Sentinel Security Life Insurance Company

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

For the Years Ended December 31, 2012 and 2011

Larson
certified public accountants

SENTINEL SECURITY LIFE INSURANCE COMPANY

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certified public accountants

Independent Auditor's Report

The Board of Directors
Sentinel Security Life Insurance Company

We have audited the accompanying financial statements of **Sentinel Security Life Insurance Company**, which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free from material misstatement.

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

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

Basis for Qualified Opinion

The Company did not estimate the following account balances in accordance with generally accepted principles in the United States of America (U.S. GAAP) as of and for the year ended December 31, 2010: future policy benefits, deferred policy acquisition costs, and deferred income taxes. Instead, the Company estimated these amounts in accordance with the financial reporting provisions prescribed or permitted by the Insurance Department of the State of Utah. As such, the effects of the aforementioned variances from U.S. GAAP on the accompanying statement of income, statement of changes in stockholders' equity, and statement of cash flows for the year ended December 31, 2011 have not been determined, but are presumed to be material.

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Unmodified Opinion on 2012 and Qualified Opinion on 2011

In our opinion, except for the effects on the 2011 statement of income, statement of changes in stockholders' equity, and statement of cash flows, from the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of **Sentinel Security Life Insurance Company** as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Larson & Company PC

Salt Lake City, Utah
June 16, 2014

SENTINEL SECURITY LIFE INSURANCE COMPANY

Balance Sheets

As of December 31, 2012 and 2011

	2012	2011
Assets		
Investments:		
Bonds held to maturity, at amortized cost	$ 1,865,655	$ 1,230,176
Bonds withheld for reinsurance, at estimated fair value	260,178,510	29,533,125
(amortized cost: **$245,348,466** and $29,290,092, respectively)		
Bonds available for sale, at estimated fair value,		
(amortized cost: **$96,691,551** and $39,690,546, respectively)	102,114,555	40,383,731
Preferred stock withheld for reinsurance, at estimated fair value		
(cost value: **$2,000,000** and $0, respectively)	2,030,000	-
Preferred stock available for sale at estimated fair value,		
(cost: **$4,487,901** and $5,351,440, respectively)	4,519,442	4,630,820
Common stock, at estimated fair value	2,823,267	5,761,240
Mortgage loans, at amortized cost	2,017,579	2,115,146
Policy loans	1,238,189	1,142,094
Total investments	376,787,197	84,796,332
Cash and cash equivalents, at estimated fair value	15,773,792	17,947,050
Cash and cash equivalents withheld for reinsurance,		
at estimated fair value	3,477,631	41,911,719
Accrued investment income	906,037	548,163
Premiums, reinsurance, and other receivables,		
net of uncollectable agent balances	4,419,025	5,557,964
Deferred policy acquisition costs	8,215,688	3,193,229
Current income tax receivable	344,448	144,976
Property and equipment, net	2,890,382	665,041
Deferred income tax asset	183,723	2,111,133
Other assets	287,555	106,647
Total assets	$ 413,285,478	$ 156,982,254
Liabilities and Stockholders' Equity		
Liabilities:		
Future policy benefits and		
policyholder account balances	$ 111,032,856	$ 50,144,263
Other policy-related balances	1,968,076	1,035,784
Payables and accrued liabilities	4,090,884	8,562,331
Funds held under reinsurance treaties	265,944,276	71,326,094
Unearned advance premiums and investment income	27,586	27,939
Total liabilities	383,063,678	131,096,411
Stockholders' equity:		
Common stock, $7 par value: 500,000 shares authorized;		
359,526 and 359,526 issued, and 290,598 and 291,771		
outstanding, respectively	1,100,470	1,142,818
Additional paid-in capital	201,229	201,229
Retained earnings	25,557,111	24,393,310
Accumulated other comprehensive income	3,362,990	148,486
Total stockholders'equity	30,221,800	25,885,843
Total liabilities and stockholders' equity	$ 413,285,478	$ 156,982,254

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

SENTINEL SECURITY LIFE INSURANCE COMPANY

Statements of Income

For the Years Ended December 31, 2012 and 2011

	2012	2011
Revenues:		
Premiums	$ 70,283,202	$ 29,278,845
Net investment income	4,512,832	2,956,026
Total revenues	74,796,034	32,234,871
Net investment gains:		
Other net investment gains	785,940	75,465
Total net investment gains	785,940	75,465
Other revenues	1,986	3,903
Total revenues	75,583,960	32,314,239
Expenses:		
Policyholder benefits and claims	69,189,283	26,135,609
Other expenses	4,188,312	4,633,650
Total expenses	73,377,595	30,769,259
Net income before provision for income taxes	2,206,365	1,544,980
(Provision for) benefit from income taxes	(576,249)	(289,806)
Net income	$ 1,630,116	$ 1,255,174

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

SENTINEL SECURITY LIFE INSURANCE COMPANY

Statements of Comprehensive Income

For the Years Ended December 31, 2012 and 2011

	2012	2011
Net income	$ 1,630,116	$ 1,255,174
Other comprehensive income:		
Unrealized investment gains arising during period	5,732,893	450,071
Less reclassification adjustment for gains included in net income	(785,940)	(75,465)
Other comprehensive income before income tax	4,946,953	374,606
Income tax expense related to items of other comprehensive income	1,732,449	76,493
Other comprehensive income net of income tax	3,214,504	298,113
Total comprehensive income	$ 4,844,620	$ 1,553,287

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

SENTINEL SECURITY LIFE INSURANCE COMPANY

Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2012 and 2011

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at December 31, 2010	$ 1,176,532	$ 201,229	$23,604,824	$ (149,627)	$ 24,832,958
Net income	-	-	1,255,174	-	1,255,174
Other comprehensive income, net of income tax	-	-	-	298,113	298,113
Dividends paid to stockholders	-	-	(466,688)	-	(466,688)
Treasury stock purchased	(33,714)	-	-	-	(33,714)
Balance at December 31, 2011	1,142,818	201,229	24,393,310	148,486	25,885,843
Net income	-	-	1,630,116	-	1,630,116
Other comprehensive income, net of income tax	-	-	-	3,214,504	3,214,504
Dividends paid to stockholders	-	-	(466,315)	-	(466,315)
Treasury stock purchased	(42,348)	-	-	-	(42,348)
Balance at December 31, 2012	$ 1,100,470	$ 201,229	$25,557,111	$ 3,362,990	$ 30,221,800

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

SENTINEL SECURITY LIFE INSURANCE COMPANY

Statements of Cash Flows

For the Years Ended December 31, 2012 and 2011

	2012	2011
Cash from operating activities:		
Net income	$ 1,630,116	$ 1,255,174
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	255,653	35,167
Amortization of premiums and discounts associated with investments	(429,508)	(69,998)
Gains on investments	(785,940)	(75,465)
Bad-debt expense on agent balances	-	202,040
Change in assets and liabilities:		
Accrued investment income	(357,874)	(125,529)
Premiums, reinsurance, and other receivables	1,138,938	(1,283,116)
Deferred policy acquisition costs	(5,022,459)	(3,193,229)
Current income tax receivable	(199,472)	(144,976)
Deferred income tax asset	271,454	104,941
Other assets	(180,908)	388,641
Future policy benefits and policyholder account balances	60,888,593	19,215,268
Other policy related balances	932,292	484,177
Payables and accrued liabilities	(4,471,447)	7,441,086
Other	(1,809)	5,108
Net cash provided by operating activities	53,667,629	24,239,289
Cash from investing activities:		
Sales, maturities and repayments from:		
Bonds	60,414,266	4,167,161
Equity securities	4,404,930	897,624
Mortgage loans	97,568	77,596
Purchases of:		
Bonds	(329,776,342)	(41,886,580)
Equity securities	(2,606,870)	(647,188)
Mortgage loans	-	(600,000)
Real estate	(1,860,551)	-
Policy loans	(96,095)	(77,501)
Property and equipment	(620,443)	-
Net cash used in investing activities	(270,043,537)	(38,068,888)

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

SENTINEL SECURITY LIFE INSURANCE COMPANY

Statements of Cash Flows

For the Year Ended December 31, 2012 and 2011

	2012	2011
Cash flow from financing activities:		
Deposits	50,068	16,609
Purchase of treasury stock	(42,348)	(33,714)
Dividends on common stock	(466,315)	(466,688)
Other cash provided for funds withheld	176,227,157	70,308,473
Net cash provided by financing activities	175,768,562	69,824,680
Change in cash and cash equivalents	(40,607,346)	55,995,081
Cash and cash equivalents, beginning of year	59,858,769	3,863,688
Cash and cash equivalents, end of year	$ 19,251,423	$ 59,858,769

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

SENTINEL SECURITY LIFE INSURANCE COMPANY
Notes to Financial Statements

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.

Basis of Presentation

The preparation of 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 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.

Insurance

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.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Future Policy Benefit Liabilities and Policyholder Account Balances (Continued)

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. 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recognition of Premium Revenue and Related Expenses (Continued)

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

	2012		2011	
	Gross	Net of Loading	Gross	Net of Loading
Ordinary new business	$ 783,163	$ 221,240	$ 746,809	$ 202,893
Ordinary renewal	2,846,700	1,931,605	2,528,063	1,682,716
Total	$ 3,629,863	$ 2,152,845	$ 3,274,872	$ 1,885,609

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, 2012 and 2011, participating policies account for less than 1% of total insurance, respectively. Total dividends for 2012 and 2011 were $18,032 and $19,269, 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

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, 2012 and 2011 was $202,040.

Investments

Bonds at December 31, 2012 and 2011 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, 2012 and 2011 consist of available-for-sale securities. Available-for-sale common and preferred stocks are recorded at fair value.

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 $223,428 and $28,903 for the years ended December 31, 2012 and 2011, 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 $17,245 and $6,264 for the years ended December 31, 2012 and 2011, respectively.

Buildings and improvements are depreciated on the straight-line basis between three and fifty years. Depreciation expense was $14,979 and $15,005 for the years ended December 31, 2012 and 2011, 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 $67,186 and $23,754 for the years ended December 31, 2012 and 2011, 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Future Policyholder Benefits (Continued)

As of December 31, 2012 and 2011, the Company had 141 and 126 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 $11,530 and $7,806 less than net premiums for 2012 and 2011, 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 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 $663,052 and $153,348 for the years ended December 31, 2012 and 2011, 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 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 2012 through 2010 are subject to examination by the Internal Revenue Service, generally for three years after they are filed.

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, 2012 and 2011. 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 $106,648 and $53,855 for the years ended December 31, 2012 and 2011, 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.

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.

3. INVESTED ASSETS ON DEPOSIT

At December 31, 2012 and 2011, bonds with a fair market value of $3,536,353 and $3,327,954 were on deposit with state insurance departments to satisfy regulatory requirements.

SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

4. INVESTMENTS

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

	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2012				
Bonds:				
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
Total bonds	343,905,672	22,042,008	(1,558,479)	364,389,201
Preferred stock:				
Available-for-sale	4,847,901	46,140	(374,599)	4,519,442
Withheld for reinsurance	2,000,000	30,000	-	2,030,000
Total preferred stocks	6,847,901	76,140	(374,599)	6,549,442
Common stock	2,855,672	290,975	(323,380)	2,823,267
Total	$ 353,609,245	$ 22,409,123	$ (2,256,458)	$ 373,761,910

	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2011				
Bonds:				
Held-to-maturity	$ 1,230,176	$ 232,006	$ -	$ 1,462,182
Available-for-sale	39,690,546	2,644,991	(1,951,806)	40,383,731
Withheld for reinsurance	29,290,092	367,101	(124,068)	29,533,125
Total bonds	70,210,814	3,244,098	(2,075,874)	71,379,038
Preferred stock:				
Available-for-sale	5,354,440	33,200	(756,820)	4,630,820
Withheld for reinsurance	-	-	-	-
Total preferred stocks	5,354,440	33,200	(756,820)	4,630,820
Common stock	5,510,935	928,933	(678,628)	5,761,240
Total	$ 81,076,189	$ 4,206,231	$ (3,511,322)	$ 81,771,098

4. INVESTMENTS (Continued)

Maturities of bonds are as follows as of December 31, 2012:

	Par Value	Fair Market Value	Amortized Cost
Within in year	$ 200,000	$ 199,450	$ 200,000
After one year through five years	109,766,130	116,571,866	110,141,200
After five years through ten years	54,835,808	58,382,554	54,987,941
After ten years through twenty years	18,863,864	19,061,950	17,849,298
After twenty years	190,315,134	170,173,381	160,727,233
Total	$ 373,980,936	$ 364,389,202	$ 343,905,672

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.

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:

	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)
December 31, 2012:				
Assets:				
Stocks:				
Common	$ 2,823,267	$ 2,823,267	$ -	$ -
Preferred	6,549,442	6,549,442	-	-
Mortgage Loans	2,017,579	-	2,017,579	-
Available-for-sale bonds	362,293,065	262,111,105	100,181,960	-
Total	$ 373,683,353	$ 271,483,814	$ 102,199,539	$ -
Liabilities:				
Available-for-sale bonds funds withheld	$ 262,208,510	$ 189,350,191	$ 72,858,319	$ -
Total	$ 262,208,510	$ 189,350,191	$ 72,858,319	$ -

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)
December 31, 2011:				
Assets:				
Stocks:				
Common	$ 5,761,240	$ 5,761,240	$ -	$ -
Preferred	4,630,820	4,630,820	-	-
Mortgage Loans	2,115,146	-	2,115,146	-
Available-for-sale bonds	69,916,856	69,916,856	-	-
Total	$ 82,424,062	$ 80,308,916	$ 2,115,146	$ -
Liabilities:				
Available-for-sale bonds funds withheld	$ 29,533,125	$ 29,533,125	$ -	$ -
Total	$ 29,533,125	$ 29,533,125	$ -	$ -

The Company's policy is to recognize transfers in and transfers out of any level as of the actual date of the event or change in circumstances that caused the transfer. There were no transfers between levels during the reporting period. The reconciliations of investments categorized as Level II are as follows:

	2012	2011
	Asset-Backed Securities	Asset-Backed Securities
Beginning Balance January 1	$ -	$ -
Adjustments:		
Transfers into Level 2	-	-
Transfers out of Level 2	-	-
Total gains and losses included in net income	-	-
Total gains and losses included in OCI	3,344,631	-
Purchases	68,840,671	-
Issuances	-	-
Sales	-	-
Accretion (Amortization)	673,017	-
Ending Balance at December 31	$ 72,858,319	$ -

4. INVESTMENTS (Continued)

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, 2012 and December 31, 2011 represent a temporary decline in market value

As of December 31, 2012 and 2011, the Company did not have any bonds and/or common and preferred stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized.

4. INVESTMENTS (Continued)

The following tables summarize those investments that, as of December 31, 2012 and 2011, were in an unrealized loss position for which other-than-temporary declines in value have not been recognized:

($ In Thousands)

At December 31, 2012	Less Than 12 Months Number Of Issues	Fair Value	Unrealized Losses
Fixed income securities:			
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)
Total fixed income securities	48	34,617	(1,025)
Equity securities:			
Common stock - industrial & misc	-	-	-
Preferred stock - industrial & misc	1	303	-
Total fixed income and equity securities	49	$ 34,920	$ (1,025)

	12 Months or More Number Of Issues	Fair Value	Unrealized Losses
Fixed income securities:			
Industrial and miscellaneous	7	$ 1,299	$ (474)
Hybrid	12	2,460	(59)
Total fixed income securities	19	3,759	(533)
Equity securities:			
Common stock - industrial & misc	7	2,037	(323)
Preferred stock - industrial & misc	11	971	(374)
Total fixed income and equity securities	37	$ 6,767	$ (1,231)

	Total Number Of Issues	Fair Value	Unrealized Losses
Fixed income securities:			
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)
Total fixed income securities	67	38,376	(1,558)
Equity securities:			
Common stock - industrial & misc	7	2,037	(323)
Preferred stock - industrial & misc	12	1,273	(374)
Total fixed income and equity securities	86	$ 41,687	$ (2,256)

4. INVESTMENTS (Continued)

($ In Thousands)

At December 31, 2011	Less Than 12 Months Number Of Issues	Fair Value		Unrealized Losses	
Fixed income securities:					
Industrial and miscellaneous	26	$	19,166	$	(444)
Hybrid	1		73		(127)
Total fixed income securities	27		19,238		(571)
Common stock - industrial & misc	3		340		(43)
Preferred stock - industrial & misc	4		200		(109)
Total fixed income and equity securities	34	$	19,778	$	(723)

	12 Months or More Number Of Issues	Fair Value		Unrealized Losses	
Fixed income securities:					
U.S. special revenue and assessments	1	$	228	$	-
Industrial and miscellaneous	10		1,623		(596)
Hybrid	23		3,961		(909)
Total fixed income securities	34		5,813		(1,505)
Common stock - industrial & misc	10		2,835		(635)
Preferred stock - industrial & misc	14		1,795		(648)
Total fixed income and equity securities	58	$	10,442	$	(2,788)

	Total Number Of Issues	Fair Value		Unrealized Losses	
Fixed income securities:					
U.S. special revenue and assessments	1	$	228	$	-
Industrial and miscellaneous	36		20,789		(1,040)
Hybrid	24		4,034		(1,036)
Total fixed income securities	61		25,051		(2,076)
Common stock - industrial & misc	13		3,174		(679)
Preferred stock - industrial & misc	18		1,995		(757)
Total fixed income and equity securities	92	$	30,220	$	(3,511)

4. INVESTMENTS (Continued)

Realized capital gains on investments consisted of the following:

	2012	2011
Bonds:		
Gross gains from sales	$ 380,344	$ 122,371
Gross losses from sales	(237,203)	-
Preferred stock:		
Gross gains from sales	-	240
Gross losses from sales	(110)	-
Common stock:		
Gross gains from sales	822,537	25,856
Gross losses from sales	(179,628)	(73,002)
Net capital gains	$ 785,940	$ 75,465

Mortgage Loans

Mortgage loans at December 31, 2012 and 2011 totaled $2,017,579 and $2,115,146, respectively. The Company periodically performs an analysis of the fair value of mortgage holdings. This analysis is based on the present value of future cash flows, using an interest rate comparable to market rates for similar holdings. The analysis of the fair value of mortgage holdings as of December 31, 2012 and 2011, respectively, resulted in estimated fair values of $2,017,578 and $2,115,146, respectively. The maximum and minimum lending rate for mortgage loans during the years 2012 and 2011 were 8.00% and 6.50%.

While the borrower is not making regular mortgage payments, on one of the mortgage loans, 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, 2012 and 2011, the Company had a $56,581 and $56,581, respectively, allowance for uncollectible mortgage interest on one of its mortgage loans and uncollectible interest on bonds.

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consisted of the following at December 31, 2012 and December 31, 2011:

	2012	2011
Cash and cash equivalents	$ 15,773,792	$ 17,947,050
Cash and cash equivalents, withheld for reinsurance	3,477,631	41,911,719
Total cash and cash equivalents	$ 19,251,423	$ 59,858,769

6. CONCENTRATION OF CREDIT AND MARKET RISK

The Company maintains several bank and brokerage accounts which may exceed federally insured limits of $250,000 in interest bearing accounts set by the Federal Deposit Insurance Corporation (FDIC). Deposits in non-interest bearing accounts are 100% insured by the FDIC. By operation of federal law, beginning January 1, 2013, funds deposited in noninterest-bearing accounts will no longer receive unlimited deposit insurance coverage by the FDIC. The Company has not experienced any losses in these accounts and believes it is not exposed to any significant credit risk on these balances.

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, 2012 and 2011 the Company held $12,994,171 and $50,168,877 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 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.

7. ACCRUED INVESTMENT INCOME RECEIVABLE

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

	2012	2011
Bonds	$ 907,913	$ 564,452
Preferred stock	32,691	18,638
Common stock	-	3,592
Mortgage loans	19,695	16,906
Policy loans	2,319	1,156
Total accrued investment income	962,618	604,744
Less: allowance of doubtful accounts	56,581	56,581
Total accrued investment income less allowance for doubtful accounts	$ 906,037	$ 548,163

8. PROPERTY AND EQUIPMENT

Property and equipment as of is summarized in the following schedules:

	2012	2011
Occupied by the Company:		
Land	$ 68,444	$ 68,444
Properties occupied by the Company	615,783	615,783
Total real estate occupied	684,227	684,227
Accumulated depreciation	(542,752)	(527,773)
Net real estate occupied by the Company	141,475	156,454
For the production of income:		
Buildings	1,860,551	-
Net real estate held for the production of income	1,860,551	-
Net real estate	2,002,026	156,454
Other property and equipment:		
Furniture and fixtures	203,217	158,938
Electronic data processing equipment	1,171,738	595,574
Total other property and equipment	1,374,955	754,512
Accumulated depreciation	(486,599)	(245,925)
Net other property and equipment	888,356	508,587
Total	$ 2,890,382	$ 665,041

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 $285,851,727 and $105,826,826, and contract liabilities by $314,800,484 and $76,961,286 for the years ended December 31, 2012 and 2011, respectively. During 2012 and 2011, 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, 2012 and 2011, 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.

9. REINSURANCE (Continued)

The following summarizes the amounts of reinsurance ceded for premiums, benefits paid or provided, and loss reserves presented in the accompanying financial statements for the years ended December 31, 2012 and 2011:

	2012	2011
Premiums:		
Gross	$ 356,134,929	$ 135,105,671
Ceded	(285,851,727)	(105,826,826)
Net	$ 70,283,202	$ 29,278,845
Net due and deferred:		
Gross due and deferred		
Gross	$ 3,629,863	$ 3,274,872
Ceded	-	-
Net	3,629,863	3,274,872
Loading		
Gross	(1,477,018)	(1,389,263)
Ceded	-	-
Net	(1,477,018)	(1,389,263)
Net due and deferred		
Gross	2,152,845	1,885,609
Ceded	-	-
Net	$ 2,152,845	$ 1,885,609
Aggregate reserves - life:		
Gross	$ 422,047,138	$ 124,018,847
Ceded	(311,702,664)	(74,447,606)
Net	$ 110,344,474	$ 49,571,241
Aggregate reserves - accident and health:		
Gross	$ 3,441,688	$ 2,792,978
Ceded	(3,097,820)	(2,513,680)
Net	$ 343,868	$ 279,298
Claims payable:		
Gross	$ 10,464,638	$ 5,621,699
Ceded	(8,764,353)	(4,703,755)
Net	$ 1,700,285	$ 917,944
Claims:		
Gross	$ 46,190,645	$ 30,684,523
Ceded	(38,835,222)	(24,748,082)
Net	$ 7,355,423	$ 5,936,441

SENTINEL SECURITY LIFE INSURANCE COMPANY
Notes to Financial Statements

10. INCOME TAXES

Income taxes for the years ended December 31, 2012 and 2011 consisted of the following:

	2012	2011
Current:		
Federal	$ 304,795	$ 183,833
Total current income taxes	304,795	183,833
Deferred:		
Federal	271,454	105,973
Total deferred income taxes	271,454	105,973
Provsion for income taxes	$ 576,249	$ 289,806

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

	2012	Percentage	2011	Percentage
Computed income tax (benefit) expense at the statutory rate of 34%	$ 750,164	34.0%	$ 525,293	34.0%
Meals and entertainment	4,467	0.2%	7,276	0.5%
Amortization of interest maintenance reserve	(12,287)	-0.6%	(6,237)	-0.4%
Dividends received deduction	(13,658)	-0.6%	(59,063)	-3.8%
Tax exempt interest	(19,683)	-0.9%	-	0.0%
Capital gains (losses)	176,364	8.0%	16,934	1.1%
Small life insurance company deduction	(327,414)	-14.8%	(131,149)	-8.5%
Loading on deferred premiums	-	0.0%	390	0.0%
Rent income	10,200	0.5%	10,200	0.7%
Investment expenses	-	0.0%	(69,947)	-4.5%
Other	8,096	0.4%	(3,891)	-0.3%
Provision for income taxes	$ 576,249	26.1%	$ 289,806	18.8%

SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

10. INCOME TAXES (Continued)

The temporary differences and carryforwards which give rise to the deferred tax assets (liabilities) as of December 31, 2012 and 2011 consist of the following:

	2012	2011
Deferred tax assets:		
Uncollected premiums	$ 53,121	$ 56,705
Advanced premium	28,483	33,028
Interest income	204,361	124,623
Dividend income	-	6,888
Reserves	3,027,287	1,715,257
Capital gains (losses)	-	22,062
Fixed assets	-	1,509
Accrued vacation	63,258	-
Other	31,522	-
AMT carryforward	1,407,212	1,338,988
Total deferred tax assets	4,815,244	3,299,060
Deferred tax liabilities:		
Deferred premiums and agent balances	720,616	632,779
Deferred acquisition costs	1,777,440	467,131
Interest maintenance reserve	61,921	11,524
Investments	1,732,449	76,493
Dividend income	103,666	-
Capital gains (losses)	91,618	-
Fixed assets	143,464	-
Other	347	-
Total deferred tax liabilities	4,631,521	1,187,927
Net deferred tax assets (liabilities)	$ 183,723	$ 2,111,133

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, 2012 and 2011.

At December 31, 2012 and 2011, the Company also has federal alternative minimum tax (AMT) credit carryforwards of $1,407,212 and $1,338,988, respectively, which have no expiration date.

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 $154,973 and $116,061 for 2012 and 2011, respectively. As of December 31, 2012 and 2011, the fair value of the plan assets was $2,077,712 and $1,941,927 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, 2012 and 2011, the Company estimated the obligation for compensated absences to be $235,015 and $125,649 respectively.

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 statutory 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, 2012 and 2011.

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, 2012 and 2011, 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 $(16,897) and $8,422 during the years ended December 31, 2012 and 2011, respectively.

	2012	2011
Balance at January 1	$ 522,639	$ 93,358
Incurred, related to:		
Current year	4,199,791	2,727,033
Prior years	(16,897)	8,422
Total incurred	4,182,894	2,735,455
Paid, related to:		
Current year	3,230,039	2,204,619
Prior years	501,540	101,555
Total paid	3,731,579	2,306,174
Balance at December 31	$ 973,954	$ 522,639

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.

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, 2012 and 2011 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
For the year ended December 31, 2012:					
American Insurance Administrators LLC	26-1193300	No	Medicare	C,CA,P,U	$ 53,919,852
2536 Countryside Blvd., Suite 430			Supplement		
Clearwater, FL 33763					
For the year ended December 31, 2011:					
American Insurance Administrators LLC	26-1193300	No	Medicare	C,CA,P,U	$ 35,796,800
2536 Countryside Blvd., Suite 430			Supplement		
Clearwater, FL 33763					

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.

	2012	2011
Statutory net income (loss) per the annual statement	$ (34,607)	$ 216,947
Statutory audit adjustment	320,433	(320,433)
Adjusted statutory net income (loss) per the statutory audit	285,826	(103,486)
Adjustments:		
Future policy benefits and policyholder's account balances	(3,554,951)	(1,560,449)
Deferred policy acquisition costs	5,022,459	3,193,229
Deferred income taxes	(271,454)	(105,973)
Interest maintenance reserve	148,236	33,893
Allowance for bad-debts	-	(202,040)
GAAP net income	$ 1,630,116	$ 1,255,174

16. STATUTORY ACCOUNTING PRINCIPLES (Continued)

	2012	2011
Statutory capital and surplus as of December 31, prior year	$ 17,521,799	$ 18,635,461
Adjustments:		
GAAP net income	1,630,116	1,255,174
Other comprehensive income	3,395,023	662,505
Asset valuation reserve	1,411,474	1,518,787
Nonadmitted assets	5,381,806	3,770,870
Interest maintenance reserve	202,024	168,130
Deferred acquisition costs	3,193,229	-
Future policy benefits and policyholder's account balances	(1,560,449)	-
Dividends	(466,315)	(466,688)
Treasury stock purchased	(42,348)	(33,714)
Allowance for doubtful accounts	(202,040)	-
Tax provision	(182,662)	342,620
Other	(59,857)	32,698
GAAP capital and surplus as of December 31, current year	$ 30,221,800	$ 25,885,843

17. SUBSEQUENT EVENTS

In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through June 16, 2014, the date the financial statements were available to be issued.

In April of 2013, the Company began selling fixed indexed annuities. Also during 2013, the Company relocated to a new office building and licensed in four additional states to sell its insurance and annuity products.

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.