

**Erie Mutual Fire Insurance Company**  
**Consolidated Financial Statements**  
For the year ended December 31, 2016

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For the year ended December 31, 2016

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## Independent Auditor's Report

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### To the policyholders of Erie Mutual Fire Insurance Company

We have audited the accompanying consolidated financial statements of Erie Mutual Fire Insurance Company, which comprise the consolidated statement of financial position as at December 31, 2016, the consolidated statements of comprehensive income, members' surplus and cash flows for the year ended December 31, 2016, and a summary of significant accounting policies and other explanatory information.

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

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatements, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

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

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

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Erie Mutual Fire Insurance Company as at December 31, 2016 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*BDO Canada LLP*

Chartered Professional Accountants, Licensed Public Accountants

Woodstock, Ontario  
February 28, 2017

**Erie Mutual Fire Insurance Company**  
**Consolidated Statement of Financial Position**

**As at December 31** **2016** **2015**

**Assets**

Cash	\$ 1,451,959	\$ 1,023,112
Investments (Note 4)	20,266,178	19,313,340
Income taxes recoverable	-	325,378
Due from reinsurer (Note 3)	45,666	33,643
Due from policyholders	1,893,381	1,860,230
Reinsurer's share of provision for unpaid claims (Note 3)	2,608,382	2,323,953
Due from facility	132,222	132,292
Prepaid expenses	1,624	3,426
Investment properties (Note 5)	401,864	510,128
Property, plant & equipment (Note 13)	767,508	831,964
Intangible assets (Note 13)	109,907	117,663
Deferred income taxes	33,790	34,990
	<b>\$ 27,712,481</b>	<b>\$ 26,510,119</b>

**Liabilities**

Accounts payable and accrued liabilities	\$ 363,141	\$ 404,581
Income taxes payable	184,525	-
Unearned premiums (Note 3)	3,243,328	3,103,111
Provision for unpaid claims (Note 3)	5,563,785	5,385,765
	<b>9,354,779</b>	<b>8,893,457</b>

**Members' Surplus**

Unappropriated members' surplus	17,695,072	17,107,663
Accumulated other comprehensive income	662,630	508,999
	<b>18,357,702</b>	<b>17,616,662</b>
	<b>\$ 27,712,481</b>	<b>\$ 26,510,119</b>

Signed on behalf of the Board by:

\_\_\_\_\_, Director

\_\_\_\_\_, Director

**Erie Mutual Fire Insurance Company**  
**Consolidated Statement of Comprehensive Income**

For the year ended December 31	2016	2015
<b>Underwriting income</b>		
Gross premiums written	\$ 6,769,017	\$ 6,472,181
Less reinsurance ceded	<u>1,080,599</u>	<u>974,840</u>
Net premiums written	5,688,418	5,497,341
Less change in unearned premiums	<u>140,217</u>	<u>174,361</u>
<b>Net premiums earned</b>	<u><b>5,548,201</b></u>	<u><b>5,322,980</b></u>
<b>Direct losses incurred</b>		
Gross claims and adjustment expenses	3,505,927	4,223,691
Less reinsurer's share of claims and adjustment expenses	<u>532,141</u>	<u>1,042,805</u>
	<u>2,973,786</u>	<u>3,180,886</u>
	<u><b>2,574,415</b></u>	<u><b>2,142,094</b></u>
<b>Expenses</b>		
Acquisition expenses (Note 8)	148,272	163,376
Other operating and administrative expenses (Note 9)	<u>2,407,102</u>	<u>2,237,985</u>
	<u>2,555,374</u>	<u>2,401,361</u>
<b>Net underwriting income (loss)</b>	<b>19,041</b>	<b>(259,267)</b>
<b>Investment and other income (Note 6)</b>	<u><b>727,669</b></u>	<u><b>613,840</b></u>
<b>Income before taxes</b>	<b>746,710</b>	<b>354,573</b>
<b>Provision for income taxes (Note 11)</b>	<u><b>159,301</b></u>	<u><b>71,550</b></u>
<b>Net income</b>	<b>587,409</b>	<b>283,023</b>
<b>Other comprehensive income (loss) (net of tax)</b>		
Change in unrealized gain (loss) on available-for-sale investments	158,614	(238,803)
Reclassification of realized gain on available-for-sale investments	<u>(4,983)</u>	<u>(35,803)</u>
<b>Total other comprehensive income (loss) (net of tax)</b>	<u><b>153,631</b></u>	<u><b>(274,606)</b></u>
<b>Total comprehensive income for the year</b>	<u><b>\$ 741,040</b></u>	<u><b>\$ 8,417</b></u>

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

**Erie Mutual Fire Insurance Company**  
**Consolidated Statement of Members' Surplus**

	Unappropriated Members' Surplus	Accumulated Other Comprehensive Income	Total
<b>Balance at January 1, 2015</b>	<b>\$ 16,824,640</b>	<b>\$ 783,605</b>	<b>\$ 17,608,245</b>
Net income	283,023	-	283,023
Change in unrealized loss on available-for-sale investments	-	(238,803)	(238,803)
Reclassification of realized gain on available-for-sale investments	-	(35,803)	(35,803)
<b>Balance at December 31, 2015</b>	<b>\$ 17,107,663</b>	<b>\$ 508,999</b>	<b>\$ 17,616,662</b>
Net income	587,409	-	587,409
Change in unrealized gain on available-for-sale investments	-	158,614	158,614
Reclassification of realized gain on available-for-sale investments	-	(4,983)	(4,983)
<b>Balance at December 31, 2016</b>	<b>\$ 17,695,072</b>	<b>\$ 662,630</b>	<b>\$ 18,357,702</b>

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

**Erie Mutual Fire Insurance Company**  
**Consolidated Statement of Cash Flows**

For the year ended December 31	2016	2015
<b>Operating activities</b>		
Net income	\$ 587,409	\$ 283,023
Adjustments for:		
Depreciation	85,556	99,020
Interest and dividend income	(748,046)	(646,064)
Provision for income taxes	159,301	71,550
Realized gain on disposal of investments	(6,644)	(47,737)
Realized loss on disposal of property, plant & equipment	870	685
Realized gain on disposal of investment property	(43,210)	-
	<u>35,236</u>	<u>(239,523)</u>
Changes in working capital		
Change in due from policyholders and facility	(45,104)	(7,406)
Change in prepaid expenses	1,802	7,302
Change in accounts payable and accrued liabilities	(41,440)	64,415
	<u>(84,742)</u>	<u>64,311</u>
Changes in insurance contract related balances, provisions		
Change in reinsurer's share of provision for unpaid claims	(284,429)	(793,850)
Change in unearned premiums	140,217	174,360
Change in provision for unpaid claims	178,020	872,513
	<u>33,808</u>	<u>253,023</u>
Cash flows related to interest, dividends and income taxes		
Interest and dividends received	748,046	646,064
Income taxes received (paid)	300,592	(442,826)
	<u>1,048,638</u>	<u>203,238</u>
<b>Total cash inflows from operating activities</b>	<u>1,032,940</u>	<u>281,049</u>
<b>Investing activities</b>		
Proceeds on sale of investments	1,100,000	750,042
Purchase of investments	(1,841,353)	(1,390,370)
Proceeds on disposal of property, plant & equipment	150	225
Purchase of property, plant & equipment	(12,027)	(38,762)
Purchase of intangible assets	-	(3,390)
Proceeds on disposal of investment property	154,524	-
Purchase of investment property	(5,387)	(5,309)
<b>Total cash outflows from investing activities</b>	<u>(604,093)</u>	<u>(687,564)</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<u>428,847</u>	<u>(406,515)</u>
<b>Cash and cash equivalents, beginning of year</b>	<u>1,023,112</u>	<u>1,429,627</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 1,451,959</u>	<u>\$ 1,023,112</u>

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

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# Erie Mutual Fire Insurance Company

## Notes to the Consolidated Financial Statements

December 31

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### 1. CORPORATE INFORMATION

Erie Mutual Fire Insurance Company (the Company) is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property, liability, automobile and farmers' accident insurance in Ontario. The Company's head office is located at 711 Main Street East, Dunnville, Ontario.

The Company is subject to rate regulation in the automobile business that it writes. Before automobile insurance rates can be changed, a rate filing is prepared as a combined filing for most Ontario Farm Mutual Insurance Companies by the Farm Mutual Reinsurance Plan Inc. The rate filing must include actuarial justification for rate increases or decreases. All rate filings are approved or denied by the Financial Services Commission of Ontario. Rate regulation may affect the automobile revenues that are earned by the Company. The actual impact of rate regulation would depend on the competitive environment at the time.

These consolidated financial statements have been authorized for issue by the Board of Directors on February 28, 2017.

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### 2. BASIS OF PREPARATION

These consolidated financial statements include the financial statements of Erie Mutual Fire Insurance Company and those of its subsidiary, 2135671 Ontario Ltd.

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

These consolidated financial statements were prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets.

The consolidated financial statements are presented in Canadian dollars ("CDN"), which is also the Company's functional currency.

The preparation of these consolidated financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving critical judgments and estimates in applying accounting policies that have the most significant risk of causing material adjustment to the carrying amounts of assets and liabilities recognized in the consolidated financial statements within the next financial year are:

- The calculation of unpaid claims, including the determination of the initial claim liability, claims development and the estimate of time until ultimate settlement (Note 3).
- The determination of the recoverability of deferred policy acquisition expenses (Note 3).
- The determination of the impairment on available-for-sale financial assets (Note 4).

The notes to the consolidated financial statements were prepared and ordered in such a way that the most relevant information was presented earlier in the notes and disclosures that management deemed to be immaterial were excluded from the notes to the consolidated financial statements. The determination of the relevance and materiality of disclosures involves significant judgment.



# Erie Mutual Fire Insurance Company

## Notes to the Consolidated Financial Statements

December 31

### 3. INSURANCE CONTRACTS

In accordance with IFRS 4, Insurance Contracts, the Company has continued to apply the accounting policies it applied in accordance with pre-changeover Canadian generally accepted accounting principles.

Balances arising from insurance contracts primarily include the following:

(a) Premiums and unearned premiums

Premiums written consist of premiums on contracts incepting in the financial year. Premiums written are stated exclusive of taxes levied on premiums.

The Company earns premium income evenly over the term of the insurance policy generally using the pro rata method. The portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums. Changes in unearned premiums recorded in the statement of financial position and their impact on net premiums earned are as follows:

*Unearned Premiums*

	2016	2015
Balance, beginning of the year	\$ 3,103,111	\$ 2,928,751
Premiums written	6,769,017	6,472,181
Premiums earned during year	(6,628,800)	(6,297,821)
Balance, end of the year	\$ 3,243,328	\$ 3,103,111

Pricing of property and liability policies are based on assumptions in regard to trends and past experience, in an attempt to correctly match policy revenue with exposed risk. Automobile premiums are subject to approval by the Financial Services Commission of Ontario and therefore may result in a delay in adjusting the pricing to exposed risk.

The Company is exposed to a pricing risk to the extent that unearned premiums are insufficient to meet the related future policy costs. Evaluation is performed regularly to estimate future claims costs, related expenses, and expected profit in relation to unearned premiums. There was no premium deficiency at December 31, 2016 or 2015.

Amounts due from policy holders are measured at amortized cost less any impairment losses. These amounts are short-term in nature consisting of a large number of policy holders, and are not subject to material credit risk. Regular review of amounts outstanding is performed to ensure credit worthiness.

(b) Unpaid claims and adjustment expenses

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, changes in reported claims and for claims incurred but not reported, based on past experience and business in force. The estimates are regularly reviewed and updated, and any resulting adjustments are included in current income.

## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

### 3. INSURANCE CONTRACTS (CONT'D)

A summary of the Company's outstanding gross unpaid liabilities, related reinsurers share of unpaid claims and net insurance liabilities are as follows:

	December 31, 2016		
	Gross	Reinsurance	Net
<i>Outstanding claims provision</i>			
Long term settlement	\$ 1,948,678	\$ 1,402,056	\$ 546,622
Short term settlement	1,763,527	706,326	1,057,201
Facility Association and other residual pools	191,580	-	191,580
	<u>3,903,785</u>	<u>2,108,382</u>	<u>1,795,403</u>
Provision for claims incurred but not reported	1,660,000	500,000	1,160,000
	<u>\$ 5,563,785</u>	<u>\$ 2,608,382</u>	<u>\$ 2,955,403</u>

	December 31, 2015		
	Gross	Reinsurance	Net
<i>Outstanding claims provision</i>			
Long term settlement	\$ 1,304,923	\$ 721,414	\$ 583,509
Short term settlement	2,228,295	1,102,539	1,125,756
Facility Association and other residual pools	192,547	-	192,547
	<u>3,725,765</u>	<u>1,823,953</u>	<u>1,901,812</u>
Provision for claims incurred but not reported	1,660,000	500,000	1,160,000
	<u>\$ 5,385,765</u>	<u>\$ 2,323,953</u>	<u>\$ 3,061,812</u>

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 3. INSURANCE CONTRACTS (CONT'D)

The Company must participate in industry automobile residual pools of business, and recognizes a share of this business based on its automobile market share. The Company records its share of the liabilities provided by the actuaries of the pools.

Changes in claim liabilities recorded in the consolidated statement of financial position and their impact on claims and adjustment expenses are as follows:

	2016	2015
Unpaid claim liabilities - beginning of year - net of reinsurance	\$ 3,061,812	\$ 2,983,149
Increase in estimated losses and expenses for losses occurring in prior years	316,951	377,199
Provision for losses and expenses on claims occurring in the current year	2,478,154	2,568,084
Payment on claims:		
Current year	(1,726,947)	(2,087,770)
Prior years	(1,174,567)	(778,850)
Unpaid claims liabilities - end of year - net of reinsurance	2,955,403	3,061,812
Reinsurer's share	2,608,382	2,323,953
	<b>\$ 5,563,785</b>	<b>\$ 5,385,765</b>

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# Erie Mutual Fire Insurance Company

## Notes to the Consolidated Financial Statements

December 31

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### 3. INSURANCE CONTRACTS (CONT'D)

#### Claim development

The principal risk the Company faces under insurance contracts is that the actual claims and benefit payments or the timing thereof, differ from expectations. This is influenced by the frequency of claims, severity of claims, actual benefits paid and subsequent development of long-term claims. Therefore, the objective of the Company is to ensure that sufficient reserves are available to cover these liabilities.

The Company writes insurance primarily over a twelve month duration. The most significant risks arise through high severity, low frequency events such as natural disasters or catastrophes. A concentration of risk may arise from insurance contracts issued in a specific geographic location since all insurance contracts are written in Ontario.

The above risk is mitigated by diversification across a large portfolio of insurance. The variability of risks is also improved by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance agreements.

The estimation of claim development involves assessing the future behaviour of claims, taking into consideration the consistency of the Company's claim handling procedures, the amount of information available, the characteristics of the line of business from which the claim arises and historical delays in reporting claims. In general, the longer the term required for the settlement of a group of claims the more variable the estimates. Short settlement term claims are those which are expected to be substantially paid within a year of being reported.

The tables that follow present the development of claims payments and the estimated ultimate cost of claims for the claim year 2009 to 2016. The tables show the cumulative amounts paid or estimated to be paid during successive years related to each claim year. The original estimates will be increased or decreased as more information becomes known about the original claims and overall claim frequency and severity.

**Erie Mutual Fire Insurance Company  
Notes to Consolidated Financial Statement**

December 31

**3. INSURANCE CONTRACTS (CONT'D)**

Gross claims	2009	2010	2011	2012	2013	2014	2015	2016	Total
Gross estimate of cumulative claims cost									
At the end year of claim	\$ 3,287,501	\$ 1,185,421	\$ 2,704,955	\$ 1,642,762	\$ 2,650,761	\$ 4,903,264	\$ 2,614,835	\$ 3,065,654	
One year later	3,278,587	1,193,125	2,796,856	1,569,578	2,734,856	5,059,946	2,773,430		
Two years later	3,212,869	1,254,303	2,900,256	1,616,925	3,129,900	5,100,663			
Three years later	3,208,175	1,243,754	2,920,308	1,633,341	2,937,393				
Four years later	3,338,002	1,225,842	3,691,808	1,734,020					
Five years later	3,329,671	1,225,836	3,727,307						
Six years later	3,329,671	1,224,700							
Seven years later	3,329,671								
Current estimate of cumulative claims cost	3,329,671	1,224,700	3,727,307	1,734,020	2,937,393	5,100,663	2,773,430	3,065,654	23,892,838
Cumulative payments	3,329,671	1,224,700	3,023,578	1,727,260	2,799,523	3,687,077	2,661,879	1,726,945	20,180,633
Outstanding claims	\$ -	\$ -	\$ 703,729	\$ 6,760	\$ 137,870	\$ 1,413,586	\$ 111,551	\$ 1,338,709	\$ 3,712,205
Facility association and other residual pools									191,580
Incurred but not reported (IBNR)									1,660,000
<b>Total gross outstanding claims including claims handling expense</b>									<b>\$ 5,563,785</b>
<b>Net claims</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>Total</b>
Net estimate of cumulative claims cost									
At the end year of claim	\$ 2,320,513	\$ 1,185,421	\$ 2,097,730	\$ 1,642,762	\$ 2,588,261	\$ 2,650,764	\$ 2,568,084	\$ 2,478,154	
One year later	2,431,475	1,193,125	2,307,119	1,569,578	2,672,356	2,764,566	2,729,472		
Two years later	2,422,431	1,254,303	2,323,958	1,616,925	2,827,849	2,711,566			
Three years later	2,417,737	1,243,754	2,311,162	1,633,341	2,811,382				
Four years later	2,453,845	1,225,842	2,388,312	1,734,020					
Five years later	2,456,155	1,225,836	2,394,054						
Six years later	2,456,155	1,224,700							
Seven years later	2,456,155								
Current estimate of cumulative claims cost	2,456,155	1,224,700	2,394,054	1,734,020	2,811,382	2,711,566	2,729,472	2,478,154	18,539,503
Cumulative payments	2,456,155	1,224,700	2,323,681	1,727,260	2,673,512	2,185,505	2,617,920	1,726,947	16,935,680
Outstanding claims	\$ -	\$ -	\$ 70,373	\$ 6,760	\$ 137,870	\$ 526,061	\$ 111,552	\$ 751,207	\$ 1,603,823
Facility association and other residual pools									191,580
Incurred but not reported (IBNR)									1,160,000
<b>Total net outstanding claims including claims handling expense</b>									<b>\$ 2,955,403</b>

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 3. INSURANCE CONTRACTS (CONT'D)

The risks associated with insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The Company uses various techniques based on past claims development experience to quantify these sensitivities. This includes indicators such as average claim cost, amount of claims occurrence, expected loss ratios and claims development.

Results of sensitivity testing based on expected loss ratios are as follows, impact on pre-tax income is shown gross and net of reinsurance:

	Property claims		Auto claims		Liability claims	
	2016	2015	2016	2015	2016	2015
5% change in the loss ratios would result in the following increase/decrease:						
Gross	\$ 155,164	\$ 147,644	\$ 152,063	\$ 144,107	\$ 21,095	\$ 20,251
Net	\$ 138,791	\$ 133,329	\$ 119,160	\$ 114,146	\$ 16,571	\$ 16,002

There have been no significant changes from the previous year in the exposure to insurance risk or policies, procedures and methods used to measure the risk.

#### (c) Liability adequacy test

At each reporting date the Company performs a liability adequacy test on its insurance liabilities less deferred policy acquisition expenses to ensure the carrying value is adequate, using current estimates of future cash flows, taking into account the relevant investment return. If that assessment shows that the carrying amount of the liabilities is inadequate, any deficiency is recognized as an expense to the statement of comprehensive income initially by writing off the deferred policy acquisition expense and subsequently by recognizing additional unearned premiums.

#### (d) Reinsurer's share of provisions for unpaid claims and adjustment expenses

The Company enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. Reinsurance premiums are accounted for in the same period as the related premiums for the direct insurance business being reinsured. Reinsurance liabilities, comprised of premiums payable for the purchase of reinsurance contracts, are included in accounts payable and accrued liabilities and are recognized as an expense on the same basis as revenue on the underlying policies being reinsured.

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 3. INSURANCE CONTRACTS (CONT'D)

The Company follows a policy of underwriting and reinsuring contracts of insurance which, in the main, limit the liability of the Company to an amount on any one claim of \$350,000 in the event of a property claim, an amount of \$275,000 in the event of an automobile claim and \$385,000 in the event of a liability claim. The Company also obtained reinsurance which limits the Company's liability to \$1,050,000 in the event of a series of claims arising out of a single occurrence. In addition, the Company has obtained stop loss reinsurance which limits the liability of all claims in a specific year to 70% (2015 - 70%) of gross net earned premiums.

Amounts recoverable from the Company's reinsurer are estimated in a manner consistent with the outstanding claims provision and are in accordance with the reinsurance contracts. Although the Company has reinsurance arrangements, it is not relieved of its direct obligations to its policyholders and thus a credit exposure exists with respect to ceded insurance, to the extent that any reinsurer is unable to meet its obligations assumed under such reinsurance agreements.

Expected reinsurance recoveries on unpaid claims and adjustment expenses are recognized as assets at the same time and using principles consistent with the Company's method for establishing the related liability. Changes in due from reinsurer recorded in the statement of financial position are as follows:

*Due from Reinsurers*

	2016	2015
Balance, beginning of the year	\$ 33,643	\$ 214,246
Submitted to reinsurer	235,689	429,558
Received from reinsurer	(223,666)	(610,161)
	\$ 45,666	\$ 33,643
Balance, end of the year	\$ 45,666	\$ 33,643

Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer. Management monitors the creditworthiness of FMRP by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract. At year-end, the Company reviewed the amounts owing from its reinsurer and determined that no allowance is necessary.

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 3. INSURANCE CONTRACTS (CONT'D)

Changes in reinsurers share of provision for unpaid claims recorded in the consolidated statement of financial position and their impact on net premiums earned are as follows:

*Reinsurer's share of provision for unpaid claims*

	2016	2015
Balance, beginning of the year	\$ 2,323,953	\$ 1,530,103
New claims reserves	587,500	333,613
Change in prior years reserves	(67,382)	889,795
Submitted to reinsurer	(235,689)	(429,558)
Balance, end of the year	\$ 2,608,382	\$ 2,323,953

(e) Salvage and subrogation recoverable

In the normal course of business, the Company obtains the ownership of damaged property, which they resell to various salvage operations. Unsold property is valued at its estimated net realizable value.

Where the Company indemnifies policyholders against a liability claim, it acquires rights to subrogate its claim against other parties.



# Erie Mutual Fire Insurance Company

## Notes to the Consolidated Financial Statements

December 31

### 4. INVESTMENTS

The Company classifies its investments as available-for-sale, which includes both debt and equity instruments. These instruments are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition. Subsequently they are carried at fair value.

Changes in fair value are recognized as a separate component of other comprehensive income. Where there is a significant or prolonged decline in the fair value of an available-for-sale financial asset, which constitutes objective evidence of impairment, the full amount of the impairment, including any amount previously recognized in other comprehensive income, is recognized in net income.

Purchases and sales of equity instruments are recognized on a settlement date basis.

Interest on debt securities classified as available-for-sale is calculated using the effective interest method and is included in net income.

#### Judgments

##### *Impairment of available-for-sale investments*

The Company determines that available-for-sale investments are impaired when there has been a significant or prolonged decline in fair value below its cost. The determination of what is significant or prolonged requires judgment. In making this judgment the Company considers among other factors, the normal volatility in the market place, the financial health of the investee and industry sector performance. Had the Company considered all declines in fair value to be significant or prolonged, the Company would have suffered an additional loss of \$108,461 in its consolidated financial statements.

The following table provides cost and fair value information of investments by type of security and issuers.

	December 31, 2016		December 31, 2015	
	Cost	Fair value	Cost	Fair value
<b>Pooled funds</b>				
Canadian equity	\$ 2,838,142	\$ 3,706,502	\$ 1,641,775	\$ 2,042,288
Fixed income	16,528,706	16,543,849	17,351,565	17,255,479
	<u>19,366,848</u>	<u>20,250,351</u>	<u>18,993,340</u>	<u>19,297,767</u>
<b>Fire Mutuals Guarantee Fund</b>	<u>15,827</u>	<u>15,827</u>	<u>15,573</u>	<u>15,573</u>
<b>Total investments</b>	<u>\$ 19,382,675</u>	<u>\$ 20,266,178</u>	<u>\$ 19,008,913</u>	<u>\$ 19,313,340</u>

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# Erie Mutual Fire Insurance Company

## Notes to the Consolidated Financial Statements

December 31

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#### 4. INVESTMENTS (CONT'D)

The Company is exposed to credit risk relating to its debt holdings in its investment portfolio.

The Company's investment policy puts limits on the investment portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The majority of fixed income investments are held within pooled funds that report the holdings of their funds to ensure that the investments are in compliance with the mandated constraints. Pooled funds are invested in bonds and debentures of Federal, Provincial, Corporate and non-Canadian issuers with a minimum rating of 'BBB' or better. The policy for fixed income pooled funds limits the investment in any one corporate name rated 'A' or better to a maximum of 5% of the total fixed income portfolio. The policy also includes limits on the Provincial 'BBB' rated investments to a maximum of 5% of the total fixed income portfolio and holdings in non-Canadian investments require a rating of 'A' or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by the Company's investment committee which reports to the board of Directors.

The maximum exposure to investment credit risk is the carrying value of the investments.

There have been no significant changes from the previous year in the exposure to this risk or policies, procedures and methods used to measure the risk.

Liquidity risk is the risk that the Company will not be able to meet all cash outflow obligations as they come due. The Company mitigates this risk by monitoring cash activities and expected outflows. The Company's current liabilities arise as claims are made. The Company does not have material liabilities that can be called unexpectedly at the demand of a lender or client. The Company has no material commitments for capital expenditures and there is no need for such expenditures in the normal course of business. Claim payments are funded by current operating cash flow including investment income.

The Company's investment policy requires that 5% to 15% of the Company's portfolio be held in cash and short-term investments. Short-term investments can include treasury bills, GICs, commercial paper and term deposits with an original maturity of less than one year.

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure liquidity risk.

Market factors that will impact the fair value of investments include three types of risk: currency risk, interest rate risk and equity risk.

The Company's investment policy operates within the guidelines of the Insurance Act of Ontario. An investment policy is in place and its application is monitored by the Investment Committee and the Board of Directors. Diversification techniques are utilized to minimize risk. Each of the company's advisors are provided with an investment mandate which restricts the types of investments that funds can be invested in.

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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#### 4. INVESTMENTS (CONT'D)

Currency risk relates to the Company operating in different currencies and converting non-Canadian earnings at different points in time at different foreign exchange levels when adverse changes in foreign currency exchange rates occur. The Company has no significant exposure to this risk.

The Company's investment income will move with interest rates over the medium to long-term with short-term interest rate fluctuations creating unrealized gains or losses in other comprehensive income. There are no occurrences where interest would be charged on liabilities; therefore, little protection is needed to ensure the fair value of asset will be offset by a similar change in liabilities due to an interest rate change.

At December 31, 2016, a 1% move in interest rates, with all other variables held constant, could impact the market value of fixed income funds by \$1,170,511 (2015 - \$1,211,988). This change would be recognized in other comprehensive income.

The Company's portfolio includes Canadian pooled funds with fair values that move with the Toronto Stock Exchange Composite Index. At December 31, 2016, a 10% movement in the stock markets with all other variables held constant would have an estimated effect on the fair values of the Company's equity pooled funds of \$370,650 (2015 - \$204,229). This change would be recognized in other comprehensive income.

The Company's investment policy limits equity investments to 25% of the total portfolio investment, in accordance the Insurance Act of Ontario. Investment managers are mandated to follow this strategy, and must also diversify across various sectors and securities in the market. All equity instruments must be freely tradeable and listed on a recognized stock exchange in Canada.

Equities are monitored by the Investment Committee and the Board of Directors on a quarterly basis.

There have been no significant changes from the previous year in the exposure to this risk or policies, procedures and methods used to measure the risk.

## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

### 4. INVESTMENTS (CONT'D)

The following table provides an analysis of investments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1: fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities using the last bid price;
- Level 2: fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Level 1	Level 2	Level 3	Total
<b>December 31, 2016</b>				
Pooled funds	\$ -	\$ 20,250,351	\$ -	\$ 20,250,351
Other investments	-	15,827	-	15,827
<b>Total</b>	<b>\$ -</b>	<b>\$ 20,266,178</b>	<b>\$ -</b>	<b>\$ 20,266,178</b>
<b>December 31, 2015</b>				
Pooled funds	\$ -	\$ 19,297,767	\$ -	\$ 19,297,767
Other investments	-	15,573	-	15,573
<b>Total</b>	<b>\$ -</b>	<b>\$ 19,313,340</b>	<b>\$ -</b>	<b>\$ 19,313,340</b>

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2015 and 2016.

## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

### 5. INVESTMENT PROPERTIES

The Company's investment properties consist of land and buildings held to earn rental income or for capital appreciation. Investment property is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses, with the exception of land which is not depreciated. Buildings are depreciated on a declining balance basis using a rate of 5%. The depreciation expense is netted against rental income.

Investment properties were subject to external valuation performed by a local real estate broker. The fair value of investment property is determined using assumptions for comparable properties, recent purchase prices and adjustments comparable to MPAC fair market value adjustments.

Rental income is included in investment and other income in the consolidated statement of comprehensive income.

	Land	Buildings	Total
<b>Cost</b>			
Balance at January 1, 2015	\$ 458,950	\$ 154,165	\$ 613,115
Additions	5,309	-	5,309
Balance on December 31, 2015	464,259	154,165	618,424
Additions	5,387	-	5,387
Disposals	(111,358)	-	(111,358)
<b>Balance on December 31, 2016</b>	<b>\$ 358,288</b>	<b>\$ 154,165</b>	<b>\$ 512,453</b>
<b>Accumulated depreciation</b>			
Balance at January 1, 2015	\$ -	\$ 105,882	\$ 105,882
Depreciation expense	-	2,414	2,414
Balance on December 31, 2015	-	108,296	108,296
Depreciation expense	-	2,293	2,293
<b>Balance on December 31, 2016</b>	<b>\$ -</b>	<b>\$ 110,589</b>	<b>\$ 110,589</b>
<b>Net book value</b>			
December 31, 2015	\$ 464,259	\$ 45,869	\$ 510,128
<b>December 31, 2016</b>	<b>\$ 358,288</b>	<b>\$ 43,576</b>	<b>\$ 401,864</b>

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 5. INVESTMENT PROPERTIES (CONT'D)

	2016	2015
Rental revenue from investment property	\$ 7,566	\$ 7,566
Direct operating costs of investment property:		
Generating rental income	4,081	9,848
Not generating rental income	4,404	4,442
Net loss	\$ (919)	\$ (6,724)

The fair value of the investment properties is \$446,100 (2015 - \$561,100).

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### 6. INVESTMENT AND OTHER INCOME

	2016	2015
Interest income	\$ 651,681	\$ 584,342
Dividend income	96,365	61,722
Realized gains on disposal of investments	6,644	47,737
Investment expenses	(78,860)	(72,546)
Loss on rental	(919)	(6,724)
Recovery of previous impairment	10,418	-
Gain on disposal of investment property	43,210	-
Loss on disposal of property, plant & equipment	(870)	(691)
	\$ 727,669	\$ 613,840

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 7. CAPITAL MANAGEMENT

The Company's objectives with respect to capital management are to maintain a capital base that is structured to exceed regulatory requirements and to best utilize capital allocations.

The regulators measure the financial strength of property and casualty insurers using a minimum capital test (MCT). The regulators require property and casualty companies to comply with capital adequacy requirements. This test compares a Company's capital against the risk profile of the organization. The risk-based capital adequacy framework assesses the risk of assets, policy liabilities and other exposures by applying various factors that are dependent on the risks associated with the Company's assets. Additionally, an interest rate risk margin is included in the MCT by assessing the sensitivity of the Company's interest-sensitive assets and liabilities to changes in interest rates. The regulator indicates that the Company should produce a minimum MCT of 150%. During the year, the Company has consistently exceeded this minimum. The regulator has the authority to request more extensive reporting and can place restrictions on the Company's operations if the Company falls below this requirement or if deemed necessary.

For the purpose of capital management, the Company has defined capital as unappropriated members' surplus including accumulated other comprehensive income.

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### 8. FEES, COMMISSIONS AND OTHER ACQUISITIONS

	<u>2016</u>	<u>2015</u>
Bad debts	\$ 452	\$ 540
Commissions	(13,930)	(13,040)
Inspection and investigations	55,606	56,706
Sales and marketing	106,144	119,170
	<u>\$ 148,272</u>	<u>\$ 163,376</u>

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**Erie Mutual Fire Insurance Company**  
**Notes to the Consolidated Financial Statements**

December 31

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**9. OTHER OPERATING AND ADMINISTRATIVE EXPENSES**

	<u>2016</u>	<u>2015</u>
Association fees	\$ 42,193	\$ 39,995
Computer costs	218,712	211,607
Donations	16,545	19,024
Insurance	35,609	43,190
Occupancy	98,036	88,800
Postage	18,516	17,956
Premium tax	16,152	15,222
Printing, stationary and office supplies	25,601	27,429
Professional fees	81,418	78,797
Salaries, benefits and directors fees	1,743,972	1,604,446
Telephone	14,866	17,098
Travel	72,809	65,996
Other	22,673	8,425
	<u>\$ 2,407,102</u>	<u>\$ 2,237,985</u>

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**10. SALARIES, BENEFITS AND DIRECTORS FEES**

	<u>2016</u>	<u>2015</u>
Total salaries and benefits paid to employees, and directors fees	<u>\$ 1,868,354</u>	<u>\$ 1,743,981</u>



## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

### 11. INCOME TAXES

Income tax expense comprises of current and deferred tax. Current tax and deferred tax are recognized in net income and other comprehensive income except to the extent that it relates to a business combination, or items recognized directly in equity.

The significant components of tax expense included in net income are composed of:

	2016	2015
<b>Current tax (recovery) expense</b>		
Based on current year taxable income	\$ 211,467	\$ (11,988)
Adjustments for over provision in prior periods	(2,156)	(6,796)
	209,311	(18,784)
<b>Deferred tax expense</b>		
Origination and reversal of temporary differences	(50,010)	90,334
<b>Total income tax expense</b>	<b>\$ 159,301</b>	<b>\$ 71,550</b>

The significant components of the tax affect of the amounts recognized in other comprehensive income are composed of:

	2016	2015
<b>Deferred tax</b>		
Change in unrealized gain (loss) on available-for-sale investments	\$ 52,871	\$ (79,596)
Reclassification of realized gain on available-for-sale investments	(1,661)	(11,934)
<b>Total tax affect of amounts recorded in other comprehensive income</b>	<b>\$ 51,210</b>	<b>\$ (91,530)</b>

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 11. INCOME TAXES (CONT'D)

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory tax rate of 26.50% are as follows:

	2016	2015
Income before taxes	\$ 746,710	\$ 354,573
Expected taxes based on the statutory rate of 26.50%	197,878	93,962
Dividend income not subject to tax	(25,537)	(2,212)
Other non deductible expenses	4,184	3,263
Mark to market and other adjustments related to investments	3,058	-
Rate adjustment related to temporary differences	1,200	(4,679)
Amortization/Capital cost allowance and claims reserve	(12,559)	-
Over provision in prior years	(2,156)	(6,796)
Utilization of current year loss carried back	-	(11,988)
Utilization of losses carried forward	(6,767)	-
	\$ 159,301	\$ 71,550

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 12. STRUCTURED SETTLEMENTS, FIRE MUTUALS GUARANTEE FUND AND FINANCIAL GUARANTEE CONTRACTS

The Company enters into annuity agreements with various life insurance companies to provide for fixed and recurring payments to claimants. Under such arrangements, the Company's liability to its claimants is substantially transferred, although the Company remains exposed to the credit risk that life insurers fail to fulfil their obligations.

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 should the Plan's capital fall below a prescribed minimum. The additional capital would be provided by purchasing subordinated debt obligations issued by the Plan.

These exposures represent financial guarantee contracts. The Company accounts for financial guarantee contracts in accordance with IFRS 4, Insurance Contracts.

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### 13. PROPERTY, PLANT & EQUIPMENT AND INTANGIBLE ASSETS

#### *Property, plant & equipment*

Property, plant & equipment is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses, with the exception of land which is not depreciated. The depreciation expense is included in other operating and administrative expenses in the consolidated statement of comprehensive income, and is provided on a declining balance basis over the estimated useful life of the asset.

Depreciation methods, useful lives and residual values are reviewed annually and adjusted if necessary.

#### *Intangible assets*

Intangible assets consist of computer software which is not integral to the computer hardware owned by the Company. Software is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses. Software is amortized on a straight-line basis over its estimated useful life of 20 years. The depreciation expense is included in other operating and administrative expenses in the consolidated statement of comprehensive income.

## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

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### 13. PROPERTY, PLANT & EQUIPMENT AND INTANGIBLE ASSETS (CONT'D)

*Property, plant and equipment*

	Declining Balance rate	2016		
		Cost	Accumulated Depreciation	Net Book Value
Land	N/A	\$ 87,537	\$ -	\$ 87,537
Buildings	5-8%	963,328	439,787	523,541
Computer equipment	30%	116,275	77,939	38,336
Telephone system	8%	30,237	10,724	19,513
Furniture and fixtures	20%	228,000	148,122	79,878
Vehicles	30%	92,737	74,034	18,703
		<u>\$ 1,518,114</u>	<u>\$ 750,606</u>	<u>\$ 767,508</u>

	Declining Balance Rate	2015		
		Cost	Accumulated Depreciation	Net Book Value
Land	N/A	\$ 85,927	\$ -	\$ 85,927
Buildings	5-8%	963,328	410,437	552,891
Computer equipment	30%	108,734	63,828	44,906
Telephone system	8%	30,237	9,027	21,210
Furniture and fixtures	20%	230,016	129,705	100,311
Vehicles	30%	92,737	66,018	26,719
		<u>\$ 1,510,979</u>	<u>\$ 679,015</u>	<u>\$ 831,964</u>

*Intangible assets*

	Useful Life	2016		
		Cost	Accumulated Depreciation	Net Book Value
Computer software	20 years	<u>\$ 155,120</u>	<u>\$ 45,213</u>	<u>\$ 109,907</u>

	Useful Life	2015		
		Cost	Accumulated Depreciation	Net Book Value
Computer software	20 years	<u>\$ 155,120</u>	<u>\$ 37,457</u>	<u>\$ 117,663</u>

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 14. PENSION PLANS

The Company makes contributions to a defined contribution group retirement program registered with Standard Life. The program consists of a Structured Retirement Savings Plan (STRP), a Deferred Profit Sharing Plan (DPSP), and a Tax Free Savings Account (TFSA).

Participation by employees and the Company is compulsory for all employees who have completed a successful probationary period. Employee contributions must be a minimum of 3% of the employees annual earnings, while the company's contribution is 100% of employee contributions to a maximum of 7.25% of the employee's annual earnings.

Contributions made during the year by the Company to the program were \$88,012 (2015 - \$85,784).

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### 15. RELATED PARTY TRANSACTIONS

The Company entered into the following transactions with key management personnel, which are defined by IAS 24, Related Party Disclosures, as those persons having authority and responsibility for planning, directing and controlling the activities of the Company, including directors and management:

	<u>2016</u>	<u>2015</u>
Compensation		
Short-term employee benefits and director fees	\$ 665,005	\$ 616,816
Total pension and other post-employment benefits	51,944	48,840
	<u>\$ 716,949</u>	<u>\$ 665,656</u>
Premiums	<u>\$ 67,680</u>	<u>\$ 84,076</u>
Claims paid	<u>\$ 14,921</u>	<u>\$ 8,635</u>

Amounts owing to and from key management personnel at December 31, 2016 are \$1,097 (2015 - \$NIL) and \$9,735 (2015 - \$8,621) respectively. These amounts are included in accounts payable and accrued liabilities and due from policyholders on the consolidated statement of financial position.

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## Erie Mutual Fire Insurance Company Notes to the Consolidated Financial Statements

December 31

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### 16. NEW STANDARDS, INTERPRETATIONS AND AMENDMENTS NOT YET EFFECTIVE

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are mandatory for accounting years beginning after January 1, 2017 or later.

The Company applied judgments related to the order and exclusion of immaterial disclosures, consistent with the amendment to IAS 1, Presentation of Financial Statements.

The Company has not yet determined the extent of the impact of the following new standards, interpretations and amendments, which have not been applied in these financial statements:

- *IFRS 9 Financial Instruments* amends the requirements for classification and measurement of financial assets, impairment and hedge accounting. IFRS 9 introduces an expected loss model of impairment and retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through profit or loss, and fair value through other comprehensive income. The basis for classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The effective date for IFRS 9 is January 1, 2018.
- *IFRS 16 Leases* eliminates the distinction between operating and finance leases from the perspective of the lessee. All contracts that meet the definition of a lease will be recorded in the statement of financial position with a "right of use" asset and a corresponding liability. The asset is subsequently accounted for as property, plant and equipment or investment property and the liability is unwound using the interest rate inherent in the lease. The accounting requirements from the perspective of the lessor remains largely in line with previous IAS 17 requirements. The effective date for IFRS 16 is January 1, 2019.