Annual Report & Financial Statements

31 December 2016

ANNUAL REPORT & FINANCIAL STATEMENTS 2016

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BOARD AND PROFESSIONAL STAFF

BOARD OF DIRECTORS

Non-Executive Directors

N J Paull BVSc MRCVS	Chairman
D H Black BVM&S DBR MRCVS	
B M H Bussell BSc (Hons) FIA (Appointed 5h February 2016)	
T A Clegg FCII ACIArb	
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	
G J Lawrie BVMS CertEP, MRCVS (Appointed 27th September 2016)	

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 (Appointed 14th January 2016)	Finance Director

General Counsel & Company Secretary

C M Gannon LL.B (Hons)

BOARD COMMITTEES

Audit, Risk and Compliance Committee

M J Pratt	Chairman
D H Black	
B M H Bussell	

Remuneration Committee

T A Clegg	Chairman
Prof S E Wolfensohn	
C W Thomson	

Nominations Committee

N J Paull	Chairman
D H Black	
N A Macfarlane	
M J Pratt	
C W Thomson	

Investment Committee

B M H Bussell	Chairman
Prof S E Wolfensohn	
N A Macfarlane	
D G Lloyd	

BOARD AND PROFESSIONAL STAFF (continued)

OPERATIONAL DIRECTORS

J D McKeown BVMS Cert SHP MRCVS	Director of Member Services
C M Magrath BVMS Hon FRCVS	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 MRCVS
K E Moore BVSc BSC VN MRCVS
A D Buxton BVSc MRCVS
R T Green BVSc CertWEL MRCVS
S Henney BVM&S 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 Auditors

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
Clyde and Co

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

Having taken over as Chairman in July 2016, this is my first annual Chairman's report. It has meant me taking time to reflect on, not just the work of VDS over 2016, but also our ongoing strategy and plans for the future. "Change is inevitable. Change is constant" - or so said Benjamin Disraeli. The success of any business is related to how it deals with this change, by developing alongside the needs of its customers without losing all that has made that business successful in the past. The current level of change within the veterinary profession shows no sign of abating. For the Veterinary Defence Society, our ability to adapt our business in order to provide our members with all the services and support they require continues to be a key driver for the whole team. We perpetuate the VDS ethos of protecting, defending, developing and supporting our members, holding dear that which has served the veterinary profession so well in the past. The focus of the Society is to maintain and safeguard the excellent reputation of the Society that has been built up over many years whilst keeping the VDS fit for future challenges faced by our members.

2016 witnessed the first ever release of a Mutual Bonus. We have been delighted to make payments by way of a return of premium, declaring a Mutual Bonus of 5.9% of the 2015 premium. The Board was pleased to offer the Mutual Bonus as a tangible benefit of the Society's mutual status. This is seen as further reinforcement of our core purpose which continues to be delivering the finest quality and value in the defence and protection of the veterinary profession. The Board is in a position to make a return of premium in years when there is a positive insurance result. This can be achieved due to our prudent approach to accurately assessing risks as they present and then setting premiums that fairly reflect those risks and consequences. Added to this, the hard work and endeavor of our experienced Claims Consultants and Claims Advisers assists in mitigating the frequency and severity of claims. The VDS continues in the development and promotion of its own and also the profession's understanding of veterinary professional risk management.

It is long overdue but, more than ever in the last year, the mental wellbeing of the veterinary team is now headline news. We are seeing the expansion of support networks, and the realisation from the veterinary regulator downwards, of the need to address so many areas where the pressures of veterinary life need attention. The VDS and its members continue to provide financial support to Vetlife and the Irish Veterinary Benevolent Funds. In 2016 we were able to pass over £52,000 raised from your donations during renewals and also the society contributed £770 on behalf of those members who returned their proxy voting forms ahead of the Annual General Meeting. Added to this we also raised over £25,000 from members offering their mutual bonus as a donation plus pooled money from individual bonuses less than £10. Both Vetlife and the IVBF work tirelessly in raising awareness of the profession's mental health and, most importantly, supporting colleagues through difficult times. The VDS has never had its focus just on professional indemnity insurance as it works continuously with our members and many of the veterinary national bodies to improve wellbeing of all the veterinary team.

One change very much for the better this year that has kept VDS busy during 2016 was our website relaunch. This enabled us to successfully implement online renewals. We were delighted that, with minimal teething problems, 65% of our members renewed online and we look forward to growing this in future years. The Board sees the investment in our IT systems and infrastructure as an important building block for our ongoing strategy. We are looking at innovative ways to further expand our role of defend, protect and develop through insurance and training based on our strategy review to which so many members contributed. The Board will continue to promote the underpinning of the development of new and improved offerings through a modern IT system designed for our needs.

Our Claims Consultants and Claims Advisers have been in demand more than ever, dealing with advice calls and claims handling. Our unique policy of representing all our members from the start to finish of any investigation by our veterinary regulators is fully justified by increased activity by the RCVS and VCI. This continues to increase overall claims costs and is driven by an ever-increasing complaints culture within our members' clientele. The Board is aware that we are working with a complex business model and are driven to deliver a quality service with the best value in the defence and protection of the veterinary profession. We are watching the development of the RCVS' second pilot of an Alternative Dispute Resolution with interest. We are in close discussion with the veterinary regulator in the UK to better understand the procedures of this second pilot and how best we can assist our members through the process. We are also keen to raise awareness of our own and our members' experiences when taking part in ADR so the RCVS is fully informed.

For the VDS, as a regulated insurance company, working closely with regulators is a key part of our work. We have developed a strong compliance team whose role is to assist in the monitoring of our work as regards regulatory process but also keep the VDS abreast of the constant changes of our regulatory requirements. We are dual regulated by both the PRA and the FCA. Under the requirements of the European Solvency II Directive we have increasing regulatory responsibilities. The Board is focused on meeting all its ongoing regulatory standards. We have completed our third ORSA (Own Risk and Solvency Assessment) in November 2016.

Following the international turmoil of 2016 we are keeping a close eye on any Brexit developments as they occur. We are aware of potential impacts in several ways and it is important that the VDS has plans in place for any changing needs. We will be monitoring the possible effect on our European veterinary colleagues working here in the UK, the possible effect on our company regulatory processes and, importantly, the potential impact with regards to our Irish members and any likely implications that all this may have on our future business strategy.

As regards the VDS Board, we maintain a majority of veterinary surgeons who continue to promote the “vets for vets” ethos that the VDS has nurtured for over 150 years. The veterinary element of the Board comes from diverse backgrounds and with a wide knowledge of the veterinary sector. Added to that we draw on the knowledge of our non-veterinary independent non-executive directors (INEDS) who bring a diverse range of expertise from the insurance and financial sector. The INEDS work closely as a team at Board level with the Executive Directors. I would like to express my thanks to all the Directors for their commitment to making the VDS what it is today and assisting in developing ongoing strategy for what the VDS will be in the future. I would like to take this opportunity to welcome one new veterinary INED, Gavin Lawrie BVMS CertEP MRCVS, who was co-opted to the Board in November 2016 and who will offer himself for election to office at this year’s AGM.

Finally, with my new role as the Chairman of the Board of VDS, my first job was to say goodbye to our previous Chairman, Chris May. Chris May has been involved with the VDS Board since 1996 and has been a fantastic servant to the Society. He has overseen the development of a forward looking modern Board structure, better corporate governance matching the needs of a progressive regulated insurance company and the increased need for compliance monitoring of our regulatory processes. He will be sorely missed and, as I have quickly learnt, will be a tough act to follow.

I would like to take this opportunity to thank all of our members for their ongoing support of the VDS and also to stress that the work of the VDS is totally focused on your needs as members. As Stephen Hawking once said “Intelligence is the ability to adapt to change” and the VDS and its Board will continue to adapt and develop on your behalf in 2017.

N J Paull BVSc MRCVS

Chairman of the Board

29 March 2017

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

2016 was another successful year for the Society and the Chairman's Statement on pages 5 and 6 provides a review of some of the Society's key activities.

Gross written premiums before return of premium amounted to £11,527,061, an increase of £593,543 on the previous year (2015: 10,933,518).

In 2015 the Society introduced a return of premium (called the "Mutual Bonus"). 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. The Society has returned a positive insurance result again in 2016 and is able to distribute £750,000 which is equivalent to approximately 6.5% of 2016 gross written premium (2015: £650,000 5.9% of 2015 gross written premium).

The costs of claims incurred net of reinsurance was £5,749,678, an increase of £2,656,615 on the previous year (2015: £3,094,063). The increase is as a result of two key factors: 2015 results benefitted from a provision release following the change in policy basis from occurrence to claims made, and 2016 has seen negative run-off deviations particularly for Disciplinary cases as a result of more cases than expected going to Disciplinary Hearings and consequently incurring increased costs.

Gross claims paid during the year increased from the previous year as a result of the conclusion of a number of routine claims and the conclusion of one large claim. 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 £28.8 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:

	2016	**2015**
Gross written Premiums before Return of Premium	£11,527,061	£10,933,518
Return of Premium	£750,000	£650,000
Deferred Income[1]	8,223,633	3,029,853
Balance on Technical Account	276,384	1,863,459
Surplus after Tax	£985,825	£983,187
Net increase in cash at bank	£4,880,747	£19,544,599
Net cash used in investing activities	£1,184,272	£18,023,241
Combined Ratio[2]	108%	89%
Employee retention	89%	90%

[1] Deferred income increased by £5,193,780 in 2016 due to the success of online renewals and accelerated payment by the majority of policyholders.

[2] The Combined Ratio is calculated as Claims incurred net of reinsurance plus Net operating expenses as a percentage of Gross written premiums after return of premium, 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 core business model is unique, utilising experienced veterinary surgeons to provide a wide ranging, comprehensive and expert advice service which helps to mitigate both the frequency and severity of claims, and thereafter a high quality claims service when they do occur. The Board sees it as important to maintain this core business model and recognises that the costs associated with providing this quality of service can be higher than industry norm and therefore continually strives to ensure this represent good value for members.

STRATEGIC REPORT (continued)

The Society's business strategy has been under review in 2015/16 and, whilst this core business model will be maintained and further developed, the Society will seek to expand its advice, risk management and training services as well as looking to develop other complementary insurance and non-insurance related products and services.

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.

Credit Risk

The Society's principal financial assets are investments, deposits with credit institutions and bank balances. The Society maintained a consistent investment strategy during 2016 with approximately £20 million invested in Debt securities and Shares and other variable-yield securities and units in unit trusts. 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.

Taking each of these in turn, the Board considers that the loss of market share is mitigated by providing a service that is unique and difficult to replicate yet achieves the optimal balance of quality and value to members. The revised strategy ensures this service remains relevant and up to date within the rapidly changing business environment by constantly reviewing and consolidating the core offering whilst extending and expanding its other complementary products and services. The Society has also continued to develop tangible benefits of the VDS's mutual status and in 2016 was able to pay out the first Mutual Bonus by way of a return of premium.

The excellent reputation of the Society has been built up over many years and it is a core value of the Society to safeguard this reputation. The Society has a firm and steady commitment to compliance and regulatory matters and has embedded in to the business many policies, procedures and practices covering areas such as customer care, communication, use of technology and constantly monitors and reviews them against best practice.

Claims trends are monitored by source and type of claim and also by their frequency and severity in order to assess the correct level of premium and to inform, on an annual basis, what levels of reinsurance are purchased in order to protect the Society's capital position. In recent years there has been an increasing trend by regulators of the veterinary profession to pursue matters of professional misconduct impacting both advice line usage and the number of claims.

Business Environment

The Society operates in two rapidly changing industries. The veterinary profession continues to see structural change with increasing corporatisation, specialisation and changing demographics from within, whilst factors such as the ever increasing 'complaint and blame culture' putting added pressure from external sources. The welfare of veterinary surgeons, nurses and the whole practice team continues to have an increasing focus across the profession. The insurance industry is also seeing rapid change particularly around compliance and regulation. Although Solvency II is now implemented the costs and management time associated with meeting the greater levels of transparency for regulators and the public (Pillar III) are still increasing. 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.

STRATEGIC REPORT (continued)

Business Plan and Future Activities

The Society's business strategy has been under review during 2015/16 and will move into implementation phase during 2017. This will see the Society continuing to devote considerable expense and effort in consolidating and extending its current well respected professional indemnity cover, and a claims service that goes beyond the simple provision of indemnity. It will also see the Society extend and expand its advice, risk management and training services both in terms of delivery methods and breadth of products and services. In all activities, the Society will endeavour to develop innovative ways in which it can serve its members and provide the right balance of quality and value. In order to do this the Society has also developed an IT and Digital strategy that will underpin and facilitate the business plan.

Approved by the Board and signed on behalf of the Board

N A Macfarlane
Chief Executive
29 March 2017

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 September 2016, 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 which led the Board to authorise the development of the Society’s product and service areas. The Society will continue to progress these as a key part of its 2017 to 2019 Business Plan.

The Board meets every two months, with a two day Board meeting being held each May and November 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 to the three committees established to consider specific areas in more detail than would be possible within Board meetings, the Board set up an Investment Committee in July 2016 to have oversight of the Society’s Investment Strategy.

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.

Investment Committee

The committee consists of its chairman, Non-Executive Director, Brian Bussell and Non-Executive Director Professor Sarah Wolfensohn. The Society’s Chief Executive Officer, Norman McFarlane, and Finance Director, Gareth Lloyd, are also members of the Investment Committee.

The committee provides challenge to the Society’s investment managers by reviewing annual performance and reports to the Board.

Audit, Risk and Compliance Committee (‘ARCC’)

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

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 auditors, and reviews and monitors the external auditors’ 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 ARCC is provided below.

The Chief Executive Officer, Finance Director, General Counsel and Company Secretary and representatives from the internal and external auditors also attend committee meetings, by invitation. 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, Professor Sarah Wolfensohn and Colin Thomson. 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, N J Paull (who is also Non-Executive Chairman of the Board) and Non-Executive Directors, Michael Pratt, David Black and Colin Thomson. 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.

Directors' attendance at Board and Committee meetings during year ending 31 December 2016

(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, Risk & Compliance	Investment
C May	4/4[1]		4/4		
D H Black	4/6		4/4	4/5	
B Bussell	5/6			1/1[6]	1/1
T A Clegg	5/6	4/4			
D S Green	5/6				
G J Lawrie (Designate)	2/2[2]				
A M Lewis	5/6				
D G Lloyd	6/6				1/1
N A Macfarlane	4/6		4/4		0/1
N J Paull	6/6	2/2[3]	4/4		
M J Pratt	6/6		4/4	5/5	
C W Thomson	6/6	2/2[4]	0/0[5]	4/5[7]	
J A Wells	6/6				
S E Wolfensohn	6/6	4/4			1/1

1 Retired Board 27 July 2016
2 Joined Board (Designate) 27 July 2016
3 Retired Rem Co 27 July 2016
4 Joined Rem Co 27 July 2016
5 Joined Nom Co 27 July 2016
6 Joined ARCC 27 July 2016
7 Retired ARCC 27 July 2016

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 2016 the Board consists of five Executive Directors and eight Non-Executive Directors including one newly appointed veterinary Non-Executive Director, Gavin Lawrie, who will be proposed for election to the Board at the Society's Annual General Meeting in July 2017.

All of the Non-Executive Directors have served on the Board 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 Principal 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. The Chief Executive is responsible for the annual appraisals of the Executive Directors and Company Secretary. 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 Schedule of Matters Reserved for the Board 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, Risk and Compliance 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, Risk and Compliance 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, Risk and Compliance 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 ARCC 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 Croner 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 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.

In 2016, the Society provided its members with an Annual Review, summarising the Society's Annual Report and Financial Statements 2015.

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.

Audit, Risk and Compliance Committee Report

The committee met five times during 2016.

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 carrying out 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.

The ARCC liaised with the Society's internal and external audit functions and during 2016 it concentrated on a number of important areas which were likely to impact on the Society's Business Strategy.

CORPORATE GOVERNANCE REVIEW (continued)

Audit, Risk and Compliance Committee Report (continued)

BDO LLP, the Society's internal auditors, continued with their rolling three year strategic audit programme overseen by the committee. In January 2016, following a review of the Society's Information Technology Change Management procedures, BDO LLP recommendations were taken forward and included within a report provided by PricewaterhouseCoopers LLP as part of their non-audit service. As a result, the Society's Board was presented with a series of strategic options for its IT function which were discussed by the Board at its meeting in March.

The ARCC also commissioned BDO LLP to carry out a review of the methodology behind the Society's first Mutual Bonus which was paid to eligible members in the UK in the second quarter of 2016 and in Ireland in the third quarter of 2016. This enabled the committee to provide assurance to the Board that the steps applied by the Society were aligned to the Board's policy.

Further reports received from BDO LLP throughout the year covered the Society's preparation for the Senior Insurance Managers' Regime; Expenditure, Claims Handling Processes, Risk Management Maturity and Compliance Monitoring, all of which the committee were pleased to report received the grading "substantially meets the expectations of the auditors".

Enhancement opportunities that were identified were collated and tracked and the committee monitored progress throughout the year and reported accordingly to the Board.

PricewaterhouseCoopers LLP are the Society's external auditors and the committee worked with PricewaterhouseCoopers LLP in agreeing an appropriate audit plan for the year ending 31 December 2016. The plan covered the Society's Annual Report and Financial Statements, prepared in accordance with UK GAAP ("FRS 102 and FRS 103"). In addition, as a result of the further reporting requirements of the Solvency II Directive, the plan also included a review of the Solvency II methodology, the first year-end Solvency II return and the narrative reporting in the Solvency Financial Condition Report ("SFCR") dealing with the valuation for solvency purposes and capital management, together with the Quantitative Reporting Templates.

The key areas of focus for the committee during 2016 were as follows:

Whether the Society's case estimate assumptions 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.

Solvency II Quantitative Reporting Templates (QRTs) and asset data for Solvency Capital Requirement (SCR)
During 2016 the audit requirements under Solvency II included components where the methodology and calculations were significantly different to the Solvency I regime. The committee ensured that the SCR calculation methodology had been applied appropriately by the external actuaries. PricewaterhouseCoopers audited this methodology during the year as an acceleration of the work required for the annual solvency II external audit.

Management override of control
This risk was discussed by PricewaterhouseCoopers LLP with a number of individuals in the business and with ARCC and the committee was able to reassure the Board that appropriate measures were in place to prevent and detect fraud, errors and non-compliance.

Risk of fraud in Revenue Recognition
The committee reviewed the risk of individuals in the Society having an incentive to manipulate revenue and affect the results of the business. PricewaterhouseCoopers LLP also discussed the potential for fraud within the business including the ARCC. PricewaterhouseCoopers LLP performed detailed testing of the revenue stream, tested the reconciliation of the policy administration system to the general ledger, tested a sample of journal entries and reviewed the customer complaints.

CORPORATE GOVERNANCE REVIEW (continued)

Own Risk and Solvency Assessment Report 2016

In November 2016 the Board approved the Society's third Own Risk and Solvency Assessment ("ORSA") report in accordance with the requirements 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 at its meeting on 16 November 2016 prior to final Board approval on 1 December 2016. 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 during 2017.

In summary;

During 2016, the committee discharged its responsibilities by:

- Reviewing the Society's Annual Report and Financial Statements prior to Board approval and reviewing the external auditors' detailed reports thereon, in respect of the year ended 31 December 2015.
- Reviewing the appropriateness of the Society's accounting policies.
- Reviewing and approving the audit fee in conjunction with an assessment of external auditors' performance.
- 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 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.
- 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.

The committee were pleased to be able to evidence to the Board that suitable accounting policies had been implemented, appropriate judgements had been made by management and that all relevant financial reporting requirements had been completed.

The committee has reviewed and considered the Annual Report and Financial Statements 2016 and presented the same to the Board. 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 2. The directors during the year and any changes since the year end were as follows:

D H Black	
B M H Bussell	(Appointed 05/02/2016)
T A Clegg	
D S Green	
G J Lawrie (Designate)	(Appointed 27/07/2016)
A M Lewis	
D G Lloyd	(Appointed 14/01/2016)
N A Macfarlane	
C May	(Retired 27/07/2016)
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 Vetlife during the year (2015: £52,500).

In addition to the above donations, as a result of returned 2016 AGM proxy forms, charitable donations of £700 (2015: £901) will be made to Vetlife and £70 (2015: £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 a 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. Whilst the Society will continue to underwrite only one line of business it will seek to offer other complementary (insurance and non-insurance based) products and services through a variety of delivery models. The business model has proven to be strong in the long term with the Society insuring over 90% of the veterinary profession. The new activities are intended to broaden the relationship with members in order to protect this share through the provision of a more comprehensive offering.

The Society's prospects are assessed through the strategic planning process the output of which is a series short and medium term objectives covering the planning period, these are set out in the Society's ORSA. 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.

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 31/12/19.

Independent Auditors'

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 auditors are 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 auditors are 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.

PricewaterhouseCoopers LLP have expressed their willingness to continue in office as auditors' 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

D G Lloyd
Finance Director
29 March 2017

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

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

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 United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law).

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 company and of the profit or loss of the company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable UK Accounting Standards, including FRS 102 have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- 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.

The directors' 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 2016 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 and Financial Statements (the "Annual Report"), comprise:

- the Balance Sheet as at 31 December 2016;
- 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 United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law (United Kingdom Generally Accepted Accounting Practice).

Our audit approach

Overview

- Overall materiality: £818,000 (2015: £680,000) which represents 1.98% of total assets.

- Our audit was scoped by updating our understanding of the Company and its environment, including internal control, and assessing the risks of material misstatement. The Company is based in a single location and offers one product, being professional indemnity insurance to veterinary practices across the UK and Republic of Ireland. Consequently, our audit is performed in a single location and we deem there to be one reporting unit for the purpose of our audit scoping assessment.

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.

<table>
<tr><th>Area of focus</th><th>How our audit addressed the area of focus</th></tr>
<tr><td colspan="2">Valuation of technical provisions
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 30 (Accounting policies) and page 43 (note 17) for further information</td></tr>
<tr><td>Case estimate assumptions may be inappropriate
The technical provisions consist of four distinct components being:
- Case estimates, being those claims that have been reported to Management and a specific provision has been recorded;
- A provision for claims incurred but not reported (IBNR) being those claims that the Company will incur on business that has previously been written on an occurrence basis, but has not yet been notified to the Company;
- A 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; and
- A claims handling provision to cover the anticipated future costs of negotiating and settling claims which have been incurred, whether reported or not.
As at 31 December 2016, technical provisions total £6.4m (£6.0m at 31 December 2015). Case estimates are significant in the context of the overall balance sheet, representing £3.7m of the technical provision balance as at 31 December 2016 (2015: £3.8m).
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.
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.</td><td>During the audit we performed the following:
- We attended a Claims Group meeting to observe and understand the judgements and uncertainty that are taken into consideration in evaluating the claims under review;
- We reviewed the minutes of all Claims Group meetings held during the year to understand the key areas of judgement and uncertainty;
- We examined the historical accuracy of the case estimate assumptions by obtaining the 2008-2015 year-end case estimates from Management, and comparing a sample of these estimates to the final paid amounts;
- For a sample of claims, including specifically those claims defined as large by the actuary, we considered the specific estimate and evidence available to support the reserve recorded, using internal claims advisory experts where appropriate;
- We examined the company's reinsurance arrangements to understand the cover in place and re-performed Management's calculation of the reinsurance recovery;
- We independently obtained written confirmation from third party lawyers for those claims where legal advice has been obtained by Management, and assessed how this had been applied in the calculation of the reserve recorded;
- We agreed a sample of claims flagged as requiring legal input per the policy administration system report to the confirmation responses received; and
- We reviewed a sample of claims not indicated as being subject to review by external legal review to confirm there was no indication that legal advice should be sought.
We found, based on the results of our testing that the judgements applied were supported by the evidence we obtained.</td></tr>
<tr><td>Actuarial assumptions may be inappropriate
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.
IBNR and IBNER reserves are significant in the context of the overall balance sheet, representing £1.1m of the technical provision balance as at 31 December 2016 (2015: £0.8m).
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</td><td>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:
- We tested the controls that the Company has in place over the claims data which is provided to the external actuarial specialist and found no material exceptions;
- 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;
- 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.</td></tr>
</table>

Area of focus	*How our audit addressed the area of focus*
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.	We tested the methodology and assumptions used to calculate the IBNR/IBNER reserves as follows: - We compared the total claims handling expense to the claims handling expense provision from 2009 - 2015 to confirm the percentage of year-end claims handling expense provision to underwriting year and found these to be materially accurate; - 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 - 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.
Valuation of investments *Refer to page 33 (Accounting policies) and page 42 (note 14) for further information*	
Investment valuation The company holds investments in UK Gilts, Corporate bonds and European equities. These investments are held and managed externally by two asset managers. We focused on this area because of the significance of the value of the investments in the context of the company balance sheet.	We performed testing over the investment portfolio as follows: - We confirmed the year-end investment valuations with the external investment managers; - 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 - For a sample of investments, we re-priced the year-end valuation using a third party data source. We found no material exceptions from the work performed.

How we tailored the audit scope

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

The Company operates from a single location and offers a single product, being professional indemnity cover for veterinary practices in the UK and the Republic of Ireland. Our 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, being the insurance technical provisions.

The audit of the insurance technical provisions was performed through an examination of the 2016 case estimate reserves, together with the utilisation of PwC actuarial specialists to evaluate the judgements made by Management's expert when calculating the IBNR and IBNER provisions at the 2016 year-end.

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 primarily 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 regulatory framework, being the first year in which the entity has been subject to Solvency II reporting.

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.

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, as well as to evaluate 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:

Overall materiality	£818,000 (2015: £680,000).
How we determined it	Our benchmark to determine materiality was total assets. Our overall materiality represented 1.98% of total assets.
Rationale for benchmark applied	We had regard to the reserves as disclosed in note 22 to the financial statements which represents the amount of surplus that would, in the event of a 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 it were 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. We are satisfied that our overall materiality was also reasonable in relation to other Key Performance Indicator metrics reported by the company, including earned premiums, the balance on the technical account and the surplus after tax.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £15,000 (2015: £15,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

The directors have chosen to voluntarily report 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 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 and compliance with applicable requirements

Companies Act 2006 reporting

In our opinion, based on the work undertaken in the course of the audit:

- 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;
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

ISAs (UK & Ireland) reporting

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, in our opinion:	
• information in the Annual Report is: – materially inconsistent with the information in the audited financial statements; or – apparently materially incorrect based on, or materially inconsistent with, our knowledge of the company acquired in the course of performing our audit; or – otherwise misleading.	We have no exceptions to report.
• the statement given by the directors on page 17, 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 position and performance, business model and strategy is materially	We have no exceptions to report.

	inconsistent with our knowledge of the company acquired in the course of performing our audit.	
•	the section of the Annual Report on page 17, 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.	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:

•	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.	We have nothing material to add or to draw attention to.
•	the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.	We have nothing material to add or to draw attention to.
•	the directors' explanation on page 19 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.	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 set out on page 20, 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. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

Thomas Tyler (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
29 March 2017

STATEMENT OF INCOME AND RETAINED EARNINGS
Year ended 31 December 2016

	Note	2016 £	Restated 2015 £
Technical account			
Gross written premiums before return of premium	5	11,527,061	10,933,518
Return of premium		(750,000)	(650,000)
Gross written premiums		**10,777,061**	**10,283,518**
Outward reinsurance premiums		(870,846)	(760,197)
Net premiums written and earned premiums net of reinsurance		**9,906,215**	**9,523,321**
Allocated investment income transferred from the non-technical account	10	1,070,260	890,657
Total technical income		**10,976,475**	**10,413,978**
Claims incurred, net of reinsurance			
Gross claims paid	6	5,109,004	4,647,279
Reinsurers' share of gross claims paid	6	(42,488)	(266,573)
Net claims paid		**5,066,516**	**4,380,706**
Change in gross provisions for claims	6,17	319,588	(1,530,753)
Change in reinsurers' share	6,17	363,574	244,110
Change in net provisions for claims		**683,162**	**(1,286,643)**
Claims incurred, net of reinsurance		**5,749,678**	**3,094,063**
Net operating expenses	7	4,950,413	5,456,456
Total technical charges		**10,700,091**	**8,550,519**
Balance on technical account		**276,384**	**1,863,459**
Non-technical account			
Balance on technical account		276,384	1,863,459
Investment income	10	1,040,569	706,647
Unrealised gains on investments	10	1,056,799	-
Investment expenses and charges	10	(74,613)	(113,373)
Unrealised losses on investments	10	-	(551,265)
Allocated investment income transferred to the technical account	10	(1,070,260)	(890,657)
Surplus on ordinary activities before tax		**1,228,879**	**1,014,811**
Tax on surplus on ordinary activities	11	(243,054)	(31,624)
Surplus for the financial year		**985,825**	**983,187**
Income and expenditure reserves at 1 January		23,168,855	22,185,668
Income and expenditure reserves at 31 December		24,154,680	23,168,855

All of the operations of the Society are continuing.

BALANCE SHEET
Year ended 31 December 2016

	Note	2016 £	2015 £
Assets			
Intangible assets			
Intangible assets	12	44,751	-
Investments			
Land and buildings	13	1,121,451	911,435
Other financial investments	14	28,793,330	26,862,261
		29,914,781	**27,773,696**
Reinsurers' share of technical provisions		50,480	414,054
Debtors			
Debtors arising out of direct insurance operations - policyholders	15	785,700	172,047
Debtors arising out of reinsurance operations	15	41,476	266,573
Other debtors	15	109,480	-
		936,656	**438,620**
Other Assets			
Tangible assets	16	532,596	610,812
Cash at bank and in hand		9,196,107	4,315,360
		9,728,703	**4,926,172**
Prepayments and accrued income		547,123	473,773
TOTAL ASSETS		**41,222,494**	**34,026,315**
Liabilities			
Reserves		24,154,680	23,168,855
Technical provision - claims outstanding	17	6,357,055	6,037,467
Creditors: amounts falling due within one year	18	1,476,730	889,008
Accruals and deferred income	19	9,234,029	3,930,985
TOTAL LIABILITIES		**41,222,494**	**34,026,315**

These financial statements of The Veterinary Defence Society Limited, registration number 2159441, were approved by the Board on 29 March 2017

Signed on behalf of the Board

D G Lloyd
Finance Director

CASH FLOW STATEMENT
Year ended 31 December 2016

	Note	2016	2015
Operating Activities		**£**	**£**
Net cash (outflow) from operating activities	21	5,241,970	(1,829,639)
Tax Paid		-	(131,797)
Interest and dividends received		823,049	506,061
Net cash (used in) / generated from operating activities		6,065,019	(1,455,375)
Investing Activities			
Purchase of tangible assets		(156,756)	(228,022)
Purchase of intangible assets		(49,776)	-
Proceeds on sale of tangible assets		-	14,499
Other investment management fees paid		(48,346)	(65,983)
Purchase of Debt securities and Shares and other variable-yield units in unit trusts		(898,028)	(14,254,906)
Net (payments to) / cash receipts from Deposits with credit institutions		(31,366)	(3,554,812)
Net cash (used in) / generated from investing activities		(1,184,272)	(18,089,224)
Net (decrease) increase in cash at bank and in hand		4,880,747	(19,544,599)
Cash and cash equivalents at the beginning of the year		4,315,360	23,859,959
Cash and cash equivalents at the end of the year		9,196,107	4,315,360
Cash and cash equivalents consists of:			
Cash at bank and in hand		9,196,107	4,315,360
Short term deposits presented within other financial investments		-	-
Cash and cash equivalents at the end of the year		9,196,107	4,315,360

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.

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 incepted during the financial year excluding insurance premium tax. Premiums received in the year relating to contracts incepted 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:

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

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.

Intangible assets

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses. Amortisation is calculated, using a straight-line method, to allocate the depreciable amount of the assets to their residual values over their estimated useful lives, as follows:

Website	33.33% per annum on cost, straight line basis

Where factors such as technological advancement or changes in market price indicate that residual value or useful life have changed, the residual value, useful life or amortisation rate are amended prospectively to reflect the new circumstances.

The assets are reviewed for impairment if the above factors indicate that the carrying amount may be impaired.

Costs associated with maintenance of computer software are recognised as an expense as incurred.

NOTES TO THE FINANCIAL STATEMENTS (continued)

3. Summary of accounting policies (continued)

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.

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the technical account of the long-term investments return (as estimated by the directors) on investments supporting the insurance technical provisions and related retained reserves. This transfer is made so that the balance on the technical account is based on a longer-term rate of investment return and is not subject to distortion from short-term fluctuations in investment return.

The longer term rate of investment return is an estimate of the long-term trends of investment return for the relevant category of investments having regard to past performance, current trends and future expectations.

In respect of equities and properties the directors have estimated the longer term rates of investment return to be as follows:

	2016	2015
Equites	8.0%	8.0%
Properties	7.6%	7.6%

Any other investments are recognised at the actual rate of return.

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).

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

3. Summary of accounting policies (continued)

Financial instruments

The Society has chosen to adopt 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 a 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, 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.

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

3. Summary of accounting policies (continued)

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

Deferred tax arises from timing differences that are differences between taxable profits and capital gains and investment income. Deferred tax is measured using tax rates and laws that have been enacted or substantively enacted by the period end and that are expected to apply to the reversal of the timing difference.

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 addressed 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 £6,357,055 (2015: £6,037,467) 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

	2016	2015
United Kingdom	**£**	**£**
Gross written premiums before return of premium	11,527,061	10,933,518
Return of premium	(750,000)	(650,000)
Gross written premiums	**10,777,061**	**10,283,518**

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 £1,047,974 (2015: £949,098).

NOTES TO THE FINANCIAL STATEMENTS (continued)

6. Claims incurred

	2016	2015
	£	£
Gross claims paid	5,109,004	4,647,279
Reinsurers' share of gross claims paid	(42,488)	(266,573)
Net claims paid	**5,066,516**	**4,380,706**
Change in gross provisions for claims	319,588	(1,530,753)
Change in reinsurers' share	363,574	244,110
Change in net provisions for claims	**683,162**	**(1,286,643)**
Claims incurred, net of reinsurance	**5,749,678**	**3,094,063**

A negative run-off deviation of £213,000 (2015: positive of £485,042) arose on prior years' claims. Negative run-off deviations arise from changes in several claims' status as further particulars are received.

7. Net operating expenses

	2016	2015
	£	£
Acquisition costs	889,888	936,318
Administration expenses	4,060,525	4,520,138
	4,950,413	**5,456,456**
Administration expenses include:		
Depreciation	234,972	269,585
Fees payable to the Society's auditors' for the audit of the financial statements	71,750	37,000
Fees payable to the Society's auditors' for other services:		
Audit related assurance services	52,560	8,000
Other non-audit services	107,188	16,000
Exchange rate (Gain)/Loss	(118,159)	95,246
Professional fees	118,140	160,449
Consultancy fees	289,271	780,230

The Other non-audit services include consultancy costs of £62,000 for IT strategy & IT infrastructure, £16,000 for Data Visualisation and £11,000 for Support for the appointment of the CIO.

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.

	2016	2015
	£	£
Wages and salaries	4,107,119	3,706,639
Social security costs	488,598	446,576
Pension and other costs	530,157	486,930
	5,125,874	4,640,145

	No.	No.
Average number of persons employed (including directors), all of whom were involved in administration	57	52

9. Directors' remuneration

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

	2016	2015
	£	£
Remuneration	947,423	941,100

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

Five directors (2015: seven) were members of defined contribution pension schemes.

The pension contributions to defined contribution pension schemes for the year	73,214	68,011
Remuneration of highest paid director	200,676	187,817
Pension contributions to defined contribution pension schemes of the highest paid director	19,689	18,038

NOTES TO THE FINANCIAL STATEMENTS (continued)

10. Investment return

	2016	Restated 2015
	£	£
Investment Income		
Income on financial assets at fair value through profit and loss	727,963	547,312
Income on financial assets not at fair value through profit and loss	139,114	159,335
Total income from other financial assets	867,077	706,647
Net gains on the realisation of investments	173,492	-
	1,040,569	706,647
Investment expenses and charges		
Other investment management fees	(74,613)	(59,663)
Net losses on the realisation of investments	-	(53,710)
	(74,613)	(113,373)
Net unrealised gains/(losses) on investments	1,056,799	(551,265)
Total investment return	2,022,755	42,009
Investment return is analysed between:		
Allocated investment return transferred to the technical account	1,070,260	890,657
Net investment return included in the non-technical account	952,495	(848,648)
Total investment return	2,022,755	42,009

A 1% increase/ decrease in the longer-term rate of investment return would result in an increase/ decrease in longer-terms investment return of £204,319 (2015: £131,700).

NOTES TO THE FINANCIAL STATEMENTS (continued)

11. Taxation

Current Taxation:

	2016	2015
	£	£
UK corporation tax on profits for the year	272,111	-
Adjustment in respect of previous years	(29,057)	31,624
Total current tax	243,054	31,624

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

	2016	2015
	£	£
Surplus for the year	1,228,879	1,014,811
Tax on surplus at standard UK tax rate of 19.78% (2015: 20.25%)	245,776	205,446
Expenses not deductible	-	25,506
Chargeable gains/(losses)	34,492	-
Deferred tax not recognised	(21,145)	-
Reduction in tax rates on deferred tax balances	(5,588)	-
Deductible expenses	(13,428)	-
Non-deductible mutual surplus	(56,000)	(210,595)
Unrecognised losses carried forward	-	(6,586)
Adjustment from previous period	(29,057)	31,624
Non-taxable dividend income	(26,716)	(13,771)
Revaluation gain on property	(45,723)	-
Allocated investment return transferred to the technical account – non deductible	214,776	-
Unrealised gain on equities	(54,333)	-
Tax charge for the year	243,054	31,624

Deferred Tax:

The provision for deferred taxation provided in the financial statements is as follows:

	2016	2015
	£	£
Unrealised gains on financial investments	18,355	-

NOTES TO THE FINANCIAL STATEMENTS (continued)

12. Intangible assets

	Website
	£
Cost	
At 1 January 2016	-
Acquisitions	49,776
At 31 December 2016	49,776
Accumulated amortisation	
At 1 January 2016	-
Amortisation	5,025
At 31 December 2016	5,025
Net book value	
At 31 December 2016	44,751
At 31 December 2015	-

The VDS website was updated during 2016 to include a renewals portal to allow policyholders to complete their proposal forms online.

NOTES TO THE FINANCIAL STATEMENTS (continued)

13. Land and buildings

	Freehold Land & Buildings
	£
Cost or valuation	
At 1 January 2016	930,035
Revaluation	191,416
At 31 December 2016	1,121,451
Accumulated depreciation	
At 1 January 2016	18,600
Charge for the year	18,600
Revaluation	(37,200)
At 31 December 2016	-
Net book value	
At 31 December 2016	1,121,451
At 31 December 2015	911,435

A valuation of land and buildings as at 31 December 2016 was carried out on 17 January 2017 by Wright Marshall Chartered Surveyors at open market value for existing use. This was valued at £1,250,000. Included within this valuation was related property refurbishment, the book value of which was £128,549. These assets have been included within Note 16, 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:

	2016	2015
	£	£
Cost	1,334,762	1,334,762
Deprecation	(350,428)	(323,733)
Net book value	984,334	1,011,029

NOTES TO THE FINANCIAL STATEMENTS (continued)

14. Other financial investments

	2016		2015	
	£ Market value	£ Cost	£ Market value	£ Cost
Debt securities	17,183,006	16,600,970	15,525,902	15,529,905
Shares and other variable-yield securities and units in unit trusts	3,078,960	2,891,075	2,836,359	2,911,807
Deposits with credit institutions	8,531,364	8,531,364	8,500,000	8,500,000
Other Financial Investments	28,793,330	28,023,409	26,862,261	26,941,712

15. Debtors

	2016	2015
Debtors arising out of direct insurance operations - policyholders	785,700	172,047
Debtors arising out of reinsurance operations	41,476	266,573
Other debtors	109,480	-
	936,656	**438,620**

Other debtors comprises wholly of the balance of online payments transacted though the Society's Website through Worldpay (payment services provider), which were still to be remitted to the Society as at 31 December 2016.

16. Tangible assets

	Fixtures and fittings	Motor Vehicles	Total
Cost	£	£	£
At 1 January 2016	1,486,926	38,530	1,525,456
Additions	156,757	-	156,757
Disposals			
At 31 December 2016	1,643,683	38,530	1,682,213
Accumulated depreciation			
At 1 January 2016	911,433	3,211	914,645
Charge for the year	225,280	9,693	234,972
Disposals	-	-	-
At 31 December 2016	1,136,713	12,904	1,149,617
Net book value			
At 31 December 2016	506,970	25,626	532,596
At 31 December 2015	575,493	35,319	610,812

NOTES TO THE FINANCIAL STATEMENTS (continued)

17. Technical provisions

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

	2016	2015
	£	£
Gross Provision		
At 1 January	6,037,467	7,568,220
Movement in provision	319,588	(1,530,753)
At 31 December	6,357,055	6,037,467
Reinsurers' Share		
At 1 January	414,054	658,164
Movement in provision	(363,574)	(244,110)
At 31 December	50,480	414,054

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 £368,300 (2015: £383,000)

18. Creditors: amounts falling due within one year

	2016	2015
	£	£
Veterinary Benevolent Fund donations	35,968	22,612
Irish Veterinary Benevolent Fund donations	7,364	4,570
Pension Scheme contributions	48,845	44,432
Other creditors including taxation and social security	1,384,553	817,394
	1,476,730	889,008

19. Accruals and Deferred Income

	2016	2015
	£	£
Accruals	260,396	251,132
Return of Premium	750,000	650,000
Deferred income	8,223,633	3,029,853
	9,234,029	3,930,985

Deferred income increased by £5,193,780 in 2016 due to the success of online renewals and accelerated payment by the majority of policyholders.

NOTES TO THE FINANCIAL STATEMENTS (continued)

20. 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 £333,165 (2015: £306,960) representing contributions payable by the Society during the year in respect of qualifying employees and £73,214 (2015: £68,011) in respect of directors. Contributions are charged to the statement of income and retained earnings as incurred.

Unpaid contributions at the year-end were £48,845 (2015: £44,432).

21. Reconciliation of surplus to net cash outflow from operating activities

	2016	2015
	£	£
Surplus for the financial year	985,825	983,187
Adjustments for:		
Tax charge	243,054	31,624
Investment income	(863,607)	(706,647)
Net (gains) / losses on realisation of investments	(173,492)	53,710
Other investment management fees	74,613	59,663
Unrealised (gains) / losses on investments	(1,056,799)	551,265
(Profit) / loss on disposal of tangible assets	-	(3,616)
Depreciation on land and buildings	18,600	18,600
Depreciation on tangible assets	234,972	250,985
Amortisation of intangible assets	5,025	-
(Increase) / Decrease in debtors arising out of direct insurance operations	(613,653)	103,523
Decrease / (Increase) in debtors arising out of reinsurance operations	225,097	(266,573)
(Increase) / Decrease in Other debtors	(109,480)	-
(Increase) / Decrease in prepayments and accrued income	(32,792)	(70,048)
Increase / (Decrease) in net technical provisions	683,162	(1,286,643)
Increase / (Decrease) in creditors, accruals and deferred income	5,621,445	(1,548,669)
Net cash inflow / (outflow) from operating activities	5,241,970	(1,829,639)

NOTES TO THE FINANCIAL STATEMENTS (continued)

22. Financial instruments

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

	2016	2015
	£	£
Financial Assets at fair value through profit and loss		
Debt securities	17,183,006	15,525,902
Shares and other variable-yield securities and units in unit trusts	3,078,961	2,836,359
	20,261,967	18,362,261
Financial Assets that are debt instruments measured at amortised cost		
Debtors arising out of direct insurance operations – policyholders	785,700	172,047
Debtors arising out of reinsurance operations	41,476	266,573
Other debtors	109,480	-
Deposits with credit institutions	8,531,366	8,500,000
Cash at bank and in hand	9,196,107	4,315,360
	18,664,129	13,253,980
Financial Liabilities that are debt instruments measured at amortised cost		
Other creditors including taxation and social security	1,435,806	817,394

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.

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:

	2016	2015
	£	£
Income on financial assets at fair value through profit and loss	727,963	547,312
Other investment management fees	(74,613)	(59,663)
Net gains/(losses) on the realisation of investments	173,492	(53,710)
Net unrealised gains/(losses) on investments	1,056,799	(551,265)
	1,883,641	(117,326)

NOTES TO THE FINANCIAL STATEMENTS (continued)

22. 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 20(ii) below. For information about the Society's exposure to price risk please refer to note 22(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 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 22 (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)

22. 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:

	2016			
As at 31 December	**Level 1**	**Level 2**	**Level 3**	**Total**
Debt Securities	17,183,006	-	-	17,183,006
Shares and other variable-yield securities and units in unit trusts	3,078,961	-	-	3,078,961
	20,261,967	-	-	20,261,967

	2015			
As at 31 December	**Level 1**	**Level 2**	**Level 3**	**Total**
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
	18,362,261	-	-	18,362,261

NOTES TO THE FINANCIAL STATEMENTS (continued)

22. 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. 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)

22. Financial instruments (continued)

(a) Credit risk (continued)

Credit risk by class of financial instrument

As 31 December 2016

	AAA	AA	A	BBB	BB	Other	Total
	£	£	£	£	£	£	£
Debt Securities	1,280,885	6,378,380	3,062,487	5,239,334	-	1,221,920	**17,183,006**
Shares and other variable-yield securities and units in unit trusts	-	-	-	-	-	3,078,961	**3,078,961**
Deposits held with credit institutions	-	-	8,531,366	-	-	-	**8,531,366**
Cash at bank and on hand			4,920,676	3,612,992	-	662,439	**9,196,107**
Debtors arising out of reinsurance operations	-	16,590	24,886	-	-	-	**41,476**
Total	1,280,885	6,394,970	16,539,415	8,852,326	-	4,963,320	**38,030,916**

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**
Total	6,003,229	886,680	14,068,550	6,016,935	-	4,468,800	**31,444,194**

Financial instruments included in Other as above, do not carry a credit risk assessment and do not therefore carry a credit risk classification.

(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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

22. Financial instruments (continued)

(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.

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 as 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 2016 by 25bps would result in a decrease in surplus before tax and the fair value of index linked securities by £231,000 (31 December 2015 : £556,000).

Increasing assumed yields on fixed interest securities at 31 December 2016 by 25bps would result in a decrease in surplus before tax and the fair value of fixed interest securities by £1.3 million (31 December 2015 : £967,000).

Decreasing assumed yields on fixed interest securities at 31 December 2016 by 25bps would result in an increase in surplus before tax and the fair value of fixed interest securities by £1.7 million (31 December 2015 : £1.2 million).

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 year 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 2016 by £64,000 (31 December 2015: £14,000). A 10% decrease in the GBP: EUR exchange rate would increase the net assets at 31 December 2016 by £78,000 (31 December 2015: £18,000).

NOTES TO THE FINANCIAL STATEMENTS (continued)

22. 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	
	2016	**2015**	**2016**	**2015**
	£	**£**	**£**	**£**
Claims paid	5,109,004	4,647,279	(42,488)	(266,573)
Gross Provision for claims	319,588	(1,530,753)	363,574	244,110
	5,428,592	**3,116,526**	**321,086**	**(22,463)**

Refer to Note 17 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 £368,300 (2015: £383,000).

NOTES TO THE FINANCIAL STATEMENTS (continued)

22. Financial instruments (continued)

(d) Insurance risk

Claims development tables

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

Claims outstanding (gross)

Underwriting year	**2011 and prior[1]**	**2012**	**2013**	**2014**	**2015**	**2016**	**Total**
Estimate of ultimate claims costs:							
- at the end of reporting year		4,525,838	5,260,659	4,040,434	4,865,214	5,578,829	
- one year later		4,435,741	4,979,369	4,160,278	5,392,434		
- two years later		4,206,479	4,257,942	4,042,470			
- three years later		4,110,364	4,208,949				
- four years later		4,161,665					
Current estimate of cumulative claims	26,413,382	4,161,665	4,208,949	4,042,470	5,392,434	5,578,829	
Cumulative claims paid	25,828,594	3,592,530	3,911,632	3,567,210	3,810,579	2,730,129	
Current year gross provision	584,788	569,135	297,317	475,260	1,581,855	2,848,700	**6,357,055**

Claims outstanding (net)

Underwriting year	**2011 and prior[1]**	**2012**	**2013**	**2014**	**2015**	**2016**	**Total**
Estimate of ultimate claims costs:							
- at the end of reporting year		4,525,838	5,160,659	4,040,434	4,865,214	5,578,829	
- one year later		4,435,741	4,979,369	4,160,278	5,392,434		
- two years later		4,206,479	4,257,942	4,042,470			
- three years later		4,059,884	4,208,949				
- four years later		4,111,185					
Current estimate of cumulative claims	25,832,323	4,111,185	4,208,949	4,042,470	5,392,434	5,578,829	
Cumulative claims paid	25,247,535	3,592,530	3,911,632	3,567,210	3,810,579	2,730,129	
Current year net provision	584,788	518,655	297,317	475,260	1,581,855	2,848,700	**6,306,575**

Reconciliation to Balance sheet:

Gross technical provisions	6,357,055
Reinsurers’ share of technical provisions	(50,480)
Net technical provisions (above)	**6,306,575**

1 –2011 and prior years’ cases (back to and including 2005 claims) have been aggregated at their position as at 31 December 2016 on both a gross and net basis.

NOTES TO THE FINANCIAL STATEMENTS (continued)

22. 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.

Under Solvency II, the Society is required to calculate its Solvency Capital Requirement The Solvency Capital Requirement (SCR) should reflect a level of eligible own funds that enables insurance and reinsurance undertakings to absorb significant losses and that gives reasonable assurance to policyholders and beneficiaries that payments will be made as they fall due.

As at 31 December 2016, the SCR was calculated at £8.3 million. The Society holds an excess of assets over liabilities of £26.4 million as calculated under Solvency II.

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 year.

The Veterinary Defence Society Limited is a company limited by guarantee and therefore does not have share capital.

Capital therefore takes the form of retained reserves only. Retained reserves for the purposes of the Financial Statements as at 31 December 2016 were £24,154,680 (2015: £23,168,855).

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

23. Operating leases

	2016	2015
	£	£
Operating leases which expire:		
Within one year	-	-
Between one and five years	42,769	56,206
After five years	-	-
	42,769	56,206

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

24. Controlling party

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

25. Related party transactions

In the ordinary course of business, a number of Executive, 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 £331,000 (2015: £230,000) and ten claims (2015: five claims) were received from related parties during the financial year. During the year £11,000 (2015: £1,500) was paid on claims involving related parties with £9,000 remaining outstanding as at 31 December 2016.

Transactions with key management personnel

See Note 9 for disclosure of the directors' remuneration.

26. Change in accounting policy

During the year, the Society changed its accounting policy with respect to the presentation of Investment Return.

The Society now transfers an amount from the non-technical account to the technical account so that the balance on the technical account is based on a longer-term rate of investment return and is not subject to distortion from short-term fluctuations in investment return.

This transfer has no impact on the Society's Surplus for the financial year in either the current or preceding financial year. The change in accounting policy has a significant impact on the Balance on the technical account and consequently the prior period has been restated to illustrate the impact. The impact on 2015 results is shown in the table below:

	As reported	Adjustment	Restated
	2015	2015	2015
	£	£	£
Technical account			
Total technical income	9,523,321	890,657	10,413,978
Total technical charges	8,550,519	-	8,550,519
Balance on technical account	972,802	890,657	1,863,459
Non-technical account			
Balance on technical account	972,802	890,657	1,863,459
Investment income	706,647		706,647
Unrealised gains on investments	-		-
Investment expenses and charges	(113,373)		(113,373)
Unrealised losses on investments	(551,265)		(551,265)
Allocated investment income transferred to the technical account	-	(890,657)	(890,657)
Surplus on ordinary activities before tax	**1,014,811**	-	**1,014,811**
Tax on surplus on ordinary activities	(31,624)	-	(31,624)
Surplus for the financial year	**983,187**	-	**983,187**