond Producers. CCS uses specialized general agencies to market its other liability insurance products.

## Competition

The insurance industry is a highly competitive industry. There are numerous firms, particularly in the specialty surety markets, which compete for a limited volume of business. Competition is based upon price, service, products offered, and financial strength of the insurance company. There are a number of companies in the industry, which offer products similar to the Company's products.

The Company competes in the small to medium size contract and commercial surety bond markets. Primary competitors include large multi-line companies, as well as small regional companies that specialize in the surety market. After a decade of stable pricing and consistent profitability, the surety industry has been hit with a spike in losses. As a result, more restrictive practices, increased rates and tightening credit conditions has created a new level of competition. Management believes it can effectively compete in the medium to small bond market.

The Company, while competitive in pricing and commission, believes that the availability of its proprietary Bond-Pro(R) surety issuance system, specialty underwriting, managerial experience and service are its primary competitive factors in the industry. To this end, the Company believes that its technology and specialization in underwriting niche surety markets will enable it to continue to compete effectively, even when challenged by the larger standard market companies.

## Regulation

The Company's subsidiaries are subject to varying degrees of regulation and supervision in the jurisdictions in which they transact business under statutes, which delegate regulatory, supervisory, and administrative powers to State insurance regulators. In general, an insurer's state of domicile has principal responsibility for such regulation. It is designed generally to protect policy holders rather than investors and relates to matters such as the standards of solvency which must be maintained; the licensing of insurers and their agents; examination of the affairs of insurance companies, including periodic financial and market conduct examinations; the filing of annual and other reports, prepared on a statutory basis, on the financial condition of insurers or for other purposes; establishment and maintenance of reserves for unearned premiums and losses; and requirements regarding numerous other matters. Licensed or admitted insurers generally must file with the insurance regulators of such states, or have filed on its behalf, the premium rates and bond and policy forms used within each state. In some states, approval of such rates and forms must be received from the insurance regulators in advance of their use.

CCS is domiciled in Florida and licensed in 27 states, the District of Columbia and Guam. SSI, SG and SA are licensed in Florida, Georgia and South Carolina respectfully. CCS is also regulated by the United States Department of the Treasury as an acceptable surety for Federal bonds.

Holding company laws impose standards on certain transactions between registered insurers and their affiliates, which include, among other things, that the terms of the transactions be fair and reasonable and that the books, accounts and records of each party be maintained so as to clearly and accurately disclose the precise nature and details of the transactions. Holding company laws also generally require that any person or entity desiring to acquire more than a specified percentage (commonly 10%) of the Company's outstanding voting securities, is required first to obtain approval of the applicable state's insurance regulators.

The National Association of Insurance Commissioners ("NAIC") has adopted a risk-based capital ("RBC") model law for property and casualty companies. The RBC model law is intended to provide standards for calculating a variable regulatory capital requirement related to a company's current operations and its risk exposures (asset risk, underwriting risk, credit risk and off balance sheet risk). These standards are intended to serve as a diagnostic solvency tool for regulators that establishes uniform capital levels and specific authority levels for regulatory interventions when an insurer falls below minimum capital levels. The model laws specifies four distinct action levels at which a regulator can intervene with increasing degrees of authority over a domestic insurer as its financial conditions deteriorates. These RBC levels are based on the percentage of an insurers surplus to its calculated RBC. The company's RBC is required to be disclosed in its statutory annual statement. The RBC is not intended to be used as a rating or ranking tool nor is to be used in premium rate making or approval. The Company calculated its RBC requirements as of December 31, 2002 and met the minimum standards under the NAIC guidelines.

## Controlling Shareholders

Francis Williams, and KC (collectively "Majority Shareholder") owns 79.9% of the outstanding ordinary shares of the Company and collectively control the policies and affairs of the Company. Circumstances may arise in which the interest of the Majority Shareholder of the Company could be in conflict with the interest of the other holders of the common stock. In addition, the Majority Shareholder may have an interest in pursuing acquisitions, divestitures or other transaction that in their judgment, could enhance their equity investment, even though such transactions might involve risk to the other holders of the common stock.

## Employees

On December 31, 2002, the Company had 34 employees. All are employed on a full-time basis. None of the Company's employees are union members or subject to collective bargaining agreements.

## Forward-looking Statements

All statements, other than statements of historical facts, included or incorporated by reference in this Form 10-K which address activities, events or developments which the Company expects or anticipates will or may occur in the future, including statements regarding the Company's competitive position, changes in business strategy or plans, the availability and price of reinsurance, the Company's ability to pass on price increases, plans to install the Bond-Pro(R) program in independent insurance agencies, the impact of insurance laws and regulation, the availability of financing, reliance on key management personnel, ability to manage growth, the Company's expectations regarding the adequacy of current financing arrangements, product demand and market growth, and other statements regarding future plans and strategies, anticipated events, trends or similar expressions concerning matters that are not historical facts are forward looking statements. These statements are based on certain assumptions and analyses made by the Company in light of its experience and its perception of historical trends, current conditions and expected future developments as well as factors it believes are appropriate in the circumstances. However, whether actual results and developments will conform with the Company's expectations and predictions is subject to a number of risks and uncertainties which could cause actual results to differ significantly and materially from past results and from the Company's expectations, including the risk factors discussed in this Form 10-K, Item 1 and 7A, and other factors, many of which are beyond the control of the Company, consequently, all of the forward-looking statements made in this Form 10-K are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized that they will have the expected consequences to or effects on the Company or its business or operations.

## Item 2. Properties

The Company's operating subsidiaries rent or lease office space in the cities in which they are located. CCS and Qualex lease office space in Tampa, Florida from a company owned by Francis Williams, the Chairman of the Board of the Company, at a monthly rate of $10,885, pursuant to a lease that was executed June 1, 1999 and is effective through May 31, 2009.

Management considers the rented and leased office facilities of its subsidiaries adequate for the current and anticipated future level of operations.

## Item 3. Legal Proceedings

CCS was named as a defendant in a class action lawsuit in the United States District Court for the District of Colorado. The plaintiffs are clients of a registered investment advisor (the "Advisor") and have alleged that the Advisor, a registered broker-dealer, and certain other defendants (excluding CCS) were negligent or otherwise responsible for losses suffered by the plaintiffs resulting from embezzlement of the plaintiffs' investments by a third party. As a separate count in the lawsuit, the plaintiffs have also asserted claims against CCS based on a policy of insurance issued by CCS to the Advisor. The policy does not provide coverage for embezzlement, rather it insures losses caused by market declines, providing that the Advisor has followed the investment guidelines required by the policy. On July 31, 2002, the District Court granted CCS motion for summary judgment and dismissed the claims against CCS.

The Company and its subsidiaries are involved in various lawsuits arising in the ordinary course of its business operations as an insurer. Management does not believe that any of these lawsuits will have a material effect on the consolidated financial position, future operations or cash flows of the Company.

## Item 4. Submission of Matters to a Vote of Security Holders

None.

### Executive Officers of the Registrant

All of the following persons are regarded as executive officers because of their responsibilities and duties as elected officers of the Company's subsidiaries. Other than Francis M. Williams and Joseph M. Williams (See Item 10), there are no family relationships between any of Company's executive officers and directors, and there are no arrangements or understandings between any of these officers and any other person pursuant to which the officer was selected as an officer.

| Name | Position Presently Held | Entity | Period of Service |
|---|---|---|---|
| Joseph M. Williams.......... | President | CTI | 06/1992 to date |
| | President | CCS | 11/2002 to date |
| Carol S. Black.............. | Secretary | CTI | 06/1995 to date |
| | Secretary/Treasurer | CCS | 06/1995 to date |
| | Secretary | SSI | 08/1995 to date |
| | Secretary/Treasurer | Qualex | 08/1995 to date |
| | Secretary | SG | 08/1995 to date |
| | Secretary | SA | 08/1995 to date |
| Edward A. Mackowiak......... | President | Qualex | 11/1994 to date |
| Sam H. Newberry............. | Vice President | SG | 01/1998 to date |

## PART II

### Item 5. Market for the Company's Common Equity and Related Stockholders Matters

The Company's common stock (symbol "CUMB") has been traded in the over-the-counter market since October 1, 1992. Effective December 16, 1996, the Company was approved and included in the trading on the Nasdaq SmallCap Market. Effective September 12, 2002, the Company's common stock was delisted from the Nasdaq SmallCap Market and on October 3, 2002, the Company announced its listing on the Nasdaq Over-the-Counter Bulletin Board. High and Low bid prices were set forth in Quotation Market Sheets published by Nasdaq. The high and low bid prices for 2002 and 2001 were as follows:

| | Bid Information | | | |
|---|---|---|---|---|
| | 2002 | | 2001 | |
| | High | Low | High | Low |
| First Quarter ............... | $ 1.00 | $ .75 | $ 1.91 | $ 1.38 |
| Second Quarter .............. | .59 | .35 | 1.10 | 1.10 |
| Third Quarter ............... | .06 | .05 | .98 | .90 |
| Fourth Quarter .............. | .15 | .06 | .95 | .95 |

As of March 6, 2003, there were 799 stockholders of record of the common stock. A number of such holders are brokers and other institutions holding shares in "street name" for more than one beneficial owner.

Dividends

The payment by the Company of dividends, if any, in the future is within the discretion of its Board of Directors and will depend upon the Company's earnings, capital requirements (including working capital needs), and other financial needs. The Company did not declare or pay dividends in 2002 and does not anticipate paying any dividends on the Company's Common Stock in the near future.

The future payment of dividends, if any, by CCS is within the discretion of its Board of Directors and will depend upon CCS's earnings, statutory limitations, capital requirements (including working capital needs) and financial condition, as well as other relevant factors. Applicable state laws and regulations restrict the payment of dividends by CCS to the extent of current year profits less any dividends that have been paid in the preceding twelve months or net investment income for the year, whichever is less, unless CCS obtains prior approval from the insurance commissioner. CCS does not anticipate paying any dividends on CCS common stock in the near future.

## Item 6. Selected Financial Data

The following selected financial data are taken from the Company's consolidated financial statements. The data should be read in conjunction with the accompanying consolidated financial statements and the related notes, Management's Discussion and Analysis and other financial information included in this Form 10-K.

| | | Year End |
|---|---|---|
| | 2002 | 2001 |
| | | (In Thousands - |
| Statement of Operations Data: | | |
| Net premium income ................................ | $ 13,432 | $ 13,641 |
| Net investment income ............................. | 486 | 605 |
| Net realized capital gains (losses) ................ | 66 | 306 |
| Income from investment in subsidiary ............... | 59 | 61 |
| Commission and other income ........................ | 2,198 | 1,909 |
| Total revenue .................................. | 16,241 | 16,522 |
| Benefits and expenses ............................. | 18,660 | 16,095 |
| Impairment of long-lived assets .................... | -- | 437 |
| Interest expense .................................. | 62 | 166 |

| | | |
|---|---|---|
| Income (loss) before income tax (benefit) expense and extraordinary gain .................... | (2,481) | (176) |
| Income tax (benefit) expense ........................ | (912) | (76) |
| (Loss) income before extraordinary gain ............ | (1,569) | (100) |
| Extraordinary gain on restructuring of note, net of income tax .......................... | -- | 158 |
| Net income (loss) .................................. | $ (1,569) | $ 58 |
| Income (loss) per common share - basic and diluted .................................. | $ (0.28) | $ 0.01* |

*Includes extraordinary gain of $.03 per common share

| | Year Ende | | |
|---|---|---|---|
| | 2002 | 2001 | |
| | | | (In |
| **Assets Balance Sheet Data:** | | | |
| Investments .......................................... | $ 9,269 | $10,815 | $ |
| Cash and cash equivalents .......................... | 593 | 2,654 | |
| Accrued investment income .......................... | 124 | 154 | |
| Accounts receivable ................................ | 2,518 | 4,687 | |
| Reinsurance recoverable ............................ | 12,089 | 6,634 | |
| Deferred policy acquisition costs .................. | 1,666 | 1,904 | |
| Intangibles ........................................ | 441 | 534 | |
| Other investment ................................... | 700 | 641 | |
| Deferred tax asset ................................. | 402 | 499 | |
| Income tax recoverable ............................. | 1,073 | -- | |
| Other assets ....................................... | 303 | 372 | |
| Total assets ....................................... | $29,178 | $28,894 | $2 |
| **Liabilities and Shareholders Equity Data:** | | | |
| Unearned premiums .................................. | $ 4,587 | $ 5,583 | $ |
| Loss and loss adjustment expense reserve ............ | 8,896 | 5,285 | |
| Derivative instruments ............................. | 4,346 | 3,598 | |
| Ceded reinsurance and accounts payable .............. | 3,803 | 5,143 | |
| Income tax payable ................................. | -- | 113 | |
| Term note to affiliate ............................. | 604 | 603 | |
| Non affiliate debt ................................. | 455 | 652 | |
| Total liabilities .................................. | 22,691 | 20,977 | 1 |
| Total stockholders' equity ......................... | $ 6,487 | $ 7,917 | $ |
| Total liabilities and stockholders' equity .......... | $29,178 | $28,894 | $2 |

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Critical Accounting Policies

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results could differ from these estimates under different assumptions or conditions.

The Company believes the following accounting policies are the most critical since these policies require significant judgment or involve complex estimations that are important to the portrayal of the Company's financial position and operating results:

The Company records valuation allowances to reduce the deferred tax assets to the amount that is more likely than not to be realized. While the Company considers taxable income in assessing the need for a valuation allowance, in the event the Company determines it would be able to realize its deferred income tax assets in the future in excess of the net recorded amount, an adjustment would be made and income increased in the period of such determination. Likewise, in the event the Company determines it would not be able to realize all or part of its deferred income tax assets in the future, an adjustment would be made and charged against income in the period of such determination.

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In accordance with the Statement of Financial Standards No. 142 Goodwill and Other Liability Assets, the Company assesses goodwill annually for impairment. Upon determination that the carrying value of the asset is impaired, the Company would record an impairment charge or loss. Future adverse changes in market conditions or poor operating results of the underlying investment could result in losses or an inability to recover the carrying value of the investment that may not be reflected therein; and therefore, might require the Company to record an impairment charge in the future.

Statement of Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS No.133") is effective for all fiscal years beginning after June 15, 2000. SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Under SFAS No. 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Company adopted SFAS No. 133 effective January 1, 2001. The Company identified one product that meets the definition of a derivative instrument as defined in SFAS No. 133. The identified derivative was formerly accounted for as an insurance contract within the policy liabilities for loss and loss adjustment expenses account in the consolidated balance sheet. At December 31, 2002 the fair value of the derivative instrument has been determined by using a financial model that incorporates market data and other assumptions. Due to the volatility in the marketplace, the Company has suspended marketing of this product effective September 2001.

The liability for loss and loss adjustment expenses including incurred but not reported losses is based on the estimated ultimate cost of settling the claim using traditional paid and incurred loss development methods. These estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes that the liabilities for loss and loss adjustment expenses are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in current operations. A liability for all costs expected to be incurred in connection with the settlement of unpaid loss and loss adjustment expenses is accrued when the related liability for unpaid losses is accrued. Loss adjustment expenses include costs associated directly with specific claims paid or in the process of settlement, such as legal and adjusters' fees. Loss adjustment expenses also include other costs that cannot be associated with specific claims but are related to losses paid or in the process of settlement, such as internal costs of the claims function. The Company does not discount its reserves for losses and loss adjustment expenses. The Company writes primarily surety contracts which are of short duration. The Company does not consider investment income in determining if a premium deficiency relating to short duration contracts exists.

## Results of Operations

The following table sets forth, for the periods indicated, (i) summary financial data (in thousands), and (ii) the percentage change in the dollar amount for such items from period to period.

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2 |
| | | | (Dollars |
| Net premium income .................................. | $ 13,432 | $ 13,641 | $ 1 |
| Net investment income ............................... | 486 | 605 | |
| Net realized investment gains ....................... | 66 | 306 | |
| Commission and other income ......................... | 2,257 | 1,970 | |
| Losses and loss adjustment expenses ........................................ | 8,552 | 4,512 | |
| Derivative expense .................................. | 506 | 1,061 | |
| Amortization of deferred acquisition costs ............................... | 3,594 | 4,363 | |
| Operating expenses and interest ..................... | 6,070 | 6,325 | |
| Impairment of long-lived assets ..................... | -- | 437 | |
| (Loss) income before income tax (benefit) expense and extraordinary gain .......... | (2,481) | (176) | |
| (Loss) income tax (benefit) expense ........................................ | (912) | (76) | |
| (Loss) income before | | | |

| | | | |
|---|---|---|---|
| extraordinary gain ............................... | (1,569) | (100) | |
| Extraordinary gain ................................... | -- | 158 | |
| Net (loss) income ................................... | $ (1,569) | $ 58 | $ |

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Premiums

During the years ended December 31, 2002 and 2001, earned direct and assumed earned premiums were $17,478,356 and $18,253,687, respectively. Overall earned premiums, net of ceded premiums decreased 2% or $(209,566). The decrease in earned premiums is a result of CCS's focus on a smaller market base in an effort to better control underwriting guidelines. The following table represents the written and earned premium for CCS and the percentage of change for the years ended December 31, 2002 and 2001, respectively.

| | Written Premiums (000's) | | | Earned Premiums (000's) | | |
|---|---|---|---|---|---|---|
| | 2002 | 2001 | % Change | 2002 | 2001 | % Change |
| Direct ....... | $ 13.849 | $ 13,867 | (.1)% | $ 13,981 | $ 14,465 | (3.4)% |
| Assumed ...... | 2,634 | 4,194 | (37.2)% | 3,498 | 3,788 | (7.7)% |
| Ceded ........ | (4,139) | (4,654) | (11.1)% | (4,047) | (4,612) | (12.3)% |
| Total .... | $ 12,344 | $ 13,407 | (7.9)% | $ 13,432 | $ 13,641 | (1.5)% |

Investments

During the years ended December 31, 2002 and 2001, net investment income earned was $486,138 and $604,463, respectively. The decrease in investment income is primarily attributed to redemption of bonds to meet the demand of claim payments. Net realized gains for the years ended December 31, 2002 and 2001 were $66,239 and $305,461, respectively. Net realized gains during 2002 and 2001 are a result of gains on bond disposals of $66,239 and $329,360. The gains for 2001 are offset by losses of $23,899 on stock disposals.

Commission Income

Commission income represents earnings from subsidiary agencies on bonds sold through insurance carriers that have the capacity for writing bonds not offered by Cumberland Casualty & Surety Company. Inter-company related commission earnings and expenses have been eliminated in preparing the consolidated financial statements. Commission income for the period ended December 31, 2002 increased by $93,690 or 23% when compared to the same period in the prior year.

Income from Investment in Affiliate

The earnings of $59,252 and $61,457 for the years ending December 31, 2002 and 2001 represent a 30% equity position the Company holds on a California agency.

Other Income

Other income is earned through an affiliate offering claims consulting services to insurance carriers. Primarily, their services include management, administration and completion of jobs defaulted under surety bonds. Other income increased by $194,082 or 13% when compared to the same period in the prior year.

Loss and Loss Adjustment Expenses

Loss and loss adjustment reserves have been prepared by consulting actuaries in accordance with accepted actuarial standards for the periods ended December 31, 2002 and 2001. Loss and loss adjustment expenses incurred represent the impact of the large influx of claims CCS experienced during 2002. Losses incurred for the year ended December 31, 2002 was $6,055,043 and represents an increase of $2,811,944 or 86.7% over 2001 losses incurred. The following table reflects the variance in losses incurred:

| | 12/31/02 | 12/31/01 | Increase | % of Increase |
|---|---|---|---|---|
| Losses incurred - direct, net .. | $3,857,512 | $2,313,544 | $1,543,968 | 66.7% |
| Losses incurred - assumed, net . | 2,197,521 | 929,545 | 1,267,976 | 136.4% |
| Total .................... | $6,055,033 | $3,243,089 | $2,811,944 | 86.7% |

The increase in direct losses when compared to prior year losses is comprised of primarily contract claims on contractors defaulting under performance and payment bond requirements. CCS encountered unexpected losses on an assumed block of business during 2002 creating incurred losses on that block of business of approximately $1,169,325.

Loss adjustment expenses totaled $2,044,046 on direct losses and $453,236 on assumed losses representing an increase over prior year loss adjustment expenses of $1,228,461 or 96.8%. Loss adjustment expenses represent the cost of the internal claims department, outside claims consultants and attorneys in connection with the settlement of claims.

In analyzing the development of large claims, CCS's management has redirected its underwriters to concentrate and focus on new business writings with small contractors and commercial surety business. Effective July 2002, CCS elected to not renew its assumption reinsurance treaties.

Derivative Instruments

Upon adoption of SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities effective January 1, 2001, it was determined that CCS has one policy, referred to as the Registered Investment Advisors (RIA) program, deemed a derivative instrument. The RIA program provides specific liability coverage for professional services rendered by registered investment advisors. The insured liability risk arises from written warranties which address minimum performance standards associated with the delivery of risk management program services. The structure of the RIA is based on market value fluctuations and is sold as an insurance policy, with a five-year maturity schedule, guaranteeing a return of the principal amount invested, subject to meeting policy criteria. The Company distributes the policy to "market timer's and has no contract with the individual client. Prior to January 1, 2001, the RIA program was included in the category of loss and loss adjustment expenses on the Consolidated Balance Sheet and Consolidated Statement of Operations. Due to the volatility in the marketplace, the Company suspended marketing of this product effective September 10, 2001.

In prior years, the Company reserved for the derivative at a percentage of the earned premium. In valuing the reserves on the derivative, the Company had no history other than relying on market fluctuation projections which had a history of supporting the actuarial formulas developed when the policy was initially approved by Consulting Actuaries and Florida regulators. At December 31, 2002 and 2001, respectively, the derivative was valued using a growth factor, lapse factor and loss projections before applying a present value factor to ultimately determine the liability to the Company. At December 31, 2002 and 2001, the derivative instrument liability for this policy was set at $4,346,285 and $3,597,782, respectively. The policies began maturing in June of 2002. Claims paid in 2002, net of reinsurance was $184,075. Derivative expense for the periods ended December 31, 2002 and 2001 was $505,816 and $1,060,799, respectively.

Amortization

During the year ended December 31, 2002 the net amortization of deferred policy acquisition costs were to $3,593,701 as compared to $4,362,721 for the year ended December 31, 2001. The acquisition costs represent 20.6% and 23.9% of the direct and assumed earned premiums for the years ended December 31, 2002 and 2001, respectively.

Operating Expenses

During the year ended December 31, 2002, operating expenses and taxes, licenses and fees (excluding income taxes) decreased slightly to $6,008,072 from $6,159,044 for the same period in 2001. Operating expenses represent 37% of total revenue for the years ended December 31, 2002 and 2001.

Interest Expense

Interest expense on non-affiliated debt is interest paid to the former owners of The Surety Group and Surety Associates on notes due to agencies the Company purchased in 1995. Interest on affiliated debt represents interest on a note payable to TransCor, a division of KC.

Income Taxes

The Company incurred income tax (benefits) during 2002 and 2001 of $(912,031) and $(75,932), respectively. The company's effective tax rate for 2002 is 36.7% and 26.7% for 2001.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Premiums

During the year ended December 31, 2001 and 2000, earned direct and assumed premium was $18,253,687 and $15,236,814, respectively. Overall earned premiums, net of ceded premiums increased 12.5% or $1,513,363. The increase in earned premiums is a result of CCS's continued growth in the surety bond market. The following table represents the written and earned premium for CCS and the percentage of change for the years ended December 31, 2001 and 2000, respectively.

| | Written Premiums (000's) | | | Earned Premiums (000's) | | |
|---|---|---|---|---|---|---|
| | 2001 | 2000 | % Change | 2001 | 2000 | % Change |

| | | | | | | |
|---|---|---|---|---|---|---|
| Direct | $ 13,867 | $ 13,775 | .7% | $ 14,465 | $ 12,756 | 13.4% |
| Assumed | 4,194 | 2,393 | 75.3% | 3,788 | 2,481 | 52.7% |
| Ceded | (4,654) | (3,510) | 32.6% | (4,612) | (3,109) | 48.3% |
| Total | $ 13,407 | $ 12,658 | 5.9% | $ 13,641 | $ 12,128 | 12.5% |

During the years ended December 31, 2001 and 2000, net investment income earned was $604,463 and $576,406, respectively. The return on average invested assets was 6.01% for the year 2001 as compared to 6.28% for the year 2000. The slight decrease in the return is attributed to the decrease in overall interest rates. Net realized gains for the years ended December 31, 2001 and 2000 were $305,461 and $38,381, respectively. Net realized gains during 2001 are a result of gains on bond disposals of $329,360 which is offset by losses of $23,899 on stock disposals. Realized gains in year 2000 are attributed to stock disposals.

### Commission Income

Commission income represents earnings from subsidiary agencies on bonds sold through insurance carriers that have the capacity for writing bonds not offered by CCS. Inter-company related commission earnings and expenses have been eliminated in preparing the consolidated financial statements. Commission income for the year ended December 31, 2001 increased by $27,060 or 7% when compared to the same period in the prior year.

### Other Income

Other income is earned through an affiliate offering claims consulting services to insurance carriers. Primarily, their services include management, administration and completion of jobs defaulted under surety bonds. Other income for 2001 increased by $200,223 or 15% when compared to the same period in the prior year.

### Loss and Loss Adjustment

Loss and loss adjustment reserves have been prepared by consulting actuaries in accordance with accepted actuarial standards. The Company writes two lines of business classified as other liability and surety and fidelity bonds. The category of other liability GAAP reporting requirements changed effective January 1, 2001 under SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities and are discussed as a separate item for the reporting year ended December 31, 2001. The following table is a presentation of how the reserves are presented on the Consolidated Balance Sheet for year ended December 31, 2001.

| | Year Ended December 31, | |
|---|---|---|
| | 2001 | 2000 |
| Loss and loss adjustment reserves | $5,284,804 | $6,245,818 |
| Derivative instruments | 3,597,782 | -- |
| Totals | $8,882,586 | $6,245,818 |
| Less: | | |
| Derivative instruments (SFAS No. 133 as of January 1, 2001 formerly | | |

| | | |
|---|---|---|
| included in loss and loss adjustment reserves | 3,237,782 | -- |
| Additional amount required under SFAS 133 | 360,000 | -- |
| Loss and loss adjustment expense reserves | $5,284,804 | $6,245,818 |

The amount that would be attributed to derivative instruments for the year ended December 31, 2000 is $310,005 and is included in liability for loss and loss adjustment expense reserves.

Loss and loss adjustment expenses totaled $4,511,910 and $3,360,358 for the years ended December 31, 2001 and 2000, respectively, representing an increase of $1,151,522 for year 2001. In analyzing losses on direct and assumed business segregated from loss adjustment expenses, losses increased $430,741 (direct business) and $1,053,943 (assumed business) over the prior year. The Company processed 193 claims for payment during 2001 with an average settlement, net of reinsurance amounting to $10,130 on its direct line of business as compared to processing 122 claims for payment during 2000 with an average settlement, net of reinsurance totaling $14,360.

Loss adjustment expenses (LAE's) represent the cost of the internal claims department, outside claims consultants and attorneys in connection with the settlement of claims. LAE's decreased $333,132 when compared to the same period in the prior year. The decrease is a result of CCS processing claims through the home office.

The loss and loss adjustment expense reserve liability at December 31, 2001 includes direct case losses and loss adjustment reserves on 30 claims with an average reserve of approximately $58,295. The balance of the loss and loss adjustment expense reserve liability is held under IBNR (incurred but not reported) on direct and assumed surety claims totaling $3,535,967.

## Derivative Instruments

Prior to 2001, the Company reserved for the RIA policy at a percentage of the earned premium. The change in valuation became significant when SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities became effective January 1, 2001.

In valuing the reserves on the RIA, the Company had no history other than relying on market fluctuation projections which had a history of supporting the actuarial formulas developed when the policy was initially approved by Consulting Actuaries and Florida regulators. With the implementation of SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, the impact on how reserves were valued was immediate. At December 31, 2001, the RIA was established using a growth factor, lapse factor and loss projections before applying a present value factor to ultimately determine the liability to the Company. At December 31, 2001 the derivative instrument liability (formerly Loss and loss adjustment expense reserves) for this policy was set at $3,597,782. The charge to earnings for the year ended December 31, 2001 was an additional $360,000. The policies will begin maturing in June of 2002.

## Amortization

During the year ended December 31, 2001 the net amortization of deferred policy acquisition costs were to $4,362,721 as compared to $3,767,107 for the year ended December 31, 2000. The acquisition costs represent 23.9% and 24.7% of the direct and assumed earned premiums for the years ended December 31, 2001 and 2000, respectively.

### Operating Expenses

During the year ended December 31, 2001, operating expenses and taxes, licenses and fees (excluding income taxes) increased to $6,159,044 from $5,308,516 for the same period in 2000. The increase of $850,600 or 16% is a result of increased salary and related expenses ($307,000); accounting and actuarial fees ($107,000); legal fees ($66,400); credit reports ($48,000); office supplies and related expenses ($178,100) and travel expenses ($93,100) and taxes, license and fees ($51,000). The Company's increase in expenses is related to the Company's direct marketing efforts and continued expansion. The Company reclassified $466,332 and $146,633 attributed to in-house in claims expenses to loss adjustment expenses for the year ended December 31, 2001 and 2000, respectively.

### Interest Expense

Interest expense on non-affiliated debt is interest paid to the former owners of The Surety Group and Surety Associates on notes due to agencies the Company purchased in 1995. Interest on affiliated debt represents interest on a note payable to TransCor, a division of KC.

### Income Taxes

The Company incurred income tax (benefit) expense during 2001 and 2000 of $(75,932) and $764,390, respectively. The Company's effective tax rate for the 2001 is 26.7% and 42% for 2000.

### Asset Impairment

In accordance with Statement of Financial Accounting Standard 121 ("SFAS 121"), goodwill and other long-lived assets that were capitalized in conjunction with the purchase of Associates Acquisition Corp., d/b/a Surety Associates, were deemed impaired as of December 31, 2001, and an asset impairment charge of $437,418 was recorded.

## Liquidity and Capital Resources

The capacity of a surety company to underwrite insurance and reinsurance is based on maintaining liquidity and capital resources sufficient to pay claims and expenses as they become due. Based on standards established by the National Association of Insurance Commissioners (NAIC) and promulgated by the Florida Department of Financial Services, the Company is permitted to write net premiums up to an amount equal to three times its statutory surplus, or approximately $14,204,000 at December 31, 2002. Statutory guidelines impose an additional limitation on increasing net written premiums to no more than 33% of prior year's net written premiums. Under these guidelines, the Company could increase net written premiums by approximately $1,800,000.

At December 31, 2002, the Company's $29,178,488 of total assets were distributed primarily as follows: 34.2 percent in cash and investments (including accrued investment income), 50.1 percent in receivables and reinsurance recoverables, 7.2 percent in intangibles and deferred policy acquisition costs, 5.1 percent in deferred income tax asset and 3.4 percent in other assets.

The Company follows investment guidelines that are intended to provide an acceptable return on investment while maintaining sufficient liquidity to meet its obligations.

Net cash (used in) provided by operating activities was $(3,723,761), $2,753,355 and $191,380 for the years ended December 31, 2002, 2001 and 2000, respectively. In 2002, cash (used in) provided by operating activities is primarily attributed to payment of claims resulting in policy liabilities and reinsurance ceded payable decreasing and reinsurance recoverables increasing. In 2001, cash provided by operating activities was primarily attributed to an increase in policy liabilities and accruals. In 2000, cash provided by operating activities was attributed to policy liabilities which was offset by reinsurance recoverable and policy acquisition costs and amortization.

Net cash provided by (used in) investing activities was $1,787,211, $(572,432) and $(1,293,487) for the years ended December 31, 2002, 2001 and 2000, respectively. Investing activities consist primarily of purchases, sales and maturities of investments.

Net cash used in financing activities was $(124,322), $(220,570) and $(204,262) for the years ended December 31, 2002, 2001 and 2000, respectively. Financing activities consist primarily of repayments on borrowings and advances to (from) affiliates during 2002, 2001 and 2000.

The following summarizes the Company's contractual cash obligations at December 31, 2002 and the effect such obligations are expected to have on its liquidity and cash flow in future periods.

| | Payments Due by Period (in thousands) | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
| Contractual cash obligations: | | | | | |
| Operating leases .................. | $1,345 | $ 262 | $ 654 | $ 365 | $ 64 |
| Debt instruments .................. | 1,059 | 676 | 144 | 144 | 95 |
| Total contractual cash obligations | $2,404 | $ 938 | $ 798 | $ 509 | $ 159 |

At December 31, 2002 and 2001, the Company did not have any other commercial commitments, such as guarantees or standby repurchase obligations, or any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

## Losses and Loss Adjustment Expenses

The consolidated financial statements include the estimated liability for unpaid losses and loss adjustment expenses (LAE) of CCS. The liabilities for losses and LAE's are determined using case-basis evaluations and statistical projections and represent estimates of the ultimate net cost of all unpaid losses and LAE's incurred through the end of the period. These estimates are subject to the effect of trends in future claim severity and frequency. These estimates are continually reviewed and, as experience develops and new information becomes known, the liability is adjusted as necessary; such adjustments, if any, are included in current operations.

## Reconciliation of Liability for Losses and Loss Adjustment Expenses

The following table provides a reconciliation of the beginning and ending liability balances, net of reinsurance recoverable, for 2002, 2001 and 2000 to the gross amounts reported in the Company's balance sheets:

| | 2002 |
|---|---|
| Gross liability for losses and LAE at beginning of year | $ 5,284,804 |
| Recoverables on losses and LAE | 1,812,616 |
| Liability for losses and LAE on unpaid losses before adjustment for incurred and paid losses | 3,472,188 |
| Incurred losses and LAE's claims, net of reinsurance, occurring during: | |
| Current year | 8,203,575 |
| Prior year | 348,740 |
| Total incurred losses, net of reinsurance | 8,552,315 |
| Losses and LAE payments for claims, net of reinsurance, occurring during: | |
| Current year | 5,469,929 |
| Prior years | 3,936,415 |
| Total payments | 9,433,344 |
| Liability for losses and LAE, net | 2,591,159 |
| Add: recoverables on losses and LAE's | 6,304,311 |
| Liability for losses and LAE, at end of year | $ 8,895,470 |

The Company experienced a deficiency of $348,740 for the period ended December 31, 2002. The deficiency is a result of settling claim basis reserves established in prior years for amounts that were more than expected. The Company experienced $936,570 and $1,003,077 in redundancies for losses and loss adjustment expenses in 2001 and 2000, respectively. The redundancies principally result from subrogation received on pooling agreement case base reserves and claims in prior years.

KC and SSI entered into an agreement with an independent contractor, AEC on August 16, 1989 on a construction contract with the United States Navy ("Navy"). At the time the bonds were issued by CCS as surety, KC entered into an indemnification agreement, whereby KC indemnified CCS from any and all losses, costs and expenses incurred related to the bonds. In 1991, the Navy defaulted and terminated AEC on the contract. The contract was subsequently litigated and

CCS was unsuccessful in its litigation activities with the Navy. As a result, KC reimbursed CCS $1,500,000 of the total subrogation recoverable of $1,850,877 in November 2001 on the contract. CCS wrote off the remaining $350,877 reinsurance recoverable as a charge to loss and loss adjustment expense and incurred an additional $240,000 in legal fees during 2001.

The anticipated effect of inflation is implicitly considered when estimating liabilities for losses and LAE. While anticipated price increases due to inflation are considered in estimating the ultimate claim costs, the increase in average severities of claims is caused by a number of factors. Future average severities are projected based on historical trends adjusted for anticipated changes in underwriting standards, policy provisions, and general economic trends. These anticipated trends are monitored based on actual development and are modified if necessary.

The differences between the December 31, 2002 liability for losses and LAE reported in the accompanying consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and that reported in the annual statement filed with the state insurance departments in accordance with insurance accounting practices prescribed or permitted by the Florida Department of Financial Services as follows:

| | |
|---|---|
| Statutory reserves for losses and LAE's (which is net of reinsurance recoverables on unpaid losses and LAE) .......... | $ 4,638,870 |
| Reinsurance recoverables on losses and LAE's .................. | 4,999,661 |
| Subrogation recoverables on losses and LAE's .................. | 1,304,649 |
| Statutory reserve for derivative instrument ................... | (2,047,710) |
| Liability for losses and LAE, as reported in the accompanying GAAP basis consolidated financial statements ................ | $ 8,895,470 |

Analysis of Loss and Loss Adjustment Expense Development

The following table represents the development of the liability for unpaid losses and LAE, net of reinsurance, for 1992 through 2002 (in thousands).

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|---|---|
| Gross liability for loss and LAE.................... | $2,426 | $ 3,355 | $ 3,138 | $2,352 | $ 2,305 | $ 2,550 | $ 3,220 $ |
| Reinsurance.................. | - | - | - | - | (313) | - | - |
| Liability for losses and loss Adjustment expenses, net of reinsurance............ | $ 2,426 | $ 3,355 | $ 3,138 | $ 2,352 | $ 1,992 | $ 2,550 | $ 3,220 $ |
| Liability re-estimated as of: | | | | | | | |
| One year later............ | 3,884 | 5,327 | 2,684 | 3,113 | 1,801 | 3,117 | 3,033 |
| Two years later........... | 4,057 | 3,878 | 2,818 | 2,972 | 2,420 | 3,479 | 2,506 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Three years later.......... | 3,561 | 4,147 | 2,788 | 3,456 | 2,888 | 3,088 | 997 |
| Four years later........... | 3,814 | 4,006 | 3,134 | 3,803 | 2,668 | 1,686 | 544 |
| Five years later........... | 3,564 | 4,582 | 3,394 | 3,571 | 1,158 | 1,715 | - |
| Six years later............ | 4,376 | 4,905 | 3,180 | 2,082 | 1,253 | - | - |
| Seven years later.......... | 4,077 | 4,791 | 1,641 | 2,102 | - | - | - |
| Eight years later.......... | 4,045 | 3,211 | 1,654 | - | - | - | - |
| Nine years later........... | 2,431 | 3,201 | - | - | - | - | - |
| Ten years later............ | 2,468 | - | - | - | - | - | - |
| Cumulative (deficiency) redundancy................... | $ (42) | $ 154 | $ 1,484 | $ 250 | $ 739 | $ 835 | $ 2,676 |

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|---|---|
| Cumulative amount of liability, net of reinsurance recoverables, paid through: | | | | | | | |
| One year later............ | $ 1,151 | $ 765 | $ 1,643 | $ 1,334 | $ 563 | $ 1,802 | $ 2,155 |
| Two years later........... | $ 1,834 | $ 1,058 | $ 2,316 | $ 2,186 | $ 1,631 | $ 2,856 | $ 1,878 |
| Three years later......... | $ 2,088 | $ 2,868 | $ 2,164 | $ 2,997 | $ 2,466 | $ 2,575 | $ 488 |
| Four years later.......... | $ 1,957 | $ 3,717 | $ 2,875 | $ 3,506 | $ 2,336 | $ 1,345 | $ 271 |
| Five years later.......... | $ 3,533 | $ 4,442 | $ 3,230 | $ 3,360 | $ 929 | $ 1,506 | $ - |
| Six years later........... | $ 3,840 | $ 4,804 | $ 3,062 | $ 1,906 | $ 1,116 | $ - | $ - |
| Seven years later......... | $ 2,278 | $ 4,769 | $ 1,572 | $ 1,998 | $ - | $ - | $ - |
| Eight years later......... | $ 2,183 | $ 3,204 | $ 1,633 | $ - | $ - | $ - | $ - |
| Nine years later.......... | $ 2,424 | $ 3,199 | $ - | $ - | $ - | $ - | $ - |
| Ten years later........... | $ 2,469 | $ - | $ - | $ - | $ - | $ - | $ - |

## Effect of Inflation

Inflation has not had a material impact upon the Company's operations for the last three years.

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

## Interest Rate Sensitivity

The following tables present principal maturity cash flows and related weighted average interest rates by expected maturity as of December 31, 2002 and 2001:

| | 2002 Expected Maturity Da | | | | |
|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 |
| | | | (In thousands) | | |
| **Assets** | | | | | |
| Debt securities available for sale | $ 2,876 | $ 630 | $ 976 | $ 1,724 | $ 29 |
| Average interest rate .......... | 5.4% | 5.83% | 6.1% | 5.6% | 7.4 |
| Debt securities held to maturity .. | 260 | 100 | -- | -- | -- |
| Average interest rate .......... | 5.5% | 5.5% | -- | -- | -- |
| Mortgage loans .................... | 40 | 1 | 1 | 1 | |
| Average interest rate .......... | 7.5% | 7.5% | 7.5% | 7.5% | 7. |
| Short-term investments ........... | 434 | -- | -- | -- | -- |
| Average interest rate .......... | 2.3% | -- | -- | -- | -- |
| **Liabilities** | | | | | |
| Debt including current portion ........................ | $ 676 | $ 72 | $ 72 | $ 72 | $ 7 |
| Average interest rate .......... | 9.8% | 6.3% | 6.3% | 6.3% | 6. |

| | 2001 Expected Maturity | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | 2006 |
| | | | (In thousands) | | |
| **Assets** | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Debt securities available for sale ..... | $ 502 | $ 3,424 | $ 1,140 | $ 1,757 | $ 1,071 |
| Average interest rate .............. | 6.4% | 5.3% | 5.8% | 6.7% | 5.8 |
| Debt securities held to maturity ....... | -- | 260 | 100 | -- | -- |
| Average interest rate .............. | -- | 5.5% | 5.5 | -- | -- |
| Mortgage loans ........................ | 2 | 2 | 2 | 2 | 2 |
| Average interest rate .............. | 7.5% | 7.5% | 7.5% | 7.5% | 7.5 |
| Short-term investments ................ | 434 | -- | -- | -- | -- |
| Average interest rate .............. | 5.5% | -- | -- | -- | -- |
| Liabilities | | | | | |
| Debt including current portion ............................ | $ 729 | $ 72 | $ 72 | $ 72 | $ 72 |
| Average interest rate .............. | 8.1% | 6.3% | 6.3% | 6.3% | 6.3 |

The operations of the Company are subject to risk resulting from interest rate fluctuations to the extent that there is a difference between the amount of the Company's interest-earning assets and the amount of interest-bearing liabilities that are prepaid/withdrawn, mature or reprice in specified periods. The principal objective of the Company's asset/liability management activities is to provide maximum levels of net interest income while maintaining acceptable levels of interest rate and liquidity risk and facilitating the funding needs of the Company.

Due to the limited nature and duration of claims, generally one to two years, the Company maintains a portfolio with a yield that approximates the money market interest rate scenario.

Additionally, the Company's exposure to rapid changes in interest rates is partially mitigated because most of the Company's interest-earning assets and interest-bearing liabilities being written are at fixed rates.

## New Accounting Standards

In August 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations ("SFAS 143"). SFAS 143 provides accounting and reporting standards related to obligations associated with the retirement of tangible long-lived assets. SFAS 143 is effective on January 1, 2003, however, earlier application is encouraged. The Company has not evaluated the effect, if any, that the adoption of SFAS 143 will have on the Company's consolidated financial statements.

In April 2002, the FASB issued SFAS 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB 13, and Technical Corrections". SFAS 145 rescinds FASB No. 4, Reporting Gains and Losses form Extinguishment of Debt, and an amendment of that Statement, FASB 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. SFAS 145 also rescinds SFAS 44, Accounting for Intangible Assets of Motor Carriers", and FASB 13, Accounting for Leases, eliminating an inconsistency between certain sale-leaseback transaction. The provisions of SFAS 145 are effective for fiscal years beginning after May 15, 2002.

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 requires costs associated with exit or disposal activities to be recognized when the costs are incurred, rather than at a date of commitment to an exit or disposal.

Item 8. Consolidated financial statements and Supplementary Data

The consolidated financial statements of the Company required by this Item are listed in Item 15(a)(1) and (2) and are submitted as a separate section of this report.

The following information presents unaudited quarterly operating results for the Company for 2002 and 2001. The data has been prepared by the Company on a basis consistent with the Consolidated Financial Statements included elsewhere in this Form 10-K, and include all adjustments, consisting of normal recurring accruals, that the Company considers necessary for a fair presentation thereof.

| | | | | Three Months End | |
|---|---|---|---|---|---|
| (In thousands, except per share data) | 12/31/02 | 9/30/02 | 6/30/02 | 3/31/02 | 12/31 |
| Revenue .......................... | $ 3,136 | $ 4,795 | $ 4,498 | $ 3,812 | $ 4, |
| Benefit related expenses .......... | 597 | 4,728 | 4,590 | 2,737 | 3, |
| Operating and other expenses ...... | 1,262 | 1,464 | 1,866 | 1,478 | 1, |
| Total benefits and expenses ....... | 1,859 | 6,192 | 6,456 | 4,215 | 4, |
| (Loss) income before income tax (benefit) expense and extraordinary gain ............. | 1,277 | (1,397) | (1,958) | (403) | ( |
| Income tax (benefit) expense ...... | (267) | (297) | (745) | (137) | |
| (Loss) income before extraordinary gain ........................... | 1,010 | (1,100) | (1,213) | (266) | ( |
| Extraordinary gain (net of taxes) . | -- | -- | -- | -- | |
| Net (loss) income ................ | $ 1,010 | $ (1,100) | $(1,213) | $ (266) | $ |
| Weighted average shares Outstanding - basic ............ | 5,597 | 5,597 | 5,597 | 5,597 | 5, |
| Net (loss) income per share - basic | $ .18 | $ (0.20) | $ (0.22) | $ (0.05) | $ (0 |
| Weighted average shares Outstanding - diluted .......... | 5,597 | 5,597 | 5,597 | 5,620 | 5, |
| Net (loss) income per share - Diluted ........................ | $ .18 | $ (0.20) | $ (0.22) | $ (0.05) | $ 0 |

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 10. Directors and Executive Officers of the Registrant

The current directors and executive officers of the Company are as follows:

| Name | Age | Position |
|---|---|---|
| Francis M. Williams | 61 | Chairman of the Board of Directors |
| Joseph M. Williams | 46 | President and Treasurer |
| Andrew J. Cohen | 49 | Director |
| R. Donald Finn | 59 | Director |

All Directors of the Company hold office until the next annual meeting of stockholders and the election and qualification of their successors. Officers of the Company are elected annually by the Board of Directors and hold office at the discretion of the Board.

Set forth below is information regarding the directors and executive officers of the Company:

Francis M. Williams has been Chairman of the Board of the Company since its inception and, until June 1992, was President of the Company. In addition, Mr. Williams has been Chairman of the Board and Director of CCS and SSI from inception and President and Chairman of the Board of KC since its inception in 1979. Prior to November 1988, Mr. Williams was the Chairman of the Board and Chief Executive Officer of Kimmins Corp. and its predecessors and sole owner of K Management Corp. From June 1981 until January 1988, Mr. Williams was the Chairman of the Board of Directors of College Venture Equity Corp., a small business investment company; and since June 1981, he has been Chairman of the Board, Director, and sole stockholder of Kimmins Coffee Service, Inc., an office coffee service company. Mr. Williams has also been a director of the National Association of Demolition Contractors and a member of the executive committee of the Tampa Bay International Trade Council.

Joseph M. Williams has served as the Treasurer and President of the Company since June 1992. He also served as Vice President and Secretary of the Company from its inception on November 18, 1991 through June 1992. Mr. Williams served as a member of the Board of Directors of the Company from November 18, 1991 through February 24, 1997. In addition, Mr. Williams has been the Secretary and Treasurer of Kimmins Corp. since October 1988 and a member of the Board of Directors of CCS since 1988. He held the position of President of CCS from 1991 through August of 1996. On November 11, 2002, Mr. Williams was elected as President of CCS. From 1989 through 1990 he held the position of Secretary and Treasurer of CCS and from 1991 through 1994 served as Treasurer of CCS. Mr. Williams has been employed by the Company and Kimmins Corp. in various capacities since 1994. From January 1982 to December 1983, he was managing partner of Williams and Grana, a firm engaged in public accounting. From January 1978 to December 1981, Mr. Williams was employed as a senior tax accountant with Price Waterhouse & Company. Joseph M. Williams is the nephew of Francis M.

Williams.

Andrew J. Cohen was elected as a Director to the Company's Board effective February 24, 1997. Currently Co-President and Chief Executive Officer of ABC Capital Corp., an investment management firm based in Tampa, Florida and also acts as Co-Chairman on their Board of Directors. In addition, Mr. Cohen is President of Albany Associates, Inc., a Tampa based management consulting firm. From June of 1972 through 1997, Mr. Cohen was co-President of ABC Fabric of Tampa, Inc. which was the fourth largest private retail fabric company in the United States. Mr. Cohen brings both national marketing and corporate management experiences to the Company.

R. Donald Finn was elected as a Director to the Company's Board effective September 9, 1999. For more than the last five years, Mr. Finn has been a partner in the law firm of Gibson, McAskill & Crosby, located in Buffalo, New York, where Mr. Finn has practiced law for more than the last 25 years.

Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors, and persons who own more than 10 percent of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission ("SEC"). Officers, directors, and greater than 10 percent stockholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms they file. Based solely on the Company's review of the copies of such forms received by it, or written representations from certain reporting persons that no Form 5 was required for those persons, the Company believes that, during the year ended December 31, 2002 all filing requirements applicable to its officers, directors, and greater than 10 percent beneficial owners were complied with.

Item 11. Executive Compensation and Other Information

Summary Compensation Table

The following table provides certain summary information concerning compensation paid or accrued by the Company and its subsidiaries to and on behalf of the Company's President and CCS's President for each of the three years in the period ended December 31, 2002:

| Name and Principal Position | Year | Salary | Bonus |
|---|---|---|---|
| Joseph M. Williams, .............................. | 2002 | $125,000 | $ 50,00 |
| President and Treasurer - CTI .................... | 2001 | $125,000 | $ 50,00 |
| | 2000 | $ 95,000 | $ 64,00 |

(1) Represents the Company's contribution to the employee's account of the Company's 401(k) Plan and premiums paid by the Company for term life insurance and long-term disability. These plans, subject to the terms and conditions of each plan, are available to all employees.

Aggregate Option Exercises in 2002 and December 31, 2002 Option Values

Mr. Joseph M. Williams exercised 56,000 and 44,000 options in 2001 and 2000, respectively. During 2002, no options were exercised or granted.

Compensation Committee Interlocks and Insider Participation

There is no compensation committee of the Company's Board of Directors or other committee of the Board performing equivalent functions. The person who performs the equivalent function is Francis M. Williams, Chairman of the Board. Francis Williams serves as an executive officer and director of Kimmins Corp. of which Joseph Williams is also an executive officer.

Compensation of Directors

During the year ended December 31, 2002 and 2001, respectively, the Company paid Francis M. Williams an annual fee of $75,000 as Chairman of the Board. All non-officer Directors received an annual fee of $5,000. Directors are reimbursed for all out-of-pocket expenses incurred in attending Board of Directors and committee meetings.

Board Compensation Committee Report on Executive Compensation

There is no formal compensation committee of the Board of Directors or other committee of the Board performing equivalent functions. As noted above, compensation is determined by Francis M. Williams, Chairman of the Board of the Company under the direction of the Board of Directors. There is no formal compensation policy for the Chief Executive Officer of the Company. Compensation of the Chief Executive Officer, which primarily consists of salary, is based generally on performance and the Company's resources. Compensation for Mr. Joseph Williams has been fixed annually each year by the Chairman of the Board. Mr. Joseph Williams' compensation is not subject to any employment contract.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Common Stock Ownership of Certain Beneficial Owners and Management

The following table sets forth the number of shares of the Company's Common Stock beneficially owned as of December 31, 2002 by (i) persons known by the Company to own more than 5 percent of the Company's outstanding Common Stock, (ii) each director and officer of the Company, and (iii) all directors and executive officers of the Company as a group:

| Name and Address | Amount and Nature of Beneficial Ownership of | Percent of Issued and Outstanding |
|---|---|---|

| of Beneficial Owner (1) (2) | Common Stock | Common Stock |
|---|---|---|
| Francis M. Williams | 3,897,145 (3) | 69.6% |
| Joseph M. Williams | 360,493 (4) | 6.4% |
| R. Donald Finn | 7,131 (5) | .1% |
| Andrew J. Cohen | 47,590 (6) | .9% |
| Kimmins Corp. | 1,723,290 | 30.8% |
| All directors and executive officers as a group (four persons) | 4,886,215 | 87.3% |

(1) The address of all officers and Directors of the Company listed above are in care of the Company at 4311 West Waters Avenue, Suite 401, Tampa, Florida 33614.

(2) The Company believes that the persons named in the table have sole voting and investment power with respect to all shares of common stock beneficially owned by them, unless otherwise noted.

(3) Includes 2,677,322 shares owned by Mr. Francis Williams; 1,149,434 shares allocated to Mr. Williams based on his 66.7% ownership in Kimmins Corp., 29,345 shares owned by Mr. Williams' wife; 22,748 shares held by Mr. Williams as trustee for his wife and children and 18,296 shares held by Mr. Williams as custodian under the New York Uniform Gifts to Minors Act for his Children. Mr. Williams owns 66.7% of the outstanding common stock of Kimmins Corp. and is its Chairman and Chief Executive Officer.

(4) Includes 133,500 shares owned by Mr. Joseph M. Williams; 1,010 shares held by Mr. Williams as trustee for his children; 219 shares held by the KC 401(K) Plan and ESOP of which Mr. Williams is fully vested. Also includes 205,764 shares held by KC's 401(K) Plan, Profit Participation Plan and ESOP, options to acquire 20,000 shares of the Company's Common Stock held by the ESOP, of which Mr. Williams is a trustee; Mr. Williams disclaims beneficial ownership of these shares.

(5) Includes 2,131 shares owned by Mr. R. Donald Finn and options to acquire 5,000 shares of the Company's common stock.

(6) Includes 72,540 shares owned by C&C Properties a partnership in which Mr. Cohen has a 50% ownership, 6,320 shares held in trust for Mr. Cohen's minor children and options to acquire 5,000 shares of the Company's common stock.

## Item 13. Certain Relationships and Related Transactions

### Surplus Debentures/Term Note

In 1988, CCS issued a surplus debenture to KC in exchange for $3,000,000 which bears interest at 10 percent per annum. In 1992, the debenture due to KC from CCS was assigned to CTI. Interest and principal payments are subject to approval by the Florida Department of Financial Services. On April 1, 1997, CTI forgave $375,000 of its $3,000,000 surplus debenture due to CCS. As a result, CCS increased paid-in-capital by $375,000. As of December 31, 1999, no payments could be made under the terms of the debenture. On June 30, 1999, CTI forgave $576,266 of its $2,625,000 surplus debenture due to CCS. As a result, CCS increased paid-in-capital to $1,000,000 from $423,734. As of December 31, 2002, no payments could be made under the terms of the debenture. In 2003, CTI forgave the balance of its surplus note to CCS in the amount of $2,048,734. As a result paid-in and contributed surplus of CCS increased to $3,048,734.

Effective November 10, 1988, the Company entered into a $1,000,000 convertible term note agreement with TransCor Waste Services, Inc., a subsidiary of KC. The note, originally due November 10, 2001, has been extended to November 10, 2004. The annual rate of interest is equal to one half of one percent per annum in excess of the stated interest rate established by the Bank of America. The average interest rate for 2002 was 8.6%. On December 26, 2001, the Company made a principal note payment of $395,945 reducing the note to $604,055. The lender may convert the principal amount of the note or a portion thereof into common stock at $3.00 per share subsequent to a six-month anniversary and prior to the close of business on the maturity date.

CCS writes surety bonds for KC and its affiliates. Revenues attributable to transactions with KC and its affiliates were $264, $88 and $7,816 for the years ended December 31, 2002, 2001 and 2000, respectively. Qualex performs consulting services for KC and affiliates. Revenue attributable to transaction with affiliates were $16,586, $121,089 and $171,292 for years ended December 31, 2002, 2001 and 2000, respectively.

## Item 14. Controls and Procedures

Within the 90-day period to the filing of this report, evaluations were carried out under the supervision and with the participation of the Company's management, including the President and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures (as defined in Rule 13a-14(c) under the Securities Exchange Act of 1934). Based upon those evaluations, the President and Chief Financial Officer concluded that, (subject to the limitations noted below), the design and operation of these disclosure controls, and procedures were effective. No significant changes have been made in internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluations.

### Limitations on the Effectiveness of Controls

Management, including the President and Chief Financial Officer, does not expect that disclosure controls and procedures and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objective, of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instance of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Item 15. Exhibits, Consolidated financial statements, Schedules, and Reports on Form 8-K

(a) The following documents are filed as part of this Annual Report on Form 10-K

1. Consolidated Financial Statements

- Independent Auditors' Report
- Consolidated Balance Sheets at December 31, 2002 and 2001
- Consolidated Statements of Operations for each of the three years in the period ended December 31, 2002.
- Consolidated Statements of Stockholders' Equity for each of the three years in the period ended December 31, 2002.
- Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2002.
- Notes to Consolidated Financial Statements

2. Financial Statement Schedule

Schedule II - Condensed Financial Information of Registrant

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and, therefore, have been omitted.

3. The following documents are filed as exhibits to this Annual Report on Form 10-K:

3(a) - Articles of Incorporation* 3(b) - Bylaws*
10(a) - Lease agreement with Cumberland Properties, Inc.*
10(c) - 1991 Stock Option Plan*
11 - Statement Re: Computation of Earnings Per Share
21 - Subsidiary list
99.1 - Certification under Section 906 of the Sarbanes-Oxley Act of 2002
99.2 - Certification under Section 906 of the Sarbanes-Oxley Act of 2002

* Note - Incorporated by reference to the same exhibit number filed with the Registrant's Registration Statement on Form 10 (File No. 0-19727.)

(b) Reports on Form 8-K - On September 12, 2002 the Company filed a Form 8-K to announce that it will be delisted from the NASDAQ SmallCap Market.

On October 3, 2002 the Company filed a Form 8-K to announce that it will be listed on the Nasdaq OTC Bulletin Board.

(c) Exhibits - The response to this portion of Item 15 is submitted as a separate section of this report.

(d) Financial Statement Schedules - The response to this portion of Item 15 is submitted as a separate section of this report.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunder duly authorized.

CUMBERLAND TECHNOLOGIES, INC.

Date: May 6, 2003 By: /s/ Joseph M. Williams

Joseph M. Williams, President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Date: May 6, 2003 By: /s/ Joseph M. Williams

Joseph M. Williams, President

Date: May 6, 2003 By: /s/ Francis M. Williams

Francis M. Williams, Chairman of the Board

Date: May 6, 2003 By: /s/ R. Donald Finn

R. Donald Finn, Director

Date: May 6, 2003 By: /s/ Andrew J. Cohen

Andrew J. Cohen, Director

Date: May 6, 2003 By: /s/ Carol S. Black

Carol S. Black, Secretary
(Principal Financial and Accounting Officer)

Annual Report on Form 10-K

Item 15(a), (c) and (d)

List of Consolidated Financial Statements

Consolidated Financial Statement Schedules and Exhibits

Year Ended December 31, 2002

Cumberland Technologies, Inc.

Tampa, Florida

CUMBERLAND TECHNOLOGIES, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS,
FINANCIAL STATEMENT SCHEDULES AND EXHIBITS

The following consolidated financial statements of Cumberland Technologies, Inc. are included herein:



The following financial statement schedule is filed as part of this report:



All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and, therefore, have been omitted.

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Cumberland Technologies, Inc.

We have audited the accompanying consolidated balance sheets of Cumberland

Technologies, Inc. and subsidiaries (the "Company") as of December 31, 2002 and 2001, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. Our audits also included the financial statement schedule listed in the Index to Consolidated Financial Statements, Financial Statement Schedules and Exhibits. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2002 and 2001 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, the Company changed in 2002 its method of accounting for goodwill to conform to Statement of Financial Standards No. 142, Goodwill and Other Intangible Assets and changed in 2001 its method for accounting for derivatives to conform to Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities.

/s/ DELOITTE & TOUCHE LLP
Tampa, Florida

March 31, 2003

CUMBERLAND TECHNOLOGIES, INC.

CONSOLIDATED BALANCE SHEETS

ASSETS

| | December 31, 2002 | December 31, 2001 |
|---|---|---|
| Investments: | | |
| Debt securities available-for-sale at fair value | $ 7,758,657 | $ 9,339,353 |
| Debt securities held-to-maturity at amortized cost (fair value, 2002 - $367,681; and | | |

| | | |
|---|---|---|
| 2001 - $374,436) | 359,898 | 359,475 |
| Mortgage loan on real estate, at unpaid principal | 716,413 | 681,790 |
| Short-term investments | 433,993 | 433,993 |
| Total investments | 9,268,961 | 10,814,611 |
| Cash and cash equivalents | 593,259 | 2,654,131 |
| Accrued investment income | 123,894 | 154,527 |
| Reinsurance recoverable | 12,089,177 | 6,634,497 |
| Accounts receivable: | | |
| Nonaffiliate less allowance for doubtful accounts of $116,323 and $40,289, respectively | 2,518,187 | 4,615,327 |
| Affiliate | -- | 72,201 |
| Income tax recoverable | 1,073,686 | -- |
| Deferred income tax asset | 401,738 | 499,145 |
| Deferred policy acquisition costs | 1,665,694 | 1,903,547 |
| Intangibles, net | 288,473 | 380,951 |
| Goodwill | 152,780 | 152,780 |
| Other investment | 700,124 | 640,872 |
| Other assets | 302,515 | 371,893 |
| Total assets | $29,178,488 | $28,894,482 |

See notes to consolidated financial statements.

CUMBERLAND TECHNOLOGIES, INC.

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

| | December 31, | |
|---|---|---|
| | 2002 | 2001 |
| Policy liabilities and accruals: | | |
| Loss and loss adjustment expense reserves | $ 8,895,470 | $ 5,284,804 |
| Derivative instruments | 4,346,285 | 3,597,782 |
| Unearned premiums | 4,587,175 | 5,582,640 |
| Ceded reinsurance payable | 26,883 | 1,755,105 |
| Accounts payable and other liabilities | 3,775,924 | 3,388,269 |
| Income tax payable | -- | 113,284 |
| Debt: | | |
| Nonaffiliate | 455,417 | 651,940 |
| Affiliate | 604,055 | 604,055 |
| Total liabilities | 22,691,209 | 20,977,879 |

| | | |
|---|---|---|
| Stockholders' equity: | | |
| Common stock, $.001 par value; 10,000,000 shares authorized; 5,915,356 shares issued | 5,916 | 5,916 |
| Capital in excess of par value | 7,270,316 | 7,270,316 |
| Accumulated other comprehensive income | 210,574 | 70,729 |
| (Accumulated deficit) retained earnings | (735,808) | 833,361 |
| | 6,750,998 | 8,180,322 |
| Less treasury stock, at cost, 318,112 shares at December 31, 2002 and 2001 | (263,719) | (263,719) |
| Total stockholders' equity | 6,487,279 | 7,916,603 |
| Total liabilities and stockholders' equity | $ 29,178,488 | $ 28,894,482 |

See notes to consolidated financial statements.

CUMBERLAND TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

| | Year |
|---|---|
| | 2002 |
| Revenue: | |
| Direct premiums earned | $ 13,980,567 |
| Reinsurance premiums assumed | 3,497,789 |
| Less reinsurance ceded | (4,046,606) |
| Net premium income | 13,431,750 |
| Net investment income | 486,138 |
| Net realized investment gains | 66,239 |
| Commission income | 507,112 |
| Income from investment in affiliate | 59,252 |
| Other income: | |
| Affiliate | 16,586 |
| Nonaffiliate | 1,673,501 |
| Total revenue | 16,240,578 |

| | |
|---|---|
| **Benefits and Expenses:** | |
| Losses and loss adjustment expenses | 8,552,315 |
| Derivative expense | 505,816 |
| Amortization of deferred policy acquisition costs | 3,593,701 |
| Operating expenses | 6,008,072 |
| Impairment of long-lived assets | -- |
| **Interest expense:** | |
| Affiliate | 59,423 |
| Nonaffiliate | 2,451 |
| Total benefits and expenses | 18,721,778 |
| (Loss) income before income tax (benefit) expense and extraordinary gain | (2,481,200) |
| Income tax (benefit) expense | (912,031) |
| (Loss) income before extraordinary gain | (1,569,169) |
| Extraordinary gain (net of income tax) | -- |
| Net (loss) income | $ (1,569,169) |
| **Income per basic share:** | |
| Income (loss) before extraordinary gain | $ (.28) |
| Extraordinary gain | -- |
| Net (loss) income | $ (.28) |
| Weighted average shares outstanding - basic | 5,597,244 |
| **Income per diluted share:** | |
| Income (loss) before extraordinary gain | $ (.28) |
| Extraordinary gain | -- |
| Net (loss) income | $ (.28) |
| Weighted average shares outstanding - diluted | 5,597,244 |

See notes to consolidated financial statements.

CUMBERLAND TECHNOLOGIES, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2000, 2001 AND 2002

| | Common Shares Stock | Common Shares Amount | Capital in Excess of Par Value | Accumulated Other Comprehensive (Loss) Income | (Accum Defic Retai Earni |
|---|---|---|---|---|---|
| Balance at January 1, 2000 .. | 5,815,356 | $ 5,816 | $ 7,257,916 | $ (40,897) | $ (266 |
| Exercise of 56,000 shares under 1991 stock option plan........... | 56,000 | 56 | 6,944 | | |
| Net unrealized appreciation of available-for-sale securities, net of income tax ... | | | | 145,382 | |
| Net income ............. | | | | | 1,041 |
| Comprehensive income..... | | | | | |
| Balance at December 31, 2000 | 5,871,356 | 5,872 | 7,264,860 | 104,485 | 774 |
| Exercise of 44,000 shares under 1991 stock option plan.......... | 44,000 | 44 | 5,456 | | |
| Net unrealized depreciation of available- for-sale securities, net of income tax......... | | | | (33,756) | |
| Net income ............ | | | | | 58 |
| Comprehensive income ... | | | | | |
| Balance at December 31, 2001 | 5,915,356 | 5,916 | 7,270,316 | 70,729 | 83 |
| Net unrealized appreciation of available-for-sale securities, net of income tax.......... | | | | 139,845 | |
| Net loss .............. | | | | | (1,569 |
| Comprehensive loss ..... | | | | | |
| Balance at December 31, 2002 | 5,915,356 | $ 5,916 | $ 7,270,316 | $ 210,574 | $ (73 |

See notes to consolidated financial statements.

CUMBERLAND TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Y |
|---|---|
| | 2002 |
| **Operating activities:** | |
| Net (loss) income | $(1,569,169) |
| Adjustments to reconcile net income to cash (used in) provided by operating activities: | |
| Extraordinary gain on restructuring of note payable | -- |
| Amortization (accretion) of investment premiums discounts | 28,532 |
| Policy acquisition costs amortized | 3,593,701 |
| Policy acquisition costs deferred | (3,355,848) |
| Amortization | 92,478 |
| Impairment of long-lived assets | -- |
| Net realized gains on sales of investments | (66,239) |
| Recoveries for bad debts | -- |
| (Increase) decrease in: | |
| Accrued investment income | 30,633 |
| Reinsurance recoverable | (5,454,680) |
| Accounts receivable | 2,097,140 |
| Income tax recoverable | (1,073,686) |
| Deferred income tax asset | 33,400 |
| Other investment | (59,252) |
| Other assets | 69,378 |
| Increase (decrease) in: | |
| Loss and loss adjustment expense reserve and unearned premiums | 2,615,201 |
| Derivative liability | 748,503 |
| Ceded reinsurance payable | (1,728,222) |
| Accounts payable and other liabilities | 387,653 |
| Income tax payable | (113,284) |
| Net cash (used in) provided by operating activities | (3,723,761) |
| **Investing activities:** | |
| Securities available-for-sale: | |
| Purchases - debt securities | (3,172,826) |
| Proceed from sales - debt securities | 4,994,660 |

| | |
|---|---|
| Proceed from sales - equities | -- |
| Proceeds from investment settlement | -- |
| Securities held-to-maturity: | |
| Proceeds from maturities | -- |
| (Purchases of) net payments on - mortgage loans | (34,623) |
| (Net purchases of short-term investments | -- |
| Net cash provided by (used in) investing activities | 1,787,211 |
| Financing activities: | |
| Payments on debt, affiliate and Non-affiliate | (196,523) |
| Stock options exercised | -- |
| Net change in advances to (from) affiliates | 72,201 |
| Net cash used in financing activities | (124,322) |
| (Decrease) Increase in cash and cash equivalents | (2,060,872) |
| Cash and cash equivalents, beginning of year | 2,654,131 |
| Cash and cash equivalents, end of year | $ 593,259 |
| Supplemental cash flows disclosure: | |
| Cash paid for interest | $ 2,451 |
| Cash paid for income taxes | $ 214,300 |

See notes to consolidated financial statements.

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

## 1. Ownership and Organization

Cumberland Technologies, Inc. ("CTI" or "the Company") f/k/a Cumberland Holdings, Inc., a Florida corporation, was formed on November 18, 1991, to be a Holding company and a wholly-owned subsidiary of Kimmins Corp. ("KC"). Effective October 1, 1992, KC contributed all of the outstanding common stock of two of its other wholly-owned subsidiaries, Cumberland Casualty & Surety Company ("CCS") and Surety Specialists, Inc. ("SSI") to CTI. KC then distributed to its stockholders CTI's common stock on the basis of one share of common stock of CTI for each five shares of KC common stock and Class B common stock owned (the "Distribution".) Effective January 30, 1997, Cumberland Holdings, Inc. changed its name to Cumberland Technologies, Inc. CTI conducts its business through five wholly-owned subsidiaries. CCS, a Florida corporation formed in May 1988, provides underwriting for specialty surety and performance and payment bonds for contractors. The surety services provided include direct surety and to a lesser extent, assumed reinsurance. SSI, a Florida corporation formed in August 1988, is a general lines agency which operates as an independent agent. Surety Group ("SG"), a Georgia corporation, and Associates Acquisition Corp. d/b/a Surety Associates ("SA"), a South Carolina corporation, purchased in February and July 1995, respectively, are general lines agencies which operate as independent agencies. Qualex Consulting Group, Inc. ("Qualex"), a Florida corporation formed in November 1994, provides claim and contracting consulting services.

## 2. Summary of Significant Accounting Policies

### Principles of Consolidation

The consolidated financial statements include the accounts of CTI and its wholly-owned subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

### Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America which, as to the subsidiary insurance company, differ from statutory accounting practices prescribed or permitted by regulatory authorities. The significant accounting policies followed by CTI and subsidiaries that materially affect the consolidated financial statements are summarized in this note.

### Investments

The Company accounts for marketable securities in accordance with Statement of Financial Accounting Standard ("SFAS") No. 115, Accounting for Certain Investments in Debt and Equity Securities.



## 2. Summary of Significant Accounting Policies (continued)

Debt securities that the Company has both the positive intent and ability to hold to maturity are classified as "held-to-maturity" securities and are reported at amortized cost. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts from the date of purchase to maturity. Such amortization and accretion, which is calculated under the interest method, is included in investment income.

Marketable equity securities and debt securities not classified as "held-to-maturity" or "trading" are classified as "available-for-sale." Available-for-sale securities are reported at estimated fair value, with the unrealized gains and losses, net of any related income taxes, reported as a separate component of equity and of other comprehensive income (loss). Realized gains and losses and declines in value judged to be other-than-temporary are included in income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities are included in investment income.

Short-term investments primarily include certificates of deposit having maturities of more than three months when purchased. These investments are reported at cost, which approximates fair value.

Investments in which the Company has a 20% - 50% ownership interest are accounted for using the equity method. The Company's proportionate share of income generated by an investee accounted for under the equity method of $59,252, $61,457, and $19,996 for the years ended December 31, 2002, 2001 and 2000, respectively, are included in income.

Cash Equivalents

The Company considers all highly liquid investments having a maturity of twelve months or less when purchased to be cash equivalents.

Deferred Policy Acquisition Costs

To the extent recoverable from future policy revenues, the costs of acquiring new surety business, principally commissions, are deferred and amortized in a manner which charges each year's operations in direct proportion to the premium revenue recognized.

Intangibles

Intangible assets are stated at cost and principally represent purchased customer accounts and the excess of costs over the fair value of identifiable net assets acquired ("Goodwill").



2. Summary of Significant Accounting Policies (continued)

Purchased customer accounts, noncompete agreements, and purchased contract agreements are being amortized on a straight-line basis over the related estimated lives and contract periods, which range from 3 to 15 years. Purchased customer accounts are records and files obtained from acquired businesses that contain information on insurance policies and the related insured parties that is essential to policy renewals.

In accordance with SFAS 142, "Goodwill and Other Intangible Assets", the Company discontinued the amortization of goodwill effective January 1, 2002. At December 31, 2002 and 2001, goodwill, net of accumulated amortization, was $152,780. Goodwill amortization expense was $55,813 for years ended December 31, 2001 and 2000. As a result of the impairment test required by SFAS 142, the Company's goodwill was found not to be impaired.

In accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which became effective for the Company as of January 1, 2002, the Company periodically reviews the carrying value of long-lived assets to determine if impairment has occurred. Impairment losses, if any, are recorded in the period identified. Significant judgment is required to determine whether or not impairment has occurred. The determination is made by evaluating expected future undiscounted cash flows or the anticipated recoverability of costs incurred and, if necessary, determining the amount of the loss, if any, by evaluating the fair value of the assets.

At December 31, 2001, Goodwill and other long-lived assets that were capitalized in conjunction with the purchase of Associates Acquisition Corp., d/b/a Surety Associates were deemed impaired as such an impairment charge of $437,418 was recorded in the consolidated statement of operations.

### Loss and Loss Adjustment Expenses

The liability for loss and loss adjustment expenses including incurred but not reported losses is based on the estimated ultimate cost of settling the claim using traditional paid and incurred loss development methods. These estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes that the liabilities for loss and loss adjustment expenses are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in current operations. A liability for all costs expected to be incurred in connection with the settlement of unpaid loss and loss adjustment expenses is accrued when the related liability for unpaid losses is accrued. Loss adjustment expenses include costs associated directly with specific claims paid or in the process of settlement, such as legal and adjusters' fees. Loss adjustment expenses also include other costs that cannot be associated with specific claims but are related to losses paid or in the process of settlement, such as internal costs of the claims function.



## 2. Summary of Significant Accounting Policies (continued)

The Company does not discount its reserves for losses and loss adjustment expenses. The Company writes primarily surety contracts which are of short duration.

The Company does not consider investment income in determining if a premium deficiency relating to short duration contracts exists.

### Derivative Instruments

The Company adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" effective January 1, 2001. The Company identified one product that meets the definition of a derivative instrument as defined in SFAS No. 133. The policy is issued to registered investment advisors ("Advisors"), and insures losses suffered by the Advisors as a result of market declines on covered investment principal, provided that the Advisors have followed the investment guidelines required by the policy. The identified derivative was formerly accounted for as an insurance contract within the policy liabilities for loss and loss adjustment expenses account in the consolidated balance sheet for periods prior to January 1, 2001 and on January 1, 2001 there was no cumulative effect of change in accounting principal due to the fact that the policy liability recorded for this policy at December 31, 2000 approximated the fair value of the derivative instrument at January 1, 2001. The fair value of the derivative instrument at December 31, 2002 and 2001 is $4,346,285 and $3,597,782, respectively. At December 31, 2002 and 2001 the fair value of the derivative instrument has been determined by using a financial model that incorporates market data and other assumptions. Due to the volatility in the marketplace, the Company suspended marketing of this product effective September 2001. The Company is not involved in any hedging activities.

### Unearned Premiums

Unearned premiums are deferred and amortized on a pro-rata basis.

### Reinsurance

The Company assumes and cedes reinsurance and participates in various pools. The accompanying consolidated financial statements reflect premiums, benefits and settlement expenses, and deferred policy acquisition costs, net of reinsurance ceded. Amounts recoverable from reinsurers for unpaid losses are estimated in a manner consistent with the claim liability associated with the reinsured policies.

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

## 2. Summary of Significant Accounting Policies (continued)

### Revenue Recognition

Premiums earned on direct insurance and assumed reinsurance are recognized on a pro-rata basis over the period of risk. Commission income, which is earned on ceded premiums and premiums written for other third party insurance carriers, is recognized at the effective date of the bonds issued. Other income, consisting primarily of consulting fees, is recognized when the negotiated services are provided.

### Stock-Based Compensation

The Company has adopted only the pro forma disclosure provisions of Statement No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123"). SFAS No. 123 encourages, but does not require companies to record at fair value compensation cost for stock-based employee compensation plans. The Company accounts for equity-based compensation arrangements in accordance with the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Intrinsic value is the amount by which the market price of the underlying stock exceeds the exercise price of the stock option or award on the measurement date, generally the date of grant.

### Income Taxes

Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company has recorded a deferred income tax asset of $401,738 and $499,145 at December 31, 2002 and 2001, respectively. Realization of the asset is dependent on generating sufficient taxable income in future years. Although realization is not assured, management believes it is more likely than not that all of the deferred income tax asset will be realized.

The Company files a consolidated tax return that includes all of its subsidiaries.



## 2. Summary of Significant Accounting Policies (continued)

### Earnings Per Share

The Company computes and discloses earnings (loss) per share in accordance with the provisions of Statement of Financial Accounting Standards No. 128, Earnings Per Share. The 39,500, 69,500 and 113,500 outstanding stock options at December 31, 2002, 2001 and 2000, respectively, had an immaterial effect on the results of the calculations of earnings per share. Additionally, 47,000 outstanding stock options were antidilutive at December 31, 2002 and 2001, respectively. There were no antidilutive stock options at December 31, 2000.

### Business Concentration

The majority of the Company's business relates to surety bonds, which provide performance and payment bonds for individual and commercial contractors, and market performance products, which provide specific liability coverage for professional services rendered by registered investment advisors. Accordingly, the occurrence of adverse economic conditions could have a material adverse effect on the Company's business, although for surety bonds, no such conditions have been encountered in the Company's past experience. For surety bonding, the Company requires collateral from surety bond customers if the customer fails to meet between 80 percent to 99 percent of the Company's underwriting criteria. Customers that fail to meet at least 80 percent of the requirements are denied surety bonding.

### Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known which would affect the amounts reported and disclosed herein.

### New Accounting Standards

The Financial Accounting Standards Board ("FASB") recently issued the following SFAS's, and the Company is currently determining the impact that these standards will have on its financial statements.

In August 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations". SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it occurred. The standard is effective for fiscal years beginning after June 15, 2002.



## 2. Summary of Significant Accounting Policies (continued)

In June 2002, the FASB issued SFA 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS 146 addresses financial accounting and reporting for costs associated with exit or deposal activities and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 requires costs associated with exit or disposal activities to be recognized when the costs are incurred, rather than at a date of commitment to an exit or disposal.

Reclassifications

Certain amounts in the 2001 and 2000 consolidated financial statements have been reclassified to conform to the 2002 consolidated financial statement presentation.

3. Related Party Transactions

CTI and its subsidiaries have entered into transactions with KC and companies affiliated through common ownership. CCS writes surety bonds for KC and its affiliates. Qualex performs consulting services for KC and affiliates. Other income from affiliates in the accompanying consolidated statements of operations consist primarily of consulting services provided to KC.

Affiliate accounts receivable represents funds advanced and joint expenses that have not yet been reimbursed from KC and its affiliates. These receivables are paid periodically and no interest is charged on the outstanding balances which are payable on demand.

The Company's operating subsidiaries rent or lease office space in the cities in which they are located. CCS and Qualex lease office space in Tampa, Florida from a company owned by Francis Williams, the Chairman of the Board of the Company, at a monthly rate of $10,885, pursuant to a lease that was executed June 1, 1999 and is effective through May 31, 2009.

KC and SSI entered into an agreement with an independent contractor, AEC on August 16, 1989 on a construction contract with the United States Navy ("Navy"). At the time the bonds were issued by CCS as surety, KC entered into an indemnification agreement, whereby KC indemnified CCS from any and all losses, costs and expenses incurred related to the bonds. In 1991, the Navy defaulted and terminated AEC on the contract. The contract was subsequently litigated and CCS was unsuccessful in its litigation activities with the Navy. As a result, KC reimbursed CCS $1,500,000 of the total subrogation recoverable of $1,850,877 in November 2001 on the contract. CCS wrote off the remaining $350,877 reinsurance recoverable as a charge to loss and loss adjustment expense and incurred an additional $240,000 in legal fees during 2001.

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

4. Investments

The Company's investments in available-for-sale securities and held-to-maturity securities are summarized as follows:

Gross

| | Amortized Cost | Unrealized Gains |
|---|---|---|
| Available-for-sale securities at December 31, 2002: | | |
| U.S. Government bonds ................................... | $3,062,496 | $ 79,12 |
| State and municipal bonds ............................... | 496,609 | 3,76 |
| Industrial and miscellaneous bonds ...................... | 3,861,932 | 256,95 |
| Total available-for-sale securities ............................ | 7,421,037 | 339,84 |
| Held-to-maturity securities at December 31, 2002: | | |
| U.S. Government bonds ................................... | 359,898 | 7,78 |
| Total securities ............................................... | $7,780,935 | $ 347,62 |
| Available-for-sale securities at December 31, 2001: | | |
| U.S. Government bonds ................................... | $5,304,913 | $ 48,83 |
| State and municipal bonds ............................... | 546,547 | -- |
| Industrial and miscellaneous bonds ...................... | 3,354,093 | 125,06 |
| Total available-for-sale securities ............................ | 9,205,553 | 173,90 |
| Held-to-maturity securities at December 31, 2001: | | |
| U.S. Government bonds ................................... | 359,475 | 14,96 |
| Total securities ............................................... | $9,565,028 | $ 188,86 |

The amortized cost and fair value of the Company's investments in debt securities, segregated by available-for-sale and held-to-maturity, at December 31, 2002 are summarized, by stated maturity, as follows:

| | Available-for-Sale | |
|---|---|---|
| Maturity | Amortized Cost | Fair Value |
| Due in one year or less .......................... | $2,843,920 | $2,875,916 |
| Due after one year through five years ........................................ | 3,402,685 | 3,623,775 |
| Due after five years through ten years ..................................... | 677,822 | 758,596 |
| Due after twenty years ............................ | 496,610 | 500,370 |
| | $7,421,037 | $7,758,657 |

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

4. Investments (continued)

The Company held no investments in any person or its affiliates (excluding obligations of the U.S. Government or its agencies), which exceeded 10 percent of stockholders' equity at the end of the respective year.

At December 31, 2002 and 2001, the Company had restricted investments held totaling $4,520,022 and $3,405,564, respectively. Restricted investments primarily represent funds held as collateral in connection with reinsurance trust agreements and bonds placed on deposit with various state departments of insurance under statutory deposit requirements. At December 31, 2002 and 2001, respectively, bonds placed on deposit with state departments of insurance total $4,432,514 and $3,319,588 of which $2,290,971 and $1,282,022 is held by the Florida Department of Financial Services.

Net investment income and net realized investment gains (losses) for the Company is comprised of the following:

| | Year |
|---|---|
| | 2002 |
| Debt and equity securities | $ 503,603 |
| Mortgage loans on real estate | 5,498 |
| Short-term investments, including cash and cash equivalents | 31,007 |
| | 540,108 |
| Less investment expenses | (53,970) |
| Net investment income | $ 486,138 |
| Realized gains (losses) on available-for-sale securities: | |
| Debt securities - gains | $ 91,826 |
| Debt securities - losses | (25,587) |
| Equity securities - losses | -- |
| Net realized investment gains | $ 66,239 |

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

5. Fair Value of Financial Instruments

The carrying amounts and fair values of the Company's financial instruments at December 31, 2002 and 2001 are as follows:

| | December 31, 2002 | |
|---|---|---|
| | Carrying Amount | Fair Value |
| Assets: | | |
| Cash and cash equivalents, including short-term investments | $1,027,252 | $1,027,252 |
| Securities | 8,118,555 | 8,126,337 |
| Mortgage loans on real estate | 716,413 | 716,413 |
| Accounts receivable | 2,518,187 | 2,518,187 |
| Reinsurance recoverable | 12,089,177 | 12,089,177 |
| Liabilities: | | |
| Debt | 1,059,472 | 1,059,472 |
| Ceded reinsurance payable | 26,883 | 26,883 |
| Derivative instrument | 4,346,285 | 4,346,285 |

| | December 31, 2001 | |
|---|---|---|
| | Carrying Amount | Fair Value |
| Assets: | | |
| Cash and cash equivalents, including short-term investments | $3,088,124 | $3,088,124 |
| Investments | 9,698,828 | 9,713,758 |
| Mortgage loans on real estate | 681,790 | 681,790 |
| Accounts receivable | 4,687,528 | 4,687,528 |
| Reinsurance recoverable | 6,634,497 | 6,634,497 |
| Liabilities: | | |
| Debt | 1,255,995 | 1,255,995 |
| Ceded reinsurance payable | 1,755,105 | 1,755,105 |
| Derivative instrument | 3,597,782 | 3,597,782 |

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

5. Fair Value of Financial Instruments (continued)

Cash and cash equivalents, short-term investments, accounts receivable, reinsurance recoverable and ceded reinsurance payable: The carrying amount reported in the consolidated balance sheet approximates fair value.

Securities: Fair values for held-to maturity and debt securities are based on quoted market prices and are recognized in the Consolidated Balance Sheet. The fair values for equity securities are based on quoted market prices and are recognized in the consolidated balance sheet.

Mortgage loans: The mortgage loans represent three mortgages. Two are small mortgages totaling $75,369 which were current at December 31, 2002. The other mortgage (referred to as the Mundy mortgage) totals $641,044 and was obtained through a bond that went into default whereby CCS held the mortgage as collateral on the Mundy mortgage.

The value of the collateral is in excess of $1,000,000 and because it greatly exceeds the balance on the mortgage, an allowance was deemed unnecessary.

Debt: Fair value of debt is based on discounted expected future cash flows, using risk rates currently available for debt with similar terms and remaining maturities.

6. Intangibles

Intangibles are comprised of the following:

| | As of December 31, | |
|---|---|---|
| | 2002 | 2001 |
| Deferred state admission costs ............... | $ 227,171 | $ 227,171 |
| Customer lists and acquisition costs ......... | 567,163 | 567,163 |
| Product development .......................... | 262,194 | 262,194 |
| Goodwill ..................................... | 280,623 | 280,623 |
| | 1,337,151 | 1,337,151 |
| Accumulated amortization ..................... | 895,898 | 803,420 |
| Total ........................................ | $ 441,253 | $ 533,731 |

Amortization expense amounted to $92,478 in 2002, $144,267 in 2001 and $151,319 in 2000 and is recorded in operating expenses in the consolidated statements of operations.

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

6. Intangibles (continued)

In July 2001, the FASB issued SFAS 142 "Goodwill and Other Intangible Assets" which was adopted by the Company as of January 1, 2002. SFAS 142 requires goodwill and intangible assets with indefinite lives to no longer be amortized, but instead be tested for impairment on an annual basis.

SFAS 142 provided a six-month transitional period from the effective date of adoption for the Company to perform an assessment of whether there is an indication that goodwill is impaired. To the extent that an indication of impairment existed, the Company was required to perform a second test to measure the amount of the impairment. In the first step, the Company identified no indications of impairment. Therefore the Company was not required to perform the second step of the initial goodwill impairment test.

A reconciliation of net loss and loss per share reported in the consolidated statements of operations to the proforma amounts adjusted for the exclusion of goodwill amortization, net of the related income (loss) tax effect, is presented below. The unaudited proforma results reflecting the exclusion of goodwill amortization have been prepared only to demonstrate the impact of goodwill amortization on net (loss) income and (loss) earnings per share and are for comparative purposes only.

| | 2002 | |
|---|---|---|
| Reported net (loss) income | $ (1,569,169) | $ |
| Add: Goodwill amortization, net of tax | -- | |
| Adjusted net (loss) income | $ (1,569,169) | $ |
| Net (loss) income per share - basic and diluted | $ (0.28) | $ |
| Add: Goodwill amortization, net of tax | -- | $ |
| Adjusted net (loss) income per share - basic and diluted | $ (0.28) | $ |

7. Other Investment

The Company has a 30 percent investment in Global Solutions Insurance Services, Inc. ("GSIS"), an agency located in California that issues cargo insurance and customs bonds, which is accounted for under the equity method.

Summarized unaudited financial information of GSIS is as follows:

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

7. Other Investment (continued)

| | Year ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Revenues .................... | $703,465 | $600,530 | $417,972 |
| Net income .................. | 197,507 | 178,738 | 66,655 |

| | As of December 31, | |
|---|---|---|
| | 2002 | 2001 |
| Current assets ........................... | $2,310,459 | $1,034,572 |
| Non-current assets ....................... | 230,974 | 250,955 |
| Current liabilities ...................... | 1,755,760 | 726,402 |
| Non-current liabilities .................. | 1,744,442 | 1,607,555 |

8. Reserve for Losses and Loss Adjustment Expenses

The following table provides a reconciliation of the beginning and ending liability balances, net of reinsurance recoverables, for the years ended December 31, 2002, 2001 and 2000, to the gross amounts reported in the Company's consolidated balance sheets:

| | 2002 |
|---|---|
| Gross liability for losses and LAE at beginning of year ............................................................ | $ 5,284,804 |
| Recoverables on losses and LAE ....................................... | 1,812,616 |

| | |
|---|---|
| Liability for losses and LAE on unpaid losses before adjustment for incurred and paid losses | 3,472,188 |
| Incurred losses and LAE's claims, net of reinsurance, occurring during: | |
| Current year | 8,203,575 |
| Prior year | 348,740 |
| Total incurred losses, net of reinsurance | 8,552,315 |
| Losses and LAE payments for claims, net of reinsurance, occurring during: | |
| Current year | 5,469,929 |
| Prior years | 3,936,415 |
| Total payments | 9,433,344 |
| Liability for losses and LAE, net | 2,591,159 |
| Add: recoverables on losses and LAE's | 6,304,311 |
| Liability for losses and LAE, at end of year | $ 8,895,470 |

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

8. Reserve for Losses and Loss Adjustment Expenses (continued)

The Company experienced a deficiency of $348,740 for the year ended December 31, 2002. The deficiency is a result of settling claim basis reserves established in prior years for amounts that were more than expected. The Company experienced $936,570 and $1,003,077 in redundancies for losses and loss adjustment expenses in 2001 and 2000. The redundancies principally result from subrogation received on pooling agreement case base reserves and claims in prior years.

The anticipated effect of inflation is implicitly considered when estimating liabilities for losses and LAE. While anticipated price increases due to inflation are considered in estimating the ultimate claim costs, the increase in average severities of claims is caused by a number of factors. Future average severities are projected based on historical trends adjusted for anticipated changes in underwriting standards, policy provisions, and general economic trends. These anticipated trends are monitored based on actual development and are modified if necessary.

9. Income Taxes

Income tax (benefit) expense consists of the following:

December 31,

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Current: | | | |
| Federal ..................... | $(945,431) | $ 294,737 | $ 595,707 |
| State ....................... | -- | 50,453 | 101,973 |
| Total current ............... | (945,431) | 345,190 | 697,680 |
| Deferred: | | | |
| Federal ..................... | 28,518 | (276,568) | 56,960 |
| State ....................... | 4,882 | (47,342) | 9,750 |
| Total deferred .............. | 33,400 | (323,910) | 66,710 |
| Total provision ............. | $(912,031) | $ 21,280 | $ 764,390 |

The provision is reported as follows:

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

9. Income Taxes (continued)

| | December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| (Benefit) for (loss) income before extraordinary gain ...... | $(912,031) | $ (75,932) | $ 764,390 |
| Expense for extraordinary gain on restructuring of note .......................... | -- | 97,212 | -- |
| Total income tax (benefit) expense ....................... | $(912,031) | $ 21,280 | $ 764,390 |

A reconciliation of the statutory federal income tax rate with the Company's effective income tax rate is as follows:

| | December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Statutory federal rate ............ | 34.00% | 34.00% | 34.00% |
| State income taxes ................ | 3.63 | 3.63 | 3.63 |
| Tax exempt income ................. | .36 | (11.04) | (.49) |

| | | | |
|---|---|---|---|
| Nondeductible expenses | (1.23) | .13 | 1.52 |
| Miscellaneous | -- | -- | 3.66 |
| Effective tax rate | 36.76% | 26.72% | 42.32% |

The following summarizes the effect of deferred income taxes items and their impact of "temporary differences" between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. Temporary differences and carry-forwards which give rise to deferred income tax assets and liabilities are as follows:

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

9. Income Taxes (continued)

| | December 31, 2002 | December 31, 2001 |
|---|---|---|
| Deferred income tax liabilities: | | |
| Deferred acquisition costs | $ (626,801) | $ (716,305) |
| Unrealized gain on investments | (127,046) | (63,039) |
| Total deferred tax liabilities | (753,847) | (779,344) |
| Deferred income tax assets: | | |
| Basis difference in fixed assets | 17,139 | -- |
| Basis difference in investments | 101,411 | 120,766 |
| Reserve discounting | 415,464 | 442,163 |
| Unearned premiums | 251,891 | 333,791 |
| Amortization | 163,945 | 279,455 |
| Surplus notes | 102,314 | 102,314 |
| State net operating loss carryforward | 103,421 | -- |
| Total deferred income tax assets | 1,155,585 | 1,278,489 |
| Net deferred income tax asset | $ 401,738 | $ 499,145 |

10. Debt

Debt as of December 31, consists of the following:

| | 2002 | 2001 |
|---|---|---|

| | | |
|---|---|---|
| Affiliate: | | |
| Convertible note payable due November 10, 2002 ........................................ | $ 604,055 | $ 604,055 |
| Nonaffiliate: | | |
| Note payable due March 1, 2002 .................. | -- | 124,523 |
| Note payable due June 30, 2010 .................. | 455,417 | 527,417 |
| | $1.059,472 | $1,255,995 |

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

10. Debt (continued)

Convertible Note Payable to Affiliate

Effective November 10, 1988, the Company entered into a $1,000,000 convertible term note agreement with TransCor Waste Services, Inc., a subsidiary of KC. The note, originally due November 10, 2001, has been extended to November 10, 2003. The annual rate of interest is equal to one half of one percent per annum in excess of the stated interest rate established by the Bank of America. The average interest rate for 2002 was 8.6%. On December 26, 2001, the Company made a principal note payment of $395,945 reducing the note to $604,055. The lender may convert the principal amount of the note or a portion thereof into common stock at $3.00 per share subsequent to a six-month anniversary and prior to the close of business on the maturity date.

Notes Payable to Nonaffiliates

In connection with the acquisition of certain agencies during 1995, the Company entered into two notes payable with the agencies' previous owners. One note was due March 1, 2002 and bore interest at 8% through February 28, 2001 and 10% thereafter. Principal payments of $125,000 are due annually beginning March 1, 2000. The other note is due June 30, 2010 and originally bore interest at 9%. Principal payments of $40,000 were due annually for three years beginning January 5, 1996. Payments of $11,104 including principal and interest were paid monthly from April 1, 1997 through March 31, 2001. On December 3, 2001, SA reached an agreement with the holder on this note payable, whereby the terms of the note were modified, such that interest rate was reduced to zero, and principal payments became payable at $6,000 per month. The modification of the terms of the note resulted in an extraordinary gain of $158,610 (net of deferred income taxes of $97,212). Payments totaling $113,312 including a lump sum payment of $50,000 were made during 2001.

Interest incurred in 2002, 2001 and 2000 for term notes due nonaffiliates was $2,451, $97,208 and $102,760, respectively.

Maturities of affiliate and non-affiliate notes payable are as follows:

| Year Ending December 31, | |
|---|---|
| 2003 | $ 676,055 |
| 2004 | 72,000 |
| 2005 | 72,000 |
| 2006 | 72,000 |
| 2007 | 72,000 |
| | 95,417 |
| | $ 1,059,472 |

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

## 11. Employee Benefit Plan

On April 1, 1996, CTI adopted a defined contribution 401(k) plan covering substantially all employees. Under the plan, the Company makes contributions equal to one percent of the participant's compensation, not to exceed six percent of the participant's annual deferrals. The Company's contributions to the plan totaled $32,663, $33,502, and $24,311 in 2002, 2001 and 2000, respectively.

## 12. Stock Option Plan

During the fiscal year ended December 31, 1999, the Company registered the 1991 Stock Option Plan. (the"Plan"). The Company applies APB Opinion No. 25 and related interpretations in accounting for the Plan. Accordingly, no compensation cost has been recognized for the Plan. Had compensation cost been determined based on the fair market value at the grant dates for awards under the Plan consistent with the method of FASB Statement No.123, the effect on the Company's net (loss) income and (loss) earnings per share would have been immaterial.

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model. The following weighted-average assumptions were used for the grant for the year ended December 31, 1998; dividend yield of 0%, risk free interest rate of 5.40%, expected life of 10 years and volatility of 99.98%. The following weighted-average assumptions were used for grants for the year ended December 31, 2000; dividend yield of 0%, risk free interest rates of 6.54%, and 6.31%, expected lives of 10 years and volatility of 80.59%.

Options granted under this plan have a term of ten years and vest ratably over a four year period immediately following the grant date. The following table summarizes all stock option transaction for the years ended December 31, 2002, 2001 and 2000:

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

12. Stock Option Plan (continued)

| | 2002 | | |
|---|---|---|---|
| | Shares | Weighted-Average Exercise Price | Shares |
| Outstanding at beginning of year | 69,500 | $ 1.38 | 113,500 |
| Grants | -- | $ -- | -- |
| Exercised | -- | $ -- | (44,000 |
| Forfeited | (30,000) | $ 1.125 | -- |
| Outstanding at end of year | 39,500 | $ 1.67 | 69,500 |
| Exercisable at end of year | 28,700 | $ 1.73 | 45,300 |
| Weighted-averagefair value of options granted during the year | $ -- | $ -- | $ -- |

The proceeds from the exercise of stock options include certain income tax benefits, which are included in capital in excess of par value.

The following table summarizes information about stock options at December 31, 2002:

| Options Outstanding | |
|---|---|
| Number Outstanding at | Weighted-Average |

| Range of Exercise Prices | December 31, 2002 | Remaining Contractual Life | Weighted-Average Exercise Price |
|---|---|---|---|
| $1.00 .......................... | 2,500 | 5 years | $ 1.00 |
| $1.50-$1.56 .................... | 27,000 | 8 years | $ 1.53 |
| $2.25 .......................... | 10,000 | 7 years | $ 2.25 |
| | 39,500 | | |

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

13. Preferred Stock

CTI is authorized to issue 10,000,000 shares of preferred stock, $.001 par value, with such rights and privileges as determined by the Board of Directors. The preferred stock shall be issued at such times and for such consideration as determined by the Board of Directors. No shares have been issued as of December 31, 2002.

14. Reinsurance

CCS assumes reinsurance premiums through a program whereby its subsidiary, SSI has contracted through two joint partnering agreements (St. Paul Fire and Marine Group, f/k/a United States Fidelity and Guaranty Company and Peerless Insurance Company) to pursue small to medium size contract and commercial surety business in states in which CCS is not licensed. Effective July 1, 2002, these programs were discontinued. CCS participates in the underwriting risk through a retrocession treaty with Transatlantic Reinsurance Company.

Effective October 1, 1996, CCS entered into a quota share agreement with First Indemnity of America Insurance Company ("FIA") whereby all of the premiums written through a shared underwriting office are subject to this treaty. The Company assumes 50% of the premiums written by FIA and cedes 50% of the premiums written by CCS.

The Company cedes to Transatlantic Reinsurance Company on an excess of loss treaty 95% of the risk insured with a maximum exposure to the Company of $235,000 per principal prior to June 30, 2001 and a maximum exposure of $300,000 per principal effective July 1, 2001 through June 30, 2002. Effective July 1, 2002, net exposure is limited to $250,000 through its reinsurance program after a $1.4 million annual aggregate deductible, limited to $350,000 per principal, is satisfied. Transatlantic Reinsurance Company is rated A+ by A.M. Best. For its liability line of registered investment advisor insurance, the Company has reduced its exposure on any one risk, with a purchase of a quota share agreement with Dorinco Reinsurance (Dorinco Treaty) which is rated A (Excellent) by A.M. Best. Under the Dorinco Treaty, CCS cedes 50% of its liability on all registered investment advisor policies, which have an aggregate net liability limit of $500,000 per endorsement. The Company continues to have exposure to risk for reinsurance ceded in the event that the reinsurer is unable to meet its obligation under the reinsurance agreement in force. Reinsurance does not relieve an insurer of its liability to policyholders, however, the reinsurer is obligated to the insurer for the portion assumed by such reinsurer.

Effective July 1, 2002, CCS entered into a quota share agreement with Transatlantic Reinsurance Company whereby CCS cedes 35% of the premiums, net of commissions, on its commercial surety bonds with penal sums less than $100,000. The quota share treaty is renegotiated annually.

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

14. Reinsurance (continued)

Gross and net written premiums in 2002, 2001 and 2000 are summarized as follows:

| | 2002 | | 2001 | |
|---|---|---|---|---|
| | Written | Earned | Written | Earned |
| Direct premiums.............. | $ 13,849,396 | $ 13,980,567 | $ 13,866,876 | $ 14,465,244 |
| Assumed premiums............. | 2,633,495 | 3,497,789 | 4,193,927 | 3,788,443 |
| Ceded premiums ............... | (4,139,382) | (4,046,606) | (4,653,722) | (4,612,371 |
| Net premiums ................ | $ 12,343,509 | $ 13,431,750 | $ 13,407,081 | $ 13,641,316 |

Losses and loss adjustment expenses in 2002, 2001, and 2000 are summarized as follows:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Direct ....................... | $ 12,300,811 | $ 5,827,451 | $ 6,301,778 |
| Assumed ...................... | 5,920,064 | 1,217,945 | 680,032 |

| | | | |
|---|---|---|---|
| Ceded | (9,668,560) | (2,533,486) | (3,621,452) |
| Net losses and loss adjustment Expenses | $ 8,552,315 | $ 4,511,910 | $ 3,360,358 |

15. Commitments and Contingencies

The Company leases certain office space and equipment under noncancelable operating leases. Rent expense was $303,366, $241,158, and $222,983 for the years ended December 31, 2002, 2001 and 2000, respectively. Minimum future rental and lease commitments as of December 31, 2002 for all noncancelable operating leases with an initial or remaining term of over one year are as follows:

| Year Ending December 31, | |
|---|---|
| 2003 | $ 261,942 |
| 2004 | 253,710 |
| 2005 | 205,204 |
| 2006 | 195,378 |
| 2007 | 194,235 |
| Thereafter | 235,200 |
| | $ 1,345,669 |

CUMBERLAND TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

15. Commitments and Contingencies (continued)

CCS was named as a defendant in a class action lawsuit in the United States District Court for the District of Colorado. The plaintiffs are clients of a registered investment advisor (the "Advisor") and have alleged that the Advisor, a registered broker-dealer, and certain other defendants (excluding CCS) were negligent or otherwise responsible for losses suffered by the plaintiffs resulting from embezzlement of the plaintiffs' investments by a third party. As a separate count in the lawsuit, the plaintiffs have also asserted claims against CCS based on a policy of insurance issued by CCS to the Advisor. The policy does not provide coverage for embezzlement, rather it insures losses caused by market declines, providing that the Advisor has followed the investment guidelines required by the policy. On July 31, 2002, the District Court granted CCS motion for summary judgment and dismissed the claims against CCS.

The Company and its subsidiaries are involved in various lawsuits arising in the ordinary course of its business operations as an insurer. Management does not believe that any of these lawsuits will have a material effect on the consolidated financial position, future operations or cash flows of the Company.

16. Statutory Accounting Practices and Regulatory Requirements

Statutory capital and surplus and net income as reported to the domiciliary state insurance department in accordance with prescribed or permitted statutory accounting practices for CCS is summarized as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Statutory capital and surplus .... | $ 4,734,899 | $ 6,503,218 | $ 5,441,336 |
| Statutory net (loss) income ...... | (1,748,676) | 105,513 | 511,624 |

CCS is domiciled in Florida and prepares its statutory-basis financial statements in accordance with insurance accounting practices prescribed or permitted by the Florida Department of Financial Services. "Prescribed" statutory accounting practices include state laws, regulations, and general administrative rules, as well as a variety of publications of the National Association of Insurance Commissioners ("NAIC"). "Permitted" statutory accounting practices encompass all accounting practices that are not prescribed; such practices may differ from state to state, may differ from company to company within a state, and may change in the future. In 1998, the National Association of Insurance Commissioner adopted the Codification of Statutory Accounting Principles (Codification) for insurance companies. Codification, which is intended to standardize regulatory accounting and reporting for the insurance industry, was effective January 1, 2001. The effect on CCS's statutory financial statements for the implementation of Codification is an additional $453,187 of surplus which is shown as a change in accounting principle in the capital and surplus section of the statutory financial statements of CCS as a "cumulative change in accounting principle."



16. Statutory Accounting Practices and Regulatory Requirements (continued)

Under applicable state insurance statutes, CCS must maintain minimum capital and surplus of $3,250,000 (as of December 31, 2002). In addition, under applicable state laws and regulations, CCS is restricted from paying dividends to the extent of surplus profits less any dividends that have been paid in the preceding twelve months or net investment income for the year, whichever is less, unless the Company obtains prior approval from the Florida Department of Financial Services. As of December 31, 2002, no dividends from CCS are available for payment to CTI without the prior approval of the Department of Insurance. The more significant variances between statutory reporting and generally accepted accounting principles are deferred policy acquisition costs and nonadmitted assets. Insurance regulations dictate expensing commissions. Nonadmitted assets represent non-liquid assets and are excluded from the statutory statement of admitted assets, liabilities and capital and surplus.

17. Comprehensive Income

--------------------

Comprehensive income is defined as any change in equity from transactions and other events originating from nonowner sources. The Company's comprehensive income is comprised of reported net income and changes in the unrealized appreciation of available-for-sale securities. The following summarizes the components of comprehensive income:

| | Consolidated Stat For the | |
|---|---|---|
| | 2002 | |
| Holding gains ........................................ | $ 281,385 | $ |
| Tax effect ........................................... | (98,485) | |
| Reclassification: | | |
| Realized gains .................................. | (66,239) | |
| Income tax ...................................... | 23,184 | |
| Other comprehensive income ........................... | 139,845 | |
| Net (loss) income .................................... | (1,569,169) | |
| Comprehensive (loss) income .......................... | $(1,429,324) | $ |

SCHEDULE II - CONDENSED FINANCIAL INFORMATION
OF REGISTRANT

CUMBERLAND TECHNOLOGIES, INC.

| Condensed Balance Sheets | December 31, 2002 | 2001 |
|---|---|---|
| Assets: | | |
| Investment in wholly-owned subsidiaries .......... | $3,508,968 | $6,301,161 |
| Other assets ..................................... | 43,012 | 1,973 |
| Other investments ................................ | 700,124 | 640,872 |
| Deferred income tax asset ........................ | 401,738 | 499,145 |
| Income tax recoverable ........................... | 1,073,686 | -- |
| Surplus debenture receivable from subsidiary ..... | 2,048,734 | 2,048,734 |
| | $7,776,262 | $9,491,885 |
| Liabilities: | | |
| Accounts payable to affiliates ................... | $1,280,663 | $1,450,710 |

| | | |
|---|---|---|
| Income tax payable | -- | 113,284 |
| Accounts payable | 8,320 | 11,288 |
| | $1,288,983 | $1,575,282 |
| Stockholders' equity: | | |
| Common stock | 5,916 | 5,916 |
| Other stockholders' equity | 6,481,363 | 7,910,687 |
| | $6,487,279 | $7,916,603 |
| | $7,776,262 | $9,491,885 |

| | Year |
|---|---|
| | 2002 |
| Condensed Statements of Operations | |
| Revenue: | |
| Management fees from wholly-Owned subsidiaries | $ 533,763 |
| | 533,763 |
| Costs and expenses: | |
| Operating expenses | 128,976 |
| Interest expense to affiliates | 59,423 |
| | 188,399 |
| Income before income taxes and equity in net income and extraordinary gain of subsidiaries | 345,364 |
| Income tax expense | 130,409 |
| Equity in (loss) income of subsidiaries before extraordinary gains | (1,784,124) |
| Equity in extraordinary gain of subsidiaries | -- |
| Net income | $(1,569,169) |

SCHEDULE II - CONDENSED FINANCIAL INFORMATION
OF REGISTRANT (CONTINUED)

CUMBERLAND TECHNOLOGIES, INC.

Supplemental Schedule of Noncash Investing and Financing Activities

The Company operates through its wholly-owned subsidiaries and all operating activities have been funded by its subsidiaries.

Notes to Condensed Financial Statements

1. Organization and summary of significant accounting policies

Organization - Cumberland Technologies, Inc. ("CTI" or "the Company"), a Florida corporation, was formed on November 18, 1991, to be a holding company and a wholly-owned subsidiary of Kimmins Corp. ("KC"). Effective October 1, 1992, KC contributed all of the outstanding common stock of two of its wholly-owned subsidiaries, Cumberland Casualty & Surety Company ("CCS") and Surety Specialists, Inc. ("SSI") to CTI. KC then distributed to its stockholders CTI's common stock on the basis of one share of common stock of CTI for each five shares of KC common stock and Class B common stock owned (the "Distribution"). CTI conducts its business through its subsidiaries, CCS, SSI, Surety Group, Inc. ("SG"), Surety Associates ("SA"), and Qualex Consulting Group, Inc. ("Qualex") CCS, a Florida corporation formed in May 1988, provides performance and payment bonds for contractors and miscellaneous surety bonds to federal and local government agencies. The surety services provided include direct surety and, to a lesser extent, reinsurance. SSI, a Florida corporation formed in August 1988, is a general lines agency which operates as an independent agent. SG, a Georgia corporation, and Associates Acquisition Corp. d/b/a Surety Associates, a South Carolina corporation, purchased by the Company in February and July 1995, respectively, are general lines insurance agencies which operate as independent agencies. Qualex, a Florida corporation formed in November 1995, provides claim and contracting consulting services.

For the years ended December 31, 2002, 2001 and 2000, CTI charged its subsidiaries, excluding CCS, a management fee.

2. Basis of Presentation - In the parent-company-only financial statements, the Company's investment in subsidiaries is stated at cost plus equity in undistributed earnings of subsidiaries since the date of acquisition. The Company's share of net income (loss) of its subsidiaries is included in income using the equity method. Parent-company-only financial statements should be read in conjunction with the Company's consolidated financial statements.

Investment in subsidiaries includes the net unrealized appreciation, net of income tax in available-for-sale securities held by CCS, of $210,574 and $70,729 as of December 31, 2002 and 2001, respectively. These amounts, net of income taxes, have been included in the CTI "other stockholders' equity" amounts.

SCHEDULE II - CONDENSED FINANCIAL INFORMATION
OF REGISTRANT (CONTINUED)

CUMBERLAND TECHNOLOGIES, INC.

3. Surplus Debenture Receivable from Subsidiary

In 1988, CCS issued a surplus debenture to KC in exchange for $3,000,000 which bears interest at 10 percent per annum. In 1992, the debenture due to KC from CCS was assigned to CTI. Interest and principal payments are subject to approval by the Florida Department of Financial Services. On April 1, 1997, CTI forgave $375,000 of its $3,000,000 surplus debenture due from CCS. As a result, CCS increased paid-in-capital by $375,000. On June 30, 1999, CTI forgave $576,266 of its $2,625,000 surplus debenture due from CCS as well as future interest. As a result, CCS increased paid-in-capital to $1,000,000. As of December 31, 2002, no payments could be made under the terms of the debenture.

In 2003, CTI forgave the balance of its surplus note to CCS in the amount of $2,048,734. As a result paid-in and contributed surplus of CCS increased to $3,048,734.

## CERTIFICATIONS

I, Joseph M. Williams, certify that:

1. I reviewed this annual report on Form 10-K of Cumberland Technologies, Inc.:

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other information included in this annul report, fairly present in all material respects the financial condition, results of operations and cash flow of the registrant as of, and for, the period presented in this annual report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) Designed such disclosure controls and procedures to ensure the material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing ate of this annual report (the "Evaluation Date"; and

c) Presented in this annual report our conclusion about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated to this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 6, 2003

By:/s/ JOSEPH M. WILLIAMS

Joseph M. Williams, President

CERTIFICATIONS

I, Carol S. Black, certify that:

1. I reviewed this annual report on Form 10-K of Cumberland Technologies, Inc.:

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other information included in this annul report, fairly present in all material respects the financial condition, results of operations and cash flow of the registrant as of, and for, the period presented in this annual report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) Designed such disclosure controls and procedures to ensure the material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing ate of this annual report (the "Evaluation Date"; and

c) Presented in this annual report our conclusion about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our

most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated to this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 6, 2003

By:/s/ CAROL S. BLACK

------------------------------------------

Carol S. Black
Secretary and
Principal Financial and Accounting Officer