

# Sentinel Security Life Insurance Company

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CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

*For the Years Ended December 31, 2013 and 2012*



# SENTINEL SECURITY LIFE INSURANCE COMPANY

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## Independent Auditor's Report

The Board of Directors  
**Sentinel Security Life Insurance Company**

We have audited the accompanying consolidated financial statements of **Sentinel Security Life Insurance Company**, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall 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 referred to above present fairly, in all material respects, the financial position of **Sentinel Security Life Insurance Company** as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Larson & Company PC*

Salt Lake City, Utah  
September 18, 2014

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Consolidated Balance Sheets  
As of December 31, 2013 and 2012

	2013	2012
<b><u>Assets</u></b>		
<b>Investments:</b>		
Bonds held to maturity, at amortized cost	\$ 10,192,442	\$ 1,865,655
Bonds withheld for reinsurance, at estimated fair value (amortized cost: \$243,953,447 and \$245,348,466, respectively)	256,173,942	260,178,510
Bonds available for sale, at estimated fair value, (amortized cost: \$113,045,618 and \$96,691,551, respectively)	113,979,061	102,114,555
Preferred stock withheld for reinsurance, at estimated fair value (cost value: \$2,000,000 and \$2,000,000, respectively)	2,018,000	2,030,000
Preferred stock available for sale at estimated fair value, (cost value: \$4,907,321 and \$4,847,901, respectively)	4,573,032	4,519,442
Common stock, at fair market value	237,877	2,823,267
Mortgage loans, amortized cost	1,628,444	2,017,579
Policy loans	1,324,839	1,238,189
<b>Total investments</b>	390,127,637	376,787,197
Cash and cash equivalents, at estimated fair value	3,847,462	15,773,792
Cash and cash equivalents withheld for reinsurance, at estimated fair value	9,648,034	3,477,631
Accrued investment income	1,242,878	906,037
Premiums, reinsurance, and other receivables, net of uncollectable agent balances	3,860,825	4,419,025
Deferred policy acquisition costs	11,258,867	8,215,688
Current income tax recoverable	674,584	344,448
Property and equipment, net	7,389,180	2,890,382
Deferred income tax asset	978,236	183,723
Other assets	799,831	287,555
<b>Total assets</b>	\$ 429,827,534	\$ 413,285,478
<b><u>Liabilities and Stockholders' Equity</u></b>		
<b>Liabilities:</b>		
Future policy benefits and policyholder account balances	\$ 125,739,696	\$ 111,032,856
Other policy-related balances	1,299,213	1,968,076
Payables and accrued liabilities	10,937,812	4,090,884
Funds held under reinsurance treaties	264,503,221	265,944,276
Unearned investment income	32,065	27,586
<b>Total liabilities</b>	402,512,007	383,063,678
<b>Stockholders' equity:</b>		
Common stock, \$4 and \$7 par value; 10,000,000 and 500,000 shares authorized; 359,526 and 359,526 issued, and 295,136 and 290,598 outstanding as of December 31, 2013 and 2012, respectively	1,438,104	2,516,685
Treasury stock	(1,257,771)	(1,416,215)
Additional paid-in capital	1,279,810	201,229
Retained earnings	25,451,316	25,557,111
Accumulated other comprehensive income	459,431	3,362,990
Noncontrolling interest	(55,363)	-
<b>Total stockholders' equity</b>	27,315,527	30,221,800
<b>Total liabilities and stockholders' equity</b>	\$ 429,827,534	\$ 413,285,478

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

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Consolidated Statements of Income  
For the Years Ended December 31, 2013 and 2012

	2013	2012
<b>Revenues:</b>		
Premiums	\$ 17,097,384	\$ 70,283,202
Commission revenue	11,364	-
Net investment income	5,830,410	4,512,832
<b>Total</b>	<b>22,939,158</b>	<b>74,796,034</b>
<b>Net investment gains:</b>		
Realized investment gains	1,634,853	785,940
<b>Total net investment gains</b>	<b>1,634,853</b>	<b>785,940</b>
Other revenues	8,942	1,986
<b>Total revenues</b>	<b>24,582,953</b>	<b>75,583,960</b>
<b>Expenses:</b>		
Policyholder benefits and claims and adjustments to policyholder accounts	16,867,815	69,189,283
Other expenses	7,143,936	4,188,312
<b>Total expenses</b>	<b>24,011,751</b>	<b>73,377,595</b>
<b>Net income before provision for income taxes</b>	<b>571,202</b>	<b>2,206,365</b>
Provision for income taxes	(267,729)	(576,249)
<b>Consolidated net income</b>	<b>303,473</b>	<b>1,630,116</b>
<b>Net loss attributable to the noncontrolling interest</b>	<b>(55,363)</b>	<b>-</b>
<b>Net income attributable to the controlling interest</b>	<b>\$ 358,836</b>	<b>\$ 1,630,116</b>

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

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Consolidated Statements of Comprehensive Income  
For the Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Net income	\$ 358,836	\$ 1,630,116
<b>Other comprehensive income (loss):</b>		
Unrealized investment gains (losses) arising during period	(2,764,479)	5,656,400
Less reclassification adjustment for gains included in net income	<u>(1,634,853)</u>	<u>(785,940)</u>
<b>Other comprehensive income (loss) before income tax</b>	(4,399,332)	4,870,460
Income tax expense (benefit) related to items of other comprehensive income (loss)	<u>(1,495,773)</u>	<u>1,655,956</u>
<b>Other comprehensive income (loss) net of income tax</b>	<u>(2,903,559)</u>	<u>3,214,504</u>
<b>Total comprehensive income (loss)</b>	<u>\$ (2,544,723)</u>	<u>\$ 4,844,620</u>

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

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Consolidated Statements of Changes in Stockholders' Equity  
For the Years Ended December 31, 2013 and 2012

	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Controlling Interest Equity	Total Non- controlling Interest	Total Stockholders' Equity
<b>Balance at December 31, 2011</b>	\$ 2,516,685	\$ (1,373,867)	\$ 201,229	\$ 24,393,310	\$ 148,486	\$ 25,885,843	\$ -	\$ 25,885,843
Net income	-	-	-	1,630,116	-	1,630,116	-	1,630,116
Other comprehensive income, net of income tax	-	-	-	-	3,214,504	3,214,504	-	3,214,504
Dividends paid to stockholders	-	-	-	(466,315)	-	(466,315)	-	(466,315)
Change in treasury stock	-	(42,348)	-	-	-	(42,348)	-	(42,348)
<b>Balance at December 31, 2012</b>	2,516,685	(1,416,215)	201,229	25,557,111	3,362,990	30,221,800	-	30,221,800
Net income (loss)	-	-	-	358,836	-	358,836	(55,363)	303,473
Other comprehensive loss, net of income tax	-	-	-	-	(2,903,559)	(2,903,559)	-	(2,903,559)
Dividends paid to stockholders	-	-	-	(464,631)	-	(464,631)	-	(464,631)
Change in common stock par value	(1,078,581)	-	1,078,581	-	-	-	-	-
Change in treasury stock	-	158,444	-	-	-	158,444	-	158,444
<b>Balance at December 31, 2013</b>	<u>\$ 1,438,104</u>	<u>\$ (1,257,771)</u>	<u>\$ 1,279,810</u>	<u>\$ 25,451,316</u>	<u>\$ 459,431</u>	<u>\$ 27,370,890</u>	<u>\$ (55,363)</u>	<u>\$ 27,315,527</u>

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

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Consolidated Statements of Cash Flows  
For the Years Ended December 31, 2013 and 2012

	2013	2012
<b>Cash from operating activities:</b>		
Consolidated net income	\$ 303,473	\$ 1,630,116
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation expense	283,202	255,653
Amortization of premiums and discounts associated with investments	(756,248)	(429,508)
Gains on investments	(1,636,543)	(785,940)
Bad-debt expense	11,337	-
Stock compensation	198,000	-
<b>Change in assets and liabilities:</b>		
Accrued investment income	(292,924)	(357,874)
Premiums, reinsurance, and other receivables	185,089	1,138,938
Deferred acquisition costs	(3,043,179)	(5,022,459)
Current income tax recoverable	(330,136)	(199,472)
Deferred income tax	701,260	271,454
Other assets	(512,277)	(180,908)
Future policy benefits	6,804,992	60,888,593
Policyholder account balances	(198,718)	-
Other policy related balances	(668,863)	932,292
Payables and accrued liabilities	3,761,623	(4,471,447)
Unearned investment income	4,479	-
Other	(4,126)	(1,809)
<b>Net cash provided from operating activities</b>	<b>4,810,441</b>	<b>53,667,629</b>
<b>Cash from investing activities:</b>		
<b>Sales, maturities and repayments of:</b>		
Bonds	115,394,661	60,414,266
Equity securities	3,674,897	4,404,930
Mortgage loans	389,135	97,568
<b>Purchases of:</b>		
Bonds	(129,795,317)	(329,776,342)
Equity securities	(1,211,066)	(2,606,870)
Mortgage loans	-	-
Property and equipment	(4,659,984)	(1,860,551)
Policy loans	(86,650)	(96,095)
Other	-	(620,443)
<b>Net cash used by investing activities</b>	<b>(16,294,324)</b>	<b>(270,043,537)</b>
<b>Cash flow from financing and miscellaneous activities:</b>		
Deposits	8,100,567	50,068
Treasury stock	(37,756)	(42,348)
Dividends on common stock	(464,632)	(466,315)
Other cash (applied) provided for funds withheld	(1,870,223)	176,227,157
<b>Net cash provided from financing activities</b>	<b>5,727,956</b>	<b>175,768,562</b>
<b>Change in cash and cash equivalents</b>	<b>(5,755,927)</b>	<b>(40,607,346)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>19,251,423</b>	<b>59,858,769</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 13,495,496</b>	<b>\$ 19,251,423</b>

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



# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 1. ORGANIZATION

**Sentinel Security Life Insurance Company** (the Company) a Utah corporation is organized in accordance with the Utah Insurance Code. The Company's principal lines of business consist of individual ordinary whole life and term life insurance. In 2010, the Company began selling Medicare supplement plans. In 2011, the Company began selling a fixed annuity product. In 2012, the Company began selling a hospital indemnity plan. The Company writes its insurance under a general agency plan. All general agents, associate general agents, and special agents contract directly with the Company as independent contractors.

### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its 75% owned subsidiary, Secure Marketing Partners (SMP). SMP is an independent marketing company and was formed in 2013 by the Company as a joint venture with Ed Porter to market insurance products for other insurance companies. Based on the terms of the joint venture agreement, the Company controls the partnership and has consolidated SMP as a subsidiary. All significant intercompany transactions and balances have been eliminated in consolidation.

### Basis of Presentation

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to adopt accounting policies and make estimates and assumptions that affect amounts reported in the consolidated financial statements. In applying these policies and estimates, management makes subjective and complex judgments that frequently require assumptions about matters that are inherently uncertain. Many of these policies, estimates and related judgments are common in the insurance and financial services industries; others are specific to the Company's business and operations. Actual results could differ from estimates.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following are the Company's significant accounting policies with references to notes providing additional information on such policies and critical accounting estimates relating to such policies.

### Future Policy Benefit Liabilities and Policyholder Account Balances

The Company establishes liabilities for amounts payable under insurance policies. Generally, amounts are payable over an extended period of time and related liabilities are calculated as the present value of future expected benefits to be paid reduced by the present value of future expected premiums. Such liabilities are established based on methods and underlying assumptions in accordance with U.S. GAAP and applicable actuarial standards. Principal assumptions used in the establishment of liabilities for future policy benefits are mortality, morbidity, policy lapse, renewal, disability incidence, investment returns, inflation, expenses and other contingent events as appropriate to the respective product type and geographical area. These assumptions are established at the time the policy is issued and are intended to estimate the experience for the period the policy benefits are payable. Utilizing these assumptions, liabilities are established on a block of business basis.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Future Policy Benefit Liabilities and Policyholder Account Balances (Continued)

For long duration insurance contracts, assumptions such as mortality, morbidity and interest rates are "locked in" upon the issuance of new business. However, significant adverse changes in experience on such contracts may require the establishment of premium deficiency reserves. Such reserves are determined based on the then current assumptions and do not include a provision for adverse deviation.

Premium deficiency reserves may also be established for short duration contracts to provide for expected future losses. These reserves are based on actuarial estimates of the amount of loss inherent in that period, including losses incurred for which claims have not been reported. The provisions for unreported claims are calculated using studies that measure the historical length of time between the incurred date of a claim and its eventual reporting to the Company.

The Company regularly reviews its estimates of liabilities for future policy benefits and compares them with its actual experience. Differences result in changes to the liability balances with related charges or credits to benefit expenses in the period in which the changes occur. Policyholder account balances relate to contract or contract features where the Company has no significant insurance risk. The Company issues directly certain annuity products with insurance risk. These annuities are accounted for as insurance liabilities.

### Other Policy-Related Balances

Other policy-related balances include policy and contract claims, unearned revenue liabilities, premiums received in advance, policyholder dividends due and unpaid, and policyholder dividends left on deposit. The liability for policy and contract claims generally relates to incurred but not reported death or accident and health claims, as well as claims which have been reported but not yet settled. The liability for these claims is based on the Company's estimated ultimate cost of settling all claims. The Company derives estimates for the development of incurred but not reported claims principally from analyses of historical patterns of claims by business line. The methods used to determine these estimates are continually reviewed. Adjustments resulting from this continuous review process and differences between estimates and payments for claims are recognized in policyholder benefits and claims expense in the period in which the estimates are changed or payments are made.

The Company accounts for the prepayment of premiums on its individual life, and accident and health contracts as premium received in advance and applies the cash received to premiums when due.

### Recognition of Premium Revenue and Related Expenses

Premiums related to traditional life, annuity policies, and long-duration accident and health policies are recognized as revenues when due from policyholders. Policyholder benefits and expenses are provided to recognize profits over the estimated lives of the insurance policies. When premiums are due over a significantly shorter period than the period over which benefits are provided, any excess profit is deferred and recognized into earnings in a constant relationship to insurance in-force or, for annuities, the amount of expected future policy benefit payments.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Recognition of Premium Revenue and Related Expenses (Continued)

Deposits related to investment-type products are credited to PABs (policyholder account balances). Revenues from such contracts consist of fees for policy administration and surrender charges and are recorded in investment-type product policy fees in the period in which services are provided. Amounts that are charged to earnings include interest credited in excess of related PABs. Premiums, policy fees, policyholder benefits and expenses are presented net of reinsurance.

Deferred and uncollected life insurance premiums as of December 31 were as follows:

	2013		2012	
	Gross	Net of Loading	Gross	Net of Loading
Ordinary new business	\$ 946,171	\$ 276,494	\$ 783,163	\$ 221,240
Ordinary renewal	3,080,900	2,114,631	2,846,700	1,931,605
<b>Total</b>	<b>\$ 4,027,071</b>	<b>\$ 2,391,125</b>	<b>\$ 3,629,863</b>	<b>\$ 2,152,845</b>

Deferred and uncollected life insurance premiums are included in the premiums, reinsurance, and other receivables account balance on the balance sheet.

### Participating Policies

At December 31, 2013 and 2012, participating policies account for less than 1% of total insurance, respectively. Total dividends for 2013 and 2012 were \$20,985 and \$18,032, respectively.

### Deferred Policy Acquisition Costs

The Company incurs significant costs in connection with acquiring new and renewal insurance business. Costs that are related directly to the successful acquisition or renewal of insurance contracts are capitalized as deferred acquisition costs (DAC).

Such costs include: (i) incremental direct costs of contract acquisition, such as commissions; (ii) the portion of an employee's total compensation and benefits related to time spent selling, underwriting or processing the issuance of new and renewal insurance business only with respect to actual policies acquired or renewed; (iii) other essential direct costs that would not have been incurred had a policy not been acquired or renewed; and (iv) in limited circumstances, the costs of direct-response advertising, the primary purpose of which is to elicit sales to customers who could be shown to have responded specifically to the advertising and that results in probable future benefits.

All other acquisition-related costs, including those related to general advertising and solicitation, market research, agent training, product development, unsuccessful sales and underwriting efforts, as well as all indirect costs, are expensed as incurred. DAC is amortized over the estimated lives of the related insurance contracts in proportion to the following:

- Non-participating and non-dividend-paying traditional contracts: Historic actual and expected future gross premiums.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Deferred Policy Acquisition Costs (Continued)

- Non-participating whole life insurance: Historic actual and expected future gross premiums
- Participating, dividend-paying traditional contracts: Actual and expected future gross margins.
- Fixed deferred annuity contracts: Actual and expected future gross profits.
- Medicare Supplement contracts: Actual and expected future gross profits.
- Hospital indemnity contracts: Actual and expected future gross profits.

### Reinsurance

For each of its reinsurance agreements, the Company determines whether the agreement provides indemnification against loss or liability relating to insurance risk in accordance with applicable accounting standards. Cessions under reinsurance agreements do not discharge the Company's obligations as the primary insurer. The Company reviews all contractual features, particularly those that may limit the amount of insurance risk to which the reinsurer is subject or features that delay the timely reimbursement of claims. For reinsurance of existing in-force blocks of long-duration contracts that transfer significant insurance risk, the difference, if any, between the amounts paid (received), and the liabilities ceded related to the underlying contracts is considered the net cost of reinsurance at the inception of the reinsurance agreement.

The net cost of reinsurance is recorded as an adjustment to DAC and recognized as a component of other expenses on a basis consistent with the way the acquisition costs on the underlying reinsured contracts would be recognized. Subsequent amounts paid on the reinsurance of in-force blocks, as well as amounts paid related to new business, are recorded as ceded premiums and ceded future policy benefit liabilities are established.

Amounts currently recoverable under reinsurance agreements are included in premiums, reinsurance and other receivables and amounts currently payable are included in other liabilities. Assets and liabilities relating to reinsurance agreements with the same reinsurer may be recorded net on the balance sheet, if a right of offset exists within the reinsurance agreement. In the event that reinsurers do not meet their obligations to the Company under the terms of the reinsurance agreements, reinsurance recoverable balances could become uncollectible. In such instances, reinsurance recoverable balances are stated net of allowances for uncollectible reinsurance.

If the Company determines that a reinsurance agreement does not expose the reinsurer to a reasonable possibility of a significant loss from insurance risk, the Company records the agreement using the deposit method of accounting. Deposits received are included in other liabilities and deposits made are included within premiums, reinsurance and other receivables. As amounts are paid or received, consistent with the underlying contracts, the deposit assets or liabilities are adjusted. Interest on such deposits is recorded as other revenues or other expenses, as appropriate. Periodically, the Company evaluates the adequacy of the expected payments or recoveries and adjusts the deposit asset or liability through other revenues or other expenses, as appropriate.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the date of acquisition to be cash equivalents. Therefore, cash and cash equivalents include demand deposits, money market funds, and funds withheld for ceded reinsurance. The carrying amounts of these assets are stated at cost which approximates fair value.

### Accounts Receivable

The Company considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations when that determination is made.

### Agent Balances

The Company has established an allowance for uncollectible agent balances. The allowance at December 31, 2013 and 2012 was \$257,294.

### Investments

Bonds at December 31, 2013 and 2012 consist of those that are available for sale (AFS) and those that are held-to-maturity securities. Held-to-maturity securities are reported at cost, adjusted for amortization of premiums and accretion of discounts that are recognized in interest income using the interest method over the period to maturity. Available-for-sale bonds are recorded at fair value.

Common stocks and preferred stocks at December 31, 2013 and 2012 consist of available-for-sale securities. Available-for-sale common and preferred stocks are recorded at fair value.

### Reclassification

Certain reclassifications have been made to the 2012 financial statement presentation to correspond to the current year's format. Total equity and net income are unchanged due to these reclassifications.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Property and Equipment

Property and equipment is carried at cost, net of accumulated depreciation. Maintenance and repairs which do not materially extend the useful lives of furniture and equipment and minor replacements are charged to earnings as incurred.

Electronic data processing (EDP) equipment is depreciated on the straight-line basis over an estimated useful life of three to five years. Depreciation expense was \$181,907 and \$223,428 for the years ended December 31, 2013 and 2012, respectively.

Furniture and fixtures are depreciated on the straight-line basis over a five to fifteen year period. Depreciation expense for furniture and fixtures was \$37,354 and \$17,245 for the years ended December 31, 2013 and 2012, respectively.

Buildings and improvements are depreciated on the straight-line basis between three and fifty years. Depreciation expense was \$63,941 and \$14,979 for the years ended December 31, 2013 and 2012, respectively.

### Guarantee Assessments

The states in which the Company operates have guaranty fund laws under which insurers doing business in the state are required to fund policyholder liabilities of insolvent insurance companies. Generally, assessments are levied within the state, up to prescribed limits, on all insurers doing business in the state on the basis of the proportionate share of the premiums written by insurers doing business in that state in the lines of business in which the impaired, insolvent or failed insurer is engaged. Guarantee assessments of \$52,735 and \$67,186 for the years ended December 31, 2013 and 2012, respectively, were expensed.

### Future Policyholder Benefits

The liability for life future policyholder benefits are based upon an earned interest rate basis, with mortality and lapses driven by experience or expected experience. The Company waives deduction of deferred fractional premiums upon death of insured and returns any portion of the final premium beyond the death date. Surrender values are not promised in excess of the legally computed reserves. The reserve for waiver of deferred fractional premiums upon death is determined, by line of business, using total net premium and a reserve factor over the average remaining premium paying period. Since all policies are monthly pay, there is no reserve for return of premium.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Future Policyholder Benefits (Continued)

As of December 31, 2013 and 2012, the Company had 155 and 141 policies in force for which the gross premiums are less than the net premium according to the standard valuation set by the State of Utah. The gross premiums for these policies were \$11,869 and \$11,530 less than net premiums for 2013 and 2012, respectively. Given the small number of policies where the net premiums exceed the gross premium the Company has not established a deficiency reserve.

### Policy and Contract Claims

The liability for life, accident, and health policyholder claims was estimated using past experience and other actuarial methods.

### Income Taxes

The Company is classified as a "C" corporation under the Internal Revenue Code and as such they are subject to income taxes. Income taxes are provided for the tax effects of transactions presented in the consolidated financial statements. Deferred income taxes are calculated using the liability method of accounting for income taxes. Under the liability method, deferred income tax assets and liabilities are provided based on the difference between the financial reporting and tax reporting bases of assets and liabilities as measured by the currently enacted tax rates in effect for the years in which these differences are expected to reverse.

Deferred income tax expense or benefit is the result of changes in deferred income tax assets and liabilities. An allowance against deferred income tax assets is recorded in whole or in part when it is more likely than not that those deferred income tax assets will not be realized.

Net cash paid for federal income taxes was \$0 and \$663,052 for the years ended December 31, 2013 and 2012, respectively.

The Company accounts for uncertain tax positions in accordance with certain provisions of FASB ASC 740. Management has determined that the Companies do not have any uncertain tax positions and associated unrecognized benefits that materially impact the consolidated financial statements or related disclosures. Since tax matters are subject to some degree of uncertainty, there can be no assurance that the Company's tax returns will not be challenged by the taxing authorities and that the Company will not be subject to additional tax, penalties, and interest as a result of such challenge.

The Company's federal income tax returns from 2013 through 2011 are subject to examination by the Internal Revenue Service, generally for three years after they are filed.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Income Taxes (Continued)

Prior to 1984, the Company was allowed certain special deductions for federal income tax reporting purposes that were required to be accumulated in a “policyholders’ surplus account” (PSA). In the event that those amounts are distributed to shareholders, or the balance of the account exceeds certain limitations prescribed by the Internal Revenue code, the excess amounts would be subject to income tax at current rates. Income taxes also would be payable at current rates if the Company ceases to qualify as a life insurance company for tax reporting purposes, or if the income tax deferral status of the PSA is modified by future tax legislation. Management does not intend to take actions nor does management expect any events to occur that would cause income taxes to become payable on the PSA balance. Accordingly, the Company has not accrued income taxes on the PSA balance of \$1,220,000 at December 31, 2013 and 2012. However, if such taxes were assessed the amount of the taxes payable would be approximately \$415,000. No deferred tax liabilities are recognized related to the PSA.

### Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist of temporary cash investments, fixed maturity securities, and receivables.

### Advertising Costs

Advertising costs are charged to operations when incurred. Advertising expense was \$398,188 and \$717,371 for the years ended December 31, 2013 and 2012, respectively.

### Adoption of New Accounting Pronouncements

On January 1, 2012, the Company adopted new guidance regarding accounting for DAC, which was retrospectively applied. The guidance specifies that only costs related directly to successful acquisition of new or renewal contracts can be capitalized as DAC; all other acquisition-related costs must be expensed as incurred. Under the new guidance, advertising costs may only be included in DAC if the capitalization criteria in the direct-response advertising guidance in Subtopic 340-20, *Other Assets and Deferred Costs—Capitalized Advertising Costs*, are met.

On January 1, 2012, the Company adopted new guidance regarding comprehensive income, which was retrospectively applied, that provides companies with the option to present the total of comprehensive income, components of net income, and the components of OCI either in a single continuous statement of comprehensive income or in two separate but consecutive statements in annual financial statements. The standard eliminates the option to present components of OCI as part of the statement of changes in stockholders’ equity. The Company adopted the two-statement approach for annual financial statements.



# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Adoption of New Accounting Pronouncements (Continued)

Effective January 1, 2012, the Company adopted new guidance regarding fair value measurements that establishes common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S GAAP and International Financial Reporting Standards. Some of the amendments clarify the Financial Accounting Standards Board's ("FASB") intent on the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements.

In February of 2013, the FASB issued Accounting Standards Update 2013-12, which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. This new guidance is effective for fiscal years, and interim periods within those years, beginning after December 31, 2013. The Company does not expect the adoption of this guidance to have any material impact on the Company's results of operations, financial position, or cash flows.

In July of 2013, the FASB issued Accounting Standards Update 2013-11, which requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. This new guidance is effective for fiscal years, and interim periods within those years, beginning after December 31, 2014. The Company does not expect the adoption of this guidance to have any material impact on the Company's results of operations, financial position, or cash flows.

### Accounting Changes

Effective January 1, 2013, the company changed the way it classifies certain annuity considerations. Fixed annuity considerations received for contracts that do not include riders containing any mortality or morbidity risk have been reclassified from premiums to deposit-type consideration. There was no effect on net income, stockholders' equity, total assets, or total liabilities as a result of this change. The change was for classification purposes only.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Accounting Changes (Continued)

The reclassification effect of this change resulted in \$8,100,567 of net annuity considerations and \$7,700,651 of related reserves from premium being reclassified to the liability for deposit-type contracts. The net difference from above (change in liability deposit-type contracts) of \$218,935 is included in the consolidated statements of income in the expenses under the policyholder benefits and claims and adjustments to policyholder account balances.

## 3. INVESTED ASSETS ON DEPOSIT

At December 31, 2013 and 2012, bonds with a fair market value of \$2,887,324 and \$3,536,353 were on deposit with state insurance departments to satisfy regulatory requirements.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 4. INVESTMENTS

The amortized cost and approximate fair values of investments are as follows:

	<u>Cost/ Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>December 31, 2013</b>				
<b>Bonds:</b>				
Held-to-maturity	\$ 10,192,442	\$ 151,049	\$ (1,384,023)	\$ 8,959,468
Available-for-sale	113,045,618	3,804,150	(2,870,707)	113,979,061
Withheld for reinsurance	243,953,447	13,519,194	(1,298,699)	256,173,942
<b>Total bonds</b>	<u>367,191,507</u>	<u>17,474,393</u>	<u>(5,553,429)</u>	<u>379,112,471</u>
<b>Preferred stock:</b>				
Available-for-sale	4,907,321	9,140	(343,429)	4,573,032
Withheld for reinsurance	2,000,000	18,000	-	2,018,000
<b>Total preferred stocks</b>	<u>6,907,321</u>	<u>27,140</u>	<u>(343,429)</u>	<u>6,591,032</u>
<b>Common stock</b>	<u>158,097</u>	<u>113,660</u>	<u>(33,880)</u>	<u>237,877</u>
<b>Total</b>	<u>\$ 374,256,925</u>	<u>\$ 17,615,193</u>	<u>\$ (5,930,738)</u>	<u>\$ 385,941,380</u>
	<u>Cost/ Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>December 31, 2012</b>				
<b>Bonds:</b>				
Held-to-maturity	\$ 1,865,655	\$ 265,541	\$ (35,060)	\$ 2,096,136
Available-for-sale	96,691,551	6,728,813	(1,305,809)	102,114,555
Withheld for reinsurance	245,348,466	15,047,654	(217,610)	260,178,510
<b>Total bonds</b>	<u>343,905,672</u>	<u>22,042,008</u>	<u>(1,558,479)</u>	<u>364,389,201</u>
<b>Preferred stock:</b>				
Available-for-sale	4,847,901	46,140	(374,599)	4,519,442
Withheld for reinsurance	2,000,000	30,000	-	2,030,000
<b>Total preferred stocks</b>	<u>6,847,901</u>	<u>76,140</u>	<u>(374,599)</u>	<u>6,549,442</u>
<b>Common stock</b>	<u>2,855,672</u>	<u>290,975</u>	<u>(323,380)</u>	<u>2,823,267</u>
<b>Total</b>	<u>\$ 353,609,245</u>	<u>\$ 22,409,123</u>	<u>\$ (2,256,458)</u>	<u>\$ 373,761,910</u>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 4. INVESTMENTS (Continued)

Maturities of bonds are as follows as of December 31, 2013:

	<u>Amortized Cost</u>
Within in year	\$ 31,662,120
After one year through five years	146,724,148
After five years through ten years	116,949,075
After ten years through twenty years	40,651,757
After twenty years	<u>31,204,405</u>
<b>Total</b>	<b><u>\$ 367,191,505</u></b>

The expected maturities in the foregoing table may differ from the contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various valuation approaches including a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the observability of inputs as follows:

Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2—Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 4. INVESTMENTS (Continued)

Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value hierarchy within which the fair value measurement falls in its entirety is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that the Company believes market participants would use in pricing the asset or liability at the measurement date.

The Company has categorized its assets and liabilities into the three-level fair value hierarchy based upon the priority of the inputs to the respective valuation technique.

Fair values for assets measured on a recurring basis are as follows:

	<b>Assets Measured at Fair Value</b>			
Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>December 31, 2013:</b>				
<b>Assets:</b>				
<b>Stocks:</b>				
Common	\$ 237,877	\$ 237,877	\$ -	\$ -
Preferred	6,591,032	6,591,032	-	-
Available-for-sale bonds	370,153,003	331,058,812	39,094,191	-
<b>Total</b>	<b>\$ 376,981,912</b>	<b>\$ 337,887,721</b>	<b>\$ 39,094,191</b>	<b>\$ -</b>
<b>Liabilities:</b>				
Available-for-sale bonds funds withheld	\$ 256,173,942	\$ 221,605,112	\$ 34,568,830	\$ -
<b>Total</b>	<b>\$ 256,173,942</b>	<b>\$ 221,605,112</b>	<b>\$ 34,568,830</b>	<b>\$ -</b>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 4. INVESTMENTS (Continued)

	Assets Measured at Fair Value			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2012:</b>				
<b>Assets:</b>				
<b>Stocks:</b>				
Common	\$ 2,823,267	\$ 2,823,267	\$ -	\$ -
Preferred	6,549,442	6,549,442	-	-
Available-for-sale bonds	362,293,065	262,111,105	100,181,960	-
<b>Total</b>	<b>\$ 371,665,774</b>	<b>\$ 271,483,814</b>	<b>\$ 100,181,960</b>	<b>\$ -</b>
<b>Liabilities:</b>				
Available-for-sale bonds funds withheld	\$ 260,178,510	\$ 187,320,191	\$ 72,858,319	\$ -
<b>Total</b>	<b>\$ 260,178,510</b>	<b>\$ 187,320,191</b>	<b>\$ 72,858,319</b>	<b>\$ -</b>

On a quarterly basis, the Company reviews its investment portfolio for securities in an unrealized loss position for other-than-temporary impairment. This review for potential impairment is performed on a specific identification basis and requires significant management judgment related to a number of qualitative and quantitative factors including the severity of the impairment, the duration of the impairment, recent trends and expected market performance. Management believes that the majority of the Company's unrealized losses on individual securities at December 31, 2013 and December 31, 2012 represent a temporary decline in market value.

As of December 31, 2013 and 2012, the Company did not have any bonds and/or common stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized.

For the year ended December 31, 2013, the Company recognized a \$102,259 other-than temporary impairment on preferred stock.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 4. INVESTMENTS (Continued)

The following tables summarize those investments that, as of December 31, 2013 and 2012, were in an unrealized loss position for which other-than-temporary declines in value have not been recognized:

(\$ In Thousands)

	<b>Less Than 12 Months</b>		
	<b>Number Of Issues</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
At December 31, 2013			
<b>Bonds:</b>			
U.S. government and agencies	13	\$ 3,953	\$ (529)
U.S. special revenue and assessments	2	467	(12)
Industrial and miscellaneous	71	41,413	(1,893)
Hybrid	5	880	(38)
Mortgage-backed securities	68	41,447	(2,053)
<b>Total bonds</b>	159	88,160	(4,524)
<b>Equity securities:</b>			
Common stock - industrial and miscellaneous	-	-	-
Preferred stock - industrial and miscellaneous	11	2,672	(229)
<b>Total bonds and equity securities</b>	170	\$ 90,832	\$ (4,752)
<b>12 Months or More</b>			
	<b>Number Of Issues</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
<b>Bonds:</b>			
U.S. government and agencies	5	\$ 838	\$ (152)
U.S. special revenue and assessments	1	242	(40)
Industrial and miscellaneous	8	2,712	(277)
Hybrid	8	1,812	(107)
Mortgage-backed securities	12	10,013	(454)
<b>Total bonds</b>	34	15,618	(1,030)
<b>Equity securities:</b>			
Common stock - industrial and miscellaneous	2	92	(34)
Preferred stock - industrial and miscellaneous	8	1,192	(115)
<b>Total bonds and equity securities</b>	44	\$ 16,902	\$ (1,178)
<b>Total</b>			
	<b>Number Of Issues</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
<b>Bonds:</b>			
U.S. government and agencies	18	\$ 4,791	\$ (680)
U.S. special revenue and assessments	3	710	(51)
Industrial and miscellaneous	79	44,125	(2,170)
Hybrid	13	2,692	(145)
Mortgage-backed securities	80	51,460	(2,507)
<b>Total bonds</b>	193	103,778	(5,553)
<b>Equity securities:</b>			
Common stock - industrial and miscellaneous	2	92	(34)
Preferred stock - industrial and miscellaneous	19	3,864	(343)
<b>Total bonds and equity securities</b>	214	\$ 107,734	\$ (5,931)

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 4. INVESTMENTS (Continued)

(\$ In Thousands)

	Less Than 12 Months		
	Number Of Issues	Fair Value	Unrealized Losses
At December 31, 2012			
<b>Bonds:</b>			
U.S. government and agencies	5	\$ 954	\$ (26)
U.S. special revenue and assessments	1	284	(1)
Industrial and miscellaneous	13	3,234	(659)
Hybrid	-	-	-
Mortgage-backed securities	29	30,145	(339)
<b>Total bonds</b>	48	34,617	(1,025)
<b>Equity securities:</b>			
Common stock - industrial and miscellaneous	-	-	-
Preferred stock - industrial and miscellaneous	1	303	-
<b>Total bonds and equity securities</b>	49	\$ 34,920	\$ (1,025)
<b>12 Months or More</b>			
	Number Of Issues	Fair Value	Unrealized Losses
<b>Bonds:</b>			
Industrial and miscellaneous	7	\$ 1,299	\$ (474)
Hybrid	12	2,460	(59)
<b>Total bonds</b>	19	3,759	(533)
<b>Equity securities:</b>			
Common stock - industrial and miscellaneous	7	2,037	(323)
Preferred stock - industrial and miscellaneous	11	971	(374)
<b>Total bonds and equity securities</b>	37	\$ 6,767	\$ (1,231)
<b>Total</b>			
	Number Of Issues	Fair Value	Unrealized Losses
<b>Bonds:</b>			
U.S. government and agencies	5	\$ 954	\$ (26)
U.S. special revenue and assessments	1	284	(1)
Industrial and miscellaneous	20	4,533	(1,133)
Hybrid	12	2,460	(59)
Mortgage-backed securities	29	30,145	(339)
<b>Total bonds</b>	67	38,376	(1,558)
<b>Equity securities:</b>			
Common stock - industrial and miscellaneous	7	2,037	(323)
Preferred stock - industrial and miscellaneous	12	1,273	(374)
<b>Total bonds and equity securities</b>	86	\$ 41,687	\$ (2,256)



# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 4. INVESTMENTS (Continued)

Realized capital gains on investments consisted of the following:

	<u>2013</u>	<u>2012</u>
<b>Bonds:</b>		
Gross gains from sales	\$ 2,141,872	\$ 380,344
Gross losses from sales	(332,694)	(97,968)
Other-than temporary impairment	-	(139,235)
<b>Preferred stock:</b>		
Gross gains from sales	2,400	-
Gross losses from sales	(207,501)	(110)
Other-than temporary impairment	(102,259)	
<b>Common stock:</b>		
Gross gains from sales	487,072	822,537
Gross losses from sales	(354,037)	(179,628)
<b>Net capital gains</b>	<u>\$ 1,634,853</u>	<u>\$ 785,940</u>

### Mortgage Loans

The Company's investments in mortgage loans principally involve commercial and residential real estate located in the state of Utah and Wyoming. Such investments consist of first mortgage liens on completed income-producing properties. Mortgage loans at December 31, 2013 and 2012 totaled \$1,628,444 and \$2,017,579 respectively. The maximum and minimum lending rate for mortgage loans during the years 2013 and 2012 were 8.00% and 6.50%. As of December 31, 2013 and 2012, the Company has one mortgage with interest more than 180 days past due.

While the borrower is not making regular mortgage payments, the fair value of the underlying property was sufficient that an allowance for bad debts was recorded on the unpaid mortgage interest only. As of December 31, 2013 and 2012, the Company had a \$12,664 and \$56,581, respectively, an allowance for uncollectible mortgage interest.

The aforementioned mortgage with interest more than 180 days past due was subsequently foreclosed on in 2014.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consisted of the following at December 31, 2013 and December 31, 2012:

	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$ 3,847,462	\$ 15,773,792
Cash and cash equivalents, withheld for reinsurance	<u>9,648,034</u>	<u>3,477,631</u>
<b>Total cash and cash equivalents</b>	<b><u>\$ 13,495,496</u></b>	<b><u>\$ 19,251,423</u></b>

## 6. CONCENTRATION OF CREDIT AND MARKET RISK

The Company maintains several bank accounts at the same institution. Accounts at this institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. Cash at this institution exceeded federally insured limits. The amount in excess of FDIC limits totaled **\$4,289,476** and \$0 as of December 31, 2013 and 2012, respectively.

The Company maintains non-interest bearing accounts. The accounts are insured by the Federal Deposit Insurance Corporation (FDIC). From December 31, 2010 through December 31, 2012, all noninterest bearing transaction accounts are fully insured by the FDIC regardless of the balance of the account and the ownership capacity of the fund. This was an extension of FDIC's Temporary Liquidity Guarantee Program which was effective on December 31, 2009. Therefore, deposits in these accounts are 100% insured by the FDIC as of December 31, 2012. Effective January 1, 2013, non-interest bearing accounts are no longer fully insured and are insured up to \$250,000 FDIC limits.

The Company invests in money market funds that are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund. As of December 31, 2013 and 2012 the Company held \$11,925,913 and \$12,994,171 in money market funds, respectively.

The Company maintains accounts with brokerage firms. These accounts contain bonds, preferred stocks and common stocks. These investments are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with these investments, it is reasonably possible that changes in the values of investments will occur in the near term and that such change could materially affect the amounts reported in the consolidated financial statements.

The Company's revenues and receivables are from customers located in 23 states. The majority of the Company's customers are located in the states of Utah, Florida, Iowa, Nebraska and California.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 7. ACCRUED INVESTMENT INCOME RECEIVABLE

Accrued interest and other investment income receivable consisted of the following at December 31:

	<u>2013</u>	<u>2012</u>
Bonds	\$ 1,202,858	\$ 907,913
Preferred stock	29,751	32,691
Mortgage loans	20,898	19,695
Policy loans	<u>2,035</u>	<u>2,319</u>
<b>Total accrued investment income</b>	1,255,542	962,618
Less: allowance of doubtful accounts	<u>12,664</u>	<u>56,581</u>
<b>Total accrued investment income less allowance for doubtful accounts</b>	<u>\$ 1,242,878</u>	<u>\$ 906,037</u>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 8. PROPERTY AND EQUIPMENT

Property and equipment as of December 31, 2013 and 2012 is summarized in the following schedules:

	<u>2013</u>	<u>2012</u>
<b>Properties occupied by the Company:</b>		
Land	\$ 364,100	\$ 68,444
Properties occupied by the Company	<u>4,883,828</u>	<u>615,783</u>
<b>Total properties occupied by the Company</b>	5,247,928	684,227
Accumulated depreciation	<u>(56,978)</u>	<u>(542,752)</u>
<b>Net properties occupied by the Company</b>	<u>5,190,950</u>	<u>141,475</u>
<b>Properties for the production of income:</b>		
Land	-	364,100
Buildings	<u>-</u>	<u>1,496,451</u>
<b>Total properties held for the production of income</b>	-	1,860,551
Accumulated depreciation	<u>-</u>	<u>-</u>
<b>Net properties held for the production of income</b>	<u>-</u>	<u>1,860,551</u>
<b>Properties held for sale:</b>		
Land	68,444	-
Buildings	<u>879,504</u>	<u>-</u>
<b>Total properties held for sale</b>	947,948	-
Accumulated depreciation	<u>(536,385)</u>	<u>-</u>
<b>Net properties held for sale</b>	<u>411,563</u>	<u>-</u>
<b>Net properties</b>	<u>5,602,513</u>	<u>2,002,026</u>
<b>Other property and equipment:</b>		
Furniture and fixtures	617,326	203,217
Electronic data processing equipment	<u>1,748,648</u>	<u>1,171,738</u>
<b>Total other property and equipment</b>	2,365,974	1,374,955
Accumulated depreciation	<u>(579,307)</u>	<u>(486,599)</u>
<b>Net other property and equipment</b>	<u>1,786,667</u>	<u>888,356</u>
<b>Total</b>	<u>\$ 7,389,180</u>	<u>\$ 2,890,382</u>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 9. REINSURANCE

Certain premiums and benefits are ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks and maintain its exposure to loss within its capital resources. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations. Amounts payable or recoverable for reinsurance on policy and contract liabilities are not subject to periodic or maximum limits.

Reinsurance ceded has reduced premiums by \$155,880,592 and \$285,851,727, and contract liabilities by \$423,712,786 and \$314,800,484 for the years ended December 31, 2013 and 2012, respectively. During 2013 and 2012, the Company did not write off to operations any reinsurance balances.

The Company actively sells individual whole life insurance. The Company also maintains other blocks of insurance business; annuities, accidental death, Medicare supplements, and hospital indemnity. The majority of the premiums and claims for the Medicare supplement block of business are administered by American Insurance Administrators LLC (AIA). The accident and health insurance contracts are reinsured by Mutual of Omaha. Life insurance, annuities, deposit funds and other related benefits were reinsured by Optimum Re Insurance Company, Athene Life Re Ltd. and Guggenheim Life and Annuity Company. As of December 31, 2013 and 2012, approximately 80% of the annuities and deposit-type contracts were reinsured. Policyholder reserves and claims liabilities are stated net of the deduction for reserves and claims applicable to reinsurance ceded to other companies. However, the Company is contingently liable for these amounts in the event such companies are unable to pay their portion of the claims.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 9. REINSURANCE (Continued)

The following summarizes the amounts of reinsurance ceded for premiums, benefits paid or provided, and loss reserves presented in the accompanying consolidated financial statements for the years ended December 31, 2013 and 2012:

	2013	2012
<b>Premiums:</b>		
Gross	\$ 172,977,976	\$ 356,134,929
Ceded	(155,880,592)	(285,851,727)
<b>Net</b>	<b>\$ 17,097,384</b>	<b>\$ 70,283,202</b>
<b>Deposit type contracts:</b>		
Deposits received	\$ 38,527,555	\$ -
Ceded	(30,802,603)	-
<b>Net deposit type contracts</b>	<b>\$ 7,724,952</b>	<b>\$ -</b>
<b>Net due and deferred:</b>		
Gross due and deferred		
Gross	\$ 4,027,071	\$ 3,629,863
Ceded	-	-
<b>Net</b>	<b>4,027,071</b>	<b>3,629,863</b>
Loading		
Gross	(1,635,946)	(1,477,018)
Ceded	-	-
<b>Net</b>	<b>(1,635,946)</b>	<b>(1,477,018)</b>
Net due and deferred		
Gross	2,391,125	2,152,845
Ceded	-	-
<b>Net</b>	<b>\$ 2,391,125</b>	<b>\$ 2,152,845</b>
<b>Aggregate reserves - life:</b>		
Gross	\$ 538,302,549	\$ 422,047,138
Ceded	(421,109,737)	(311,702,664)
<b>Net</b>	<b>\$ 117,192,812</b>	<b>\$ 110,344,474</b>
<b>Aggregate reserves - accident and health:</b>		
Gross	\$ 2,904,293	\$ 3,441,688
Ceded	(2,603,049)	(3,097,820)
<b>Net</b>	<b>\$ 301,244</b>	<b>\$ 343,868</b>
<b>Claims payable:</b>		
Gross	\$ 5,796,393	\$ 10,464,638
Ceded	(4,567,787)	(8,764,353)
<b>Net</b>	<b>\$ 1,228,606</b>	<b>\$ 1,700,285</b>
<b>Claims:</b>		
Gross	\$ 49,356,156	\$ 46,190,645
Ceded	(40,918,868)	(38,835,222)
<b>Net</b>	<b>\$ 8,437,288</b>	<b>\$ 7,355,423</b>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 10. INCOME TAXES

Income taxes for the years ended December 31, 2013 and 2012 consisted of the following:

	<b>2013</b>	<b>2012</b>
<b>Current:</b>		
Federal	\$ (433,531)	\$ 304,795
<b>Total current income taxes</b>	(433,531)	304,795
<b>Deferred:</b>		
Federal	701,260	271,454
<b>Total deferred income taxes</b>	701,260	271,454
<b>Total tax benefit</b>	\$ 267,729	\$ 576,249

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

	<b>2013</b>	<b>Percentage</b>	<b>2012</b>	<b>Percentage</b>
Computed income tax (benefit) expense at the statutory rate of 34%	\$ 213,032	34.0%	\$ 750,164	34.0%
Meals and entertainment	15,137	2.4%	4,467	0.2%
Amortization of interest maintenance reserve	(64,248)	-10.3%	(12,287)	-0.6%
Dividends received deduction	(1,584)	-0.3%	(13,658)	-0.6%
Tax exempt interest	(119,866)	-19.1%	(19,683)	-0.9%
Capital gains (losses) reclassification	(189,184)	-30.2%	176,364	8.0%
Small life insurance company deduction	458,562	73.2%	(327,414)	-14.8%
Reduction in the AMT credit	86,238	13.8%	-	0.0%
Rent income	-	0.0%	10,200	0.5%
NOL carryback rate differential	305,707	48.8%	-	0.0%
Change in income tax recoverable	(388,084)	-61.9%	-	0.0%
Other	(47,981)	-7.7%	8,096	0.4%
<b>Total tax provision</b>	\$ 267,729	42.7%	\$ 576,249	26.1%

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 10. INCOME TAXES (Continued)

The temporary differences and carryforwards which give rise to the deferred tax assets (liabilities) as of December 31, 2013 and 2012 consist of the following:

	<b>2013</b>	<b>2012</b>
<b>Deferred tax assets:</b>		
Uncollected premiums	\$ 55,526	\$ 53,121
Advanced premium	17,603	28,483
Interest income	298,297	204,361
Policyholder share of tax-exempt interest	116,477	-
Reserves	2,919,490	3,027,287
Capital gains (losses)	454,804	-
Accrued vacation	58,320	63,258
NOL carryforward	615,747	-
AMT carryforward	1,320,974	1,407,212
Other	-	31,522
	<b>5,857,238</b>	<b>4,815,244</b>
<b>Deferred tax liabilities:</b>		
Deferred premiums and agent balances	989,578	720,616
Deferred acquisition costs	2,803,710	1,777,440
Interest maintenance reserve	320,142	61,921
Investments	236,676	1,732,449
Dividend income	197,050	103,666
Capital gains (losses)	-	91,618
Fixed assets	310,092	143,464
Other	21,754	347
	<b>4,879,002</b>	<b>4,631,521</b>
<b>Net deferred tax assets (liabilities)</b>	<b>\$ 978,236</b>	<b>\$ 183,723</b>

The Company has examined all available evidence, both positive and negative, and has determined that a valuation allowance is not needed for its deferred tax assets at December 31, 2013 and 2012.

At December 31, 2013 and 2012, the Company has federal alternative minimum tax (AMT) credit carryforwards of \$1,320,974 and \$1,407,212, respectively, which have no expiration date.

At December 31, 2013 and 2012, the Company has a net operating loss carryforward (NOL) of \$1,811,020 and \$0, respectively, which is set to expire in 2028.



# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 11. EMPLOYEE BENEFITS

### Defined Contribution Plans

The Company has a noncontributory master profit sharing and trust plan that qualifies under Section 401(a) of the Internal Revenue Code and is therefore exempt from income taxes. All eligible Company employees may participate in the plan after completing three months of service. The Company's annual contribution is 10% of the eligible participants' compensation as defined, but only to the extent net profits exceed \$50,000 in the taxable year of contribution. Contributions are made to participants in the same percentage that the individual participant's compensation bears to the total compensation of all participants for the plan year. All contributions to the plan are made to an independent trustee for investment and administration. The contributions become partially vested after two years and fully vested after six years of service. The Company's cost of the plan was \$274,722 and \$154,973 for 2013 and 2012, respectively. As of December 31, 2013 and 2012, the fair value of the plan assets was \$2,804,405 and \$2,077,712 respectively.

The Company's health, long-term disability, dental, and group life plans cover substantially all of its employees and qualified employee dependents. The Company makes contributions to these plans sufficient to provide for benefit payments required under the plans.

Postemployment benefits and compensated absences have been accrued in accordance with FASB ASC Topic 715. As of December 31, 2013 and 2012, the Company estimated the obligation for compensated absences to be \$216,668 and \$235,015 respectively.

In 2013, the Compensation Committee approved an equity incentive plan for the Company. The incentive plan is designed to allow the Company to compensate employee performance through stock compensation by a committee designated by the Board of Directors. The stock compensation can be administered in the following ways: (i) options to purchase shares of common stock in the form of Incentive Stock Options or Nonqualified Stock Options (which may include Performance Options), (ii) stock appreciation rights (SARs) in the form of Tandem SARs or Free Standing SARs or (iii) stock awards in the form of unrestricted stock awards, restricted stock, restricted stock units or performance stock units. In November 2013, the committee approved restricted stock awards for employee performance in the amount \$198,000. The employees receiving the restricted stock awards were compensated with Company treasury stock.

## 12. CONTINGENCIES

The Company is subject to assessments for its proportionate share of liabilities of insolvent insurers in the states where the Company operates which have guaranty company statutes. A provision for future assessments has not been recorded in the accompanying consolidated financial statements because they cannot be estimated.

The Company is subject to litigation from the settlement of claims contested in the normal course of business. The losses from the actual settlement of such unknown claims are taken into consideration in the computation of the estimated claims liabilities. No contingent liabilities have been established by the Company. There is no pending litigation as of December 31, 2013 and 2012.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
For the Years Ended December 31, 2013 and 2012

## 13. CAPITAL REQUIREMENTS

The State of Utah has adopted the National Company of Insurance Commissioners' (NAIC) risk-based capital (RBC) calculation to evaluate the minimum capital requirements for an insurance Company to support its overall business operations in consideration of its size and risk profile. The Company's risk-based capital is calculated by applying factors to various asset, premium, and reserve items.

The RBC requirements provide for four different levels of regulatory attention depending on the ratio of the Company's total adjusted capital (TAC) to its authorized control level (ACL). The four regulatory attention levels (and the associated percentage of TAC to ACL) are defined as follows: (1) Company Action (200%), (2) Regulatory Action (150%), (3) Authorized Control (100%), and (4) Mandatory Control Levels (75%). As of December 31, 2013 and 2012, the Company maintained TAC in excess of 200% of ACL.

## 14. UNPAID CLAIMS, LOSSES AND LOSS ADJUSTMENT EXPENSES

Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years has increased (decreased) by approximately \$27,400 and \$(16,897) during the years ended December 31, 2013 and 2012, respectively.

	<u>2013</u>	<u>2012</u>
<b>Balance at January 1</b>	\$ 973,954	\$ 522,639
<b>Incurred, related to:</b>		
Current year	4,035,452	4,199,791
Prior years	<u>27,400</u>	<u>(16,897)</u>
<b>Total incurred</b>	<u>4,062,852</u>	<u>4,182,894</u>
<b>Paid, related to:</b>		
Current year	3,523,654	3,230,039
Prior years	<u>995,592</u>	<u>501,540</u>
<b>Total paid</b>	<u>4,519,246</u>	<u>3,731,579</u>
<b>Balance at December 31</b>	<u>\$ 517,560</u>	<u>\$ 973,954</u>

Management believes that the liability for unpaid claims is adequate to cover the ultimate development of claims. The liability is continually reviewed and revised to reflect current conditions and claim trends and any resulting adjustments are reflected in operating results in the year made.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

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## 15. DIRECT PREMIUM WRITTEN/PRODUCED BY THIRD PARTY ADMINISTRATOR

The aggregate amount of direct premiums written through managing general agents or third party administrators as of December 31, 2013 and 2012 was:

Name and Address Managing General Agent Or Third Part Administrator	FEIN#	Exclusive Contract	Type of Business Written	Type of Activity Granted	Total Direct Prem Written/ Produced By
<b>For the year ended December 31, 2013:</b>					
American Insurance Administrators LLC 2536 Countryside Blvd., Suite 430 Clearwater, FL 33763	26-1193300	No	Medicare Supplement	C,CA,,P,U	<u>\$ 51,660,776</u>
<b>For the year ended December 31, 2012:</b>					
American Insurance Administrators LLC 2536 Countryside Blvd., Suite 430 Clearwater, FL 33763	26-1193300	No	Medicare Supplement	C,CA,,P,U	<u>\$ 53,919,852</u>

## 16. STATUTORY ACCOUNTING PRINCIPLES

The Company, which is domiciled in State of Utah, prepares its statutory financial statements in accordance with accounting principles and practices prescribed or permitted by the Utah Insurance Department, which Utah recognizes for determining solvency under the Utah Insurance Law.

The following schedules reconcile the Company's statutory net income and statutory surplus and capital stock determined in accordance with accounting practices prescribed or permitted by the Utah Insurance Department with net earnings (loss) and equity on a U.S. GAAP basis.

	<u>2013</u>	<u>2012</u>
Statutory net income (loss)		
per the annual statement	\$ (2,808,567)	\$ (34,607)
Statutory audit adjustment	-	320,433
<b>Adjusted statutory net income (loss) per the statutory audit</b>	(2,808,567)	285,826
<b>Adjustments:</b>		
Future policy benefits and policyholder's account balances	(253,855)	(3,554,951)
Deferred policy acquisition costs	3,043,179	5,022,459
Deferred income taxes	(313,176)	(271,454)
Interest maintenance reserve	759,473	148,236
Allowance for bad-debts	(11,336)	-
Net loss from consolidation	(166,089)	-
Other	109,207	-
<b>GAAP net income</b>	<u>\$ 358,836</u>	<u>\$ 1,630,116</u>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Consolidated Financial Statements  
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## 16. STATUTORY ACCOUNTING PRINCIPLES (Continued)

	2013	2012
Statutory capital and surplus as of December 31, prior year	\$ 19,683,946	\$ 17,521,799
<b>Adjustments:</b>		
GAAP net income	303,473	1,630,116
Other comprehensive income	618,151	3,395,023
Asset valuation reserve	1,796,900	1,411,474
Nonadmitted assets	2,212,210	5,381,806
Interest maintenance reserve	350,252	202,024
Deferred acquisition costs	8,215,688	3,193,229
Future policy benefits and policyholder's account balances	(5,127,828)	(1,560,449)
Dividends	(464,632)	(466,315)
Treasury stock	158,444	(42,348)
Allowance for doubtful accounts	(258,622)	(258,622)
Tax provision	(284,638)	(182,662)
Noncontrolling interest adjustment	55,363	-
Other	56,820	(3,275)
<b>GAAP capital and surplus as of December 31, current year</b>	<b>\$ 27,315,527</b>	<b>\$ 30,221,800</b>

## 17. SUBSEQUENT EVENTS

In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through September 18, 2014, the date the consolidated financial statements were available to be issued.

On March 26, 2014, the Utah Insurance Department approved a contribution (surplus) note between the Company (issuer) and Ability Insurance Company (lender) in the amount of \$10,000,000. The scheduled maturity date of the loan is April 1, 2025. Subject to the approval of the Insurance Commissioner of the State of Utah the Company will pay interest thereon, quarterly, in arrears on July 1, October 1, January 1, and April 1 each year commencing July 1, 2014 at the rate of 7.5% annum.