

SOUTHEASTERN MUTUAL INSURANCE COMPANY
FINANCIAL STATEMENTS
DECEMBER 31, 2017



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INDEPENDENT AUDITORS' REPORT

To the policyholders of Southeastern Mutual Insurance Company:

Report on the Financial Statements

We have audited the accompanying statement of financial position of Southeastern Mutual Insurance Company as at December 31, 2017 and the statements of changes in equity, operations, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' 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.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Southeastern Mutual Insurance Company as at December 31, 2017, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Matters

In accordance with section 78 of the Insurance Act of New Brunswick, we confirm that, within the scope of materiality we have verified cash, bank balance and securities, we have checked the reserve of unearned premiums and it is calculated as required by the Insurance Act, we have examined the reserve for unpaid claims and in our opinion it is adequate, we have verified the balances owing by agents and other insurers, we have verified that the statement of financial position does not include as assets items prohibited by the Insurance Act, and that all transactions of the company that have come within our notice have been within its power.

Stevenson + Partners

Riverview, NB
March 15, 2018

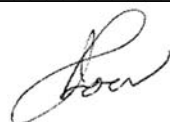
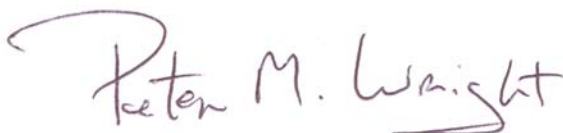
Chartered Professional Accountants

SOUTHEASTERN MUTUAL INSURANCE COMPANY**STATEMENT OF FINANCIAL POSITION**

Statement 1

DECEMBER 31, 2017

	2017	2016
ASSETS		
Cash and cash equivalents	\$ 2,507,647	\$ 1,805,510
Accrued interest receivable	69,700	57,200
Premiums receivable	1,905,295	1,661,569
Deferred premium acquisition costs (Note 4)	909,417	816,602
Investments (Note 5)	13,927,718	11,833,711
Investment in associate (Note 6)	4,265,382	4,242,054
Property and equipment (Note 7)	1,476,243	1,308,501
Intangible assets (Note 7)	75,792	14,819
Investment property (Note 8)	-	595,431
Prepaid expenses	<u>182,765</u>	<u>22,542</u>
	<u>\$ 25,319,959</u>	<u>\$ 22,357,939</u>
LIABILITIES		
Accounts payable and accrued liabilities (Note 9)	\$ 375,573	\$ 374,107
Income taxes payable (Note 10)	74,140	442,681
Reserve for unpaid claims, net of reinsurance (Note 4)	1,583,877	696,802
Mortgage payable on demand (Note 11)	1,214,917	-
Unearned premiums (Note 4)	<u>4,887,933</u>	<u>4,436,267</u>
	<u>8,136,440</u>	<u>5,949,857</u>
EQUITY		
General Reserve - Statement 2	15,557,775	15,200,757
Accumulated other comprehensive income - Statement 2	<u>1,625,744</u>	<u>1,207,325</u>
	<u>17,183,519</u>	<u>16,408,082</u>
	<u>\$ 25,319,959</u>	<u>\$ 22,357,939</u>
Contingent Liabilities (Note 15)		

APPROVED ON BEHALF OF THE BOARD:

The accompanying summary of significant accounting policies and other explanatory information are an integral part of these financial statements.

SOUTHEASTERN MUTUAL INSURANCE COMPANY**STATEMENT OF CHANGES IN EQUITY**

Statement 2

FOR THE YEAR ENDED DECEMBER 31, 2017

	2017	2016
General Reserve (Note 16)		
General Reserve, beginning of year	\$ 15,200,757	\$ 14,159,544
Net income for the year - Statement 3	<u>357,018</u>	<u>1,041,213</u>
General Reserve, end of year - Statement 1	<u>\$ 15,557,775</u>	<u>\$ 15,200,757</u>
Accumulated Other Comprehensive Income		
Accumulated other comprehensive income, beginning of year	\$ 1,207,325	\$ 819,946
Other comprehensive income - Statement 4	<u>418,419</u>	<u>387,379</u>
Accumulated other comprehensive income, end of year - Statement 1	<u>\$ 1,625,744</u>	<u>\$ 1,207,325</u>

The accompanying summary of significant accounting policies and other explanatory information are an integral part of these financial statements.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

STATEMENT OF OPERATIONS

Statement 3

FOR THE YEAR ENDED DECEMBER 31, 2017

	2017	2016
Premiums written	\$ 9,188,993	\$ 8,384,933
Reinsurance premiums	(887,073)	(947,505)
Change in unearned premiums (Note 4)	<u>(451,666)</u>	<u>(329,745)</u>
Net premiums earned	7,850,254	7,107,683
Service charge revenue	<u>149,322</u>	<u>121,940</u>
Net underwriting revenue	<u>7,999,576</u>	<u>7,229,623</u>
Losses		
Claims incurred	4,098,174	2,712,374
Adjusting expenses	335,940	115,903
Reinsurance recoveries	<u>(151,421)</u>	<u>(175,750)</u>
Net claims incurred	<u>4,282,693</u>	<u>2,652,527</u>
	<u>3,716,883</u>	<u>4,577,096</u>
Premium acquisition expenses		
Commissions expense	1,360,799	1,206,323
Change in commissions earned	<u>(74,457)</u>	<u>(79,921)</u>
Net commissions	1,286,342	1,126,402
Agents expenses	60,230	58,128
Premium tax	255,198	233,991
Fire Marshall's tax	64,167	55,439
Other premium acquisition costs	<u>33,230</u>	<u>25,226</u>
	1,699,167	1,499,186
Operating expenses - Schedule 1	<u>1,791,986</u>	<u>1,719,350</u>
	<u>3,491,153</u>	<u>3,218,536</u>
Underwriting profit	<u>225,730</u>	<u>1,358,560</u>
Investment and other income (expense)		
Equity loss from associate (Note 6)	(82,931)	(104,664)
Investment income (Note 13)	348,669	207,778
Rental income (loss) net of expenses (Note 8)	21,356	(24,158)
Impairment of tangible assets	<u>-</u>	<u>(17,730)</u>
	<u>287,094</u>	<u>61,226</u>
Income before income taxes	512,824	1,419,786
Provision for income taxes (Note 10)	<u>(155,806)</u>	<u>(378,573)</u>
Net income for the year - Statement 2	<u>\$ 357,018</u>	<u>\$ 1,041,213</u>

The accompanying summary of significant accounting policies and other explanatory information are an integral part of these financial statements.

SOUTHEASTERN MUTUAL INSURANCE COMPANY**STATEMENT OF COMPREHENSIVE INCOME**

Statement 4

FOR THE YEAR ENDED DECEMBER 31, 2017

	2017	2016
Net income - Statement 3	<u>\$ 357,018</u>	<u>\$ 1,041,213</u>
Other comprehensive income:		
Unrealized gain (loss) on available-for-sale financial assets:		
Equities	494,155	218,099
Bonds and debentures	<u>(65,891)</u>	<u>(18,901)</u>
	<u>428,264</u>	<u>199,198</u>
Reclassification of loss (gains) included in net income:		
Equities	6,192	40,899
Bonds and debentures	<u>(11,296)</u>	<u>(5,697)</u>
	<u>(5,104)</u>	<u>35,202</u>
Other comprehensive income from associate (Note 6)	<u>106,259</u>	<u>210,179</u>
Net unrealized gain	<u>529,419</u>	<u>444,579</u>
Provision for income tax:		
Current income tax (Note 10)	(99,000)	(50,000)
Deferred income tax (Note 10)	<u>(12,000)</u>	<u>(7,200)</u>
	<u>(111,000)</u>	<u>(57,200)</u>
Other comprehensive income - Statement 2	<u>418,419</u>	<u>387,379</u>
Comprehensive income	<u>\$ 775,437</u>	<u>\$ 1,428,592</u>

The accompanying summary of significant accounting policies and other explanatory information are an integral part of these financial statements.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

STATEMENT OF CASH FLOWS

Statement 5

FOR THE YEAR ENDED DECEMBER 31, 2017

	2017	2016
Cash flows from operating activities:		
Net income for the year - Statement 3	\$ 357,018	\$ 1,041,213
Income taxes in other comprehensive income	(111,000)	(57,200)
Items not requiring an outlay of cash:		
Depreciation and amortization	147,046	130,148
Loss on disposal of investments	21,360	33,558
Equity loss from associate	82,931	104,664
Gain on disposal of property and equipment	(47,345)	-
Amortization of bond premiums	35,948	52,358
Impairment of assets	-	17,730
	<u>485,958</u>	<u>1,322,471</u>
Changes in non-cash working capital balances:		
Accrued interest receivable	(12,500)	(21,293)
Premiums receivable	(243,726)	(99,899)
Prepaid expenses	(160,223)	(6,966)
Deferred premium acquisition costs	(92,815)	(93,233)
Accounts payable and accrued liabilities	1,466	(203,609)
Reserve for unpaid claims, net of reinsurance	887,075	(174,292)
Income taxes payable/recoverable	(368,541)	528,632
Unearned premiums	451,666	329,745
	<u>948,360</u>	<u>1,581,556</u>
Cash flows from operating activities	<u>948,360</u>	<u>1,581,556</u>
Cash flows from financing activities:		
Proceeds from issue of mortgage	1,220,000	-
Payments on mortgage payable	(5,083)	-
	<u>1,214,917</u>	<u>-</u>
Cash flows from financing activities	<u>1,214,917</u>	<u>-</u>
Cash flows from investing activities:		
Additions to property, equipment and intangibles	(358,774)	(17,954)
Proceeds on disposal of property and equipment	625,789	-
Proceeds from sale of investments	2,435,753	4,436,128
Purchase of investments	(4,163,908)	(4,522,566)
	<u>(1,461,140)</u>	<u>(104,392)</u>
Cash flows used for investing activities	<u>(1,461,140)</u>	<u>(104,392)</u>
Increase in cash and cash equivalents	702,137	1,477,164
Cash and cash equivalents, beginning of year	1,805,510	328,346
	<u>1,805,510</u>	<u>328,346</u>
Cash and cash equivalents, end of year - Statement 1	<u>\$ 2,507,647</u>	<u>\$ 1,805,510</u>
See supplementary cash flow information		
Interest paid	<u>\$ 3,593</u>	<u>\$ -</u>
Interest received	<u>\$ 245,927</u>	<u>\$ 197,446</u>
Income taxes paid	<u>\$ 635,347</u>	<u>\$ 6,792</u>
Income taxes received	<u>\$ -</u>	<u>\$ 99,652</u>

The accompanying summary of significant accounting policies and other explanatory information are an integral part of these financial statements.

SOUTHEASTERN MUTUAL INSURANCE COMPANY**SCHEDULE OF OPERATING EXPENSES**

Schedule 1

FOR THE YEAR ENDED DECEMBER 31, 2017

	2017	2016
Advertising and donations	\$ 71,966	\$ 70,877
Agents' benefits	144,657	135,285
Association fees and memberships	11,310	10,609
Building occupancy costs	100,000	98,414
Computer operations	240,601	174,294
Conventions and meetings	12,323	45,161
Depreciation and amortization	124,464	94,428
Directors' remuneration (Note 14)	77,755	74,308
Directors expenses (Note 14)	5,539	7,553
Insurance and bonding	20,844	22,593
Interest and bank charges	45,633	44,951
Loss prevention	115,618	114,662
Office, postage and stationery	60,551	63,747
Professional fees	111,785	112,595
Salaries and employee benefits	589,681	594,476
Scholarship	6,000	6,000
Telephone	14,218	16,610
Training and education	11,576	5,038
Travel	27,465	27,749
	<u>\$ 1,791,986</u>	<u>\$ 1,719,350</u>

The accompanying summary of significant accounting policies and other explanatory information are an integral part of these financial statements.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

General information and statement of compliance with International Financial Reporting Standards

Southeastern Mutual Insurance Company is incorporated under the laws of New Brunswick and is subject to the Insurance Act of New Brunswick. The Company sells property and casualty insurance in the Province. Products include personal, commercial and farm insurance and automobile insurance through its associated company.

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

1. Adoption of new and revised standards and interpretations

There are no new standards, interpretations and amendments, effective for the first time on January 1, 2017 that have a material effect on the financial statements.

At the date of authorization of these financial statements, the IASB and IFRS Interpretations committee (IFRIC) has issued the following new and revised standards, amendments and interpretations which are not yet effective during period covered by these financial statements.

IFRS 9 Financial Instruments includes revisions on the classification and measurement of financial instruments, changes to calculation of impairment on financial assets and new hedge accounting requirements. IFRS 9 replaces the current IAS 39 Financial Instruments: Recognition and Measurement and is effective for reporting periods beginning on or after January 1, 2018, with a deferral option for insurance companies to January 1, 2021 to coincide with the IFRS 17 adoption date.

IFRS 15 Revenue from Contracts with Customers includes revisions to criteria on how much and when revenue is recognized. It replaces several standards currently in place (IAS 18, IAS 11 and IFRIC 13). IFRS 15 is effective for reporting periods beginning on or after January 1, 2018, with a deferral option for insurance companies to January 1, 2021 to coincide with the IFRS 17 adoption date.

IFRS 16 Leases includes new standards for accounting for leases. Under this new standard all leases except insignificant and short term leases will include an asset and corresponding liability. This standard replaces parts of standards currently in place (IAS 17, IFRIC 4, SIC-15 and SIC-27). The effective date of this standard is for year ends beginning on January 1, 2019.

IFRS 17 Insurance Contracts is a new standard for insurance contracts. Under this new standard insurance contracts may be classified differently and reserve for policy and claims liabilities may be accounted for differently. This standard replaces the current IFRS 4 Insurance Contracts standard. The effective date of this standard is for year ends beginning on January 1, 2021.

The company is currently assessing the potential impact on its financial statements of the above standards. It is expected that IFRS 17 may have a material impact on the financial statements.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the company's future financial statements.

2. Summary of significant accounting policies

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards and in accordance with the regulations of the Financial and Consumer Services Commission of New Brunswick (FCNB).

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments. The significant accounting policies adopted by the company are set out below.

In accordance with IFRS 4 Insurance Contracts, the company has applied previous Canadian generally accepted accounting principles (GAAP) modified as appropriate to comply with the IFRS framework. These Canadian GAAP accounting principles will continue to be applied for the company's insurance contracts until January 1, 2021 when IFRS 17 is to be adopted.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

2. Summary of significant accounting policies (continued)

(a) Financial instruments

All financial instruments are classified as either fair value through profit or loss (FVTPL), available-for-sale, held-to-maturity, loans and receivables, or other liabilities. FVTPL and available-for-sale financial instruments are revalued to their fair value as of the financial statement reporting date. FVTPL financial instruments are recognized through the statement of operations and available-for-sale financial instruments are recognized through other comprehensive income until the instrument is derecognized or impaired. Held-to-maturity, loans and receivables, and other liabilities are measured at amortized cost. Transactions costs are included in the carrying value of the financial instruments.

For information on the classification of each financial instrument of the company see Note 18.

Available-for-sale financial assets are assessed for indicators of impairment at each reporting period date. They are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. A significant or prolonged decline in fair value of an available-for-sale financial asset below its cost is considered to be objective evidence of impairment.

For certain categories of financial assets that are assessed not to be impaired individually can subsequently be assessed for impairment on a collective basis. These assets include receivables.

The carrying amount of the financial assets is reduced by the impairment loss directly for all financial assets and the loss is recognized in net income for the year.

In respect of available-for-sale financial instruments, impairment losses previously recognized through net income are not reversed through net income for the year. Any increase in fair value subsequent to an impairment loss is recognized directly in other comprehensive income for the year.

Investments

Equities, preferred shares, bonds and debentures and short-term investments are classified as available-for-sale financial instruments. They are carried at fair value based on bid prices published in financial newspapers or bid quotations received from securities dealers. Any premiums or discounts on bond acquisitions are amortized, and any specific investment provisions flow through net earnings.

Unrealized gains and losses

Unrealized gains or losses on the Investments represents the difference between the carrying value at the year end and the carrying value at the previous year end or purchase value during the year, less the reversal of previously recognized unrealized gains and losses in respect of disposals during the year.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

2. Summary of significant accounting policies (continued)

(b) Insurance contracts

Deferred premium acquisition costs

Deferred premium acquisition costs consist of agents' commissions and premium taxes related to unearned premiums. These costs, to the extent that they are considered recoverable, are deferred and written off to income over the same periods that the related premiums are earned. In determining the amount recoverable consideration is given to claims and related expenses expected to be incurred as the premiums are earned.

Reserve for unpaid claims

Reserve for unpaid claims includes claims and adjustment expenses which represent the estimated amounts required to settle all outstanding and unreported claims incurred to the end of the fiscal year. The valuation of the claims liabilities are determined on a non-discounted basis.

Earned/unearned premium revenue

Premium revenue is recognized on a daily pro rata basis over the terms of the insurance policies. Unearned premiums represent the portion of premiums written which are applicable to the unexpired terms of the policy in force.

Reinsurance premiums and recoveries

Reinsurance premiums and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts.

Expected reinsurance recoveries on unpaid claims are recognized as assets at the same time and using principles consistent with the company's method for establishing the related liability.

(c) Cash and cash equivalents

Cash and cash equivalents are comprised of cash on hand, balances with banks and highly liquid temporary investments which are readily convertible into cash and which are subject to insignificant risk of changes in value.

(d) Investment in associate

The investment in the shares of the associate is accounted for on the equity basis whereby the carrying value of the investment is adjusted for the company's share of net income and other comprehensive income of the associate. Investments are written down when a decline in the value below cost is determined to be other than temporary.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

2. Summary of significant accounting policies (continued)

(e) Property and equipment

Property and equipment are recorded at cost or deemed cost less accumulated amortization and any recognized impairment loss. Depreciation is provided annually on a straight-line basis at rates calculated to write-off the cost or valuation of the property and equipment over their estimated useful lives using the following rates:

Building	2.5 % to 10%
Furniture and fixtures	10 %
Computers	17 % to 33%
Vehicles	20 %
Signs	20 %

(f) Intangible assets

Intangible assets consist of computer software, which are not integral to the operation of computer hardware owned by the company.

Software is initially recorded at cost and subsequently measured at cost less accumulated amortization and accumulated impairment losses. Software is amortized on a straight-line basis over its estimated useful life of 3 years.

(g) Investment property

The company's investment property consisted of land and building held to earn rental income. Investment property was initially recorded at cost or deemed cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses. Land was not depreciated. Buildings were depreciated on a straight-line basis over their estimated useful life of 15 to 40 years. These properties were sold during the year for net proceeds of \$625,789.

(h) Impairment of tangible assets

At the end of each reporting period, the company reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the asset's useful life.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized as an expense immediately.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

2. Summary of significant accounting policies (continued)

(h) Impairment of tangible assets (continued)

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increase in carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized as income immediately.

(i) Income taxes

The tax expense represents the sum of current income tax payable and deferred income tax.

The income tax currently payable is based on taxable income for the year. Taxable income differs from net income as reported in the statement of operations because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current income tax is calculated using income tax rates effective at the statement of financial position date.

Deferred income tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statement and the corresponding income tax bases used in the computation of taxable income. Deferred tax is accounted for as an asset or liability on the statement of financial position. Deferred income tax liabilities are generally recognized for all taxable temporary differences and deferred income tax assets are recognized to the extent that it is probable that taxable income will be available against which deductible temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered.

Deferred income tax is calculated at the tax rates that have been enacted or substantially enacted at the end of the reporting period. Deferred tax is charged or credited to the statement of operations, except when it relates to items charged or credited directly to equity, in which case the deferred income tax is charged or credited in equity.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right of offset of current income tax assets and liabilities and when the company intends to settle its current income tax assets and liabilities on a net basis.

(j) Comprehensive income

Comprehensive income includes the change in the company's net assets that result from transactions, events and circumstances from sources other than the company's equity and includes items that would not normally be included in net income, such as unrealized gains and losses on available-for-sale financial instruments.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

2. Summary of significant accounting policies (continued)

(k) Product classification

The company's product consists of property and liability insurance and is classified, for accounting purposes, as an insurance contract. A contract that is classified as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire.

Insurance contracts are those contracts that transfer significant insurance risk, if and only if, an insured event could cause an insurer to make significant additional benefits in any scenario, excluding scenarios that lack commercial substance. Such contracts may also transfer financial risk.

3. Critical accounting judgments and key sources of estimation uncertainty

In the application of the company's accounting policies, which are described in Note 2, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily available from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in a period of the revision and future periods if the revision affects both current and future periods.

(a) Critical judgments in applying the company's accounting policies

Management has not made any critical judgments apart from those involving estimations (which are dealt with separately below) in the process of applying the company's accounting policies that have significant effect on the amounts recognized in these financial statements.

(b) Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Valuation of reserve for unpaid claims

Determining the reserve for unpaid claims involves an assessment of the future development of the claims. The process takes into account the consistency of the company's claims handling procedures, the amount of information available, the characteristics of the line of business from which the claim arises, and the delays in reporting of claims. These reserve unpaid claims are estimates and, as such, are subject to variability, which could be material in the near term. Changes to the estimates could result from future events such as receiving additional claim information, changes in judicial interpretations of contracts or significant changes in severity or frequency of claims from past trends. In general, the longer the term required for settlement of a group of claims, the more variable the estimates.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

3. Critical accounting judgments and key sources of estimation uncertainty (continued)

(b) Key sources of estimation uncertainty (continued)

Valuation of reserve unpaid claims (continued)

The estimates are principally based on the company's historical experience. Methods of estimation have been used that the company believes produce reasonable results given current information. As additional experience and other data become available, the estimates could be revised. Any future changes in estimation would be reflected in the statement operations for the year in which the change occurred.

4. Insurance contracts

Deferred premium acquisition costs

The following is a schedule of the changes in deferred premium acquisition costs for the year:

	2017	2016
Beginning of year	\$ 816,602	\$ 723,369
Acquisition costs incurred during the year	1,791,982	1,592,419
Expensed during the year	<u>(1,699,167)</u>	<u>(1,499,186)</u>
End of year	<u>\$ 909,417</u>	<u>\$ 816,602</u>

Unearned premiums

Unearned premiums on the statement of financial position consist of the unearned portions of premiums. The following is a schedule of the changes in the above for the year:

	2017	2016
Beginning of year	\$ 4,436,267	\$ 4,106,522
Premiums written in year	9,188,993	8,384,933
Premiums earned in year	<u>(8,737,327)</u>	<u>(8,055,188)</u>
Change in year	<u>451,666</u>	<u>329,745</u>
End of year	<u>\$ 4,887,933</u>	<u>\$ 4,436,267</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

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4. Insurance contracts (continued)

Reserve for unpaid claims

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 is as follows:

	2017	2016
Reserve, beginning of year		
Gross	\$ 839,402	\$ 995,741
Reinsurance recoverable	<u>(142,600)</u>	<u>(124,647)</u>
	<u>696,802</u>	<u>871,094</u>
Decrease in estimated losses and expenses, for losses occurring in prior years	(4,907)	(150,213)
Provision for losses and expenses on claims occurring in the current year	<u>4,287,600</u>	<u>2,802,740</u>
	<u>4,282,693</u>	<u>2,652,527</u>
Paid claims occurring during:		
Current year events	(2,710,888)	(2,166,227)
Prior events	<u>(684,730)</u>	<u>(660,592)</u>
	<u>(3,395,618)</u>	<u>(2,826,819)</u>
Reserve, end of year	<u>\$ 1,583,877</u>	<u>\$ 696,802</u>
Reserve for unpaid claims, end of year:		
Gross	1,738,841	839,402
Reinsurer's share	<u>(154,964)</u>	<u>(142,600)</u>
	<u>\$ 1,583,877</u>	<u>\$ 696,802</u>

The company has determined estimated settlements in the next fiscal year on the reserve for unpaid claims noted above to be \$1,497,000. This estimate was determined through the use of historical data on claims payments year over year.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

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4. Insurance contracts (continued)

Reserve for unpaid claims (continued)

Claims development

The estimation of claim development involves assessing the future behaviour of claims, taking into account 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 settlement of a group of claims the more variable the estimates. Short-term settlement claims are those which are expected to be substantially paid within a year of being reported

The table below presents the development of claim payments and the estimated total cost of claims for the years 2014 to 2017. The upper half of the table 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.

Claims net of reinsurer's share	(\$'000)				
	2014	2015	2016	2017	Total
Net estimate of cumulative claims cost					
At the end year of claim	\$ 2,879	\$ 3,423	\$ 2,743	\$ 4,205	
One year later	2,806	3,289	2,791		
Two years later	2,803	3,271			
Three years later	<u>2,768</u>				
Current estimate of cumulative claims cost	2,768	3,271	2,791	4,205	13,035
Cumulative payments	<u>2,768</u>	<u>3,271</u>	<u>2,784</u>	<u>2,628</u>	<u>11,451</u>
Outstanding claims	<u>-</u>	<u>-</u>	<u>7</u>	<u>1,577</u>	<u>\$ 1,584</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

5. Investments

Investments are classified on an available-for-sale basis, and therefore are carried at their fair value. The maximum exposure to credit risk would be the fair value as shown below.

	2017 Fair Value	2016 Fair Value
<i>Available-for-Sale</i>		
Bonds and debentures maturing within one year:		
Provincial/Municipal Governments	\$ 1,246,256	\$ 864,463
Canadian Corporate	448,842	-
Guaranteed investment certificates	<u>-</u>	<u>555,000</u>
	<u>1,695,098</u>	<u>1,419,463</u>
Bonds and debentures maturing between one and five years:		
Government of Canada	164,678	171,170
Provincial/Municipal Governments	1,759,613	1,394,303
Canadian Corporate	<u>3,511,625</u>	<u>3,163,008</u>
	<u>5,435,916</u>	<u>4,728,481</u>
Bonds and debentures maturing in more than five years:		
Provincial/Municipal Governments	682,763	671,980
Canadian Corporate	<u>603,756</u>	<u>601,946</u>
	<u>1,286,519</u>	<u>1,273,926</u>
	<u>8,417,533</u>	<u>7,421,870</u>
Equities	3,622,160	2,701,075
Preferred shares	1,788,015	1,108,967
Short term investments	<u>100,010</u>	<u>601,799</u>
	<u>5,510,185</u>	<u>4,411,841</u>
	<u>\$13,927,718</u>	<u>\$11,833,711</u>

The company's effective interest rate on bonds and guaranteed investment certificates is calculated based on interest received and accrued in the year less amortization of bond premiums in the year. The effective interest rate on these investments is 2.75% (2016 - 2.82%).

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

6. Investment in associate

United General Insurance Corporation (United General) is owned by four New Brunswick Mutual Insurance companies which includes Southeastern Mutual Insurance Company. United General writes automobile policies for these New Brunswick Mutuals.

The investment in associate includes:

	2017	2016
Voting shares	\$ 73,838	\$ 73,838
Participating shares	2,668,788	2,668,788
Undistributed share of income (see below)	<u>1,252,310</u>	<u>1,335,241</u>
	3,994,936	4,077,867
Undistributed share of income from other comprehensive income	<u>270,446</u>	<u>164,187</u>
	<u>\$ 4,265,382</u>	<u>\$ 4,242,054</u>

At December 31, 2017, the company's share of the total equity of United General was approximately 31% (2016 - 31%) and had 25% of voting control.

Subject to the terms of a shareholder agreement, the net income or loss of United General is to be allocated to each shareholder annually. For each dollar of income allocated to one of the shareholders, one share of United General's participating shares is to be issued. For each dollar of loss attributable to one of the shareholders, one of their participating shares must be surrendered for cancellation.

The company's portion of United General's underwriting income is based on the auto business written by the company's agents for United General, net of the expenses relating to those premiums. The company's portion of United General's investment income and other comprehensive is based on the average net assets of United General contributed by the company. The following is a summary of the company's portion of United General's financial position and operations:

Statement of financial position

	2017	2016
Assets		
Investments	\$ 5,703,195	\$ 5,368,749
Due from agents, brokers and policyholders	556,180	513,171
Reserve for unpaid claims recoverable from reinsurers	245,511	230,946
Other assets	<u>403,181</u>	<u>519,243</u>
	<u>\$ 6,908,067</u>	<u>\$ 6,632,109</u>
Liabilities		
Reserve for unpaid claims	\$ 1,426,317	\$ 1,239,132
Unearned premiums	1,073,138	991,850
Other liabilities	<u>143,230</u>	<u>159,073</u>
	2,642,685	2,390,055
Shareholder's equity	<u>4,265,382</u>	<u>4,242,054</u>
	<u>\$ 6,908,067</u>	<u>\$ 6,632,109</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

6. Investment in associate (continued)

Statement of income

	2017	2016
Gross premiums earned	\$ 3,273,979	\$ 3,018,099
Reinsurance costs	<u>(702,109)</u>	<u>(675,877)</u>
Net premiums earned	2,571,870	2,342,222
Net claims incurred	(1,601,866)	(1,539,866)
Commissions and other expenses	<u>(1,267,260)</u>	<u>(1,168,059)</u>
Underwriting loss	(297,256)	(365,703)
Investment and other income	<u>185,802</u>	<u>230,445</u>
Loss before income tax	(111,454)	(135,258)
Income tax recovery	<u>28,523</u>	<u>30,594</u>
Company's portion of annual loss	(82,931)	(104,664)
Beginning undistributed share of income	<u>1,335,241</u>	<u>1,439,905</u>
Ending undistributed share of income	<u>\$ 1,252,310</u>	<u>\$ 1,335,241</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

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7. Property and equipment and intangibles

	Property and equipment						Total	Intangibles
	Land	Building	Furniture and Fixtures	Computers and Hardware	Vehicle	Signs		
Gross Carrying Amount								
Balance December 31, 2016	\$ 338,000	\$ 947,721	\$ 148,733	\$ 108,832	-	\$ 48,300	\$ 1,591,586	\$ 71,663
Additions	-	-	3,450	241,955	30,798	-	276,203	82,571
Disposals	-	-	(500)	-	-	(48,300)	(48,800)	-
Balance December 31, 2017	<u>338,000</u>	<u>947,721</u>	<u>151,683</u>	<u>350,787</u>	<u>30,798</u>	<u>-</u>	<u>1,818,989</u>	<u>154,234</u>
Depreciation and impairment								
Balance December 31, 2016	-	72,308	105,030	64,455	-	41,292	283,085	56,844
Additions	-	48,205	7,470	42,198	3,080	1,913	102,866	21,598
Disposals	-	-	-	-	-	(43,205)	(43,205)	-
Balance December 31, 2017	<u>-</u>	<u>120,513</u>	<u>112,500</u>	<u>106,653</u>	<u>3,080</u>	<u>-</u>	<u>342,746</u>	<u>78,442</u>
Carrying amount, December 31, 2017	<u>\$ 338,000</u>	<u>\$ 827,208</u>	<u>\$ 39,183</u>	<u>\$ 244,134</u>	<u>\$ 27,718</u>	<u>\$ -</u>	<u>\$ 1,476,243</u>	<u>\$ 75,792</u>
Gross Carrying Amount								
Balance December 31, 2015	\$ 488,000	\$ 1,478,598	\$ 148,533	\$ 228,733	-	\$ 48,300	\$ 2,392,164	\$ 207,142
Additions	-	-	200	12,698	-	-	12,898	5,056
Transfer to investment property	(150,000)	(530,877)	-	-	-	-	(680,877)	-
Disposals	-	-	-	(132,599)	-	-	(132,599)	(140,535)
Balance December 31, 2016	<u>338,000</u>	<u>947,721</u>	<u>148,733</u>	<u>108,832</u>	<u>-</u>	<u>48,300</u>	<u>1,591,586</u>	<u>71,663</u>
Depreciation and impairment								
Balance December 31, 2015	-	191,227	97,557	173,188	-	38,768	500,740	185,019
Additions	-	48,205	7,473	23,866	-	2,524	82,068	12,360
Transfer to investment property	-	(167,124)	-	-	-	-	(167,124)	-
Disposals	-	-	-	(132,599)	-	-	(132,599)	(140,535)
Balance December 31, 2016	<u>-</u>	<u>72,308</u>	<u>105,030</u>	<u>64,455</u>	<u>-</u>	<u>41,292</u>	<u>283,085</u>	<u>56,844</u>
Carrying amount, December 31, 2016	<u>\$ 338,000</u>	<u>\$ 875,413</u>	<u>\$ 43,703</u>	<u>\$ 44,377</u>	<u>\$ -</u>	<u>\$ 7,008</u>	<u>\$ 1,308,501</u>	<u>\$ 14,819</u>

The company did not record any impairment charges or reversals during the years noted above.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

8. Investment property

	Land	Building	Total
Gross Carrying Amount			
Balance December 31, 2016	\$ 192,000	\$ 625,370	\$ 817,370
Additions	-	-	-
Disposals	<u>(192,000)</u>	<u>(625,370)</u>	<u>(817,370)</u>
Balance December 31, 2017	<u>-</u>	<u>-</u>	<u>-</u>
Depreciation and impairment			
Balance December 31, 2016	-	221,939	221,939
Additions	-	22,582	22,582
Disposals	<u>-</u>	<u>(244,521)</u>	<u>(244,521)</u>
Balance December 31, 2017	<u>-</u>	<u>-</u>	<u>-</u>
Carrying amount, December 31, 2017	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Gross Carrying Amount			
Balance December 31, 2015	\$ 42,000	\$ 112,223	\$ 154,223
Additions	-	-	-
Transfer from property and equipment	150,000	530,877	680,877
Impairment of tangible assets	-	(17,730)	(17,730)
Disposals	<u>-</u>	<u>-</u>	<u>-</u>
Balance December 31, 2016	<u>192,000</u>	<u>625,370</u>	<u>817,370</u>
Depreciation and impairment			
Balance December 31, 2015	-	19,095	19,095
Additions	-	35,720	35,720
Transfer from property and equipment	-	167,124	167,124
Disposals	<u>-</u>	<u>-</u>	<u>-</u>
Balance December 31, 2016	<u>-</u>	<u>221,939</u>	<u>221,939</u>
Carrying amount, December 31, 2016	<u>\$ 192,000</u>	<u>\$ 403,431</u>	<u>\$ 595,431</u>

The income and expenses recognized in these financial statements for company's investments property is as follows:

Revenue	\$ 100,202	\$ 103,877
Direct expenses	(56,264)	(92,315)
Depreciation	<u>(22,582)</u>	<u>(35,720)</u>
	<u>\$ 21,356</u>	<u>\$ (24,158)</u>

Included in the above is income and expenses related to the rental of a portion of the company's operating property.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

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9. Accounts payable and accrued liabilities

	2017	2016
Payable to reinsurer	\$ 68,374	\$ 69,258
Premium and fire marshall taxes payable	150,929	135,771
Due to other government agencies	11,708	10,369
Other payables and accruals	<u>144,562</u>	<u>158,709</u>
	<u>\$ 375,573</u>	<u>\$ 374,107</u>

10. Income taxes

Recovery of (provision for) income taxes included on Statement 3 is comprised of the following:

	2017	2016
Current income tax expense	\$ (159,806)	\$ (397,273)
Deferred income tax recovery	<u>4,000</u>	<u>18,700</u>
	<u>\$ (155,806)</u>	<u>\$ (378,573)</u>

In computing the company's taxable income there are certain items that are restricted in their deduction or are not taxable as follows:

	2017	2016
Company's income before income taxes	\$ 512,824	\$ 1,419,786
Temporary differences	(1,652)	10,134
Non-taxable loss from associate	82,931	104,664
Mark to market adjustments	423,161	234,564
Tax reserve on mark to market adjustments	48,470	48,470
Taxable dividends deductible	(95,740)	(71,619)
Non-deductible and restricted deductible expenses	<u>7,293</u>	<u>9,883</u>
Taxable income	977,287	1,755,882
Current effective tax rate	<u>29.0%</u>	<u>28.5%</u>
	283,413	500,426
Small business deduction	(32,537)	(53,153)
Adjustment for under provision of prior year	<u>7,930</u>	<u>-</u>
Income tax expense	<u>\$ 258,806</u>	<u>\$ 447,273</u>

The income tax expense noted above is made up of the following:

Income tax expense included on Statement 3 - statement of operations	\$ 159,806	\$ 397,273
Income tax expense included on Statement 4 - statement of comprehensive income	<u>99,000</u>	<u>50,000</u>
	<u>\$ 258,806</u>	<u>\$ 447,273</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

10. Income taxes (continued)

Income taxes payable is comprised of the following:

	2017	2016
Current income payable	\$ (63,940)	\$ (440,481)
Deferred income taxes payable	<u>(10,200)</u>	<u>(2,200)</u>
	<u>\$ (74,140)</u>	<u>\$ (442,681)</u>

The effects of temporary differences, which give rise to the net deferred income tax assets (liabilities) reported, are as follows:

	Beginning of year	2017 Included in comprehensive income	End of year
Net book value of property and equipment over their undepreciated capital cost for income tax purposes	(9,886)	\$ (13,995)	\$ (23,881)
Temporary difference on fair value of bonds	(14,611)	2,494	(12,117)
Other temporary differences	12,071	(6,071)	6,000
Unpaid claims reserve for accounting purposes in excess of their carrying value for income tax purposes	<u>10,226</u>	<u>9,572</u>	<u>19,798</u>
	<u>\$ (2,200)</u>	<u>\$ (8,000)</u>	<u>\$ (10,200)</u>

	Beginning of year	2016 Included in comprehensive income	End of year
Net book value of property and equipment over their undepreciated capital cost for income tax purposes	(22,219)	\$ 12,333	\$ (9,886)
Temporary difference on fair value of bonds	(22,011)	7,400	(14,611)
Other temporary differences	5,100	6,971	12,071
Unpaid claims reserve for accounting purposes in excess of their carrying value for income tax purposes	<u>25,230</u>	<u>(15,004)</u>	<u>10,226</u>
	<u>\$ (13,900)</u>	<u>\$ 11,700</u>	<u>\$ (2,200)</u>

Deferred income taxes included above comprise of the following:

Deferred income tax recovery - above	\$ 4,000	\$ 18,700
Deferred income tax expense - Statement 4	<u>(12,000)</u>	<u>(7,200)</u>
	<u>\$ (8,000)</u>	<u>\$ 11,500</u>

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11. Payments on mortgage payable

The company has a mortgage payable with Canadian Imperial Bank of Commerce repayable in monthly instalments of \$5,083 plus interest at a rate of CIBC prime plus 0.15% per annum (currently 3.6%). The mortgage is secured by land and building located at 663 Pinewood Road which has a net book value of \$1,165,209. The mortgage is due on demand.

The anticipated principal payments on the mortgage payable for each of the five years subsequent to December 31, 2017 are as follows:

2018	\$	61,000
2019		61,000
2020		61,000
2021		61,000
2022		61,000

12. Related party transactions

Key management of the company are senior employees, officers and members of the board of directors. The following is a detail of key management remuneration:

	2017	2016
Key management remuneration	<u>\$ 433,374</u>	<u>\$ 391,515</u>

Included in the statement of operations are the following items relating to key management:

Property and liability insurance premiums received	<u>\$ 8,310</u>	<u>\$ 15,572</u>
Property and liabilities insurance claims incurred	<u>\$ 3,547</u>	<u>\$ 2,000</u>

13. Investment and other income

	2017	2016
Interest from term deposits, bonds and debentures and GICs, net of bond amortization	\$ 213,443	\$ 149,872
Dividends	109,241	91,464
Loss on disposal of investments	(21,360)	(33,558)
Gain on sale of property and equipment	<u>47,345</u>	<u>-</u>
	<u>\$ 348,669</u>	<u>\$ 207,778</u>

14. Board compensation and expense reimbursement

Each director of the company received an annual stipend in 2017 of \$7,425 per director, \$14,459 for the chair (2016 - \$7,193 per director, \$14,008 for the chair).

In addition, each director received an attendance fee in 2017 of \$256 from January to March and \$264 from April to December (2016 - \$249 and \$256) for each attendance at board meetings, board committee meetings and various industry events.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

14. Board compensation and expense reimbursement (continued)

The total compensation paid and expenses reimbursed to each director in respect of 2017 and 2016 was as follows:

	Annual Stipend	Attendance Fees for Attending Board and Committee Meetings	Total Compensation per Director	Courses, Conferences and Mileage	Total Compensation and expenses per Director
Kevin Burdett					
2017	7,425	4,181	11,606	-	11,606
2016	4,842	4,199	9,041	1,822	10,863
Jack Low					
2017	7,425	4,164	11,589	681	12,270
2016	7,193	5,111	12,304	2,366	14,670
James Stark					
2017	7,425	5,012	12,437	2,079	14,516
2016	7,193	5,119	12,312	800	13,112
Lynn Roy					
2017	7,425	3,901	11,326	675	12,001
2016	6,018	2,156	8,174	-	8,174
Nancy Whipp					
2017	7,425	3,901	11,326	2,104	13,430
2016	3,934	1,628	5,562	20	5,582
Peter Wright					
2017	14,459	5,012	19,471	-	19,471
2016	14,008	4,168	18,176	1,929	20,105
Don Howe					
2017	-	-	-	-	-
2016	2,956	2,112	5,068	304	5,372
Robert Moreau					
2017	-	-	-	-	-
2016	<u>2,351</u>	<u>1,320</u>	<u>3,671</u>	<u>312</u>	<u>3,983</u>
Total for all directors					
2017	<u>\$ 51,584</u>	<u>\$ 26,171</u>	<u>\$ 77,755</u>	<u>\$ 5,539</u>	<u>\$ 83,294</u>
2016	<u>\$ 48,495</u>	<u>\$ 25,813</u>	<u>\$ 74,308</u>	<u>\$ 7,553</u>	<u>\$ 81,861</u>

Each director is provided with coverage under the OMIA health insurance plan. These benefits include coverage for Accidental Death and Dismemberment (AD&D)

The directors did not receive any retirement benefits, pension benefits, bonuses, profit sharing benefits, incentive payments. In 2017 directors received long-term service awards of \$NIL (2016 - \$450), which is commensurate with long-term service awards payable to employees and agents generally. The directors did not receive any discounts on premiums payable to the company (other than the premium discounts applicable generally to all policy holders).

15. Contingent liabilities

In common with the insurance industry in general, the company is subject to litigation arising in the normal course of conducting its insurance business which is taken into account in establishing the reserve for unpaid claims.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

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16. Capital management

The corporation's capital management objective is to ensure the corporation is capitalized in a manner that provides a strong financial position for its policyholders, and at the same time exceeds the regulatory capital requirements. Reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable (see Note 17(a)).

Government regulators expect the corporation to establish an internal target capital ratio above supervisory target capital ratio when applying the Minimum Capital Test (MCT). The MCT calculation incorporates operating results, financial position and other factors and includes a calculated amount of capital available. As of December 31, 2017 and 2016, the corporation's MCT exceeded the supervisory target capital ratio required by the regulator (150%) as well as the corporation's internal target ratio (450%).

The following is the detail MCT calculations of the corporation:

	2017	2016
Calculated capital available	\$ 12,918,000	\$ 12,166,000
Supervisory target capital required	\$ 2,907,000	\$ 2,485,000
Internal target capital	\$ 8,721,000	\$ 7,455,000
Ratio of capital available over supervisory target capital required	444 %	490 %
Ratio of capital available over internal target capital	148 %	163 %

The company also maintains a required amount of general reserve. In accordance with the Insurance Act of New Brunswick this requirement at December 31, 2017 is computed as \$12,415,663 (2016 - \$11,546,793) and is available only to discharge obligations of the company not provided for out of its ordinary receipts. The ultimate disposition of this general reserve is at the discretion of the Lieutenant-Governor in Council.

17. Risk management, reinsurance and other risks

(a) Insurance risk

Reserve for unpaid claims

The principal risk the company faces under insurance contracts is the actual claims and liabilities payments or the timing thereof may differ from expectations. This is influenced by the severity of claims, actual claims 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 reserve for unpaid claims and related reinsurer's share are estimates subject to variability and which might be material in the near term. The variability arises because all events affecting the ultimate settlement of claims may not have taken place and may not take place for some time. Variability 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 principally based on the company's historical experience. Methods of estimation are used, which the company believes produce reasonable results given current information. All changes in estimates are recorded as incurred claims in the current period.

The company assists in minimizing risk of the above by diversifying risk across a large portfolio of insureds.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

17. Risk management, reinsurance and other risks (continued)

(a) Insurance risk (continued)

Reinsurance and underwriting

The company mitigates its insurance risk by having in place underwriting guidelines as well as reinsuring insurance contracts which limit the liability of the company to a maximum amount on any one claim. The company uses its underwriting guidelines to minimize risk by assessing individual policies, determining if the risk is within the tolerable range and then pricing the policy accordingly.

The current reinsurance contracts are as follows:

Property claims

First \$250,000 per loss is paid by the company, which limits the company's exposure in any one property claim to \$250,000. In addition, the company has obtained reinsurance which limits the company's liability to \$750,000 in a catastrophe. Stop loss reinsurance is also in effect which protects the company to limit the "Net Incurred Loss Ratio" to 80% of its insurance premiums.

Liability claims

The company will pay 100% of all losses, up to a maximum retention of \$250,000 per loss, which limits the company's exposure in any one liability claim to \$250,000.

The reinsurance of insurance contracts does not relieve the company's obligation to the policyholders. The company is exposed to the risk that the reinsurer will be unable to meet its obligations.

The Superintendent of Insurance also limits the company's maximum retention through its reinsurance arrangements to be the maximum of 2% of general reserve or \$350,000. The company's allowed maximum retention as of December 31, 2017 would be \$311,000.

Insurance pricing

The company is exposed to pricing risk to the extent that the company's unearned premiums are insufficient to meet related future policy cost. The company evaluates this risk on a regular basis by estimating future policy costs through extrapolation of historical loss trends.

Sensitivity analysis

The risks associated with insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The company's uses various techniques based on past claims development and experience to determine these sensitivities. This includes indicators such as average claim cost, amount of claims occurrence, expected loss ratios and claims development as described in Note 4.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

17. Risk management, reinsurance and other risks (continued)

(a) Insurance risk (continued)

Reinsurance undertaken

The company participates in programs to provide re-insurance for crop reinsurance through two separate reinsurance programs. The maximum retained liability for the company in any one year is \$1,200,000 (2016 - \$900,000). For this reinsurance undertaken the company has recorded \$68,832 (2016 - \$77,677) of premium income included in premiums written on Statement 3. In the 2018 year the company will undertake two re-insurance programs with a maximum retained liability of \$1,200,000.

Property insurance risk

The company's property and equipment (Note 7) is insured for any losses exceeding \$250,000 for each property and liability insurance, which results in a maximum risk of \$500,000. This maximum risk takes into consideration that the company will be subject to maximum property and liability claims. This policy follows standard reinsurance arrangements as noted above.

(b) Other risks

Credit risks

Credit risk arises from the potential that a counter party will fail to perform its obligations. The company conducts a thorough assessment of debtors prior to granting credit and actively monitors the financial health of its debtors on an on-going basis. The company is also exposed to this risk relating to its debt holdings in its investment portfolio, premiums receivable from policyholders and the reliance on reinsurers to make payment when certain loss conditions are met.

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 consists of investment grade bonds rated "BBB" or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

Reinsurance is placed with FMRP, a Canadian registered reinsurer. FMRP's creditworthiness is monitored through its A.M. Best rating. As of April 2016, A.M. Best has rated FMRP with a rate of A- (Excellent). Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Premiums receivable are short-term in nature consisting of a large number of policyholders, and are not subject to material credit risk.

The maximum exposure to investment credit risk and concentration of this risk is outlined in Note 5.

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

17. Risk management, reinsurance and other risks (Continued)

(b) Other risks (Continued)

Liquidity Risks

Liquidity risk is the risk that the company will not be able to meet all cash outflow obligations as they become due. The company mitigates this risk by monitoring cash activities and expected outflows. 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 period in the exposure to risk or policies procedures and methods used to measure the risk.

Southeastern Mutual Insurance Company maintains a line of credit with Canadian Imperial Bank of Commerce in the amount of \$125,000 with an interest rate of prime plus 0.15% (currently 3.60%). The line of credit is secured the same as the mortgage in Note 11. At year end, Southeastern Mutual Insurance Company has utilized none of the line of credit available. In addition the company has a corporate visa facility in the amount of \$27,500.

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 Board of Directors. Diversification techniques are utilized to minimize risk.

Currency risk

Foreign currency risk is the risk that the fair value or cash flows of a financial instrument will fluctuate because of changes in exchange rates and produce an adverse impact on comprehensive income when measured in the company's operating currency.

The company's foreign currency risk is related to its foreign stock holdings. Foreign currency changes are monitored by the investment committee. Foreign stocks included in the company's available-for-sale financial assets primarily relate to US dollar denominated equities totaling \$1,540,399 Canadian at year end. A 10% rise in the value of the US dollar, with all other variables held constant, would increase comprehensive income by \$121,000, net of tax. A 10% reduction in the value of the US dollar, with all other variables held constant, would decrease comprehensive income by \$121,000, net of tax. The company has not entered into any derivative financial instruments to hedge this currency risk exposure.

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

17. Risk management, reinsurance and other risks (Continued)

(b) Other risks (Continued)

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The company is exposed to this risk through its interest bearing investments. Diversification techniques are utilized to minimize risk. The company's investment policy sets out guidelines on types and ratings of investments to help minimize this risk. Fair value of these investments is affected positively in falling rate conditions but negatively in rising interest rate conditions. At December 31, 2017, an increase of 1% in interest rates, with all other variables held constant, would decrease bond fair values by \$71,000 and decrease other comprehensive income by \$54,000 net of income taxes. A decrease of 1% in interest rates, with all other variables held constant, would increase bond values by \$71,000 and increase other comprehensive income by \$54,000 net of income taxes.

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.

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 equities with fair values that move with the changes in stock markets. A 10% increase in the stock markets, with all other variables held constant would increase the fair value of equities held by the company by \$496,000 and increase other comprehensive income by \$377,000 net of income tax. A 10% decrease in the stock markets, with all other variables held constant would decrease the fair value of equities held by the company by \$496,000 and decrease other comprehensive income by \$377,000 net of income tax. For equities that the company did not sell during the year the change in fair value would be recognized in the asset value and other comprehensive income. For equities sold during the year, the change would be recognized in the asset value and in net 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.

18. Fair value of financial instruments

Financial instruments included in the statement financial position of Southeastern Mutual Insurance Company are broken down as follows:

Loans and receivables

Accrued interest receivable

Available-for-sale

Cash and cash equivalents and investments

Other liabilities

Reserve for unpaid claims net of reinsurance, accounts payable and accrued liabilities and mortgage payable.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND EXPLANATORY INFORMATION

DECEMBER 31, 2017

18. Fair value of financial instruments (continued)

The above financial instruments are carried at their fair value. This is the maximum credit exposure for these financial instruments. Fair values were determined by management using the assumptions outlined below. Fair values are an estimate based on current market conditions and may not be reliable due to the use of assumption and are at a specific point in time and may not be reflective of future fair values.

The fair values of accrued interest receivable, cash and cash equivalents, accounts payable and accrued charges, reserve for unpaid claims net of reinsurance and mortgage payable are the same as their carrying amount due to their short-term nature or are due on demand.

The fair value of investments was determined through information from the company's investment statements which information is reflective of current market values.

The Company employs a fair value hierarchy to categorize the inputs it uses in valuation techniques to measure the fair value. The extent of use of (Level 1) quoted prices in active markets for identical assets or liabilities, (Level 2) inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly, and (Level 3) inputs for the asset or liability that are not based on observable market data in the valuation of securities as at December 31, 2017 is as follows:

	Total Fair Value	Level 1 Quoted Prices	Level 2 Observable Inputs	Level 3 Unobservable Inputs
Assets				
Cash and cash equivalents	\$ 2,507,647	\$ 2,507,647	\$ -	\$ -
Accrued interest receivable	69,700	-	-	69,700
Bonds and guaranteed investment certificates	8,417,533	-	8,417,533	-
Equities	3,622,160	3,622,160	-	-
Preferred shares	1,788,015	1,788,015	-	-
Short-term investments	100,010	100,010	-	-
	<u>\$16,505,065</u>	<u>\$ 8,017,832</u>	<u>\$ 8,417,533</u>	<u>\$ 69,700</u>
Liabilities				
Accounts payable and accrued charges	\$ 375,573	\$ -	\$ -	\$ 375,573
Reserve unpaid claims net of reinsurance	1,583,877	-	-	1,583,877
Mortgage payable	1,214,917	-	-	1,214,917
	<u>\$ 3,174,367</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,174,367</u>