L & A MUTUAL INSURANCE COMPANY

FINANCIAL STATEMENTS

AS AT DECEMBER 31, 2012

WILKINSON

L & A MUTUAL INSURANCE COMPANY

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AS AT DECEMBER 31, 2012

WILKINSON

INDEPENDENT AUDITORS' REPORT

To the Policyholders of
L & A Mutual Insurance Company

Report on the Financial Statements

We have audited the accompanying financial statements of L & A Mutual Insurance Company, which comprise the balance sheet as at December 31, 2012 and the statements of surplus and resources for protection of policyholders, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of L & A Mutual Insurance Company as at December 31, 2012 and the results of its operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

Wilkinson & Company LLP

BELLEVILLE, Canada
January 31, 2013

Chartered Accountants
Licensed Public Accountants

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L & A MUTUAL INSURANCE COMPANY
BALANCE SHEET AS AT DECEMBER 31, 2012

	2012	2011
	$	$
ASSETS		
Cash	**726,802**	651,622
Portfolio investments - Note 4	**9,937,173**	9,337,458
Accrued investment income	**47,459**	43,349
Accounts receivable		
- Agents and policyholders	**2,624,949**	2,388,600
- Other - Note 5	**183,372**	174,139
Reinsurers' share of provisions for unpaid claims and adjustment expenses - Note 5	**510,105**	866,514
Deferred policy acquisition expenses - Note 5	**749,376**	725,069
Property, plant and equipment - Note 6	**605,151**	566,998
Intangible assets - Note 6	**12,756**	12,552
Deferred income taxes - Note 7	**46,000**	27,000
	15,443,143	14,793,301
LIABILITIES		
Accounts payable and accrued liabilities	**448,264**	527,774
Income taxes payable	**9,899**	64,925
Provision for unpaid claims and adjustment expenses - Note 5	**3,868,747**	3,596,096
Unearned premiums - Note 5	**4,795,087**	4,583,170
	9,121,997	8,771,965
POLICYHOLDERS' SURPLUS		
Surplus and resources for protection of policyholders	**6,321,146**	6,021,336
	15,443,143	14,793,301

APPROVED ON BEHALF OF THE BOARD

_______________________________ Director

_______________________________ Director

The accompanying notes form an integral part of these financial statements

L & A MUTUAL INSURANCE COMPANY
STATEMENT OF SURPLUS AND
RESOURCES FOR PROTECTION OF POLICYHOLDERS
FOR THE YEAR ENDED DECEMBER 31, 2012

	2012 **$**	2011 $
BALANCE - BEGINNING OF YEAR	**6,021,336**	5,783,641
COMPREHENSIVE INCOME FOR YEAR	**299,810**	237,695
BALANCE - END OF YEAR	**6,321,146**	6,021,336

The accompanying notes form an integral part of these financial statements

L & A MUTUAL INSURANCE COMPANY
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2012

	2012	2011
	$	$
PREMIUM INCOME		
Gross premiums written	**9,335,566**	8,912,621
Less reinsurance premiums	**(2,626,819)**	(2,119,138)
Net premiums written	**6,708,747**	6,793,483
Increase in unearned premiums	**(212,707)**	(444,046)
Net premiums earned	**6,496,040**	6,349,437
Service charges	**129,869**	123,148
	6,625,909	6,472,585
DIRECT LOSSES INCURRED		
Gross claims and adjusting expenses		
(including salaries and benefits $95,181; 2011 $71,711)	**4,358,852**	3,953,464
Less reinsurers' share of claims and adjusting expenses	**(426,777)**	38,620
	3,932,075	3,992,084
	2,693,834	2,480,501
EXPENSES		
Commissions	**1,373,200**	1,255,750
Salaries and benefits	**553,423**	536,284
Advertising and promotion	**43,858**	37,228
Bank charges and interest	**46,749**	41,997
Professional fees	**28,805**	21,631
Loss prevention	**85,453**	79,436
Travel and education	**56,939**	49,163
Other expenses	**89,910**	67,364
Office, printing and telephone	**86,962**	70,077
Computer expenses	**103,519**	95,003
Insurance	**16,526**	19,307
Ontario premium taxes	**25,687**	23,806
Association, bureau fees and donations	**40,709**	35,720
Building occupancy costs	**33,921**	40,007
Depreciation of property, plant and equipment and intangibles	**59,242**	53,293
	2,644,903	2,426,066
UNDERWRITING PROFIT (LOSS)	**48,931**	54,435
OTHER INCOME (EXPENSES)		
Investment income - Note 10	**342,693**	268,372
Management fees - portfolio investments	**(57,814)**	(42,112)
	284,879	226,260
COMPREHENSIVE INCOME BEFORE INCOME TAXES	**333,810**	280,695
INCOME TAX EXPENSE (RECOVERY)		
Current - Note 7	**53,000**	49,000
Deferred - Note 7	**(19,000)**	(6,000)
	34,000	43,000
COMPREHENSIVE INCOME FOR YEAR	**299,810**	237,695

The accompanying notes form an integral part of these financial statements

L & A MUTUAL INSURANCE COMPANY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2012

	2012 $	2011 $
OPERATING ACTIVITIES		
Comprehensive income for year	**299,810**	237,695
Adjustment for items which do not affect cash -		
Depreciation of property, plant and equipment	**59,242**	53,293
Gain on sale of portfolio investments (realized and unrealized) - Note 10	**(45,544)**	(19,346)
Deferred income taxes	**(19,000)**	(6,000)
	294,508	265,642
Net change in non-cash working capital balances related to operations - Note 8	**432,442**	(247,811)
CASH FLOWS PROVIDED FROM OPERATING ACTIVITIES	**726,950**	17,831
INVESTING ACTIVITIES		
Purchase of portfolio investments	**(6,817,236)**	(16,934,918)
Proceeds on sale of portfolio investments	**6,263,066**	16,794,287
Purchase of property, plant and equipment	**(97,600)**	
CASH FLOWS USED IN INVESTING ACTIVITIES	**(651,770)**	(140,631)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS FOR YEAR	**75,180**	(122,800)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	**651,622**	774,422
CASH AND CASH EQUIVALENTS - END OF YEAR	**726,802**	651,622
REPRESENTED BY:		
Cash	**726,802**	651,622

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

1. NATURE OF BUSINESS OPERATIONS

(a) Reporting Entity

The Company was incorporated without share capital in August, 1876 under the laws of the Province of Ontario as a mutual insurance company and is subject to the Ontario Insurance Act. It is licenced to conduct its principal business activity which is to write property, liability and automobile insurance in Ontario. The Company's head office is located on 32 Mill Street East, Napanee, Ontario.

The Company is subject to rate regulation in the automobile business that it writes. Before automobile insurance rates can be changed, a rate filing is prepared as a combined filing for most Ontario Farm Mutuals by the Farm Mutual Reinsurance Plan Inc. The rate filing must include actuarial justification for rate increases or decreases. All rate filings are approved or denied by the Financial Services Commission of Ontario. Rate regulation may affect the automobile revenues that are earned by the Company. The actual impact of rate regulation would depend on the competitive environment at the time.

These financial statements have been authorized for issue by the Board of Directors on January 31, 2013.

(b) Basis of Presentation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (the IASB).

These financial statements were prepared under the historical cost convention.

The Company presents the balance sheet based on order of liquidity with a distinction based on expectations regarding recovery or settlement within twelve months after the balance sheet date (current) and more than twelve months after the balance sheet date (non-current) presented in the notes.

The following balances are generally classified as current unless otherwise noted in these financial statements, cash, portfolio investments, accrued investment income, accounts receivable, reinsurance share of provisions for unpaid claims and adjustment expenses, deferred policy acquisition expenses, accounts payable and accrued liabilities, income taxes payable, provision for unpaid claims and adjustment expenses and unearned premiums.

The following balances are generally classified as non-current unless otherwise noted in these financial statements, property, plant and equipment, intangible assets and deferred income taxes.

The Company's functional and presentation currency is the Canadian dollar.

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment of complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2(a).

2. ACCOUNTING POLICIES

The Company follows International Financial Reporting Standards, which comply with the requirements for filing with the Financial Services Commission of Ontario. Those accounting policies considered to be particularly significant are as follows:

(a) Accounting Estimates

The Company makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change effects that period only; or in the period of the change and future periods, if the change affects both.

The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

(i) Provision for Unpaid Claims

The estimation of the provision for unpaid claims and the related reinsurers' share are the Company's most critical accounting estimates. There are several sources of uncertainty that need to be considered by the Company in estimating the amount that will ultimately be paid on these claims. The uncertainty arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Changes in the estimate of the provision can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, or significant changes in severity or frequency of claims from historical trends. The estimates are based on the Company's historical experience and industry experience. More details are included in Note 5.

(ii) Income Taxes

The Company periodically assesses its liabilities and contingencies related to income taxes for all years open to audit based on the latest information available. For matters where it is probable that an adjustment will be made, the Company records its best estimate of the tax liability including the related interest and penalties in the current tax provision. Management believes they have adequately provided for the probable outcome of these matters; however, the final outcome may result in a materially different outcome than the amount included in the tax liabilities.

2. ACCOUNTING POLICIES (Cont'd)

(b) Insurance Contracts

In accordance with IFRS 4, Insurance Contracts, the Company has continued to apply the accounting policies it applied in accordance with pre-changeover Canadian GAAP.

Balances arising from insurance contracts primarily include unearned premiums, provisions for unpaid claims and adjustment expenses, the reinsurers' share of provisions for unearned premiums and unpaid claims and adjustment expenses, deferred policy acquisition expenses, and salvage and subrogation recoverable.

(i) Premiums and Unearned Premiums

Premiums written comprise the premiums on contracts incepting in the financial year. Premiums written are stated gross of commissions' payable to agents and exclusive of taxes levied on premiums.

The Company earns premium income evenly over the term of the insurance policy generally using the pro rata method. The portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums.

(ii) Reinsurers' Share of Unearned Premiums

The reinsurers' share of unearned premiums are recognized as an asset using principles consistent with the Company's method for determining the unearned premium liability. The amount reflected on the balance sheet is on a gross basis to indicate the extent of credit risk related to the reinsurance and its obligations to policyholders.

(iii) Deferred Policy Acquisition Expenses

Acquisition costs are substantially comprised of agents' commissions. These costs are deferred and amortized over the terms of the related policies to the extent that they are considered to be recoverable from unearned premiums, after considering the related anticipated claims and expenses.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

2. ACCOUNTING POLICIES (Cont'd)

(b) Insurance Contracts (Cont'd)

(iv) Provisions for Unpaid Claims and Adjustment Expenses

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, changes in reported claims and for claims incurred but not reported, based on past experience and business in force. The estimates are regularly reviewed and updated, and any resulting adjustments are included in current income.

Claim liabilities are carried on an undiscounted basis.

(v) Liability Adequacy Test

At each reporting date, the Company performs a liability adequacy test on its insurance liabilities less deferred policy acquisition expenses to ensure the carrying value is adequate, using current estimates of future cash flows, taking into account the relevant investment return. If that assessment shows that the carrying amount of the liabilities is inadequate, any deficiency is recognized as an expense to the income statement initially writing off the deferred policy acquisition expense and subsequently by recognizing an additional claims liability for claims provisions.

(vi) Reinsurers' Share of Provisions for Unpaid Claims and Adjustment Expenses

The Company enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. Reinsurance premiums are accounted for in the same period as the related premiums for the direct insurance business being reinsured. Reinsurance liabilities, comprised of premiums payable for the purchase of reinsurance contracts, are included in accounts payable and accrued liabilities and are recognized as an expense when due.

Expected reinsurance recoveries on unpaid claims and adjustment expenses are recognized as assets at the same time and using principles consistent with the Company's method for establishing the related liability.

(vii) Salvage and Subrogation Recoverable

In the normal course of business, the Company obtains the ownership of damaged property, which they resell to various salvage operations. Unsold property is valued at its estimated net realizable value.

Where the Company indemnifies policyholders against a liability claim, it acquires rights to subrogate its claim against other parties. These claims are recognized when funds are received.

2. ACCOUNTING POLICIES (Cont'd)

(b) Insurance Contracts (Cont'd)

(viii) Refund from Premium

Under the discretion of the Board of Directors, the Company may declare a refund to its policyholders based on the premiums paid in the fiscal period. This refund is recognized in the statement of comprehensive income.

(c) Structured Settlements, Fire Mutuals Guarantee Fund and Financial Guarantee Contracts

The Company has the ability to enter into annuity agreements with various life insurance companies to provide for fixed and recurring payments to claimants. Under such arrangements, the Company's liability to its claimants is substantially transferred, although the Company remains exposed to the credit risk that life insurers fail to fulfil their obligations.

The Company is a member of the Fire Mutuals Guarantee Fund ("the Fund"). The Fund was established to provide payment of outstanding policyholders' claims if a member company becomes bankrupt. As a result, the Company may be required to contribute assets to their proportionate share in meeting this objective.

These exposures represent financial guarantee contracts. The Company accounts for financial guarantee contracts in accordance with IFRS 4, Insurance Contracts.

(d) Financial Instruments

The Company classifies its financial instruments into one of the following categories based on the purpose for which the asset was acquired or liability incurred. All transactions related to financial instruments are recorded on a trade date basis. The Company's accounting policy for each category is as follows:

(i) Loans and Receivables

These assets are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specified date or dates, or on demand. They are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition or issue and subsequently carried at amortized cost, using the effective interest rate method, less any impairment losses.

Impairment provisions are recognized when there is objective evidence (such as significant financial difficulties on the part of the counterparty or default or significant delay in payment) that the Company will be unable to collect all of the amounts due under the terms receivable, the amount of such a provision being the difference between the net carrying amount and the present value of the future expected cash flows associated with the impaired receivable. For amounts due from policyholders and reinsurers, which are reported net, such provisions are recorded in a separate allowance account with the loss being recognized in comprehensive income. On confirmation that the amounts receivable will not be collectable, the gross carrying value of the asset is written off against the associated provision.

2. ACCOUNTING POLICIES (Cont'd)

(d) Financial Instruments (Cont'd)

(ii) Fair Value Through Profit and Loss Investments

Financial assets at fair value through profit and loss are financial assets held for trading. A financial asset is classified in this category if it is acquired principally for selling in the short term. Deriatives are also classified as held for trading unless they are designated hedges. Fair value through profit and loss instruments are carried at fair value in the statement of financial position with changes in fair value recorded in the statement of comprehensive income.

Purchases and sales of equity instruments are recognized on settlement date.

(iii) Other Financial Liabilities

Other financial liabilities include all financial liabilities and comprise accounts payables, and other short-term monetary liabilities. These liabilities are initially recognized at fair value net of any transaction costs directly attributable to the issuance of the instrument and subsequently carried at amortized cost using the effective interest rate method, which ensures that any interest expense over the period to repayment is at a constant rate on the balance of the liability carrying in the balance sheet. Interest expense in this context includes initial transaction costs and premium's payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

(iv) Classification

Cash and cash equivalents are classified as fair value through profit and loss. Receivables are classified as loans and receivables, which are measured at amortized cost. Portfolio investments are classified in accordance with Note 2(e) below. Accounts payable and accrued liabilities, due to reinsurers and other insurance companies and structured settlements are classified as other financial liabilities, which are measured at amortized cost.

(e) Portfolio Investments

Portfolio investments invested are classified as fair value through profit and loss, and are initially recorded at their acquisition cost on the date of trade. Portfolio investments are subsequently adjusted to fair value as at the date of the balance sheet, and the corresponding unrealized gains and losses are recorded in income.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

2. ACCOUNTING POLICIES (Cont'd)

(f) Property, Plant and Equipment and Depreciation

Property, plant and equipment are stated at acquisition cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses. Gains or losses on the disposal of individual assets are recognized in income in the year of disposal. Depreciation is provided on the basis as detailed below:

Asset	Basis	Rate
Building	Declining balance	5%
Land and parking improvements	Declining balance	8%
Computer equipment	Straight-line	3 years
Office furniture and fixtures	Declining balance	20%

Depreciation methods and useful lives are reviewed annually and adjusted if necessary.

(g) Intangible Assets

Intangible assets consist of computer software which are not integral to the computer hardware owned by the Company. Software is initially recorded at cost and subsequently measured at cost less accumulated amortization and accumulated impairment losses. Software is amortized on a straight-line basis over 3 years.

(h) Income Taxes

Income tax expense is comprised of current and deferred tax. Current tax and deferred tax are recognized in comprehensive income except to the extent that it relates to a business combination, or items recognized directly in equity or in other earnings.

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting or taxable profit or loss.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

2. ACCOUNTING POLICIES (Cont'd)

(h) Income Taxes (Cont'd)

The amount of the deferred tax asset or liability is measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been acted or substantively enacted by the year-end date and are expected to apply when the liabilities / (assets) are settled / (recovered).

(i) Provisions

Provisions are recognized for liabilities of uncertain timing or amount that have arisen as a result of past transactions, including legal, equitable or constructive obligations. The provision is measured at the best estimate of the expenditure required to settle the obligation at the reporting date.

(j) Accounts Receivable

Accounts receivable are classified as loans and receivables and are measured at initial recognition at fair value and are expected to be settled within one year. Appropriate allowances for estimated irrecoverable amounts are recognized in profit or loss when there is objective evidence that the asset is impaired. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments (more than 90 days overdue) are considered indicators that the trade receivable is impaired.

The carrying amount of the asset is reduced through the direct write-down of the asset in the statement of income. Subsequent recoveries of amounts previously written off are credited against operating expenses in the statement of income.

(k) Pension plan

The Company participates in a multi-employer defined benefit pension plan, however, sufficient information is not available to use defined benefit accounting. Therefore, the company accounts for the plan as if it were a defined contribution plan, recognizing contributions including deficit payments as an expense in the year to which they relate.

(l) Cash and Equivalents

Cash and equivalents consist of cash on deposit.

2. ACCOUNTING POLICIES (Cont'd)

(m) Standards, Amendments and Interpretations Not Yet Effective

Certain new standards, amendments and interpretations have been published that are mandatory for the Company's accounting periods beginning on or after January 1, 2013 or later periods that the Company has decided not to early adopt. The standards, amendments and interpretations that will be relevant to the Company are:

- IFRS 7 - Financial Instruments Disclosures - was amended to enhance disclosure requirements related to offsetting of financial assets and financial liabilities. This amendment is effective for years beginning on or after January 1, 2013.

- IFRS 7 - Financial Instruments Disclosures - was amended to require additional disclosure on transition from IAS 39 to IFRS 9. This amendment is effective for years beginning on or after January 1, 2015.

- IFRS 9 - Financial Instruments: classification and measurement. This standard will replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 has two measurement categories: amortized cost and fair value. All equity instruments are measured at fair value. A debt instrument is measured at amortized cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest. Otherwise, it is measured at fair value through profit or loss. This standard is effective for years beginning on or after January 1, 2015. OFSI has indicated it will not allow early adoption of this standard for federally regulated financial institutions.

- IAS 32 - Financial Instruments: Presentation. This standard was amended to clarify requirements for offsetting of financial assets and financial liabilities. This amendment is effective for years beginning on or after January 1, 2015.

- IAS 1 - Presentation of Other Comprehensive Income ("OCI"). IAS 1 is amended to change the disclosure of items presented in OCI, including a requirement to separate items presented in OCI into two groups based on whether or not they may be recycled to profit or loss in the future. This amendment is effective for years beginning on or after January 1, 2013.

- IFRS 13 - Fair value measurement and disclosure requirements. This standard provides guidance on how to measure fair value where its use is already required or permitted by other standards and enhances disclosure requirements for information about fair value measurements. This standard is effective for years beginning on or after January 1, 2013.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

3. FINANCIAL INSTRUMENT CLASSIFICATION

The carrying amount of the Company's financial instruments by classification is as follows:

	Fair value through profit and loss $	Loans and Receivables $	Other Financial Liabilities $	Total $
December 31, 2012				
Cash	**726,802**			**726,802**
Portfolio investments - Note 4	**9,937,173**			**9,937,173**
Accrued investment income		**47,459**		**47,459**
Accounts receivable				
- Agents and policyholders		**2,624,949**		**2,624,949**
- Other - Note 5		**183,372**		**183,372**
Accounts payable and accrued liabilities			**(448,264)**	**(448,264)**
	10,663,975	**2,855,780**	**(448,264)**	**13,071,491**
December 31, 2011				
Cash	651,622			651,622
Portfolio investments - Note 4	9,337,458			9,337,458
Accrued investment income		43,349		43,349
Accounts receivable				
- Agents and policyholders		2,388,600		2,388,600
- Other - Note 5		174,139		174,139
Accounts payable and accrued liabilities			(527,774)	(527,774)
	9,989,080	2,606,088	(527,774)	12,067,394

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

4. PORTFOLIO INVESTMENTS

As noted in Note 2(e) to these financial statements, portfolio investments are classified as fair value through profit and loss and are adjusted to market value as at the balance sheet.

The cost and market values of the investments are as follows:

	December 31, 2012		December 31, 2011	
	Cost	**Fair Value**	Cost	Fair Value
	$	**$**	$	$
Money Market Fund	**1,485,952**	**1,485,952**	903,463	903,463
Term deposits	**420,000**	**420,000**	645,000	645,000
Canadian Treasury Bills	**337,134**	**337,134**	317,356	317,356
	2,243,086	**2,243,086**	1,865,819	1,865,819
Fixed income-securities				
Federal government	**3,322,483**	**3,391,338**	4,371,139	4,535,728
Provincial government & Provincially guaranteed	**750,780**	**752,862**	558,510	565,814
Canadian Corporate	**1,955,817**	**2,006,280**	1,145,388	1,187,943
	6,029,080	**6,150,480**	6,075,037	6,289,485
Guarantee Fund	**20,619**	**20,619**	17,177	17,177
Preference shares, common shares and income trusts	**1,484,778**	**1,522,988**	1,180,942	1,164,977
	9,777,563	**9,937,173**	9,138,975	9,337,458

The effective interest rates range from 1.267 % to 4.066% (2.0% to 5.0% for December 31, 2011).

The maximum exposure to credit risk would be the carrying value as shown above.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

4. PORTFOLIO INVESTMENTS (Cont'd)

Fair Value

The estimated market value of bonds and debentures are based on quoted market values. The estimated market value of preference and common shares are determined using the last bid price.

Maturity Profile

The expected maturity dates for fixed-income securities and term deposits are as follows:

	2012	2011
	$	$
Maturing within one year	**375,000**	225,000
Maturing between one and five years	**1,713,143**	2,068,771
Maturing over five years	**4,482,337**	4,640,714
	6,570,480	6,934,485

5. INSURANCE CONTRACTS

Accounts Receivable - Other

	2012	2011
	$	$
Due from reinsurers, beginning of the year	**10,142**	16,757
Submitted to reinsurer	**694,292**	147,851
Received from reinsurer	**(704,434)**	(154,466)
Due from reinsurers, end of the year	**NIL**	10,142
Due from facility	**70,166**	71,781
Due from risk sharing pool	**113,206**	92,216
Accounts receivable - other	**183,372**	174,139

Expected settlement

Within one year	**183,372**	174,139
More than one year	**NIL**	NIL

At year end, the Company reviewed the amounts owing from its reinsurer and determined that no allowance is necessary.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

5. INSURANCE CONTRACTS (Cont'd)

Reinsurers Share of Provision for Unpaid Claims

	2012 $	2011 $
Balance, beginning of the year	**866,514**	1,269,229
New claims reserve	**409,515**	844,883
Change in prior years reserve	**(71,632)**	(1,099,747)
Submitted to reinsurer	**(694,292)**	(147,851)
Balance, end of the year	**510,105**	866,514

Expected settlement

	2012	2011
Within one year	**231,658**	353,230
More than one year	**278,447**	513,284

Deferred Policy Acquisition Expenses

	2012 $	2011 $
Balance, beginning of the year	**725,069**	642,461
Acquisition costs incurred	**1,397,507**	1,338,358
Expensed during the year	**(1,373,200)**	(1,255,750)
Balance, end of the year	**749,376**	725,069

Deferred policy acquisition expenses will be recognized as an expense within one year.

Unearned Premiums (UEP)

	2012 $	2011 $
Balance, beginning of the year	**4,583,170**	4,136,723
Premiums written	**9,335,566**	8,912,621
Premiums earned during year	**(9,123,649)**	(8,466,174)
Changes in UEP recognized in income	**211,917**	446,447
Balance, end of the year	**4,795,087**	4,583,170

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

5. INSURANCE CONTRACTS (Cont'd)

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of the following variables: development of claims and reinsurance recoveries. The estimates are based on the Company's historical experience and classified as follows:

	December 31, 2012		December 31, 2011	
	Gross	**Ceded**	Gross	Ceded
	$	**$**	$	$
Short settlement term	**861,383**	**231,658**	832,445	353,230
Long settlement term	**1,136,319**	**278,447**	1,070,216	513,284
Facility association and other residual pools	**251,045**		223,435	
Provision for claims incurred but not reported	**1,620,000**		1,470,000	
	3,868,747	**510,105**	3,596,096	866,514

Short settlement term is defined as expected settlement within one year, long term settlement is defined as expected settlement of more than one year.

Comments and Assumptions for Specific Claims Categories

The ultimate cost of long term settlement general liability claims are difficult to predict for several reasons. Claims may not be reported until many years after a policy expires. Changes in the legal environment have created further complications. Court decisions and federal and provincial legislation may dramatically increase the liability between the time a policy is written and associated claims are ultimately resolved. For example, liability for exposure to toxic substances and environmental impairment, which did not appear likely or even exist when the policies were written, has been imposed by legislators and judicial interpretation. Tort liability has been expanded by some jurisdictions to cover defective workmanship. Provisions for such difficult-to-estimate liabilities are established by examining the facts of tendered claims and adjusted in the aggregate for ultimate loss expectations based upon historical experience patterns and current socioeconomic trends.

The Company must participate in industry automobile residual pools of business and recognizes a share of this business based on its automobile market share. The Company records its share of the liabilities provided by the actuaries of the pools.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

5. INSURANCE CONTRACTS (Cont'd)

Claims and Adjustment Expenses

Changes in claim liabilities recorded in the balance sheet for the years ended December 31, 2012 and 2011 and their impact on claims and adjustment expenses for the two years follow:

	2012 **$**	2011 $
Unpaid claim liabilities, beginning of year	**3,596,096**	4,454,401
Increase (decrease) in estimated losses and expenses for losses occurring in prior years	**(750,908)**	(2,340,306)
Provision for losses and expenses on claims occurring in the current year	**5,137,371**	6,309,980
Payment on claims:		
Current year	**(2,964,922)**	(4,086,246)
Prior years	**(1,148,890)**	(741,733)
Unpaid claims, end of year	**3,868,747**	3,596,096
Reinsurer's share and subrogation recoverable	**510,105**	866,514
Unpaid claims, end of year - net	**3,358,642**	2,729,582

The change in estimate of losses occurring in prior years is due to changes arising from new information received.

5. INSURANCE CONTRACTS (Cont'd)

Provision for Unpaid Claims and Adjustment Expenses

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of three major variables which are the development of claims, reinsurance recoveries and future investment income.

The Superintendent of the Financial Services Commission of Ontario has required that consideration of future investment income be disregarded except in the evaluation of automobile accident benefit claims.

Claim Development

The estimation of claim development involves assessing the future behaviour of claims, taking into consideration the consistency of the Company's claim handling procedures, the amount of information available, the characteristics of the line of business from which the claim arises and historical delays in reporting claims. In general, the longer the term required for the settlement of a group of claims the more variable the estimates. Short settlement term claims are those which are expected to be substantially paid within a year of being reported.

The table that follows present the development of claims payments and the estimated ultimate cost of claims for the claim year 2007 to 2012. The upper half of the tables shows the cumulative amounts paid or estimated to be paid during successive years related to each claim year. The original estimates will be increased or decreased, as more information becomes known about the original claims and overall claim frequency and severity.

In 2012, the year of adoption of IFRS, only information from periods beginning on or after January 1, 2007 is required to be disclosed. This is being increased in each succeeding additional year, until ten years of information in included.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
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5. INSURANCE CONTRACTS (Cont'd)

Net Claims

	2007 $ (000's)	2008 $ (000's)	2009 $ (000's)	2010 $ (000's)	2011 $ (000's)	2012 $ (000's)	Total $ (000's)
Net estimate of cumulative claims costs							
At the end year of claim	2,964	3,417	3,451	5,043	5,500	4,890	
One year later	2,652	3,019	2,862	4,244	4,703		
Two years later	2,529	2,682	2,667	4,112			
Three years later	2,402	2,524	2,619				
Four years later	2,234	2,545					
Current estimate of cumulative claims cost	2,234	2,545	2,619	4,112	4,703	4,890	21,103
Cumulative payments	2,234	2,529	2,520	3,695	4,051	2,715	17,744
Outstanding claims	NIL	16	99	417	652	2,175	3,359
Outstanding claims 2007 and prior							NIL
Total net outstanding claims net of reinsurance							3,359
Reinsurers' share of provision for unpaid claims and expenses							510
Provision for unpaid claims and expenses							3,869

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

6. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLES

	Property, plant and Equipment						Intangibles
	Land $	Building $	Parking Lot $	Computer Equipment $	Office Furniture and Fixtures $	Total $	Computer Software $
Balance on December 31, 2011	80,924	482,000	17,576	137,651	52,037	770,188	25,103
Additions		48,799		14,670	23,844	87,313	10,286
Disposals				(46,277)		(46,277)	
Balance on December 31, 2012	80,924	530,799	17,576	106,044	75,881	811,224	35,389
Balance on December 31, 2011	NIL	46,995	2,700	112,789	40,706	203,190	12,551
Depreciation expense		22,970	1,190	20,349	4,651	49,160	10,082
Disposals				(46,277)		(46,277)	
Balance on December 31, 2012	NIL	69,965	3,890	86,861	45,357	206,073	22,633
Net book value							
December 31, 2011	80,924	435,005	14,876	24,862	11,331	566,998	12,552
December 31, 2012	80,924	460,834	13,686	19,183	30,524	605,151	12,756

The Company's land and buildings were last valued at January 1, 2010. Land and buildings were subject to external valuation performed by F.G. Myatt Commercial Appraisal Services, qualified professional valuers adhering to the generally accepted Standards of Professional Practice (CUSPAP) and the Code of Ethics of the Appraisal Institute of Canada. The fair value of land and buildings is determined by the "Income Approach to Value" and on comparable market transactions. Had land and buildings not been accounted for using the revaluation model, on a historical cost basis, their net book values would have been approximately $14,000 and $432,000 (2011 -$15,000 and $405,000).

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

7. INCOME TAX INFORMATION

The Company has a reduced effective income tax rate due to eligibility for the small business deduction and exemptions within the Income Tax Act for a proportion of its taxable income relating to insuring farm related risks.

The significant components of tax expense included in net income are composed of:

	2012	2011
	$	$
Current Tax Expense		
Based on current year taxable income	**53,000**	49,000
Deferred Tax Expense		
Origination and reversal of temporary differences	**(19,000)**	(2,900)
Increase in tax rate		(3,100)
	(19,000)	(6,000)
Total income tax expense	**34,000**	43,000

Reasons for the difference between tax expense for the year and the expected income taxes based on the effective statutory tax rate are as follows:

	2012	2011
	$	$
Net income for the year	**333,810**	280,695
Effective statutory rate	**15.50 %**	15.50 %
Expected taxes based on the effective statutory rate	**51,741**	43,508
Income from insuring farm related risks	**(6,692)**	(6,274)
Non-taxable dividends	**(3,290)**	
Non-taxable portion of unearned premiums and deferred acquisition costs	**2,802**	1,035
Market to market and other adjustments related to investments		11,424
Depreciation in excess of capital cost allowance	**2,349**	2,777
Non-deductible portion of claims liabilities	**4,875**	(3,530)
Other non-deductible expenses	**699**	706
Other	**516**	(646)
Total income tax expense	**53,000**	49,000

Adjustments to the opening carrying value of temporary differences based on changes to the federal and provincial tax rates result in changes to deferred income tax payable and is reflected in deferred income taxes.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

7. INCOME TAX INFORMATION (Cont'd)

The movement in 2012 deferred tax assets (liabilities) are:

	Opening Balance at January 1, 2012 $	Recognize in Net Income $	Closing Balance at December 31, 2012 $
Deferred Tax Assets			
Unearned premiums	26,400	2,500	28,900
Claims liabilities	18,800	4,300	23,100
Other	4,000	(1,200)	2,800
Deferred tax asset	49,200	5,600	54,800
Deferred Tax Liabilities			
Property, plant and equipment	(20,500)	12,700	(7,800)
Intangible assets	(1,700)	700	(1,000)
Deferred tax liability	(22,200)	13,400	(8,800)
2012 net deferred income taxes asset movement	27,000	19,000	46,000

L & A MUTUAL INSURANCE COMPANY
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FOR THE YEAR ENDED DECEMBER 31, 2012

7. INCOME TAX INFORMATION (Cont'd)

The movement in 2011 deferred tax assets (liabilities) are:

	Opening Balance at January 1, 2011 $	Recognize in Net Income $	Closing Balance at December 31, 2011 $
Deferred Tax Assets			
Payment of accrued liabilities			
Unearned premiums	22,500	3,900	26,400
Claims liabilities	19,300	(500)	18,800
Other	1,200	2,800	4,000
Deferred tax asset	43,000	6,200	49,200
Deferred Tax Liabilities			
Property,plant and equipment	(19,500)	(1,000)	(20,500)
Intangible assets	(2,500)	800	(1,700)
Deferred tax liability	(22,000)	(200)	(22,200)
2011 net deferred income taxes asset movement	21,000	6,000	27,000

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

7. INCOME TAX INFORMATION (Cont'd)

	2012 $	2011 $
Deferred Tax Assets		
Deferred tax assets to be recovered within 12 months	**36,800**	33,700
Deferred tax assets to be recovered after more than 12 months	**18,000**	15,500
	54,800	49,200
Deferred Tax Liability		
Deferred tax liabilities to be settled within 12 months	**(1,000)**	(3,400)
Deferred tax liabilities to be settled after more than 12 months	**(7,800)**	(18,800)
	(8,800)	(22,200)
Net deferred income taxes asset movement	**46,000**	27,000

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

8. NET CHANGE IN NON-CASH WORKING CAPITAL BALANCES RELATED TO OPERATIONS

Cash provided from (used in) non-cash working capital is compiled as follows:

	2012 $	2011 $
(INCREASE) DECREASE IN CURRENT ASSETS		
Accrued interest	**(4,110)**	(4,997)
Accounts receivable - agents and policyholders	**(236,349)**	(271,941)
Accounts receivable - other	**(9,233)**	(1,731)
Income taxes recoverable		66,079
Reinsurers' share of provision for unpaid claims and adjustment expenses	**356,409**	402,715
Deferred policy acquisition expenses	**(24,307)**	(82,608)
	82,410	107,517
INCREASE (DECREASE) IN CURRENT LIABILITIES		
Accounts payable and accrued liabilities	**(79,510)**	(8,395)
Income taxes payable	**(55,026)**	64,925
Provision for unpaid claims and adjustment expenses	**272,651**	(858,305)
Unearned premiums	**211,917**	446,447
	350,032	(355,328)
NET CHANGE IN NON-CASH WORKING CAPITAL BALANCES RELATED TO OPERATIONS	**432,442**	(247,811)

9. INSURANCE RISK MANAGEMENT

The principal risk the Company faces under insurance contracts is that the actual claims and benefit payments or the timing thereof, differ from expectations. This is influenced by the frequency of claims, severity of claims, actual benefits paid and subsequent development of long-term claims. Therefore, the objective of the Company is to ensure that sufficient reserves are available to cover these liabilities.

The above risk exposure is mitigated by diversification across a large portfolio of insurance. The variability of risks is also improved by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements.

The Company purchases reinsurance as part of its risks mitigation program. Retention limits for the excess-of-loss reinsurances vary by product line.

Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision and are in accordance with the reinsurance contracts. Although the Company has reinsurance arrangements, it is not relieved of its direct obligations to its policyholders and thus a credit exposure exists with respect to ceded insurance, to the extent that any reinsurer is unable to meet its obligations assumed under such reinsurance agreements.

The Company writes insurance primarily over a twelve month duration. The most significant risks arise through high severity, low frequency events such as natural disasters or catastrophes. A concentration of risk may arise from insurance contracts issued in a specific geographic location since all insurance contracts are written in Ontario.

The Company manages this risk via its underwriting and reinsurance strategy within an overall risk management framework. Exposures are limited by having documented underwriting limits and criteria. Pricing of property and liability policies are based on assumptions in regard to trends and past experience, in an attempt to correctly match policy revenue with exposed risk. Automobile premiums are subject to approval by the Financial Services Commission of Ontario, and therefore, may result in a delay in adjusting the pricing to exposed risk; in this case, the Company has policies regarding renewal and new business accepted. Reinsurance is purchased to mitigate the effect of the potential loss to the Company. Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer.

The Company follows a policy of underwriting with reinsuring contracts of insurance. The limit of liability of the Company to a maximum amount of any one claim of $180,000 in the event of a property claim, $120,000 in the event of a liability claim and $145,000 in the event of an auto claim and $20,000 for Farmers Accident claims. For amounts over the respective limits there is a 10% retention to a specified maximum. In addition, the Company has obtained reinsurance which limits the Company's liability to approximately $290,000 in the event of a series of claims arising out of a single occurrence. The Company also has obtained stop loss reinsurance which limits the liability of all claims in a specific year to 80% of gross net earned premiums for all property, liability and automobile lines of business.

9. INSURANCE RISK MANAGEMENT (Cont'd)

The Company is exposed to a pricing risk to the extent that unearned premiums are insufficient to meet the related future policy costs. Evaluation is performed regularly to estimate future claims costs, related expenses and expected profit in relation to unearned premiums. There was no premium deficiency at December 31, 2012 and 2011.

The risks associated with insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The Company uses various techniques based on past claims development experience to quantify these sensitivities. This includes indicators such as average claim cost, amount of claims occurrences, expected loss ratios and claims development as described in Note 5.

Results of sensitivity testing based on expected loss ratios are as follows, shown gross and net of reinsurance on a pre-tax basis:

	Property Claims		Auto Claims		Liability Claims	
	2012	2011	**2012**	2011	**2012**	2011
	$	**$**	$	$	$	$
5% change in loss ratios						
Gross claims change	**264,981**	250,165	**162,857**	156,096	**38,941**	39,370
Net claims change	**189,308**	189,218	**96,020**	102,913	**16,565**	13,576

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure the risk.

10. INVESTMENT AND OTHER INCOME

	2012	2011
	$	$
Interest income	**251,135**	223,257
Dividend income	**46,024**	25,769
Unrealized gains on fair value measurement	**45,534**	18,112
Realized gains on disposal of investments		1,234
	342,693	268,372

11. RELATED PARTY TRANSACTIONS

The Company entered into the following transactions with key management personnel, which are defined by IAS 24, Related Party Disclosures, as those persons having authority and responsibility for planning, directing and controlling the activities of the Company including directors and management:

	2012	2011
	$	$
Compensation		
Salary, wages, short-term employee benefits and director's fees	**373,855**	360,848
Premiums	**47,461**	49,095
Claims incurred	**1,140**	8,978

Amounts owing from and to key management personnel and directors (excluding compensation due and accrued) at December 31, 2012 are $2,132 (2011 - $2,582) and $Nil (2011 - $4,433) respectively. The amounts owing are subject to regular payment terms for policyholders and are included in due from agents and policyholders on the balance sheet.

12. FINANCIAL RISK MANAGEMENT

Credit Risk

Credit risk is the risk of financial loss to the Company if a debtor fails to make payments of interest and principal when due. The Company is exposed to this risk relating to its fixed-income securities in its investment portfolio and the reliance on reinsurers to make payment when certain loss conditions are met.

The Company's investment policy puts limits on the fixed-income securities including portfolio composition limits, issuer type limits and corporate sector limits. No foreign bonds are allowed and bonds must have a minimum credit rating of A. The maximum amount that may be invested in Guaranteed Investment Certificates may not exceed the amount guaranteed by the Canadian Deposit Insurance Corporation. All fixed income portfolios are monitored by management on a monthly basis and by the Board of Directors on a quarterly basis. Investment transactions are approved by any two of four specified management and Directors.

12. FINANCIAL RISK MANAGEMENT (Cont'd)

Credit Risk (Cont'd)

Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer. Management monitors the creditworthiness of FMRP by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Accounts receivable are short term in nature and are not subject to material credit risk. The maximum exposure to credit risk and concentration of this risk is limited to the carrying value of these instruments.

There have been no significant changes from the previous period in the exposure to risk or policies procedures and methods used to measure the risk.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of market factors. Market factors include three types of risk: currency risk, interest rate risk and equity risk.

The Company's investment policy operates within the guidelines of the Insurance Act. An investment policy is in place and its application is monitored by the Board of Directors. Diversification techniques are utilized to minimize risk.

Interest Rate Risk

Interest rate risk is the potential for financial loss caused by fluctuations in fair value or future cash flows of financial instruments because of changes in market interest rates.

The Company is exposed to risk through its interest-bearing investments (term deposits and debt securities).

Historical data and current information is used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. However, because a significant portion of the Company's assets relate to its capital rather than liabilities, the value of its interest rate based assets exceeds its interest rate based liabilities. As a result, generally the Company's investment income will move with interest rates over the medium to long-term with short-term interest rate fluctuations creating unrealized gains or losses in Comprehensive Income. There are no occurrences where interest would be charged on liabilities, therefore, little protection is needed to ensure the fair market value of assets will be offset by a similar change in liabilities due to an interest rate change.

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12. FINANCIAL RISK MANAGEMENT(Cont'd)

Interest Rate Risk (Cont'd)

The objective and policies and procedures for managing interest rate risk is to diversify the bond portfolio in such a way that the bonds are a portfolio laddered over several years and an approximately equal portion of the bond portfolio would come due each year and be reinvested. This protects the Company from fluctuations in the interest rates.

As prevailing interest rates increase or decrease, the market value of these interest-bearing investments change. If interest rates were to increase by 1%, with all other variables being held constant, then the effect on the market value of these investments would be a decrease of approximately $344,700 (2011 - $381,500). If interest rates were to decrease by 1%, with all other variables being held constant, then the effect on the market value of these investments would be an increase of approximately $370,100 (2011 - $419,200). The Company has structured its portfolio in a manner as to be able to allow fixed-income securities to be held to maturity to reduce any potential interest rate risk. For bonds that the Company did not sell during the year, the change during the year would be recognized as Comprehensive Income during the year.

There have been no significant changes from the previous period in the exposure to risk or policies procedures and methods used to measure the risk.

Equity Risk

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The Company is exposed to this risk through its equity holdings within its investment portfolio.

The Company's portfolio includes Canadian stocks with fair values that move with the Toronto Stock Exchange Composite Index. A 10% movement in the stock markets with all other variables held constant would have an estimated effect on the fair values of the Company's preference and common shares of $152,000 (2011 - $116,000). For shares that the Company did not sell during the period, the change would be recognized in the asset value and in Comprehensive Income. For shares that the Company did sell during the period, the change during the period and changes prior to the period would be recognized as net realized gains or losses in income during the period.

12. FINANCIAL RISK MANAGEMENT (Cont'd)

The Company's investments policy operates within the guidelines of the Insurance Act. An investment policy is in place and its application is monitored by the Investment Committee and the Board of Directors. Diversification techniques are utilized to minimize risk. The Policy limits the investment in preference and common shares are as follows:

Investment Category	Maximum Percentage of Investment Portfolio
Preference shares	25%
Common shares	25%
Income trusts	25%
Mutual and pooled funds	25%
Corporate securities	10%
Individual corporate group	10%
Individual sector	10%
Foreign securities	10%

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet all cash outflow obligations as they come due. The Company mitigates this risk by monitoring cash activities and expected outflows. Current liabilities arise as claims are made. There are no material liabilities that can be called unexpectedly at the demand of a lender or client. There are no material commitments for capital expenditures and there is no need for such expenditures in the normal course of business. Claim payments are funded by current operating cash flow including the investment income.

There have been no significant changes from the previous period in the exposure to risk or policies procedures and methods used to measure the risk.

13. DISCLOSURES RELATING TO FAIR VALUE MEASUREMENTS

The Company has categorized its financial assets and liabilities where fair value does not approximate cost based on the priority of the inputs to the valuation techniques used to measure fair value, into a three level fair value hierarchy. Financial assets and liabilities measured at fair value are categorized as follows:

Level 1: Fair value is based on unadjusted quoted prices for identical assets or liabilities in an active market.

Level 2: Fair value is based on quoted prices in markets that are not active or inputs that are observable for the asset or liability either directly as price or indirectly derived from price.

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13. DISCLOSURES RELATING TO FAIR VALUE MEASUREMENTS (Cont'd)

Level 3: Fair value is based on valuation techniques that require one or more significant unobservable inputs that are supported by little or no market activity and are significant to the estimated fair value of the assets and liabilities.

	Level 1 $ (000's)	Level 2 $ (000's)	Total $ (000's)
December 31, 2012			
Fixed-income securities			
Federal government	3,391		3,391
Provincial government and Provincially guaranteed	753		753
Canadian Corporate	2,006		2,006
Preference shares, common shares and income trusts	1,523		1,523
Fire Mutuals' Guarantee Fund		21	21
TOTAL ASSETS MEASURED AT FAIR VALUE	7,673	21	7,694

	Level 1 $ (000's)	Level 2 $ (000's)	Total $ (000's)
December 31, 2011			
Fixed-income securities			
Federal government	4,536		4,536
Provincial government and Provincially guaranteed	566		566
Canadian Corporate	1,188		1,188
Preference shares, common shares and income trusts	1,165		1,165
Fire Mutuals' Guarantee Fund		17	17
TOTAL ASSETS MEASURED AT FAIR VALUE	7,455	17	7,472

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14. CAPITAL MANAGEMENT

The Company's objectives with respect to capital management are to maintain a capital base that is structured to exceed regulatory requirements and to best use capital allocations. Reinsurance is utilized as outlined in the company's underwriting policy on Note 9 to the these financial statements to protect the company's capital. In addition, reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable. To limit their potential impact, catastrophic coverage limits exposure to $290,000 plus 5% of the remaining loss. The $290,000 net retained amount represents approximately 4.59% of the Company's capital. For the purpose of capital management, the Company has defined capital as policyholders' surplus.

The regulators measure the financial strength of property and casualty insurers using a minimum capital test (MCT). The regulators generally expect property and casualty companies to comply with capital adequacy requirements. This test compares a Company’s capital against the risk profile of the organization. The risk-based capital adequacy framework assesses the risk of assets, policy liabilities and other exposures by applying various factors. The regulator indicates that the Company should produce a minimum MCT of 150%. The regulator has the authority to request more extensive reporting and can place restrictions on the Company’s operations if deemed necessary.

In certain actuarial studies, the Net Risk Ratio was shown to have a high correlation to the MCT. As a result of these findings, the company uses Net Risk Ratio to monitor capital adequacy.

The Company has several guidelines and benchmarks established by the Financial Services Commission of Ontario regarding capital management. All of these guidelines and benchmarks have historically been met or exceeded by the Company, and management believes they will continue to do so in current and future years.

15. PENSION PLAN

Substantially all employees participate in a multi-employer pension plan that is a defined benefit plan. The plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities; there is no consistent and reliable basis of allocating the plan assets, obligation and the net pension benefit obligation to the plan participants. Accordingly, the pension plan is accounted for as if it was a defined contribution plan.

For the year ended December 31, 2012, the Company recognized $46,163 (2011 - $41,759) in operating expenses for current pension contributions.

The most recent actuarial valuation of the plan filed under the Pension Benefits Act (Ontario) was at December 31, 2010. As a result of this valuation, on a going concern basis, the actuarial value of the plan assets exceeded the actuarial value of plan liabilities by $4,187,000 with a solvency deficit of $3,344,000. The Company’s solvency contribution for the year ended December 31, 2011 was $37,364 which was recorded in operating expenses in 2011. The Company was not required to make a solvency contribution for the year ended December 31, 2012.

L & A MUTUAL INSURANCE COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2012

15. PENSION PLAN (Cont'd)

As at December 31, 2011, an interim actuarial valuation was performed on the plan. This valuation concluded that on a going concern basis, the actuarial value of plan liabilities exceeded the actuarial value of the plan assets by $14,390,000 with a solvency deficit of $26,370,000. The plan establishes a schedule of solvency contributions with the plan participants in conjunction with an actuarial valuation filed under the Pension Benefit Act. The next scheduled actuarial valuation to be filed under the Pension Benefit Act is December 31, 2013. The Company is expecting to be required to make a solvency contribution of approximately 1% of any solvency deficit that is calculated based on the actuarial valuation as at December 31, 2013. The future potential solvency contribution has not been recorded as a liability and expense in the December 31, 2012 financial statements.