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INDEPENDENT AUDITOR'S REPORT

To the Policyholders of Grenville Mutual Insurance Company

We have audited the accompanying financial statements of Grenville Mutual Insurance Company, which comprise the statement of financial position as at December 31, 2012, and the statement of comprehensive income, statement of policyholders' equity and statement of 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 of 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 in our audit 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 Grenville Mutual Insurance Company as at December 31, 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Bennett Lewis McMahon Stillar

Chartered Accountants, Licensed Public Accountants

February 6, 2013
Brockville, Canada

GRENVILLE MUTUAL INSURANCE COMPANY

Statement of Financial Position

December 31, 2012, with comparative figures for 2011

	2012	2011
		(as restated - note 2)
Assets		
Cash	$ 1,081,231	$ 2,112,946
Investments (note 6)	39,656,976	39,788,732
Accrued investment income	263,391	300,798
Premiums uncollected	7,234,249	7,354,989
Due from other insurers	42,841	164,290
Income taxes recoverable	–	13,689
Receivable from employees	4,703	6,197
Recoverable subrogation of claims	725,000	758,656
Unpaid claims and adjusting expenses recoverable from reinsurer (note 11)	11,530,926	11,333,969
Prepaid expenses	96,769	64,993
Refundable construction deposit	126,430	–
Deferred policy acquisition expenses (note 11)	2,062,785	2,092,865
Loan receivable from a broker (note 7(a))	210,589	–
Assets held for resale (note 8)	597,348	–
Property and equipment (note 9)	7,318,434	802,099
Intangible assets (note 10)	909,286	795,995
Deferred income taxes	–	48,000
	$ 71,860,958	$ 65,638,218
Liabilities		
Accounts payable and accrued liabilities	$ 2,702,794	$ 809,860
Income taxes payable	606,443	–
Unearned premiums (note 11)	11,298,488	11,488,447
Provision for unpaid claims and adjusting expenses (note 11)	21,965,010	21,363,541
Deferred income taxes	31,000	–
	36,603,735	33,661,848
Policyholders' Equity (note 2)	35,257,223	31,976,370
	$ 71,860,958	$ 65,638,218

See accompanying notes to financial statements.

On behalf of the Board:

Director

Director

GRENVILLE MUTUAL INSURANCE COMPANY

Statement of Comprehensive Income

Year ended December 31, 2012, with comparative figures for 2011

	2012	2011
		(as restated - note 2)
Underwriting income:		
Premiums written	$ 22,735,814	$ 22,893,824
Decrease (increase) in unearned premiums	189,959	(923,093)
	22,925,773	21,970,731
Premiums ceded to reinsurer	(4,326,475)	(3,920,408)
Net premiums earned	18,599,298	18,050,323
Claims incurred:		
Gross claims and adjusting expenses (note 12)	14,753,280	22,019,344
Less reinsurer's share of claims and adjusting expenses	(5,607,294)	(8,473,224)
	9,145,986	13,546,120
	9,453,312	4,504,203
Expenses:		
Commissions	4,668,543	3,972,200
Premium taxes	75,883	74,988
Management and administrative salaries and benefits (note 13)	1,336,598	1,135,942
Directors fees and travel	220,829	158,377
Risk management	35,608	46,406
Professional and consulting fees	127,925	81,364
Advertising	105,774	84,591
Postage and telephone	60,354	57,499
Printing, stationery and office supplies	90,048	96,416
Training and meetings	37,552	48,916
Insurance	48,225	50,137
Licences and association fees	122,172	121,227
Building (note 14)	93,268	79,690
Furniture and office equipment depreciation	10,870	11,242
Computer operations and statistical information (note 15)	512,194	372,970
Bank and payroll service charges	45,132	42,938
Other	70,247	62,167
Amortization of customer relationship acquired (note 10)	16,087	–
	7,677,309	6,497,070
Net underwriting income (loss)	1,776,003	(1,992,867)
Other income (expenses):		
Investment income, net of investment expenses (note 16)	1,938,250	1,531,454
Community support program donations	(19,430)	(19,095)
Gain (loss) on disposal of equipment	(19,012)	7,030
Impairment loss on office premises (note 8)	119,194	(119,194)
	2,019,002	1,400,195
Income (loss) before income taxes	3,795,005	(592,672)
Income taxes (note 17):		
Current (recovery)	435,152	(98,112)
Deferred	79,000	(23,000)
	514,152	(121,112)
Net comprehensive income (loss)	$ 3,280,853	$ (471,560)

See accompanying notes to financial statements.

GRENVILLE MUTUAL INSURANCE COMPANY

Statement of Policyholders' Equity

Year ended December 31, 2012, with comparative figures for 2011

	2012	2011
Balance, beginning of year:		
As previously reported	$ 30,899,370	$ 31,522,930
Restatement to correct prior years' deferred policy acquisition expenses (note 2)	1,077,000	925,000
As restated	31,976,370	32,447,930
Net comprehensive income (loss)	3,280,853	(471,560)
Balance, end of year	$ 35,257,223	$ 31,976,370

Statement of Cash Flows

Year ended December 31, 2012, with comparative figures for 2011

	2012	2011 (as restated - note 2)
Cash provided by (used for):		
Operations:		
Net comprehensive income (loss)	$ 3,280,853	$ (471,560)
Items not involving cash:		
Depreciation of property and equipment	138,339	140,380
Amortization of intangible assets	338,721	204,101
Amortization of discounts and premiums on bonds and debentures	55,194	49,039
Discount on loan receivable	13,454	–
Loss (gain) on investments	(389,363)	326,694
Loss (gain) on disposal of equipment	19,012	(7,030)
Impairment loss on office premises (reversal)	(119,194)	119,194
Deferred income taxes	79,000	(23,000)
	3,416,016	337,818
Change in working capital (note 18)	2,548,157	(1,437,335)
Change in insurance contract related balances (note 18)	366,082	2,290,925
	6,330,255	1,191,408
Investments:		
Loan advanced to broker	(250,000)	–
Principal received on loan receivable	25,957	–
Additions to property and equipment	(7,152,625)	(103,204)
Proceeds on disposal of equipment	785	16,440
Additions to intangible assets	(452,012)	(271,027)
Purchase of investments	(4,121,036)	(3,147,027)
Proceeds on sale of investments	4,586,961	3,508,067
	(7,361,970)	3,249
Increase (decrease) in cash	(1,031,715)	1,194,657
Cash, beginning of year	2,112,946	918,289
Cash, end of year	$ 1,081,231	$ 2,112,946

See accompanying notes to financial statements.

The Company is incorporated without share capital under the laws of Ontario as a mutual insurance company. The Company is subject to the Insurance Act (Ontario) and is licensed to write all classes of insurance other than life and surety in Ontario. The Company is subject to regulation by the Financial Services Commission of Ontario.

These financial statements have been authorized for issue by the Board of Directors on February 6, 2013.

1. Summary of significant accounting policies:

(a) Basis of accounting:

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

(b) Financial instruments:

The Company classifies its financial instruments into the following categories: held to maturity, fair value through profit or loss, and loans and receivables.

The classification of investments is determined by management at initial recognition and depends on the purpose for which the investments were acquired. All transactions related to financial instruments are recorded on a trade date basis.

(i) Bonds and debentures:

Investments in bonds and debentures are classified as held-to-maturity financial assets and are carried at amortized cost with premiums and discounts amortized using the effective interest rate method.

(ii) Marketable common and preferred shares, pooled funds and mutual funds:

Management has designated to voluntarily classify its investments in marketable common and preferred shares, pooled funds and mutual funds at fair value through profit and loss. These investments are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition. Subsequently these investments are carried at fair value, fair value is not reliably determinable, in which case they are carried at cost. Fair values are determined by reference to published price quotations in an active market. Dividend income on common and preferred shares is accrued on the ex-dividend date. Gains and losses are reflected in net comprehensive income for the period in which they arise.

(iii) Loan receivable from a broker:

Loan receivable from a broker is classified as loans and receivable and is measured at amortized cost using the effective interest method.

1. Summary of significant accounting policies (continued):

(b) Financial instruments (continued):

(iv) Other investments:

The Fire Mutuals Guarantee Fund is carried at cost, less provision for permanent decline in value (where appropriate) as the fair value is not reasonably determinable and there is no active market for trading this investment.

(v) Transaction costs:

Transaction costs associated with the acquisition and disposal of investments are capitalized and are included in the acquisition costs or reduced proceeds on disposal. Investment management fees are expensed as incurred.

(c) Property and equipment:

Property and equipment is initially recorded at cost and subsequently measured at cost less depreciation and accumulated impairment losses, with the exception of land which is not depreciated. Depreciation is recognized in net comprehensive income and is provided using the following methods and annual rates:

Asset	Method	Rate
Office premises	Straight-line	2 1/2%
Parking lot	Straight-line	5%
Building service equipment, acquired prior to 2012	Declining balance	20%
Building service equipment, acquired after 2011	Straight-line	5% - 10%
Furniture and office equipment, acquired prior to 2012	Declining balance	20%
Furniture and office equipment, acquired after 2011	Straight-line	20%
Computer equipment	Straight-line	33 1/3%
Automobiles	Declining balance	30%

Amortization methods, rates and residual values are reviewed annually and adjusted if necessary.

(d) Intangible assets:

(i) Computer software:

Costs associated with maintaining computer software programs are recognized as an expense as incurred. Costs that are directly attributable to the design and testing of identifiable computer software are recognized as intangible assets when the costs can be measured reliably, the product is feasible, future economic benefits are probable and the Company intends to and has sufficient resources to complete the development and use the asset. The expenditures capitalized include the cost of software development, testing and implementation. Computer software is not amortized until such time as the asset is available for use, after which it is amortized on a straight-line basis over its useful life which is 3 years. Amortization is included in computer operations and statistical information expenses in the statement of comprehensive income.

1. Summary of significant accounting policies (continued):

(d) Intangible assets (continued):

(ii) Customer relationships acquired:

Customer relationships result from the purchasing of a book of business from an exclusive agent and is recorded at cost. The Company amortizes this asset on a straight-line basis over the estimated useful life of the asset which is 6 years. The estimated useful life is re-evaluated annually.

(e) Impairment of non-financial assets:

Property and equipment and intangible 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.

(f) Insurance contracts:

In accordance with IFRS 4, Insurance Contracts, the Company has continued to apply the accounting policies it applied in accordance with Canadian generally accepted accounting principles in effect prior to the adoption of IFRS.

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

(i) Premiums and unearned premiums:

Premiums written comprise the premiums on contracts commencing (or renewing) in the financial year. Premiums written are stated gross of commissions payable to agents and exclusive of taxes levied on premiums.

Insurance premiums are included in income on a daily pro rata basis over the terms of the policies. The portion of the premiums related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums.

1. Summary of significant accounting policies (continued):

(f) Insurance contracts (continued):

(ii) Deferred policy acquisition expenses:

Acquisition expenses related to unearned premiums, which include commissions and premium taxes, are deferred and charged to expense over the periods in which the premiums are earned. The amount of the deferral is limited to its realizable value by giving consideration to investment income as well as claims and adjusting expenses expected to be incurred as the premiums are earned.

(iii) Provision for unpaid claims and adjusting expenses:

The provision for unpaid claims and adjusting expenses represents an estimate for the full amount of all costs, including investigation and the projected final settlements, of claims reported and for claims incurred but not reported. These estimates of future loss activity are subject to uncertainty and are selected from a wide range of possible outcomes based on past experience and business in force. These provisions are adjusted, up or down, as additional information affecting the estimated amounts becomes known during the course of claims settlement. All changes in estimates are recorded as incurred claims in the current period.

The Company does not consider the time value of money or actuarially determined estimates of uncertainty when calculating this provision.

The Company also makes provisions for recovery from subrogation of claims, which are recorded as reductions in claims and adjusting expenses. These provisions are also adjusted, up or down, as additional information affecting the estimated amounts becomes known during the course of settlement. All changes in estimates are recorded as incurred claims in the current period.

(iv) 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 statement of comprehensive income initially by writing off the deferred policy acquisition expenses and subsequently by recognizing an additional claims liability for claims provisions.

(v) Reinsurance ceded and reinsurer's share of provisions for unpaid claims and adjusting 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 ceded are calculated based on earned premiums. 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.

Reinsurance recoveries on unpaid claims and adjusting expenses are recognized as assets at the same time that the Company recognizes the related liabilities.