



**SOUTH EASTHOPE MUTUAL  
INSURANCE COMPANY**

**CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**South Easthope Mutual Insurance Company**  
**Consolidated Financial Statements**  
For the year ended December 31, 2011

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## INDEPENDENT AUDITOR'S REPORT

To the Policyholders of  
**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**

We have audited the accompanying consolidated financial statements of **SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**, which comprise of the consolidated statement of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, and the consolidated statements of comprehensive income, members' surplus and cash flows for the years ended December 31, 2011 and December 31, 2010, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated financial statements based on our audits. We conducted our audits 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 presentation of the consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of South Easthope Mutual Insurance Company as at December 31, 2011, December 31, 2010 and January 1, 2010, and the results of its operations and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

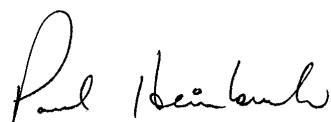
*BDO Canada LLP*

Chartered Accountants, Licensed Public Accountants  
Woodstock, Ontario  
February 2, 2012

**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
**Consolidated Statement of Financial Position**  
**December 31, 2011**

	December 31 2011	December 31 2010	January 1 2010
<b>Assets</b>			
Cash	\$ 3,020,613	\$ 3,507,135	\$ 4,591,099
Investments (Note 4)	30,637,978	29,273,860	25,276,914
Investment income accrued	87,085	89,094	95,048
Income taxes recoverable	451,704	-	-
Due from reinsurers (Note 8)	276,359	148,367	65,876
Due from policyholders	3,571,670	3,277,762	2,995,384
Reinsurers' share of provision for unpaid claims (Note 8)	4,729,686	3,979,833	3,717,322
Other receivables	73,593	213,383	31,926
Deferred policy acquisition expenses (Note 8)	530,768	502,835	467,298
Investment property (Note 5)	154,991	160,469	165,220
Property, plant & equipment (Note 6)	1,230,379	970,642	995,809
Intangible assets (Note 7)	118,510	101,046	191,638
Other assets	28,340	20,464	11,162
Deferred income taxes (Note 11)	62,890	103,146	123,903
	<u>\$ 44,974,566</u>	<u>\$ 42,348,036</u>	<u>\$ 38,728,599</u>
<b>Liabilities</b>			
Accounts payable and accrued liabilities	\$ 537,161	\$ 736,377	\$ 679,826
Provision for refund of premium	542,170	686,348	325,367
Income taxes payable	-	295,836	380,727
Unearned premiums (Note 8)	6,790,864	6,412,256	5,878,856
Deferred revenue	-	3,925	-
Provision for unpaid claims (Note 8)	12,125,815	11,614,461	12,226,757
	<u>19,996,010</u>	<u>19,749,203</u>	<u>19,491,533</u>
<b>Members' Surplus</b>			
Unappropriated members' surplus	24,978,556	22,598,833	19,237,066
	<u>\$ 44,974,566</u>	<u>\$ 42,348,036</u>	<u>\$ 38,728,599</u>

Signed on behalf of the Board by:

 Director

 Director

**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
**Consolidated Statement of Comprehensive Income**  
**For the Year-Ended December 31, 2011**

For the year ended December 31	2011	2010
<b>Underwriting income</b>		
Gross premiums written	\$ 13,688,950	\$ 13,066,731
Less reinsurance ceded	<u>(2,394,303)</u>	<u>(2,332,912)</u>
Net premiums written	11,294,647	10,733,819
Less increase in unearned premiums	<u>(378,608)</u>	<u>(533,400)</u>
<b>Net premiums earned</b>	10,916,039	10,200,419
<b>Service charges</b>	<u>89,760</u>	<u>78,932</u>
	<u>11,005,799</u>	<u>10,279,351</u>
<b>Direct losses incurred</b>		
Gross claims and adjustment expenses	9,020,892	7,262,413
Less reinsurers' share of claims and adjustment expenses	<u>(2,982,663)</u>	<u>(2,790,971)</u>
	<u>6,038,229</u>	<u>4,471,442</u>
	<u>4,967,570</u>	<u>5,807,909</u>
<b>Expenses</b>		
Fees, commissions and other acquisition expenses	1,576,690	1,991,884
Other operating and administrative expenses (Note 12)	<u>1,196,161</u>	<u>1,323,583</u>
	<u>2,772,851</u>	<u>3,315,467</u>
<b>Net underwriting income before refund</b>	2,194,719	2,492,442
<b>Refund of premium</b>	<u>521,142</u>	<u>660,291</u>
<b>Net underwriting income</b>	1,673,577	1,832,151
<b>Net loss from subsidiary (Note 14)</b>	(237,416)	(30,221)
<b>Investment and other income (Note 15)</b>	<u>1,374,105</u>	<u>2,288,480</u>
<b>Income before taxes</b>	2,810,266	4,090,410
<b>Provision for income taxes (Note 11)</b>	<u>430,543</u>	<u>728,643</u>
<b>Comprehensive income for the year</b>	<u>\$ 2,379,723</u>	<u>\$ 3,361,767</u>

The accompanying notes are an integral part of these financial statements.

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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
Consolidated Statement of Members' Surplus  
For the Year-Ended December 31, 2011

For the year ended December 31	2011	2010
<hr/>		
Unappropriated members' surplus		
Balance, beginning of year	\$22,598,833	\$ 19,237,066
Comprehensive income for the year	<u>2,379,723</u>	<u>3,361,767</u>
Balance, end of year	<u>\$24,978,556</u>	<u>\$ 22,598,833</u>

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The accompanying notes are an integral part of these financial statements.

**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
**Consolidated Statement of Cash Flows**  
**For the Year-Ended December 31, 2011**

	2011	2010
<b>Operating activities</b>		
Comprehensive income for the year	\$ 2,379,723	\$ 3,361,767
Adjustments for:		
Depreciation of property, plant & equipment and intangible assets	187,620	221,327
Depreciation of investment property	5,478	5,452
Interest and dividend income	(1,538,885)	(1,283,983)
Provision for income taxes	430,543	728,643
Realized gain from disposal of investments	-	(399,957)
Unrealized loss (gain) on investments	69,759	(685,285)
Realized loss from disposal of capital assets	12,389	-
	<u>1,546,627</u>	<u>1,947,964</u>
Changes in working capital		
Change in due from policyholders and other receivables	(154,118)	(463,835)
Change in other assets	(7,876)	(9,302)
Change in accounts payable and other liabilities	(315,279)	443,902
Change in deferred revenue	(3,925)	3,925
	<u>(481,198)</u>	<u>(25,310)</u>
Changes in insurance contract related balances		
Change in due from reinsurers	(877,845)	(345,002)
Change in deferred policy acquisition expenses	(27,933)	(35,537)
Change in unearned premiums	378,608	533,400
Change in provision for unpaid claims	511,354	(612,296)
	<u>(15,816)</u>	<u>(459,435)</u>
Cash flows related to interest, dividends and income taxes		
Interest and dividends received	1,540,894	1,289,937
Income taxes paid	(1,165,942)	(819,147)
	<u>374,952</u>	<u>470,790</u>
<b>Total cash inflows from operating activities</b>	<u>1,424,565</u>	<u>1,934,009</u>
<b>Investing activities</b>		
Sale of investments	336,376	4,137,414
Purchase of investments	(1,770,253)	(7,049,118)
Proceeds on disposal of property plant & equipment	16,000	-
Purchase of property plant & equipment and intangibles assets	(493,210)	(105,568)
Purchase of investment property	-	(701)
	<u>(1,911,087)</u>	<u>(3,017,973)</u>
<b>Total cash outflows from investing activities</b>	<u>(1,911,087)</u>	<u>(3,017,973)</u>
<b>Net decrease in cash and cash equivalents</b>	<u>(486,522)</u>	<u>(1,083,964)</u>
<b>Cash and cash equivalents, beginning of year</b>	<u>3,507,135</u>	<u>4,591,099</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 3,020,613</u>	<u>\$ 3,507,135</u>

The accompanying notes are an integral part of these financial statements.

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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
Consolidated Notes to Financial Statements

December 31, 2011

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1. Nature of operations and summary of significant accounting policies

*Reporting entity*

SOUTH EASTHOPE MUTUAL INSURANCE COMPANY (the Company) is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property, liability, automobile, boiler and machinery, fidelity and farmer's accident insurance in Ontario. The Company's head office is located in Tavistock, 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 February 2, 2012.

*Basis of presentation*

These financial statements include the financial statements of SOUTH EASTHOPE MUTUAL INSURANCE COMPANY and those of its subsidiary company, SEH COMPUTER SYSTEMS INC.

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (the IASB). This is the first time that the Company has prepared its financial statements in accordance with IFRS, having previously prepared its financial statements in accordance with Canadian Generally Accepted Accounting Principles (Canadian GAAP). Details of how the transition from pre-changeover Canadian GAAP to IFRS has affected the financial position, financial performance and cash flows are disclosed in Note 22.

These financial statements were prepared under the historical cost convention, as modified by the revaluation of financial instruments designated as fair value through profit and loss.

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.



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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
Consolidated Notes to Financial Statements

December 31, 2011

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1. Nature of operations and summary of significant accounting policies (cont'd)

*Significant accounting policies*

*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 the following:

(a) 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 brokers 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.

(b) Deferred policy acquisition expenses

Acquisition costs are comprised of agents' and brokers' commissions and premium taxes. 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.

(c) 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.

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**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
**Consolidated Notes to Financial Statements**

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**December 31, 2011**

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**1. Nature of operations and summary of significant accounting policies (cont'd)**

**(d) 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. The liability adequacy test uses current estimates of future cash flows which take 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 in the income statement. It is recognized by initially writing off the deferred policy acquisition expense and subsequently by recognizing any additional claims liability for claims provisions.

**(e) 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.

**(f) 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 reflected at amounts expected to be received from the subrogated parties net of related costs.

**(g) Refund from premium**

Under the discretion of the board of directors, the Company may declare a refund to qualifying property policy holders based on the premiums paid in the fiscal period.

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**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
**Consolidated Notes to Financial Statements**

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**December 31, 2011**

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**1. Nature of operations and summary of significant accounting policies (cont'd)**

*Structured settlements, Fire Mutuals Guarantee Fund and financial guarantee contracts*

The Company enters 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 will 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.

*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:

*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 policy holders and reinsurers, which are reported net, such provisions are recorded in a separate allowance account with the loss being recognized in net 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.

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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
Consolidated Notes to Financial Statements

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December 31, 2011

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1. Nature of operations and summary of significant accounting policies (cont'd)

*Fair value through profit and loss*

The Company does not have any instruments that are held for trading purposes. However, management has designated to voluntarily classify its investments at fair value through profit and loss. These instruments are carried at fair value with changes in fair value recognized in net income. Transaction costs on these instruments are expensed as incurred. Interest on debt securities classified as fair value through profit and loss is calculated using the effective interest method.

*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 carried in the Consolidated Statement of Financial Position. Interest expense in this context includes initial transaction costs and premiums payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

*Investment property*

The Company's investment property consists of land, building and furniture and fixtures held to earn rental income. Investment property is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses. Land is not depreciated. Buildings are depreciated on a straight-line basis over their estimated useful life of 20 years. Furniture and fixtures are depreciated on a straight-line basis over their estimated useful life of 5 years.

Rent receivable is recognized in net income and is recorded on a straight-line basis over the period of the lease. Where an incentive, such as a rent free period is given to a tenant, the carrying value of the investment property excludes any amount reported as a separate asset as a result of recognizing rental income on this basis.

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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
Consolidated Notes to Financial Statements

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December 31, 2011

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1. Nature of operations and summary of significant accounting policies (cont'd)

*Property, plant & equipment*

Property, plant & equipment is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses, with the exception of land which is not depreciated. Depreciation is recognized in comprehensive income and is provided on a straight-line basis over the estimated useful life of the assets as follows:

Buildings	20 years
Land improvements	5 years
Leasehold improvements	10 years
Computer hardware	5 years
Furniture and fixtures	5 years
Vehicles	5 years

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

*Intangible assets*

Intangible assets consist of computer software, which are not integral to the computer hardware owned by the Company, and developed software. Computer software is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses. Software is amortized on a straight-line basis over its estimated useful life of 3 years. The depreciation expense is included in other operating and administrative expenses in the statement of comprehensive income. Developed software relates to the cost of developing new products. These costs are capitalized and amortized over the expected useful life of the software.

*Impairment of non-financial assets*

Non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly.

For the purpose of assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
**Consolidated Notes to Financial Statements**

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December 31, 2011

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**1. Nature of operations and summary of significant accounting policies (cont'd)**

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash flows.

Impairment charges are included in comprehensive income.

***Income taxes***

Income tax expense comprises 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.

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.

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 enacted or substantively enacted by the year-end date and are expected to apply when the liabilities are settled or assets are recovered.

***Pension plan***

The Company participates in a multiple 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 as an expense in the year to which they relate.

***Provisions***

Provisions are recognized for liabilities of uncertain timing or amounts 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.

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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
Consolidated Notes to Financial Statements

December 31, 2011

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1. Nature of operations and summary of significant accounting policies (cont'd)

*Foreign currency translation*

Foreign currency accounts are translated into Canadian dollars as follows:

At the transaction date, each asset, liability, revenue and expense denominated in a foreign currency is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year-end date, unsettled monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at the year-end date and the related translation differences are recognized in net income. Exchange gains and losses arising on the retranslation of monetary available-for-sale financial assets are treated as a separate component of the change in fair value and recognized in net income. Exchange gains and losses on non-monetary available-for-sale financial assets form part of the overall gain or loss recognized in respect of that financial instrument.

Non-monetary assets and liabilities that are measured at historical cost are translated into Canadian dollars by using the exchange rate in effect at the date of the initial transaction and are not subsequently restated. Non-monetary assets and liabilities that are measured at fair value or a revalued amount are translated into Canadian dollars by using the exchange rate in effect at the date the value is determined and the related translation differences are recognized in net income or other comprehensive income consistent with where the gain or loss on the underlying non-monetary asset or liability has been recognized.

*Leased assets*

Where substantially all of the risks and rewards incidental to ownership of a leased asset have been transferred to the Company (a "finance lease"), the asset is treated as if it had been purchased outright. The amount initially recognized as an asset is the lower of the fair value of the leased property and the present value of the minimum lease payments payable over the term of the lease. The corresponding lease commitment is shown as a liability. Lease payments are split between capital and interest. The interest element is charged to the Consolidated Statement of Comprehensive Income over the period of the lease and is calculated so that it represents a constant proportion of the lease liability. The capital element reduces the balance owed to the lessor.

Where substantially all of the risks and rewards incidental to ownership are not transferred to the Company (an "operating lease"), the total rentals payable under the lease are charged to the Consolidated Statement of Comprehensive Income on a straight-line basis over the lease term. The aggregate benefit of lease incentives is recognized as a reduction of the rental expense over the lease term on a straight-line basis.

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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
Consolidated Notes to Financial Statements

December 31, 2011

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1. Nature of operations and summary of significant accounting policies (cont'd)

*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, 2012. The standards, amendments and interpretations that will be relevant to the Company are:

*IFRS 9 Financial Instruments*

IFRS 9 Financial Instruments is part of the IASB's wider project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2015. The Company is in the process of evaluating the impact of the new standard.

None of the other new standards, interpretations and amendments, which are effective for the Company's accounting periods beginning after January 1, 2012, are expected to have a material effect on the Company's future financial statements.



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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
Consolidated Notes to Financial Statements

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December 31, 2011

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2. Critical accounting estimates and judgments

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.

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.

*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 8.

*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.

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**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
<b>December 31, 2011</b>				
Cash	\$ 3,020,613	\$ -	\$ -	\$ 3,020,613
Investments	30,637,978	-	-	30,637,978
Investment income accrued	-	87,085	-	87,085
Due from policy holders	-	3,571,670	-	3,571,670
Accounts payable and accrued liabilities	-	-	(537,161)	(537,161)
	<u>\$ 33,658,591</u>	<u>\$ 3,658,755</u>	<u>\$ (537,161)</u>	<u>\$ 36,780,185</u>
<b>December 31, 2010</b>				
Cash	\$ 3,507,135	\$ -	\$ -	\$ 3,507,135
Investments	29,273,860	-	-	29,273,860
Investment income accrued	-	89,094	-	89,094
Due from policy holders	-	3,277,762	-	3,277,762
Accounts payable and accrued liabilities	-	-	(736,377)	(736,377)
	<u>\$ 29,273,860</u>	<u>\$ 3,366,856</u>	<u>\$ (736,377)</u>	<u>\$ 35,411,474</u>
<b>January 1, 2010</b>				
Cash	\$ 4,591,099	\$ -	\$ -	\$ 4,591,099
Investments	25,276,914	-	-	25,276,914
Investment income accrued	-	95,048	-	95,048
Due from policy holders	-	2,995,384	-	2,995,384
Accounts payable and accrued liabilities	-	-	(679,826)	(679,826)
	<u>\$ 29,868,013</u>	<u>\$ 3,090,432</u>	<u>\$ (679,826)</u>	<u>\$ 32,278,619</u>

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**4. Investments**

The following table provides cost and fair value information of investments by type of security and issuer. The maximum exposure to credit risk would be the fair value as shown below.

	December 31, 2011		December 31, 2010		January 1, 2010	
	Cost	Fair value	Cost	Fair value	Cost	Fair value
<b>Bonds issued by:</b>						
Federal	\$ 2,120,856	\$ 2,382,669	\$ 2,115,554	\$ 2,236,876	\$ 2,671,375	\$ 2,777,677
Provincial	3,094,208	3,363,738	2,836,996	2,994,720	2,595,386	2,690,720
Corporate						
AAA	4,207,525	4,408,232	3,921,038	3,951,952	2,588,613	2,667,657
AA	2,392,200	2,531,026	2,365,718	2,475,014	2,710,113	2,813,065
A	734,597	760,682	880,832	897,345	430,563	436,439
	<b>12,549,386</b>	<b>13,446,347</b>	<b>12,120,138</b>	<b>12,555,907</b>	<b>10,996,050</b>	<b>11,385,558</b>
<b>Equity Investments</b>						
<i>Canadian Common</i>						
Finance/Utility	2,628,053	3,318,054	2,516,640	3,054,163	2,078,069	2,413,354
Consumer	623,219	514,470	467,963	442,548	538,208	489,184
Mining/Energy/Industrials	2,256,834	2,986,122	2,321,510	3,508,731	1,594,044	2,347,988
Technology	227,390	51,660	227,390	203,245	-	-
<i>US Common</i>						
Finance/Utility	94,297	37,609	94,297	69,769	66,000	47,295
Consumer	361,170	355,522	361,170	325,907	296,254	260,292
Mining/Energy/Industrials	140,230	150,424	140,230	156,572	116,218	91,715
Technology	354,190	339,832	354,190	326,902	194,623	197,368
	<b>6,685,383</b>	<b>7,753,693</b>	<b>6,483,390</b>	<b>8,087,837</b>	<b>4,883,416</b>	<b>5,847,196</b>
<b>Farm Mutual Pooled Funds</b>						
Canadian Fixed Income	<b>9,359,157</b>	<b>9,404,802</b>	<b>8,557,564</b>	<b>8,598,025</b>	<b>7,971,058</b>	<b>8,013,164</b>
<b>Other Investments</b>						
Fire Mutuals Guarantee Fund	<b>33,136</b>	<b>33,136</b>	<b>32,091</b>	<b>32,091</b>	<b>30,996</b>	<b>30,996</b>
<b>Total Investments</b>	<b>\$28,627,062</b>	<b>\$30,637,978</b>	<b>\$ 27,193,183</b>	<b>\$ 29,273,860</b>	<b>\$ 23,881,520</b>	<b>\$ 25,276,914</b>

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**4. Investments (cont'd)**

The following table provides an analysis of investments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities using the last bid price;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Level 1	Level 2	Level 3	Total
<b>December 31, 2011</b>				
Bonds	\$13,446,347	\$ -	\$ -	\$13,446,347
Equities	7,753,693	-	-	7,753,693
Farm mutual pooled funds	-	9,404,802	-	9,404,802
Other investments	-	33,136	-	33,136
<b>Total</b>	<b>\$21,200,040</b>	<b>\$ 9,437,938</b>	<b>\$ -</b>	<b>\$30,637,978</b>
<b>December 31, 2010</b>				
Bonds	\$ 12,555,907	\$ -	\$ -	\$ 12,555,907
Equities	8,087,837	-	-	8,087,837
Farm mutual pooled funds	-	8,598,025	-	8,598,025
Other investments	-	32,091	-	32,091
<b>Total</b>	<b>\$ 20,643,744</b>	<b>\$ 8,630,116</b>	<b>\$ -</b>	<b>\$ 29,273,860</b>
<b>January 1, 2010</b>				
Bonds	\$ 11,385,558	\$ -	\$ -	\$ 11,385,558
Equities	5,847,196	-	-	5,847,196
Farm mutual pooled funds	-	8,013,164	-	8,013,164
Other investments	-	30,996	-	30,996
<b>Total</b>	<b>\$ 17,232,754</b>	<b>\$ 8,044,160</b>	<b>\$ -</b>	<b>\$ 25,276,914</b>

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2011 and 2010.

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**December 31, 2011**

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**4. Investments (cont'd)**

Maturity profile of bonds held is as follows:

	Within 1 year	2 to 5 years	6 to 10 years	Over 10 years	Fair value
December 31, 2011	\$ 474,130	\$8,554,337	\$4,417,880	\$ -	\$13,446,347
Percent of Total	4 %	64 %	33 %	- %	
December 31, 2010	\$ 312,522	\$ 8,651,136	\$ 3,592,249	\$ -	\$ 12,555,907
Percent of Total	2 %	69 %	29 %	- %	
January 1, 2010	\$ 654,772	\$ 4,279,004	\$ 6,451,782	\$ -	\$ 11,385,558
Percent of Total	6 %	38 %	57 %	- %	

The effective interest rate of the bonds portfolio held is 3.64%, 3.66% and 4.12% at December 31, 2011, 2010 and January 1, 2010 respectively.

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**5. Investment property**

	Land	Buildings	Furniture and fixtures	Total
<b>Cost</b>				
Balance at January 1, 2010	\$ 60,000	\$ 105,000	\$ 661	\$ 165,661
Additions	-	-	701	701
Balance on December 31, 2010	\$ 60,000	\$ 105,000	\$ 1,362	166,362
Balance on December 31, 2011	\$ 60,000	\$ 105,000	\$ 1,362	\$ 166,362
<b>Accumulated depreciation</b>				
Balance at January 1, 2010	\$ -	\$ -	\$ 441	441
Depreciation expense	-	5,250	202	5,452
Balance on December 31, 2010	\$ -	\$ 5,250	\$ 643	5,893
Depreciation expense	-	5,250	228	5,478
Balance on December 31, 2011	\$ -	\$ 10,500	\$ 871	\$ 11,371
<b>Net book value</b>				
January 1, 2010	\$ 60,000	\$ 105,000	\$ 220	165,220
December 31, 2010	\$ 60,000	\$ 99,750	\$ 719	160,469
December 31, 2011	\$ 60,000	\$ 94,500	\$ 491	\$ 154,991

	2011	2010
Rental income from investment property	\$ 6,000	\$ 6,000

The fair value of the investment property is \$165,000 (December 31, 2010 - \$165,000, January 1, 2010 - \$165,000).

Investment properties were subject to external valuation performed by a local real estate brokerage. The fair value of investment property is determined by discounting the expected cash flows of the properties based upon internal plans and assumptions and comparable market transactions.

The investment property held by the Company is currently leased out on a month to month basis.

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**6. Property, plant & equipment**

	<b>Property, plant and equipment</b>							
	<b>Land</b>	<b>Buildings</b>	<b>Land improvements</b>	<b>Leasehold improvements</b>	<b>Computer hardware</b>	<b>Furniture and fixtures</b>	<b>Vehicles</b>	<b>Total</b>
<b>Cost</b>								
Balance - January 1, 2010	\$ 195,000	\$ 603,436	\$ 14,375	\$ -	\$ 637,699	\$ 288,223	\$ 158,479	\$ 1,897,212
Additions	-	21,748	-	38,800	17,352	11,164	-	89,064
Disposals	-	-	-	-	-	-	-	-
Balance - December 31, 2010	\$ 195,000	\$ 625,184	\$ 14,375	\$ 38,800	\$ 655,051	\$ 299,387	\$ 158,479	\$ 1,986,276
Additions	-	28,600	-	233,053	46,652	57,067	58,880	424,252
Disposals	-	-	-	-	(385,414)	-	(66,121)	(451,535)
Balance - December 31, 2011	\$ 195,000	\$ 653,784	\$ 14,375	\$ 271,853	\$ 316,289	\$ 356,454	\$ 151,238	\$ 1,958,993
<b>Accumulated depreciation</b>								
Balance - January 1, 2010	\$ -	\$ -	\$ -	\$ -	\$ 561,223	\$ 246,924	\$ 93,256	\$ 901,403
Depreciation expense	-	30,338	2,875	-	40,008	19,402	21,608	114,231
Disposals	-	-	-	-	-	-	-	-
Balance - December 31, 2010	\$ -	\$ 30,338	\$ 2,875	\$ -	\$ 601,231	\$ 266,326	\$ 114,864	\$ 1,015,634
Depreciation expense	-	32,451	2,875	22,028	39,330	19,722	19,720	136,126
Disposals	-	-	-	-	(379,065)	-	(44,081)	(423,146)
Balance - December 31, 2011	\$ -	\$ 62,789	\$ 5,750	\$ 22,028	\$ 261,496	\$ 286,048	\$ 90,503	\$ 728,614
<b>Net book value of</b>								
January 1, 2010	\$ 195,000	\$ 603,436	\$ 14,375	\$ -	\$ 76,476	\$ 41,299	\$ 65,223	\$ 995,809
December 31, 2010	\$ 195,000	\$ 594,846	\$ 11,500	\$ 38,800	\$ 53,820	\$ 33,061	\$ 43,615	\$ 970,642
December 31, 2011	\$ 195,000	\$ 590,995	\$ 8,625	\$ 249,825	\$ 54,793	\$ 70,406	\$ 60,735	\$ 1,230,379

**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
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**7. Intangible assets**

	Intangible assets		
	Computer software	Developed Software	Total
<b>Cost</b>			
Balance - January 1, 2010	\$ 314,497	\$ 855,813	\$ 1,170,310
Additions	1,559	14,945	16,504
Disposals	-	-	-
Balance - December 31, 2010	\$ 316,056	\$ 870,758	\$ 1,186,814
Additions	64,038	4,920	68,958
Disposals	(112,191)	-	(112,191)
Balance - December 31, 2011	\$ 267,903	\$ 875,678	\$ 1,143,581
<b>Accumulated depreciation</b>			
Balance - January 1, 2010	\$ 213,880	\$ 764,792	\$ 978,672
Depreciation expense	27,927	79,169	107,096
Disposals	-	-	-
Balance - December 31, 2010	\$ 241,807	\$ 843,961	\$ 1,085,768
Depreciation expense	35,784	15,710	51,494
Disposals	(112,191)	-	(112,191)
Balance - December 31, 2011	\$ 165,400	\$ 859,671	\$ 1,025,071
<b>Net book value</b>			
January 1, 2010	\$ 100,617	\$ 91,021	\$ 191,638
December 31, 2010	\$ 74,249	\$ 26,797	\$ 101,046
December 31, 2011	\$ 102,503	\$ 16,007	\$ 118,510



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**8. Insurance contracts**

Due from reinsurers	2011	2010
	<u>2011</u>	<u>2010</u>
Balance, beginning of the year	\$ 148,367	\$ 65,876
Submitted to reinsurer	713,948	2,527,245
Received from reinsurer	<u>(585,956)</u>	<u>(2,444,754)</u>
Balance, end of the year	<u>\$ 276,359</u>	<u>\$ 148,367</u>
Expected settlement		
Within one year	<u>\$ 275,790</u>	<u>\$ 11,982</u>
More than one year	<u>\$ 569</u>	<u>\$ 136,385</u>

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

Reinsurers share of provision for unpaid claims	2011	2010
	<u>2011</u>	<u>2010</u>
Balance, beginning of the year	\$ 3,979,833	\$ 3,717,322
New claims reserve	2,314,940	2,933,977
Change in prior year's reserve	(851,139)	(144,221)
Submitted to reinsurer	<u>(713,948)</u>	<u>(2,527,245)</u>
Balance, end of the year	<u>\$ 4,729,686</u>	<u>\$ 3,979,833</u>
Expected settlement		
Within one year	<u>\$ 571,337</u>	<u>\$ 515,993</u>
More than one year	<u>\$ 4,158,349</u>	<u>\$ 3,463,840</u>

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**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
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**December 31, 2011**

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**8. Insurance contracts (cont'd)**

Deferred policy acquisition expenses	2011	2010
	<u>2011</u>	<u>2010</u>
Balance, beginning of the year	\$ 502,835	\$ 467,298
Acquisition costs incurred	1,065,642	1,017,897
Expensed during the year	(1,037,709)	(982,360)
	<u>(1,037,709)</u>	<u>(982,360)</u>
Balance, end of the year	\$ 530,768	\$ 502,835
	<u>\$ 530,768</u>	<u>\$ 502,835</u>

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

Unearned premiums	2011	2010
	<u>2011</u>	<u>2010</u>
Balance, beginning of the year	\$ 6,412,256	\$ 5,878,856
Premiums written	13,688,950	13,066,731
Premiums earned during year	(13,310,342)	(12,533,331)
	<u>(13,310,342)</u>	<u>(12,533,331)</u>
Balance, end of the year	\$ 6,790,864	\$ 6,412,256
	<u>\$ 6,790,864</u>	<u>\$ 6,412,256</u>

**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
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**8. Insurance contracts (cont'd)**

The following is a summary of the insurance contract provisions and related reinsurance assets at December 31.

	December 31, 2011			December 31, 2010			January 1, 2010		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Outstanding claims provision									
Long term	\$ 6,328,405	\$ 2,719,849	\$ 3,608,556	\$ 6,767,146	\$ 2,138,840	\$ 4,628,306	\$ 7,586,523	\$ 2,437,321	\$ 5,149,202
Short term	2,076,057	571,337	1,504,720	1,049,893	515,993	533,900	575,798	18,001	557,797
Facility Association and other residual pools	472,853	-	472,853	490,922	-	490,922	470,436	-	470,436
	8,877,315	3,291,186	5,586,129	8,307,961	2,654,833	5,653,128	8,632,757	2,455,322	6,177,435
Provision for claims incurred but not reported	3,248,500	1,438,500	1,810,000	3,306,500	1,325,000	1,981,500	3,594,000	1,262,000	2,332,000
	<b>\$12,125,815</b>	<b>\$ 4,729,686</b>	<b>\$ 7,396,129</b>	<b>\$ 11,614,461</b>	<b>\$ 3,979,833</b>	<b>\$ 7,634,628</b>	<b>\$ 12,226,757</b>	<b>\$ 3,717,322</b>	<b>\$ 8,509,435</b>

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**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
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December 31, 2011

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**8. Insurance contracts (cont'd)**

**Comments and assumptions for specific claims categories**

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.

**Claims and adjustment expenses**

Changes in claim liabilities recorded in the statement of financial position for the years ended December 31, 2011 and 2010 and their impact on claims and adjustment expenses for the two years are as follow:

	<u>2011</u>	<u>2010</u>
Unpaid claim liabilities - beginning of year - net of reinsurance	\$ 7,634,628	\$ 8,509,435
Decrease in estimated losses and expenses, for losses occurring in prior years	(3,061,762)	(2,411,691)
Provision for losses and expenses on claims occurring in the current year	9,930,826	5,979,537
Payment on claims:		
Current year	(5,977,464)	(3,220,686)
Prior years	<u>(1,130,099)</u>	<u>(1,221,967)</u>
Unpaid claims - end of year - net	7,396,129	7,634,628
Reinsurer's share and subrogation recoverable	<u>4,729,686</u>	<u>3,979,833</u>
	<u>\$12,125,815</u>	<u>\$ 11,614,461</u>

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

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**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
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**December 31, 2011**

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**8. 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.

**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 tables that follow present the development of claims payments and the estimated ultimate cost of claims for the claim year 2007 to 2011. The tables show 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 2011, 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 is included.

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8. Insurance contracts (cont'd)

Gross claims	2007	2008	2009	2010	2011	Total
Gross estimate of cumulative claims cost						
At the end year of claim	\$ 8,761,584	\$ 11,470,647	\$ 8,507,858	\$ 8,913,514	\$ 11,865,980	
One year later	9,473,680	9,786,728	7,196,376	8,558,935		
Two years later	9,068,841	8,655,600	5,361,577			
Three years later	9,137,483	8,002,676				
Four years later	8,887,857					
Current estimate of cumulative claims cost	8,887,857	8,002,676	5,361,577	8,558,935	11,865,980	42,677,025
Cumulative payments	8,141,020	7,916,917	4,072,573	4,963,412	5,977,464	31,071,386
Outstanding claims	\$ 746,837	\$ 85,759	\$ 1,289,004	\$ 3,595,523	\$ 5,888,516	11,605,639
Outstanding claims 2006 and prior						520,176
Total gross outstanding claims and claims handling expense						<u>\$ 12,125,815</u>
Net of Reinsurance	2007	2008	2009	2010	2011	Total
Net estimate of cumulative claims cost						
At the end year of claim	\$ 6,933,378	\$ 8,575,855	\$ 7,459,571	\$ 5,979,537	\$ 8,051,643	
One year later	6,982,347	7,395,606	6,256,745	5,365,280		
Two years later	6,783,531	6,836,067	4,923,555			
Three years later	6,761,393	6,413,599				
Four years later	6,473,952					
Current estimate of cumulative claims cost	6,473,952	6,413,599	4,923,555	5,365,280	8,051,643	31,228,029
Cumulative payments	5,896,210	6,356,340	4,072,573	3,925,549	4,098,281	24,348,953
Outstanding claims	\$ 577,742	\$ 57,259	\$ 850,982	\$ 1,439,731	\$ 3,953,362	6,879,076
Outstanding claims 2006 and prior						517,053
Total net outstanding claims and claims handling expense						<u>\$ 7,396,129</u>

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**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
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**December 31, 2011**

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**9. Other provisions and contingent liabilities**

In common with the insurance industry in general, the Company is subject to litigation arising in the normal course of conducting its insurance business which is taken into account in establishing the provision for unpaid claims and adjustment expenses. There are no outstanding provisions in the current year.

The Company is a member of the Farm Mutual Reinsurance Plan Inc. ("the Plan"), which is a general reinsurer that shares in the insurance risks originally accepted by member insurance companies. As a member of the Plan, the Company may be required to contribute additional capital to the Plan in the form of subordinated debt should the Plan's capital fall below a prescribed minimum.

**10. Pension Plan**

The Company makes contributions to the Ontario Mutual Insurance Association Pension Plan, which is a multiple employer plan, on behalf of members of its staff. The plan is a money purchase plan, with a defined benefit option at retirement available to some employees, which specifies the amount of the retirement benefit plan to be received by the employees based on length of service and rates of pay. However, the plan is accounted for as a defined contribution plan as insufficient information is available to account for the plan as a defined benefit plan. The Company is only one of a number of employers that participates in the plans and the financial information provided to the Company on the basis of the contractual agreements is insufficient to reliably measure the Company's proportionate share in the plan assets and liabilities using defined benefit accounting requirements.

The amount contributed to the plan for 2011 was \$231,879 (2010 - \$222,265). The contributions were made for current service and these have been recognized in comprehensive income.

A payment of \$223,844 was also made in 2011 for the Company's share of the pension plan deficit that existed for the year ended December 31, 2010 based on an actuarial valuation. The Company had accrued \$230,000 at December 31, 2010 for the December 31, 2010 pension plan deficit. The next actuarial valuation is planned for the three years ending December 31, 2013.

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SOUTH EASTHOPE MUTUAL INSURANCE COMPANY  
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December 31, 2011

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11. Income taxes

The Company is subject to income taxes on that portion of its income derived from insuring other than farm related risks.

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

	2011	2010
Current tax expense		
Based on current year taxable income	\$ 390,287	\$ 728,375
Adjustments for over / under provision in prior periods	-	(20,489)
	<u>390,287</u>	<u>707,886</u>
Deferred tax expense		
Origination and reversal of temporary differences	43,526	4,557
Reduction in tax rate	(3,270)	16,200
	<u>40,256</u>	<u>20,757</u>
Total income tax expense	<u>\$ 430,543</u>	<u>\$ 728,643</u>



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**11. Income taxes (cont'd)**

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory tax rate of 25.6% (2010 - 31%) are as follows:

	<u>2011</u>	<u>2010</u>
Income before taxes	\$ 2,810,266	\$ 4,090,410
Expected taxes based on the statutory rate of 25.6% (2010 - 31%)	719,428	1,268,027
Income from insuring farm related risks	(183,214)	(485,728)
Income from dividends	(52,234)	(52,599)
Other non deductible expenses	7,582	11,136
Market to market and other adjustments related to investments	(54,558)	(1,860)
Change in deferred tax rates on temporary differences	(13,855)	(10,760)
Over (under) provision in prior years	-	(20,489)
Other	7,394	20,916
Total income tax expense	<u>\$ 430,543</u>	<u>\$ 728,643</u>

Changes to the federal and provincial tax rates were announced in 2011 which resulted in an adjustment to the opening carrying value of temporary differences. The reduction in deferred income tax payable is reflected in deferred income taxes.

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11. Income taxes (cont'd)

The movement in 2011 deferred tax liabilities and assets are:

	Opening balance at Jan 1, 2011	Recognize in net income	Closing Balance at Dec 31, 2011
<b>Deferred tax liabilities</b>			
Adjustments related to investments	\$ (67,400)	\$ 6,700	\$ (60,700)
<b>Deferred tax assets</b>			
Property, plant & equipment	48,900	(4,300)	44,600
Intangible assets	9,300	3,300	12,600
Claims liabilities	68,400	(3,700)	64,700
Other	43,946	(42,256)	1,690
	<u>170,546</u>	<u>(46,956)</u>	<u>123,590</u>
2011 net deferred tax asset movement	\$ 103,146	\$ (40,256)	\$ 62,890

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11. Income taxes (cont'd)

The movement in 2010 deferred tax liabilities and assets are:

	Opening balance at Jan 1, 2010	Recognize in net income	Closing Balance at Dec 31, 2010
Deferred tax liabilities			
Intangible assets	\$ (7,200)	\$ 16,500	\$ 9,300
Adjustments related to investments	(96,700)	29,300	(67,400)
	(103,900)	45,800	(58,100)
Deferred tax assets			
Property, plant & equipment	\$ 55,400	\$ (6,500)	\$ 48,900
Claims liabilities	170,000	(101,600)	68,400
Other	2,403	41,543	43,946
	227,803	(66,557)	161,246
2010 net deferred tax asset movement	\$ 123,903	\$ (20,757)	\$ 103,146

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**12. Other operating and administrative expenses**

	2011	2010
Depreciation	\$ 97,181	\$ 127,281
Computer costs	88,209	46,129
Licenses, fees and dues	48,418	55,227
Postage and office supplies	128,194	126,239
Professional fees	39,509	40,708
Repairs and maintenance	9,066	10,527
Salaries, benefits and directors fees	324,146	495,892
Utilities	23,787	22,008
Other	437,651	399,572
	<u>\$ 1,196,161</u>	<u>\$ 1,323,583</u>

**13. Salaries, benefits and directors fees**

	2011	2010
Sales salaries, commissions and benefits	\$ 1,288,608	\$ 1,718,189
Other salaries and benefits	507,516	721,379
Directors fees	110,961	101,475
	<u>\$ 1,907,085</u>	<u>\$ 2,541,043</u>

**14. Subsidiary operations**

	2011	2010
Revenue	\$ 1,220,294	\$ 1,360,698
Expenses		
Salaries and benefits	989,372	948,950
Amortization	96,431	128,014
General and administrative	267,953	246,918
Premise expenses	103,954	67,037
	<u>1,457,710</u>	<u>1,390,919</u>
	<u>\$ (237,416)</u>	<u>\$ (30,221)</u>

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15. Investment and other income

	2011	2010
Interest income	\$ 1,317,527	\$ 1,100,751
Dividend income	221,358	183,232
Realized gains on disposal of investments	-	399,957
Unrealized gains (losses) on investments	(69,759)	685,285
Investment expenses	(111,821)	(97,545)
Rental income	16,800	16,800
	<u>\$ 1,374,105</u>	<u>\$ 2,288,480</u>

16. Commitments

During the year, the Company entered into an operating lease for some of its computer hardware. The equipment is leased at \$9,072 per month under a lease expiring in October 2014.

The Company also entered into a building lease at \$500 per month under a lease that will expire May 2012.

During the year, the Company's subsidiary entered into three operating leases for some of its computer hardware. The equipment is leased at \$1,503 per month under the lease expiring in December 2013, \$3,189 per month under the lease expiring in October 2014 and \$2,149 per month under the lease expiring in October 2016.

The company's subsidiary entered into a building lease which commenced in February 2011 and will expire in January 2021.

The minimum annual lease payments for the next five years is as follows:

2012	\$ 34,287
2013	\$ 34,961
2014	\$ 35,682
2015	\$ 36,407
2016	\$ 37,136

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**17. 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:

	2011	2010
Short term employee benefits and directors' fees	\$ 643,115	\$ 572,142
Total pension and other post-employment benefits	88,238	113,334
	<u>\$ 731,353</u>	<u>\$ 685,476</u>
Premiums written	\$ 88,535	\$ 85,401
Claims paid	\$ 25,996	\$ 14,961

Amounts owing to and from key management personnel at December 31, 2011 are \$24,223 (2010 - \$34,859, January 1, 2010 - \$23,770) and \$24,821 (2010 - \$24,256, January 1, 2010 - \$24,838) respectively. The amounts are included in due from policyholders and accounts payable and accrued liabilities on the statement of financial position.

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**18. 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 utilize capital allocations.

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%. During the year, the Company has consistently exceeded this minimum. The regulator has the authority to request more extensive reporting and can place restrictions on the Company's operations if the Company falls below this requirement and the regulator deems it necessary.

The Company uses Net Risk Ratio (unappropriated members' surplus to gross premiums written) to monitor capital adequacy. The ratio the board of directors desires for the Company is 1.5:1 (150%) with a minimum not less than a 1:1 (100%). The Company's Net Risk Ratio at December 31, 2011 was 182% (2010, 158%).

The Company's objective is to maintain this ratio by increasing surplus in proportion to written premium. Accordingly, this ratio is the primary consideration in determining the amount of new business written, allocating new business budgets for agents and brokers and policyholder premium refunds in years the Company realizes an underwriting profit.

**19. Financial instrument and Insurance risk management**

*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 reinsurance 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.

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**19. Financial instrument and Insurance risk management (cont'd)**

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. 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 and reinsuring contracts of insurance which, in the main, limit the liability of the Company to an amount on any one claim of \$225,000 in the event of a property claim, an amount of \$200,000 in the event of an automobile claim and \$250,000 in the event of a liability claim. For amounts over the respective limits there is a 10% retention to a specified maximum. The Company also obtained reinsurance which limits the Company's liability to \$675,000 in the event of a series of claims arising out of a single occurrence. In addition, the Company has obtained stop loss reinsurance which limits the liability of all claims in a specific year to 80% of the gross net earned premiums incurred for property and automobile.

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, 2011 and 2010.

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, frequency of claims occurrence, expected loss ratios and claims development as described in Note 8.



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**19. Financial instrument and Insurance risk management (cont'd)**

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

	Property claims		Auto claims		Liability claims	
	2011	2010	2011	2010	2011	2010
5% change in loss ratios would result in the following increase/decrease:						
Gross	\$ 307,905	\$ 297,381	\$ 328,247	\$ 311,328	\$ 48,295	\$ 44,628
Net	\$ 260,742	\$ 249,173	\$ 273,531	\$ 260,405	\$ 30,459	\$ 27,113

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.

***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 debt holdings 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 bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The bond portfolio remains a very high quality with 100% of bonds rated A or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

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 the board and management prior to renewal of the reinsurance contract.

Accounts receivable are short-term in nature consisting of a large number of policyholders, and are not subject to material credit risk. Regular review of outstanding receivables is performed to ensure credit worthiness.

The maximum exposure to investment credit risk would be the fair value of the company's interest bearing securities investment.

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.

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19. Financial instrument and Insurance risk management (cont'd)

*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 Finance Committee and the Board of Directors. Diversification techniques are utilized to minimize risk. The Policy limits the investment in any one corporate issuer rated "AAA/AA" to a maximum of 5% and "A" to a maximum of 2.5% of the Company's fixed income portfolio. There is no single issuer limit on securities of the Government of Canada or of Provinces and guaranteed Crown Corporations rated A- or better.

The Company's investment policy limits investment in the Farm Mutual Canadian Fixed Income Pool Fund to a maximum of 50% of investible assets. Funds are invested in bonds and debentures of Federal, Provincial or Municipal Government and Canadian companies rated BBB or better. The fund is monitored by the Farm Mutual Pooled Fund Investment Committee appointed by the Ontario Mutual Insurance Association.

*Currency risk*

Currency risk relates to the Company operating in different currencies and converting non Canadian earnings at different points in time at different foreign exchange levels when adverse changes in foreign currency exchange rates occur.

The Company's foreign exchange risk is related to stock holdings which are limited to United States equities in sectors which are not readily available in Canada. The Company limits its holdings in foreign equity to 15% of the equity portfolio in accordance with its investment policy. Foreign currency changes are monitored by the investment committee and holdings are adjusted when offside of the investment policy. A 1% change in the value of the United States dollar would affect the fair value of stocks by \$10,400 which would be reflected in investment income.

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.

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19. Financial instrument and Insurance risk management (cont'd)

*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 this risk through its interest bearing investments (bonds and fixed income pooled funds).

At December 31, 2011, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds by \$510,000 (2010 - \$525,000). Also, a 1% move in interest rates, with all other variables held constant, could impact the market value of the fixed income pooled fund by \$566,200 (2010 - \$588,800). These changes would be recognized in comprehensive income.

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.

*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. At December 31, 2011, 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 Canadian common equities of \$775,000 (2010 - \$809,000). This change would be recognized in comprehensive income.

The Company's investment policy limits equity investments to 25% of total assets. Investment managers are mandated to follow the same conservative strategy that they have demonstrated to the Company since 1992. All stocks must be freely tradable and listed on a recognized stock exchange in Canada or the US. The Company investment policy limits the investment in any single issuer to a maximum of 15% by market value of the equity portfolio. In the 10 global classification sectors, sector weights are limited to a maximum of 35%. Holdings in the four economic sectors (Technology, Consumer, Energy/Industrials and Financials/Utilities) are maintained within 50% to 150% of the BMO/TSX CAP 10% index. The Investment Manager must suspend further sales when net realized losses in one quarter exceed \$40,000.

Equities are monitored by the Finance Committee and holdings are adjusted following each quarter to ensure holdings are in compliance with the investment policy.

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19. Financial instrument and Insurance risk management (cont'd)

*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. The Company's current liabilities arise as claims are made. The Company does not have material liabilities that can be called unexpectedly at the demand of a lender or client. The Company has 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 investment income.

The Company's investment policy requires that 2.5% to 7.5% of assets available for investments to be held in cash in an interest bearing demand account which includes a pre-approved line of credit to meet immediate cash flow requirements.

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.

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20. First time adoption of international financial reporting standards

IFRS 1, First Time Adoption of International Financial Reporting Standards, requires that comparative financial information be provided. As a result, the first date at which the Company has applied IFRS was January 1, 2010 (the "Transition Date"). IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Company will be December 31, 2011. Therefore, the financial statements for the year-ended December 31, 2011, the comparative information presented in these financial statements for the year-ended December 31, 2010 and the opening IFRS statement of financial position at January 1, 2010 are prepared in accordance with IFRS standards effective at the reporting date. However, IFRS also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

In preparing its opening IFRS statement of financial position, the Company has adjusted amounts reported previously in financial statements prepared in accordance with pre-changeover Canadian GAAP. An explanation of how the transition from pre-changeover Canadian GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following notes and tables.

*IFRS 1 exemptions and exceptions*

The IFRS 1 applicable exemptions and exceptions applied in the conversion from pre-changeover Canadian GAAP to IFRS are as follows:

Optional exemptions

*Business combinations*

The Company elected not to retrospectively apply IFRS 3, Business Combinations, to business combinations that occurred prior to its Transition Date and such business combinations have not been restated.

*Insurance contracts*

The Company has elected to apply the transitional provisions of IFRS 4, Insurance Contracts. IFRS 4 restricts the changes in accounting policies for insurance contracts.

*Fair value as deemed cost*

The Company has elected to measure land and buildings included in both investment property and property, plant and equipment at the Transition Date at its fair value and use that fair value as its deemed cost at that date.

*Designation of previously recognized financial instruments*

The Company elected to designate certain previously recognized financial instruments as fair value through profit and loss at the Transition Date. These designations differ from the financial instrument designations under pre-changeover Canadian GAAP.

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20. First time adoption of international financial reporting standards (cont'd)

Mandatory exceptions

*Derecognition of financial assets and liabilities*

The Company has applied the derecognition requirements in IAS 39, Financial Instruments: Recognition and Measurement, prospectively from the Transition Date. As a result any non-derivative financial assets or non-derivative financial liabilities derecognized prior to the Transition Date in accordance with pre-changeover Canadian GAAP have not been reviewed for compliance with IAS 39.

*Estimates*

The estimates previously made by the Company under pre-changeover Canadian GAAP were not revised for the application of IFRS except where necessary to reflect any difference in accounting policy or where there was objective evidence to re-evaluate those estimates. As a result the Company has not used hindsight to revise estimates.

**Reconciliation of equity and comprehensive income**

In preparing these financial statements, management has amended certain accounting policies previously applied in the pre-changeover Canadian GAAP financial statements to comply with IFRS. The comparative figures for 2010 were restated to reflect these adjustments. The following reconciliations and explanatory notes provide a description of the effect of the transition from pre-changeover Canadian GAAP to IFRS on members' surplus, net income and comprehensive income:

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**20. First time adoption of international financial reporting standards (cont'd)**

Statement of Financial Position for the year-ended January 1, 2010 - Transition Date

	Sub-note	Pre- changeover Canadian GAAP	Adjustments	IFRS
<b>Assets</b>				
Cash		\$ 4,591,099	\$ -	\$ 4,591,099
Investments	(i)	25,276,914	-	25,276,914
Investment income accrued		95,048	-	95,048
Due from reinsurers	(iv)	-	65,876	65,876
Due from policyholders		2,995,384	-	2,995,384
Reinsurers' share of provision for unpaid claims	(iv)	3,772,203	(54,881)	3,717,322
Other receivables	(iv)	42,921	(10,995)	31,926
Deferred policy acquisition expenses		467,298	-	467,298
Investment property	(ii)	-	165,220	165,220
Property, plant & equipment	(ii), (iii)	960,147	35,662	995,809
Intangible assets	(iii)	91,021	100,617	191,638
Other assets		11,162	-	11,162
Deferred income taxes	(v)	126,903	(3,000)	123,903
		<u>\$ 38,430,100</u>	<u>\$ 298,499</u>	<u>\$ 38,728,599</u>
<b>Liabilities</b>				
Accounts payable and accrued liabilities	(iii)	\$ 664,990	\$ 14,836	\$ 679,826
Provision for refund of premium		325,367	-	325,367
Income taxes payable		380,727	-	380,727
Unearned premiums		5,878,856	-	5,878,856
Provision for unpaid claims		12,226,757	-	12,226,757
		<u>19,476,697</u>	<u>14,836</u>	<u>19,491,533</u>
<b>Members' Surplus</b>				
Unappropriated members' surplus	(v)	17,847,098	1,389,968	19,237,066
Accumulated other comprehensive income	(i)	1,106,305	(1,106,305)	-
		<u>18,953,403</u>	<u>283,663</u>	<u>19,237,066</u>
		<u>\$ 38,430,100</u>	<u>\$ 298,499</u>	<u>\$ 38,728,599</u>

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**20. First time adoption of international financial reporting standards (cont'd)**

Statement of Financial Position for the year-ended December 31, 2010

	Sub-note	Pre- changeover Canadian GAAP	Adjustments	IFRS
<b>Assets</b>				
Cash		\$ 3,507,135	\$ -	\$ 3,507,135
Investments	(i)	29,273,860	-	29,273,860
Investment income accrued		89,094	-	89,094
Due from reinsurers	(iv)	-	148,367	148,367
Due from policyholders		3,277,762	-	3,277,762
Reinsurers' share of provision for unpaid claims	(iv)	4,065,314	(85,481)	3,979,833
Other receivables	(iv)	276,270	(62,887)	213,383
Deferred policy acquisition expenses		502,835	-	502,835
Investment property	(ii)	-	160,469	160,469
Property, plant & equipment	(ii), (iii)	947,322	23,320	970,642
Intangible assets	(iii)	26,797	74,249	101,046
Other assets		20,464	-	20,464
Deferred income taxes	(v)	101,146	2,000	103,146
		<u>\$ 42,087,999</u>	<u>\$ 260,037</u>	<u>\$ 42,348,036</u>
<b>Liabilities</b>				
Accounts payable and accrued liabilities		\$ 736,377	\$ -	\$ 736,377
Provision for refund of premium		686,348	-	686,348
Income taxes payable		295,836	-	295,836
Unearned premiums		6,412,256	-	6,412,256
Deferred revenue		3,925	-	3,925
Provision for unpaid claims		11,614,461	-	11,614,461
		<u>19,749,203</u>	<u>-</u>	<u>19,749,203</u>
<b>Members' Surplus</b>				
Unappropriated members' surplus	(vi)	20,635,405	1,963,428	22,598,833
Accumulated other comprehensive income	(i)	1,703,391	(1,703,391)	-
		<u>22,338,796</u>	<u>260,037</u>	<u>22,598,833</u>
		<u>\$ 42,087,999</u>	<u>\$ 260,037</u>	<u>\$ 42,348,036</u>



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**20. First time adoption of international financial reporting standards (cont'd)**

Statement of Comprehensive Income for the year-ended December 31, 2010

	Sub-note	Pre- changeover Canadian GAAP	Adjustments	IFRS
<b>Underwriting income</b>				
Gross premiums written		\$ 13,066,731	\$ -	\$ 13,066,731
Less reinsurance ceded		(2,332,912)	-	(2,332,912)
Net premiums written		10,733,819	-	10,733,819
Less increase in unearned premiums		(533,400)	-	(533,400)
Net premiums earned		10,200,419	-	10,200,419
Service charges		78,932	-	78,932
		10,279,351	-	10,279,351
<b>Direct losses incurred</b>				
Gross claims and adjustment expenses		7,262,413	-	7,262,413
Less reinsurers' share of claims and adjustment expenses		(2,790,971)	-	(2,790,971)
		4,471,442	-	4,471,442
		5,807,909	-	5,807,909
<b>Expenses</b>				
Fees, commissions and other acquisition expenses		1,991,884	-	1,991,884
Other operating and administrative expenses	(ii), (iii)	1,294,959	28,624	1,323,583
		3,286,843	28,624	3,315,467
Net underwriting income before refund		2,521,066	(28,624)	2,492,442
Refund of premium		660,291	-	660,291
Net underwriting income		1,860,775	(28,624)	1,832,151
Net loss from subsidiary		(30,221)	-	(30,221)
Investment and other income	(i)	1,603,194	685,286	2,288,480
Income before taxes		3,433,748	656,662	4,090,410
Provision for income taxes	(v)	(645,443)	(83,200)	(728,643)
Net income		2,788,305	573,462	3,361,767
<b>Other comprehensive income (net of tax)</b>				
Change in unrealized gain / losses on available-for-sale investments	(i), (v)	940,339	(940,339)	-
Reclassification of realized gains / losses on available-for-sale investments	(i), (v)	(343,253)	343,253	-
		597,086	(597,086)	-
Comprehensive income		\$ 3,385,391	\$ (23,624)	\$ 3,361,767

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**SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**  
**Consolidated Notes to Financial Statements**

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**December 31, 2011**

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**20. First time adoption of international financial reporting standards (cont'd)**

Statement of Comprehensive Income for the year-ended December 31, 2010

Where no adjustments were made certain amounts have been reclassified to match current presentation.

Statement of Cash Flows for the year-ended December 31, 2010

The transition to IFRS had no impact on total operating or financing activities on the statement of cash flows. The change in comprehensive income for year-ended December 31, 2010 has been offset by adjustments to operating activities.

Explanations for the adjustments are as follows:

(i) Investments

Under pre-changeover Canadian GAAP, the Company classified all investments as available-for-sale. Upon transition to IFRS the company changed the classification to fair value through profit and loss. The change in classification of these investments has no impact on the amount recognized on the statement of financial position, however, unrealized gains / losses of \$1,106,305 at January 1, 2010 have been reclassified from accumulated other comprehensive income to unappropriated members surplus.

For the year-ended December 31, 2010 the change in unrealized gain / loss on available-for-sale investments and the reclassification of realized gains / losses on available-for-sale investments have been adjusted by \$940,339 and \$(343,253) respectively, with corresponding adjustments of \$685,286 to investment income and \$88,200 to the provision for income taxes as a result of the change in classification of these financial instruments.

(ii) Investment property

IFRS requires property that is held to earn rental income or capital appreciation or both to be accounted for separately from property used in the ordinary supply of services or for administrative purposes. A similar concept did not exist under pre-changeover Canadian GAAP. As a result land, buildings and furniture and fixtures that had a net book value of \$20,220 at January 1, 2010 (December 31, 2010 - \$20,719) under pre-changeover Canadian GAAP has been reclassified to investment property. In addition, the company elected to use the fair value of the investment property at January 1, 2010 as its deemed cost. The fair value adjustment of \$145,000 at January 1, 2010 has been recorded in unappropriated members' surplus. Using the fair value as deemed cost election also increases the amount subject to depreciation. As a result depreciation expense for the year-ended December 31, 2010 has been increased by \$5,250.

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**20. First time adoption of international financial reporting standards (cont'd)**

Explanations for the adjustments are as follows (cont'd):

**(iii) Property, plant & equipment**

The Company elected to use the fair value as deemed cost election for certain land and buildings. The fair value adjustment of \$141,663 at January 1, 2010 has been recorded in unappropriated members' surplus. The fair value as deemed cost election also increases the amount subject to depreciation. As a result depreciation expense for the year-ended December 31, 2010 has been increased by \$5,203.

The Company reclassified computer software to intangible assets on the transition to IFRS.

The Company adjusted the depreciation policy for computer software to 3 years from the 5 used under pre-changeover Canadian GAAP. As a result the cost base increased \$14,836 and depreciation expense for the year-ended December 31, 2010 has been increased by \$28,577.

**(iv) Reclassification of various amounts**

To comply with disclosure requirements of IFRS 4 the Company has reclassified any amounts due from reinsurers from reinsurers' share of provision for unpaid claims and other receivables.

**(v) Deferred income taxes**

As a result of the transition to IFRS the carrying amounts of various assets and liabilities have been adjusted (see (i) to (vi) above). There has not been a corresponding change to the tax basis of these assets and liabilities. As a result an adjustment \$(3,000) is required to deferred taxes at January 1, 2010. Details of the various deferred tax liabilities at January 1 and December 31, 2010 and the corresponding amounts recorded in comprehensive income for the year-ended December 31, 2010 are provided in Note 11.

**(vi) Unappropriated members surplus**

The following table outlines the adjustments to unappropriated members' surplus:

	December 31, 2010	January 1, 2010
Previous year balance	\$ 283,663	\$ -
Investment property (ii)	(5,250)	145,000
Property, plant & equipment (iii)	(23,376)	141,663
Deferred income taxes (iv)	5,000	(3,000)
	<u>\$ 260,037</u>	<u>\$ 283,663</u>