Halwell Mutual Insurance Company
Financial Statements
For the year ended December 31, 2017

Contents

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Independent Auditor's Report

To the Policyholders of Halwell Mutual Insurance Company

We have audited the accompanying financial statements of Halwell Mutual Insurance Company, which comprise the statement of financial position as at December 31, 2017 and the statements of comprehensive (loss) income, members' surplus and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Halwell Mutual 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

Mississauga, Ontario
February 14, 2018

Halwell Mutual Insurance Company
Statement of Financial Position

December 31		2017		2016
Assets				
Cash	**$**	**823,260**	$	539,902
Due from policyholders		**6,086,643**		5,727,990
Income taxes recoverable		**626,220**		463,975
Due from reinsurer		**54,180**		8,057
Reinsurer's share of provision for unpaid claims (Note 3e)		**8,950,378**		8,556,115
Deferred policy acquisition expenses (Note 3b)		**2,137,884**		2,151,925
Investments (Note 4)		**35,627,285**		37,050,308
Investment income accrued		**144,487**		131,069
Property and equipment (Note 11)		**8,255,384**		5,638,508
Intangible assets (Note 11)		**1,330**		25,574
Other assets		**25,852**		41,921
Deferred income taxes		**81,544**		116,544
	$	**62,814,447**	$	60,451,888
Liabilities				
Accounts payable and accrued liabilities	**$**	**1,178,464**	$	1,072,817
Due to reinsurer		**153,097**		228,769
Unearned premiums (Note 3a)		**11,295,728**		10,678,814
Provision for unpaid claims (Note 3e)		**19,287,746**		17,099,840
		31,915,035		29,080,240
Members' Surplus				
Unappropriated members' surplus		**30,899,412**		31,371,648
	$	**62,814,447**	$	60,451,888

Signed on behalf of the Board by:

Director

Director

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

Halwell Mutual Insurance Company
Statement of Comprehensive (Loss) Income

For the year ended December 31	2017	2016
Underwriting income		
Gross premiums written	**$ 21,979,073**	$ 20,690,292
Less: change in unearned premiums	**620,852**	749,520
Less: reinsurance ceded	**3,240,505**	2,919,651
Net premiums earned	**18,117,716**	17,021,121
Service charges	**289,985**	262,045
	18,407,701	17,283,166
Direct losses incurred		
Gross claims and adjustment expenses (Note 8)	**16,641,062**	11,317,926
Less: reinsurer's share of claims and adjustment expenses	**3,410,440**	906,491
	13,230,622	10,411,435
Underwriting income before expenses	**5,177,079**	6,871,731
Expenses		
Fees, commissions and other acquisition expenses	**4,361,840**	4,054,511
Other operating and administrative expenses (Note 7)	**3,117,478**	3,131,522
	7,479,318	7,186,033
Net underwriting loss	**(2,302,239)**	(314,302)
Investment and other income (Note 5)	**1,433,150**	1,433,440
(Loss) income before income taxes	**(869,089)**	1,119,138
(Loss) income before income taxes	**(869,089)**	1,119,138
Income tax (recovery) expense (Note 9)		
Current	**(431,853)**	204,408
Future	**35,000**	-
	(396,853)	204,408
Comprehensive (loss) income for the year	**$ (472,236)**	$ 914,730

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

Halwell Mutual Insurance Company
Statement of Members' Surplus

For the year ended December 31	2017	2016
Unappropriated Members' Surplus		
Balance, beginning of year	**$ 31,371,648**	$ 30,456,918
Comprehensive (loss) income for the year	**(472,236)**	914,730
Balance, end of year	**$ 30,899,412**	$ 31,371,648

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

Halwell Mutual Insurance Company
Statement of Cash Flows

For the year ended December 31	2017	2016
Operating activities		
Comprehensive (loss) income for the year	**$ (472,236)**	$ 914,730
Adjustments for:		
Amortization and depreciation of property, equipment and intangibles	**232,710**	115,533
Interest and dividend income	**(1,075,068)**	(1,101,498)
Provision for (recovery of) income taxes	**(431,853)**	204,408
Provision for future tax	**35,000**	-
Realized gains on disposal of investments	**(10,883)**	(96,058)
Realized gain on disposal of building	**(386,182)**	-
Change in market value adjustment	**(91,198)**	(366,040)
	(1,727,474)	(1,243,655)
Changes in working capital and insurance contract related balances		
Change in due from policyholders	**(358,653)**	(410,615)
Change in reinsurer's share of provision for unpaid claims	**(394,263)**	167,505
Change in other assets	**16,069**	18,620
Change in accounts payable and accrued liabilities	**105,647**	(345,896)
Change in due to reinsurer	**(121,795)**	148,254
Change in provision for refund to policy holders	**-**	(500,000)
Change in deferred policy acquisition expenses	**14,041**	(146,872)
Change in unearned premiums	**616,914**	783,772
Change in provision for unpaid claims	**2,187,906**	436,910
	2,065,866	151,678
Cash flows related to interest, dividends and income taxes		
Interest and dividends received	**1,061,650**	1,114,252
Income taxes paid	**269,609**	(588,936)
	1,331,259	525,316
Total cash inflows from operating activities	**1,197,415**	348,069
Investing activities		
Sale of investments	**20,496,004**	32,726,105
Purchase of investments	**(19,056,661)**	(32,002,288)
Sale of property, equipment and intangibles	**1,400,000**	-
Purchase of property, equipment and intangibles	**(3,753,400)**	(3,015,153)
Total cash outflows from investing activities	**(914,057)**	(2,291,336)
Net increase (decrease) in cash	**283,358**	(1,943,267)
Cash, beginning of year	**539,902**	2,483,169
Cash, end of year	**$ 823,260**	$ 539,902

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

1. Corporate Information

Halwell Mutual Insurance Company (the "Company") was incorporated without share capital under the laws governing Ontario on January 9, 1861. The Company is licensed to write property, liability, automobile and farmers' accident insurance in Ontario. The Company's head office is located at 535 Hanlon Creek Blvd., Guelph, Ontario.

The Company is subject to rate regulation on 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 Mutuals. 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 (“FSCO”). 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 financial statements have been authorized for issue by the Board of Directors on February 13, 2018.

2. Basis of Preparation

(a) Statement of Compliance

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

(b) Basis of Measurement

These financial statements were prepared under the historical cost convention, as modified by revaluation of investments (Note 4).

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

(c) Judgment and Estimates

The preparation of 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 a higher degree of judgment of complexity, or areas where assumptions and estimates are significant to the financial statements within the next financial year are:

- The calculation of unpaid claims, including the determination of the initial claim liability, discount rates, the estimate of time until ultimate settlement and the performance of a liability adequacy test (Note 3)
- The determination of the recoverability of deferred policy acquisition expenses (Note 3)

In addition, in preparing the financial statements, the notes to the financial statements were ordered such that the most relevant information was presented earlier in the notes and the disclosures that management deemed to be immaterial were excluded from the notes to the financial statements. The determination of the relevance and materiality of disclosures involved 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 ("GAAP").

Balances arising from insurance contracts primarily include unearned premiums, provision for unpaid claims, the reinsurer's share of provision for unpaid claims, and deferred policy acquisition expenses.

(a) Premiums and unearned premiums

Premiums written comprise the premiums on contracts incepting in the financial year. Premiums written are stated gross of commissions payable to agents and 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 (UEP). Changes in unearned premiums recorded in the statement of financial position for the year-ended December 31, 2017 and their impact on net premiums earned is as follows:

Unearned premiums (UEP)	**2017**	2016
Balance, beginning of the year	**$ 10,678,814**	$ 9,895,042
Premiums written	**21,979,073**	20,690,292
Premiums earned during the year	**(21,983,011)**	(20,656,040)
Changes in UEP recognized in income	**620,852**	749,520
Balance, end of the year	**$ 11,295,728**	$ 10,678,814

3. Insurance Contracts (cont'd)

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.

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

(b) Deferred policy acquisition expenses

Acquisition costs are comprised of commissions, premium taxes, and overheads. These costs are deferred and amortized over the terms of the related policies to the extent that they are considered to be recoverable from unearned premiums, after considering the related anticipated claims and expenses. Changes in deferred policy acquisition expenses recorded in statement of financial position for the year-ended December 31, 2017 and their impact on fees, commissions and other acquisition expenses is as follows:

	2017	2016
Balance, beginning of the year	**$ 2,151,925**	$ 2,005,053
Acquisition costs incurred	**7,567,275**	7,564,765
Expensed during the year	**(7,581,316)**	(7,417,893)
Balance, end of the year	**$ 2,137,884**	$ 2,151,925

Deferred policy acquisition expenses will be recognized as an expense within one year.

(c) Provision for unpaid claims

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, claims development 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 comprehensive (loss) income.

Claim liabilities are carried on a discounted basis to reflect the time value of money. As required by actuarial standards in Canada, claims liabilities also include a provision for adverse deviation (PFAD), which represents an additional margin on valuation variable factors, which are claims development reinsurance recoveries and interest rates used in discounting claims liabilities.

3. Insurance Contracts (cont'd)

(c) Provision for unpaid claims (cont'd)

The following is a summary of the insurance contract provisions and related reinsurance assets:

	December 31, 2017			December 31, 2016		
	Gross	**Re-insurance**	**Net**	Gross	Re-insurance	Net
Outstanding claims provision						
Long-term	**$ 6,710,376**	**$ 3,656,829**	**$ 3,053,547**	$ 9,885,575	$ 6,166,869	$ 3,718,706
Short-term	**6,895,594**	**3,020,549**	**3,875,045**	2,240,599	300,303	1,940,296
Facility Association and other residual pools	**343,776**	**-**	**343,776**	336,666	-	336,666
	13,949,746	**6,677,378**	**7,272,368**	12,462,840	6,467,172	5,995,668
Provision for claims incurred but not reported	**5,338,000**	**2,273,000**	**3,065,000**	4,637,000	2,097,000	2,540,000
	$ 19,287,746	**$ 8,950,378**	**$ 10,337,368**	$ 17,099,840	$ 8,564,172	$ 8,535,668

3. Insurance Contracts (cont'd)

(c) Provision for unpaid claims (cont'd)

The ultimate cost of long-term general liability claims are difficult to predict for several reasons. Claims may not be reported until many years after a policy expires. Changes in the legal environment may have created further complications. Court decisions and federal and provincial legislation may dramatically increase the liability between the time a policy is written and associated claims are ultimately resolved. Provisions for such difficult-to-estimate liabilities are established by examining the facts of tendered claims and adjusting in the aggregate for ultimate loss expectations based upon historical experience patterns and current socioeconomic trends.

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 based on its share of the pool.

Changes in claim liabilities recorded in the statement of financial position for the year-ended December 31, 2017 and their impact on claims and adjustment expenses for the year is as follow:

	2017	2016
Unpaid claim liabilities - beginning of year – net of reinsurance	**$ 8,535,668**	$ 7,931,253
Increase (decrease) in estimated losses and expenses, for losses occurring in prior years	**3,427,293**	3,058,202
Provision for losses and expenses on claims occurring in the current year	**8,195,631**	6,278,105
Increase in provision for claims incurred but not reported	**525,000**	137,521
Payment on claims:		
Current year	**(6,849,853)**	(6,071,214)
Prior years	**(3,496,371)**	(2,798,199)
Unpaid claims – end of year - net	**10,337,368**	8,535,668
Reinsurer's share and subrogation recoverable	**8,950,378**	8,564,172
	$ 19,287,746	$ 17,099,840

The change in estimate of losses occurring in prior years is due to changes arising from new information received.

3. Insurance Contracts (cont'd)

(c) Provision for unpaid claims (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 exposure 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 arrangements.

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-term claims are those which are expected to be substantially paid within a year of being reported.

The following tables show how the Company’s estimate of cumulative incurred claim cost for each accident year has changed at successive year ends and reconcile the cumulative claims to the amount appearing in the statement of financial position. An accident-year basis is considered to be the most appropriate for the business written by the Company.

3. Insurance Contracts (cont'd)

(c) Provision for unpaid claims (cont'd)

Gross claims (in 000's)

	Accident Year										
Reporting Date	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Total**
At end of accident year	$ 12,532	$ 8,533	$ 9,720	$ 13,962	$ 10,342	$ 13,470	$ 9,623	$ 9,095	$ 12,006	$ 14,456	
1 year later	11,766	8,404	9,558	13,450	9,901	13,747	9,336	9,037	12,611		
2 years later	12,661	8,379	9,154	12,434	9,578	13,181	8,996	8,603			
3 years later	12,381	7,640	8,774	12,431	9,121	12,827	8,441				
4 years later	11,125	7,288	8,279	10,847	8,660	12,897					
5 years later	10,534	7,263	8,621	10,310	9,519						
6 years later	10,452	7,246	8,500	10,523							
7 years later	10,452	7,245	8,510								
8 years later	10,452	7,245									
9 years later	10,452										
Current estimate of ultimate cost	10,452	7,245	8,510	10,523	9,519	12,897	8,441	8,603	12,611	14,456	103,257
Cumulative payments	10,452	7,245	8,436	9,974	7,844	9,890	7,987	7,449	9,462	7,336	86,075
Outstanding claims	$ -	$ -	$ 74	$ 549	$ 1,675	$ 3,007	$ 454	$ 1,154	$ 3,149	$ 7,120	$ 17,182
Liability for all prior accident years											35
Impact of discount and PFAD											1,727
Facility Association and risk sharing pool											344
Total gross outstanding claims											$ 19,288

3. Insurance Contracts (cont'd)

(c) Provision for unpaid claims (cont'd)

Net of reinsurance (in 000's)

	Accident Year										
Reporting Date	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Total**
At end of accident year	$ 8,708	$ 6,234	$ 6,641	$ 6,965	$ 6,244	$ 7,674	$ 7,672	$ 7,395	$ 9,936	$ 12,122	
1 year later	7,727	6,351	6,159	6,745	6,727	8,115	7,625	7,602	10,185		
2 years later	8,277	5,822	6,218	6,852	6,395	7,821	7,402	7,251			
3 years later	7,231	5,474	6,120	6,615	6,074	7,546	7,314				
4 years later	6,726	5,318	5,852	6,351	5,983	7,534					
5 years later	6,446	5,308	5,916	6,219	5,882						
6 years later	6,391	5,294	5,809	6,190							
7 years later	6,392	5,294	5,819								
8 years later	6,392	5,294									
9 years later	6,392										
Current estimate of ultimate cost	6,392	5,294	5,819	6,190	5,882	7,534	7,314	7,251	10,185	12,122	73,983
Cumulative payments	6,392	5,294	5,745	6,103	5,800	7,056	7,097	6,647	8,453	6,850	65,437
Outstanding claims	$ -	$ -	$ 74	$ 87	$ 82	$ 478	$ 217	$ 604	$ 1,732	$ 5,272	$ 8,546
Liability for all prior accident years											35
Impact of discount and PFAD											1,413
Facility Association and risk sharing pool											344
Total gross outstanding claims											$ 10,338

3. Insurance Contracts (cont'd)

(c) Provision for unpaid claims (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, shown gross and net of reinsurance as it impacts on pre-tax income:

	Property claims		Auto claims		Liability claims	
	2017	2016	**2017**	2016	**2017**	2016
5% increase in loss ratios						
Gross	**$ 5,984,000**	$ 5,350,000	**$ 3,651,000**	$ 3,287,000	**$ 1,152,000**	$ 1,034,000
Net	**$ 5,216,000**	$ 4,621,000	**$ 2,923,000**	$ 2,639,000	**$ 841,000**	$ 748,000
5% decrease in loss ratios						
Gross	**$(5,984,000)**	$(5,350,000)	**$(3,651,000)**	$(3,287,000)	**$(1,152,000)**	$(1,034,000)
Net	**$(5,216,000)**	$(4,621,000)	**$(2,923,000)**	$(2,639,000)	**$ (841,000)**	$ (748,000)

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

(d) 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 in the statement of comprehensive (loss) income initially by writing down the deferred policy acquisition expense and subsequently by recognizing an additional unearned premiums.

3. Insurance Contracts (cont'd)

(e) Reinsurer's share of provision for unpaid claims

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 when due.

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 $400,000 (2016 - $400,000) in the event of a property claim, an amount of $500,000 (2016 - $500,000) in the event of an automobile claim and $750,000 (2016 - $500,000) in the event of a liability claim. For amounts over the respective limits there is a 20% retention to a specified maximum. The Company also obtained reinsurance which limits the Company's liability to $1,200,000 (2016 - $1,200,000) plus 20% of the amount in excess of $1,200,000 (2016 - $1,200,000) 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% of gross net earned premiums for property and automobile.

Amounts recoverable from the 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 the 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 reinsurer's share of provision for unpaid claims in the statement of financial position for the year ended December 31, 2017 is as follows:

	2017	2016
Balance, beginning of the year	**$ 8,564,172**	$ 8,731,677
New claims reserve	**1,461,883**	1,741,087
Change in prior years' reserve	**1,994,680**	(873,028)
Submitted to reinsurer	**(3,016,177)**	(1,035,564)
Balance, end of the year	**$ 9,004,558**	$ 8,564,172

Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian 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)

(f) Refund of premium

Under the discretion of the Board of Directors, the Company may declare a refund to its policyholders based on the property premiums paid in the fiscal period.

4. Investments

The Company classifies its instruments as fair value through profit and loss. All transactions related to investments are recorded on a settlement date basis. Investments are carried at fair value with changes in fair value recognized in comprehensive (loss) income. Transaction costs on investments are expensed as incurred. Interest on debt securities classified as fair value through profit and loss is calculated using the effective interest method.

The following table provides cost and fair value information of investments by type of security and issuer. The maximum exposure to credit risk would be the fair value as shown below:

4. Investments (Cont'd)

	2017		2016	
	Cost	**Fair value**	Cost	Fair value
Cash	**$ 102,259**	**$ 102,259**	$ 61,722	$ 61,722
Bankers acceptance/ GICs	**270,009**	**270,009**	270,341	270,341
	372,268	**372,268**	332,063	332,063
Bonds issued by				
Federal	**5,240,183**	**5,048,534**	6,076,874	5,913,171
Provincial	**5,756,965**	**5,643,109**	6,217,044	6,140,535
Municipal	**1,407,526**	**1,392,874**	1,407,526	1,452,612
Corporate				
A or better	**10,699,656**	**10,465,207**	9,051,140	8,957,259
BBB	**1,259,309**	**1,256,892**	2,303,454	2,315,317
	24,363,639	**23,806,616**	25,056,038	24,778,894
Equity investments				
Canadian	**3,008,047**	**1,732,465**	2,054,231	2,052,064
Canadian equity pooled fund	**4,936,389**	**5,911,406**	5,742,163	6,256,024
	7,944,436	**7,643,871**	7,796,394	8,308,088
Other investments				
Fire Mutuals guarantee fund	**42,196**	**42,196**	42,196	42,196
Commercial mortgage pooled fund	**2,789,021**	**2,751,926**	3,147,401	3,128,414
Money market iquidity pooled fund	**1,010,407**	**1,010,407**	460,652	460,652
Other - MCCG	**1**	**1**	1	1
	3,841,625	**3,804,530**	3,650,250	3,631,263
Total investments	**$ 36,521,968**	**$ 35,627,285**	$ 36,834,745	$ 37,050,308

4. Investments (Cont'd)

Credit risk is the risk of financial loss to the Company if a debtor fails to make payments of interest and principal when due. The Company is exposed to this risk relating to its debt holdings and pooled fund investments in its investment portfolio.

The Company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The bond portfolio includes 95% (2016 – 91%) of bonds rated A or better. The Company's investment policy limits investment in bonds and debentures of the various ratings to limits ranging from 50% to 85% of the Company's portfolio. Funds should be invested in bonds and debentures of Federal, Provincial or Municipal Government and corporations rated BBB or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

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

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure the credit 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 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 0% to 10% of the Company's portfolio be held in cash and short-term investments. Short-term investments include treasury bills, commercial paper and term deposits with an original maturity of less than one year.

The maturity profile of bonds held is as follows:

	Within 1 year	1 to 5 years	6 to 10 years	Over 10 years	Fair value
December 31, 2017	**$ 110,363**	**$ 12,922,469**	**$ 10,715,279**	**$ 58,505**	**$ 23,806,616**
Percent of Total	**- %**	**54 %**	**45 %**	**- %**	
December 31, 2016	$ 1,379,939	$ 9,589,934	$ 12,660,756	$ 1,148,265	$ 24,778,894
Percent of Total	6 %	39 %	51 %	5 %	

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

4. Investments (cont'd)

Market Rate Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of market factors. Market factors 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. 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.

Currency Rate Risk

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 was not operating in different currencies during the year and therefore has no currency risk.

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

Interest Rate Risk

Interest rate risk is the potential for financial loss caused by fluctuations in fair value or future cash flows of financial instruments because of changes in market interest rates.

The Company is exposed to this risk through its interest-bearing investments including the commercial mortgage pooled fund.

Historical data and current information is used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. However, because a significant portion of the Company's assets relate to its capital rather than liabilities, the value of its interest rate based assets exceeds its interest rate based liabilities. As a result, generally, 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 comprehensive (loss) income. There are no occurrences where interest would be charged on liabilities; therefore, little protection is needed to ensure the fair market value of assets 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 bonds and the commerical mortgage pooled fund by $1,209,731 (2016 - $1,360,258). These changes would be recognized in comprehensive (loss) income.

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

4. Investments (cont'd)

Equity Risk

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The Company is exposed to this risk through its equity and pooled equity holdings within its investment portfolio.

The Company’s portfolio includes Canadian stocks and Canadian equity 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 Canadian equity instruments of $591,141 (2016 - $634,071). This change would be recognized in comprehensive (loss) income.

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

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				
Bankers acceptance/GICs	**$ 270,009**	**$ -**	**$ -**	**$ 270,009**
Bonds	**-**	**23,806,616**	**-**	**23,806,616**
Equities	**1,732,465**	**-**	**-**	**1,732,465**
Other investments	-	**-**	**3,804,530**	**3,804,530**
Total	**$ 2,002,474**	**$ 23,806,616**	**$ 3,804,530**	**$ 29,613,620**
December 31, 2016				
Bankers acceptance/GICs	$ 270,341	$ -	$ -	$ 270,341
Bonds	-	24,778,894	-	24,778,894
Equities	2,052,064	-	-	2,052,064
Other investments	-	-	3,631,263	3,631,263
Total	$ 2,322,405	$ 24,778,894	$ 3,631,263	$ 30,732,562

4. Investments (cont'd)

Transfers between levels are considered to have occurred at the date of the event or change in circumstances that caused the transfer. There were no transfers between Level 1 and Level 2 for the year ended December 31, 2017. There were also no transfers in and out of Level 3.
The fair value of the commerical mortgage pooled fund is based on the net asset value of the pooled fund as provided by the investment manager of the fund. The commercial mortgages included in the commercial mortgage pooled fund are valued at the present value of discounted future cash flows. The discount rate is based on the equivalent Government of Canada rate and an additional spread to compensate for a loan's particular risk.

5. Investment and Other Income

	2017	2016
Interest income	**$ 745,805**	$ 766,676
Dividend income	**329,263**	334,822
Realized gains on disposal of investments	**397,065**	96,058
Investment expenses	**(130,181)**	(130,156)
Market value adjustment	**91,198**	366,040
	$ 1,433,150	$ 1,433,440

6. 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. For the purpose of capital management, the Company has defined capital as members' surplus.

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 in its quarterly filings. 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 and deemed necessary.

7. Other Operating and Administrative Expenses

		2017		2016
Computer costs	**$**	**316,816**	$	339,731
Licenses, fees and dues		**112,143**		220,513
Amortization and depreciation		**232,710**		115,533
Utilities		**43,584**		33,740
Postage and office supplies		**211,634**		170,285
Professional fees		**115,971**		208,216
Salaries, benefits and directors' fees (Note 12)		**1,631,308**		1,698,743
Other		**453,312**		344,761
	$	**3,117,478**	$	3,131,522

8. Gross Claims and Adjustment Expenses

Included in claims expenses are wage costs of $592,149 (2016 - $509,903).

9. Income taxes

Income tax expense comprises current and deferred tax. Current and deferred tax are recognized in comprehensive (loss) 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 comprehensive (loss) income are composed of:

		2017		2016
Current tax (recovery) expense				
Based on current year taxable income	**$**	**-**	$	234,390
Provision for losses carried back to prior years		**(379,023)**		-
Adjustments for over / under provision in prior periods		**(52,830)**		-
		(431,853)		234,390
Deferred tax expense (recovery)				
Origination and reversal of temporary differences		**35,000**		(29,982)
Total income tax (recovery) expense	**$**	**(396,853)**	$	204,408

9. 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 26.5% (2016 - 26.5%) are as follows:

	2017	2016
(Loss) income for the year	**$ (869,089)**	$ 1,119,138
Expected taxes (recovery) based on the statutory rate of 26.5% (2016 – 26.5%)	**(230,309)**	296,572
Canadian dividend income not subject to tax	**(87,255)**	(88,743)
Other	**(79,289)**	(3,421)
Total income tax expense	**$ (396,853)**	$ 204,408

10. Fire Mutuals Guarantee Fund

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 in their proportionate share to meet this objective.

11. Property, Equipment and Intangible Assets

Property, equipment and intangible assets are initially recorded at cost and subsequently measured at cost less accumulated depreciation, amortization or accumulated impairment losses, with the exception of land which is not depreciated. Amortization and depreciation is recognized in comprehensive (loss) income and is provided on a straight-line basis over the estimated useful life of the assets as follows:

Buildings	40 years
Computer hardware	5 years
Furniture and fixtures	10 years
Vehicles	3 years
Software	2 years

	2017 Cost	2017 Accumulated Depreciation and Amortization	2017 Net Book Value
Property and Equipment			
Land	$ 1,029,754	$ -	$ 1,029,754
Buildings	6,967,199	101,605	6,865,594
Computer hardware	108,953	35,819	73,134
Furniture and fixtures	310,035	23,133	286,902
Vehicles	76,584	76,584	-
Total	**$ 8,492,525**	**$ 237,141**	**$ 8,255,384**
Intangible assets			
Computer software	**$ 162,836**	**$ 161,506**	**$ 1,330**

	2016 Cost	2016 Accumulated Amortization and Depreciation	2016 Net Book Value
Property and Equipment			
Land	$ 1,481,754	$ -	$ 1,481,754
Buildings	4,176,892	135,712	4,041,180
Computer hardware	243,999	200,699	43,300
Furniture and fixtures	291,204	231,124	60,080
Vehicles	76,584	64,390	12,194
Total	**$ 6,270,433**	**$ 631,925**	**$ 5,638,508**
Intangible assets			
Computer software	**$ 160,174**	**$ 134,600**	**$ 25,574**

During the year, the Company completed construction of their new corporate office with a carrying value of $6,967,198. Additionally, the Company completed the sale of their previous location which resulted in the carrying values of $608,353 and $452,000 being removed from buildings and land respectively.

12. Pension Plan

The Company makes contributions on behalf of its employees to "The Retirement Annuity Plan for Employees of the Ontario Mutual Insurance Association and Member Companies", which is a multi-employer plan. Each member company has signed an Ontario Mutual Insurance Association Pension Plan Agreement. Eligible employees participate in the defined benefit plan and sales agents participate in the defined contribution plan. The defined benefit plan specifies the amount of the retirement benefit to be received by the employee based on the number of years the employee has contributed and his/her final average earnings. The plan is accounted for as a defined contribution plan as insufficient information is available to account for the plan as a defined benefit plan. The Company is one of a number of employers that participates in the plan and the financial information provided to the Company on the basis of the contractual agreements is insufficient to reliably measure the Company's proportionate share in the plan assets and liabilities on defined benefit accounting requirements.

The Company matches the employee contributions and funds the excess defined benefit based on the Company's percentage of pensionable earnings as calculated by the Pension Plan actuaries. The Pension Plan agreement states that the Company is responsible for its share of any deficit as a result of any actuarial valuation or cost certificate. The minimum funding requirement is the solvency valuation amount determined by the Pension Plan actuary on the valuation dates prescribed by the Pensions Benefit Act. In the event of a wind-up, voluntary withdrawal or bankruptcy, either by the Company or the group as a whole, the Company is responsible for its portion of all expenses and deficit related to such.

The amount contributed to the plan for 2017 was $145,873 (2016 - $140,331). The contributions were made for current service and these have been recognized in comprehensive (loss) income. The current service amount is determined by the Pension Plan actuary using the projected accrued benefit actuarial cost method. These contributions amount to 1.9% (2016 - 2.5%) of the total contributions made to the Ontario Mutual Insurance Association Pension Plan by all participating entities during the current fiscal year.

Expected contributions to the plan for the next annual reporting period amount to $175,000.

13. 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 directors' fees	**$**	**808,722**	$	793,233
Total pension and other post-employment benefits		**77,357**		76,678
	$	**886,079**	$	869,911
Premiums	**$**	**59,212**	$	62,046
Claims paid	**$**	**8,733**	$	19,091

14. Standards, Amendments and Interpretations Not Yet Effective

At the date of authorization of these financial statements, certain new standards, amendments and interpretations to existing standards have been published by the IASB but are not yet effective, and have not been early adopted by the Company.

Information on new standards, amendments and interpretations that are expected to be relevant to the Company's financial statements is provided below. Certain other new standards, amendments, and interpretations have been issued but are not expected to have a material impact on the Company's financial statements.

IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement

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 (loss) income. The basis of 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; however, the Company has been provided the option of deferring the adoption of IFRS 9 given the nature of its insurance operations until January 1, 2021, which is the effective date of IFRS 17, *Insurance Contracts*. The Company does not plan to defer the effective date of IFRS 9 and therefore expects to adopt IFRS 9 on January 1, 2018. The Company has not yet evaluated what impact this adoption will have on its financial results.

14. Standards, Amendments and Interpretations Not Yet Effective (continued)

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 to 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.