# Erie Mutual Fire Insurance Company
## Consolidated Financial Statements
For the year ended December 31, 2017

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For the year ended December 31, 2017

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# Independent Auditor's Report

**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, 2017, the consolidated statements of comprehensive income, members' surplus and cash flows for the year ended December 31, 2017, 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, 2017 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 26, 2018

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

| As at December 31, 2017 | | 2017 | | 2016 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash | $ | 971,109 | $ | 1,451,959 |
| Investments (Note 4) | | 19,920,310 | | 20,266,178 |
| Income taxes recoverable | | 351,117 | | - |
| Due from reinsurer (Note 3) | | 169,551 | | 45,666 |
| Due from policyholders | | 2,021,587 | | 1,893,381 |
| Reinsurer's share of provision for unpaid claims (Note 3) | | 2,680,022 | | 2,608,382 |
| Due from facility | | 132,672 | | 132,222 |
| Prepaid expenses | | 2,579 | | 1,624 |
| Investment properties (Note 5) | | 403,750 | | 401,864 |
| Property, plant & equipment (Note 13) | | 750,459 | | 767,508 |
| Intangible assets (Note 13) | | 102,152 | | 109,907 |
| Deferred income taxes | | 39,210 | | 33,790 |
| | $ | 27,544,518 | $ | 27,712,481 |
| **Liabilities** | | | | |
| Accounts payable and accrued liabilities | $ | 446,835 | $ | 363,141 |
| Income taxes payable | | - | | 184,525 |
| Unearned premiums (Note 3) | | 3,429,754 | | 3,243,328 |
| Provision for unpaid claims (Note 3) | | 5,826,195 | | 5,563,785 |
| | | 9,702,784 | | 9,354,779 |
| **Members' Surplus** | | | | |
| Unappropriated members' surplus | | 16,982,723 | | 17,695,072 |
| Accumulated other comprehensive income | | 859,011 | | 662,630 |
| | | 17,841,734 | | 18,357,702 |
| | $ | 27,544,518 | $ | 27,712,481 |

Signed on behalf of the Board by:

______________________________, Director

______________________________, Director

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

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

| For the year ended December 31 | 2017 | 2016 |
|---|---|---|
| **Underwriting income** | | |
| Gross premiums written | $ 7,184,736 | $ 6,769,017 |
| Less reinsurance ceded | 1,227,660 | 1,080,599 |
| Net premiums written | 5,957,076 | 5,688,418 |
| Less change in unearned premiums | 183,173 | 140,217 |
| **Net premiums earned** | 5,773,903 | 5,548,201 |
| **Direct losses incurred** | | |
| Gross claims and adjustment expenses | 5,962,819 | 3,505,927 |
| Less reinsurer's share of claims and adjustment expenses | 1,513,296 | 532,141 |
| | 4,449,523 | 2,973,786 |
| | 1,324,380 | 2,574,415 |
| **Expenses** | | |
| Fees, commissions and other acquisition (Note 8) | 99,182 | 148,272 |
| Other operating and administrative expenses (Note 9) | 2,575,683 | 2,407,102 |
| | 2,674,865 | 2,555,374 |
| **Net underwriting (loss) income** | (1,350,485) | 19,041 |
| **Investment and other income** (Note 6) | 339,404 | 727,669 |
| **(Loss) income before taxes** | (1,011,081) | 746,710 |
| **Provision for income taxes** (Note 11) | (298,732) | 159,301 |
| **Net (loss) income** | (712,349) | 587,409 |
| **Other comprehensive income (net of tax)** | | |
| Change in unrealized gain on available-for-sale investments | 72,724 | 158,614 |
| Reclassification of realized loss (gain) on available-for-sale investments | 123,657 | (4,983) |
| **Total other comprehensive income (net of tax)** | 196,381 | 153,631 |
| **Total comprehensive (loss) income for the year** | $ (515,968) | $ 741,040 |

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 |
|---|---|---|---|
| Balance at January 1, 2016 | $ 17,107,663 | $ 508,999 | $ 17,616,662 |
| 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) |
| Balance at December 31, 2016 | $ 17,695,072 | $ 662,630 | $ 18,357,702 |
| **Net loss** | **(712,349)** | **-** | **(712,349)** |
| **Change in unrealized gain on available-for-sale investments** | **-** | **72,724** | **72,724** |
| **Reclassification of realized loss on available-for-sale investments** | **-** | **123,657** | **123,657** |
| **Balance at December 31, 2017** | **$16,982,723** | **$ 859,011** | **$17,841,734** |

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, 2017 | 2017 | 2016 |
|---|---|---|
| **Operating activities** | | |
| Net (loss) income | $ (712,349) | $ 587,409 |
| Adjustments for: | | |
| Depreciation | 85,508 | 85,556 |
| Interest and dividend income | (588,065) | (748,046) |
| Provision for income taxes | (298,732) | 159,301 |
| Realized loss (gain) on disposal of investments | 168,241 | (6,644) |
| Realized loss on disposal of property, plant & equipment | 4,418 | 870 |
| Realized gain on disposal of investment property | - | (43,210) |
| | (1,340,979) | 35,236 |
| Changes in working capital | | |
| Change in due from policyholders and facility | (252,541) | (45,104) |
| Change in prepaid expenses | (955) | 1,802 |
| Change in accounts payable and accrued liabilities | 83,694 | (41,440) |
| | (169,802) | (84,742) |
| Changes in insurance contract related balances, provisions | | |
| Change in reinsurer's share of provision for unpaid claims | (71,640) | (284,429) |
| Change in unearned premiums | 186,426 | 140,217 |
| Change in provision for unpaid claims | 262,410 | 178,020 |
| | 377,196 | 33,808 |
| Cash flows related to interest, dividends and income taxes | | |
| Interest and dividends received | 588,065 | 748,046 |
| Income taxes (paid) received | (331,165) | 300,592 |
| | 256,900 | 1,048,638 |
| **Total cash (outflows) inflows from operating activities** | (876,685) | 1,032,940 |
| **Investing activities** | | |
| Proceeds on sale of investments | 7,334,350 | 1,100,000 |
| Purchase of investments | (6,871,507) | (1,841,353) |
| Proceeds on disposal of property, plant & equipment | 2,000 | 150 |
| Purchase of property, plant & equipment | (64,943) | (12,027) |
| Proceeds on disposal of investment property | - | 154,524 |
| Purchase of investment property | (4,065) | (5,387) |
| **Total cash inflows (outflows) from investing activities** | 395,835 | (604,093) |
| **Net (decrease) increase in cash and cash equivalents** | (480,850) | 428,847 |
| **Cash and cash equivalents, beginning of year** | 1,451,959 | 1,023,112 |
| **Cash and cash equivalents, end of year** | $ 971,109 | $ 1,451,959 |

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

## 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. 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 26, 2018.

## 2. BASIS OF PRESENTATION

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.

## 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 recognizes 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*

| | **2017** | 2016 |
|---|---|---|
| Balance, beginning of the year | **$ 3,243,328** | $ 3,103,111 |
| Premiums written | **7,184,736** | 6,769,017 |
| Premiums earned during year | **(6,998,310)** | (6,628,800) |
| Balance, end of the year | **$ 3,429,754** | $ 3,243,328 |

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, 2017 or 2016.

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.

## 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, 2017 | | |
|---|---|---|---|
| | **Gross** | **Reinsurance** | **Net** |
| *Outstanding claims provision* | | | |
| Long term settlement | **$ 2,860,135** | **$ 1,693,149** | **$ 1,166,986** |
| Short term settlement | **1,109,559** | **486,873** | **622,686** |
| Facility Association and other residual pools | **196,501** | **-** | **196,501** |
| | **4,166,195** | **2,180,022** | **1,986,173** |
| Provision for claims incurred but not reported | **1,660,000** | **500,000** | **1,160,000** |
| | **$ 5,826,195** | **$ 2,680,022** | **$ 3,146,173** |

| | December 31, 2016 | | |
|---|---|---|---|
| | Gross | Reinsurance | Net |
| *Outstanding claims provision* | | | |
| 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 |
| | 3,903,785 | 2,108,382 | 1,795,403 |
| Provision for claims incurred but not reported | 1,660,000 | 500,000 | 1,160,000 |
| | $ 5,563,785 | $ 2,608,382 | $ 2,955,403 |

## 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:

| | **2017** | 2016 |
|---|---|---|
| Unpaid claim liabilities - beginning of year – net of reinsurance | **$ 2,955,403** | $ 3,061,812 |
| Increase in estimated losses and expenses for losses occurring in prior years | **252,459** | 316,951 |
| Provision for losses and expenses on claims occurring in the current year | **3,992,243** | 2,478,154 |
| Payment on claims: | | |
| Current year | **(2,975,053)** | (1,726,947) |
| Prior years | **(1,078,879)** | (1,174,567) |
| Unpaid claims liabilities – end of year - net of reinsurance | **3,146,173** | 2,955,403 |
| Reinsurer's share | **2,680,022** | 2,608,382 |
| | **$ 5,826,195** | $ 5,563,785 |

### 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 2010 to 2017. 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.

## 3. INSURANCE CONTRACTS (CONT'D)

| **Gross claims** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **Total** |
|---|---|---|---|---|---|---|---|---|---|
| Gross estimate of cumulative claims cost | | | | | | | | | |
| At the end year of claim | $ 1,185,421 | $ 2,704,955 | $ 1,642,762 | $ 2,650,761 | $ 4,903,264 | $ 2,614,835 | $ 3,065,654 | $ 5,378,042 | |
| One year later | 1,193,125 | 2,796,856 | 1,569,578 | 2,734,856 | 5,059,946 | 2,773,430 | 3,399,936 | | |
| Two years later | 1,254,303 | 2,900,256 | 1,616,925 | 3,129,900 | 5,100,663 | 2,814,106 | | | |
| Three years later | 1,243,754 | 2,920,308 | 1,633,341 | 2,937,393 | 5,044,795 | | | | |
| Four years later | 1,225,842 | 3,691,808 | 1,734,020 | 3,095,493 | | | | | |
| Five years later | 1,225,836 | 3,727,307 | 1,773,095 | | | | | | |
| Six years later | 1,224,700 | 3,486,547 | | | | | | | |
| Seven years later | 1,224,700 | | | | | | | | |
| Current estimate of cumulative claims cost | 1,224,700 | 3,486,547 | 1,773,095 | 3,095,493 | 5,044,795 | 2,814,106 | 3,399,936 | 5,378,042 | 26,216,714 |
| Cumulative payments | 1,224,700 | 3,467,865 | 1,773,095 | 3,074,636 | 3,695,253 | 2,741,329 | 2,986,181 | 3,283,961 | 22,247,020 |
| Outstanding claims | $ - | $ 18,682 | $ - | $ 20,857 | $ 1,349,542 | $ 72,777 | $ 413,755 | $ 2,094,081 | $ 3,969,694 |
| Facility association and other residual pools | | | | | | | | | 196,501 |
| Incurred but not reported (IBNR) | | | | | | | | | 1,660,000 |
| **Total gross outstanding claims including claims handling expense** | | | | | | | | | **$ 5,826,195** |

| **Net claims** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **Total** |
|---|---|---|---|---|---|---|---|---|---|
| Net estimate of cumulative claims cost | | | | | | | | | |
| At the end year of claim | $ 1,185,421 | $ 2,097,730 | $ 1,642,762 | $ 2,588,261 | $ 2,650,764 | $ 2,568,084 | $ 2,478,154 | $ 3,992,243 | |
| One year later | 1,193,125 | 2,307,119 | 1,569,578 | 2,672,356 | 2,764,566 | 2,729,472 | 2,490,456 | | |
| Two years later | 1,254,303 | 2,323,958 | 1,616,925 | 2,827,849 | 2,711,566 | 2,770,148 | | | |
| Three years later | 1,243,754 | 2,311,162 | 1,633,341 | 2,811,382 | 2,655,697 | | | | |
| Four years later | 1,225,842 | 2,388,312 | 1,734,020 | 2,947,282 | | | | | |
| Five years later | 1,225,836 | 2,394,054 | 1,773,095 | | | | | | |
| Six years later | 1,224,700 | 2,369,978 | | | | | | | |
| Seven years later | 1,224,700 | | | | | | | | |
| Current estimate of cumulative claims cost | 1,224,700 | 2,369,978 | 1,773,095 | 2,947,282 | 2,655,697 | 2,770,148 | 2,490,456 | 3,992,243 | 20,223,599 |
| Cumulative payments | 1,224,700 | 2,368,110 | 1,773,095 | 2,927,046 | 2,193,680 | 2,697,371 | 2,274,872 | 2,975,053 | 18,433,927 |
| Outstanding claims | $ - | $ 1,868 | $ - | $ 20,236 | $ 462,017 | $ 72,777 | $ 215,584 | $ 1,017,190 | $ 1,789,672 |
| Facility association and other residual pools | | | | | | | | | 196,501 |
| Incurred but not reported (IBNR) | | | | | | | | | 1,160,000 |
| **Total net outstanding claims including claims handling expense** | | | | | | | | | **$ 3,146,173** |

## 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** | |
|---|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 |
| 5% change in the loss ratios would result in the following increase/decrease: | | | | | | |
| Gross | **$ 163,466** | $ 155,164 | **$ 159,690** | $ 152,063 | **$ 22,793** | $ 21,095 |
| Net | **$ 142,505** | $ 138,791 | **$ 124,255** | $ 119,160 | **$ 18,851** | $ 16,571 |

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.

## 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% (2016 - 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*

| | **2017** | 2016 |
|---|---|---|
| Balance, beginning of the year | **$ 45,666** | $ 33,643 |
| Submitted to reinsurer | **1,317,771** | 235,689 |
| Received from reinsurer | **(1,193,886)** | (223,666) |
| Balance, end of the year | **$ 169,551** | $ 45,666 |

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.

## 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*

| | 2017 | 2016 |
|---|---|---|
| Balance, beginning of the year | $ 2,608,382 | $ 2,323,953 |
| New claims reserves | 1,385,800 | 587,500 |
| Change in prior years reserves | 3,611 | (67,382) |
| Submitted to reinsurer | (1,317,771) | (235,689) |
| Balance, end of the year | $ 2,680,022 | $ 2,608,382 |

(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.

## 4. INVESTMENTS

The Company classifies it 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 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 $86,933 in its consolidated financial statements.

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

| | **December 31, 2017** | | December 31, 2016 | |
|---|---|---|---|---|
| | **Cost** | **Fair value** | Cost | Fair value |
| **Pooled funds** | | | | |
| Canadian equity | **$ 2,939,198** | **$ 4,095,057** | $ 2,838,142 | $ 3,706,502 |
| Fixed income | **15,796,286** | **15,809,146** | 16,528,706 | 16,543,849 |
| | **18,735,484** | **19,904,203** | 19,366,848 | 20,250,351 |
| **Fire Mutuals Guarantee Fund** | **16,107** | **16,107** | 15,827 | 15,827 |
| **Total investments** | **$18,751,591** | **$19,920,310** | $ 19,382,675 | $ 20,266,178 |

## 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.

## 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, 2017, a 1% move in interest rates, with all other variables held constant, could impact the market value of fixed income funds by $1,106,640 (2016 - $1,170,511). 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, 2017, 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 $409,506 (2016 - $370,650). 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.

## 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 |
|---|---|---|---|---|
| **December 31, 2017** | | | | |
| Pooled funds | **$ -** | **$ 19,904,203** | **$ -** | **$ 19,904,203** |
| Other investments | **-** | **16,107** | **-** | **16,107** |
| **Total** | **$ -** | **$ 19,920,310** | **$ -** | **$ 19,920,310** |
| **December 31, 2016** | | | | |
| Pooled funds | $ - | $ 20,250,351 | $ - | $ 20,250,351 |
| Other investments | - | 15,827 | - | 15,827 |
| **Total** | $ - | $ 20,266,178 | $ - | $ 20,266,178 |

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2016 and 2017.

## 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 |
|---|---|---|---|
| **Cost** | | | |
| Balance at January 1, 2016 | $ 464,259 | $ 154,165 | $ 618,424 |
| Additions | 5,387 | - | 5,387 |
| Disposals | (111,358) | - | (111,358) |
| Balance on December 31, 2016 | 358,288 | 154,165 | 512,453 |
| Additions | 4,065 | - | 4,065 |
| **Balance on December 31, 2017** | **$ 362,353** | **$ 154,165** | **$ 516,518** |
| **Accumulated depreciation** | | | |
| Balance at January 1, 2016 | $ - | $ 108,296 | $ 108,296 |
| Depreciation expense | - | 2,293 | 2,293 |
| Balance on December 31, 2016 | - | 110,589 | 110,589 |
| Depreciation expense | - | 2,179 | 2,179 |
| **Balance on December 31, 2017** | **$ -** | **$ 112,768** | **$ 112,768** |
| **Net book value** | | | |
| December 31, 2016 | $ 358,288 | $ 43,576 | $ 401,864 |
| **December 31, 2017** | **$ 362,353** | **$ 41,397** | **$ 403,750** |

## 5. INVESTMENT PROPERTIES (CONT'D)

| | | **2017** | | 2016 |
|---|---|---|---|---|
| Rental revenue from investment property | **$** | **7,566** | $ | 7,566 |
| Direct operating costs of investment property: | | | | |
| Generating rental income | | **2,460** | | 4,081 |
| Not generating rental income | | **4,064** | | 4,404 |
| Net income (loss) from rental | **$** | **1,042** | $ | (919) |

The fair value of the investment properties is $519,000 (2016 - $446,100).

## 6. INVESTMENT AND OTHER INCOME

| | | **2017** | | 2016 |
|---|---|---|---|---|
| Interest income | **$** | **487,009** | $ | 651,681 |
| Dividend income | | **101,056** | | 96,365 |
| Realized (loss) gains on disposal of investments | | **(168,241)** | | 6,644 |
| Investment expenses | | **(77,044)** | | (78,860) |
| Income (loss) on rental | | **1,042** | | (919) |
| Recovery of previous impairment | | **-** | | 10,418 |
| Gain on disposal of investment property | | **-** | | 43,210 |
| Loss on disposal of property, plant & equipment | | **(4,418)** | | (870) |
| | **$** | **339,404** | $ | 727,669 |

## 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.

## 8. FEES, COMMISSIONS AND OTHER ACQUISITION EXPENSES

| | **2017** | 2016 |
|---|---|---|
| Bad debts (recovery) | **$ (407)** | $ 452 |
| Commissions (recovery) | **(9,470)** | (13,930) |
| Inspection and investigations | **42,522** | 55,606 |
| Sales and marketing | **66,537** | 106,144 |
| | **$ 99,182** | $ 148,272 |

## 9. OTHER OPERATING AND ADMINISTRATIVE EXPENSES

| | 2017 | 2016 |
|---|---|---|
| Association fees | **$ 46,105** | $ 42,193 |
| Computer costs | **469,561** | 218,712 |
| Donations | **14,663** | 16,545 |
| Insurance | **34,679** | 35,609 |
| Occupancy | **106,844** | 98,036 |
| Postage | **12,847** | 18,516 |
| Premium tax | **16,845** | 16,152 |
| Printing, stationary and office supplies | **18,069** | 25,601 |
| Professional fees | **72,140** | 81,418 |
| Salaries, benefits and directors fees | **1,672,307** | 1,743,972 |
| Telephone | **17,963** | 14,866 |
| Travel | **71,765** | 72,809 |
| Other | **21,895** | 22,673 |
| | **$ 2,575,683** | $ 2,407,102 |

## 10. SALARIES, BENEFITS AND DIRECTORS FEES

| | 2017 | 2016 |
|---|---|---|
| Total salaries and benefits paid to employees, and directors fees | **$ 1,760,751** | $ 1,868,354 |

## 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:

| | 2017 | 2016 |
|---|---|---|
| **Current tax (recovery) expense** | | |
| Based on current year taxable income | **$ (204,482)** | $ 211,467 |
| Adjustments for over provision in prior periods | **-** | (2,156) |
| | **(204,482)** | 209,311 |
| **Deferred tax expense** | | |
| Origination and reversal of temporary differences | **(94,250)** | (50,010) |
| **Total income tax (recovery) expense** | **$ (298,732)** | $ 159,301 |

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

| | 2017 | 2016 |
|---|---|---|
| **Deferred tax** | | |
| Change in unrealized gain (loss) on available-for-sale investments | **$ (44,251)** | $ 52,871 |
| Reclassification of realized gain on available-for-sale investments | **(44,584)** | (1,661) |
| **Total tax affect of amounts recorded in other comprehensive income** | **$ (88,835)** | $ 51,210 |

## 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:

| | 2017 | 2016 |
|---|---|---|
| Income before taxes | **$ (1,011,081)** | $ 746,710 |
| Expected taxes based on the statutory rate of 26.50% | **(267,936)** | 197,878 |
| Dividend income not subject to tax | **(26,780)** | (25,537) |
| Other non deductible expenses | **3,562** | 4,184 |
| Mark to market and other adjustments related to investments | **(16,932)** | 3,058 |
| Rate adjustment related to temporary differences | **5,420** | 1,200 |
| Amortization/Capital cost allowance and claims reserve | **3,934** | (12,559) |
| Over provision in prior years | **-** | (2,156) |
| Utilization of losses carried forward | **-** | (6,767) |
| Provision for income taxes | **$ (298,732)** | $ 159,301 |

## 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.

## 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.

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

*Property, plant & equipment*

**2017**

| | Declining Balance rate | Cost | Accumulated Depreciation | Net Book Value |
|---|---|---|---|---|
| **Land** | **N/A** | **$ 89,276** | **$ -** | **$ 89,276** |
| **Buildings** | **5-8%** | **963,328** | **467,532** | **495,796** |
| **Computer equipment** | **30%** | **124,806** | **88,650** | **36,156** |
| **Telephone system** | **8%** | **46,968** | **13,624** | **33,344** |
| **Furniture and fixtures** | **20%** | **229,753** | **164,448** | **65,305** |
| **Vehicles** | **30%** | **76,994** | **46,412** | **30,582** |
| | | **$ 1,531,125** | **$ 780,666** | **$ 750,459** |

2016

| | Declining Balance Rate | 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 |
| | | $ 1,518,114 | $ 750,606 | $ 767,508 |

*Intangible assets*

**2017**

| | Useful Life | Cost | Accumulated Depreciation | Net Book Value |
|---|---|---|---|---|
| **Computer software** | **20 years** | **$ 155,120** | **$ 52,968** | **$ 102,152** |

2016

| | Useful Life | Cost | Accumulated Depreciation | Net Book Value |
|---|---|---|---|---|
| Computer software | 20 years | $ 155,120 | $ 45,213 | $ 109,907 |

## 14. PENSION PLANS

The Company makes contributions to a defined contribution group retirement program registered with Manulife. 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 $85,713 (2016 - $88,012).

## 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:

| | **2017** | 2016 |
|---|---|---|
| Compensation | | |
| Short-term employee benefits and director fees | **$ 714,142** | $ 665,005 |
| Total pension and other post-employment benefits | **50,157** | 51,944 |
| | **$ 764,299** | $ 716,949 |
| Premiums | **$ 57,919** | $ 67,680 |
| Claims paid | **$ 27,450** | $ 14,921 |

Amounts owing to and from key management personnel at December 31, 2017 are $209 (2016 - $1,097) and $6,429 (2016 - $9,735) respectively. These amounts are included in accounts payable and accrued liabilities and due from policyholders on the consolidated statement of financial position.

## 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, 2018 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 (loss). The basis of classification depends on the entity's business model and contractual cash flow characteristics of the financial asset. The effective date for IFRS 9 is January 1, 2018; however, insurance entities have been provided with the option of deferring the adoption of IFRS 9 until January 1, 2021, which is the effective date of IFRS 17, *Insurance Contracts*. The Company plans to adopt IFRS 9 on January 1, 2018.

  The Company expects that its investments will be classified at fair value through profit or loss based on the business model assessment, therefore the adoption of IFRS is expected to have a material impact on the Company's financial position and performance.

- *IFRS 17 Insurance Contracts* was issued in May 2017 and lays out a fundamentally new way of measuring and presenting insurance contracts and related financial statement items for entities that issue insurance contracts. Some of the key aspects of IFRS 17 include new models for insurance liabilities, changes to discounting and the rate being used discount claims liabilities, and changes to deferred premium acquisition costs. The technical aspects of IFRS 17 are complex and will require specific consultation on the situation to determine the exact impact. The effective date for IFRS 17 is January 1, 2021 with the requirement to restate comparative figures. The Company is in the process of evaluating the impact of the new standard.