

CAYUGA MUTUAL INSURANCE COMPANY

FINANCIAL STATEMENTS

For the year ended December 31, 2010



Millard, Rouse & Rosebrugh LLP
Chartered Accountants

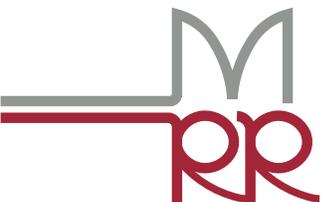


CAYUGA MUTUAL INSURANCE COMPANY

For the year ended December 31, 2010

INDEX

| | Page |
|---|--------|
| INDEPENDENT AUDITORS' REPORT | 1 |
| FINANCIAL STATEMENTS | |
| Balance Sheet | 2 |
| Statement of Retained Earnings | 3 |
| Statement of Accumulated Other Comprehensive Income | 3 |
| Statement of Comprehensive Income | 3 |
| Statement of Income | 4 |
| Schedule of Expenses | 5 |
| Statement of Cash Flows | 6 |
| Notes to the Financial Statements | 7 - 19 |



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INDEPENDENT AUDITORS' REPORT

To the Policyholders of
Cayuga Mutual Insurance Company

We have audited the accompanying financial statements of Cayuga Mutual Insurance Company, which comprise the balance sheet as at December 31, 2010 and the statements of income, comprehensive income, retained earnings, accumulated other comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal controls as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Cayuga Mutual Insurance Company as at December 31, 2010 and its financial performance and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

February 17, 2011

CHARTERED ACCOUNTANTS
Licensed Public Accountants

CAYUGA MUTUAL INSURANCE COMPANY

BALANCE SHEET

| As at December 31 | 2010 | 2009 |
|--|------------|------------|
| ASSETS | | |
| Cash and cash equivalents | 1,251,150 | 946,073 |
| Bonds, Debentures and Marketable Securities (Note 5) | 14,298,894 | 13,889,759 |
| Investment income accrued | 63,447 | 97,818 |
| Premiums outstanding | 1,011,154 | 822,422 |
| Income taxes recoverable | - | 116,865 |
| Prepaid expenses and other assets | 62,711 | 59,967 |
| Due from reinsurers | 594,896 | 477,418 |
| Reinsurance recoverable on unpaid claims | 3,211,816 | 3,613,968 |
| Deferred policy acquisition expenses | 327,960 | 280,427 |
| Future income tax | 27,117 | 155,633 |
| Property, plant and equipment (Note 6) | 1,849,214 | 1,860,110 |
| | 22,698,359 | 22,320,460 |
| LIABILITIES | | |
| Provision for unpaid claims | 7,703,161 | 8,618,626 |
| Unearned premiums | 2,802,924 | 2,510,111 |
| Accounts payable and accrued liabilities | 362,559 | 225,337 |
| Income taxes payable | 9,386 | - |
| F.A.R.M. Funds due to Facility Association | 120,582 | 130,988 |
| Premiums paid in advance | 23,462 | 33,197 |
| | 11,022,074 | 11,518,259 |
| EQUITY | | |
| Retained Earnings | 11,915,791 | 11,272,426 |
| Accumulated other comprehensive income (loss) | (239,506) | (470,225) |
| | 11,676,285 | 10,802,201 |
| | 22,698,359 | 22,320,460 |

Approved on behalf of the Board of Directors

- B. Horvath - Director

- H. Meadows - Director

CAYUGA MUTUAL INSURANCE COMPANY

STATEMENT OF RETAINED EARNINGS

| For the year ended December 31 | 2010 | 2009 |
|------------------------------------|------------|------------|
| Balance - Beginning of Year | 11,272,426 | 11,581,044 |
| Net Income (Loss) | 643,365 | (308,618) |
| Balance - End of Year | 11,915,791 | 11,272,426 |

STATEMENT OF ACCUMULATED OTHER COMPREHENSIVE INCOME

| For the year ended December 31 | 2010 | 2009 |
|------------------------------------|-----------|-----------|
| Balance - Beginning of Year | (470,225) | (863,434) |
| Other Comprehensive Income (Loss) | 230,719 | 393,209 |
| Balance - End of Year | (239,506) | (470,225) |

STATEMENT OF COMPREHENSIVE INCOME

| For the year ended December 31 | 2010 | 2009 |
|---|---------|-----------|
| Net Income (Loss) | 643,365 | (308,618) |
| Change in Unrealized Gains and Losses on Available for Sale Investments | 227,880 | 393,209 |
| Reclassification adjustment for realized (gain) losses included in income | 2,839 | - |
| Total Other Comprehensive Income (Loss) | 230,719 | 393,209 |
| Total Comprehensive Income | 874,084 | 84,591 |

CAYUGA MUTUAL INSURANCE COMPANY

STATEMENT OF INCOME

| For the year ended December 31 | 2010 | 2009 |
|---|-----------|-----------|
| Underwriting Operations | | |
| Gross premiums written net of rebates and returned premiums | 6,830,553 | 6,023,504 |
| Less: Premiums paid reinsurance | 1,410,520 | 1,118,592 |
| Increase (Decrease) in reserve for unearned premiums | 292,813 | 203,965 |
| | 1,703,333 | 1,322,557 |
| Net Premiums Earned | 5,127,220 | 4,700,947 |
| Expenses | | |
| Claims Expenses | | |
| Claims less reinsurance recoveries | 1,923,922 | 3,274,252 |
| Adjusting expenses (net) | 546,407 | 452,559 |
| Commissions paid (net) | 624,780 | 549,624 |
| | 3,095,109 | 4,276,435 |
| Salaries, Fees and Travelling Expenses (Page 5) | 805,086 | 640,566 |
| Other Expenses (Page 5) | 766,943 | 755,144 |
| Total Expenses | 4,667,138 | 5,672,145 |
| Underwriting Income (Loss) | 460,082 | (971,198) |
| Investment and Other Income | | |
| Interest on bonds, debentures and bank balances | 587,883 | 524,528 |
| Dividend income | - | 4,045 |
| Realized gain (loss) on maturity of investments and bond amortization | (12,269) | (4,248) |
| Loss on sale of investments | (3,762) | - |
| Loss on disposal of property, plant and equipment | (2,231) | - |
| Other income and expense (net) | (6,598) | 20,231 |
| Total Investment and Other Income | 563,023 | 544,556 |
| Income (Loss) Before Income Taxes | 1,023,105 | (426,642) |
| Provision for income taxes (Note 8) | 125,120 | (118,024) |
| Income (Loss) After Income Taxes | 897,985 | (308,618) |
| Extraordinary Item - Settlement Costs (Note 11) | 254,620 | - |
| Net Income (Loss) | 643,365 | (308,618) |

CAYUGA MUTUAL INSURANCE COMPANY

SCHEDULE OF EXPENSES

| For the year ended December 31 | 2010 | 2009 |
|---|----------------|----------------|
| Salaries, Fees and Travelling Expenses | | |
| Salaries | 322,849 | 285,175 |
| Directors' fees | 94,986 | 98,730 |
| Professional fees | 90,786 | 83,519 |
| Travelling expenses | 66,662 | 79,894 |
| Canada pension plan and staff benefits | 222,417 | 87,627 |
| Employment insurance | 7,386 | 5,621 |
| | 805,086 | 640,566 |
| Other Expenses | | |
| Advertising | 24,498 | 38,999 |
| Postage and telephone | 41,572 | 41,559 |
| Printing, stationery and office supplies | 83,195 | 85,050 |
| Corporation premium tax | 13,114 | 12,121 |
| Association fees | 28,276 | 25,266 |
| Insurance | 28,124 | 19,297 |
| Other administrative expense | 118,508 | 97,400 |
| Computer expenses | 164,449 | 196,079 |
| Building expenses | 76,877 | 74,482 |
| Amortization | 95,327 | 107,915 |
| Fire prevention expenses (net) | 93,003 | 56,976 |
| | 766,943 | 755,144 |

CAYUGA MUTUAL INSURANCE COMPANY

STATEMENT OF CASH FLOWS

| For the year ended December 31 | 2010 | 2009 |
|---|-------------|-------------|
| Cash Flows From Operating Activities | | |
| Net Income | 643,365 | (308,618) |
| Adjustments to convert income to a cash basis: | | |
| Amortization | 98,359 | 109,188 |
| Future income taxes (benefit) | 50,847 | (2,460) |
| (Increase) Decrease in reinsurance recoverable on unpaid claims | 402,152 | (1,380,960) |
| Increase (Decrease) in provision for unpaid claims | (915,465) | 2,801,363 |
| Increase (Decrease) in unearned premiums | 292,813 | 203,965 |
| Increase (Decrease) in accounts payable, accrued liabilities and other operating liabilities | 136,202 | (24,061) |
| Increase (Decrease) in premiums paid in advance | (9,735) | (535) |
| (Increase) Decrease in deferred policy acquisition expense | (47,533) | (23,997) |
| (Increase) Decrease in receivables and other operating assets | (157,718) | (49,999) |
| Amortization of bond discounts/premiums | 12,269 | 4,248 |
| (Gain) Loss on sale of investments | 3,762 | - |
| Gain (Loss) on disposal of equipment and property | 2,231 | - |
| | 511,549 | 1,328,134 |
| Cash Flows From Investing Activities | | |
| Purchase of property, plant and equipment | (90,435) | (49,278) |
| Proceeds on disposal of equipment and property | 741 | - |
| Sale of investments | 1,512,396 | 755,000 |
| Purchase of investments | (1,629,174) | (1,987,973) |
| | (206,472) | (1,282,251) |
| Net Increase in Cash and Cash Equivalents | 305,077 | 45,883 |
| Opening Cash and Cash Equivalents | 946,073 | 900,190 |
| Closing Cash and Cash Equivalents | 1,251,150 | 946,073 |

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

Cayuga Mutual Insurance Company is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property and automobile insurance in Ontario.

1. CHANGES IN ACCOUNTING POLICIES

Future Accounting Changes

In 2008, the Canadian Accounting Standards Board announced that GAAP for publicly accountable enterprises will be replaced by International Financial Reporting Standards (IFRS) for fiscal years beginning on or after January 1, 2011. As a publicly accountable enterprise, the Company will be required to prepare its December 31, 2011 financial statements including comparative information in compliance with IFRS.

IFRS uses a conceptual framework similar to Canadian GAAP, but there could be significant differences in recognition, measurement and disclosures. The Company has prepared a reconciliation of equity from Canadian GAAP to IFRS on the date of transition (January 1, 2010) and does not expect any material adjustments on transition.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Company conform with those generally accepted in Canada and comply with the requirements for filing with the Financial Services Commission of Ontario.

(a) Measurement

Financial statements are based on representations that may require estimates to be made in anticipation of future transactions and events and include measurement that may, by their nature, be approximations.

(b) Financial Assets

Available for Sale (AFS) Financial Assets

AFS financial assets with quoted prices in an active market are carried at fair value on the balance sheet from the settlement date. Any changes in fair values are recorded, net of income taxes, in other comprehensive income (OCI) until the financial asset is disposed of or has become other than temporarily impaired. When the asset is disposed of, or has become impaired, the accumulated fair value adjustments recognized in accumulated other comprehensive income (AOCI) are transferred to the income statement and, accordingly, a corresponding adjustment (net of income taxes) is made to OCI. A provision for impairment for equity instruments and debt securities classified as AFS is established when there is objective evidence that the investment is impaired and the impairment is other than temporary. A provision for impairment for loans and receivables classified as AFS is established when there is objective evidence that the Company will not be able to collect all amounts due according to their original terms. Equity investments that are classified as AFS and do not have a quoted price in an active market are recorded at cost.

The Company has classified all stocks, mutual and pooled funds as AFS.

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Financial Assets (continued)

Held to Maturity (HTM) Financial Assets

HTM financial assets have fixed or determinable payments and management has the positive intention and ability to hold them to maturity. These assets are recognized initially at fair value and subsequently measured at amortized cost using the effective interest rate method. A provision for impairment of debt securities classified as HTM is established when there is objective evidence of impairment and the impairment is other than temporary. The investment will be written down to its fair value.

The Company has classified all bonds and debentures as HTM.

Held for Trading (HFT) Financial Assets and Liabilities

HFT financial assets and liabilities are carried at fair value on the balance sheet from the settlement date and changes in fair values are recorded in net income. HFT financial assets and liabilities are purchased or incurred with the intention of generating profits in the near term (classified as HFT) or are designated as such by the Company.

The Company has classified cash as HFT.

Loans and Receivables

Financial assets classified as loans and receivables are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method.

The Company has classified accounts receivable as loans and receivables.

Transaction Costs

Transaction costs are expensed as incurred for financial instruments classified or designated as HFT. For other financial instruments, transactions costs are expensed on initial recognition.

(c) Fair Value

The fair value of financial instruments, such as accounts receivable, accounts payable and accrued liabilities and customer deposits are determined to approximate their recorded value due to their short term maturity.

The fair value of bonds, debentures, mutual funds and marketable securities is based on quoted market values as at year end.

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Premiums Earned and Deferred Policy Acquisition Expenses

Insurance premiums are included in income on an annual pro-rata basis over the life of the policies. Acquisition expenses related to unearned premiums, which expenses comprise commissions, premium taxes, association fees and certain identified business development costs, are deferred and amortized to income over the periods in which the premiums are earned. The method followed in determining the deferred acquisition expenses limits the amount of the deferral to its realizable value by giving consideration to claims and expenses expected to be incurred as the premiums are earned. Premium deficiencies arising as a result of anticipated future claims and expenses exceeding unearned premiums are recognized by writing off any unamortized deferred policy acquisition expenses to the extent required.

(e) Unpaid Claims

The provision for unpaid claims represents an estimate for the full amount of all costs including investigation and the projected final settlements of claims incurred prior to the balance sheet date. These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. These provisions are adjusted up or down as additional information affecting the estimated amounts becomes known during the course of claims settlement. All changes in estimates are recorded as incurred claims in the current period.

(f) Reinsurance Ceded

Reinsurance premiums ceded and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts. Unearned premiums on business ceded are recorded as deductions from unearned premiums. Estimates of amounts recoverable from the reinsurer on unpaid claims and adjustment expenses are recorded as an asset.

A contingent liability exists with respect to reinsurance ceded which could become a liability of the Company in the event that the reinsurer might be unable to meet its obligations under the reinsurance agreements.

(g) Property, Plant and Equipment and Amortization

Property, plant and equipment are stated at historical cost. Amortization is provided for in the accounts at rates reflecting the estimated useful lives of the assets as follows:

| | |
|--------------------------------|---|
| Building | annual rate of 2.5% straight line basis |
| Parking lot | annual rate of 10% straight line basis |
| Automotive equipment | 30% declining balance |
| Office furniture and equipment | 20% declining balance |
| Computer equipment | straight line basis over a 5 year term |

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Future Income Taxes

The Company follows the liability method of accounting for income taxes.

Under this method, future income tax assets are recognized based on the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax basis, using the enacted income tax rates for the years in which the differences are expected to reverse.

3. UNDERWRITING POLICY

The Company follows the policy of underwriting and reinsuring contracts of insurance which, in the main, limit the liability of the Company to a maximum amount on any one claim of \$175,000 in the event of a property claim, an amount of \$100,000 in the event of a liability claim, and an amount of \$150,000 in the event of an automobile claim.

In addition, the Company has obtained catastrophe reinsurance having no upper limit and which limited the Company's liability in the event of a series of claims arising out of a single occurrence.

4. REINSURANCE CEDED

The Company cedes reinsurance to another insurer in order to limit the maximum loss through the spreading of risks. Reinsurance ceded does not relieve the Company of primary liability as the originating insurer. All reinsurance is placed with Farm Mutual Reinsurance Plan Inc.

5. INVESTMENTS

The fair value of the Company's investment portfolio by financial instrument classification at December 31 is as follows:

| 2010 | Classified as AFS | Classified as HTM | Total Carrying Value |
|----------------------------|----------------------|----------------------|----------------------------|
| Bonds, debentures and GICs | - | 9,164,282 | 9,164,282 |
| Preferred shares | 86,360 | - | 86,360 |
| Common shares | 500 | - | 500 |
| Other invested assets | | | |
| -mutual & pooled funds | 5,047,752 | - | 5,047,752 |
| Total investments | 5,134,612 | 9,164,282 | 14,298,894 |

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

5. INVESTMENTS (continued)

| 2009 | Classified as AFS | Classified as HTM | Total Carrying Value |
|----------------------------|----------------------|----------------------|----------------------------|
| Bonds, debentures and GICs | - | 9,217,401 | 9,217,401 |
| Preferred shares | 86,360 | - | 86,360 |
| Common shares | 500 | - | 500 |
| Other invested assets | | | |
| -mutual & pooled funds | 4,585,498 | - | 4,585,498 |
| Total investments | 4,672,358 | 9,217,401 | 13,889,759 |

(a) Stocks and Other Invested Assets

| 2010 | Cost amount | Fair value carrying amount | Difference |
|---|------------------|-------------------------------|------------------|
| Canadian preferred shares | 86,360 | 86,360 | - |
| Canadian common shares | 500 | 500 | - |
| Mutual Funds | 1,262,204 | 1,233,720 | (28,484) |
| Pooled funds | 4,070,254 | 3,814,032 | (256,222) |
| Total stocks and other invested assets | 5,419,318 | 5,134,612 | (284,706) |

| 2009 | Cost amount | Fair value carrying amount | Difference |
|---|------------------|-------------------------------|------------------|
| Canadian preferred shares | 86,360 | 86,360 | - |
| Canadian common shares | 500 | 500 | - |
| Mutual Funds | 1,240,177 | 1,163,426 | (76,751) |
| Pooled funds | 3,938,416 | 3,422,072 | (516,344) |
| Total stocks and other invested assets | 5,265,453 | 4,672,358 | (593,095) |

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

5. INVESTMENTS (continued)

| (b) Bonds, Debentures and GICs | 2010 | | 2009 | |
|----------------------------------|-----------|------------|-----------|------------|
| | Cost | Fair value | Cost | Fair value |
| GICs | 100,000 | 100,000 | 783,000 | 783,000 |
| Federal | 1,817,294 | 1,927,145 | 1,928,640 | 2,016,550 |
| Provincial | 3,218,248 | 3,349,176 | 2,997,227 | 3,114,390 |
| Municipal | 2,210,811 | 2,313,760 | 1,999,425 | 2,072,983 |
| Corporate - A or better | 1,802,254 | 1,864,487 | 1,493,969 | 1,550,529 |
| Other | 15,675 | 15,675 | 15,140 | 15,140 |
| Total bonds, debentures and GICs | 9,164,282 | 9,570,243 | 9,217,401 | 9,552,592 |

(c) Investment Income

Investment income for the year ended December 31, 2010 was derived from the following:

| | 2010 | 2009 |
|---|----------|---------|
| AFS securities - dividend income | - | 4,045 |
| - interest income | 157,626 | 109,997 |
| HTM interest income | 430,257 | 414,531 |
| Realized gain (loss) on maturity of HTM | (12,269) | (4,248) |
| Gain (loss) on sale of investments | (3,762) | - |
| | 571,852 | 524,325 |

The effective investment yield for 2010 is 3.65% (2009 3.73%).

(d) Disclosures Relating to Fair Value Measurements

In compliance with CICA 3862, the Company has categorized its assets and liabilities that are carried at fair value on a recurring basis, based on the priority of the inputs to the valuation techniques used to measure fair value, into a three level fair value hierarchy. Financial assets and liabilities measured at fair value are categorized as follows:

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

5. INVESTMENTS (continued)

(d) Disclosures Relating to Fair Value Measurements (continued)

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

Level 2: - Fair value is based on quoted prices for similar assets or liabilities in active markets, valuation that is based on significant observable inputs or inputs that are derived principally for or corroborated with observable market data through correlation or other means.

Level 3: - Fair value is based on valuation techniques that require one or more significant unobservable inputs or the use of broker quotes. These unobservable inputs reflect the Company's assumptions about the assumptions market participants would use in pricing the assets or liabilities.

Disclosures of fair value are not required:

- i) when the carrying amount is a reasonable approximation of fair value, such as short term receivables and payables, and
- ii) for investments in equity instruments that do not have a quoted market value in an active market and are carried at cost (other than instruments classified as HFT).

| 2010 | Level 1 | Level 2 | Total |
|-------------------------------------|----------------|----------------|--------------|
| Assets - Cash and cash equivalents | 1,251,150 | - | 1,251,150 |
| Farm Mutual Pooled Funds | | | |
| - Canadian Fixed Income | - | 1,925,414 | 1,925,414 |
| - Canadian Equity | - | 1,888,618 | 1,888,618 |
| Mutual Funds | - | 1,233,720 | 1,233,720 |
| Total assets measured at fair value | 1,251,150 | 5,047,752 | 6,298,902 |

| 2009 | Level 1 | Level 2 | Total |
|-------------------------------------|----------------|----------------|--------------|
| Assets - Cash and cash equivalents | 946,073 | - | 946,073 |
| Farm Mutual Pooled Funds | | | |
| - Canadian Fixed Income | - | 1,794,441 | 1,794,441 |
| - Canadian Equity | - | 1,627,631 | 1,627,631 |
| Mutual Funds | - | 1,163,426 | 1,163,426 |
| Total assets measured at fair value | 946,073 | 4,585,498 | 5,531,571 |

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

| 6. PROPERTY, PLANT AND EQUIPMENT | Cost | Accumulated Amortization | 2010 | 2009 |
|---|------------------|---------------------------------|------------------|------------------|
| Land | 311,093 | - | 311,093 | 311,093 |
| Building | 1,597,998 | 268,172 | 1,329,826 | 1,369,918 |
| Parking lot | 44,937 | 35,905 | 9,032 | 11,885 |
| Automotive equipment | 101,601 | 44,874 | 56,727 | 24,348 |
| Office furniture and equipment | 321,952 | 236,117 | 85,835 | 89,879 |
| Computer equipment | 204,636 | 147,935 | 56,701 | 52,987 |
| | 2,582,217 | 733,003 | 1,849,214 | 1,860,110 |

Automotive equipment amortization has been allocated to specific expense categories as follows:

| | | | |
|--------------------|----|-------|------------------|
| Adjusting expenses | \$ | 3,032 | (2009 - \$1,273) |
|--------------------|----|-------|------------------|

7. PENSION PLAN

The Company participates in the OMIA Pension Plan. The pension plan has a defined benefit, best five years, option available to employees. This option is funded by employee and employer contributions at levels determined by the Plan Actuaries. The pension fund uses the accrued benefit actuarial method and best estimate assumptions in valuing pension obligations for the defined benefit portion.

The most recent actuarial valuation using this method and these assumptions was made as of December 31, 2009. Pension plan assets were valued at market related values.

The amount contributed by the Company for 2010 was \$61,039 (2009 - \$49,195) to cover its obligations for current service under the defined benefit option of the plan. The Company also contributed \$130,713 in 2010 to fund the solvency deficit of the plan.

Since the Company makes up for any funding deficits and discontinues contributions when there is a funding surplus as a result of an actuarial valuation, no accrued assets or liabilities of the defined benefit plan are included in the balance sheet. It is expected that further solvency deficit funding for the pension plan will be necessary in 2011.

The next actuarial valuation of the plan will be made as of December 31, 2010. It is anticipated that the valuation report will be issued in the first half of 2011.

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

8. INCOME TAXES

Under provisions in the Canadian Income Tax Act, the Company is responsible for income taxes on the portion of its income that relates to non-farm business. The portion of income in respect of the insurance of farm property or the residences of farmers is exempt from income taxes under Section 149(1)(t) of the Canadian Income Tax Act. The provision for income taxes reported differs from the amount computed by applying the Canadian Statutory rate to income before income taxes for the following reasons:

| | 2010 | 2009 |
|---|----------|-----------|
| Provision for (Recovery of) income taxes before under-noted items | 317,163 | (172,235) |
| Tax effect of extraordinary item | (78,932) | - |
| Small business tax credit | (70,175) | - |
| Farm Income exemption | (37,278) | 101,385 |
| Other items | (5,658) | (47,174) |
| Income tax expense (recovery) | 125,120 | (118,024) |

During the year the Company made income tax payments totaling \$13,000 (2009 - \$11,878).

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

9. FINANCIAL INSTRUMENT RISK EXPOSURE AND MANAGEMENT

The principal financial instruments from which financial instrument risk arises are trade accounts receivable, investments and accounts payable.

Risk Management

The Company's management and Board of Directors identify and address risks facing the Company. There has been no significant change in the Company's risk management framework.

(a) Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause a financial loss for the Company. The Company remains exposed to credit risk primarily through amounts receivable from policyholders and reinsurers and its investment portfolio.

The Company's credit exposure to any one individual policyholder is not material.

The Company monitors the financial condition of its reinsurer, Farm Mutual Reinsurance Plan Inc.

The majority of the Company's investment portfolio is invested in well-established, active and liquid markets. The Company's investment policy is to invest primarily in fixed income securities and requires that at the time of investment all fixed income securities have a minimum credit rating of A. Management monitors subsequent credit rating changes on a regular basis. See Note 5 (Investments) for additional information regarding the credit quality of investments, investments that are impaired and concentration of investments by issuer.

The Company's maximum exposure to credit risk for investments is the fair value carrying amount. The risk of significant credit loss for accounts receivable is considered remote.

(b) Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet cash flow obligations as they come due.

The liquidity requirements of the Company's business have been met primarily by funds generated from operations, asset maturities and income and other returns received on securities. Cash provided from these sources is used primarily for claims and claim adjustment expenses payments and operating expenses. The timing and amount of catastrophe claims are inherently unpredictable and may create increased liquidity requirements. To manage its cash flow requirements, the Company maintains a portion of its invested assets in liquid securities.

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

9. FINANCIAL INSTRUMENT RISK EXPOSURE AND MANAGEMENT (continued)

(b) Liquidity Risk (continued)

| 2010 | No fixed maturity | <1 year | 1-5 years | >5 years | Total |
|----------------------------|-------------------|----------------|------------------|------------------|-------------------|
| Bonds, debentures & GICs | - | 650,991 | 3,470,880 | 5,042,411 | 9,164,282 |
| Preferred shares | 86,360 | - | - | - | 86,360 |
| Common shares | 500 | - | - | - | 500 |
| Mutual & Pooled funds | 5,047,752 | - | - | - | 5,047,752 |
| Total | 5,134,612 | 650,991 | 3,470,880 | 5,042,411 | 14,298,894 |
| Percentage of Total | 35.9 % | 4.6 % | 24.3 % | 35.2 % | - |

| 2009 | No fixed maturity | <1 year | 1-5 years | >5 years | Total |
|----------------------------|-------------------|------------------|------------------|------------------|-------------------|
| Bonds, debentures & GICs | - | 1,398,212 | 3,122,796 | 4,696,393 | 9,217,401 |
| Preferred shares | 86,360 | - | - | - | 86,360 |
| Common shares | 500 | - | - | - | 500 |
| Mutual & Pooled funds | 4,585,498 | - | - | - | 4,585,498 |
| Total | 4,672,358 | 1,398,212 | 3,122,796 | 4,696,393 | 13,889,759 |
| Percentage of Total | 33.6 % | 10.1 % | 22.5 % | 33.8 % | - |

(c) Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.

Currency Risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange values. The Company is not significantly exposed to foreign exchange rate risk.

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

9. FINANCIAL INSTRUMENT RISK EXPOSURE AND MANAGEMENT (continued)

(c) (continued)

Interest Rate Risk

Interest rate risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company is exposed to interest rate risk, as the majority of its investment portfolio is comprised of fixed income bonds and debentures that are held to maturity. Periodic changes in interest rates cause reinvestment yields to be different than the original yields on maturing bonds and debentures.

In order to manage interest rate risk, the Company varies the maturity dates of bonds to avoid a significant number of bond maturities occurring at the same date. In addition, the Company avoids placing a significant amount of investment with a specific bond issuer.

The impact of an assumed 1% (100 basis point) decrease in interest rates on renewal of fixed rate investments maturing within the next twelve months would decrease investment income in the next twelve month period by approximately \$6,500 (2009 - \$13,760).

Other Price Risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Company is exposed to other price risk through its holdings in common shares, preferred shares, mutual funds and pooled funds that are subject to changes in market prices. Fluctuations in the market value of these investments affect the carrying value of these securities causing changes in realized and unrealized gains and losses. Management monitors the ongoing performance of mutual and pooled funds monthly and ensures that investments are diversified by sector and geographically.

| The Company's equity investments are concentrated as follows: | 2010 | 2009 |
|---|-----------|-----------|
| Trimark Core Canadian Balanced Fund | 89,248 | 92,337 |
| Trimark Income & Growth Fund | 1,005,867 | 1,055,128 |
| AIM Invesco Core Canadian Balanced Fund | 138,605 | 15,961 |
| Farm Mutual Canadian Equity Pooled Fund | 1,888,618 | 1,627,631 |
| Farm Mutual Canadian Fixed Income Pooled Fund | 1,925,414 | 1,794,441 |
| | 5,047,752 | 4,585,498 |

It is estimated that an immediate hypothetical 5% decrease in market value of stocks, mutual and pooled funds would result in a unrealized loss of \$252,388 at December 31, 2010 (2009 - \$229,275).

CAYUGA MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2010

10. CAPITAL MANAGEMENT

The Company's objectives in managing its capital are to maintain financial stability for policyholders and meet regulatory requirements. Mutual insurance companies are regulated by the provisions of the Insurance Companies Act (ICA) and the Financial Services Commission of Ontario (FSCO).

The Company has a capital management process in place to monitor its capital. Reinsurance placed with Farm Mutual Reinsurance Plan and the Farm Mutual Guarantee Fund serve to protect capital and limit losses on any one claim (see Note 3). The Company meets its objectives for managing capital through management and Board monitoring and oversight of regulatory capital measures.

The Company's capital consists of retained earnings and accumulated other comprehensive income (loss). The Company's capital structure at December 31 was as follows:

| | 2010 | 2009 |
|---|------------|------------|
| Retained earnings | 11,915,791 | 11,272,426 |
| Accumulated other comprehensive income (loss) | (239,506) | (470,225) |
| Total Capital | 11,676,285 | 10,802,201 |

The Company is subject to an annual examination by the Financial Examination Committee, the results of which are reported to the Superintendent of Financial Institutions for Ontario. In its most recent examination report, the Company was in compliance with regulatory expectations.

11. EXTRAORDINARY ITEM - SETTLEMENT COSTS

During the year the Company participated in a settlement relating to legal actions, which had been commenced in 2009. The litigation arose out of prior actions of a subsidiary Company. The settlement resolves the litigation relating to the matter and was concluded out of court without admission of liability. The settlement amount has been classified in the current year as an extraordinary item.

12. GUARANTEES AND CONTINGENT LIABILITIES

Pursuant to an agreement effective January 1, 1976, the Company is a member of the Fire Mutuals Guarantee Fund ("the Fund"). The Fund was established to provide payment of outstanding policyholders' claims if a member company becomes bankrupt. As a result, the Company may be required to contribute assets to their proportionate share in meeting this objective.

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

13. COMPARATIVE FIGURES

Certain of the prior year's figures, provided for the purposes of comparison, have been reclassified to conform with the current year's statement presentation.