PRINCE EDWARD ISLAND MUTUAL INSURANCE COMPANY 2017 ANNUAL REPORT

P.E.I. MUTUAL
Insurance Company

PROTECTING EACH OTHER
SINCE 1885

2017 FINANCIAL STATEMENTS

NOTICE OF ANNUAL GENERAL MEETING
of the
PRINCE EDWARD ISLAND MUTUAL
INSURANCE COMPANY

The Annual Meeting of the Members of the Prince Edward Island Mutual Insurance Company will be held at the Royal Canadian Legion building, 340 Notre Dame Street, Summerside, PEI on the **10th day of April, 2018, at 2:00 p.m.**

The purpose of the meeting is to receive the financial statements and the auditor's report for 2017; to elect directors; to appoint auditors; and to transact other business which may properly be brought before the meeting.

A copy of PEI Mutual's Annual Report is available on our website www.peimutual.com or by contacting head office at 1-800-565-5441.

Blair Campbell,
Corporate Secretary

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PRESIDENT'S REPORT 2017

Once again, PEI Mutual had a successful year in underwriting and investments. We have a great team of agents, staff, management, and directors. Terry Shea and Blair Campbell shared this year as CEO's, with Terry retiring the end of May 2017, and being succeeded by Blair.

We value our Island Company in giving back and continuing to support Island organizations and events.

PEI Mutual had excellent year end results, and your Board of Directors are pleased to issue a special Mutual rebate cheque of 10% of your 2017 premium PLUS giving you another 10% off your 2018 premium at renewal time, for a total of $4.8 million being returned to policyholders.

Thank you to everyone at PEI Mutual for my opportunity to serve as President for the past year.

Brian MacKinley,
President

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GENERAL MANAGER'S REPORT 2017

To the Policyholder / Members of PEI Mutual it has been a pleasure to serve in my new role as CEO & General Manager. I have been blessed to work with such talented and engaged people in our Staff, Service Agents and Board of Directors. We continually keep the best interests of our Members in mind as we do our work for you.

Growing our Staff and Transitions

We have completed a year of transition with retirements of longstanding staff, hiring of new staff and transfers within.

Notably we said farewell this year to our CEO Terry Shea, Service Agent Tom Kickham and Safety Surveyor Franklin Sanderson, who each had more than 30 years of dedicated service with the company. We welcomed new field Service Agents Thomas Clark (Brackley), Lisa Roche (Lower Montague), and Gary Sheehan (Rollo Bay). We also hired our new Manager of Claims Services Josh Toombs and Safety Surveyor Gary Bryson. In addition we added 5 new personnel within our office. Our staffing compliment has increased to 29 staff at head office and 16 field Service Agents who live and work in their areas.

I would like to thank the Board of Directors who supported the hiring processes in the interests of service excellence for our growing Policyholder / Membership base. To our Staff and Agents you deserve much credit for your support in ensuring that all transitions have gone smoothly. We make an excellent team!

Strategic Planning

A major initiative for the Board of Directors this year has been to renew the path forward in a Strategic Planning process. The theme is "***Looking Forward for our Members***". We began the process in 2017 and are enthusiastically engaging with all personnel to chart our priorities for the next 3 years.

Excellent Financial Results

PEI Mutual has experienced excellent financial results in 2017. This was due to reduced net claims experience, a stable expense ratio, and positive overall returns on investments. While our members experienced some significant losses, these have been offset by reinsurance arrangements with Farm Mutual Re that are designed to smooth out our longer term claims experience.

Eighty three percent (83%) of the company's surplus is held in secure bonds where we have been in a lower yield environment. Equity or common stock investments represent seventeen percent (17%) of surplus. Our common stocks have provided good returns. They are held in relatively stable companies with positive longer term outlooks however they can be subject to greater market volatility than bonds.

I would like to say a special thank you to Rudy Smith our Chief Financial Officer who has provided the Board and me with excellent financial support and guidance.

Mutual Rebates

Policyholders of PEI Mutual share a special relationship as Members of the Company. Due to our shared financial success in 2017, Members of the company will receive approximately $4,800,000 in Mutual Rebates that have been declared by the Board of Directors. A Special Mutual Rebate representing 10% of premiums will be paid to all members, as at December 31, 2017, in the form of a cheque. In Addition 10% will be deducted from your 2018 renewal premiums.

This is Mutuality at its best. We strive to provide fair pricing for insurance products and when financial results allow we are able to provide Rebates to our Members.

Thank you to our Members for choosing PEI Mutual as your Insurance provider.

Blair Campbell,
General Manager / CEO

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Financial Statements

Prince Edward Island Mutual Insurance Company

December 31, 2017

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MANAGEMENT RESPONSIBILITY FOR FINANCIAL REPORTING

DECEMBER 31, 2017

The accompanying financial statements and all other information contained in this annual report are the responsibility of the management of Prince Edward Island Mutual Insurance Company. The financial statements have been prepared by management in accordance with International Financial Reporting Standards and have been approved by the Board of Directors.

Preparation of financial information is an integral part of management's broader responsibilities for the ongoing operations of Prince Edward Island Mutual Insurance Company. Management maintains a system of internal accounting controls to provide reasonable assurance that transactions are accurately recorded on a timely basis, are properly approved and result in reliable financial information. Such information also includes data based on management's best estimates and judgements.

The Audit Committee and the Board of Directors review and approve the annual financial statements. In addition, the Audit Committee meets periodically with financial officers of Prince Edward Island Mutual Insurance Company and the external auditors, and reports to the Board of Directors thereon.

The accompanying financial statements have been audited by Grant Thornton LLP, authorized to practice public accounting by the Chartered Professional Accountants of Prince Edward Island, who are engaged by the Board of Directors and whose appointment was ratified at the annual meeting of the policyholders. The auditors have access to the Audit Committee, without management present, to discuss the results of their work. Their report dated February 13, 2018 expresses their unqualified opinion on the Company's 2017 financial statements.

Blair Campbell, CEO/Manager	Rudy Smith, CFO/Treasurer

Independent auditor's report

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To the policyholders of
Prince Edward Island Mutual Insurance Company

We have audited the accompanying financial statements of Prince Edward Island Mutual Insurance Company, which comprise the statement of financial position as at December 31, 2017, and the statement of comprehensive income, statement of members' surplus and statement of 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 in our audit 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 Prince Edward Island 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.

Grant Thornton LLP

Summerside, Canada
February 13, 2018

Chartered Professional Accountants

Prince Edward Island Mutual Insurance Company

Statement of Financial Position

December 31

	2017	2016
ASSETS		
Cash and cash equivalents	**$ 5,059,432**	$ 5,679,086
Receivables (Note 6)	**3,177,446**	3,066,386
Income taxes receivable	**975,438**	-
Prepaid items	**53,044**	62,446
Deferred policy acquisition expenses	**1,459,965**	1,301,778
Reinsurers' share of provision for unpaid claims (Note 10)	**5,181,722**	268,429
Assets held for sale (Note 7)	**-**	250,050
Investments (Note 8)	**62,587,722**	59,092,732
Property, plant and equipment (Note 9)	**4,381,285**	4,520,786
Deferred income taxes (Note 12)	**403,590**	245,354
	$ 83,279,644	$ 74,487,047

	2017	2016
LIABILITIES		
Accounts payables and accrued liabilities	**$ 685,930**	$ 615,022
Income taxes payable	**-**	1,460,604
Special mutual rebate payable (Note 23)	**2,410,643**	-
Provision for unpaid claims (Note 10)	**14,092,906**	8,764,040
Unearned premium reserve	**13,832,847**	13,113,169
	31,022,326	23,952,835
MEMBERS' SURPLUS		
Unappropriated members' surplus	**50,021,527**	48,145,863
Accumulated other comprehensive income	**2,235,791**	2,388,349
	52,257,318	50,534,212
	$ 83,279,644	$ 74,487,047

The accompanying notes are an integral part of these financial statements

On behalf of the Board

_______________________ Director _______________________ Director

Prince Edward Island Mutual Insurance Company

Statement of Comprehensive Income

Year ended December 31

	2017	2016
Underwriting Income		
Gross premiums written	**$ 23,890,617**	$ 22,764,586
Less: reinsurance premiums ceded	**(2,289,570)**	(1,897,479)
Net premiums written	**21,601,047**	20,867,107
Less: increase in unearned premiums	**(719,678)**	(1,119,766)
Net premiums earned	**20,881,369**	19,747,341
Direct losses incurred		
Gross claims and adjustment expenses (Note 13)	**17,451,460**	10,120,629
Less: reinsurance recoveries	**(4,913,293)**	(279,401)
Net losses incurred	**12,538,167**	9,841,228
Gross underwriting income	**8,343,202**	9,906,113
Expenses		
Fees, commissions and other acquistion expenses (Note 14)	**2,371,136**	2,162,742
Other operating and administrative expenses (Note 15)	**4,548,431**	4,387,291
	6,919,567	6,550,033
Net underwriting income	**1,423,635**	3,356,080
Investment and other income (Note 17)	**3,257,777**	3,244,120
Other expense (Note 7)	**-**	(125,045)
Earnings before special mutual rebate	**4,681,412**	6,475,155
Special mutual rebate (Note 23)	**(2,410,643)**	-
Income before income taxes	**2,270,769**	6,475,155
Provision for income taxes (Note 12)	**395,105**	1,300,394
Net income	**1,875,664**	5,174,761
Other comprehensive (loss) income		
Items that may be classified subsequently to net income:		
Change in unrealized gain on available for sale investments	**546,275**	1,669,369
Net gain reclassified to net income	**(740,988)**	(795,043)
	(194,713)	874,326
Income tax effect (Note 12)	**42,155**	(185,532)
	(152,558)	688,794
Total comprehensive income for the year	**$ 1,723,106**	$ 5,863,555

The accompanying notes are an integral part of these financial statements

Prince Edward Island Mutual Insurance Company
Statement of Members' Surplus
December 31

	Unappropriated Members' Surplus	Accumulated Other Comprehensive Income	Total
Balance at January 1, 2016	$ 42,971,102	$ 1,699,555	$ 44,670,657
Net income	5,174,761	-	5,174,761
Change in unrealized gain/losses on available-for-sale investments, net of income taxes	-	688,794	688,794
Balance at December 31, 2016	48,145,863	2,388,349	50,534,212
Net income	1,875,664	-	1,875,664
Change in unrealized gain/losses on available-for-sale investments, net of income taxes	-	(152,558)	(152,558)
Balance at December 31, 2017	**$ 50,021,527**	**$ 2,235,791**	**$ 52,257,318**

The accompanying notes are an integral part of these financial statements

Prince Edward Island Mutual Insurance Company

Statement of Cash Flows

Year ended December 31

		2017		2016
Increase (decrease) in cash equivalents				
Operating				
Net income, being total comprehensive income for the year	**$**	**1,723,106**	$	5,863,555
Depreciation		**304,299**		298,651
Bond premium amortized		**335,041**		247,504
Gain on sale of investments		**(740,988)**		(795,043)
Gain on disposal of equipment		**(5,077)**		(2,955)
Impairment of held for sale assets		**-**		125,045
Deferred income taxes		**(158,236)**		(185)
Unrealized losses (gains) on investments		**152,558**		(688,794)
		1,610,703		5,047,778
Change in non-cash operating working capital (Note 18)		**920,915**		2,153,457
Income tax provision - comprehensive income		**42,155**		(185,532)
		2,573,773		7,015,703
Investing				
Purchase of investments		**(10,891,751)**		(13,781,982)
Proceeds on disposal of investments		**7,607,995**		7,113,503
Proceeds on disposal of assets held for sale		**250,050**		-
Purchase of property, plant and equipment		**(168,346)**		(118,332)
Proceeds on disposal of property, plant and equipment		**8,625**		12,420
		(3,193,427)		(6,774,391)
Net (decrease) increase in cash and cash equivalents		**(619,654)**		241,312
Cash and cash eqvivalents, beginning of year		**5,679,086**		5,437,774
Cash and cash eqvivalents, end of year	**$**	**5,059,432**	$	5,679,086

The accompanying notes are an integral part of these financial statements

1. Nature of operations

The Company is incorporated without share capital under the laws of Prince Edward Island and is subject to the Prince Edward Island Insurance Act. It is licensed to write property and casualty insurance in Prince Edward Island. The Company's head office is located at 116 Walker Avenue, Summerside, Prince Edward Island.

These financial statements have been authorized for issue by the Board of Directors on February 13, 2018.

2. Basis of presentation

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

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

The Company's functional and presentation currency is the Canadian dollar.

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 are disclosed in Note 4.

3. Significant accounting policies

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 GAAP.

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, deferred policy acquisition expenses, and salvage and subrogation recoverable.

(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.

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.

(b) Deferred policy acquisition expenses
Acquisition costs are those expenses such as agents' commissions, which relate directly to the acquisition of premiums. 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.

3. Significant accounting policies (cont'd)

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

Claim liabilities are carried on an undiscounted basis.

(d) Reinsurers' share of provisions for unpaid claims and adjustment expenses
The Company enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. Reinsurance premiums are accounted for in the same period as the related premiums for the direct insurance business being reinsured. Reinsurance liabilities, comprised of premiums payable for the purchase of reinsurance contracts, are included in accounts payable and accrued liabilities and are recognized as an expense when due.

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.

(e) Refund from premium
Under the discretion of the board of directors the Company may declare a refund to its policyholders based on the premiums paid in the fiscal period. This refund is recognized as a reduction of revenue in the period for which it is declared.

Financial instruments
The Company's financial assets are classified as held for trading, held to maturity, available for sale, or loans and receivables. Financial liabilities are classified as held for trading or other financial liabilities. Financial assets and liabilities are initially recognized at fair value with subsequent measurement based on classification. The classification depends on the purpose for which the financial instruments were acquired, their characteristics and choice where applicable.

All financial instruments are measured at fair value except for loans & receivable, held to maturity and other financial liabilities, which are measured at amortized cost using the effective interest method. Unrealized gains and losses on available for sale investments are recognized in other comprehensive income until the financial asset is derecognized or other than temporarily impaired, at which time any unrealized gains or losses are recorded in net income.

Accumulated other comprehensive income is included in the balance sheet as a separate component of equity (net of income tax) and includes net unrealized gains or losses on available for sale assets.

Fair values are based on quoted market values where available from active markets, otherwise fair values are estimated using a variety of valuation techniques and models.

3. Significant accounting policies (cont'd)

Property, plant and 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. Assets under construction are not depreciated until they are available for use. Depreciation of an asset commences when it is available for use and is recognized in net income using the diminishing balance method over the estimated useful life of the assets at the following rates:

Building structure	4%
Building components	8%
Office equipment	20%
Computer equipment	30%, 45%
Vehicles	30%
Parking lots	8%

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

Impairment of non-financial assets
Non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly.

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash flows. The Company has one cash-generating unit for which impairment testing is performed.

Impairment charges are included in net income, except to the extent they reverse gains previously recognized in other comprehensive income.

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

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset of liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting or taxable profit or loss.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

3. Significant accounting policies (cont'd)

The amount of the deferred tax asset or liability is measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date and are expected to apply when the liabilities / (assets) are settled / (recovered).

Provisions
Provisions are recognized for liabilities of uncertain timing or amount that have arisen as a result of past transaction, including legal, equitable or constructive obligations. The provision is measured at the best estimate of the expenditure required to settle at the reporting date.

Foreign currency translation
Foreign currency accounts are translated into Canadian dollars as follows:

At the transaction date, each asset, liability, revenue and expense denominated in a foreign currency is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year-end date, unsettled monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at the year-end date and the related translation differences are recognized in net income. Exchange gains and losses arising on the retranslation of monetary available-for-sale financial assets are treated as a change in fair value and recognized in net income or other comprehensive income.

Cash and cash equivalents
Cash and cash equivalents comprise cash on hand together with other short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

Assets held for sale
Non-current assets are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition. For the sale to be highly probable, management must be committed to a plan to sell the asset and an active program to locate a buyer and complete the plan must have been initiated. The asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value and the sale should be expected to be completed within one year from the date of classification.

Non-current assets classified as held for sale are measured at the lower of the carrying amount and fair value less costs of disposal, with impairments recognized in the statement of income in the period measured. Non-current assets held for sale are presented in current assets and liabilities within the balance sheet. Assets held for sale are not depleted, depreciated or amortized.

3. Significant accounting policies (cont'd)

Standards, amendments and interpretations not yet effective
Certain new standards, amendments and interpretations have been published that are mandatory for the Company's accounting periods beginning on or after January 1, 2018 or later periods that the Company has decided not to early adopt.

- 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, insurance entities have been provided the option of deferring the adoption of IFRS 9 until January 1, 2021, which is the effective date of IFRS 17, Insurance Contracts. The Company does not plan to defer the effective date of IFRS 9 and therefore expects to adopt IFRS 9 on January 1, 2018.

  The Company's investments are currently comprised of: debt instruments, in the form of bonds and fixed income securities, classified as held-to-maturity; as well as, equity instruments, in the form of common stock, classified as available-for-sale.

  The Company's bonds and fixed income securities are expected to be classified and measured at amortized cost due to them being managed in a hold-to-collect business model. The amortized cost classification is similar to held-to-maturity, so it is not expected to have a material impact on the Company's financial position or performance.

  The Company's equity investments are expected to be classified as fair value through profit and loss. As a result, changes in fair value of these assets will no longer be reflected in other comprehensive income and realized gains and losses will no longer be recycled from other comprehensive income to income. The changes in fair value related to these assets will be recognized directly in income. Accumulated other comprehensive income will no longer be a separate class of equity and will form part of unappropriated members' surplus. The Company will no longer be required to determine if an impairment in these assets is permanent or temporary as all changes will be already be included in income. The Company does not expected any changes in the determination of fair value related to the adoption of this new standard

- IFRS 17 Insurance Contracts supersedes IFRS 4 Insurance Contracts. IFRS 17 fundamentally changes how entities account for insurance contracts, introducing a default "building block approach", which disaggregates the cash flows in an insurance contract and provides a different measurement basis for each component, and a simplified "premium allocation approach" for certain short-term contracts. Assumptions used in measuring insurance assets and liabilities such as cash flows, discount rates and risk adjustment will be updated at each reporting period. The discount rate will reflect the characteristics of the insurance liabilities and the estimated future cash flows to settle claims incurred will be discounted unless the period of time between claim occurrence and settlement is less than one year. Presentation changes include 'insurance revenue' replacing the current reporting of 'written premiums' and 'earned premiums' and insurance contract assets and liabilities will not be netted. Under this standard, premiums receivable, unearned premiums and claims payable may no longer be presented separately from other insurance assets and liabilities. The effective date for IFRS 17 is January 1, 2021 with mandatory restatement of comparative periods. The Company is currently assessing the impact of IFRS 17.

4. Critical accounting estimates and judgments

The Company makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated and based on historical experience and other IAS factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only; or in the period of the change and future periods, if the change affects both.

The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Deferred policy acquisition expenses
Deferred policy acquisition expenses are those expenses such as agents' commissions, which relate directly to the acquisition of policies. These expenses, to the extent that they are considered recoverable, are estimated, deferred and amortized over the terms of the related policies.

Provision for unpaid claims
The estimation of the provision for unpaid claims and the related reinsurers' share are the Company's most critical accounting estimates. There are several sources of uncertainty that need to be considered by the Company in estimating the amount that will ultimately be paid on these claims. The uncertainty arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Changes in the estimate of the provisions can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, or significant changes in severity or frequency of claims from historical trends. The estimates are based on the Company's historical experience and industry experience. More details are included in Note 8.

4. Critical accounting estimates and judgments (cont'd)

Unearned premium reserve
The unearned premium reserve is calculated based on the estimated unexpired term of all policies of the Company in force as at December 31. The factor used to estimate the unexpired term is based on the Company's historical experience.

Impairment of available-for-sale investments
The Company determines that available-for-sale investments are impaired when there has been a significant or prolonged decline in fair value below its cost. The determination of what is significant or prolonged requires judgment. In making this judgment the Company considers among other factors, the normal volatility in market price, the financial health of the investee and industry and sector performance. Had the Company considered all declines in fair value to be significant or prolonged, the Company would have suffered an additional loss of $282,171 in its 2017 financial statements, being the transfer of the entire amount in accumulated other comprehensive income related to available-for-sale investments to net income.

Income taxes
The Company periodically assesses its liabilities and contingencies related to income taxes for all years open to audit based on the latest information available. For matters where it is probable that an adjustment will be made, the Company records its best estimate of the tax liability including the related interest and penalties in the current tax provision. Management believes they have adequately provided for the probable outcome of these matters; however, the final outcome may result in a materially different outcome than the amount included in the tax liabilities.

5. Financial instrument classification

The carrying amount of the Company's financial instruments by classification is as follows:

	Available for sale	Held to maturity	Loans and receivables	Other financial liabilities	Total
December 31, 2017					
Cash and cash equivalents	**$ -**	**$ -**	**$ 5,059,432**	**$ -**	**$ 5,059,432**
Receivables (Note 6)	**-**	**-**	**3,177,446**	**-**	**3,177,446**
Investments (Note 8)	**13,155,764**	**49,431,958**	**-**	**-**	**62,587,722**
Accounts payable and accrued liabilities	**-**	**-**	**-**	**685,930**	**685,930**
	$13,155,764	**$ 49,431,958**	**$ 8,236,878**	**$ 685,930**	**$71,510,530**
December 31, 2016					
Cash and cash equivalents	$ -	$ -	$ 5,679,086	$ -	$ 5,679,086
Receivables (Note 6)	-	-	3,066,386	-	3,066,386
Investments (Note 8)	12,805,511	46,287,221	-	-	59,092,732
Accounts payable and accrued liabilities	-	-	-	(615,022)	(615,022)
	$12,805,511	$ 46,287,221	$ 8,745,472	$(615,022)	$67,223,182

6. Receivables

	2017	2016
Policyholders for premiums	**$ 2,587,272**	$ 2,478,416
Accrued interest	**539,684**	500,113
Other	**50,490**	87,857
	$ 3,177,446	$ 3,066,386

7. Assets held for sale

In June 2015, the Company relocated its head office from 201 Water Street, Summerside, PE to 116 Walker Avenue, Summerside, PE. This decision was made as per the Board's approved plan in February 2013, to construct a new head office building. All remaining assets at 201 Water Street were classified as held for sale and measured at their carrying value, as calculated immediately before their held for sale classification. No subsequent depreciation has been recognized on these assets.

Subsequent to original classification, assets held for sale are measured at the lower of carrying amount and fair value less costs to sell. At December 31, 2015, these assets were measured at $375,095, being their carrying value. At December 31, 2016, these assets were measured at $250,050, being their fair value less cost to sell. This has resulted in an impairment loss of $125,045, which had been recognized as other expense in the current year's statement of comprehensive income.

On November 29, 2016, the company signed a purchase and sale agreement for these assets, with a closing date of February 24, 2017. The fair value, less cost to sell, amount of $250,050 is based on this signed agreement.

The sale of these assets closed as expected on February 24, 2017 at their fair value, less costs to sell, being $250,050.

Measurement details are as follows:

	2017	2016
Carrying value	**$ -**	$ 375,095
Fair value, less costs to sell	**$ -**	$ 250,050
Impairment loss	**$ -**	$ 125,045

8. Investments

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 carrying value as shown below.

Carrying value	**2017**	2016
Held to maturity investments, at amortized cost	**$ 49,431,958**	$ 46,287,221
Available for sale investments, at fair value	**13,155,764**	12,805,511
	$ 62,587,722	$ 59,092,732

	December 31, 2017		December 31, 2016	
Held to maturity investments	**Cost**	**Fair Value**	Cost	Fair Value
Term deposits and GIC's	**$ 4,620,000**	**$ 4,620,000**	$ 3,820,000	$ 3,820,000
Bonds, at par less unamortized purchase discounts and premiums				
- Federal	**192,725**	**224,190**	191,815	229,138
- Provincial	**13,720,324**	**14,760,759**	13,107,601	14,283,721
- Municipal	**11,776,439**	**13,023,283**	12,223,304	13,613,478
- Corporate	**19,122,470**	**20,326,346**	16,944,501	18,131,010
Total bonds	**44,811,958**	**48,334,578**	42,467,221	46,257,347
	$ 49,431,958	**$ 52,954,578**	$ 46,287,221	$50,077,347
Available for sale investments				
Equities - Canadian Common Stock	**$ 7,927,415**	**$ 10,167,456**	$ 7,663,443	$ 9,960,078
Equities - US Common Stock	**2,520,966**	**2,988,308**	2,239,972	2,845,433
	$ 10,448,381	**$ 13,155,764**	$ 9,903,415	$12,805,511

8. Investments (cont'd)

The following table summarizes fair value measurements recognized in the statement of financial position or disclosed in the Company's financial statements, categorized by level according to the significance of the inputs used in making the measurements.

- 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).

	Carrying Value	Fair Value Level 1	Level 2	Level 3	Total
December 31, 2017					
Equity investments					
- Canadian	**$10,167,456**	**$10,167,456**	**$ -**	**$ -**	**$10,167,456**
- US	**2,988,308**	**2,988,308**	**-**	**-**	**2,988,308**
Bonds	**49,431,958**	**-**	**52,954,578**	**-**	**52,954,578**
Total	**$62,587,722**	**$13,155,764**	**$52,954,578**	**$ -**	**$66,110,342**
December 31, 2016					
Equity investments					
- Canadian	$ 9,960,078	$ 9,960,078	$ -	$ -	$ 9,960,078
- US	2,845,433	2,845,433	-	-	2,845,433
Bonds	46,287,221	-	50,077,347	-	50,077,347
Total	$59,092,732	$12,805,511	$50,077,347	$ -	$62,882,858

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

The company has determined that certain investments have incurred a significant or prolonged decline in their fair value, which constitutes objective evidence of impairment. As a result, an impairment loss of $129,718 has been recognized in net income for the year ended December 31, 2017 and $140,283 for the year ended December 31, 2016.

8. Investments (cont'd)

Maturity profile of held to maturity investments is as follows:

	Within 1 Year	2 to 5 Years	6 to 10 Years	Over 10 Years	Total
December 31, 2017					
Bonds	**$ 2,300,000**	**$ 8,239,806**	**$ 22,720,531**	**$ 11,551,621**	**$ 44,811,958**
Term Deposits	**2,200,000**	**2,420,000**	**-**	**-**	**4,620,000**
Total	**$ 4,500,000**	**$ 10,659,806**	**$ 22,720,531**	**$ 11,551,621**	**$ 49,431,958**
Percent of total	**9%**	**22%**	**46%**	**23%**	**100%**
December 31, 2016					
Bonds	$ 1,600,000	$ 10,093,536	$ 17,994,927	$ 12,778,758	$ 42,467,221
Term Deposits	1,820,000	2,000,000	-	-	3,820,000
Total	$ 3,420,000	$ 12,093,536	$ 17,994,927	$ 12,778,758	$ 46,287,221
Percent of total	7%	26%	39%	28%	100%

The effective interest rate of the held to maturity investments is 4.09% and 4.42% at December 31, 2017 and December 31, 2016 respectively.

9. Property, plant & equipment

	Land	Building	Office equipment	Computer equipment	Vehicles	Parking lots	Total
Cost							
Balance on January 1, 2016	$ 608,343	$3,778,619	$ 302,257	$ 227,767	$ 290,233	$ 89,666	$ 5,296,885
Additions	-	2,872	11,446	35,536	68,478	-	118,332
Disposals	-	-	-	(71,966)	(60,873)	-	(132,839)
Balance on December 31, 2016	608,343	3,781,491	313,703	191,337	297,838	89,666	5,282,378
Additions	-	-	9,703	27,015	131,628	-	168,346
Disposals	-	-	-	(2,639)	(40,198)	-	(42,837)
Balance on December 31, 2017	**$ 608,343**	**$3,781,491**	**$ 323,406**	**$ 215,713**	**$ 389,268**	**$ 89,666**	**$ 5,407,887**
Accumulated depreciation							
Balance on January 1, 2016	$ -	$ 87,559	$ 99,465	$ 178,974	$ 213,144	$ 7,173	$ 586,315
Depreciation expense	-	170,772	42,848	36,912	41,520	6,599	298,651
Disposals	-	-	-	(69,664)	(53,710)	-	(123,374)
Balance on December 31, 2016	-	258,331	142,313	146,222	200,954	13,772	761,592
Depreciation expense	-	162,100	36,219	32,351	67,558	6,071	304,299
Disposals	-	-	-	(2,401)	(36,888)	-	(39,289)
Balance on December 31, 2017	**$ -**	**$ 420,431**	**$ 178,532**	**$ 176,172**	**$ 231,624**	**$ 19,843**	**$ 1,026,602**
Net book value							
December 31, 2016	$ 608,343	$3,523,160	$ 171,390	$ 45,115	$ 96,884	$ 75,894	$ 4,520,786
December 31, 2017	**$ 608,343**	**$3,361,060**	**$ 144,874**	**$ 39,541**	**$ 157,644**	**$ 69,823**	**$ 4,381,285**

10. Insurance contracts

The following is a summary of the insurance contract provisions and related reinsurance assets at December 31.

	December 31, 2017			December 31, 2016		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Outstanding claims provision						
Long settlement term	**$ 2,790,198**	**$ 215,565**	**$ 2,574,633**	$2,580,328	$ 232,929	$2,347,399
Short settlement term	**9,464,503**	**4,966,157**	**4,498,346**	4,596,480	35,500	4,560,980
	12,254,701	**5,181,722**	**7,072,979**	7,176,808	268,429	6,908,379
Provision for claims incurred but not reported	**1,838,205**	**-**	**1,838,205**	1,587,232	-	1,587,232
	$14,092,906	**$ 5,181,722**	**$ 8,911,184**	$8,764,040	$ 268,429	$8,495,611

10. Insurance contracts (cont'd)

Comments and assumptions for specific claims categories

The ultimate cost of long settlement 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 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. For example, liability for exposure to toxic substances and environmental impairment, which did not appear likely or even exist when the policies were written, has been imposed by legislators and judicial interpretation. Tort liability has been expanded by some jurisdictions to cover defective workmanship. Provisions for such difficult-to-estimate-liabilities are established by examining the facts of tendered claims and adjusted in the aggregate for ultimate loss expectations based upon historical experience patterns and current socioeconomic trends.

Claims and adjustment expenses

Changes in claim liabilities recorded in the balance sheet 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 - beginning of year – net of reinsurance	**$ 6,908,379**	$ 7,432,731
Increase (decrease) in estimated losses and expenses, for losses occurring in prior years	**(234,394)**	(906,704)
Provision for losses and expenses on claims occurring in the current year	**12,521,588**	10,575,239
Payment on claims:		
Current year	**(7,898,081)**	(5,643,016)
Prior years	**(4,224,513)**	(4,549,871)
Unpaid claims – end of year - net of reinsurance	**$ 7,072,979**	$ 6,908,379

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

Provision for unpaid claims and adjustment expenses

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of three major variables which are the development of claims, reinsurance recoveries, and future investment income. As the Company does not sell auto insurance, future investment income has been disregarded for this purpose.

10. Insurance contracts (cont'd)

Claim development

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

The tables that follow present the development of claims payments and the estimated ultimate cost of claims for the claim year 2008 to 2017. The upper half of the tables shows the cumulative amounts paid or estimated to be paid during successive years related to each claim year. The original estimates will be increased or decreased, as more information becomes known about the original claims and overall claim frequency and severity.

Net Claims **($'000)**

	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Total**
Net estimate of cumulative claims cost											
At the end year of claim	8,746	8,098	8,890	9,885	9,012	12,918	13,670	13,945	10,575	12,522	
One year later	8,133	8,347	8,797	9,966	8,596	12,472	13,893	13,523	10,246		
Two years later	8,110	8,296	8,774	9,846	8,344	12,362	13,770	13,760			
Three years later	8,127	8,326	8,731	9,778	8,335	12,309	13,712				
Four years later	8,121	8,123	8,686	9,677	8,340	12,297					
Five years later	8,144	8,325	8,592	9,499	8,274						
Six years later	8,020	8,318	8,576	9,492							
Seven years later	7,920	8,304	8,576								
Eight years later	7,920	8,304									
Nine years later	7,920										
Current estimate of cumulative claims cost	7,920	8,304	8,576	9,492	8,274	12,297	13,712	13,760	10,246	12,522	
Cumulative payments	7,885	8,304	8,576	9,297	8,252	12,153	13,544	13,012	9,185	7,898	
Outstanding claims	35	-	-	195	22	144	168	748	1,061	4,624	6,997
Outstanding claims 2007 and prior											76
Claims handling expense											(566)
Total net outstanding claims net of claims handling expense											**6,507**

11. Pension plan

The Company has a defined contribution plan providing pension benefits to eligible employees. The total plan expense for the Company's defined contribution plan for 2017 was $270,532 (2016 - $230,827).

12. Income taxes

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

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

	2017	2016
Current tax expense		
Based on current year taxable income	**$ 553,341**	$ 1,300,579
Adjustments for over / under provision in prior periods	**-**	-
	$ 553,341	$ 1,300,579
Deferred tax expense		
Origination and reversal of temporary differences	**(149,843)**	6,385
(Increase) reduction in tax rate	**(8,393)**	(6,570)
	(158,236)	(185)
Total income tax expense	**$ 395,105**	$ 1,300,394

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

	2017	2016
Current tax		
Change in unrealized gain / losses on available-for-sale investments	**$ (42,155)**	$ 185,532

12. Income taxes (cont'd)

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory tax rates are as follows:

	2017	2016
Income before income taxes	**$ 2,270,769**	$ 6,475,155
Combined basic Canadian Federal and provincial income tax rate	**31%**	31%
Income taxes at statutory rates	**703,938**	2,007,298
Income from insuring farming & fishing related risks	**(220,753)**	(685,296)
Non deductible portion of claims liabilities	**165,195**	(17,586)
Depreciation in excess of capital cost allowance	**5,016**	2,063
Other non deductible expenses	**11,725**	(1,014)
Market to market and other adjustments related to investments	**(60,361)**	271,041
Deduction for CCPC dividends	**(93,574)**	(90,395)
Change in tax rates	**(8,393)**	(6,570)
Origination and reversal of temporary timing differences	**(149,843)**	6,385
Total income tax expense	**$ 352,950**	$ 1,485,926

The significant components of deferred tax assets are:

Deferred tax assets	**2017**	**2016**
Pension obligation	**$ 24,405**	**$ 17,431**
Provision for unpaid claims	**311,735**	**189,829**
Property, plant & equipment	**67,450**	**38,094**
	$ 403,590	**$ 245,354**

13. Gross claims and adjustment expenses

Included in claims expenses were wage costs of $427,641 (2016 - $422,017).

14. Fees, commissions and other acquisition expenses

	2017	2016
Commissions	**$ 1,731,952**	$ 1,515,676
Sales salaries	**442,955**	487,822
Other	**196,229**	159,244
	$ 2,371,136	$ 2,162,742

15. Other operating and administrative expenses

	2017	2016
Advertising	**$ 165,045**	$ 138,212
Conventions, courses and travel	**109,531**	92,605
Depreciation	**241,663**	262,076
Directors fees	**282,883**	262,357
Donations	**98,705**	86,205
Fire prevention tax (Note 22)	**-**	227,646
Loss Prevention	**55,058**	30,863
Office supplies	**155,432**	182,385
Other administration costs	**404,139**	369,487
Postage	**148,198**	200,071
Premium tax (Note 22)	**298,633**	-
Professional fees	**69,947**	48,496
Salaries and benefits	**2,332,590**	2,312,838
Taxes, dues and licences	**115,749**	111,312
Telephone	**70,858**	62,738
	$ 4,548,431	$ 4,387,291

16. Salaries, benefits and directors fees

	2017	2016
Claims handling - Salaries, adjusting fees & benefits (Note 13)	**$ 427,641**	$ 422,017
Sales salaries, commissions and benefits (Note14)	**2,174,907**	2,003,498
Director fees (Note 15)	**282,883**	262,357
Other salaries and benefits (Note 15)	**2,332,590**	2,312,838
	$ 5,218,021	$ 5,000,710

17. Investment and other income

2017	**AFS**	**FVTPL**	**HTM**	**Other**	**Total**
Interest Income	**$ -**	**$ 30,546**	**$ 1,955,563**	**$ -**	**$ 1,986,109**
Interest Expense				**(1,161)**	**(1,161)**
Dividend Income	**384,595**				**384,595**
Net realized gains	**870,706**				**870,706**
Impairment Losses	**(129,718)**				**(129,718)**
Gain (loss) on disposal of PPE				**5,077**	**5,077**
Other income				**142,169**	**142,169**
Investment and Other Income	**$ 1,125,583**	**$ 30,546**	**$ 1,955,563**	**$ 146,085**	**$ 3,257,777**

2016	AFS	FVTPL	HTM	Other	Total
Interest Income	$ -	$ 23,638	$ 1,930,147	$ -	$ 1,953,785
Interest Expense				(1,328)	(1,328)
Dividend Income	370,923				370,923
Net realized gains	935,326				935,326
Impairment Losses	(140,283)				(140,283)
Gain (loss) on disposal of PPE				2,955	2,955
Other income				122,742	122,742
Investment and Other Income	$ 1,165,966	$ 23,638	$ 1,930,147	$ 124,369	$ 3,244,120

18. Changes in non-cash operating working capital

	2017	2016
Receivables	**$ (111,060)**	$ (410,392)
Prepaid expenses	**9,402**	13,629
Deferred policy acquisition expenses	**(158,187)**	(97,156)
Reinsurers' share of provision for unpaid claims	**(4,913,293)**	215,655
Payables and accruals	**70,908**	78,850
Income tax payable/receivable	**(2,436,042)**	1,800,419
Refund from surplus payable	**2,410,643**	-
Unpaid claims	**5,328,866**	(567,314)
Unearned premiums	**719,678**	1,119,766
	$ 920,915	$ 2,153,457
Income taxes paid, net	**$ 2,947,228**	$ (314,308)

19. Related party transactions

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

	2017	2016
Compensation		
Short term employee benefits and director's fees	**$ 1,005,198**	$ 1,092,585
Total pension and other post-employment benefits	**103,426**	82,722
	$ 1,108,624	$ 1,175,307

20. 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. Reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable. To limit their potential impact, catastrophe coverage limits the Company's exposure to $1.35 million. The $1.35 million net retained amount represents approximately 2.7% of Company's capital. For the purpose of capital management, the Company has defined capital as policyholders' security fund, excluding accumulated other comprehensive income (loss).

Section 317.(1) of the Insurance Act of Prince Edward Island requires insurers to maintain a reserve fund equal to the sum of $500 for every $100,000 of the first $1 million of insurance in force, and $3,000 for each additional $1 million or part thereof insurance in force. The Company's reserve fund as at December 31, 2017 was1.53 times that which is required by S317.(1) of the Insurance Act.

21. Financial instrument and Insurance risk management

Insurance risk management

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 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 Company purchases reinsurance as part of its risk mitigation program. Retention limits for the excess-of-loss reinsurance vary by product line.

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

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 Prince Edward Island.

The Company manages this risk via its underwriting and reinsurance strategy within an overall risk management framework. Exposures are limited by having documented underwriting limits and criteria. 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.

21. Financial instrument and Insurance risk management (cont'd)

Reinsurance is purchased to mitigate the effect of the potential loss to the company. Reinsurance is placed with Farm Mutual Re, a Canadian registered reinsurer.

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 $450,000 in the event of a property claim, and $400,000 in the event of a liability claim. The Company also obtained reinsurance which limits the Company's liability to $1.35 million 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% of gross net earned premiums for property and liability combined.

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.

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 as described in Note 10.

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

	Property claims		Liability claims	
	2017	2016	**2017**	2016
5% increase in loss ratios				
Gross	**1,035,920**	988,270	**158,611**	149,960
Net	**943,069**	921,936	**136,984**	121,419
5% decrease in loss ratios				
Gross	**(1,035,920)**	(988,270)	**(158,611)**	(149,960)
Net	**(943,069)**	(921,936)	**(136,984)**	(121,419)

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.

Credit Risk

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 in its investment portfolio and the reliance on reinsurers to make payment when certain loss conditions are met.

The Company's investment policy includes guidelines on the bond portfolio relating to portfolio composition, issuer type, bond quality ratings (at time of acquisition – rated as "AL" or better) and general guidelines for geographic exposure. All fixed income portfolios and monitored by management on a monthly basis.

21. Financial instrument and Insurance risk management (cont'd)

Reinsurance is placed with Farm Mutual Re, a Canadian registered reinsurer. Management monitors the creditworthiness of Farm Mutual Re by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Accounts receivable 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.

The maximum exposure to investment credit risk is outlined in Note 8.

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.

Market 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 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's foreign exchange risk is related to stock holdings which are limited to United States equities in sectors which are not readily available in Canada. The Company limits its holdings in foreign equity to 25% of its total equity holdings 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. A 1% change in the value of the United States dollar would affect the fair value of stocks by $29,883 which would be reflected in net income or OCI.

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.

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 not exposed to this risk as its interest bearing investments are being held to maturity.

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.

21. Financial instrument and Insurance risk management (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 holdings within its investment portfolio.

The Company's portfolio includes Canadian stocks with fair values that move with the Toronto Stock Exchange Composite Index and United States stocks with fair values that move with the S&P 500 Index. 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 common stock and United States common stock of $1.32 million (2016 - $1.28 million). For stocks that the Company did not sell during the period, the change would be recognized in the asset value and in other comprehensive income. For stocks that the Company did sell during the period, the change during the period and changes prior to the period would be recognized as net realized gains (losses) in income during the period.

The Company's investment policy limits investment in common shares to a maximum of 25% of the adjusted cost base of the portfolio.

Equities are monitored by the board of directors on a semi-annual basis. Holdings are adjusted by the Investment Committee, as required.

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

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.

22. Premium tax/Fire prevention tax

Effective January 1, 2017 the Province of Prince Edward Island amended the Premium Tax Act and Fire Prevention Tax Act to effect the following changes:

Premium tax
Every mutual insurance company to which sub clause 1(a)(ii) applies shall pay to the Superintendent of Insurance for the use of the province a tax equal to one point two five percent (1.25%) of gross premiums written.

Fire prevention tax
Section 9, tax on fire insurers, equal to one percent (1.0%) of gross premiums written was repealed.

23. Special mutual rebate payable

The Board of Directors declared a Special Mutual Rebate in December 2017, payable to all policyholders with policies in force on December 31, 2017, at a rate of 10% of gross written premiums as at December 31, 2017. This rebate is to be paid out to all qualifying policyholders within 120 days of December 31, 2017.