



## **Annual Report & Financial Statements**

**31 December 2015**

## **ANNUAL REPORT & FINANCIAL STATEMENTS 2015**

<b>CONTENTS</b>	<b>Page</b>
Board and Professional Staff	2
Chairman's Statement	5
Strategic Report	7
Corporate Governance Review	9
Directors' Report	17
Directors' Responsibilities Statement	19
Independent Auditor's Report	20
Statement of Income and Retained Earnings	26
Balance Sheet	27
Cash Flow Statement	28
Notes to the Financial Statements	29

## BOARD AND PROFESSIONAL STAFF

### BOARD OF DIRECTORS

#### Non-Executive Directors

C May MA VetMB CertSAO PhD MRCVS

Chairman

D H Black BVM&S DBR MRCVS

B M H Bussell BSc (Hons) FIA

T A Clegg FCII ACI Arb

N J Paull BVSc MRCVS

M J Pratt BA (Hons) FCA

C W Thomson BVM&S MBA MRCVS

Prof S E Wolfensohn OBE BSc MA VetMB FSB DipECLAM DipECAWBM-WSEL MRCVS

#### Executive Directors

N A Macfarlane CA

Chief Executive

A M Lewis BSc (Hons) ACII

Commercial Director

J A Wells BVSc MRCVS

Claims Director

D S Green BVSc CertEP MRCVS

Veterinary Risk Director

D G Lloyd BSc (Hons) ACA

Finance Director

#### General Counsel & Company Secretary

C M Gannon LL.B (Hons)

### BOARD COMMITTEES

#### Audit and Risk Committee

M J Pratt

Chairman

D H Black

C W Thomson

#### Remuneration Committee

T A Clegg

Chairman

N J Paull

Prof S E Wolfensohn

#### Nominations Committee

C May

Chairman

D H Black

N A Macfarlane

M J Pratt

N J Paull

## **BOARD AND PROFESSIONAL STAFF (continued)**

### **OPERATIONAL DIRECTORS**

J D McKeown BVMS Cert SHP MRCVS

F J McKeating BVMS FRCVS

C M Magrath BVMS Hon FRCVS

Director of Member Services

Director of Technical Services

Director of Communications Training

### **CLAIMS CONSULTANTS**

S R Ellis BVSc CertVOphthal MRCVS

O M Hosegood BVSc MRCVS

C E Latham MA VetMB CertVR MRCVS

C Padgett BVMS CertCHP MRCVS

N J A Perkins BVSc CertCHP MRCVS

T J Phillips BVetMed CertEP CertEO DESTS MRCVS

Dr J F Pycock BVetMed DESM PhD MRCVS

N M Saunders BSc BVetMed MRCVS

M D Stanford BVSc FRCVS

C A Wright BVSc CertSAS CertVR MRCVS

J R Oliver BVSc MRCVS

### **VETERINARY CLAIMS ADVISERS**

R L McNeil BVetMed MRCVS

A M Grundy BVSc MRCVS

J E F Houlton MA VetMB DSAO DVR DipECVS MRCVS

J F R Hird BVSc MA DVA DipECVAA MRCA MRCVS

M G Jones BVetMed MRCVS

R S Tee BVSc CertVC MRCVS

K H Perry BVSc MRCVS

L G Morgan BVM&S MRCVS

E Drummond BVM&S MA LLM VN MRCVS

K E Moore BVSc BSC MRCVS

A D Buxton BVSc MRCVS

R T Green BVSc CertWEL MRCVS

**PROFESSIONAL ADVISERS**

**RE-INSURANCE BROKERS**

Capsicum Re

**INSURANCE BROKERS**

Arthur J Gallagher

**INVESTMENT MANAGERS**

Quilter Cheviot Asset Management  
Barclays Wealth Management

**INDEPENDENT AUDITORS**

PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditor

**INTERNAL AUDITOR**

BDO LLP  
Accountants and Business Advisers

**ACTUARIES**

Mazars LLP  
Consultancy and Actuarial Services

**SOLICITORS**

Hill Dickinson LLP  
A & L Goodbody  
Mason Hayes and Curran  
Hayes & Sons  
William Fry  
BLM  
Johns Elliot  
Sheridan & Leonard

**BANKERS**

The Royal Bank of Scotland plc  
Barclays Bank plc  
Close Brothers Limited  
Santander UK plc  
HSBC Bank plc

**REGISTERED OFFICE**

4 Haig Court  
Parkgate Estate  
Knutsford  
Cheshire  
WA16 8XZ  
Registered number: 2159441

## CHAIRMAN'S STATEMENT

I am pleased to present this annual statement as Chairman of the Board, following an exciting year at the Veterinary Defence Society in which we commenced a substantial strategic review to ensure that the Society continues to deliver optimum services to its members in the medium and long term. Many members contributed to that review in one form or another and I am grateful to all that did; it was a most useful and informative exercise that will help to shape the Society in coming years.

At an operational level, the number of notifications of a claim from members continues to be outstripped more than tenfold by requests for telephone advice each year. Modern veterinary life can unavoidably result in a work environment in which veterinary surgeons have fewer experienced colleagues immediately available to call on for wisdom and advice. This working environment makes the advice call service, exclusively available to members of the Society, a major benefit to the member and the practice. The Society is uniquely placed amongst insurance companies in its ability to respond and even encourage such telephone requests for advice from members and as a result it is often able to avert a crisis almost before it happens. This helps to ensure that only a minority of requests for advice subsequently develop into a notification of a claim of professional negligence or misconduct. This is good for the Society in controlling costs and good for the reputation of the profession as a whole, but perhaps most importantly it is excellent for members in mitigating the stress that accusations of negligence or misconduct can bring.

In addition to our highly experienced Claims Consultants, we have a team of Claims Advisers and other professionals who together provide a whole methodology aimed at minimising professional risk for members of the Society. Strong communications both within the Society and between the Society and the wider veterinary profession position the Society uniquely in its ability to forecast and manage new areas of veterinary professional risk as they develop. This ensures that the Society not only has an unsurpassed understanding of the issues that traditionally trouble veterinary surgeons in their professional lives, it is also the leading veterinary body for future proofing veterinary professional risk management.

The Society must also have the resources it needs to defend members when a claim of negligence is made. The appropriate management of the mutual funds of the Society which form the bedrock for this resource is, quite rightly, a matter of tight regulatory control. As a mutual insurance Society, it is incumbent upon the Society to maintain sufficient financial resource to meet even the most extreme of possible needs that might be placed upon it. To this end, the financial resource of the Society is constantly reviewed and tested by the Board of Directors ("the Board"). The output of this assessment forms the basis for the Society's "Own Risk and Solvency Assessment" report to the Prudential Regulation Authority in compliance with the requirements of the European Solvency II Directive in the UK which came into force on 1 January 2016. Similarly, the standards of conduct of the Society are monitored by the Financial Conduct Authority and the Society's ability to meet the standards required is a continuous matter for the Board and the subject of a formal annual review. In this regard, the Board has a particular focus in ensuring its members are treated fairly. This regulatory environment, though substantial, sets appropriate standards and a framework which the Board is proud to meet year on year.

This year has seen major change at Board level, particularly in the Executive Committee. This is part of the Board's long term strategic succession plans to ensure that the Executive Committee maintains and expands the skill sets it needs to take the Veterinary Defence Society Limited ("VDS") into its next phase of development. Bill Mavir retired from his position as Chairman of Executive at the last AGM after many years of sterling service to the Society. Bill was a moderniser of the Society and it was in no small part due to his foresight and energy that the VDS Executive made such a successful transition into the dual regulated environment. Fred McKeating and David McKeown also stepped down from their Director roles this year to focus on the highly successful contributions they make to the operational aspects of technical and member services. Many of you will know Fred and David as they are at the vanguard of the interface of the VDS with its members. They bring immense experience and wisdom to their roles and epitomise the ethos of the VDS in everything they do.

New appointments to the Executive Committee include David Green who was appointed as Veterinary Risk Director and Anthony Lewis as Commercial Director. Gareth Lloyd was promoted from Financial Controller to Finance Director to allow the CEO, Norman Macfarlane, to take on some of the duties previously fulfilled by Bill Mavir. The restructured Executive is extremely well placed to continue to develop the governance of the Society in line with all current and foreseeable regulatory requirements as well as being a superb team to develop the outputs from this year's strategic review.

The VDS Board still maintains a majority of veterinary surgeons, but is now strengthened enormously by the expertise of a diverse range of individuals that constitute the Board and I would like to thank all of them for their ongoing teamwork and dedication to the membership.

**CHAIRMAN'S STATEMENT (continued)**

Finally, as always, I want to thank you, the members of the Society for your continued annual donations to the UK and Irish Veterinary Benevolent Funds through a gratuity at the time of your policy renewal and by returning proxy forms at the AGM. Your donations during the 2016 renewal exceeded £52,000 for the immensely valuable work of these organisations the help of which, but for serendipity, any of us might need.

2016 will no doubt prove to be another busy year for the Society. This, however, is a farewell year for me as I am scheduled to step down from the Board at the AGM in July. Nicky Paull is our very able Chairperson elect and she takes over the reins when I go. I have thoroughly enjoyed my time at the VDS, which has been one of constant and exciting change and challenge. I have no doubt that change in the veterinary profession is set to continue apace, but I leave the leadership of the Society in the absolute and confident knowledge that it is in excellent and enthusiastic hands, with a solid strategy in place to ensure the highest calibre of its services to members for many years.

Knowing the Society is so well positioned, makes it feel like a good time to go. Adieu.

**Chris May**

**Dr C May**

**Chairman of the Board**

**9 March 2016**

## STRATEGIC REPORT

### Principal Activity

The principal activity of the Veterinary Defence Society Limited (“the Society”) is the provision of professional indemnity insurance to veterinary surgeons in the United Kingdom and the Republic of Ireland, against claims arising from allegations of professional negligence and costs of disciplinary and criminal proceedings.

### Business Review

2015 was another successful year for the Society and the Chairman’s Statement on pages 6 and 7 provides a review of some of the Society’s key activities.

Gross premiums written amounted to £10,933,518, an increase of £98,241 on the previous year (2014: £10,835,277).

The Society has introduced a return of premium (called the “Mutual Bonus”) for 2015. This enables the Society to distribute a share of surplus in years when there is a positive insurance result. The Society is in a position to do this as a result of its ongoing development of accurate risk based underwriting and pricing, proactive risk management and a prudent finance and investment strategy. It is envisaged that this will be an annual distribution starting with a return of premium of £650,000 which is equivalent to approximately 5.9% of 2015 gross written premium.

The costs of claims incurred net of reinsurance was £3,094,063, a decrease of 21% on the previous year (2014: £3,899,088). During the year the Society recorded a positive run-off deviation on prior years’ case reserves of £485,042.

Gross claims paid during the year increased from the previous year as a result of the conclusion of a small number of large claims. Claims costs and gross provisions are the main uncertainty in the business and by continually monitoring our reserves, including the frequency of large claims, we hope to reduce the impact of uncertainty in future years.

The Society remains in a strong financial position with almost £27 million of other financial investments at the year-end. These financial investments underpin both the technical insurance reserves and the retained reserves, and provide the Society with an excellent foundation from which to deliver its strategy.

The Key Performance Indicators used were as follows:

Gross written Premiums before Return of Premium	£10,933,518
Return of Premium	£650,000
Balance on Technical Account	£1,679,449
Surplus after Tax	£983,187
Net decrease in cash at bank	£19,544,599
Net cash used in investing activities	£18,023,241
Combined Ratio	89%
Employee retention	90%

**Note:** The Combined Ratio is calculated as Claims incurred net of reinsurance plus Net operating expenses as a percentage of Net premiums written net of reinsurance. Employee retention is the number of employees employed at the year-end expressed as a percentage of the number employed at the beginning of the year.

### Business Model

The Society’s business model is based on a stable business strategy and risk profile with the primary aim of providing members with professional indemnity insurance cover priced to reflect veterinary risk and to meet the changing needs of the profession. As detailed in the Corporate Governance Review, the Board meets regularly to ensure that strategy is set within the context of the Society’s risk appetite which, in turn, is reviewed throughout the year as part of the Society’s Own Risk and Solvency Assessment (ORSA).

### Financial Risk Management

The Society is exposed to financial risk through its financial assets, reinsurance assets and policyholder liabilities. In particular one of the key financial risks is that proceeds from, or the valuation of, financial assets are not sufficient to fund the obligations arising from policies as they fall due.

Our main aim is to minimise risk to the Society’s funds, and our policies towards investment, reinsurance and cash deposits reflect this aim. Our control over these three areas plus close control over premium income and claims costs ensures a sound financial base for the Society’s activities.



## **STRATEGIC REPORT (continued)**

### **Credit Risk**

The Society's principal financial assets are investments, deposits with credit institutions and bank balances. During the financial year the Society invested an additional £15 million into debts securities, shares and other variable-yield securities and units in unit trusts in line with its updated investment strategy. The Society has a policy of spreading its exposure over a large number of counterparties in order to avoid any significant concentration of credit risk.

There is also potential exposure to reinsurance credit risk. The Society has a policy of using reinsurance organisations with a minimum credit rating of A.

The Society is also exposed to foreign exchange risk. The principal method of matching this is predominantly by matching currency assets and liabilities rather than by the use of any derivative instruments.

### **Principal Risks and Uncertainties**

In conducting its business, the Society faces a range of risks and these are fully discussed in the Society's ORSA. The most significant risk exposures continue to be loss of market share, loss of reputation, exposure to major losses, insufficient reserves and deterioration of the claims ratio.

The Board closely monitors the volume of claims notified and the value of those claims particularly so as, in recent years, there has been an increasing trend by regulators of the veterinary profession to pursue matters of professional misconduct. The Board acquires reinsurance protection to reduce the impact on the Society's capital position of a number of significant claims arising in any one period. The reinsurance requirements of the Society are reviewed annually. Further, in the event that the Society sees a trend of an increasing volumes and values of claims, the Board would consider whether the current premium levels are appropriate.

The Board consider that a potential reduction in the number of policyholders is mitigated by the quality of the service the Society provides, especially in respect of the advice provided by our Claims Consultants and our growing team of Claims Advisers. In addition, the Society is actively engaged in structured consultation with its members and the wider profession in ensuring that its services continue to be of value and relevance.

### **Business Environment**

The Society operates in an environment which is characterised by continuing changes in the veterinary profession. This includes increasing corporatisation, changing demographics and a burgeoning demand for the Society's veterinary advice services. Added to these are the Society's increasing costs associated in complying with new regulatory requirements, particularly those related to the European Solvency II Directive. Responding to each and all of these challenges is undertaken by the Board and senior management in the best interests of the Society and its members. In addition, from 1 November 2015 the Society was required to charge 9.5% Insurance Premium Tax on UK premiums; an increase of 3.5%. This change will have increased premiums for many of the Society's policyholders.

### **Business Plan and Future Activities**

The Society's business strategy has been under review during 2015 and will continue to be developed in 2016. The Board is satisfied that the level of Gross Written Premium for 2015 is in line with the current business plan and the Society will, over the next three years, continue to steadily grow its member base and strive to develop further, innovative ways in which it can serve its members.

### **Approved by the Board and signed on behalf of the Board**

**N A Macfarlane**  
**Chief Executive**  
**9 March 2016**

## **CORPORATE GOVERNANCE REVIEW**

The Society is committed to good practice in corporate governance and as part of that commitment joined the Association of Financial Mutuals ("AFM") in 2011. In April 2015 the AFM issued an annotated version of the 2014 UK Corporate Governance Code ("the Code") produced by the Financial Reporting Council. This report explains how the Society applies the principles of the Code.

Whilst the Society is not required to comply with the Code, as it is not a listed company, the recommendations have been adopted where they are appropriate and proportionate.

### **The Board**

*Code principle A.1: Every Company should be headed by an effective board, which is collectively responsible for the long term success of the Company.*

The principle functions of the Board are the determination of the Society's strategic direction (including its key financial objectives), the review of business and financial performance and ensuring effective systems and controls are in place for risk management. During 2015 the Board undertook a strategic review and will continue to develop strategic plans in 2016.

The Board meets every two months, with a two day Board meeting being held each May to allow time for detailed strategic planning and review of policies.

There is a formal schedule of matters reserved for the Board and the Board has full and timely access to all relevant information to enable it discharge its duties effectively.

The Non-Executive Directors meet without the Executive Directors present at least once a year.

The Board conducts an annual self-assessment exercise to review its effectiveness and highlight any areas which should be improved.

In addition, the Board has established three committees to consider specific areas in more detail than would be possible within Board meetings. Each of the Board committees has Board approved terms of reference, which are published on the Society's website. The composition of each committee is reviewed in July each year by the Chairman and any changes are approved by the Board.

The Board receives recommendations from the committees and the minutes of the committee meetings are provided to the Board. The Board also receives a monthly report from the Executive Committee.

### **Audit and Risk Committee**

The committee consists of its chairman, Non-Executive Director, Michael Pratt, a chartered accountant and two other Non-Executive Directors, David Black and Colin Thomson.

This committee monitors internal controls, financial reporting, risk management and regulatory compliance matters. It reviews the work of the Internal Audit, Compliance and Risk Management functions and assesses their effectiveness. It considers and makes a recommendation for the appointment of the external auditor, and reviews and monitors the external auditor's independence, objectivity and the effectiveness of the audit process. It also has responsibility for ensuring that effective whistle-blowing arrangements are in place, which enable any concerns to be raised by employees in confidence. A separate report on the work of the Audit and Risk Committee is provided below.

The Chief Executive Officer, General Counsel and Company Secretary, Financial Controller and representatives from the internal and external auditors also attend committee meetings, by invitation, to assist in its deliberations. Other members of the management team attend as required.

## CORPORATE GOVERNANCE REVIEW (continued)

### Remuneration Committee

The committee consists of its chairman, Non-Executive Director, Trevor Clegg and two other Non-Executive Directors, Sarah Wolfensohn and Nicky Paull. The Committee's main role is to determine and agree with the Board the Society's Remuneration Policy for the Chairman of the Board, Executive Directors and senior management.

### Nominations Committee

This consists of its Chairman, Dr Chris May (who is also Non-Executive Chairman of the Board) and Non-Executive Directors, Michael Pratt, Nicky Paull and David Black. The Society's Chief Executive Officer, Norman Macfarlane, is also a member of the Nominations Committee. The Committee is responsible for making recommendations to the Board on matters relating to the composition of the Board, including Board and Executive succession planning, the appointment of new directors and the election and re-election of directors. The Society operates an Equal Opportunities and Diversity Policy. Two of the Society's Non-Executive Directors are female.

### Directors' attendance at Board and Committee meetings during year ending 31 December 2015

(The figure after the forward slash indicates the number of meetings that the director was eligible to attend during the year)

Director	Board	Remuneration	Nominations	Audit and Risk
C May	6/6		6/6	
G Berville	2/4 <sup>1</sup>	1/3 <sup>2</sup>		
D H Black	6/6		5/6	2/4
T A Clegg	6/6	3/3		
N A Macfarlane	5/6		5/6	
F J McKeating	4/4 <sup>3</sup>			
J D McKeown	4/4 <sup>4</sup>			
W B Mavir	4/4 <sup>5</sup>		4/6 <sup>6</sup>	
N J Paull	5/6	3/3	3/6 <sup>7</sup>	
M J Pratt	5/6		6/6	4/4
C W Thomson	6/6	2/3 <sup>8</sup>		4/4
J A Wells	6/6			
S E Wolfensohn	6/6	1/3 <sup>9</sup>		3/4 <sup>10</sup>

1 Resigned Board 29 July 2015

2 Resigned Remuneration Committee 29 July 2015

3 Retired Board 14 August 2015

4 Retired Board 29 July 2015

5 Retired Board 29 July 2015

6 Retired Nominations Committee 29 July 2015

7 Joined Nominations Committee 30 July 2015

8 Retired Remuneration Committee 30 July 2015

9 Joined Remuneration Committee 30 July 2015

10 Retired Audit and Risk 30 July 2015

## **CORPORATE GOVERNANCE REVIEW (continued)**

### **Division of Responsibilities**

*Code Principle A.2: There should be clear division of responsibilities at the head of the Company between the running of the board and the executive responsibility for the running of the Company's business. No one individual should have unfettered powers of decision.*

The roles of Chairman and Chief Executive Officer are held by different individuals, with a clear division of responsibilities. The Chairman, who is a Non-Executive Director, is responsible for leading the Board and ensuring it acts effectively. The Chief Executive Officer, who is an Executive Director, has responsibility for managing the Society and for the implementation of strategies and policies agreed by the Board.

### **The Chairman**

*Code Principle A.3: The Chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.*

The Chairman sets the direction of the Board and promotes a culture of openness and debate by facilitating the effective contribution of Non-Executive Directors and maintaining constructive relations between Executive and Non-Executive Directors. The Chairman also ensures that Directors receive accurate, timely and clear information.

### **Non-Executive Directors**

*Code Principle A.4: As part of their role as members of a unitary board, Non-Executive Directors should constructively challenge and help develop proposals on strategy.*

The Non-Executive Directors of the Society are drawn from a wide range of backgrounds to provide the appropriate skills, knowledge and experience to ensure a robust level of challenge and debate. The role requires an understanding of the risks in a financial services business, commercial leadership within a framework of prudent and effective risk management controls and the ability to monitor performance and resources while providing support to executive management in developing the Society.

### **The Composition of the Board**

*Code Principle B.1: The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the Company to enable them to discharge their respective duties and responsibilities effectively.*

*Where mutual insurers have significant numbers of members with common interests, through geographic location, occupation or otherwise, this might also be considered in determining the appropriate balance for the Board and its committees.*

As at 31 December 2015 the Board consists of four Executive and seven Non-Executive Directors. A further non veterinary, Non-Executive Director has been appointed by the Board. The Financial Controller will also join the Board in 2016 as Finance Director. Both appointments are subject to regulatory approval and election by the members at the next AGM.

With the exception of the Chairman of the Board, who was re-elected to office by Special Resolution of the members at the Annual General Meeting 2014 for a period of two years to conclude at the Annual General Meeting 2016, all of the Non-Executive Directors have served for less than nine years. All the directors can be defined as independent under the Code.

In the view of the Board, all the Non-Executive Directors are independent in character and judgement and can bring wide and varied commercial experience to Board deliberations.

Michael Pratt is the Senior Independent Director. He is available to members if they have concerns which they either have been unable to resolve, or feel cannot be resolved by contact through the normal channels of the Chairman of the Board or the Executive Directors.

## **CORPORATE GOVERNANCE REVIEW (continued)**

### **Appointment to the Board**

*Code Principle B.2: There should be a formal, rigorous and transparent procedure for appointment of new directors to the board.*

The Nominations Committee leads the process for Board appointments and makes recommendations to the Board. The Board approves and maintains a Board Composition and Succession Plan. Candidates are identified in a number of ways, which include external search consultants, with appointments to the Board made on merit and against objective criteria and in line with the requirements of the succession plan. All Directors must meet and maintain the fitness and propriety standards of the Prudential Regulation Authority and Financial Conduct Authority and must be approved by them in order to hold the controlled functions of Director or Non-Executive Director. They are also subject to election by members at the AGM following their appointment.

All Board and senior management appointments are subject to the new regulatory requirements of the Senior Insurance Managers Regime from March 2016 and Solvency II governance requirements from 1 January 2016.

### **Commitment**

*Code Principle B.3: All directors should be able to allocate sufficient time to the Company to discharge their responsibilities effectively.*

The Nominations Committee evaluates the ability of Directors to commit the time required for their role prior to appointment. The formal appraisal process carried out by the Chairman of the Board each year also assesses whether Non-Executive Directors have demonstrated this ability during the year.

### **Development**

*Code Principle B.4: All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.*

On appointment, Directors are provided with a structured induction programme tailored to their individual needs. To ensure their skills remain updated, Directors attend conferences and seminars. Training and development needs are identified as part of the annual appraisal of Directors and in-house training is provided to the Board throughout the year by the Society's external advisers.

### **Information and Support**

*Code Principle B.5: The board should be supplied in a timely manner with information in a form and a quality appropriate to enable it to discharge its duties.*

The Chairman of the Board ensures the Board receives sufficient, accurate, timely and clear information to enable it to fulfil its responsibilities. The Directors have access to the advice and services of the General Counsel and Company Secretary and, if necessary, they are able to take independent professional advice at the Society's expense.

### **Performance Evaluation**

*Code Principle B.6: The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.*

The Society has a process to evaluate, annually, the performance and effectiveness of individual Directors, the Chairman of the Board, the Board and Board committees. The performance of the Non-Executive Directors is evaluated annually by the Chairman of the Board. The Chairman of the Board is evaluated by the Senior Independent Director, after consulting and obtaining the views of the other directors. The Chief Executive Officer is evaluated by the Chairman of the Board and it was the responsibility of the Chairman of Executive to evaluate the other Executive Directors. Non-Executive Directors who have served more than six years on the Board are subject to a particularly rigorous performance evaluation in line with the Code's requirements.

The Board and the Board committees also annually evaluate their overall performance. Annually, the membership and terms of reference of the Board committees are reviewed and agreed by the Board.

## **CORPORATE GOVERNANCE REVIEW (continued)**

### **Re-election**

*Code Principle B.7: All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The board should ensure planned and progressive refreshing of the board.*

The Board seeks to ensure planned and progressive refreshing of its membership. All Directors are subject to election by members at the Annual General Meeting following their appointment.

The Board does not require the Executive Directors to offer themselves for re-election. It is a requirement of the Society's Articles of Association that the majority of Board directors are also veterinary surgeons. It is the view of the Board that regular re-election of Executive Directors would interfere with efforts to promote stability and continuity. The Board annually reviews its decision on this aspect of the Code.

On expiry of their terms of office, Non-Executive Directors are submitted for re-election. Non-Executive Directors serving over nine years will be subject to re-election annually.

### **Financial and Business Reporting**

*Code Principle C.1: The board should present a fair, balanced and understandable assessment of the Company's position and prospects.*

The Statement of Directors' Responsibilities sets out the Board's responsibilities in relation to the preparation of the Annual Report and Financial Statements. Business performance is reviewed in the Chairman's Statement.

The Strategic Report provides a review of the Society's business during the year together with an explanation of its principal risks and how they are managed, including a review of financial risk management. The report also includes further information on the Society's business model.

### **Risk Management and Internal Control**

*Code Principle C.2: The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.*

The Board has delegated responsibility for overseeing the Society's risk management to the Audit and Risk Committee. The Internal Audit function provides independent assurance to the Board on the effectiveness of the systems of internal control through their reporting to and attendance at the Audit and Risk Committee.

The information received and considered by the Committee provided assurance that during the financial year there were no material breaches of control or regulatory standards. Further information on the Society's approach to risk management is included in the Strategic Report.

### **Audit Committee and Auditors**

*Code Principle C.3: The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the Company's auditors.*

The role and membership of the Audit and Risk Committee is set out earlier in this report.

The committee meets at least three times a year. At least annually, the external auditors meet with the committee without the Executive Directors present. Minutes of the committee's meetings are provided to the subsequent Board Meeting.

The committee oversees the Society's relationship with its external auditors, including (but not limited to) approving the scope of the external audit plan, reviewing the external audit report and approving external audit fees in advance.

## **CORPORATE GOVERNANCE REVIEW (continued)**

### **Remuneration**

*Code Principle D.1: Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the Company successfully, but a Company should avoid paying more than is necessary for this purpose. A significant proportion of Executive Directors' remuneration should be structured so as to link rewards to corporate and individual performance.*

*Code Principle D.2: There should be a formal and transparent procedure for developing policy on Executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.*

The Society's Remuneration Committee is responsible for recommending the remuneration of the Executive Directors, Chairman of the Board, and senior management in accordance with the Society's Remuneration Policy. The committee adopts a rigorous approach to determining appropriate levels of remuneration and takes external independent advice from Croners Reward before recommending remuneration which it considers necessary to attract, retain, and motivate directors and employees of the right calibre. Executive Directors' remuneration is not currently linked to corporate or individual performance as this is not consistent with the Society's business model. No Executive Director or Senior Manager has an employment contract with a notice period in excess of 26 weeks.

### **Dialogue with members**

*Code Principle E.1: There should be dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that satisfactory dialogue with shareholders.*

As a mutual organisation, the Society has members rather than shareholders. The Society seeks the views of its members in a variety of ways, including feedback provided directly to veterinary Executive Directors throughout the year at conferences and seminars. A Veterinary Advisory Committee comprising veterinary members who are not employed by the Society meets regularly throughout the year and provides input to the Veterinary Risk Director and Director of Technical Services on developments in the profession. Non-Executive Directors attend meetings of the Veterinary Advisory Committee and Claims Group by rotation throughout the year. The Society operates a successful Communications Training Programme which maintains strong and effective links with all members of the veterinary profession.

Members are invited to attend the AGM, where they can ask questions and voice their opinions. During 2015, as part of its strategic review, the Society engaged a global strategy consulting firm, L.E.K. Consulting LLP, who undertook an extensive information gathering exercise with a large number of the Society's members.

In 2015, the Society provided its members with an Annual Review, summarising the Society's Annual Report and Financial Statements 2014.

### **Constructive Use of the Annual General Meeting**

*Code Principle E.2: The Board should use the AGM to communicate with investors and to encourage their participation.*

Each year the Society sends details of the AGM and proxy voting forms to all members who are eligible to vote. The Society makes a small donation to veterinary charities for each proxy vote returned.

All members of the Board are present at the AGM each year unless there are exceptional circumstances. The Chairs of the Board and of its committees are available to answer questions.

## **CORPORATE GOVERNANCE REVIEW (continued)**

### **Audit and Risk Committee Report**

The Committee met four times during 2015.

The role of the committee is to assist the Board in discharging its responsibilities for financial reporting, corporate governance, internal controls, internal and external audit and risk management. In fulfilling its role, the committee took a number of steps to ensure that it could, where necessary, make recommendations to the Board following the output of the internal and external audit functions and the committee reported to the Board throughout the year on their respective reports. In doing so, the committee was able to assure the Board of the effectiveness of the Society's audit programme and of the independence and objectivity of the internal and external auditors. In April 2015, the committee undertook a formal process to enable large accountancy firms to tender for the Society's external audit work. The review concluded with a recommendation from the committee that PricewaterhouseCoopers LLP be appointed the Society's new external auditors with effect from 29 July 2015.

During 2015 the committee concentrated on a number of important areas which were likely to impact on the Society's Corporate Strategy. The committee commissioned an internal audit review of underwriting and policy processing, in order to be able to satisfy itself, the Board, members of the Society and key stakeholders that the Practice Insurance project continued to be managed effectively. The committee was pleased to receive a report from the internal auditors that the Society's processes substantially met their expectations.

In addition, the committee oversaw a number of internal audit reports which were prepared in furtherance of the agreed three year internal audit plan. Internal auditors reviewed the Society's Data Protection arrangements, preparedness for the new Senior Insurance Managers' Regime and for Compliance Monitoring. The committee were pleased to be assured that arrangements substantially met the expectations of the internal auditors. Where enhancement opportunities were identified, the committee was able to monitor progress throughout the year and report accordingly to the Board. The result of an internal audit review of IT and Change Management will be known during the first quarter of 2016.

In November 2015 the Board approved the Society's second Own Risk and Solvency Assessment ("ORSA") report in accordance with the requirement of Solvency II. The report and policy, which were submitted to the Prudential Regulation Authority, were developed by Executive and the Board throughout the year, with input given by the committee prior to final Board approval. The ORSA ensures that the Society takes a forward looking approach to its solvency requirements bringing together business strategy, risk appetite and risk profile to help determine future capital requirement. The committee will continue to take an active part in the ORSA process in the future on an annual basis.

During 2015, the committee discharged its responsibilities by:

- Reviewing the Society's Annual Report and Financial Statements prior to Board approval and reviewing the external auditor's detailed reports thereon, in respect of the year ended 31 December 2014
- Reviewing the appropriateness of the Society's accounting policies
- Reviewing and approving the audit fee in conjunction with an assessment of external auditor performance
- On behalf of the Board, conducting a formal tendering process for the appointment of external auditors and making an appropriate recommendation to the Board
- Reviewing the external audit plan for the audit of the Society's financial statements, including an assessment of key risks and in advance of approving non-audit services, the committee requested from the external auditors their assessment of any threats to independence, which the committee reviewed and determined
- Reviewing the updated Annual Report and Financial Statements following the impact of assessment of FRS 102 and FRS 103
- Reviewing and approving a new three year internal audit plan with the internal auditors ensuring that the plan is properly tailored to address key functions of the business with a view to safeguarding the management of risk
- Discussing and monitoring progress on recommendations arising from regular reports from the internal auditors
- Assessing internal audit effectiveness by consideration of suggestions for improvement
- Reviewing the Executive Committee report on the Society's key risks, risk appetite and risk management, reporting to the Board on the results of the review



## CORPORATE GOVERNANCE REVIEW (continued)

### Audit and Risk Committee Report (continued)

- Reviewing the Society's policies relating to fraud, whistle-blowing and conflicts of interest
- Reviewing and overseeing the Society's Own Risk and Solvency Assessment in accordance with the requirements of Solvency II

### Key Issues

Financial reporting issues and judgements:

The committee's role in monitoring financial reporting issues is essential in ensuring that all of its stakeholders maintain their trust in its activities and reporting.

The committee uses PwC to help ensure that suitable accounting policies have been implemented and appropriate judgements have been made by management. The main issues which the Committee considered during 2015 were as follows:

- **Whether the actuarial claims projection techniques and assumptions made by the external actuaries in determining IBNR and IBNER reserves were appropriate.**  
The committee reviewed external reports in detail and compared them to internal reports to ensure consistency. They closely investigated any material variations and made appropriate enquiries to satisfy themselves that the approach was appropriate and reasonable.
- **The integrity of the process for valuing outstanding claims.**  
The committee carried out sufficient work to satisfy itself on the integrity of the process for valuing outstanding claims.
- **Whether the reinsurance recoveries have been correctly calculated.**  
The committee considered information on all claims where reinsurance cover or possible reinsurance cover was applicable. It satisfied itself that appropriate claims for reinsurance had been made and accepted by the Society's reinsurers.
- **Whether the changes applied to the Annual Report and Financial Statements following implementation of FRS 102 and FRS 103 were correctly applied**  
The committee considered the work of external advisers and the finance team in preparing this Annual Report and Financial Statements in accordance with 'new UK GAAP'. The committee reviewed and considered the amended primary statements and the additional disclosures required.

The committee has advised the Board on the Annual Report and Financial Statements and each of the Directors has agreed that, taken as a whole, the Annual Report and Financial Statements are fair, balanced and understandable and provide the information necessary for members to assess the Society's performance, business model and strategy.

## DIRECTORS' REPORT

### Going Concern

Having assessed the principle risks, the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

### Subsequent Events

There have been no material post balance sheet events.

### Directors and their interests

The present directors of the Society are shown on page 4. The directors during the year and any changes since the year end were as follows:

G M Berville	(resigned 31/07/2015)
D H Black	
B M H Bussell	(appointed 05/02/2016)
T A Clegg	
D S Green	(appointed 15/10/2015)
A M Lewis	(appointed 28/10/2015)
D G Lloyd	(appointed 14/01/2016)
N A Macfarlane	
W B Mavir	(retired 31/07/2015)
C May	
F J McKeating	(retired 14/08/2015)
J D McKeown	(retired 31/07/2015)
N J Paull	
M J Pratt	
C W Thomson	
J A Wells	
S E Wolfensohn	

The following directors have service agreements terminable by the director or the Society on not more than 26 weeks written notice.

### Executive Directors

D S Green  
A M Lewis  
D G Lloyd  
N A Macfarlane  
J A Wells

### Charitable Donations

A charitable donation of £52,000 was made to Veterinary Surgeons' Health Support Programme during the year (2014: £28,476). Charitable donations of £14,700 were made to the Irish Veterinary Benevolent Fund to mark the Society's 150 year anniversary.

In addition to the above donations, as a result of returned 2015 AGM proxy forms, charitable donations of £901 were made to Vetlife and £78 to the Irish Veterinary Benevolent Fund

## **DIRECTORS' REPORT (continued)**

### **Viability Statement**

The Strategic Report on pages 7 and 8 sets out the Society's business model, financial performance and strategy in the context of its business environment and principal risks. The Society's business model and strategy has been in place for a number of years and is based on stable and low risk appetite whereby the Society underwrites only one line of business and focusses on a high quality of claims handling and risk mitigating services. This business model has proven to be strong in the long term with the Society insuring over 90% of the veterinary profession.

The Society's prospects are assessed through the strategic planning process the output of which is a series of objectives, currently steady growth, embedding Practice Insurance and building stronger relationships with our members. Also considered is an analysis of risks that could prevent the plan being delivered, (the top five risks are set out on page 8) and also includes a number of scenarios being tested. Finally, financial forecasts are derived from the planning process over a three year period. Currently the financial forecasts assume a stable position across the review period.

The Executive and Board have been reviewing the business strategy during 2015 with a view to the possibility of extending our current Training, Advice and Support services and other relevant new areas. Risk appetite will be considered and any decision to change will feed into the strategic planning process and may require a change to the financial forecasts, risk assumptions and the Society's ORSA.

Based on their assessment of the Society's current strategy, prospects and viability, and the fact that the Society's capital position can support any revision in strategy, the Directors confirm they have a reasonable expectation that the Society will be able to continue in operation across the planning period of three years to 31/12/18.

### **Auditor**

Each person who is a director at the date of approval of this report confirms that:

- 1) so far as the director is aware, there is no relevant audit information of which the Society's auditor is unaware; and
- 2) the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

PwC have expressed their willingness to continue in office as auditor and a resolution to reappoint them may be proposed at the forthcoming Annual General Meeting.

### **Approved by the Board and signed on behalf of the Board**

**N A Macfarlane**  
**Chief Executive**  
**9 March 2016**

## **DIRECTORS' RESPONSIBILITIES STATEMENT**

The directors are responsible for preparing the Annual Report and Financial Statements (the "financial statements") in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including Financial Reporting Standard 102 and 103. The Financial Reporting Standard Applicable in the UK and Republic of Ireland (FRS 102).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Society and of the income and expenditure of the Society for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards, including FRS 102 have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Society will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Society's transactions and disclose with reasonable accuracy at any time the financial position of the Society and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

# ***Independent auditors' report to the members of The Veterinary Defence Society Limited***

## **Report on the financial statements**

### **Our opinion**

In our opinion, The Veterinary Defence Society Limited's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2015 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **What we have audited**

The financial statements, included within the Annual Report, comprise:

- the Balance Sheet as at 31 December 2015;
- the Statement of Income and Retained Earnings for the year then ended;
- the Cash Flow Statement for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" and FRS 103 "Insurance Contracts".

### **Context**

PwC were formally appointed as the external auditors of The Veterinary Defence Society Limited for the first time at the July 2015 Annual General Meeting. Accordingly, any comparatives shown, for example when comparing materiality thresholds, are against those used by the previous auditors.

With effect from 1 January 2015, the Financial Reporting Council (FRC) revised financial reporting requirements in the United Kingdom and Republic of Ireland. FRS 102, commonly referred to as 'new UK GAAP' and FRS 103 'Insurance Contracts' have subsequently been adopted by VDS for the first time in these financial statements.

### **Our audit approach**

#### *Overview*



- Overall materiality: £680,000 (2014: £300,000) which represents 2% of total assets.
- 
- Our audit was scoped by obtaining an understanding of the Company and its environment, including internal control, and assessing the risks of material misstatement. The Society is based in a single location and offers one product, being professional indemnity insurance to veterinary practices across the UK and Republic of Ireland. Our audit work was therefore focused on those areas we deemed to be financially significant or inherently complex due to the degree of estimation and judgement required.
- 
- Our areas of focus were:
- The valuation of technical provisions, particularly focusing on actuarial assumptions and case estimates; and
  - The valuation of investments.

#### *The scope of our audit and our areas of focus*

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as “areas of focus” in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

<i>Area of focus</i>	<i>How our audit addressed the area of focus</i>
<i>Valuation of technical provisions</i>	
<i>The financial statements include liabilities for the estimated future expense that will be incurred to pay claims relating to events that occurred prior to the period end. These liabilities comprise four components, as detailed below. Refer to page 29 (Accounting policies) and page 39 (note 15) for further information</i>	
<i>Actuarial assumptions may be inappropriate</i>	
<p>The technical provisions consist of four distinct components being:</p> <ul style="list-style-type: none"> <li>- Provision for claims incurred but not reported (IBNR) being those claims that the Society will incur on business that has previously been written on an occurrence basis, but has not yet been notified to the Society;</li> <li>- Provision for claims incurred but not enough reported (IBNER) being those claims where management have been notified of a claim but there remains significant uncertainty regarding the expected future settlement of the claim;</li> <li>- Case estimates, being those claims that have been reported to management and a specific provision has been recorded; and</li> <li>- A claims handling provision to cover the anticipated future costs of negotiating and settling claims which have been incurred, whether reported or not.</li> </ul> <p>As at 31 December 2015, technical provisions total £6m (£7.5m at 31 December 2014) of which £0.8m (2014: £2m) relate to the IBNR and IBNER provisions.</p> <p>The valuation of IBNR and IBNER provisions at the balance sheet date requires significant judgement in the selection of the actuarial assumptions, which are applied to the company's policy data to estimate the total liability that will be incurred. A change in actuarial assumption could have a material impact on the total value of technical provisions.</p> <p>During our audit, our focus was on the most material actuarial assumptions in calculating the IBNR and IBNER reserves, being the claims development factors and expected loss ratios. Claims development factors use historical evidence of claims to generate an expectation regarding how existing claims of a similar maturity will develop over time. Expected loss ratios estimate the ultimate claim by multiplying the premium by the expected loss ratio when the policy was issued.</p>	<p>We tested the completeness and accuracy of data used by management’s external actuarial expert in the calculation of the total technical provisions as follows:</p> <ul style="list-style-type: none"> <li>- We tested a sample of claims and other policy data within the policy administration system to source documentation to provide evidence over the accuracy of data used. This testing was performed without material exception;</li> <li>- We tested the completeness of the claim data used by the external actuarial expert by agreeing data used to the policy administration system and found no material exceptions.</li> </ul> <p>We tested the methodology and assumptions used to calculate the IBNR/IBNER reserves as follows:</p> <ul style="list-style-type: none"> <li>- We used PwC actuarial specialists to evaluate the judgements made by the external actuarial expert in setting the IBNR and IBNER assumptions and found these to be appropriate; and</li> <li>- We used PwC actuarial specialists to evaluate the methodology used by the external actuarial expert to derive the IBNR and IBNER reserves and found it to be appropriate.</li> </ul>
<i>Case estimate assumptions may be inappropriate</i>	
<p>Case estimates are significant in the context of the overall balance sheet, representing £3.8m of the technical provision balance as at 31 December 2015 (2014: £4.2m). Case estimate reserves are for claims to which the company has been notified, but are not settled at the balance sheet date. Final claim settlement remains uncertain and thus requires judgement from the Claims Group, and in some instances third party legal advice is also sought.</p>	<p>During the audit we performed the following:</p> <ul style="list-style-type: none"> <li>- We read the minutes of other Claims Group meetings held during the year to obtain evidence of completeness of large or complex cases requiring specific focus in our work;</li> <li>- We attended a Claims Group meeting to observe and understand the judgements and uncertainty taken into consideration in evaluating the claims under review;</li> </ul>

<i>Area of focus</i>	<i>How our audit addressed the area of focus</i>
<p>During the audit we focused on the valuation of material case estimates, focusing particularly on those requiring a greater degree of judgement and estimation from management.</p>	<ul style="list-style-type: none"> <li>- We examined the historical accuracy of the case estimate assumptions by obtaining the 2008-2014 year-end case estimates from the external actuarial specialist and comparing a sample of these estimates to the final paid amounts;</li> <li>- For a sample of claims, we considered the specific estimate and evidence available to support the reserve recorded;</li> <li>- We examined the company's reinsurance arrangements to understand the cover in place and re-performed Management's calculation of the reinsurance recovery; and</li> <li>- We independently obtained written confirmation from third party lawyers for those claims where legal advice has been obtained by Management.</li> </ul> <p>We found, based on the results of our testing that the judgements applied were supported by the evidence we obtained.</p>

*Valuation of investments*  
*Refer to page 31 (Accounting policies) and page 38 (note 13) for further information*

<i>Investment valuation</i>	
<p>The company holds investments in UK Gilts, Corporate bonds and European equities. These investments are managed externally by Barclays and Quilter Cheviot.</p> <p>We focused on this area because of the significance of the value of the investments in the context of the company balance sheet.</p>	<p>We performed testing over the investment portfolio as follows:</p> <ul style="list-style-type: none"> <li>- We confirmed the year-end investment valuations with the external investment managers;</li> <li>- We received the ISAE 3402 report from one of the investment managers, and reviewed to identify whether there were any significant control findings that would impact our ability to rely on their reporting; and</li> <li>- For a sample of investments, we re-priced the year-end valuation using a third party data source.</li> </ul> <p>We found no material exceptions from the work performed.</p>

*How we tailored the audit scope*

The company operates from a single location and offers a single product, being professional indemnity cover for veterinary practices in the UK and Ireland only. We focused on those areas of the financial statements that were inherently complex and judgemental, being the insurance technical provisions. The audit of the insurance technical provisions was performed through an examination of the 2015 case estimate reserves, together with the utilisation of PwC Actuarial specialists to evaluate the judgements made by Management's expert when calculating the insurance technical provisions.

We also focused on those areas of the financial statements that were significant in value, being the valuation of financial investments. The company's investment portfolio consists of UK Gilts, Corporate bonds and European equities, which are non-complex and are traded in an active market. We received external confirmations from third party investment managers, whilst also re-performing a sample of valuations using an independent data source.

Finally, our scope was impacted by the change in accounting framework, for example the inclusion of claims development tables and more comprehensive disclosures for financial instruments.

The scope of our audit ensured that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the relevant processes and controls, and the industry in which the company operates.

*Materiality*

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

<b>Overall materiality</b>	£680,000 (2014: £300,000).
<b>How we determined it</b>	Our benchmark to determine materiality was total assets. Our overall materiality represented 2% of total assets.
<b>Rationale for benchmark applied</b>	<p>We had regard to the reserves as disclosed in note 19 to the financial statements which represents the amount of surplus that would, in the event of the winding up of the company, be distributed to the members of the company to whom this opinion is addressed. Given the significance of the reserves in the context of the balance sheet we determined that our materiality would be too high, if our materiality was based on this benchmark alone. We therefore also had regard to the other financial statement line items that would be significant to the members and deemed total assets provided an appropriate benchmark on which to base our materiality threshold.</p> <p>We were satisfied that our overall materiality was also reasonable in relation to other Key Performance Indicator metrics reported by the company, including the earned premium, balance on the technical account and surplus after tax.</p>

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £15,000 (2014: £15,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

### Going concern

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the directors' statement, the directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the company has adequate resources to remain in operation, and that the directors intend it to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate. However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the company's ability to continue as a going concern.

## Other required reporting

### Consistency of other information

#### Companies Act 2006 opinion

In our opinion, the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### ISAs (UK & Ireland) reporting

As a result of the directors' voluntary reporting on how they have applied the UK Corporate Governance Code – An Annotated Version for Mutual Insurers (the "Code"), under ISAs (UK & Ireland) we are required to report to you if, in our opinion:	
<ul style="list-style-type: none"> <li>information in the Annual Report is: <ul style="list-style-type: none"> <li>materially inconsistent with the information in the audited financial statements; or</li> <li>apparently materially incorrect based on, or materially inconsistent with, our knowledge of the company acquired in the course of performing our audit; or</li> <li>otherwise misleading.</li> </ul> </li> </ul>	We have no exceptions to report.
<ul style="list-style-type: none"> <li>the statement given by the directors on page 16, in accordance with provision C.1.1 of the Code, that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the company's performance, business model and strategy is materially inconsistent with our knowledge of the company acquired in the course of performing our audit.</li> </ul>	We have no exceptions to report.
<ul style="list-style-type: none"> <li>the section of the Annual Report on page 16, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.</li> </ul>	We have no exceptions to report.



**The directors’ assessment of the prospects of the company and of the principal risks that would threaten the solvency or liquidity of the company**

As a result of the directors’ voluntary reporting on how they have applied the Code, under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:	
<ul style="list-style-type: none"> <li>the directors’ confirmation on page 8 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity.</li> </ul>	We have nothing material to add or to draw attention to.
<ul style="list-style-type: none"> <li>the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.</li> </ul>	We have nothing material to add or to draw attention to.
<ul style="list-style-type: none"> <li>the directors’ explanation on page 18 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.</li> </ul>	We have nothing material to add or to draw attention to.

**Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

**Directors’ remuneration**

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors’ remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

**Responsibilities for the financial statements and the audit**

**Our responsibilities and those of the directors**

As explained more fully in the Directors’ Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company’s members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

**What an audit of financial statements involves**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company’s circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors’ judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Thomas Tyler (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Manchester  
9 March 2016

**STATEMENT OF INCOME AND RETAINED EARNINGS**

**Year ended 31 December 2015**

	Note	2015 £	2014 £
<b>Technical account</b>			
Gross written premiums before return of premium	5	10,933,518	10,835,277
Return of premium		(650,000)	-
<b>Gross written premiums</b>		<b>10,283,518</b>	<b>10,835,277</b>
Outward reinsurance premiums		(760,197)	(745,112)
<b>Net premiums written and earned premiums net of reinsurance</b>		<b>9,523,321</b>	<b>10,090,165</b>
Gross claims paid	6	4,647,279	4,278,806
Reinsurers' share of gross claims paid	6	(266,573)	-
<b>Net claims paid</b>		<b>4,380,706</b>	<b>4,278,806</b>
Change in gross provisions for claims	6,15	(1,530,753)	(520,610)
Change in reinsurers' share	6,15	244,110	140,892
<b>Change in net provisions for claims</b>		<b>(1,286,643)</b>	<b>(379,718)</b>
<b>Claims incurred, net of reinsurance</b>		<b>3,094,063</b>	<b>3,899,088</b>
Net operating expenses	7	5,456,456	4,117,584
<b>Total technical charges</b>		<b>8,550,519</b>	<b>8,016,672</b>
<b>Balance on technical account</b>		<b>972,802</b>	<b>2,073,493</b>
<b>Non-technical account</b>			
Balance on technical account		972,802	2,073,493
Investment income	10	706,647	487,558
Unrealised gains on investments	10	-	287,066
Investment expenses and charges	10	(113,373)	(40,914)
Unrealised losses on investments	10	(551,265)	-
<b>Surplus on ordinary activities before tax</b>		<b>1,014,811</b>	<b>2,807,203</b>
Tax on surplus on ordinary activities	11	(31,624)	(98,481)
<b>Surplus for the financial year</b>		<b>983,187</b>	<b>2,708,722</b>
Income and expenditure reserves at 1 January		22,185,668	19,476,946
Income and expenditure reserves at 31 December		23,168,855	22,185,668

All of the operations of the Society are continuing.

## BALANCE SHEET

Year ended 31 December 2015

	Note	2015 £	2014 £
<b>ASSETS</b>			
<b>Investments</b>			
Land and buildings	12	911,435	930,035
Other financial investments	13	26,862,261	9,657,518
		<b>27,773,696</b>	<b>10,587,553</b>
Reinsurers' share of technical provisions	15	414,054	658,164
<b>Debtors</b>			
Debtors arising out of direct insurance operations - policyholders	19	172,047	275,570
Debtors arising out of reinsurance operations	19	266,573	-
Other debtors		-	51,193
		<b>438,620</b>	<b>326,763</b>
<b>Other Assets</b>			
Tangible assets	14	610,812	644,658
Cash at bank and in hand		4,315,360	23,859,959
		<b>4,926,172</b>	<b>24,504,617</b>
Prepayments and accrued income		473,773	151,947
<b>TOTAL ASSETS</b>		<b>34,026,315</b>	<b>36,229,044</b>
<b>Liabilities</b>			
Reserves	19	23,168,855	22,185,668
Technical provision - claims outstanding	15	6,037,467	7,568,220
Creditors: amounts falling due within one year	16	889,008	1,001,278
Accruals and deferred income		3,930,985	5,473,878
<b>TOTAL LIABILITIES</b>		<b>34,026,315</b>	<b>36,229,044</b>

These financial statements of The Veterinary Defence Society Limited, registration number 2159441, were approved by the Board on 9 March 2016.

Signed on behalf of the Board

**N A Macfarlane**

Chief Executive

## CASH FLOW STATEMENT

Year ended 31 December 2015

	Note	2015 £	2014 £
<b>Operating Activities</b>			
Net cash (outflow) from operating activities	18	(1,829,639)	(1,395,450)
Tax Paid		(131,797)	(96,725)
Interest and dividends received		506,061	582,558
<b>Net cash generated from operating activities</b>		<b>(1,455,375)</b>	<b>(909,617)</b>
<b>Investing Activities</b>			
Purchase of tangible assets		(228,022)	(301,814)
Proceeds on sale of tangible assets		14,499	-
Other investment management fees paid		(65,983)	(27,087)
Purchase of Debt securities and Shares and other variable-yield units in unit trusts		(14,254,906)	(112,006)
Net (payments to) / cash receipts from Deposits with credit institutions		(3,554,812)	17,054,812
<b>Net cash (used in) / generated from investing activities</b>		<b>(18,089,224)</b>	<b>16,613,905</b>
<b>Net (decrease) increase in cash at bank and in hand</b>		<b>(19,544,599)</b>	<b>15,704,288</b>
Cash and cash equivalents at the beginning of the year		23,859,959	8,155,671
<b>Cash and cash equivalents at the end of the year</b>		<b>4,315,360</b>	<b>23,859,959</b>
<b>Cash and cash equivalents consists of:</b>			
Cash at bank and in hand		4,315,360	23,859,959
Short term deposits presented within other financial investments		-	-
<b>Cash and cash equivalents at the end of the year</b>		<b>4,315,360</b>	<b>23,859,959</b>

## NOTES TO THE FINANCIAL STATEMENTS

### 1. Constitution and general information

The company was incorporated and domiciled in England and Wales on 31 August 1987 as a company limited by guarantee and not having share capital. The address of the company's registered office is 4 Haig Court, Parkgate Estate, Knutsford, Cheshire, WA16 8XZ.

Every member of the Society undertakes to contribute such amount as may be required, not exceeding £5 to the Society's assets if it should be wound up while he/she is a member, or within one year after he/she ceases to be a member, for payment of the Society's debts and liabilities contracted before he/she ceased to be a member, and of the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves.

In the event of the winding up of the Society, after its liabilities have been discharged, the remaining assets shall be distributed to the members in the manner set out in Article 85 of the Articles of Association.

### 2. Statement of compliance

The financial statements of the Society have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" ("FRS 102"), Financial Reporting Standard 103, "Insurance contracts" ("FRS 103") and the Companies Act 2006, under the provision of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) relating to insurance companies. Details of the transition to FRS 102 and FRS 103 are disclosed in Note 23.

### 3. Summary of accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These accounting policies have been applied consistently in both the current and the preceding year in dealing with items which are considered material in relation to the Society's financial statements.

#### Basis of preparation

The preparation of financial statements in conformity with FRS 102 and FRS 103 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Society's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 4.

#### Going concern

Having assessed the principle risks, the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

#### Premiums

Gross written premiums before the return of premium represents amounts received for business inception during the financial year excluding insurance premium tax. Premiums received in the year relating to contracts inception in subsequent periods are treated as deferred income and are not included in gross written premiums until inception of that contract. Contracts are written on a calendar year basis and therefore there is no unearned premium recognised in the balance sheet. Reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct insurance business. Return of premiums granted to policyholders are recognised as a reduction to gross written premiums during the year in which the return of premium is approved by the Board.

#### Claims incurred

Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years.

Provision is made at the year-end for the estimated cost of claims incurred but not settled, including the costs of claims incurred but not yet reported. The estimated cost of claims includes expenses to be incurred in settling claims. The Society takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the inevitable uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

Provisions are calculated allowing for reinsurance recoveries and a separate asset is recorded for the reinsurers' share of the provision.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 3. Summary of accounting policies (continued)

#### Land and buildings

Freehold land and buildings are stated at valuation and are depreciated at 2% of valuation. Land and buildings are valued at open market valuation. Full valuations are made by independent, professionally qualified external valuers every two years. The aggregate surplus or deficit on revaluation is taken to the non-technical account. Included within the open market valuation is related property refurbishment costs; the net book value of which has been removed from the valuation and included within tangible assets.

#### Tangible fixed assets and depreciation

All assets are shown at cost less accumulated depreciation and accumulated impairment losses. Cost includes the original purchase price, costs directly attributable to bringing the asset to its working condition for its intended use, dismantling and restoration costs and borrowing costs capitalised.

Depreciation is calculated to write off the cost of fixed assets, which includes purchase cost together with any incidental cost of acquisition, over the useful life of the asset. Depreciation is charged from the date of acquisition, to the date of disposal. The annual rates of depreciation, which are consistent with prior years, are:

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Motor vehicles	25% per annum on cost, straight line basis
Fixtures and fittings	between 8% and 25% per annum on cost, straight line basis
Freehold buildings	2% per annum on valuation, straight line basis

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Subsequent costs, including major inspections, are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that economic benefits associated with the item will flow to the Society and the cost can be measured reliably.

The carrying amount of any replaced component is derecognised. Major components are treated as a separate asset where they have significantly different patterns of consumption of economic benefits and are depreciated separately over its useful life.

Tangible assets are derecognised on disposal or when no future economic benefits are expected. On disposal, the difference between the net disposal proceeds and the carrying amount is recognised in the statement of income and retained earnings.

#### Investment Return

Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses and charges.

Account is taken of dividend income when the related investment goes 'ex-dividend' and other investment income is included on an accruals basis.

Realised gains and losses on investments carried at fair value are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Movements in unrealised gains and losses in investments are included in the statement of income and retained earnings.

Gains and losses on realisation of investments are included in the Non-Technical Account. Unrealised gains and losses are also included within the Non-Technical Account.

#### Impairment of non-financial assets

At each balance sheet date non-financial assets not carried at fair value are assessed to determine whether there is an indication that the asset (or asset's cash generating unit) may be impaired. If there is such an indication the recoverable amount of the asset (or asset's cash generating unit) is compared to the carrying amount of the asset (or asset's cash generating unit).

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 3. Summary of accounting policies (continued)

The recoverable amount of the asset (or asset's cash generating unit) is the higher of the fair value less costs to sell and value in use. Value in use is defined as the present value of the future cash flows before interest and tax obtainable as a result of the asset's (or asset's cash generating unit) continued use. These cash flows are discounted using a pre-tax discount rate that represents the current market risk-free rate and the risks inherent in the asset.

If the recoverable amount of the asset (or asset's cash generating unit) is estimated to be lower than the carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is recognised in the statement of income and retained earnings, unless the asset has been revalued when the amount is recognised in other comprehensive income to the extent of any previously recognised revaluation. Thereafter any excess is recognised in the statement of income and retained earnings.

If an impairment loss is subsequently reversed, the carrying amount of the asset (or asset's cash generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the revised carrying amount does not exceed the carrying amount that would have been determined (net of depreciation or amortisation) had no impairment loss been recognised in prior periods. A reversal of an impairment loss is recognised in the statement of income and retained earnings.

#### Financial instruments

The Society has chosen to adopt the Section 11 FRS 102 in respect of financial instruments.

##### (i) Financial assets

Basic financial assets, including Deposits with credit institutions, Debtors arising out of direct insurance operations – policyholders, Debtors arising out of reinsurance operations, Cash and cash equivalents, and Other debtors, are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at a market rate of interest.

Such assets are subsequently carried at amortised cost using the effective interest method.

At the end of each reporting period financial assets measured at amortised cost are assessed for objective evidence of impairment. If an asset is impaired the impairment loss is the difference between the carrying amount and the present value of the estimated cash flows discounted at the asset's original effective interest rate. The impairment loss is recognised in the statement of income and retained earnings.

If there is decrease in the impairment loss arising from an event occurring after the impairment was recognised the impairment is reversed. The reversal is such that the current carrying amount does not exceed what the carrying amount would have been had the impairment not previously been recognised. The impairment reversal is recognised in the statement of income and retained earnings.

Other financial assets, including investments in equity instruments, are initially measured at fair value, which is normally the transaction price.

Debt securities and Shares and other variable-yield securities and units in unit trusts are included in the balance sheet at market value. The market value of the investments represents quoted securities at bid price. Any surplus or deficit on any revaluation is recognised in the non- technical account.

Financial assets are derecognised when (a) the contractual rights to the cash flows from the asset expire or are settled, or (b) substantially all the risks and rewards of the ownership of the asset are transferred to another party or (c) control of the asset has been transferred to another party who has the practical ability to unilaterally sell the asset to an unrelated third party without imposing additional restrictions.

##### (ii) Financial liabilities

Basic financial liabilities, including other creditors including taxation and social security that are classified as debt, are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the debt instrument is measured at the present value of the future receipts discounted at a market rate of interest.

Debt instruments are subsequently carried at amortised cost, using the effective interest rate method.

Trade creditors are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognised initially at transaction price and subsequently measured at amortised cost using the effective interest method.



## **NOTES TO THE FINANCIAL STATEMENTS (continued)**

### **3. Summary of accounting policies (continued)**

Financial liabilities are derecognised when the liability is extinguished, that is when the contractual obligation is discharged, cancelled or expires.

#### **(iii) Offsetting**

Financial assets and liabilities are offset and the net amounts presented in the financial statements when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

#### **Cash and cash equivalents**

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts, when applicable, are shown within borrowings in current liabilities.

#### **Foreign currency**

##### **(i) Functional and presentation currency**

The Society's functional and presentation currency is pound sterling.

##### **(ii) Transactions and balances**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign currency gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of income and retained earnings.

#### **Taxation**

The Society is a mutual insurance company and is therefore not liable to Corporation Tax on dealings with its members. The taxation shown in the accounts represents the Corporation Tax liability on capital gains and investment income.

Taxation expense for the period comprises current and deferred tax recognised in the reporting period. Tax is recognised in the statement of income and retained earnings.

##### **(i) Current tax**

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

##### **(ii) Deferred tax**

The Society has not recognised any deferred tax assets or liabilities.

#### **Employee benefits**

The Society provides a range of benefits to employees, including paid holiday arrangements and defined contribution pension plans.

##### **(i) Short term benefits**

Short term benefits are recognised as an expense in the period in which the service is received.

##### **(ii) Defined contribution pension plans**

The Society participates in a group defined contribution pension scheme. As an alternative the Society contributes to personal pension schemes of qualifying employees and qualifying directors. Contributions are charged to the statement of income and retained earnings as incurred.

#### **Acquisition costs**

Acquisition costs incurred in writing the business are recognised in the period in which the related premiums are earned.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 4. Critical accounting judgements and estimation uncertainty

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

#### Sources of estimation uncertainty

The Society makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are addresses below.

#### Valuation of insurance contract liabilities

The estimation of the ultimate liability arising from claims made under insurance contracts is the Society's most critical accounting estimate. The Society's technical provisions at year-end total £6,037,467 (2014: £7,568,220) and consist of four components: claims incurred but not reported ("IBNR"); claims incurred but not enough reported ("IBNER"); case reserves; and a claims handling provision.

Case reserves are estimated on a case by case basis by Claims Consultants and, where deemed necessary and appropriate, further opinions are sought from third party solicitors.

External actuaries estimate IBNR and IBNER using standard actuarial claims projection techniques. Such methods extrapolate the development of paid and incurred claims, recoveries from third parties, average cost per claim and expected loss ratios. The main assumption underlying these techniques is that past claims development experience is used to project ultimate claims costs. To the extent that the ultimate cost is different from the estimate, where experience is better or worse than that assumed, the surplus or deficit will be credited or charged the statements of income and retained earnings in future years.

#### Depreciation and residual values

The directors have reviewed the asset lives and associated residual values of all fixed asset classes and have concluded that asset lives and residual values are appropriate.

#### Impairment indicators

At each balance sheet date non-financial assets not carried at fair value are assessed to determine whether there is an indication that the asset may be impaired. If there is any such indication the recoverable amount of the asset is compared to the carrying amount of the asset. The recoverable amount of the asset is the higher of the fair value less costs to sell and value in use. Value in use is defined as the present value of future cash flows before interest and tax obtainable as a result of the asset's continued use.

### 5. Earned premiums

Analysis of earned premiums written by the Society

	2015	2014
<b>United Kingdom</b>	<b>£</b>	<b>£</b>
Gross written premiums before return of premium	10,933,518	10,835,277
Return of premium	(650,000)	-
<b>Gross written premiums</b>	<b>10,283,518</b>	<b>10,835,277</b>

The Society has one class of business, third party liability insurance.

All premiums are written in the United Kingdom. Insurance premiums paid by members in the Republic of Ireland were £949,098 (2014: £939,278). The Society has made a return of premium of £650,000 in 2015 (2014: £nil).

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 6. Claims incurred

	2015	2014
	£	£
Gross claims paid	4,647,279	4,278,806
Reinsurers' share of gross claims paid	(266,573)	-
<b>Net claims paid</b>	<b>4,380,706</b>	<b>4,278,806</b>
Change in gross provisions for claims	(1,530,753)	(520,610)
Change in reinsurers' share	244,110	140,892
<b>Change in net provisions for claims</b>	<b>(1,286,643)</b>	<b>(379,718)</b>
<b>Claims incurred, net of reinsurance</b>	<b>3,094,063</b>	<b>3,899,088</b>

A positive run-off deviation of £485,042 (2014: positive of £809,110) arose on prior years' case reserves. Positive run-off deviations arise from changes in several claims' status as further particulars are received.

### 7. Net operating expenses

	2015	2014
	£	£
Acquisition costs	936,318	1,029,396
Administration expenses	4,520,138	3,088,188
	<b>5,456,456</b>	<b>4,117,584</b>
<b>Administration expenses include:</b>		
Depreciation	269,585	365,200
Fees payable to the Society's auditor for the audit of the financial statements	37,000	32,600
Fees payable to the Society's auditor for other services:		
Audit related assurance services	8,000	-
Other non-audit services	16,000	12,900
Exchange rate loss	95,246	41,207
Professional fees	160,449	111,279
Consultancy fees <sup>1</sup>	780,230	142,695

1 – the increase in consultancy fees in 2015 relates primarily to the cost of the strategic review undertaken during the year.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 8. Employees

Staff costs excluding the remuneration of Non-Executive Directors is shown below. Non-Executive Directors' remuneration is included within Other remuneration in Note 9.

	<b>2015</b>	<b>2014</b>
	<b>£</b>	<b>£</b>
Wages and salaries	3,706,639	3,431,059
Social security costs	446,576	422,984
Pension and other costs	486,930	438,448
	<u>4,640,145</u>	<u>4,292,491</u>
	<b>No.</b>	<b>No.</b>
Average number of persons employed (including directors), all of whom were involved in administration	<u>52</u>	<u>46</u>

### 9. Directors' remuneration

This analysis includes the remuneration of Executive and Non-Executive Directors

	<b>2015</b>	<b>2014</b>
	<b>£</b>	<b>£</b>
Other remuneration	941,100	1,025,423

Other remuneration includes salaries and benefits of Executive Directors (excluding company pension contributions) and fees paid to Non-Executive Directors

Seven directors (2014: five) were members of defined contribution pension schemes.

The pension contributions to defined contribution pension schemes for the year	68,011	77,331
Remuneration of highest paid director	187,817	199,670
Pension contributions to defined contribution pension schemes of the highest paid director	18,038	19,494

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. Investment return

	2015	2014
	£	£
<b>Investment Income</b>		
Income on financial assets at fair value through profit and loss	547,312	214,591
Income on financial assets not at fair value through profit and loss	159,335	272,967
	<u>706,647</u>	<u>487,558</u>
<b>Investment expenses and charges</b>		
Other investment management fees	(59,663)	(28,830)
Net losses on the realisation of investments	(53,710)	(12,084)
	<u>(113,373)</u>	<u>(40,914)</u>
Net unrealised (losses) / gains on investments	(551,265)	287,066
<b>Total investment return</b>	<u>42,009</u>	<u>733,710</u>

### 11. Taxation

#### Current Taxation:

	2015	2014
	£	£
UK corporation tax on profits for the period	-	98,481
Adjustment in respect of previous periods	31,624	-
Total current tax	<u>31,624</u>	<u>98,481</u>

The charge for the year can be reconciled to the profit per the statement of income and retained earnings as follows:

	2015	2014
	£	£
Surplus for the period	1,014,811	2,807,203
Tax on surplus at standard UK tax rate of 20.25% (2014: 21.50%)	205,446	603,549
Expenses not deductible	25,506	5,700
Non-deductible mutual surplus	(210,595)	(484,173)
Unrecognised losses carried forward	(6,586)	-
Exempt increase / (decrease) on treasury bonds	-	(1,655)
Marginal relief	-	(3,855)
Adjustment from previous periods	31,624	-
Non-taxable dividend income	(13,771)	-
Revaluation gain on property	-	(21,085)
Tax charge for the period	<u>31,624</u>	<u>98,481</u>

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**12. Land and buildings**

	<b>Freehold Land &amp; Buildings £</b>
<b>Cost of valuation</b>	
At 1 January 2015	930,035
Revaluation	-
At 31 December 2015	<u>930,035</u>
<b>Accumulated depreciation</b>	
At 1 January 2015	-
Charge for the year	18,600
Revaluation	-
At 31 December 2015	<u>18,600</u>
<b>Net book value</b>	
At 31 December 2015	<u><u>911,435</u></u>
At 31 December 2014	<u>930,035</u>

A valuation of land and buildings as at 31 December 2014 was carried out on 27 January 2015 by Wright Marshall Chartered Surveyors at open market value for existing use. This was valued at £1,110,000. Included within this valuation was related property refurbishment, the book value of which was £179,965. These assets have been included within Note 14, fixtures and fittings, and have been removed from the valuation.

The directors are not aware of any material change in the valuation of the property and therefore no further valuation adjustment, other than to recognise depreciation, has been recognised.

On a historical cost basis land and buildings would have been included as follows:

	<b>2015</b>	<b>2014</b>
	<b>£</b>	<b>£</b>
Cost	1,334,762	1,334,762
Depreciation	(323,733)	(297,038)
Net book value	<u><u>1,011,029</u></u>	<u><u>1,037,724</u></u>

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**13. Other financial investments**

	2015		2014	
	£ Market value	£ Cost	£ Market value	£ Cost
Debt securities	15,525,902	15,529,905	4,712,330	4,202,607
Shares and other variable-yield securities and units in unit trusts	2,836,359	2,911,807	-	-
Deposits with credit institutions	8,500,000	8,500,000	4,945,188	4,945,188
Other Financial Investments	26,862,261	26,941,712	9,657,518	9,147,795

**14. Tangible assets**

	Fixtures and fittings	Motor Vehicles	Total
	£	£	£
<b>Cost</b>			
At 1 January 2015	1,620,471	34,875	1,655,346
Additions	189,492	38,530	228,022
Disposals	(323,037)	(34,875)	(357,912)
At 31 December 2015	1,486,926	38,530	1,525,456
<b>Accumulated depreciation</b>			
At 1 January 2015	992,513	18,175	1,010,688
Charge for the year	241,958	9,027	250,985
Disposals	(323,038)	(23,991)	(347,029)
At 31 December 2015	911,433	3,211	914,644
<b>Net book value</b>			
At 31 December 2015	575,493	35,319	610,812
At 31 December 2014	627,958	16,700	644,658

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 15. Technical provisions

The reconciliation of opening and closing provision for claims is as follows:

	2015	2014
	£	£
<b>Gross Provision</b>		
At 1 January	7,568,220	8,088,830
Movement in provision	(1,530,753)	(520,610)
At 31 December	<u>6,037,467</u>	<u>7,568,220</u>
<b>Reinsurers' Share</b>		
At 1 January	658,164	799,056
Movement in provision	(244,110)	(140,892)
At 31 December	<u>414,054</u>	<u>658,164</u>

The sources of estimation uncertainty in establishing the ultimate liability arising from claims made under insurance contracts is discussed in Note 4. A 10% increase or reduction in net case reserves would impact net assets by approximately £383,000.

### 16. Creditors: amounts falling due within one year

	2015	2014
	£	£
Veterinary Benevolent Fund donations	22,612	31,114
Irish Veterinary Benevolent Fund donations	4,570	7,274
Pension Scheme contributions	44,432	42,646
Other creditors including taxation and social security	817,394	920,244
	<u>889,008</u>	<u>1,001,278</u>

### 17. Pension costs

The Society operates a group defined contribution pension scheme. As an alternative the Society contributes to personal pension schemes of qualifying employees and qualifying directors. The assets of all schemes are held separately from those of the Society in independently administered funds. The pension cost includes £306,960 (2014: £323,435) representing contributions payable by the Society during the year in respect of qualifying employees and £68,011 (2014: £77,331) in respect of directors. Contributions are charged to the statement of income and retained earnings as incurred.

Unpaid contributions at the year-end were £44,432 (2014: £42,646).



**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**18. Reconciliation of surplus to net cash outflow from operating activities**

	<b>2015</b>	<b>2014</b>
	<b>£</b>	<b>£</b>
<b>Surplus for the financial year</b>	983,187	2,708,722
Adjustments for:		
Tax charge	31,624	98,481
Investment income	(706,647)	(487,558)
Net losses on realisation of investments	53,710	12,084
Other investment management fees	59,663	28,830
Unrealised losses / (gains) on investments	551,265	(287,066)
(Profit) / loss on disposal of tangible assets	(3,616)	-
Depreciation on land and buildings	18,600	17,340
Depreciation on tangible assets	250,985	347,860
Decrease in debtors arising out of direct insurance operations	103,523	33,516
Increase in debtors arising out of reinsurance operations	(266,573)	-
(Increase) in prepayments, other debtors and accrued income	(70,048)	(19,283)
Decrease in net technical provisions	(1,286,643)	(379,718)
(Decrease) in creditors, accruals and deferred income	(1,548,669)	(3,468,658)
<b>Net cash (outflow) from operating activities</b>	<b>(1,829,639)</b>	<b>(1,395,450)</b>

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**19. Financial instruments**

**(i) The categories of financial assets and financial liabilities, at the reporting date, in total, are as below:**

	<b>2015</b>	<b>2014</b>
	<b>£</b>	<b>£</b>
<b>Financial Assets at fair value through profit and loss</b>		
Debt securities	15,525,902	4,712,330
Shares and other variable-yield securities and units in unit trusts	2,836,359	-
	<u>18,362,261</u>	<u>4,712,330</u>
<b>Financial Assets that are debt instruments measured at amortised cost</b>		
Debtors arising out of direct insurance operations – policyholders	172,047	275,570
Debtors arising out of reinsurance operations	266,573	-
Other debtors	-	51,193
Deposits with credit institutions	8,500,000	4,945,188
Cash at bank and in hand	4,315,360	23,859,959
	<u>13,253,980</u>	<u>29,131,910</u>
<b>Financial Liabilities that are debt instruments measured at amortised cost</b>		
Other creditors including taxation and social security	<u>817,394</u>	<u>920,244</u>

**Financial Assets at fair value through profit and loss**

**(a) Classification of financial assets at fair value through profit or loss**

The Society classifies financial assets at fair value through profit or loss if they are acquired principally for the purpose of selling in the short term, i.e. are held for trading. The Debt securities and Shares and other variable-yield securities and units in unit trusts are valued at fair value through profit and loss which is determined using observable inputs. The fair values of listed investments are based on current bid price on the balance sheet date. For listed investments with no active market or for unquoted investments, for which no active market exists, fair value is determined by the Society's third party wealth managers utilising a range of daily pricing feeds.

See accounting policy for financial instruments for the Society's other accounting policies for financial assets.

**(b) Amounts recognised in profit or loss**

The income, expense and changes in fair values of financial assets at fair value through profit or loss recorded in the statement of income and retained earnings is as follows:

	<b>2015</b>	<b>2014</b>
	<b>£</b>	<b>£</b>
Income on financial assets at fair value through profit and loss	547,312	214,591
Other investment management fees	(59,663)	(28,830)
Net losses on the realisation of investments	(53,710)	(12,084)
Net unrealised (losses) / gains on investments	(551,265)	287,066
	<u>(117,326)</u>	<u>460,743</u>

## **NOTES TO THE FINANCIAL STATEMENTS (continued)**

### **19. Financial instruments (continued)**

#### **(c) Risk exposure and fair value measurements**

Information about the methods and assumptions used in determining fair value is provided in note 19(ii) below. For information about the Society's exposure to price risk please refer to note 19(iii) below.

#### **Financial Assets that are debt instruments measured at amortised cost**

##### **(a) Classification of financial assets that are debt instruments measured at amortised cost**

Debtors include debtors arising out of direct insurance operations – policyholders and reinsurance debtors include reinsurers' share of technical provisions arising from insurance contracts which are subject to FRS 103.

Other debtors include other short term receivables (excluding those arising from insurance contracts which are subject to FRS 103). Other debtors generally arise from transactions outside the usual operating activities of the Society. They represent undiscounted amounts of cash expected to be received (within a year).

Cash and cash equivalents includes cash in hand, deposits held at call with banks other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts, where applicable are shown within borrowings in current liabilities.

Investment in short term deposits - deposits with credit institutions represents cash deposits which are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Cash deposits, under other financial investments, are classified as deposits with credit institutions which are not repayable without notice or financial penalty for early withdrawal. This is considered to reflect these investments more appropriately.

##### **(b) Fair values of financial assets that are debt instruments measured at amortised cost**

The carrying amounts of financial assets and liabilities measured at amortised cost are assumed to be the same as their fair values due to their short-term nature.

##### **(c) Impairment and risk exposure**

There were no impaired receivables. Information about the impairment of trade and other receivables, their credit quality and the Society's exposure to credit risk can be found in accounting policy note for financial instruments and 19 (iii) below.

#### **Financial liabilities measured at amortised cost**

The carrying amounts of other creditors including taxation and social security are assumed to be the same as their fair values due to their short-term nature.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 19. Financial instruments (continued)

#### (ii) Fair Value Methodology

This section explains the judgements and estimates made in determining the fair values of the financial instruments that are recognised and measured at fair value in the financial statements. To provide an indication about the reliability of the inputs used in determining fair value, the Society has classified its financial instruments into the three levels. An explanation of each level follows underneath the table.

Investments carried as fair value have been categorised using a fair value hierarchy as detailed below:

#### Fair value hierarchy:

##### Level 1 - Quoted market prices in active market

Inputs to level 1 fair value are quoted prices (unadjusted) in active markets for identical assets. An active market is one in which transactions for the asset occurs with sufficient frequency and volume to provide pricing information on an on-going basis. Instruments included in level 1 comprise primarily FTSE or equivalent listed equity instruments.

##### Level 2 – Internal models or broker quotes with observable market parameters

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined using valuation techniques which maximise the use of observable market data and rely as little as possible on entity-specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2. The Society did not have any such instruments.

##### Level 3 – Internal models with significant unobservable market parameters

Inputs to level 3 fair values are based on unobservable inputs for the assets at the last measurement date. If all significant inputs required to fair value an instrument are observable then the instrument is included in level 2, if not it is included in level 3. The Society did not have any such instruments.

There were no transfers between levels for recurring fair value measurements during the year.

#### An analysis of investments according to fair value hierarchy is given below:

As at 31 December	2015			Total
	Level 1	Level 2	Level 3	
Debt Securities	15,525,902	-	-	15,525,902
Shares and other variable-yield securities and units in unit trusts	2,836,359	-	-	2,836,359
	<b>18,362,261</b>	<b>-</b>	<b>-</b>	<b>18,362,261</b>
	2014			
As at 31 December	Level 1	Level 2	Level 3	Total
Debt Securities	4,712,330	-	-	4,712,330
Shares and other variable-yield securities and units in unit trusts	-	-	-	-
	<b>4,712,330</b>	<b>-</b>	<b>-</b>	<b>4,712,330</b>

## **NOTES TO THE FINANCIAL STATEMENTS (continued)**

### **19. Financial instruments (continued)**

#### **(iii) Financial risk management**

The Society is exposed to financial risk through its financial assets, reinsurance assets and policyholder liabilities. In particular the key financial risk is that proceeds from, or the valuation of, financial assets are not sufficient to fund the obligations arising from policies as they fall due. The Society's operations expose it to a variety of financial risks that include the effects of credit risk, liquidity risk and market risk (including price risk and currency risk).

Our main aim is to minimise risk to the Society's funds, and our policies towards investment, reinsurance and cash deposits reflect this aim. Our control over these three areas plus close control over premium income and claims costs ensures a sound financial base for the Society's activities.

#### **(a) Credit risk**

The Society is principally exposed to credit risk through its bank accounts and term deposits and debt securities. The objective is to minimise these risks by spreading the exposure over a number of counterparties. All counterparties must have investment grade ratings. The Society is also exposed to credit risk through its reinsurance arrangements. The Society utilises a panel of reinsurers and ensures that all have a minimum credit rating of A. There have been no changes from the previous period.

The carrying amount of all classes of financial instruments represents the maximum exposure to credit risk. The Society does not hold any collateral as security and no derivatives have been used to mitigate the credit risk.

None of the financial assets is either past due or impaired.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 19. Financial instruments (continued)

#### Credit risk by class of financial instrument

##### As 31 December 2015

	AAA	AA	A	BBB	BB	Other	Total
	£	£	£	£	£	£	£
Debt Securities	6,003,229	761,121	3,299,143	4,128,544	-	1,333,865	15,525,902
Shares and other variable-yield securities and units in unit trusts	-	-	-	-	-	2,836,359	2,836,359
Deposits held with credit institutions	-	-	8,500,000	-	-	-	8,500,000
Cash at bank and on hand	-	18,930	2,109,463	1,888,391	-	298,576	4,315,360
Debtors arising out of reinsurance operations	-	106,629	159,944	-	-	-	266,573
<b>Total</b>	<b>6,003,229</b>	<b>886,680</b>	<b>14,068,550</b>	<b>6,016,935</b>	<b>-</b>	<b>4,468,800</b>	<b>31,444,194</b>

##### As 31 December 2014

	AAA	AA	A	BBB	BB	Other	Total
	£	£	£	£	£	£	£
Debt Securities	1,439,663	-	1,014,339	697,944	-	1,560,384	4,712,330
Shares and other variable-yield securities and units in unit trusts	-	-	-	-	-	-	-
Deposits held with credit institutions	-	-	4,945,188	-	-	-	4,945,188
Cash at bank and on hand	-	3,965,988	14,119,521	5,771,211	-	3,239	23,859,959
<b>Total</b>	<b>1,439,663</b>	<b>3,965,988</b>	<b>20,079,048</b>	<b>6,469,155</b>	<b>-</b>	<b>1,563,623</b>	<b>33,517,477</b>

#### Notes

UK government gilts are included in the above analysis as AAA rated despite the individual securities being unrated. This presentation accurately reflects the credit risk of these assets. Debt securities rated as 'Other' are investment grade bonds that are not rated.

#### (b) Liquidity risk

The Society maintains cash at bank and on hand equal to its forecast annual expenditure in order to minimise liquidity risk. As well as cash assets, the Society holds a significant portion of highly liquid assets such as government bonds within the investment portfolio.

All financial liabilities will mature within 12 months of the balance sheet date.

#### (c) Market risk

The Society is principally exposed to market risk through its investment portfolio which includes debt securities and shares and other variable-yield securities and units in unit trusts which are traded on active markets. The Society's policy is to hold a significant proportion of reserves against such assets since the Society's strong capital position allows for short term fluctuations in value whilst maximising returns over the longer term.

In acknowledgment of these risks, the Society matches the value of technical reserves with fixed term investments (deposits with credit institutions) which are not exposed to the same level of market risk as the investment portfolio assets.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 19. Financial instruments (continued)

#### Price risk

The Society is exposed to equity securities price risk as a result of its holdings in shares and other variable-yield securities and units in unit trusts, classified as financial assets at fair value through profit or loss. Exposures to individual companies and to equity shares in aggregate are monitored in order to ensure compliance with the relevant regulatory limits for solvency purposes and the Society's own investment policy.

The Society is also exposed to price risk from debt securities which are classified as financial assets at fair value through profit or loss. Again, exposures to individual companies are monitored in order to ensure compliance with the relevant regulatory limits for solvency purposes and the Society's own investment policy.

The Society has a defined investment policy which sets limits on the Society's exposure to shares and other variable-yield securities and units in unit trusts and debt Securities both in aggregate terms and by geography, industry and counterparty and currency. This policy of diversification is used to manage the Society's price risk arising from its investments.

#### Sensitivity to debt security yields

Increasing assumed yields on index linked securities at 31 December 2015 by 25bps would result in a decrease in surplus before tax and the fair value of index linked securities by £556,000 (31 December 2014 : £79,000).

Increasing assumed yields on fixed interest securities at 31 December 2015 by 25bps would result in a decrease in surplus before tax and the fair value of fixed interest securities by £967,000 (31 December 2014 : £192,000).

Decreasing assumed yields on fixed interest securities at 31 December 2015 by 25bps would result in an increase in surplus before tax and the fair value of fixed interest securities by £1.2 million (31 December 2014 : £214,000).

The increased sensitivity to bond yields during 2015 is caused by the Society's decision to invest more of its funds in fixed interest securities during the financial year.

#### Interest rate risk

Interest rate risk arises primarily from portfolio investments and deposits with credit institution. The effects of changes in Bank of England base rates on gross interest earned on deposits with credit institutions is insignificant while interest rates remain at historically low levels. Therefore, the interest rate risk to future cash flows from cash deposits is immaterial at the end of the reporting period and no sensitivity analysis is deemed necessary.

#### Currency Risk

Foreign currency risk can only arise on financial instruments that are denominated in a currency other than the functional currency in which they are measured.

#### Sensitivity to currency

An increase in the GBP: EUR exchange rate will reduce the sterling value of assets and increase the sterling value of liabilities denominated in Euros.

An increase of 10% in the GBP: EUR exchange rate would reduce the net assets at 31 December 2015 by £14,000 (31 December 2014: £74,000). A 10% decrease in the GBP: EUR exchange rate would increase the net assets at 31 December 2015 by £18,000 (31 December 2014: £91,000).

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 19. Financial instruments (continued)

#### (d) Insurance risk

Insurance risk is the risk arising from the issuance of insurance contracts. The sources of estimation uncertainty in establishing the ultimate liability arising from claims made under insurance contracts is discussed in Note 4.

#### Insurance Concentration risk

As a mutual Society operating solely in the veterinary profession, our insurance risks are inherently concentrated. However, our ability to offer tailored indemnity limits via Practice Insurance to the majority of the profession allows us to share and mitigate this risk appropriately.

The table below represents the insurance expenses:

	Gross Claims Incurred		Reinsurers' share	
	2015	2014	2015	2014
	£	£	£	£
Claims paid	4,647,279	4,278,806	(266,573)	-
Gross Provision for claims	(1,530,753)	(520,610)	244,110	140,892
	<b>3,116,526</b>	<b>3,758,196</b>	<b>(22,463)</b>	<b>140,892</b>

Refer to Note 15 on technical provisions for further details regarding the insurance assets, liabilities and its movement.

#### Sensitivity

The Society's surplus and reserves are sensitive to the number of 'high value' claims. These 'high value' claims tend to be equine or farm civil cases, or small animal disciplinary cases. The surplus is particularly sensitive to the number of disciplinary cases which progress to Disciplinary Hearings as a result of which the Society will incur higher external legal costs. A 10% increase or reduction in case reserves would impact surplus and net assets by approximately £383,000.



## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 19. Financial instruments (continued)

#### Claims development tables

The following tables represents the development on claims on a gross and net basis.

#### Claims outstanding (gross)

Underwriting year	2010 and prior <sup>1</sup>	2011	2012	2013	2014	2015	Total
<b>Estimate of ultimate claims costs:</b>							
- at the end of reporting year		4,877,979	4,525,838	5,260,659	4,040,434	4,865,214	
- one year later		4,330,692	4,435,741	4,979,369	4,160,278		
- two years later		4,430,406	4,206,479	4,257,942			
- three years later		4,189,357	4,110,364				
- four years later		4,117,961					
Current estimate of cumulative claims	22,920,167	4,117,961	4,110,364	4,257,942	4,160,278	4,865,214	
Cumulative claims paid	21,712,123	3,928,882	3,447,497	3,635,219	3,122,683	2,548,055	
Current year gross provision	1,208,044	189,079	662,867	622,723	1,037,595	2,317,159	<b>6,037,467</b>

#### Claims outstanding (net)

Underwriting year	2010 and prior <sup>1</sup>	2011	2012	2013	2014	2015	Total
<b>Estimate of ultimate claims costs:</b>							
- at the end of reporting year		4,877,979	4,525,838	5,160,659	4,040,434	4,865,214	
- one year later		4,324,692	4,435,741	4,979,369	4,160,278		
- two years later		4,385,406	4,206,479	4,257,942			
- three years later		4,144,357	4,059,884				
- four years later		4,072,980					
Current estimate of cumulative claims	22,183,353	4,072,980	4,059,884	4,257,942	4,160,278	4,865,214	
Cumulative claims paid	21,338,883	3,883,901	3,447,497	3,635,219	3,122,683	2,548,055	
Current year net provision	844,470	189,079	612,387	622,723	1,037,595	2,317,159	<b>5,623,413</b>

#### Reconciliation to Balance sheet:

Gross technical provisions	6,037,467
Reinsurers' share of technical provisions	414,054
Net technical provisions (above)	<b>5,623,413</b>

1 – The Society is not required to disclose claims development for claims more than five years old; however, to provide additional information and to ensure the analysis reconciles to the Balance sheet, the 2010 and prior years' cases (back to and including 2005 claims) have been aggregated at their position as at 31 December 2015 on both a gross and net basis.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 19. Financial instruments (continued)

#### (iv) Capital Management

VDS is required to hold sufficient capital to meet the PRA's capital requirements for Solvency II from 1 January 2016. The Society has an established process which ensures compliance with the requirements to hold adequate capital.

The Veterinary Defence Society Limited (VDS) is a company limited by guarantee and therefore does not have share capital. Capital therefore takes the form of retained reserves only. Retained reserves at 31 December 2015 were £23,168,855 (2014: £22,185,668).

The Society has a risk appetite which determines a range of values within which the Retained reserves should be maintained.

The Society has complied with all externally imposed capital requirements throughout the year. There are no changes in the Capital Management Policies between the previous or current period.

### 20. Operating leases

	2015	2014
	£	£
Operating leases which expire:		
Within one year	-	-
Between one and five years	56,206	-
After five years	-	-
	<hr/> 56,206	<hr/> -

The operating lease relates to an office space adjacent to the Society's owned and occupied property.

### 21. Controlling party

In the opinion of the directors, the Society has no individual controlling party.

## **NOTES TO THE FINANCIAL STATEMENTS (continued)**

### **22. Related party transactions**

In the ordinary course of business, a number of Executive and Non-Executive directors and senior managers hold policies, and these are handled consistently both in terms of premium payments, and where claims arise. These are not considered to be material to either the Society or the related parties.

During the year related parties paid total premiums of £230,000 and five claims were received from related parties during the financial year. During the year £1,500 was paid on claims involving related parties.

#### **Transactions with key management personnel**

See Note 9 for disclosure of the directors' remuneration.

### **23. Transition to FRS 102 and FRS 103**

This is the first year that the Society has presented its results under FRS 102 and FRS 103. The last financial statements under old UK GAAP were for the year ended 31 December 2014. The date of transition to FRS 102 was 1 January 2015. There were no changes to accounting policies which impacted on surplus from the Statement of Income and Retained earnings or on the Balance Sheet. Consequently, no reconciliation between old UK GAAP and FRS 102 has been presented.

#### **Statement of cash flows**

The Society's cash flow statement reflects the presentation requirements of FRS 102, which is different to that prepared under FRS 1. In addition the cash flow statement reconciles to cash and cash equivalents whereas under previous UK GAAP the cash flow statement reconciled to cash. Cash and cash equivalents in FRS 102 is defined as 'cash on hand and demand deposits and short term highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value' whereas cash is defined in FRS 1 as 'cash in hand and deposits repayable on demand with any qualifying institution, less overdrafts from any qualifying institution repayable on demand'. The FRS 1 definition is more restrictive.