

These illustrative financial statements do not include all disclosures and presentation items required by U.S. Generally Accepted Accounting Principles (GAAP), but some of the mostly likely reporting requirements encountered by property and casualty insurance companies. The format and wording presented are only illustrative and not necessarily the only possible presentation.

## **Accountants' Mutual Insurance Company**

Financial Statements

December 31, 2017 and 2016

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# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

## Balance Sheets As of December 31, 2017 and 2016

	2017	2016
<b>Assets</b>		
Available-for-sale securities	\$ 83,661,361	\$ 82,136,875
Cash and cash equivalents	7,977,397	7,853,960
Accrued interest	603,350	516,765
Uncollected premiums, net of allowance for doubtful accounts of \$104,752 and \$223,626 for 2017 and 2016, respectively	14,654,939	11,761,288
Reinsurance recoverable	9,222,007	9,201,709
Deposits with reinsurers	75,000	75,000
Deferred policy acquisition costs	1,538,789	1,175,986
Property and equipment, net	3,318,885	3,461,400
Income taxes recoverable	30,119	-
Deferred tax asset, net	6,191,971	5,366,671
Other assets	818,637	530,619
Total assets	\$ 128,092,455	\$ 122,080,273
<b>Liabilities and Shareholder's Equity</b>		
Liabilities:		
Reserve for losses and loss adjustment expenses	\$ 84,176,329	\$ 90,329,208
Unearned premium	9,623,648	9,046,048
Reinsurance payable on paid losses and loss adjustment expenses	5,052	6,237
Ceded reinsurance premium payable	3,350,773	808,641
Policy deposits held in escrow	3,081,288	2,784,063
Income taxes payable	-	3,074
Other payables	2,627,018	2,194,606
Total liabilities	102,864,108	105,171,877
Shareholder's equity:		
Common stock, \$50 par value, 100,000 shares authorized, 20,000 issues and outstanding	1,000,000	1,000,000
Additonal paid-in capital	12,200,196	12,200,196
Accumulated other comprehensive income	(154,835)	100,432
Accumulated surplus	12,182,986	3,607,768
Total shareholder's equity	25,228,347	16,908,396
Total liabilities and shareholder's equity	\$ 128,092,455	\$ 122,080,273

*See accompanying notes to financial statements.*

## ACCOUNTANTS' MUTUAL INSURANCE COMPANY

### Statements of Operations For the Years Ended December 31, 2017 and 2016

	2017	2016
Underwriting:		
Premiums earned	\$ 33,520,109	\$ 32,942,752
Ceded premiums	(8,344,662)	(4,299,355)
Net earned premiums	25,175,447	28,643,397
Losses and loss adjustment expenses	14,597,695	21,693,363
Policy acquisition and other underwriting expenses	5,062,187	5,707,128
Total underwriting expense	19,659,882	27,400,491
Net underwriting income	5,515,565	1,242,906
Investment income, net	2,443,415	1,979,508
Realized gains, net	14,734	53,156
Other income, net	33,537	12,962
Income before income taxes	8,007,251	3,288,532
Income tax benefit	(567,967)	(4,772,492)
Net income	\$ 8,575,218	\$ 8,061,024

*See accompanying notes to financial statements.*

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

## Statements of Comprehensive Income For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Net income	\$ 8,575,218	\$ 8,061,024
Other comprehensive income:		
Unrealized holding (loss) gain on available-for-sale securities, net of tax (benefit) expense of \$(136,519) and \$714,461	(265,007)	1,386,894
Reclassification adjustments for amounts included in net income, net of tax expense of \$5,018 and \$18,073	<u>9,740</u>	<u>35,079</u>
Unrealized holding (loss) gain on available-for-sale securities, net of tax (benefit) expense of \$(131,501) and \$732,534 in 2015 and 2014, respectively	<u>(255,267)</u>	<u>1,421,973</u>
Comprehensive income	<u><u>\$ 8,319,951</u></u>	<u><u>\$ 9,482,997</u></u>

*See accompanying notes to financial statements.*

## ACCOUNTANTS' MUTUAL INSURANCE COMPANY

### Statements of Changes in Shareholder's Equity For the Years Ended December 31, 2017 and 2016

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive (Loss) Income	Accumulated (Deficit) Surplus	Total Shareholder's Equity
Balance at January 1, 2016	\$ 1,000,000	\$ 12,200,196	\$ (1,321,541)	\$ (4,453,256)	\$ 7,425,399
Net income	-	-	-	8,061,024	8,061,024
Change in unrealized gains	-	-	1,421,973	-	1,421,973
Balance at December 31, 2016	1,000,000	12,200,196	100,432	3,607,768	16,908,396
Net income	-	-	-	8,575,218	8,575,218
Change in unrealized gains	-	-	(255,267)	-	(255,267)
Balance at December 31, 2017	\$ 1,000,000	\$ 12,200,196	\$ (154,835)	\$ 12,182,986	\$ 25,228,347

*See accompanying notes to financial statements.*

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

## Statements of Cash Flows For the Years Ended December 31, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Net income	\$ 8,575,218	\$ 8,061,024
Adjustments to reconcile net income to net cash used in operating activities:		
Bad debts	104,752	151,761
Depreciation	334,618	194,612
Net realized gains on sale of securities	(14,734)	(53,131)
Net amortization of bond premium	100,543	116,894
Deferred income taxes	(693,777)	(4,840,528)
Change in:		
Accrued interest	(86,585)	(88,027)
Uncollected premiums	(2,998,403)	(934,091)
Reinsurance recoverable	(20,298)	(1,804,246)
Deposits with reinsurers	-	66,000
Deferred policy acquisition costs	(362,803)	(14,716)
Income taxes recoverable	(30,119)	-
Other assets	(288,018)	575,635
Reserve for losses and loss adjustment expenses	(6,152,879)	1,818,074
Unearned premium	577,600	147,426
Reinsurance payable on paid losses and loss adjustment expenses	(1,185)	(6,606)
Ceded reinsurance premium payable	2,542,132	793,445
Policy deposits held in escrow	297,225	430,340
Income taxes payable	(3,074)	3,074
Other payables	432,412	301,110
Net cash provided by operating activities	2,312,625	4,918,050
Cash flows from investing activities:		
Payments for purchase of securities	(22,101,061)	(18,324,569)
Proceeds from sale and maturity of securities	20,103,976	12,792,211
Proceeds from disposal of property and equipment	-	2,622
Payments for purchase of property and equipment	(192,103)	(190,725)
Net cash used in investing activities	(2,189,188)	(5,720,461)
Net increase (decrease) in cash and cash equivalents	123,437	(802,411)
Cash and cash equivalents at beginning of year	7,853,960	8,656,371
Cash and cash equivalents at end of year	\$ 7,977,397	\$ 7,853,960
Supplemental disclosure about cash flows:		
Income taxes paid	\$ 159,000	\$ 64,955

*See accompanying notes to financial statements.*

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements  
December 31, 2017 and 2016

## 1. Summary of Significant Accounting Policies

### *Nature of Operations*

Accountants' Mutual Insurance Company (The Company) offers workers' compensation insurance to certified public accountants. The Company specializes in insuring certified public accounting (CPA) practices with up to 100 employees. The Company is licensed in 5 states. For the years ended December 31, 2017 and 2016, the Company's California business represented 62% and 58%, respectively, of its total premiums written.

The Company was incorporated in California in 1974 as a mutual insurance company. The Company is a wholly owned subsidiary of Accountants' Holdings, LLC.

### *Basis of Presentation*

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

### *Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### *Investments*

Investments are classified as available-for-sale and reported at fair value, with unrealized gains and losses, net of tax, reported in other comprehensive income. Realized gains and losses are determined using the specific identification method.

The Company reviews its investment portfolio to determine whether declines in fair value are other-than-temporary. Generally, debt securities that have a fair value to amortized cost ratio of less than 80% for six consecutive months or have received downgraded credit ratings are considered for other-than-temporary impairment. Any securities that are considered other-than-temporarily impaired are written down to fair value through a charge to current period income.



# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

## 1. Summary of Significant Accounting Policies (Continued)

### *Fair Value Measurements*

Accounting standards establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Accordingly, when market observable data is not readily available, the Company's own assumptions are set to reflect those that market participants would be presumed to use in pricing the asset or liability at the measurement date. Financial assets and financial liabilities recorded in the balance sheets at fair value are categorized based on the reliability of inputs to the valuation techniques as follows:

**Level 1** - Financial assets and financial liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in active markets that the Company can access.

**Level 2** - Financial assets and financial liabilities whose values are based on (a) quoted prices for similar assets or liabilities in active markets, (b) quoted prices for identical or similar assets or liabilities in non-active markets, or (c) Valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability.

**Level 3** - Financial assets and financial liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect the Company's estimates of the assumptions that market participants would use in valuing the financial assets and financial liabilities.

The Company uses prices and inputs that are current as of the measurement date, including during periods of market disruption. In periods of market disruption, the ability to observe prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2, or from Level 2 to Level 3.

### *Cash and Cash Equivalents*

For purposes of the Company's statement of cash flows, the Company includes all highly liquid investments that are both (a) readily convertible to known amounts of cash and (b) so near to maturity that they present insignificant risk of changes in value due to changing interest rates.

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

## 1. Summary of Significant Accounting Policies (Continued)

### *Premium Receivable*

Accounts receivable are stated at the amount management expects to collect from outstanding balances based on an evaluation of the uncollected accounts. Bad debts are provided for using the allowance method. Concentrations of credit risk with respect to sales and trade receivables are limited due to the nature of the insurance billing process. Insurance deposits are billed in advance, while premium adjustments are posted in arrears.

### *Reinsurance*

Reinsurance recoverable (including amounts related to losses incurred but not reported) and prepaid reinsurance premiums are reported as assets. Estimated reinsurance recoverables are recognized in a manner consistent with the liabilities relating to the underlying reinsured contracts. Reinsurance premiums, losses, and loss adjustment expenses are accounted for on basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Losses and loss adjustment expenses are reported net of reinsured amounts. All reinsurance assets and liabilities are shown on a gross basis.

### *Deferred Policy Acquisition Costs*

Commissions and premium taxes related to the production of new or renewal business are deferred and amortized over the terms of the policies to which they relate. Deferred policy acquisition costs are limited to the amount which remains after deduction of any deficiency in unearned premium.

### *Property and Equipment*

Property and equipment is recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the respective assets. Buildings are depreciated over thirty to forty years. Capitalized improvements are depreciated over the remaining useful lives of the buildings. Office furniture and equipment are depreciated over seven to twelve years. Data processing equipment and software is depreciated over three years.

### *Reserve for Losses and Loss Adjustment Expenses*

The liability for losses and loss adjustment expenses is based on case-basis estimates for reported claims and on estimates that are actuarially determined for incurred but not yet reported losses and loss adjustment expenses based on experience, estimates of future rates of inflation, industry data, and other factors such as recent settlements, claim frequency, health care costs, and other economic factors. Reinsurance assumed and ceded is considered in such estimates. Adjustments to loss and loss adjustment expense reserves are charged or credited to expense in the period in which they become known.

Amounts recorded for losses and loss adjustment expenses, however, are necessarily based on estimates, and accordingly, there can be no assurance that the ultimate liability will not exceed such estimates. Management believes that the reserves for losses and loss adjustment expenses is adequate to cover the ultimate net cost of claims and the related adjustment expenses incurred to date.

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

## 1. Summary of Significant Accounting Policies (Continued)

### *Income Taxes*

The Company accounts for income taxes based on the asset and liability method. Deferred income taxes have been provided for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Such differences are related principally to investments, discounting of reserves for unearned premium, losses and loss adjustment expenses, and net operating losses.

The tax returns may be subject to examination by the IRS, generally for three years after they were filed.

### *Premium Recognition*

Premiums consist of the estimated annual premium earned pro rata over the policy term and estimated earned but unbilled premium determined on a per policy basis. Unearned premiums are provided for the unexpired portion of estimated annual premiums. The Company does not utilize anticipated investment income as a factor in determining whether a premium deficiency reserve is required.

## 2. Investments

Amortized cost and estimated fair values of available-for-sale bonds at December 31 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2017				
U.S. Government	\$ 1,173,303	\$ 8,198	\$ -	\$ 1,181,501
States and possessions	2,958,604	27,058	(5,501)	2,980,161
Political subdivisions	6,300,416	32,916	(29,771)	6,303,561
Revenue and special assessment obligations	18,485,302	137,511	(73,416)	18,549,397
Corporate securities	54,978,360	325,311	(656,930)	54,646,741
Total	<u>\$ 83,895,985</u>	<u>\$ 530,944</u>	<u>\$ (765,618)</u>	<u>\$ 83,661,361</u>
2016				
U.S. Government	\$ 1,576,999	\$ 9,146	\$ -	\$ 1,586,145
States and possessions	2,726,632	41,944	(14,301)	2,754,275
Political subdivisions	6,490,913	15,775	(55,223)	6,451,465
Revenue and special assessment obligations	15,465,071	155,708	(51,241)	15,569,538
Corporate securities	55,725,089	437,495	(387,132)	55,775,452
Total	<u>\$ 81,984,704</u>	<u>\$ 660,068</u>	<u>\$ (507,897)</u>	<u>\$ 82,136,875</u>

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

## Notes to Financial Statements (Continued) December 31, 2017 and 2016

### 2. Investments (Continued)

Amortized cost and estimated fair values of available-for-sale bonds at December 31, 2017, listed by contractual maturity, are shown below. Actual maturities may differ from contractual maturities as certain borrowers have the right to call or prepay obligations with or without penalty.

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 5,564,402	\$ 5,567,842
Due after one year through five years	31,541,606	31,417,484
Due after five years through ten years	43,518,786	43,388,835
Due after ten years	3,271,191	3,287,200
Total	\$ 83,895,985	\$ 83,661,361

Net investment income earned was derived as follows:

	2017	2016
Debt securities	\$ 1,915,967	\$ 1,569,490
Cash and short-term investments	11,780	9,090
Rent income from real estate	796,956	785,526
Less investment expenses	(281,288)	(384,598)
Net investment income earned	\$ 2,443,415	\$ 1,979,508

Proceeds from sale of available-for-sale securities during the year ended December 31, 2017 and 2016 were \$16,939,328 and \$9,092,412, respectively. Realized gains on sale of investments for the years ended December 31 are as follows:

	2017	2016
Gross gains	\$ 71,038	\$ 54,062
Gross losses	(56,304)	(906)
Realized gains, net	\$ 14,734	\$ 53,156

## ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

### 2. Investments (Continued)

#### *Other-than-Temporary Impairment*

The following tables summarize unrealized losses on all securities by the length of time that a security has been in an unrealized loss position as of December 31 as follows:

	12 Months or Greater		Less than 12 Months	
	Unrealized	Fair Value	Unrealized	Fair Value
	Losses		Losses	
2017				
U.S. Government	\$ -	\$ -	\$ -	\$ -
States and possessions	(5,501)	953,103	-	-
Political subdivisions	(2,585)	1,036,241	(27,186)	2,346,040
Revenue and special assessment obligations	(25,279)	3,919,721	(48,137)	3,188,059
Corporate securities	(417,077)	21,115,694	(239,853)	12,646,954
Totals	\$ (450,442)	\$ 27,024,759	\$ (315,176)	\$ 18,181,053

	12 Months or Greater		Less than 12 Months	
	Unrealized	Fair Value	Unrealized	Fair Value
	Losses		Losses	
2016				
U.S. Government	\$ -	\$ -	\$ -	\$ -
States and possessions	(14,301)	1,206,645	-	-
Political subdivisions	(55,223)	3,901,835	-	-
Revenue and special assessment obligations	(50,971)	5,966,314	(270)	285,608
Corporate securities	(336,820)	23,853,811	(50,312)	4,630,199
Totals	\$ (457,315)	\$ 34,928,605	\$ (50,582)	\$ 4,915,807

As of December 31, 2017, the number of investments held in an unrealized loss position was 134. The ratio of fair value to carrying value of securities with unrealized losses as of December 31, 2017 ranged from 68% to 100%. Securities with a ratio of fair value to carrying value in this range are typically securities that have been impacted by increases in market interest rates or credit spreads. The Company has the ability and intent to hold these securities until maturity or recovery. The Company did not recognize any other-than-temporary-impairments in 2017 and 2016.

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

## Notes to Financial Statements (Continued) December 31, 2017 and 2016

### 3. Fair Value Measurements

The following tables set forth, by level within the fair value hierarchy, invested assets as of December 31 are as follows:

	Level 1	Level 2	Level 3	Total
2017				
Available-for-sale securities:				
U.S. Government agencies	\$ 1,181,501	\$ -	\$ -	\$ 1,181,501
States and possessions	-	2,980,161	-	2,980,161
Political subdivisions	-	6,303,561	-	6,303,561
Revenue and special assessment obligations	-	18,549,397	-	18,549,397
Corporate securities	-	54,646,741	-	54,646,741
Money market funds	-	1,764,247	-	1,764,247
Total	\$ 1,181,501	\$ 84,244,107	\$ -	\$ 85,425,608
2016				
Available-for-sale securities:				
U.S. Government agencies	\$ 1,586,145	\$ -	\$ -	\$ 1,586,145
States and possessions	-	6,451,465	-	6,451,465
Political subdivisions	-	2,754,275	-	2,754,275
Revenue and special assessment obligations	-	15,569,538	-	15,569,538
Corporate securities	-	55,775,452	-	55,775,452
Money market funds	-	1,827,071	-	1,827,071
Total	\$ 1,586,145	\$ 82,377,801	\$ -	\$ 83,963,946

The carrying value of cash, short-term investments, accrued interest, unpaid losses, loss adjustment expenses, unearned premiums, and other liabilities approximate fair value due to the short-term maturity, and low interest rate environment of those items.

### 4. Pledged Cash and Investments

The Company maintains certain deposits with the State of California and certain ceding carriers as security to assure the faithful performance of its obligations to policyholders. Pledged deposits included in cash and cash equivalents, investments, and short-term investments as of December 31 are as follows:

	2017	2016
State of California	\$ 76,501,847	\$ 76,298,393
Ceding carriers	190,551	196,287
Total	\$ 76,692,398	\$ 76,494,680

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

## Notes to Financial Statements (Continued) December 31, 2017 and 2016

### 5. Uncollected Premiums

Uncollected premiums as of December 31 are as follows:

	2017	2016
Premiums in course of collections	\$ 303,861	\$ 141,716
Premiums written and unbilled	14,341,087	11,463,268
Premiums earned and unbilled	114,743	228,169
Allowance for doubtful accounts	(104,752)	(71,865)
Net	\$ 14,654,939	\$ 11,761,288

### 6. Reinsurance

The Company cedes certain risks under excess of loss reinsurance contracts, but these reinsurance contracts do not relieve the Company from its obligations to policyholders. Failure of these reinsurers to honor their obligations could result in losses to the Company. To minimize exposure to significant losses from reinsurance the Company cedes to Companies rated "A" or better by A.M. Best and a number of Lloyds syndicates. At December 31, 2017 net reinsurance receivables of \$3,155,000 and \$1,304,000 were associated with two reinsurers.

The Company maintains a reinsurance agreement that cedes \$19,500,000 of losses in excess of the Company's \$500,000 retention. Under a quota share reinsurance agreement the Company cedes 20% of the first \$500,000 net liability in any one loss occurrence and 20% of the Company's net liability after considering all other reinsurance in excess of \$500,000 as respects each loss occurrence.

The effects of reinsurance on premium written and earned for the year ended December 31 are as follows:

	2017		2016	
	Written	Earned	Written	Earned
Direct	\$ 36,310,896	\$ 33,520,109	\$ 33,246,864	\$ 32,942,752
Ceded	(8,850,693)	(8,344,662)	(6,006,510)	(4,299,355)
Net	\$ 27,460,203	\$ 25,175,447	\$ 27,240,354	\$ 28,643,397

Recoveries pertaining to reinsurance contracts that were deducted from losses incurred during 2017 and 2016 amounted to \$3,887,365 and \$2,037,379, respectively.

## ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

### 7. Deferred Policy Acquisition Costs

Deferred policy acquisition costs as of December 31 are as follows:

	2017	2016
Balance at January 1	\$ 1,175,986	\$ 1,161,270
Acquisition costs deferred	2,406,085	2,909,941
Amortization	(2,043,283)	(2,895,225)
Balance at December 31	\$ 1,538,789	\$ 1,175,986

### 8. Property and Equipment

Property and equipment consists of the following as of December 31:

	2017	2016
Land	\$ 836,834	\$ 836,834
Building and improvements	2,824,524	2,658,197
Office furniture and equipment	401,121	401,121
Data processing equipment and software	1,912,031	1,888,256
Property and equipment not placed in service	5,367	3,366
Total property and equipment	5,979,877	5,787,774
Less: accumulated depreciation	(2,660,992)	(2,326,374)
Property and equipment, net	\$ 3,318,885	\$ 3,461,400

Depreciation expense amounted to \$334,618 and \$194,612 for the years ended December 31, 2017 and 2016, respectively.



# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

## Notes to Financial Statements (Continued) December 31, 2017 and 2016

### 9. Reserve for Losses and Loss Adjustment Expenses

Activity in the liability for unpaid losses and loss adjustment expenses as of December 31 is summarized as follows:

	2017	2016
Balance at January 1	\$ 90,329,208	\$ 88,511,134
Less reinsurance recoverables	(9,201,709)	(7,326,986)
Net balance at January 1	81,127,449	81,184,148
Incurred related to:		
Current year	16,901,308	22,442,393
Prior years	(2,303,611)	(749,030)
Total incurred	14,597,697	21,693,363
Paid related to:		
Current year	(2,235,849)	(2,944,995)
Prior years	(18,408,074)	(18,805,017)
Total paid	(20,643,923)	(21,750,012)
Net balance at December 31	75,081,273	81,127,449
Plus reinsurance recoverables	9,095,056	9,201,709
Balance at December 31	\$ 84,176,329	\$ 90,329,208

Decrease in incurred losses and loss adjustment expenses during 2017 pertaining to previously reported amounts is the result of favorable development of insured events of previous years. As a result of this favorable development a return premiums of \$50,000 were accrued relating to retrospectively rated contracts.

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

## 9. Reserve for Losses and Loss Adjustment Expenses (Continued)

The following summarizes loss and allocated loss adjustment expenses data by accident year as of December 31, 2017:

Accident Year	Cumulative Incurred	Cumulative Paid	Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
2008	\$ 9,350,000	\$ 8,331,000	\$ 486,000	850
2009	16,696,000	14,042,000	1,243,000	1,256
2010	37,850,000	31,635,000	2,460,000	2,509
2011	46,889,000	38,813,000	2,968,000	2,630
2012	26,590,000	21,500,000	1,540,000	1,506
2013	24,200,000	18,218,000	2,341,000	1,278
2014	17,594,000	11,187,000	3,221,000	979
2015	18,757,000	10,510,000	4,425,000	864
2016	19,049,000	6,831,000	6,170,000	920
2017	15,609,000	1,770,000	9,381,000	892
	<u>\$ 232,584,000</u>	<u>\$ 162,837,000</u>		

The following reconciles the above cumulative incurred and paid data to the liability for unpaid losses and loss adjustment expenses as of December 31:

	<u>2017</u>
Cumulative incurred losses and ALAE	\$ 232,584,000
Less cumulative paid losses and ALAE	<u>(162,837,000)</u>
Unpaid losses and ALAE 2010 to 2017	69,747,000
Unpaid losses and ALAE prior to 2010	2,528,000
Unpaid ULAE	<u>2,805,000</u>
Total unpaid losses and LAE, net	75,081,000
Reinsurance recoverable	<u>9,095,000</u>
Total unpaid losses and LAE	<u>\$ 84,176,000</u>

The Company's practice is to estimate ultimate incurred losses and loss adjustment expenses. Case-basis incurred amounts have been subtracted from ultimate losses and loss adjustment expenses in order to derive the amount of incurred but not reported liabilities including expected development.

The Company determines the number of reported claims on the basis of claimants regardless of the number of loss events. Claims that are closed without the payments of loss or allocated loss adjustment expenses are excluded from determining of the number of reported claims.

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

## Notes to Financial Statements (Continued) December 31, 2017 and 2016

### 10. Federal Income Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax asset at December 31 are as follow:

	2017	2016
Deferred tax asset:		
Discounting of unpaid losses	\$ 3,724,314	\$ 4,246,564
Unearned premium reserve	654,408	499,045
Policy deposit	206,127	189,316
Net operating loss	1,998,925	4,221,457
Unrealized loss on investments	79,789	-
Other	298,583	160,053
Total deferred tax asset	6,962,146	9,316,435
Less valuation allowance	-	(3,251,205)
Deferred tax asset, net	6,962,146	6,065,230
Deferred tax asset liability:		
Unrealized gains on investments	-	(51,737)
Depreciation	(246,987)	(246,987)
Other	(523,188)	(399,835)
Total deferred tax liability	(770,175)	(698,559)
Deferred tax asset, net	\$ 6,191,971	\$ 5,366,671

The Company has a net operating loss of approximately \$5,900,000 which expires beginning in 2030.

The provision for income taxes consists of the following components:

	2017	2016
Current	\$ 125,807	\$ 68,029
Deferred	(693,774)	(4,840,521)
Income tax expense	\$ (567,967)	\$ (4,772,492)

For 2017 and 2016, the change in the valuation allowance is the most significant reconciling difference between the provision for income tax expense and the amount that would result from applying the domestic federal statutory rate of 34%.

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

## 11. Regulation and Risk-Based Capital

All insurance companies are subject to insurance laws and regulations established by the states in which they transact business. The laws of the various states establish supervisory agencies with broad administrative and supervisory powers related to granting and revoking licenses to transact business, regulating trade practices, establishing guaranty associations, licensing agents, approving policy forms, filing premium rates and setting reserve requirements for certain lines of business, determining the form and content of required regulatory financial statements, conducting periodic examinations of insurers' records, determining the reasonableness and adequacy of capital and surplus, and prescribing the maximum concentrations of certain classes of investments. Most states have also enacted legislation that regulates insurance holding company systems, including acquisitions, extraordinary dividends, the terms of affiliate transactions and other related matters. The Company and certain other affiliates have registered as a holding company system pursuant to such legislation in California and routinely report to other jurisdictions. It is not possible to predict the future impact of changing state and federal regulation on the operations of the Company and its insurance subsidiary.

Insurers are required to maintain certain levels of capital based upon the NAIC's Risk-Based Capital (RBC) formula. Under this formula, insurers' minimum capital and surplus is determined based on an insurer's asset, credit, premium, and reserve risk. Insurance companies are required to report their RBC ratios based on their most recent annual statement. At December 31, 2017, the Company maintained capital and surplus in excess of RBC regulations.

## 12. Statutory Net Income and Shareholder's Equity

Accounting principles generally accepted in the United States of America (GAAP) differ in certain respects from the accounting practices prescribed or permitted by insurance regulatory authorities (statutory basis), which are primarily intended to demonstrate solvency. A reconciliation of net income and shareholder's equity as determined in accordance with GAAP to statutory amounts reported to regulatory authorities as of December 31 is as follows:

	2017		2016	
	Net Income	Shareholder's Equity	Net Loss	Shareholder's Equity
GAAP basis	\$ 8,575,218	\$ 25,228,349	\$ 8,061,024	\$ 16,908,396
Investments, net of tax	-	234,622	-	(152,167)
Nonadmitted assets	-	(1,748,453)	-	(5,150,668)
Deferred acquisition costs	(362,803)	(1,538,789)	(14,716)	(1,175,986)
Allowance for doubtful accounts	32,887	104,752	(151,761)	71,865
Income taxes	(693,774)	(1,444,532)	(4,840,521)	1,831,480
Contributed property	(115,470)	5,669,621	(71,208)	5,785,089
Statutory basis	<u>\$ 7,436,058</u>	<u>\$ 26,505,570</u>	<u>\$ 2,982,818</u>	<u>\$ 18,118,009</u>

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

## 13. Statutory Net Income and Shareholder's Equity (Continued)

The Company's ability to pay dividends is restricted by the California Insurance Code and requires prior notification of the DOI. Amounts that may be paid as dividends on a non-cumulative basis generally must be paid from statutory basis retained earnings exclusive of unrealized gains. The payment of "extraordinary" dividends must be approved in advance by the DOI. A dividend is deemed "extraordinary" if, when aggregated with all other dividends paid within the preceding 12 months, the dividend exceeds the greater of (a) the Company's statutory net income for the preceding year or (b) 10% of surplus as regards policyholders as of the preceding December 31. The DOI may disallow the payment of any dividend if, in the opinion of the DOI, the payment would in any way violate DOI regulations or be hazardous to policyholders, creditors, or the public.

## 14. Commitments and Contingencies

The Company leases certain software and equipment under operating leases with a remaining noncancelable lease terms expiring in 2020. Rental expense for 2017 and 2016 were \$63,379 and \$65,638, respectively. Future commitments as of December 31, 2017 are as follows:

Year ending December 31:

2018	\$ 24,370
2019	18,565
2020	2,552
Thereafter	-

## 15. Concentrations of Risk

The Company maintains cash at financial institutions which at time are in excess of Federal Deposit Insurance Corporation limits. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risk on its cash in bank deposit accounts.

## 16. Related Party Transactions

The Company and its affiliates are directly or indirectly under common ownership and management control. The existence of this control could result in operating results or financial position being significantly different from those that would have resulted if the Company were autonomous.

In addition to transactions described elsewhere in these notes to statutory financial statements, the following related party activity exists:

- In both 2017 and 2016 about 1.00% of the Company's direct policies were written for subsidiaries of the Parent and other affiliated companies.

# ACCOUNTANTS' MUTUAL INSURANCE COMPANY

Notes to Financial Statements (Continued)  
December 31, 2017 and 2016

## 17. Defined Contribution Plan

The Company adopted a matching 401(k) plan in which the Company matched 50% of the first 3% of gross wages of employee contributions for a maximum of 1.5% matching. The Company recognized expense of \$19,271 and \$22,068 related to the plan in 2017 and 2016, respectively.

## 18. Subsequent Events

Management has evaluated subsequent events through May 5, 2018, which is the date the financial statements were available to be issued. Other than as disclosed above, no events have occurred subsequent to December 31, 2017 requiring recording or disclosure in these financial statements.

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**SUPPLEMENTARY INFORMATION**

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**ACCOUNTANTS' MUTUAL INSURANCE COMPANY**  
 Loss and Allocated Loss Adjustment Expenses Development Data  
 December 31, 2017

Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance  
 (in thousands)

Accident Year	2010	2011	2012	2011	2012	2013	2014	2015	2016	2017
2008	\$ 10,438	\$ 9,937	\$ 9,570	\$ 9,261	\$ 9,099	\$ 8,930	\$ 8,870	\$ 8,921	\$ 9,710	\$ 9,350
2009		15,952	16,100	15,510	15,277	15,127	15,320	16,550	16,586	16,696
2010			32,599	31,601	33,258	33,700	35,600	36,759	37,139	37,850
2011				41,900	42,200	44,701	46,001	46,560	46,481	46,889
2012					25,494	24,978	28,073	27,289	27,290	26,590
2013						23,976	26,400	24,699	24,800	24,200
2014							20,575	19,177	17,637	17,594
2015								19,922	19,336	18,757
2016									20,958	19,049
2017										15,609
										<u>\$ 232,584</u>

Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance  
 (in thousands)

Accident Year	2010	2011	2012	2011	2012	2013	2014	2015	2016	2017
2008	\$ 1,053	\$ 3,288	\$ 5,133	\$ 6,255	\$ 6,872	\$ 7,408	\$ 7,763	\$ 7,970	\$ 8,276	\$ 8,331
2009		2,484	6,188	8,741	10,444	11,500	12,574	13,128	13,603	14,042
2010			4,295	11,518	18,001	23,333	26,847	28,794	29,981	31,635
2011				6,159	15,956	25,639	31,402	34,349	36,926	38,813
2012					3,742	9,971	14,964	18,139	19,992	21,500
2013						3,236	9,230	13,255	16,477	18,218
2014							2,550	6,920	9,660	11,187
2015								2,384	6,690	10,510
2016									2,418	6,831
2017										1,770
										<u>\$ 162,837</u>

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance

Years	1	2	3	4	5	6	7	8	9	10
Professional Liability	12.9%	22.8%	18.0%	11.8%	7.1%	5.7%	3.6%	3.1%	3.0%	0.6%



