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

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Table of Contents **Page**

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Independent Auditor's Report

To the Policyholders of
Howard Mutual Insurance Company

We have audited the accompanying financial statements of Howard Mutual Insurance Company, which comprise the statement of financial position as at December 31, 2017 and the statement of comprehensive income, statement of policyholders' surplus and statement of cash flows for the year then ended, 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 Howard 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

Chatham, Ontario
February 20, 2018

Howard Mutual Insurance Company
Statement of Financial Position

December 31	2017	2016
Assets		
Cash	**$ 2,067,785**	$ 2,528,110
Investments (Note 4)	**41,799,580**	40,250,868
Investment income accrued	**172,619**	165,999
Income taxes recoverable (Note 11)	**290,113**	22,881
Due from reinsurer (Note 3)	**28,379**	111,579
Due from policyholders	**2,427,837**	2,288,052
Reinsurer's share of provision for unpaid claims (Note 3)	**4,626,148**	4,463,963
Deferred policy acquisition expenses (Note 3)	**458,269**	449,163
Property, plant & equipment (Note 13)	**1,387,351**	1,514,342
Other assets	**28,776**	26,535
Deferred income taxes (Note 11)	**112,800**	36,900
	$53,399,657	$ 51,858,392
Liabilities		
Accounts payable and other liabilities	**$ 1,274,278**	$ 1,278,566
Premiums due to reinsurer	**41,121**	63,014
Unearned premiums (Note 3)	**5,796,180**	5,560,073
Provision for unpaid claims (Note 3)	**12,031,190**	10,552,049
Premium refund payable (Note 3)	**350,000**	500,000
	19,492,769	17,953,702
Policyholders' Surplus		
Unappropriated policyholders' surplus	**33,906,888**	33,904,690
	$53,399,657	$ 51,858,392

Signed on behalf of the Board by:

Jim Clark Director

Robert H McKinley Director

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

Howard Mutual Insurance Company
Statement of Comprehensive Income

For the year ended December 31	2017	2016
Underwriting income		
Gross premiums written	$11,862,568	$ 11,398,990
Less reinsurance ceded	1,480,107	1,581,818
Net premiums written	10,382,461	9,817,172
Less increase in unearned premiums	236,107	177,168
Net premiums earned	10,146,354	9,640,004
Service charges	79,226	136,803
	10,225,580	9,776,807
Direct losses incurred		
Gross claims and adjustment expenses (Note 10)	8,034,468	6,728,218
Less reinsurer's share of claims and adjustment expenses	337,421	1,206,305
	7,697,047	5,521,913
	2,528,533	4,254,894
Expenses		
Fees, commissions and other acquisition expenses (Note 7)	982,370	982,753
Other operating and administrative expenses (Note 8)	1,887,015	2,074,221
	2,869,385	3,056,974
Net underwriting income (loss) before premium refund	(340,852)	1,197,920
Premium refund	350,000	500,000
Net underwriting income (loss)	(690,852)	697,920
Other items		
Investment and other income (Note 5)	637,381	950,493
Comprehensive income (loss) before income taxes	(53,471)	1,648,413
Provision (recovery) for income taxes (Note 11)	(55,669)	296,106
Comprehensive income for the year	$ 2,198	$ 1,352,307

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

Howard Mutual Insurance Company
Statement of Policyholders' Surplus

For the year ended December 31	2017	2016
Unappropriated policyholders' surplus		
Balance, beginning of year	**$33,904,690**	$ 32,552,383
Comprehensive income for the year	**2,198**	1,352,307
Balance, end of year	**$33,906,888**	$ 33,904,690

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

Howard Mutual Insurance Company
Statement of Cash Flows

For the year ended December 31	2017	2016
Operating activities		
Comprehensive income for the year	$ 2,198	$ 1,352,307
Adjustments for:		
Depreciation property, plant and equipment	145,960	146,847
Interest and dividend income	(768,739)	(490,345)
Realized gains from disposal of investments	(524,059)	(524,730)
Unrealized (gains) losses on investments	543,589	(10,672)
Provision (recovery) for income tax	(55,669)	296,106
	(658,918)	(582,794)
Changes in working capital		
Change in due from policyholders	(139,785)	(130,159)
Change in other assets	(2,241)	58,032
Change in accounts payable and other liabilities	(4,288)	(16,143)
Change in amounts due to/from reinsurer	61,307	17,227
Change in premium refund payable	(150,000)	-
	(235,007)	(71,043)
Changes in insurance contract related balances, provisions		
Change in deferred policy acquisition expenses	(9,106)	(6,700)
Change in unearned premiums	236,107	177,168
Reinsurer's share of provision for unpaid claims	(162,185)	(264,011)
Change in provision for unpaid claims	1,479,141	398,536
	1,543,957	304,993
Cash flows related to interest, dividends and income taxes		
Interest and dividends received	762,119	374,466
Income taxes paid	(287,463)	(150,760)
	474,656	223,706
Total cash inflows from operating activities	1,126,886	1,227,169
Investing activities		
Sale of investments	23,581,689	23,847,460
Purchase of investments	(25,149,931)	(33,234,797)
Purchase of property, plant & equipment	(18,969)	(68,727)
Total cash outflows from investing activities	(1,587,211)	(9,456,064)
Net decrease in cash and cash equivalents	(460,325)	(8,228,895)
Cash and cash equivalents, beginning of year	2,528,110	10,757,005
Cash and cash equivalents, end of year	$ 2,067,785	$ 2,528,110

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

1. Corporate Information

Howard Mutual 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 20 Ebenezer Street West in Ridgetown, 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 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. 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 20, 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 the revaluation of financial assets designated at fair value through profit and loss.

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 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 financial statements within the next financial year are:

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

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.

Balances arising from insurance contracts primarily include unearned premiums, provisions for unpaid claims and adjustment expenses, the Reinsurer's share of provisions for unearned premiums and unpaid claims and adjustment expenses 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 recognizes premium income evenly over the term of the insurance policy 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 years ended December 31, 2017 and 2016 and their impact on net premiums earned for the two years follow:

	2017	2016
Balance, beginning of the year	**$ 5,560,073**	$ 5,382,905
Premiums written	**11,862,568**	11,398,990
Premiums earned during year	**(11,390,354)**	(11,044,654)
Changes in UEP recognized in income	**(236,107)**	(177,168)
Balance, end of the year	**$ 5,796,180**	$ 5,560,073

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 and 2016.

Amounts due from policyholders are measured at amortized cost less any impairment losses. 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 amounts outstanding is performed to ensure credit worthiness.

3. Insurance Contracts (Continued)

(b) Deferred policy acquisition expenses

Acquisition costs are comprised of agents' commissions, premium taxes and other incremental costs of acquiring and renewing policies. 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 the statement of financial position for the years ended December 31, 2017 and 2016 and their impact on fees, commissions and other acquisition expenses for the two years follow:

	2017	2016
Balance, beginning of the year	**$ 449,163**	$ 442,463
Acquisition costs incurred	**933,632**	913,796
Expensed during the year	**(924,526)**	(907,096)
Balance, end of the year	**$ 458,269**	$ 449,163

(c) Unpaid claims and adjustment expenses

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 current income.

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

	December 31, 2017		
	Gross	**Reinsurance**	**Net**
Outstanding claims provision			
Long settlement term	**$ 6,185,437**	**$ 1,965,338**	**$ 4,220,099**
Short settlement term	**1,783,224**	**410,810**	**1,372,414**
Facility Association and other residual pools	**304,029**	**-**	**304,029**
	8,272,690	**2,376,148**	**5,896,542**
Provision for claims incurred but not reported	**3,758,500**	**2,250,000**	**1,508,500**
	$12,031,190	**$ 4,626,148**	**$ 7,405,042**

3. Insurance Contracts (Continued)

(c) Unpaid claims and adjustment expenses (continued)

	December 30, 2016 Gross	Reinsurance	Net
Outstanding claims provision			
Long settlement term	$ 5,764,529	$ 1,964,495	$ 3,800,034
Short settlement term	846,683	249,468	597,215
Facility Association and other residual pools	302,337	-	302,337
	6,913,549	2,213,963	4,699,586
Provision for claims incurred but not reported	3,638,500	2,250,000	1,388,500
	$ 10,552,049	$ 4,463,963	$ 6,088,086

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 assets, liabilities, revenue and expenses provided by the actuaries of the pools.

Changes in claim liabilities recorded in the statement of financial position for the years ended December 31, 2017 and 2016 and their impact on claims and adjustment expenses for the two years follow:

	2017	2016
Unpaid claim liabilities - beginning of year – net of reinsurance	**$ 6,088,086**	$ 5,953,561
Decrease in estimated losses and expenses, for losses occurring in the prior years	**(859,644)**	(1,385,496)
Provision for losses and expenses on claims occurring in the current year	**8,449,299**	6,119,486
Payment on claims:		
Current year	**(5,006,375)**	(3,549,727)
Prior years	**(1,266,324)**	(1,049,738)
Unpaid claim liabilities - end of year – net of reinsurance	**7,405,042**	6,088,086
Reinsurer’s share of outstanding claims	**4,626,148**	4,463,963
Total provision for unpaid claims	**$12,031,190**	$ 10,552,049

3. Insurance Contracts (Continued)

(c) Unpaid claims and adjustment expenses (continued)

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 claims reporting patterns. 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 below 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 (Continued)

(c) Unpaid claims and adjustment expenses (continued)

Gross claims	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
Gross estimate of cumulative claims cost											
At the end of accident year	$10,423,428	$4,952,938	$6,065,153	$6,876,961	$7,142,498	$7,513,848	$7,609,941	$6,821,730	$7,469,126	$10,221,591	
One year later	10,437,718	4,565,195	4,767,418	6,232,963	5,908,276	6,323,928	6,233,941	5,590,696	6,887,574		
Two years later	9,809,526	4,167,175	4,645,199	5,699,128	5,748,122	5,981,550	5,637,745	5,040,226			
Three years later	9,593,004	4,295,042	4,210,356	5,276,094	5,787,239	5,867,014	5,387,429				
Four years later	9,543,316	3,925,180	4,028,980	5,098,305	5,816,993	6,123,577					
Five years later	9,501,763	3,778,191	4,027,230	5,017,115	5,690,613						
Six years later	9,545,469	3,734,191	3,918,162	5,131,737							
Seven years later	9,580,185	3,734,191	3,917,016								
Eight years later	10,237,775	3,734,191									
Nine years later	9,932,246										
Current estimate of cumulative claims cost	9,932,246	3,734,191	3,917,016	5,131,737	5,690,613	6,123,577	5,387,429	5,040,226	6,887,574	10,221,591	$62,066,200
Cumulative payments	9,932,246	3,734,191	3,917,016	4,191,278	5,219,329	5,070,384	4,853,382	3,623,636	5,162,586	5,023,684	50,727,732
Outstanding claims	$-	$-	$-	$940,459	$471,284	$1,053,193	$534,047	$1,416,590	$1,724,988	$5,197,907	11,338,468
Outstanding claims 2007 and prior											388,693
Outstanding reserves - facility and risk sharing pool											304,029
Total gross unpaid claims and adjustment expenses											**$12,031,190**

3. Insurance Contracts (Continued)

(c) Unpaid claims and adjustment expenses (continued)

Net of reinsurance	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
Net estimate of cumulative claims cost											
At the end of accident year	$ 5,514,000	$ 4,116,000	$ 4,504,000	$ 5,535,000	$ 4,926,000	$ 6,207,332	$ 5,885,099	$ 5,307,742	$ 6,119,486	$ 8,449,299	
One year later	5,143,000	3,163,000	4,008,000	5,204,000	4,314,021	5,666,293	5,089,191	4,268,075	5,732,545		
Two years later	4,770,000	3,837,000	4,047,000	4,911,327	4,453,368	5,545,407	4,788,995	3,998,057			
Three years later	4,716,000	3,733,000	3,609,216	4,644,483	4,521,170	5,543,905	4,673,217				
Four years later	4,685,000	3,639,977	3,538,806	4,507,657	4,570,775	5,578,912					
Five years later	4,647,639	3,537,825	3,565,001	4,464,838	4,428,204						
Six years later	4,694,670	3,527,825	3,497,042	4,483,918							
Seven years later	4,698,116	3,527,825	3,496,928								
Eight years later	4,707,126	3,527,825									
Nine years later	4,707,126										
Current estimate of cumulative claims cost	4,707,126	3,527,825	3,496,928	4,483,918	4,428,204	5,578,912	4,673,217	3,998,057	5,732,545	8,449,299	$ 49,076,031
Cumulative payments	4,707,126	3,527,825	3,496,928	4,217,902	4,376,502	4,941,361	4,300,632	3,226,235	4,213,000	5,006,375	42,013,886
Outstanding claims	$ -	$ -	$ -	$ 266,016	$ 51,702	$ 637,551	$ 372,585	$ 771,822	$ 1,519,545	$ 3,442,924	7,062,145
Outstanding claims 2007 and prior											38,868
Outstanding reserves - facility and risk sharing pool											304,029
Total net unpaid claims and adjustment expenses											**$ 7,405,042**

3. Insurance Contracts (Continued)

(c) Unpaid claims and adjustment expenses (continued)

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 frequency, expected loss ratios and claims development.

Results of sensitivity testing based on expected loss ratios are as follows, showing gross and net of reinsurance and the impact on comprehensive income before tax:

	Property claims		Auto claims		Liability claims	
	2017	2016	**2017**	2016	**2017**	2016
5% increase in loss ratios						
Gross	**$ 267,000**	$ 259,000	**$ 260,000**	$ 247,000	**$ 49,000**	$ 48,000
Net	**$ 255,000**	$ 247,000	**$ 228,000**	$ 210,000	**$ 37,000**	$ 34,000
5% decrease in loss ratios						
Gross	**$ (267,000)**	$ (259,000)	**$ (260,000)**	$ (247,000)	**$ (49,000)**	$ (48,000)
Net	**$ (255,000)**	$ (247,000)	**$ (228,000)**	$ (210,000)	**$ (37,000)**	$ (34,000)

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.

(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 discount rate. If that assessment shows that the carrying amount of the liabilities is inadequate, any deficiency is recognized as an expense in profit and loss initially by writing down the deferred policy acquisition expense and subsequently by recognizing additional unearned premiums.

(e) 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. Retention limits for the excess-of-loss reinsurance are set by product line. 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.

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 $335,000 (2016 - $335,000) in the event of a property claim, an amount of $500,000 (2016 - $500,000) in the event of an automobile claim and $225,000 (2016 - $225,000) in the event of a liability claim. The Company also obtained reinsurance which limits the Company's liability to $1,005,000 (2016 - $1,005,000) 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 80% (2016 - 80%) of gross net earned premiums income.

3. Insurance Contracts (Continued)

(e) Reinsurer's share of provisions for unpaid claims and adjustment expenses (continued)

Amounts recoverable from 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 due from reinsurer recorded in the statement of financial position for the years ended December 31, 2017 and 2016 follow:

	2017	2016
Balance, beginning of the year	**$ 111,579**	$ 65,792
Submitted to reinsurer	**337,421**	1,206,305
Received from reinsurer	**(420,621)**	(1,160,518)
Balance, end of the year	**$ 28,379**	$ 111,579

Reinsurance is placed with Farm Mutual Re (FMRe), a Canadian registered reinsurer. Management monitors the creditworthiness of FMRe 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.

Changes in reinsurer's share of provision for unpaid claims recorded in the statement of financial position for the years ended December 31, 2017 and 2016 and their impact on net premiums earned for the two years follow:

Reinsurer's share of provision for unpaid claims	2017	2016
Balance, beginning of the year	**$ 4,463,963**	$ 4,199,952
New claims reserve	**428,119**	249,468
Change in prior years' reserve	**71,487**	1,220,848
Submitted to reinsurer	**(337,421)**	(1,206,305)
Balance, end of the year	**$ 4,626,148**	$ 4,463,963

(f) Refund of premium

At the discretion of the board of directors, the Company may declare a refund to its policyholders based on the premiums paid. This refund is recognized as an expense in the period for which it is declared.

4. Investments

The Company does not have any instruments that are held for trading purposes; however, management has designated to voluntarily classify its investments at fair value through profit and loss. These instruments are carried at fair value with changes in fair value recognized in net income. Transaction costs on these instruments are expensed as incurred.

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

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.

	December 31, 2017		December 31, 2016	
	Cost	**Fair value**	Cost	Fair value
Canada Treasury Bills	**$ 1,100,359**	**$ 1,100,790**	$ 8,398,031	$ 8,405,184
Guaranteed Investment Certificates	**3,398,948**	**3,398,948**	12,336,262	12,336,262
Bonds issued by				
Federal	**13,503,695**	**12,827,203**	8,561,790	8,173,632
Provincial	**1,967,790**	**1,951,757**	-	-
Corporate				
Canadian	**8,771,025**	**8,676,220**	-	-
Foreign	**1,035,574**	**938,725**	-	-
	25,278,084	**24,393,905**	8,561,790	8,173,632
Equity investments				
Canadian	**7,605,373**	**7,518,016**	6,135,453	6,190,190
Foreign	**4,012,246**	**5,061,133**	3,872,061	4,819,700
	11,617,619	**12,579,149**	10,007,514	11,009,890
Other investments				
Fire Mutuals guarantee fund	**26,788**	**26,788**	25,900	25,900
Debentures	**300,000**	**300,000**	300,000	300,000
	326,788	**326,788**	325,900	325,900
Total investments	**$ 41,721,798**	**$ 41,799,580**	$ 39,629,497	$ 40,250,868

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

4. Investments (Continued)

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 100% (2016 - 100%.) of bonds rated B or better. The Company's investment policy limits investment in bonds and debentures of the various ratings to limits ranging from 60% to 90% of the Company's portfolio. The Company's policy requires that funds be invested in high quality bonds and debentures of Federal, Provincial or Municipal Government and corporations. 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 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 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.

The Company's investment policy requires that up to 40% of the Company's portfolio be held in cash and short-term investments, which mitigates liquidity risk. Short-term investments include treasury bills, commercial paper and term deposits with an original maturity of less than one year.

Maturity profile of bonds, T-bills and GICs held is as follows:

	Within 1 year	2 to 5 years	6 to 10 years	Over 10 years	Fair value
December 31, 2017	$ 2,467,738	$ 9,153,279	$ 15,824,023	$ 1,448,603	$ 28,893,643
Percent of Total	8 %	32 %	55 %	5 %	
December 31, 2016	$ 19,691,446	$ 1,050,000	$ 8,173,632	$ -	$ 28,915,078
Percent of Total	68 %	4 %	28 %	- %	

The effective interest rate of the bond portfolio is 2.26% at December 31, 2017 (2016 - 1.07%).

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.

4. Investments (Continued)

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.

The Company's currency risk is related to stock holdings which are limited to foreign equities in sectors which are not readily available in Canada. The Company limits its holdings in foreign equities to 20% of the total investment portfolio in accordance with its investment policy. Foreign currency changes are monitored by the Investment Committee and holdings are adjusted when offside of the investment policy.

The Company is exposed to interest rate risk through its interest bearing investments (T-Bills, GICs, and Bonds).

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.

At December 31, 2017, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds by $1,452,055 (2016 - $656,215). These changes would be recognized in income.

The Company is exposed to equity risk through its portfolio of Canadian and foreign stocks. 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 equities of $1,257,915 (2016 - $1,100,989). This change would be recognized in profit or loss.

The Company's investment policy limits investment in preferred and common shares to a maximum of 35% of the market value of the investment assets.

Equities are monitored by the Investment Committee and the board of directors and holdings are adjusted following each quarter to ensure the investments portfolio remains in compliance with the investment policy.

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

4. Investments (Continued)

	Level 1	Level 2	Level 3	Total
December 31, 2017				
Treasury bills	**$ 1,100,790**	**$ -**	**$ -**	**$ 1,100,790**
Guaranteed investment certificates	**-**	**3,398,948**	**-**	**3,398,948**
Bonds	**-**	**24,393,905**	**-**	**24,393,905**
Equities	**12,579,149**	**-**	**-**	**12,579,149**
Other investments	-	**-**	**326,788**	**326,788**
Total	**$13,679,939**	**$27,792,853**	**$ 326,788**	**$41,799,580**
December 31, 2016				
Treasury bills	$ 8,405,184	$ -	$ -	$ 8,405,184
Guaranteed investment certificates	-	12,336,262	-	12,336,262
Bonds	-	8,173,632	-	8,173,632
Equities	11,009,890	-	-	11,009,890
Other investments	-	-	325,900	325,900
Total	$ 19,415,074	$ 20,509,894	$ 325,900	$ 40,250,868

During the year, bonds were transferred to level 2 as quoted prices on an active market were no longer available at the measurement date.

5. Investment and Other Income

	2017	2016
Interest income	**$ 422,043**	$ 260,967
Dividend income	**346,696**	229,378
Realized gains on disposal of investments	**524,059**	524,730
Investment expenses	**(113,328)**	(76,754)
Unrealized gains (losses) on investments	**(543,589)**	10,672
Other income	**1,500**	1,500
	$ 637,381	$ 950,493

6. Capital Management

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

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 and deemed necessary.

The Company uses a ratio of unappropriated members' surplus to gross premiums written to monitor capital adequacy. The Company’s Surplus to Premiums Ratio at December 31, 2017 was 286% (2016 - 297%).

7. Fees, Commissions and Other Acquisition Expenses

	2017	2016
Sales commissions	**$ 924,526**	$ 907,096
Benefits	**47,679**	60,521
Other	**10,165**	15,136
	$ 982,370	$ 982,753

8. Other Operating and Administrative Expenses

	2017	2016
Advertising	$ 96,081	$ 79,432
Bad debt	7,940	13,946
Bank charges and interest	5,643	7,523
Computer costs	292,354	284,183
Directors' fees and expenses	132,591	147,711
Equipment expenses	26,556	21,896
Inspections and investigations	59,388	57,855
Insurance	22,720	36,360
Licenses, fees and dues	47,172	41,094
Occupancy costs	116,844	121,703
Postage and office supplies	62,424	77,143
Professional fees	25,977	42,045
Salaries and benefits	897,439	1,066,199
Telephone and communication	30,432	28,821
Travel	31,650	31,059
Other	31,804	17,251
	$ 1,887,015	$ 2,074,221

Depreciation is included in the above expense categories as follows:

	2017	2016
Advertising	$ 972	$ 972
Computer costs	71,716	70,254
Equipment expenses	26,422	26,425
Occupancy costs	39,944	39,944
Travel	-	2,340
	$ 139,054	$ 139,935

9. Salaries, Benefits, Commissions and Directors Fees

	2017	2016
Claims salaries and benefits (Note 10)	$ 199,031	$ 272,475
Sales commissions and benefits (Note 7)	972,205	967,617
Other salaries and benefits (Note 8)	897,439	1,066,199
Directors' fees and expenses (Note 8)	132,591	147,711
	$ 2,201,266	$ 2,454,002

10. Gross Claims and Adjustment Expenses

Included in claims expenses were salaries and benefits of $199,031 (2016 - $272,475), other operating and administrative costs of $643,863 (2016 - $351,445) and depreciation of $6,906 (2016 - $6,912).

11. Income Taxes

Income tax expense is comprised of current and deferred tax. Current and deferred tax are recognized in net income except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

The Company is subject to income taxes on that portion of its income derived from insuring other than farm related risks.

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

	2017	2016
Current tax		
Based on current year taxable income	**$ 20,231**	$ 295,006
Deferred tax		
Change resulting from temporary differences	**(72,400)**	1,400
Change resulting from change in tax rate	**(3,500)**	(300)
	(75,900)	1,100
Total income tax expense	**$ (55,669)**	$ 296,106

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory tax rate of 26.5% are as follows:

	2017	2016
Comprehensive income (loss) before tax for the year	**$ (53,471)**	$ 1,648,413
Expected taxes based on the statutory rate of 26.5%	**(14,170)**	436,829
Tax reduction on exempt income from:		
Insuring farm related risks	**3,805**	(120,565)
Canadian dividends	**(46,543)**	(23,747)
Other	**1,239**	3,589
Total income tax expense	**$ (55,669)**	$ 296,106

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

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

13. 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. Depreciation is recognized in net income and is provided on a straight-line basis over the estimated useful lives of the assets.

			2017	
	Useful Life	Cost	Accumulated Depreciation	Net Book Value
Land	N/A	$ 41,878	$ -	$ 41,878
Buildings	40 years	1,845,411	719,537	1,125,874
Land improvements	10 years	24,657	24,657	-
Computer	3 to 5 years	696,132	578,462	117,670
Furniture and fixtures	5 years	477,376	419,929	57,447
Vehicles	4 to 5 years	102,653	58,171	44,482
Total		$ 3,188,107	$ 1,800,756	$ 1,387,351

13. Property, Plant & Equipment (Continued)

	Useful Life	Cost	2016 Accumulated Depreciation	Net Book Value
Land	N/A	$ 41,878	$ -	$ 41,878
Buildings	40 years	1,845,411	681,811	1,163,600
Land improvements	10 years	24,657	22,440	2,217
Computer	3 to 5 years	677,163	506,745	170,418
Furniture and fixtures	5 years	477,376	392,535	84,841
Vehicles	4 to 5 years	102,653	51,265	51,388
Total		$ 3,169,138	$ 1,654,796	$ 1,514,342

14. Pension Plan

The company maintains a defined contribution pension plan for its employees with more than three months of service. The Company's obligation with respect to this plan is to make specified monthly contributions based on a percentage of the employee's eligible earnings. The pension contributions by the Company for the year amounted to $91,350 (2016 - $90,077), were for current service and have been recognized in net income.

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 salaries, directors' fees and other benefits	**$ 316,023**	$ 273,527
Total pension and other post-employment benefits	**14,075**	10,460
	$ 330,098	$ 283,987
Insurance premiums paid by key management	**$ 82,011**	$ 72,015
Insurance claims paid to key management	**$ 15,951**	$ 8,031

Amounts owing to and from key management personnel at December 31, 2017 are $11,408 (2016 - $8,000) and $NIL (2016 - $NIL) respectively. The amounts are included in due from policyholders and accounts payable and accrued liabilities on the statement of financial position.

16. Standards, Amendments and Interpretations 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.

- 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 the contractual cash flow characteristics of the financial asset. The effective date for IFRS 9 is January 1, 2018; however, Howard Mutual Insurance 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 expects that its investments will continue to be classified at fair value through profit or loss based on the business model assessment, therefore, the adoption of IFRS 9 is not expected to have a material impact on the Company’s financial position or 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 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.