ASSURANCEAMERICA CORP
Form 10-Q
November 14, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2012

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number: 0-06334

AssuranceAmerica Corporation

(Exact name of smaller reporting company as specified in its charter)

Nevada	**87-0281240**
(State of Incorporation)	**(IRS Employer ID Number)**
5500 Interstate North Parkway, Suite 600	**30328**
(Address of principal executive offices)	**(Zip Code)**

(770) 952-0200

(Issuer s telephone number, including area code)

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

There were 66,110,531 shares of the Registrant s $.01 par value Common Stock outstanding as of November 12, 2012.

ASSURANCEAMERICA CORPORATION

Index to Form 10-Q

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2012	(As Restated) December 31, 2011
ASSETS		
Cash and cash equivalents	$ 8,118,773	$ 7,733,287
Cash restricted	172,963	254,222
Short-term investments	125,346	125,008
Long-term investments, at fair value (amortized cost $7,326,035 and $7,831,560)	7,608,530	7,886,617
Other long-term investments	488,537	600,435
Investment income due and accrued	68,008	63,533
Real estate mortgage loans due from a related party	4,000,000	4,000,000
Receivable from insureds	22,792,383	25,132,462
Reinsurance recoverable (including $7,988,199 and $9,114,187 on paid losses)	28,716,629	36,664,396
Prepaid reinsurance premiums	19,145,185	19,466,923
Deferred acquisition costs	1,183,587	1,928,401
Property and equipment (net of accumulated depreciation of $4,040,401 and $3,847,396)	1,979,146	1,904,368
Other receivables	915,958	1,240,464
Prepaid expenses	388,725	450,080
Security deposits	36,333	33,833
Assets of discontinued operations	27,032	204,059
Total assets	$ 95,767,135	$ 107,688,088
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable and accrued expenses	$ 5,364,835	$ 6,376,418
Unearned premium	26,252,145	28,101,244
Unpaid losses and loss adjustment expenses	34,466,484	42,098,263
Reinsurance payable	20,492,374	20,538,203
Provisional commission reserve	2,643,119	2,453,125
Funds withheld from reinsurers	243,618	325,000
Liabilities of discontinued operations	50,056	595,014
Notes payable due to a related party	1,819,563	1,557,911
Other notes and interest payable	43,999	116,956
Total liabilities	91,376,193	102,162,134
Commitments and Contingencies		
Common stock, $.01 par value (authorized 120,000,000 and outstanding 66,110,531 and 65,810,531)	661,105	658,105
Paid in capital	20,847,032	20,618,146
Accumulated deficit	(17,293,044)	(15,784,708)
Accumulated other comprehensive income	175,849	34,411
Total stockholders equity	4,390,942	5,525,954
Total liabilities and stockholders equity	$ 95,767,135	$ 107,688,088

See accompanying notes to consolidated financial statements.

Table of Contents

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

(UNAUDITED) CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30, 2012	Three Months Ended September 30, (As Restated) 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, (As Restated) 2011
Revenue:				
Gross premiums written	$ 18,240,319	$ 22,160,011	$ 56,666,236	$ 71,570,796
Gross premiums ceded	(13,231,728)	(15,395,290)	(38,232,258)	(46,005,673)
Net premiums written	5,008,591	6,764,721	18,433,978	25,565,123
Decrease in unearned premiums, net of prepaid reinsurance premiums	1,167,894	1,210,593	1,522,965	724,112
Net premiums earned	6,176,485	7,975,314	19,956,943	26,289,235
Commission income	2,146,263	3,210,775	6,241,733	9,612,330
Managing general agent fees	1,984,063	2,535,896	6,038,506	8,162,882
Net investment income	104,280	81,831	298,615	186,178
Net investment gains (losses) on securities	0	(7,278)	(28,214)	49,933
Other income	6,078	12,796	35,842	12,796
Total revenue	10,417,169	13,809,334	32,543,425	44,313,354
Expenses:				
Losses and loss adjustment expenses	3,893,246	7,559,973	14,287,201	24,746,504
Selling, general and administrative expenses	5,904,035	8,023,215	18,885,271	23,624,569
Stock option expense	46,000	88,264	141,886	262,784
Depreciation and amortization expense	1,763	190,797	193,005	519,384
Interest expense	215,142	947	647,398	7,494
Total expenses	10,060,186	15,863,196	34,154,761	49,160,735
Income (loss) from continuing operations before income taxes	356,983	(2,053,862)	(1,611,336)	(4,847,381)
Income tax benefit on continuing operations	0	752,093	0	1,758,839
Income (loss) from continuing operations	356,983	(1,301,769)	(1,611,336)	(3,088,542)
Income (loss) from discontinued operations (including loss on disposal of $831,654 and $1,237,951 for the three and nine months ended September 30, 2011, respectively)	0	(92,093)	103,000	(2,236,540)
Income tax expense on discontinued operations	0	(460,521)	0	(242,795)
Income (loss) from discontinued operations, net of taxes	0	(552,614)	103,000	(2,479,335)
Net Income (loss)	$ 356,983	$ (1,854,383)	$ (1,508,336)	$ (5,567,877)
Earnings (loss) Per Common Share				
Basic-Income (Loss) from continuing operations	$ 0.005	$ (0.020)	$ (0.024)	$ (0.047)
Diluted-Income (Loss) from continuing operations	$ 0.005	$ (0.020)	$ (0.024)	$ (0.047)
Basic-Income (Loss) from discontinued operations	$ 0.000	$ (0.008)	$ 0.002	$ (0.038)
Diluted-Income (Loss) from discontinued operations	$ 0.000	$ (0.008)	$ 0.002	$ (0.038)

Basic-Net Income (Loss)	$	0.005	$	(0.028)	$	(0.023)	$	(0.085)
Diluted-Net Income (Loss)	$	0.005	$	(0.028)	$	(0.023)	$	(0.085)
Weighted average shares outstanding-basic		66,110,531		65,797,593		66,030,604		65,717,987
Weighted average shares outstanding-diluted		66,110,531		65,797,593		66,030,604		65,717,987

See accompanying notes to consolidated financial statements.

Table of Contents

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

(UNAUDITED) CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	(As Restated) 2011	2012	(As Restated) 2011
Net income (loss)	$ 356,983	$ (1,854,383)	$ (1,508,336)	$ (5,567,877)
Other comprehensive income:				
Change in unrealized gains (losses) of investments:				
Unrealized gains (losses) arising during the period	78,099	(461,879)	199,224	(256,255)
Reclassification adjustment for realized (gains) losses recognized during the period	0	7,278	28,214	(49,933)
Net change in unrealized gains (losses)	78,099	(454,601)	227,438	(306,188)
Deferred income taxes on above changes	(29,998)	170,475	(86,000)	114,820
Other comprehensive income (loss), net of tax	48,101	(284,126)	141,438	(191,368)
Comprehensive income (loss)	$ 405,084	$ (2,138,509)	$ (1,366,898)	$ (5,759,245)

See accompanying notes to consolidated financial statements.

Table of Contents

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

(UNAUDITED) CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011 (As Restated)
Cash flows from operating activities:		
Loss from continuing operations	$ (1,611,336)	$ (3,088,542)
Income (loss) from discontinued operations	103,000	(2,479,335)
Net loss	(1,508,336)	(5,567,877)
Adjustments to reconcile net loss to net cash provided (used) by operating activities		
Net investment (gains) losses on securities	28,214	(49,933)
Depreciation and amortization	613,543	775,815
Loss on disposal of property and equipment	0	3,084
Loss on disposal of discontinued operations	0	1,160,566
Stock option expense	141,886	262,784
Compensation stock award	90,000	94,852
Deferred tax benefit	(86,000)	(1,510,090)
Changes in assets and liabilities:		
Investment income due and accrued	(4,475)	95,445
Receivables	2,664,585	1,956,312
Prepaid expenses and other assets	58,855	58,987
Unearned premiums	(1,849,099)	(2,914,311)
Unpaid loss and loss adjustment expenses	(7,631,779)	10,149,360
Ceded reinsurance payable	(45,829)	(3,263,374)
Reinsurance recoverable	7,947,768	(10,220,029)
Prepaid reinsurance premiums	321,738	2,178,531
Accounts payable and accrued expenses	(1,011,583)	(990,150)
Prepaid income taxes/federal income taxes payable	0	(73,962)
Funds withheld from reinsurers	(81,382)	(1,300,000)
Other operating activities	(367,930)	295,396
Deferred acquisition costs	744,814	109,372
Provisional commission reserve	189,994	(851,492)
Net cash provided (used) by operating activities continuing operations	214,984	(9,600,714)
Net cash used by operating activities discontinued operations	(86,827)	(150,859)
Net cash provided (used) by operating activities	128,157	(9,751,573)
Cash flows from investing activities:		
Purchases of property and equipment, net	(267,783)	(737,804)
Change in short term investments	(338)	20,077
Proceeds from sales, call and maturities of investments	430,322	4,659,652
Purchases of investments	0	(1,671,690)
Transfer of cash to restricted cash	81,259	1,298,920
Proceeds from sale of agencies discontinued operations	0	4,255,000
Net cash provided by investing activities continuing operations	243,460	7,824,155
Net cash used by investing activities discontinued operations	0	(10,370)
Net cash provided by investing activities	243,460	7,813,785

Cash flows from financing activities:		
Repayment of line of credit	0	(1,500,000)
Repayment of notes payable	(72,958)	(42,495)
Net cash used by financing activities	(72,958)	(1,542,495)
Net increase (decrease) in cash and cash equivalents	298,659	(3,480,283)
Cash and cash equivalents, beginning of period continuing operations	7,733,287	7,958,473
Cash and cash equivalents, beginning of period discontinued operations	95,563	420,541
Cash and cash equivalents, end of period	8,127,509	4,898,731
Less cash and cash equivalents, end of period - discontinued operations	8,736	259,312
Cash and cash equivalents, end of period - continuing operations	$ 8,118,773	$ 4,639,419

See accompanying notes to consolidated financial statements.

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2012 and 2011

(1) Description of Business

AssuranceAmerica Corporation (AAC), a Nevada corporation (the Company), is an insurance holding company whose business is comprised of AssuranceAmerica Insurance Company (AAIC), AssuranceAmerica Managing General Agency, LLC (MGA) and TrustWay Insurance Agencies, LLC (TrustWay), each wholly owned. The sale of TrustWay was completed in the third quarter of 2011. The Company solicits and underwrites nonstandard personal passenger automobile insurance. The Company is headquartered in Atlanta, Georgia.

(2) Summary of Significant Accounting Policies

Basis of Consolidation and Presentation

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. In management s opinion, the financial statements reflect all adjustments (consisting solely of normal recurring accruals) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim period. For further information, please refer to our audited consolidated financial statements appearing in the Form 10-K for the year ended December 31, 2011.

On March 22, 2012, the Company entered into an agreement with an investment banker to assist in identifying strategic alternatives for the Company, including the potential sale of its wholly owned subsidiaries AAIC and MGA. The assets have been evaluated for impairment and no impairment has been recorded as of September 30, 2012. AAIC and MGA represent substantially all of the operating assets of the Company and as such, are currently reflected as continuing operations in the consolidated financial statements ending September 30, 2012 and 2011. TrustWay was sold in 2011 and is reported as discontinued operations in the consolidated financial statements for those same periods.

Basis of Investments and Presentation

Valuation of available-for-sale investments. Our available-for-sale investment portfolio is recorded at fair value, which is typically based on publicly-available quoted prices. From time to time, the carrying value of our investments may be temporarily impaired because of the inherent volatility of publicly-traded investments.

We conduct regular reviews to assess whether our investments are impaired and if any impairment is other than temporary. Factors considered by us in assessing whether impairment is other than temporary include the credit quality of the investment, the duration of the impairment, our ability and intent to hold the investment until recovery or maturity and overall economic conditions. If we determine that the value of any investment is other-than-temporarily impaired, we record a charge against earnings in the amount of the impairment. The credit loss component of an impairment charge is recognized in net earnings while the non-credit component is recognized in accumulated other comprehensive income.

Gains and losses realized on the disposition of available-for-sale investment securities are determined on the specific identification basis and credited or charged to income. Premiums and discounts on available for sale investment securities are amortized and accreted using the interest method and charged or credited to investment income.

Other long-term investments. Our other long-term investments consists of low income federal housing tax credits, which are being amortized over the life of the credits using the straight-line method. The credits will be utilized over 10 years as required by the federal government and will be offset against the Company s federal income tax expenses.

Estimates

A discussion of our significant accounting policies and the use of estimates is included in the notes to the consolidated financial statements included in the Company s Financial Statements for the year ended December 31, 2011 as filed with the Securities and Exchange Commission in the 2011 Form 10-K.

Table of Contents

New Accounting Standards Adopted

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-26, *Financial Services Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* (ASU 2010-26) which specifies which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The guidance modifies the definition of acquisition costs to require that deferred costs be directly related to the successful acquisition of a new or renewal insurance contract. The Company adopted ASU 2010-26 on January 1, 2012, on a prospective basis. If the new method had been in place at December 31, 2011, the impact to the Company s financial statements would have been a reduction in net income of $451 thousand. Adoption of the new method as of January 1, 2012 reduced the Company s net income for the nine months ended September 30, 2012 by $405 thousand, when compared to the old method.

Amendments to Fair Value Measurement and Disclosure Requirements

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). This guidance results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between GAAP and International Financial Reporting Standards. While many of the amendments to GAAP are not expected to have a significant effect on practice, this guidance changes some fair value measurement principles and disclosure requirements. ASU 2011-04 is to be applied prospectively. For public entities, this guidance is effective during the interim and annual periods beginning after December 15, 2011. The Company adopted the amendments in ASU 2011-04 on January 1, 2012 and does not expect the adoption to have a material impact on the Company s financial condition or results of operations. Additional disclosures required by this adoption are located in Note 5 of the Consolidated Financial Statements.

Presentation of Comprehensive Income

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income* (ASU 2011-05). ASU 2011-05 requires all non-owner changes in stockholders equity to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 is to be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this standard as of January 1, 2012 and elected to use two separate but consecutive statements. As ASU 2011-05 changes only the presentation of certain financial statement information, there will be no impact on the Company s financial condition or results of operations.

(3) Restatement of Consolidated Financial Statements

During the second quarter of 2012, the Company s management discovered errors in two of its stated balance sheet accounts other receivables and accounts payable and accrued expenses. The effect of the errors is a cumulative increase in income, after giving effect to taxes, of $559,005 over the five-year period of 2007 through 2011. The impact of the errors to prior year financial statements is not material; therefore the errors are being restated on a prospective basis.

The error in the other receivables account arose from a process used to record receivable activity as policies on a front carrier were rolled over to AAIC policies. The effect of the error is a charge to earnings, after giving effect to taxes, of $353,478. The error in accounts payable and accrued expenses resulted in an overstatement of accrued commissions and unclaimed property liability. The effect of the error is a cumulative increase in income, after giving effect to taxes, of $912,753.

The cumulative adjustments required to correct the errors in the financial statements prior to fiscal year 2012 are reflected in the restated stockholders equity balance as of December 31, 2011, as shown in the Consolidated Balance Sheets. The cumulative effect of the correction of errors resulted in an increase in Stockholders equity of $559,005 as of December 31, 2011.

The impact of 2011 fiscal year adjustments is reflected in the Consolidated Statements of Operations in the fiscal quarters in which they relate. Of the aggregate increase to 2011 earnings, after giving effect to taxes, $101,124 related to the three-month period ended March 31, 2011; $13,945 related to the three-month period ended June 30, 2011; $9,510 related to the three-month period ended September 30, 2011. The three-month period ended December 31, 2011 resulted in a charge to earnings, after giving effect to taxes, of $35,393.

8

Table of Contents

The nature of the restatement adjustments and the impact of the adjustments on the Consolidated Balance Sheet as of December 31, 2011 are shown in the following table:

Consolidated Balance Sheet (extract)

	December 31, 2011		
	As Reported	**Effect of Correction**	**As Restated**
Assets			
Other receivables	$ 1,594,212	(353,748)	$ 1,240,464
Total assets	$ 108,041,836	(353,748)	$ 107,688,088
Liabilities			
Accounts payable and accrued expenses	$ 7,289,171	(912,753)	$ 6,376,418
Total liabilities	$ 103,074,887	(912,753)	$ 102,162,134
Stockholders equity			
Accumulated deficit	$ (16,343,713)	559,005	$ (15,784,708)
Total stockholders equity	$ 4,966,949	559,005	$ 5,525,954
Total liabilities and stockholders equity	$ 108,041,836	(353,748)	$ 107,688,088

The nature of the restatement adjustments and the impact of the adjustments on the Consolidated Statement of Operations for the nine months ended September 30, 2011 are shown in the following table:

Consolidated Statement of Operations (extract)

	For the Nine Months ended September 30, 2011		
	As Reported	**Effect of Correction**	**As Restated**
Expenses:			
Selling, general and administrative expenses	$ 23,823,895	(199,326)	$ 23,624,569
Total operating expenses	$ 49,360,061	(199,326)	$ 49,160,735
Loss from continuing operations before taxes	$ (5,046,707)	199,326	$ (4,847,381)
Income tax benefit on continuing operations	$ 1,833,586	(74,747)	$ 1,758,839
Loss from continuing operations	$ (3,213,121)	124,579	$ (3,088,542)
Net loss	$ (5,692,456)	124,579	$ (5,567,877)
Loss per common share:			
Basic - Loss from continuing operations	$ (0.049)	0.002	$ (0.047)
Diluted - Loss from continuing operations	$ (0.049)	0.002	$ (0.047)
Basic - Net Loss	$ (0.087)	0.002	$ (0.085)
Diluted - Net Loss	$ (0.087)	0.002	$ (0.085)

(4) Investments

All of the Company s marketable long-term investment securities have been classified as available-for-sale. The Company s long-term securities are available to be sold in response to the Company s liquidity needs, changes in market interest rates, asset-liability management strategies, and other economic factors. Investments available-for-sale are stated at fair value on the balance sheet. The other long-term investments consist of low income federal housing tax credits, which are being amortized over the life of the credits using the straight-line method. Unrealized gains and losses are excluded from earnings and are reported as a component of other comprehensive income within stockholders equity, net of related deferred income taxes.

A decline in the fair value of an available-for-sale security below cost that is deemed other than temporary and related to credit results in a charge to income. The decline in value attributed to non-credit related factors is recognized in other comprehensive income. For a decline in value deemed to be credit related, a new cost basis for the security is established. Gross unrealized gains, net of unrealized losses and deferred income taxes as of September 30, 2012 and December 31, 2011 were $175,849 and $34,411, respectively.

Table of Contents

Premiums and discounts are amortized or accreted, respectively, over the life of the related fixed maturity security as an adjustment to yield using a method that approximates the effective interest method. Dividends and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

At September 30, 2012 and December 31, 2011, long-term investments carried at market value of $5,111,115 and $4,346,810, respectively, and cash and short-term investments of approximately $125,346 and $125,008, respectively, were pledged by one of the Company s subsidiaries under requirements of regulatory authorities.

A summary of investments follows as of:

	September 30, 2012	December 31, 2011
Short-term investments and bank certificates of deposit	$ 125,346	$ 125,008
U.S. government sponsored enterprises	4,740,070	5,201,132
Corporate debt securities	2,868,460	2,685,485
Other long-term investments	488,537	600,435
Total	$ 8,222,413	$ 8,612,060

The amortized cost, fair value and gross unrealized gains or losses of U.S. sponsored enterprises and corporate debt securities available-for-sale at September 30, 2012 and December 31, 2011, by contractual maturity, are shown below:

Years to Maturity September 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Within one year	$ 1,271,815	$ 24,740	$ 0	$ 1,296,555
One to five years	3,863,147	199,010	11,230	4,050,927
Five to ten years	1,660,450	51,468	1,205	1,710,713
Over ten years	530,623	19,712	0	550,335
Total	$ 7,326,035	$ 294,930	$ 12,435	$ 7,608,530

Years to Maturity December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Within one year	$ 580,257	$ 0	$ 4,050	$ 576,207
One to five years	3,362,908	171,362	3,745	3,530,525
Five to ten years	2,695,544	0	96,543	2,599,001
Over ten years	1,192,851	11,814	23,781	1,180,884
Total	$ 7,831,560	$ 183,176	$ 128,119	$ 7,886,617

The amortized cost, fair value and gross unrealized gains or losses of securities available-for-sale at September 30, 2012 and December 31, 2011, by security type, are shown below:

Security Type September 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government sponsored enterprises	$ 4,515,785	$ 224,285	$ 0	$ 4,740,070

Corporate debt securities	2,810,250	70,645	12,435	2,868,460
Total	$ 7,326,035	$ 294,930	$ 12,435	$ 7,608,530

Security Type December 31, 2011	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. government sponsored enterprises	$ 5,047,921	$ 183,176	$ 29,965	$ 5,201,132
Corporate debt securities	2,783,639	0	98,154	2,685,485
Total	$ 7,831,560	$ 183,176	$ 128,119	$ 7,886,617

As of September 30, 2012, the Company has determined that all of the unrealized losses in available-for-sale securities were temporary.

Table of Contents

There were no fundamental issues with any of these securities and the Company has the ability and intent to hold the securities until there is a recovery in fair value. The carrying amounts of individual assets are reviewed at each balance sheet date to assess whether the fair values have declined below the carrying amounts. The Company considers internal and external information, such as credit ratings, in concluding that the impairments are not other than temporary. The decline in value of investments (bonds) is principally driven by interest rate.

The following table shows the gross unrealized losses and fair value of securities, aggregated by category and length of time that securities have been in a continuous unrealized loss position at September 30, 2012 and December 31, 2011.

	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Estimated Market Fair Value	Gross Unrealized Losses	Estimated Market Fair Value
September 30, 2012:				
U.S. government sponsored enterprises	$ 0	$ 0	$ 0	$ 0
Corporate debt securities	1,205	251,145	11,230	536,250
	$ 1,205	$ 251,145	$ 11,230	$ 536,250
December 31, 2011:				
U.S. government sponsored enterprises	$ 7,075	$ 1,223,100	$ 22,890	$ 637,875
Corporate debt securities	10,983	1,644,527	87,171	1,040,958
	$ 18,058	$ 2,867,627	$ 110,061	$ 1,678,833

The Company had investments called during the nine-month period ended September 30, 2012, but did not receive any proceeds from sales of investments during this period. The total proceeds received on sales of investments for the nine months ended September 30, 2011 amounted to $4,659,652. The Company had realized gains and losses of $0 and $28,214, respectively, for the nine months ended September 30, 2012 and $115,183 and $65,250, respectively, for the same period in 2011.

(5) Fair Value Disclosures

The fair value of our investments in fixed income securities is based on observable market quotations, other market observable data, or is derived from such quotations and market observable data. The Company utilizes third party pricing servicers, brokers and internal valuation models to determine fair value. Management gains assurance of the overall reasonableness and consistent application of the assumptions and methodologies and compliance with accounting standards for fair value determination through our ongoing monitoring of the fair values received or derived internally.

Level 1 inputs are unadjusted, quoted prices in active markets for identical instruments at the measurement date (e.g., U.S. Treasury securities and active exchange-traded equity securities). Level 2 securities are comprised of securities whose fair value was determined by a nationally recognized pricing service using observable market inputs. Level 3 securities are comprised of (i) securities for which the pricing service is unable to provide a fair value, (ii) securities whose fair value is determined by the pricing service based on unobservable inputs and (iii) securities, other than securities backed by the U.S. Government, that are not rated by a nationally recognized statistical rating organization.

The methods and assumptions used to estimate fair value of each class of financial instruments are as follows:

Cash, Restricted Cash and Cash Equivalents

The carrying amount approximates fair value.

Short-term investments

Short-term investments primarily consist of money market funds and are considered highly liquid. The carrying amount approximates fair value.

Table of Contents

Fixed Maturities

The Company utilizes a third party pricing service for the valuation of its fixed maturity securities. Fixed maturities other than U.S. treasury securities generally do not trade on a daily basis; therefore the pricing service prepares estimates of fair value for those securities using pricing applications based on a market approach. Inputs into fair value pricing common to all asset classes include: benchmark U.S. Treasury security yield curves; reported trades of identical or similar fixed maturity securities; broker/dealer quotes of identical or similar fixed maturity securities and structural characteristics such as maturity date, coupon, mandatory principal payments dates, frequency of interest and principal payments, and optional redemption features. Inputs that are unique by asset class include but are not limited to:

U.S. government agencies determination of direct versus indirect government support and whether any contingencies exist with respect to timely payment of principal and interest.

Corporate debt securities overall credit quality, including assessments of the level and variability of: industry economic sensitivity; company financial policies; quality of management; regulatory environment; competitive position; restrictive covenant; and security or collateral.

Other Financial Instruments

Low income federal housing credits present value of credits received; IRS tax credit rate

Real estate mortgage loans overall credit quality including assessments underlying collateral; underlying collateral interest rate forecast; borrower credit quality characteristics

Notes payable current interest rates and yield curves; credit risks consistent with debt being valued.

The following table illustrates the recurring fair value measurements as of September 30, 2012:

	Total	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Available-for-sale securities:				
U.S. government sponsored enterprises	$ 4,740,070	$ 4,740,070	$ 0	$ 0
Corporate debt securities	2,868,460	0	2,868,460	0
Total	$ 7,608,530	$ 4,740,070	$ 2,868,460	$ 0

The following table illustrates the recurring fair value measurements as of December 31, 2011:

	Total	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Available-for-sale securities:				
U.S. government sponsored enterprises	$ 5,201,132	$ 5,201,132	$ 0	$ 0
Corporate debt securities	2,685,485	0	2,685,485	0
Total	$ 7,886,617	$ 5,201,132	$ 2,685,485	$ 0

Table of Contents

The following presents the estimated fair values of financial instruments and their hierarchy levels as of September 30, 2012. The carrying value is the same as fair value.

	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Cash and cash equivalents	$ 8,118,773	$ 0	$ 0	$ 8,118,773
Restricted cash	172,963	0	0	172,963
Short-term investments	125,346	0	0	125,346
Available-for-sale securities:				
U.S. government sponsored enterprises	4,740,070	0	0	4,740,070
Corporate debt securities	0	2,868,460	0	2,868,460
Low income federal housing credits	0	488,537	0	488,537
Real estate mortgage loans due from a related party	0	4,000,000	0	4,000,000
Total cash and investments	$ 13,157,152	$ 7,356,997	$ 0	$ 20,514,149
Liabilities:				
Notes payable due to a related party	$ 0	$ 4,000,000	$ 0	$ 4,000,000

The following presents the estimated fair values of financial instruments and their hierarchy levels as of December 31, 2011. The carrying value is the same as fair value.

	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Cash and cash equivalents	$ 7,733,287	$ 0	$ 0	$ 7,733,287
Restricted cash	254,222	0	0	254,222
Short-term investments	125,008	0	0	125,008
Available-for-sale securities:				
U.S. government sponsored enterprises	5,201,132	0	0	5,201,132
Corporate debt securities	0	2,685,485	0	2,685,485
Low income federal housing credits	0	600,435	0	600,435
Real estate mortgage loans due from a related party	0	4,000,000	0	4,000,000
Total cash and investments	$ 13,313,649	$ 7,285,920	$ 0	$ 20,599,569
Liabilities:				
Notes payable due to a related party	$ 0	$ 4,000,000	$ 0	$ 4,000,000

(6) Real estate mortgage loans due from related party

On December 30, 2011, the Company entered into an agreement with its subsidiary AAIC. Pursuant to the agreement, the Company assigned two promissory notes (one for $2,500,000 and one for $1,500,000) to AAIC as a capital contribution to AAIC. The assigned promissory notes are secured by mortgages and real estate deeds owned by the Chairman of the Company. The notes carry an interest rate of 5%, due and payable quarterly in arrears, with the first payment due March 31, 2012 and each quarter, thereafter. The principal balance is due and payable on the earlier to occur of: (i) the sale of the real estate securing the note, (ii) the payment of the notes payable described in Note 11 of the Consolidated Financial Statements, or (iii) December 28, 2018.

(7) Losses and Loss Adjustment Expenses

The estimated liabilities for losses and loss adjustment expenses include the accumulation of estimates for losses for claims reported prior to the balance sheet dates (case reserves), estimates (based upon actuarial analysis of historical data) of losses for claims incurred but not reported (IBNR) and for the development of case reserves to ultimate values, and estimates of expenses for investigating, adjusting and settling all incurred claims. Amounts reported are estimates of the ultimate costs of settlement, net of estimated salvage and subrogation. These estimated liabilities are subject to the outcome of future events, such as changes in medical and repair costs as well as economic and social conditions that impact the settlement of claims. Management believes that, given the inherent variability in any such estimates, the aggregate reserves are reasonably adequate. The methods of making such estimates and for establishing the resulting reserves are reviewed and updated quarterly and any resulting adjustments are reflected in current operations.

Table of Contents

A summary of unpaid losses and loss adjustment expenses, net of reinsurance ceded, is as follows:

	September 30, 2012	December 31, 2011
Case basis	$ 4,270,889	$ 5,110,499
IBNR	9,467,165	9,437,555
Total	$ 13,738,054	$ 14,548,054

(8) Reinsurance

In the normal course of business, the Company seeks to reduce its overall risk levels by obtaining reinsurance from other insurance enterprises or reinsurers. Reinsurance premiums and reserves on reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Effective January 1, 2011, the Company entered into a new quota share agreement with Swiss Reinsurance America Corporation for the 2011 treaty year business. The Company cedes 75.0% of the bodily injury liability coverage and 82.5% of physical damage and other automobile liability coverages. The reinsurance contract covered all states except Florida. The losses incurred are ceded on a similar basis. The agreement includes a loss corridor of 75.0%-79.0%, whereby the Company shall retain the amount by which losses and LAE incurred exceed 75% of collected net premiums earned, subject to a maximum additional retention equal to 4% of collected net premiums earned. Further, the Company shall retain the amount by which losses and LAE incurred, after the application of the loss corridor, exceeds 120% of collected net premiums earned. The Company will receive a 21% ceding commission on ceded premiums earned if the loss and loss adjustment expense ratio as a percentage of earned premium is 73.5% or greater. If the loss ratio is 73.5%, but not less than 71.5% then the ceding commission shall be 21.0%, plus the difference in percentage points between 73.5% and the actual loss ratio. If the loss ratio is 71.5% or less, then the ceding commission rate will be 23.0%. The Company receives a provisional commission rate of 23% in advance, which is subject to adjustment once the final loss ratio is known.

Effective April 1, 2011, the Company entered into a twelve month quota share agreement with Greenlight Reinsurance Ltd. for business written in Florida. The Company ceded 50% of premium and losses for bodily injury liability, physical damage and other automobile liability coverages. The Company will receive a 19% ceding commission on ceded premiums earned if the loss and loss adjustment expense ratio as a percentage of earned premium is 75.5% or greater. If the loss ratio is less than 75.5%, but not less than 71.5% then the ceding commission shall be 19.0%, plus one half of the difference in percentage points between 75.5% and the actual loss ratio. If the loss ratio is 71.5% or less, then the ceding commission rate will be 21.0%. The Company receives a provisional commission rate of 20% in advance, which is subject to adjustment once the final loss ratio is known.

Effective May 15, 2011, the Company entered into a new catastrophe agreement with Shelter Mutual Insurance Company (SMIC). SMIC shall be liable for private passenger automobile physical damage coverage with respect to each loss occurrence, for the ultimate net loss over and above an initial ultimate net loss of $400,000 each event, such as a storm or flood, subject to a limit of liability to SMIC of $1,600,000 each event, and further subject to a limit of liability to SMIC of $3,200,000 with respects all events commencing during the term of this contract.

Effective January 1, 2012, the Company entered into a new quota share agreement with Greenlight Reinsurance Ltd. (Greenlight) for premium written for the period of January 1, 2012 to December 31, 2012 in all states excluding Florida, Texas and Louisiana. Premium written in the state of Florida will be covered by the agreement for the period of April 1, 2012 to December 31, 2012. The Company will cede 50% of premiums and losses for bodily injury liability and 85% of premiums and losses for coverages other than bodily injury liability. The Company will receive a ceding comm