Annual Report & Financial Statements 2017

Company No. 727F

Contents

Chairman's Statement

Introduction

I am pleased to introduce Police Mutual's 2017 Annual Report. The Group's results have been delivered during a time of significant internal change, cost challenge and a demanding regulatory environment. Despite these challenges, the Group held true to its original values which were established over 150 years ago. In 1866, serving Police officers formed an organisation run by the Police for the benefit of the Police and their families and which has recently been expanded to the Military.

Economic and Regulatory environment

The UK macro-economic environment during the year turned out to be one of modest growth and stability and our results reflect this. Economic growth held steady at around 1.7% and the FTSE 100 index grew by 7%, despite ongoing uncertainty around Brexit, a change of US president and a general election in the UK. The Bank of England raised interest rates by 0.25% on 1 November 2017 which had a direct impact on savings and borrowing rates charged to our customers and will have increased the financial pressure on their disposable incomes. We were able to constrain increases in general insurance costs to beneath the market norms and ensure that existing customers are charged rates which are broadly comparable to those we offer to new customers, although rising insurance costs will also have impacted our customer's pockets. It is pleasing to see that 83% of our Police members would recommend us which is incredibly high compared to the financial services industry. This results in a very high Net Promoter Score (a measure of customer loyalty based on the quality of their relationships) of 42 for Police Mutual compared to the majority of financial service brands which tend to have negative scores.

Due to ongoing austerity policies adopted by central government, members from our Police and Military affinities have experienced ongoing low salary growth. Ongoing financial constraints continue to put Police forces under pressure and it is widely expected that cutbacks will be required across all three Military services.

The regulatory environment in which the Group operates has become increasingly complex and demanding. Coupled with the growth and increased diversity of the Group this has resulted in an increased level of oversight and requests from our regulators, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) and we have invested materially in our risk and compliance functions to meet these new expectations. Demonstrating financial strength and ongoing controls and oversight will continue to remain a key element of our ongoing dialogue with the PRA, in common with other firms.

In 2016, the FCA announced it would investigate six firms, including Police Mutual, in connection with the fair treatment of longstanding customers in the life insurance sector. A number of products we no longer sell or market to members (less than 1% of our total policies in force) were subject to review to determine whether there were any breaches of FCA rules that might merit further action and whether any customers may have suffered any detriment. The FCA investigation focused on whether we had provided members with sufficient information to take informed decisions.

On 7 September 2017, the FCA announced that it was closing its investigation into Police Mutual with no further action required. We are very supportive of the FCA's agenda in seeking higher standards from firms in the fair treatment of longstanding customers and we strive to meet these standards for all our products. Our belief that we had met requirements was also supported by the independent reviews we commissioned and at no time was there any risk of our members losing out. Nevertheless it was frustrating that such an investigation was initiated given the impact on our key people and the cost to our members of responding to it.

Financial results

2017 saw further integration and consolidation of the Group after a number of years of acquisition and diversification, agreement of an enhanced 5 year general insurance proposition with our strategic partner and a substantial change in the Executive. Whilst revenues remained flat compared to prior year partially impacted by disposals of non-core revenues, our costs have increased. This reflects investment in our control functions, one off adjustments to write down historical system developments and costs associated with our Change and Simplification agenda for redundancy costs and other change programme costs. Police Mutual's investment performance for our With Profits Fund achieved an annual return (gross of tax) of 10.8% (2016: 6.5%).

It is disappointing to report that we have had to restate the 2016 figures to correct an overstatement of £38.2m in the valuation of the Society's subsidiary undertakings. Although this does not impact the consolidated Group position or our liquidity, I am disappointed that the error was not detected by our own internal controls or by external audit. Internal controls with increased rigour have been implemented for the 2017 year end.

Future initiatives

The aim of our simplification agenda was to streamline the organisation so that it can grow more efficiently in the future and have the capacity to invest to facilitate future growth. During 2017, the Society divested itself from the group insurance scheme market, we reduced our location footprint from eight offices to three locations in Lichfield, Liverpool and Basingstoke, shrank the number of products in our portfolio by three quarters and reduced the number of trading entities in the Group.

We have also committed to further cost saving initiatives in 2018 which should reduce costs by a further £3m through headcount savings, rationalisation of our supplier base and delivering enhanced value through our data management and distribution channels.

Improving lives

Demonstrating financial strength and ongoing controls and oversight to ensure that the Group delivers its financial and regulatory responsibilities enables us to deliver our purpose, namely to "improve the lives" of the Police and the Military.

We believe we're able to demonstrate a holistic approach that improves lives and makes a real, tangible difference to the wellbeing of our Police and Military affinities by focusing on the four key areas:

- Financial;
- Physical;
- Mental; and
- Community wellbeing.

In 2017, we delivered over 2,000 financial education courses, helping almost 20,000 Police officers and staff to make sense of their finances. We funded around 2,400 health screenings across the UK, helped 113 families with a respite break and made over 100 referrals for telephone support, helping Police employees and their family members with a range of health issues. In addition, we supported 874 community projects with gifts or funding towards worthy causes, supported major policing events including the Police Bravery Awards, the UK Police Memorial, the National Police Memorial Day and the Police Unity Tour. We were also pleased to roll out our BeFit4Life initiative to over 100 stations in 31 forces, delivering a range of wellbeing activities including food vans, financial education and providing a welcome break from the day-to-day routine. I am pleased to confirm that our sole sponsorship of the Police Bravery Awards has been renewed until 2021.

For members of the Military family we delivered 300 financial education courses, offering information and guidance through workshops, and both one-to-one and group briefings, helping around 7,000 individuals to understand the importance of taking control of their finances to protect their future. We also helped a number of families take much needed time out on respite breaks, as well as sponsoring a number of sports teams, events and activities such as boxing, the Army Ladies Hockey Team, Royal Navy Field Gun competition and Row2Recovery's Team Trident in the Talisker Whisky Atlantic Challenge.

2018 outlook

Looking forward, 2018 will be a year of further consolidation and simplification for the Group, embedding the new Executive team and Target Operating Model, delivery of cost savings and managing risks effectively, all of which serve to deliver our purpose to 'improve the lives' of our affinities.

In closing, on behalf of our Board and Committee of Management, I would like to thank colleagues across the Group, our Volunteer Authorised and Force Authorised Officers, along with our distribution and business partners for their support in delivering and contributing to our 2017 results.

Chief Executive's Statement

2017 Strategic and Operational Review

2017 has been a challenging year as highlighted by our Chairman but overall I am pleased that we have made progress in consolidating and simplifying our businesses after a period of diversification and addressed successfully the challenges which a demanding regulatory agenda continue to pose. I am also pleased to report that we have maintained our levels of revenue during the year, whilst showing a slight net increase in total membership, with 18,000 new Police members secured during the year. Whilst there were no significant new product launches, we continued to develop and enhance our existing product range, especially in the military offering. We also took steps to focus on a smaller total range of products which had grown particularly as a result of recent acquisitions to help simplify our IT and Operations and to maximise our negotiating power with insurers, partners and other suppliers. Despite this we remain committed to giving our customers access to products where there is a need but where other providers might not be able to supply them.

The Group is building on our strong position to make sure that we can continue to modernise the organisation and have the resources and income to achieve our purpose of "improving lives" on a long term basis. At the same time we want to ensure that the Group remains a sustainable operation over the very long term by investing in the improvement of our services. To help meet these aims, we established a Transformation programme in 2017 which is working to streamline the business through a top down review of products, processes and costs to help create the headroom to do so.

In the autumn of 2017 we accelerated the strategic review of the Group that would otherwise have been scheduled for 2018 to ensure that there was no inconsistency with our approach to Transformation. Significantly, the review concluded that there was material potential to grow in both affinities whether in line with the wider market or above through our continued investment in data and in increasing the average number of products each customer holds, where we sit beneath market averages.

Products and services

Motor insurance prices have risen quickly over the past year due to increases to Insurance Premium Tax, increases to reserves for lump sum compensation and rising cost of repairs. These increases have been reported at around 20% by the AA, however we have deliberately maintained our increases at lower levels of an average 9%. We have also sought to make sure that prices paid by our existing members are comparable to those prices offered to new customers, this has resulted in two thirds of our motor policy holders paying less than the new price. Press coverage has also been critical of many insurers charging high levels of interest on the monthly instalments they make, we do not make any charge. During 2017 we have also successfully agreed a new 5 year strategic relationship with our existing partner allowing us to offer enhanced propositions to our members.

In the November 2017 budget, the Chancellor announced the removal of indexation for companies in the calculation of capital gains, indexation allowed companies to increase their tax allowances in line with inflation. This includes companies like Police Mutual which holds investments on behalf of their members. Indexation of gains has been a benefit to members in past years as it has reduced the level of tax. As a result of this change in government tax policy, returns on taxable policies such as the Regular Savings Plan are expected to reduce by between 0.2% and 0.3% a year. It will not affect Options ISA, GISA, Child Trust Fund or our pension products.

In 2011 we revised substantially our investment strategy with the aims of diversifying where we invested and of producing stable and consistent investment returns. Since then we have been building a track record that provides both a stable return that our members seek to achieve and one which outperforms a cash ISA.

Regulatory

The regulatory requirements have continued to increase during the past year. This has resulted in us having increased dialogue with the PRA and FCA, resulting in more requests for information which in turn places pressure on staff time and overhead costs.

The business has made significant investments and progress during the year to acknowledge the increased expectations in the regulatory environment and the recent growth in the size and complexity of the Group. This has involved the following:

- Creation of a Risk Committee;
- Implementation of a target operating model for risk and compliance functions and a target operating model for the Group which sets out the capability we need to achieve our strategy;
- Refreshment of our risk appetite statements;
- Improvement in risk reporting; and
- Education and training across the business to underline how risks are managed and better define individuals' roles and responsibilities.

As our business model continues to change and new products are introduced we continue to engage with our regulators to ensure that these are set up robustly and that we have enough financial strength to support them without causing any risk beyond that we are comfortable with.

Chief Executive's Statement (continued)

2017 Financial Results

Against this operational backdrop the financial result for the year has been affected by a number of one off events which have resulted in an overrun for the year and impacted the year on year growth. The main drivers were:

- Enhanced costs resulting from increased investment in our control functions.
- Booking a write down of £4.5m of historic system developments to provide a consistent and clear basis moving forward.
- Enhanced change and restructuring costs supporting our Transformation and Simplification agenda, resulting in a one off cost of £5m.
- R3 – this business was sold on 30 December 2016 and generated a post-tax loss of £220k in 2016.
- Abacus – this business was acquired on 19 April 2016. The 2017 result included a full year contribution from Abacus with an increased contribution to the overall financial result of £300k.
- Group insurance schemes – this was transferred to a third party provider in the year, with a consequent annualised revenue impact of £400k.

At 31 December 2017, the Society's funds for future appropriation (FFA) have reduced from £154.3m to £132.9m and note 19 analyses the movement in FFA for the year. The FFA represents the sum of the Society's assets, less liabilities. Key components of the movement in the assets and liabilities comprising the FFA are as follows:

	£'m
Value of FFA at 1 January 2017	154.3
Asset: Increase in cash and investments following a year of strong investment returns	18.2
Liability: Increase in long term business provision mainly due to favourable market movement	(23.9)
Asset: Decrease in valuation of group undertakings following a change in valuation basis and updated assumptions	(13.3)
Liability: Decrease in defined benefit pension fund liability caused by improved investment returns and a number of transfers out during the year	1.9
Asset: Decrease in other debtors due to timing differences between the 2016 and 2017 year end	(2.9)
Asset: Decrease in deferred tax assets due to changes in recognition basis for the individual components of the balance	(1.4)
Value of FFA at 31 December 2017	132.9

Misstatement of Subsidiary valuation in 2016

During 2017 a calculation error was discovered in the model which calculates our subsidiary valuation resulting in the 2016 subsidiary valuation being restated to correct an overstatement of £38.2m. Although this does not impact the Group position and does not result in a cash outflow, it is disappointing to me that this error was not detected by our own internal controls or by external audit. Internal controls with increased rigour have been implemented for the 2017 year end.

Capital

The start of 2016 saw a new regulatory regime in the UK come into force for insurers called Solvency II ("SII"). The key objectives of SII are to improve consumer protection, ensure a uniform and enhanced level of policyholder protection across the EU and modernise supervision with the "Supervisory Review Process". Our supervisors' focus is now on evaluating insurers' risk profiles and the quality of their risk management and governance systems.

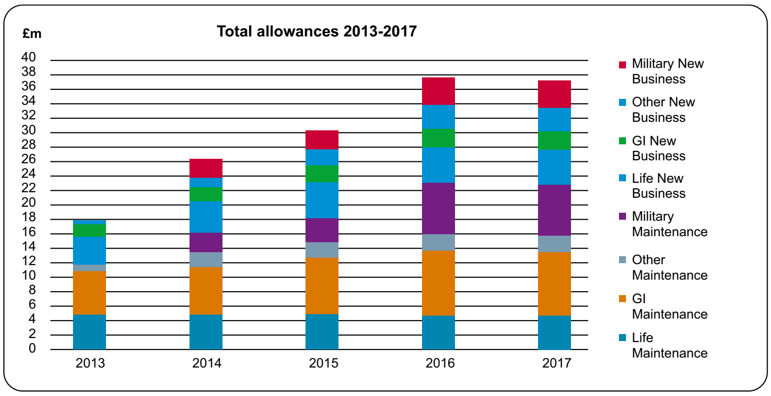
Our capital strength exceeds our internal risk appetite and during 2017, there has been increased focus on the liquidity and quality of our capital, at 31 December 2017, our capital position is 160% of our solvency capital requirement. The Group aims to improve this capital position further so that there are no risks to our strategy even when times are sustainably tough.

After the year end, agreement was reached with the Trustee of the Staff Pension Fund to address the deficit in the pension fund by making an annual capital contribution of £3m for the next six years.

Chief Executive's Statement (continued)

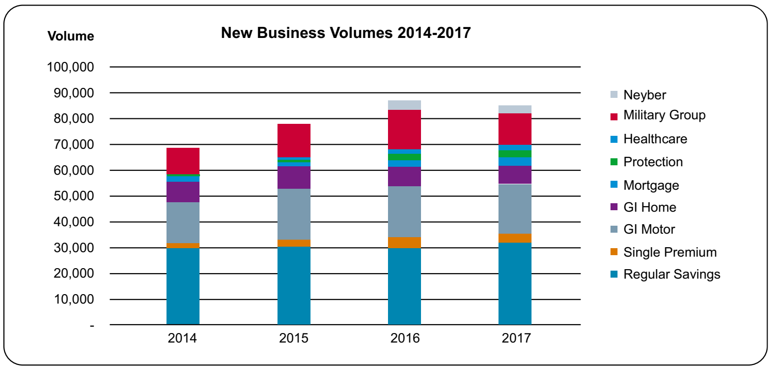
Operational Performance

Income growth and diversification



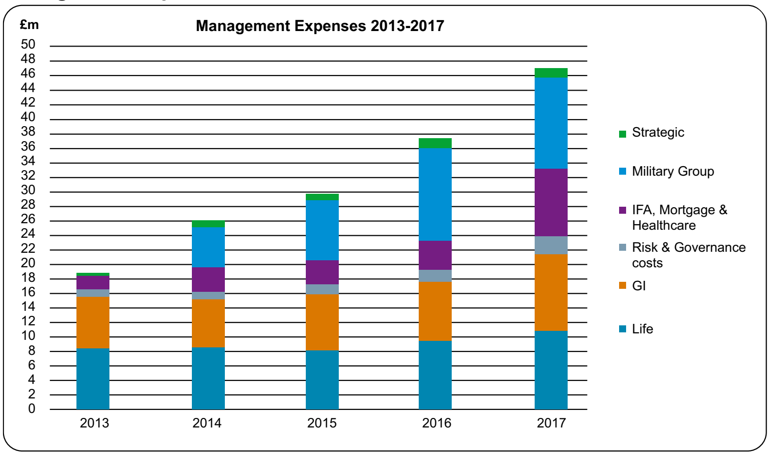
Total Allowances = the net present value of policy charges over the duration of life and savings products plus commissions for general insurance products

Income levels remained very similar to 2016. The acquisition of the Abacus group in April 2016 contributed to the prior year growth. In 2017, the Group was very stable with no businesses acquired or disposed. With effect from end of 2016 a number of products were removed following the disposal of R3 and the withdrawal from group insurance schemes, both of which contributed to the 2016 result.



New business volumes were at similar levels to prior year. Strong growth was recorded in regular savings, healthcare products and independent financial advice, however this was offset by falls in Military as we focused on consolidating the business into the wider Group. New business volumes only includes ongoing products.

Management expenses



Costs increased in 2017 reflecting increased investment in our risk and control functions, costs relating to delivering our change and cost saving agenda and some write downs of historic systems development.

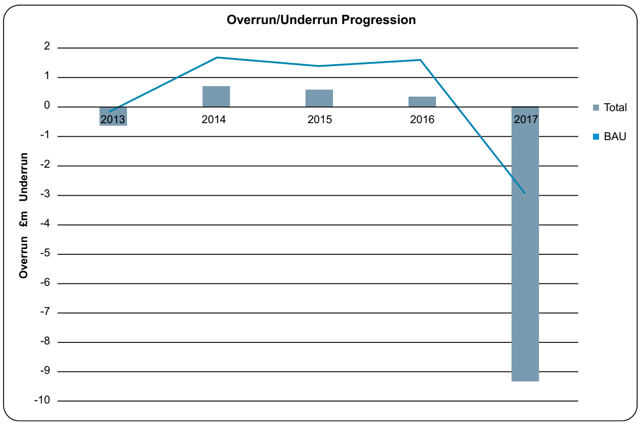
A key focus of our Transformation Programme is cost control and reduction as we continue to streamline our business processes.

Chief Executive's Statement (continued)

Overrun for 2017

The balance between income and expenditure is a key area of focus for the Society and continues to be important for us to remain self-sustaining as well as demonstrating our not for profit credentials where we do not seek to maximise income. However, we run ourselves commercially so that we can maximise the benefits to our members but in a corridor agreed with our Committee of Management that while income should typically exceed expenses this underrun should be in the range of £nil to no more than £2m.

In 2017, we incurred around £5m of costs in respect of the Transformation programme which will deliver target annualised cost savings of £3m as well as other operational and process improvements. This £5m is the major contributor to the recorded overrun in 2017.



People development

Our colleagues deliver support to our members that consistently receives positive personal feedback and supports our members with their needs. With that in mind, a people strategy linked to our forthcoming Strategic Business Plan has been devised and launched which will support the achievement of our plans and aspirations as a Group. Our people strategy will provide the direction for our colleagues and consists of four strategic pillars: Accountable Engaging Leadership, Highly Engaged Colleagues, Capable Colleagues & People Risk Rigour. To support this, work has been undertaken to articulate a clear, consistent and credible People Promise that defines a target employment experience for all colleagues, present and future. The People Promise will help Police Mutual Group to attract, engage and retain the people it needs to embrace change and drive the business forward.

Our annual engagement survey took place in October, and again we received a high level of participation with 81% of colleagues taking the opportunity to participate. We have maintained our "One to Watch" classification in Best Companies Engagement Index which is evidence of good levels of engagement. This was a pleasing result in a year when there was a lot of change affecting my colleagues.

Headcount at the end of 2017 was 552 on a full time equivalent basis.

Changes to Executive

During 2017, Kathryn Winup was appointed as Group Finance Director, Kathryn joined us from Aviva. Following Kathryn's appointment, Ian Cordwell who had been Group Finance Director since 2010 has moved to the role of Chief Investment Officer where he will oversee the development and sourcing of products and the progress on our investment strategy prior to his planned departure from the business during the latter part of 2018. I would like to extend my thanks to Ian on behalf of the Society for his material contribution to the development of the business.

In addition, I would like to thank Chief Risk Officer & Compliance Director, Vicky Kubitscheck, who left the business during 2017 and Sales and Marketing Director, Dave Wright, who retired, for their contribution to the Society. David Vallery and Andy Elkington have been appointed to replace Vicky and Dave respectively.

After the year end, Pete Marr, our Chief Operating Officer, decided to leave the business. Pete has had a major influence in the development of our business over the last eight years and will remain with us until summer 2018.

And finally….

Transformation is the most significant programme of activity in the next 2 years of our strategy. The focus for 2018 is therefore very much to concentrate on a reduced number of priorities as we make material progress in our Transformation programme. Given the fast pace at which the organisation has grown over the past few years, we will also benefit from letting our recent initiatives get embedded and refined. Achievement of these priorities will truly ensure that Police Mutual will be "getting ahead of the curve".

I would like to thank all my colleagues for their tremendous dedication and hard work over the last year and all our supporters more widely. We have a very special business and I know how rewarding it is to see the impact we have on people who put their lives on the line and how we improve their lives.

Risk Management Report

The Managing Board has over the course of 2017 exercised appropriate governance over the principal risks facing Police Mutual which impact its financial soundness, brand and reputation, and organisational capability. In discharging its governance duties, during 2017 the Managing Board:

- reviewed and approved a revised risk appetite statement setting out which risks it wished to take and avoid;
- discussed and agreed the principal risks as well as the circumstances that could threaten the longer term viability of the business model and successful delivery of the annual business plan and strategy;
- monitored and challenged, where appropriate, management of these principal risks, changes in the risk profile of the business and progress of mitigation actions taken to address those risk exceptions identified during the year;
- approved a plan to accelerate progress towards a revised Target Operating Model for the business to mitigate recognised vulnerabilities in the business model;
- considered critically the on-going suitability of the investment strategy as aligned to the long term goals of the business that include the interests of all our members;
- approved the business' solvency and capital requirements; and
- reviewed and approved those key risk policies as appropriate for governance of risks and smooth running of the business.

The Managing Board is supported by the work of its sub-committees that include the:

- Investment Committee for oversight and delivery of the investment strategy;
- Audit Committee for oversight of the financial reporting process, the integrity of financial statements and information, and the internal systems of control;
- Risk Committee for oversight of the Chief Executive in managing the business in accordance with risk appetite;
- Remuneration Committee for oversight of the framework and policy for Executive remuneration; and
- With-Profits Committee that provides in the main an independent assessment of compliance with the Principles and Practices of Financial Management.

Police Mutual adopts an enterprise-wide risk management framework to ensure that it manages risks effectively. This is underpinned by the three lines of defence model which ensures independent oversight and audit of risk management carried out by the business. The Board recognised shortcomings in the Group's risk management and internal control systems during 2017 and supported the Executive in addressing these. Important steps have been taken in 2017 to improve the effectiveness of the Risk function and broader risk management across the business and in reporting at Executive and Board level. Further improvements are being progressed which will bring the business to its target effectiveness state by the end of 2018. These improvements are additional to the establishment of the Risk Committee which was formed in January 2017. An improvement in controls has been observed in the 2017 year end process.

The principal risks facing the business are set out below.

Market Risk (including credit): Risk of fluctuations in values of, or income from, assets or in interest arising from fluctuations in interest rates and other market rates which can affect the value of the Group's investments and therefore the size of its assets and solvency position. This includes the risk of loss arising from the default or failure of third parties to meet their financial obligations or variations in market values against expectations related to these risks.

Insurance Risk: Risk of fluctuations in the timing, frequency and severity of insured events relative to the expectations at the time of underwriting or when set against the claims settled.

Liquidity Risk: Risk that the Group, whether solvent or not, either does not have available sufficient financial resources to meet its obligations as they fall due, or can secure them only at excessive cost.

Capital Risk (including Strategic & Business Risks): Risk of not maintaining sufficient quality and quantity of capital commensurate with the effective delivery of our business strategy.

Conduct Risk: Risk of customer detriment which may occur throughout the customer relationship and that has resulted from the Group's conduct and/or behaviour; and failure to deliver against its Values, business strategies and its obligations for the prevention of financial crime.

Operational Risk: Risk of loss resulting from inadequate or failed internal processes, systems, human factors or due to external events.

For each of these principal risks, the Managing Board has determined a formal statement of risk appetite which sets out how much risk the Board is prepared to take in pursuit of achieving Police Mutual's fundamental purpose and established a framework for decision making. Performance is reviewed regularly against this statement to ensure that the business operates within risk appetite.

Risk Management Report (continued)

In addition, Police Mutual manages each of these principal risks through adopting policies, controls and mitigation activities as summarised in the following table:

Risk types	Key aspects of risks	Key controls and risk mitigation activities
Market Risk (including Credit)	• Equity and property market falls • Equity volatility • Bond volatility • Fall and rise in bond yields • Currency movements • Inflation (staff pension fund risk) • Exposures relating to holdings in corporate bonds and cash deposits • Defaults in key strategic partners, counterparties and reinsurers	• Market Risk (including credit) Policy and risk limits in place. • Diversified portfolio of asset types within which investment managers operate. • Regular monitoring of markets and solvency triggers including 5 year gilt yields and unit price. • Currency hedging strategy in place and weekly review and rebalancing of currency hedges. • Agreed staff pension scheme deficit funding arrangements • Due diligence of third parties prior to any agreements and on-going monitoring. • Daily review of credit spreads as part of pricing activity.
Insurance Risk	• Adverse movements in mortality, morbidity and persistency rates of policyholders • The possibility that guarantees could acquire a value that affects adversely the finances of a firm and its ability to meet the expectations of policyholders and to treat them fairly • Expense overruns relative to pricing or provisioning assumptions	• Insurance Risk Policy and risk limits in place. • Existing risk from term assurance business is limited through reinsurance. • Annual experience analyses of mortality, lapse rates and expenses. • Monthly solvency estimates. • Annual business plan and budget approved by the Board. • Monthly monitoring of business volumes and expense experience. • Financial risk assessment of options and guarantees at product design. • Annual review of guarantee charge.
Liquidity Risk	• Inappropriate cashflows constrain the ability to pay liabilities to policyholders as they fall due or obligations to third parties	• Liquidity Risk Policy and risk limits in place. • Cash flow is closely monitored across key transactions across the Group. • Investment management strategies including levels of liquid and readily marketable assets are closely monitored to allow for timely adjustments to match expected liabilities.
Capital Risk (including Strategic & Business)	• Management decisions or external developments impact the appropriateness of the quantity, quality or reliability of value of capital	• Capital Risk Policy and associated risk metrics. • Capital management action plan in place. • Regular solvency monitoring processes.

Risk Management Report (continued)

Risk types	Key aspects of risks	Key controls and risk mitigation activities
Conduct Risk	• Business Strategy & Governance • People and culture • Distribution and sales • Post sales administration and complaints handling • Financial crime • Personal data	• Incentive schemes are balanced and monitored to ensure they promote the delivery of good customer outcomes. • Recruitment processes are competence based. • Identify target markets, assess their needs and ensure that the products marketed are suitable for those customers. • Produce transparent marketing and promotional material, ensuring that it meets regulatory requirements and is clear, fair and not misleading. • Monitor KPIs such as fund performance to ensure appropriate customer outcomes. • Maintain a robust T&C Scheme to ensure colleagues demonstrate competence. • Monitor the quality of sales (whether advised or non-advised) to ensure good customer outcomes continue to be delivered.
Operational Risk	• Customer administration • Systems/technology • Information and data security • Financial processes • People • Premises • Third parties (including outsourcing)	• Operational Risk Policy and risk limits in place. • Key risk frameworks set and operated. • Mandatory training for all staff. • Methodical assessment of risks through the established risk management process. • Clear ownership of risks and controls at executive and management levels. • Regular review of people competency and performance to strengthen recruitment strategy, training and people development.

Report of the Committee of Management

The members of the Committee of Management present their report and Group financial statements for the year ended 31 December 2017. The financial statements have been prepared in accordance with the presentation and disclosure requirements of The Friendly Societies (Accounts and Related Provisions) Regulations 1994.

Business Objectives and Activities of the Society

The Society is an incorporated friendly society. Its core business objective continues to be the provision of financial services products to members and retired members of the Police service and the Military and their immediate families. The membership of the Society as at 31 December 2017 was nearly 220,000 (2016: 216,000). The Society has not undertaken any activities during the year which are outside of its powers.

Details of the Society's subsidiaries are included in note 14 to the financial statements.

Results of the Society

Details of the Society's operating performance are set out in the technical accounts and related notes. Group earned premiums for the year were £99,082,000 (2016: £93,544,000) with total technical income (including total investment returns) of £224,720,000 for the year (2016: £201,204,000). Total technical charges before the transfer from the Fund for Future Appropriations were £235,846,000 (2016: £221,982,000). A transfer of £11,126,000 (2016: £20,778,000) was made from the Fund for Future Appropriations.

Solvency

As at 31 December 2017 (and throughout 2016 and 2017), the Group maintained its required margin of solvency as prescribed in regulations made under the Prudential Sourcebook for Insurers. The management of solvency and the inherited estate is included in the Principles and Practices of Financial Management. This sets out the purposes for which it may be used. Note 19 to the financial statements gives details of the funds for future appropriations, the method of calculation and the reconciliation between 2017 and 2016.

Donations and Sponsorships

Police Mutual takes very seriously its commitment to mutuality and working for the interests of the Police family. Direct support was given in the form of donations, sponsorships and respite contributions of £445,000 (2016: £392,000).

Key Risks and Uncertainties

Details of the key generic risks to the Society and its approach to risk management are set out in the risk management report on pages 6 to 8. These comprise market risk (including credit), insurance risk, liquidity risk, capital risk (including strategic & business), conduct risk and operational risk.

Report of the Committee of Management (continued)

Committee of Management Membership, Directors and Officers

Details of the Committee of Management, directors and officers who were in office as at the date of signing of the annual report and financial statements are as follows:

Committee of Management

President
Sir Hugh Orde OBE QPM, formerly President, Association of Chief Police Officers

Vice Presidents
Simon Cole QPM BA (Hons) MA DipCrim, Chief Constable, Leicestershire Police
Mike Cunningham QPM, Chief Executive Officer, College of Policing
Charlie Hall QPM MA (Cantab) MSc, Chief Constable, Hertfordshire Constabulary
Sir Jon Murphy QPM DL LLB (Hons), formerly Chief Constable, Merseyside Police

Chairman
Julie Spence OBE QPM BEd LLB MA MBA, formerly Chief Constable, Cambridgeshire Constabulary

Claire Beck, Cambridgeshire Constabulary
Paul Bishop MA ACA
David Campbell MSc, West Yorkshire Police
Richard Coates BSc (Econ) FCA
John Edwards, Dyfed Powys Police
Inspector Carwyn Evans, South Wales Police
Detective Constable Martin Guest, Humberside Police
Julie Hopes MBA ACIB
Constable Robin Hardiman, Lancashire Constabulary
John Lister BSc FIA
Kirsty Norman, Derbyshire Constabulary
Barry Sanjana MA
Graham Smillie, formerly Police Scotland
Detective Sergeant Ieuan Watkins, Gwent Police

Chief Executive
Stephen Mann LLB FPMI FIoD

Other Officers

Executive Directors (on the Managing Board)
Andy Elkington, BA (Hons) MBA, Group Sales & Marketing Director
Kathryn Winup, FCCA AMCT, Finance Director

Company Secretary
Rachel Kirwan BSc ACIS

Life Vice Presidents
Mick Foster QPM, formerly Chairman
Peter Sharpe MBE FCII, formerly Chief Executive

No members of the Committee of Management, directors or officers have an interest in the shares of the Society's subsidiary undertakings.

The following individuals stood down as members of the Committee of Management during 2017 (date of leaving in brackets):
Neil Richardson OBE QPM BA MBA FCMI, formerly Deputy Chief Constable, Police Scotland (20 January 2017)
Justine Curran QPM, formerly Chief Constable, Humberside Police (1 March 2017)
Deirdre Allen, former Chief Inspector, Hertfordshire Constabulary (28 April 2017)
Mike Urmston BA FIA (28 April 2017)
Iain Livingstone QPM, Deputy Chief Constable, Police Scotland (1 August 2017)

Directors' Remuneration

Details regarding statutory directors' emoluments are set out in note 9 of the financial statements. A remuneration report for Managing Board members including the directors' remuneration policy can be found on our website www.policemutual.co.uk/about-us/corporate-governance.

Report of the Committee of Management (continued)

Total tax contributions (unaudited)

The following tax contributions were generated by the activities of the Group.

	2017 £'m	2016 £'m
Corporation Tax and Income Tax borne	-	0.2
Irrecoverable Value Added Tax	2.8	2.4
Employment taxes borne – Employer NIC	2.2	2.1
Total taxes borne	**5.0**	**4.7**
Insurance Premium Tax generated	5.2	3.9
Employment taxes collected – Employee PAYE and NIC	5.6	5.2
Total tax contributions	**15.8**	**13.8**

Payments totalling £282,000 (2016: £312,000) were made to local authorities in regard to business rates.

All investment gains made during the year taxable under capital gains tax were offset against investment losses brought forward from previous years.

Corporate Governance

Police Mutual is committed to maintaining high standards of corporate governance and has voluntarily chosen to use the UK Corporate Governance Code for companies quoted on the London Stock Exchange as the basis for reporting on its corporate governance arrangements (the Code). In applying the Code the Group considers its requirements and looks to put them into practice in a way that reflects its business, culture and values and which helps to support the following:

- Transparency; giving members the information they need to judge whether the Executive team, Board and Committee of Management are doing a good job on their behalf;
- Effective decision-making, risk management and control;
- A proper balance between executive and non-executive directors; and
- Keeping the interests of Police Mutual's members aligned with, and at the front of the mind of, the people responsible for running the business.

The Committee of Management considers the 2017 annual report & financial statements taken as a whole to be fair, balanced and understandable and provides the information necessary for members and customers to assess the Group's performance, business model and strategy.

Our complete Corporate Governance report can be found on our website www.policemutual.co.uk/about-us/corporate-governance.

Going Concern Statement

The directors have at the time of approving the financial statements, a reasonable expectation that the Group and the Society have adequate resources to continue in operational existence for the foreseeable future. Therefore they continue to adopt the going concern basis of preparing the financial statements.

The directors have made this assessment following review of the Group's performance and the latest forecasts for a period of twelve months from the date of signing the financial statements.

Viability Statement

The Chief Executive's Statement gives details of the Group's business activities, together with the factors likely to affect its future development, performance and position. Notes 16 and 19 to the financial statements and the Risk Management Report give details on the Group's objectives, policies and processes for managing its risks and capital base.

In addition to the directors' responsibilities in respect of going concern, the directors have voluntarily chosen to follow the UK Corporate Governance Code requirement to include a Business Viability Statement in the annual report which states whether there is a reasonable expectation that Police Mutual will be able to continue in operation and meet its liabilities as they fall due. The period assessed under the Business Viability Statement is required to be significantly longer than the minimum period of 12 months over which going concern is assessed.

Report of the Committee of Management (continued)

Viability Statement (continued)

The directors confirm that they have a reasonable expectation that Police Mutual will be able to continue in operation and meet its liabilities as they fall due over the next five years. The directors' assessment has been made with reference to the Group's current financial position, its prospects and strategy as set out in the 2018 – 2022 business plan and the overall risk appetite of the Group as set out in the Risk Management Report. In making this confirmation the Managing Board has specifically sought input from its Audit and Risk Committees.

The assessment covers a period of five years as this is within the period covered by the business plan and the rigorous analysis and stress testing performed to understand vulnerabilities within the business model and performance. The time period chosen reflects the consideration that the level of uncertainty relating to the assessment increases the longer the period chosen. The pace of change of the economic, market and regulatory environments in which Police Mutual operates may undermine the reliability of longer forecasts.

The directors have based this statement on an assessment of those risks that could threaten the business model, future allowances, solvency, liquidity or its capital adequacy. In making the assessment, the directors considered a range of information concerning each of the principal risks across a range of scenarios, including but not limited to the business plan, the rigorous programme of analysis and stress testing performed as well as levels of regulatory capital held (for the Society) which comfortably exceed the regulatory minimum.

In making this confirmation, the directors recognise both current challenges and emerging risks which if sustained in future years could potentially threaten Police Mutual's viability beyond 2022, noting that the business is well positioned to meet its long term obligations to policyholders.

Statement of Responsibility in Respect of the Financial Statements

The Friendly Societies Act 1992 requires the Committee of Management to prepare financial statements for each financial year which conform with the requirements of Section 70 of the Act and regulations made under it. The Act requires that the financial statements shall give a true and fair view of the state of affairs of the Group and Society at the end of the financial year, and of the results of the Group and Society for that financial year.

In preparing the annual financial statements the Committee of Management is required to:

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

The Committee of Management is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and Society and which enable them to ensure that the financial statements comply with the Friendly Societies Act 1992 and regulations made under the Act. It is also responsible for safeguarding the assets of the Group and Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Committee of Management confirms that, in its view, it has complied with the above requirements in preparing the financial statements.

Statement of Disclosure of Information to Auditors

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

- so far as each of them is aware, there is no information relevant to the audit of the Group's financial statements for the period ended 31 December 2017 of which the auditors are unaware; and
- they have taken all steps that they ought to have taken in their duty as a director in order to make themselves aware of any relevant audit information and to establish that the Group's auditors are always aware of that information.

Rachel Kirwan

Company Secretary

12 April 2018

Audit Committee Report

The Audit Committee is a sub-committee of the Managing Board, which in turn is a sub-committee of the Committee of Management. A full description of the work of the Committee of Management and all of its sub-committees is set out in the separate Annual Governance and Directors' Remuneration Reports.

Membership

Paul Bishop (from May 2017, Chairman from November 2017)
Richard Coates (Chairman until November 2017)
John Lister (from May 2017)
Barry Sanjana
Mike Urmston (to April 2017)

Secretary

Rachel Kirwan

Role

The main role, responsibilities and authority of the Audit Committee, as delegated to it by the Managing Board, are set out in its terms of reference, which are available on the Police Mutual website and summarised below:

- Reviewing the adequacy and effectiveness of internal systems of control that impact on the strategic, financial and operational policies and plans of the Group;
- Monitoring the integrity of financial statements;
- Reviewing significant financial reporting issues and judgements;
- Overseeing the relationship with and appointment of the external auditor, including their remuneration and terms of engagement;
- Reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the external audit process;
- Developing and implementing the policy on the engagement of the external auditor to supply non-audit services;
- Considering the effectiveness and scope of external and internal audits;
- Overseeing the appointment of the Chief Internal Auditor;
- Reporting to the Managing Board on how it has discharged its responsibilities;
- Identifying matters and making recommendations where it considers action or improvement is needed.

As part of the Audit Committee's reporting to the Managing Board, it considers whether the annual report and financial statements taken as a whole are fair, balanced and understandable and provide the information necessary for members to assess Police Mutual's position and performance, business model and strategy.

How the Audit Committee has discharged its responsibilities

In 2017 the Audit Committee met five times and met the UK Corporate Governance Code requirement to have at least three independent non-executive directors. The Managing Board is satisfied that Paul Bishop brings recent and relevant financial expertise, augmented by the financial expertise and experience of the other members of the Audit Committee.

The Audit Committee schedules time annually, without any executive directors or senior management present, to discuss issues with the Chief Internal Auditor and external auditors. The Chairman of the Audit Committee meets the Chief Internal Auditor to review current issues before each Audit Committee meeting.

Financial Reporting

During 2017 the Audit Committee considered in detail the financial statement preparation process and the matters of judgement to be applied. Reports from the external auditor were received before and after the annual statutory audit.

A summary of the significant issues the Audit Committee considered in relation to the 2017 financial statements and how these issues were addressed, together with judgements made and sources of assurance and other evidence used to satisfy itself of the appropriateness of the conclusions reached is as follows:

- Going concern

As part of their oversight of the financial statements, the Audit Committee considers a detailed assessment of the Group and Society's ability to operate as a going concern. The Committee has made this assessment following a review of the Group's performance and the latest forecasts for a period of twelve months from the date of signing the financial statements, which has included the current strategy and business plan and Own Risk and Solvency Assessment (ORSA) information. The Committee has concluded that there is a reasonable expectation that the Group and Society have adequate resources to prepare the financial statements on a going concern basis. A going concern and viability statement are included in the Report of the Committee of Management.

Audit Committee Report (continued)

Financial Reporting (continued)

- Valuation of assets and liabilities

A number of assets in the Group and Society's balance sheets are held at valuation, including:

Investments in subsidiary undertakings and goodwill
The Society carries its subsidiary undertakings at valuation. In prior years, this valuation had been prepared based on discounted cash flow techniques taken over the timeframe it was expected the subsidiaries would generate value to the Group. An alternative valuation methodology has been adopted in 2017 to apply an EBITDA multiple to forecast results. Whilst this has generated a lower valuation, we consider the outcome better reflects the commercial value of the subsidiaries.

Carrying value of goodwill
There have been no additions to goodwill in the year, the balance has reduced by the annual amortisation charge. The valuation of the subsidiary undertakings referred to above has calculated a value greater than the remaining value held in goodwill and related intangible assets, we therefore consider there is no impairment charge to record.

Investment in Pinkerton
The Pinkerton investment is valued in line with the methodology adopted for the subsidiary undertakings as described above.

Alexandra House (held within tangible assets)
Alexandra House was last subject to an external valuation in 2014, however after considering external indices, the Committee considered its value has not changed significantly from this date.

Other financial investments (including valuation of the Neyber shares and loans)
The majority of financial investments are valued by external fund managers who hold these investments on the Society's behalf and base valuations on readily available market data. The valuation of Neyber loans is based on an internally developed discounted cash flow model, the Committee have assessed the appropriateness of the assumptions within this model, compared valuation results to previous years, considered how the future cashflows have been determined and if there are any deviations from the current business plan. The investment in Neyber equity is valued based on recent external transactions.

Valuation of long term business provision
This area is particularly significant for Police Mutual and involves multiple complex and subjective judgements. The Chief Actuary advised on the methodologies and assumptions to be used and these are reviewed and approved or adjusted by the Audit Committee on behalf of the Managing Board. The Chief Actuary presented the results of those investigations and calculations which include a range of validation measures. The Audit Committee also considered the external auditors' views on the appropriateness of the models, methodologies and assumptions used. The subjective judgements required include an assumption for the best estimate of the costs that will be incurred to administer the existing life assurance business. The Transformation Programme that we have embarked upon introduces some uncertainty as to the costs of delivering the programme and the benefits that will be realised both in terms of amount and timing. We are also undertaking a comprehensive review of the way in which we allocate our costs between our businesses and products. The review has been started but not concluded in time for the completion of the financial statements and this introduces further uncertainty. In determining the expense assumptions we have made some allowance for the benefits of the Transformation Programme to the extent that we reasonably expect them to be realised but have made some further provision for the additional expenses that are likely to arise from the cost allocation methodology review.

- Deferred Taxation

The Audit Committee considered the assumptions in the recognition of deferred tax assets in respect of unrealised losses on investments. At 31 December 2016, no deferred tax asset had been recognised on the grounds that insufficient capital gains were forecast against which the losses could be offset. This position was reviewed in 2017 and it was concluded that the assumptions used should be updated to reflect better investment performance. This resulted in a deferred tax asset being recognised in respect of a portion of unrealised losses. Other deferred tax assets are recognised to the extent the Society is able to forecast taxable profits against which the deferred tax assets can be offset. The ten year period is used for this forecast which is consistent with prior years.

External Auditors
The independence, objectivity and appointment of the external auditors is subject to regular review. The Senior Statutory Auditor is rotated every five years and 31 December 2017 will be Thomas Tyler's first year as the Senior Statutory Auditor.

A tender process will take place during 2018 for the appointment of external auditors to undertake the audit for the year ending 31 December 2019. PwC have been in post as external auditor since 2004 and were successful in retaining their appointment following a competitive tender for the 31 December 2009 year end.

The level of non-audit fees paid to the external auditor is subject to a formal policy to safeguard their independence and objectivity. PwC were engaged in 2017 to provide an assessment of management prepared figures which did not impact the financial statements, before agreeing to this the Audit Committee followed its formal policy and considered the external auditors' independence and safeguards to protect it based on written assurances from the external auditors. The Audit Committee concluded that to the extent that safeguards were required, these were adequate and therefore external auditors independence had not been impaired. Total fees paid to PwC in 2017 were £501,000 (2016: £1,501,000) excluding VAT of which £27,000 (2016: £797,000) related to non-audit services.

In 2016 a desk based review of the external auditors' effectiveness was conducted. Having considered the results of the review the Audit Committee, supported by the Managing Board, concluded that the external auditors provided a satisfactory service. No review will be undertaken in 2017 in view of the forthcoming tender for the appointment of external auditors.

Independent auditors' report to the members of Police Mutual Assurance Society

Report on the financial statements

Opinion

In our opinion, Police Mutual Assurance Society's Group financial statements and Society financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and the Society's affairs as at 31 December 2017 and of the Group's and the Society's income and expenditure for the year then ended;
- have been properly prepared 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); and
- have been prepared in accordance with the requirements of the Friendly Societies Act 1992.

We have audited the financial statements, included within the Annual Report, which comprise: the Consolidated and Society statements of financial position as at 31 December 2017; the Consolidated and Society technical accounts for the year then ended; the accounting policies; and the notes to the financial statements.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

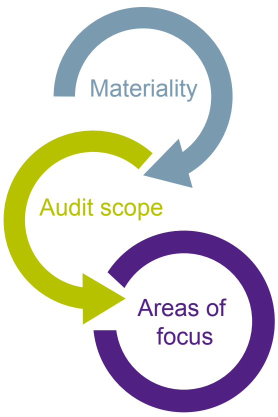
We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society.

Other than those disclosed in note 10 to the financial statements, we have provided no non-audit services to the Group or Society in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview



Materiality

- Overall Group materiality: £5.3 million (2016: £8.2million) based on 8.4% of the Consolidated Fund for Future Appropriations.
- Overall Society materiality: £5 million (2016: £8.2 million) based on 3.8% of the Society Fund for Future Appropriations.

Audit Scope

- The Group comprises the Society and a number of subsidiaries which provide distinct revenue streams and support functions. Our audit procedures covered 99.9% of the Group's gross assets and 97.2% of its total technical income.

Areas of focus

- The assumptions relation to expenses underlying the valuation of the long term business provision;
- The valuation of the Society's investment in Pinkerton; and
- The valuation of the Society's investments in subsidiaries.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Committee of Management made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Independent auditors’ report to the members of Police Mutual Assurance Society (continued)

The scope of our audit (continued)

We gained an understanding of the legal and regulatory framework applicable to the Group and the industry in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group and Society financial statements including but not limited to, the Friendly Societies Act 1992 legislation, the Prudential Regulation Authority’s regulations, and the UK tax legislation. Our tests included, but were not limited to, review of correspondence with the regulators, review of correspondence with legal advisors, enquiries of Management, and review of internal audit reports, in so far as they related to financial information. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. 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 Committee of Management that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors’ professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Valuation of the long term business provision – expense assumptions Expense assumptions impact the valuation of the long term business provision which is £719.8m as at 31 December 2017 (2016: £695.9m). See note 18 to the financial statements for more information. When valuing the long term business provision assumptions need to be made about the costs that will be incurred in maintaining the in-force policies to their expected maturity. The judgements applied in setting the assumptions for expected expenses are grounded in actual experience but involve an element of subjectivity including the identification of expenses incurred to maintain in force policies, allocation of expenses between group entities, and to particular long term product types. Planned transformation projects also increase the level of subjectivity in setting future expense assumptions.	Our work to address the valuation of the long-term insurance contract liabilities was supported by our in-house life actuarial specialists and included the following procedures: - We tested the underlying data, including key reconciliations, and this testing was performed with no material exceptions. - We compared the methodology, models and assumptions used against recognised actuarial practises and underlying internal experience, and by applying our industry knowledge and experience, and found them to be reasonable. - We performed an independent annual benchmarking survey, which allowed us to further challenge the assumptions setting process by comparing certain assumptions used relative to the Society’s industry peers. In respect of expense assumptions we: - We tested the reasonableness of the expense allocation methodology by reviewing the drivers of cost used by Management for each significant cost; - We re-performed the calculation of the maintenance costs allocated to the Society; - Reviewed the latest business plan as presented to the Board to identify planned transformation savings and challenged Managements quantification by seeking supporting project plans for significant savings, and requested evidence for savings achieved in the year to date; - We agreed inputs to the cost allocation calculations to supporting evidence on a sample basis; and - Used the above information to critically assess and challenge the judgements made by Management and to determine whether there was any evidence of Management bias. Based on the work performed we found that the expense assumptions used were supported by the evidence we obtained.

Independent auditors' report to the members of Police Mutual Assurance Society (continued)

Key audit matters (continued)

Key audit matter	How our audit addressed the key audit matter
Valuation of the Society's investment in Pinkerton Pinkerton is a Bermudan cell to which general insurance business is intermediated by subsidiaries in the Group and is reinsured by third party insurers. Police Housing Fund Ltd, a subsidiary of the Group, owns 100% of the entity's preference share capital, with a valuation of £75.8m (2016: £68.5m) in the Society balance sheet. See note 14 to the financial statements for more details. Pinkerton was valued as at 31 December 2017 using an earnings multiple model based on the future discounted EBITDA, plus the value of surplus assets over those required to be held for the cell to continue to operate. This valuation methodology differs from the prior year, when the valuation was based on discounted cash flow model. The key assumptions within the new valuation model are the forecast earnings, the discount factor and the earnings multiple	Our work to address the valuation of the investment in Pinkerton was supported by our in-house valuation experts and included the following procedures: - We tested the reasonableness of the forecast earnings used by agreeing to the latest business plan as presented to the Board, to contractual arrangements with third party insurers and assessing the reasonableness compared to past performance; - We tested Managements discount factor by agreeing the inputs to the calculation to supporting evidence and re-performing the calculation; - We tested the appropriateness of Managements earnings multiple by independently calculating a range of earnings multiples based on comparator companies; and - We tested the surplus net assets included within the year end valuation to Managements supporting calculation and third party confirmations. Based on the work performed, we found that the evidence supporting Management's valuation of the investment in Pinkerton was appropriate. We noted no material exceptions from our testing of the valuation.
The valuation of the Society's investments in subsidiaries The Society's investments in subsidiary undertakings are measured at fair value in the Society financial statements, and as unlisted illiquid investments this is estimated using an earnings multiple model, plus the value of surplus assets over those required to be held for the entities to continue to operate. The value using this model as at 31 December 2017 is £17.6m (2016: restated £38.1m). See note 14 to the financial statements for more information. This valuation methodology differs from the prior year, when the valuation was based on discounted cash flow model. The key assumptions within the new valuation model are the forecast earnings, the discount factor and the earnings multiple. In the forecast earnings adjustments are made to derive earnings were the entities to be sold to a willing buyer, specifically group recharges are adjusted to Managements estimate of the cost that would be borne by the entities on a standalone basis. The prior period comparative investments in subsidiaries balance has been restated to reduce the value by £38.3m following identification of an error in the valuation calculation.	Our work to address the valuation of the investment in subsidiaries was supported by our in-house valuation experts and included the following procedures: - We tested the reasonableness of the forecast earnings used by agreeing to the latest business plan as presented to the Board, to contractual arrangements with third party insurers where appropriate, and assessing the reasonableness compared to past performance; - We tested adjustments made to centrally recharged expenses by reviewing the line by line assessment performed by Management and agreeing to supporting evidence provided including third party cost estimates; - We tested Managements discount factor by agreeing the inputs to the calculation to supporting evidence and re-performing the calculation; - We tested the appropriateness of Managements earnings multiple by independently calculating a range of earnings multiples based on comparator companies; and - We tested the surplus net assets included within the year end valuation to Managements supporting calculation and third party confirmations where possible. With regards to the prior year restatement we: - Re-performed Managements calculation of the restated valuation and agreed key inputs to supporting evidence; and - Assessed the appropriateness of the related disclosures made against the requirements of the accounting standards. Based on the work performed, we found that the evidence supporting Management's valuation of the investment in subsidiaries was appropriate. We noted no material exceptions from our testing of the valuation.

Independent auditors' report to the members of Police Mutual Assurance Society (continued)

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 Group and the Society, the accounting processes and controls, and the industry in which it operates.

Materiality

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

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

	Group financial statements	Society financial statements
Overall materiality	£5.3 million (2016: £8.2 million).	£5.0 million (2016: £8.2million).
How we determined it	8.4% of consolidated Fund for Future Appropriations.	3.8% of Society Fund for Future Appropriations.
Rationale for benchmark applied	The FFA represents the surplus arising in the Group where the allocation has not been determined at the year end and as such is akin to the retained earnings of a company. The FFA is therefore of primary interest to the members of the Group and is the principal balance sheet metric against which the performance of the Group is measured. We have also had regard to other measures such as the Group's regulatory capital surplus and other performance metrics and have compared the level of audit work required to be performed over the Consolidated Technical Account using these alternative benchmarks. Materiality for the Group is higher than Society materiality as the Group includes the results of the wider subsidiaries.	

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £0.9 million and £0.1 million. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Audit Committee that we would report to them misstatements for the Society identified during our audit above £250,000 (2016: £420,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the Committee of Management's statement in the financial statements about whether the Committee of Management considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Committee of Management's identification of any material uncertainties to the Group's and the Society's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Society's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Committee of Management is responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Committee of Management's Report, we also considered whether it had been prepared in accordance the Friendly Societies Act 1992 and the regulations made under it.

Independent auditors' report to the members of Police Mutual Assurance Society (continued)

Reporting on other information (continued)

Based on the responsibilities described above and our work undertaken in the course of the audit, the Friendly Societies Act 1992, (FSA92) and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Committee of Management's Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Committee of Management's Report for the financial year for which the financial statements are prepared is consistent with the financial statements and has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it. *(FSA92)*

In light of the knowledge and understanding of the Group and the Society and their environment obtained in the course of the audit, we did not identify any material misstatements in the Committee of Management's Report. *(FSA92)*

The Committee of Management's assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

As a result of the Committee of Management's reporting on how they have applied the UK Corporate Governance Code – An Annotated version for mutual insurers (the "Code"), we are required to report to you if we have anything material to add or draw attention to regarding:

- The Committee of Management's confirmation on page 9 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The Committee of Management's explanation on pages 11 and 12 of the Annual Report as to how they have assessed the prospects of the Group, 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 Group 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 to report in respect of this responsibility.

Other Code Provisions

As a result of the Committee of Management's reporting on how they have applied the Code, we are required to report to you if, in our opinion:

- The statement given by the Committee of Management, on page 12, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Society's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Society obtained in the course of performing our audit.
- The section of the Annual Report on pages 13 and 14 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The Committee of Management's statement relating to the Society's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, for review by the auditors.

We have nothing to report in respect of this responsibility.

Responsibilities for the financial statements and the audit

Responsibilities of the Committee of Management for the financial statements

As explained more fully in the Committee of Management's Responsibilities Statement, the Committee of Management is responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Committee of Management is also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Committee of Management is responsible for assessing the Group's and Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Committee of Management either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Independent auditors' report to the members of Police Mutual Assurance Society (continued)

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 73 of the Friendly Societies Act 1992 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.

Other required reporting

Friendly Societies Act 1992 exception reporting

Under the Friendly Societies Act 1992 we are required to report to you if, in our opinion:

- we have not received all the information and explanations and access to documents we require for our audit; or
- adequate accounting records have not been kept by the Group or Society, or
- the financial statements are not in agreement with the accounting records.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the Committee of Management on 18 October 2004 to audit the financial statements for the year ended 31 December 2004 and subsequent financial periods. The period of total uninterrupted engagement is 14 years, covering the years ended 31 December 2004 to 31 December 2017.

Thomas Tyler (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Cornwall Court
19 Cornwall Street
Birmingham
B3 2DT

12 April 2018

Consolidated Technical Account

Long-Term Business for the Year Ended 31 December 2017

	Note	2017 £'000	2016 £'000
Earned Premiums, Net of Reinsurance	2	99,082	93,544
Investment Income	3	79,609	24,874
Unrealised gains on Investments	3	6,737	43,138
Other Technical Income	4	39,292	39,648
Total Technical Income		**224,720**	**201,204**
Claims Paid - Gross Amount		125,742	119,677
- Reinsurers' Share		(1,922)	(1,926)
Change in Provision for Claims - Gross Amount		1,288	167
- Reinsurers' Share		(537)	318
Claims Incurred, Net of Reinsurance		**124,571**	**118,236**
Change in Long-Term Business Provision	6	14,174	8,050
Change in Technical Provision for Linked Liabilities		10,900	6,333
Change in Other Technical Provisions, Net of Reinsurance		**25,074**	**14,383**
Net Operating Expenses	7	18,380	15,642
Investment Expenses and Charges	3	19,079	21,952
Other Charges		**37,459**	**37,594**
Other Technical Charges		47,883	46,299
Taxation Attributable to Long-Term Business	11	859	5,470
Transfer from the Fund for Future Appropriations	12	(11,126)	(20,778)
Total Technical Charges		**224,720**	**201,204**
Balance on the Technical Account		-	-

Consolidated Statement of Other Comprehensive Income

Long-Term Business for the Year Ended 31 December 2017

	Note	2017 £'000	2016 £'000
Actuarial (gain)/loss on Pension Scheme	24	(1,630)	11,959
Deferred tax on actuarial (gain)/loss on Pension Scheme	11	213	(1,523)
Transfer to/(from) the Fund for Future Appropriations	12	1,417	(10,436)
Other Comprehensive Income for the year		**-**	**-**
Total Comprehensive Income for the year		**-**	**-**

The inclusion of unrealised gains and losses in the Technical Account to reflect the marking to market of interests carried on the Balance Sheet is deemed not to be a departure from the unmodified historical cost basis of accounting. Accordingly, a separate note of historical costs profits and losses is not given.

The Group has no recognised gains or losses other than those included in the Technical Account or statement of other comprehensive income for the year.

The Group has not presented a statement of changes in equity as there are no equity holders in the Group.

Society Technical Account

Long-Term Business for the Year Ended 31 December 2017

	Note	2017 £'000	2016 £'000 (as restated)
Earned Premiums, Net of Reinsurance	2	99,082	93,544
Investment Income	3	79,607	24,874
Unrealised (loss)/gain on Investments	3	(21,000)	45,959
Other Technical Income	4	1,047	923
Total Technical Income		**158,736**	**165,300**
Claims Paid - Gross Amount		125,742	119,677
- Reinsurers' Share		(1,922)	(1,926)
Change in Provision for Claims - Gross Amount		1,288	167
- Reinsurers' Share		(537)	318
Claims Incurred, Net of Reinsurance		**124,571**	**118,236**
Change in Long-Term Business Provision	6	14,174	8,050
Change in Technical Provision for Linked Liabilities		10,900	6,333
Change in Other Technical Provisions, Net of Reinsurance		**25,074**	**14,383**
Net Operating Expenses		11,649	9,955
Investment Expenses and Charges	3	19,079	21,827
Other Charges		**30,728**	**31,782**
Taxation Attributable to Long-Term Business	11	1,157	5,657
Transfer from the Fund for Future Appropriations	12	(22,794)	(4,758)
Total Technical Charges		**158,736**	**165,300**
Balance on the Technical Account		**-**	**-**

Statement of Other Comprehensive Income

Long-Term Business for the Year Ended 31 December 2017

	Note	2017 £'000	2016 £'000
Actuarial (gain)/loss on Pension Scheme	24	(1,630)	11,959
Deferred tax on actuarial (gain)/loss on Pension Scheme	11	213	(1,523)
Transfer to/(from) the Fund for Future Appropriations	12	1,417	(10,436)
Other Comprehensive Income for the year		**-**	**-**
Total Comprehensive Income for the year		**-**	**-**

The inclusion of unrealised gains and losses in the Technical Account to reflect the marking to market of interests carried on the Balance Sheet is deemed not to be a departure from the unmodified historical cost basis of accounting. Accordingly, a separate note of historical costs profits and losses is not given.

The Society has no recognised gains or losses other than those included in the Technical Account or statement of other comprehensive income for the year.

The Society has not presented a statement of changes in equity as there are no equity holders in the Society.

Consolidated Balance Sheet as at 31 December 2017

	Note	2017 £'000	2016 £'000
Assets			
Intangible Assets			
Goodwill	13	15,326	20,662
Other	13	3,684	4,493
		19,010	**25,155**
Investments			
Other Financial Investments	15	**726,258**	**726,317**
Assets Held to Cover Linked Liabilities	18(B)	**100,550**	**83,364**
Reinsurers' Share of Technical Provisions			
Long-Term Business Provision	18(A)	8,205	7,851
Claims Outstanding	18(A)	873	336
		9,078	**8,187**
Debtors			
Debtors Arising Out of Direct Insurance Operations		1,487	1,385
Other Debtors	20	28,392	24,092
		29,879	**25,477**
Other Assets			
Tangible Assets	17	9,783	12,671
Cash at Bank and In Hand		43,297	28,186
Deferred Tax	11	3,328	4,499
		56,408	**45,356**
Prepayments and Accrued Income			
Accrued Interest		2,835	3,778
Other Accrued Investment Income		-	15
Other Prepayments and Accrued Income		3,672	4,604
		6,507	**8,397**
Total Assets		**947,690**	**922,253**

Consolidated Balance Sheet as at 31 December 2017 (continued)

	Note	2017 £'000	2016 £'000
Liabilities			
Fund for Future Appropriations	12	**62,743**	**72,452**
Technical Provisions			
Long-Term Business Provision	18(A)	719,849	695,881
Claims Outstanding	18(A)	7,065	5,777
		726,914	**701,658**
Technical Provisions for Linked Liabilities	18(B)	**100,550**	**83,364**
Provisions for other risks and charges			
Provisions for Pensions	24	14,141	16,031
Other Provisions	22	1,972	2,220
		16,113	**18,251**
Creditors			
Creditors Arising out of Direct Insurance Operations		380	600
Other Creditors	21	40,990	45,928
		41,370	**46,528**
Total Liabilities		**947,690**	**922,253**

The financial statements on pages 21 to 55 were approved by the Committee of Management on 12th April 2018 and signed on its behalf by:-

Julie Spence
Chairman

Rachel Kirwan
Company Secretary

Society Balance Sheet as at 31 December 2017

	Note	2017 £'000	2016 £'000 (as restated)
Assets			
Intangible assets	13	**560**	**-**
Investments			
Investments In Group Undertakings	14	93,447	106,684
Other Financial Investments	15	726,258	726,317
		819,705	**833,001**
Assets Held to Cover Linked Liabilities	18(B)	**100,550**	**83,364**
Reinsurers' Share of Technical Provisions			
Long-Term Business Provision	18(A)	8,205	7,851
Claims Outstanding	18(A)	873	336
		9,078	**8,187**
Debtors			
Debtors Arising out of Direct Insurance Operations		1,468	1,361
Other Debtors	20	868	1,224
		2,336	**2,585**
Other Assets			
Tangible Assets	17	6,193	5,330
Cash at Bank and In Hand		33,856	15,728
Deferred Tax	11	3,897	5,321
		43,946	**26,379**
Prepayments and Accrued Income			
Accrued Interest		2,835	3,779
Other Accrued Investment Income		-	15
Other Prepayments and Accrued Income		347	3,166
		3,182	**6,960**
Total Assets		**979,357**	**960,476**

Society Balance Sheet as at 31 December 2017 (continued)

	Note	2017 £'000	2016 £'000 (as restated)
Liabilities			
Fund for Future Appropriations	12	**132,912**	**154,289**
Technical Provisions			
Long-Term Business Provision	18(A)	719,849	695,881
Claims Outstanding	18(A)	7,065	5,777
		726,914	**701,658**
Technical Provisions for Linked Liabilities	18(B)	**100,550**	**83,364**
Provisions for other risks and charges			
Provisions for Pensions	24	**14,141**	**16,031**
Creditors			
Creditors Arising out of Direct Insurance Operations		13	237
Other Creditors	21	4,827	4,897
		4,840	**5,134**
Total Liabilities		**979,357**	**960,476**

The financial statements on pages 21 to 55 were approved by the Committee of Management on 12th April 2018 and signed on its behalf by:-

Julie Spence
Chairman

Rachel Kirwan
Company Secretary

Notes to the Financial Statements for the year ended 31 December 2017

1 Accounting Policies

Police Mutual Assurance Society Limited is a friendly society incorporated and domiciled in England and Wales. The address of its registered office is:

Alexandra House
Queen Street
Lichfield
Staffordshire
WS13 6QS

(A) Basis of Presentation

The financial statements have been prepared in compliance with the special provisions relating to Friendly Societies as set out in The Friendly Societies (Accounts and Related Provisions) Regulations 1994. Applicable United Kingdom accounting standards, including the Financial Reporting Standard 102 – 'The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland' ('FRS 102') and Financial Reporting Standard 103 – 'Insurance Contracts' ('FRS 103') have been adopted where those recommendations do not contradict the 1994 regulations.

The principal accounting policies used in preparing the financial statements are set out below and are in accordance with applicable accounting standards in the United Kingdom with one exception. A requirement of the Friendly Societies Regulations 1994 is to depreciate all properties, however no depreciation has been provided. All of the properties held by the Society are owner occupied which therefore do not satisfy the definition of investment properties in FRS 102, Section 16, and therefore are not exempt from the requirement that they are depreciated. The justification for not applying depreciation however is set out in (N) below.

As a mutual life assurance society, under Financial Reporting Standard 102, Section 7, Police Mutual is exempt from the requirement to prepare a cash flow statement.

The prior year figures have been subject to a prior year adjustment to correct an overstatement of £38,184,000 in the valuation of the Society's subsidiary undertakings. The impact of the adjustment is to reduce the carrying value of investments and Fund for Future Appropriations reported in the Society Balance Sheet and to reduce the unrealised gains on investments reported in the Society Technical Account. There is no impact on either the Consolidated Balance Sheet or the Consolidated Technical Account.

The Technical Account for both the Group and Society has been restated to exclude the actuarial movement and associated deferred tax on the pension scheme which has been included in the Statement of Other Comprehensive Income.

(B) Use of estimates and judgements

The preparation of the financial statements requires the Committee of Management to make judgements, estimates and assumptions in the process of applying the Group's accounting policies. Although these estimates are based on management's best knowledge of current circumstances and expectations of future events and actions, actual results may differ significantly from those estimates.

The following are the Group's key areas of estimation uncertainty:

Valuation of financial assets – notes 15 and 16 explain the assumptions used in the valuations, particularly in respect of level 3 assets, being those where the valuation is not based on observable market data.

Technical provisions – note 18 explains the assumptions used.

Goodwill – the carrying value of goodwill is assessed where there are indicators of impairment using a discounted future net cash flow model. The significant estimates involved are expected future cash flows and the discount rate used.

Deferred taxation – note 11 sets out the key assumption in the recognition of deferred tax asset is the likelihood of future taxable profits arising against which the timing differences will reverse. Projections of future profitability are undertaken to inform the level of deferred tax to be recognised.

Pensions - note 24 sets out the major assumptions used to calculate the surplus or deficit in the defined benefit pension scheme.

Investments in group undertakings – the Society holds its investments in subsidiary companies at fair value. In determining fair value, an EBITDA multiple model is used with assumptions made in respect of cash flows and duration, as shown in note 14.

Provisions – as a regulated financial services business, the Group has ongoing discussions with external regulators and other authorities in respect of compliance with product and other legislation. Where such issues or other potential exposures arise, the Group evaluates whether or not the matter requires a provision to be recognised or a contingent liability to be disclosed by assessing the likelihood of a constructive or legal obligation to settle a past event and whether the amount can be estimated reliably. The amount of provision is determined based on the Group's estimate of the expenditure required to settle the obligation, as shown in note 22.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

1 Accounting Policies (continued)

(C) Basis of Consolidation

The consolidated financial statements incorporate the assets, liabilities and results of Police Mutual Assurance Society Limited and its subsidiary undertakings drawn up to 31 December each year. All intra-group transactions, balances, income and expenses are eliminated on consolidation. The financial statements also include the results of Pinkerton segregated account as the activities are conducted on behalf of the Group according to its specific business needs.

Any subsidiary sold or acquired during the year is included up to, or from, the dates of change of control.

(D) Contract Classification

The Society issues contracts that transfer insurance risk or financial risk or both.

Insurance contracts are liabilities with a significant element of insurance risk. The Society has defined a significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event that is at least 10% more than the benefits payable if the event did not occur. A contract that is classified as an insurance contract continues to be treated as such until all rights and obligations under the contract expire.

Contracts that are not classified as insurance contracts are investment contracts. Investment contracts are those contracts that transfer financial risk with no significant insurance risk. Unit linked contracts, where the liability under the contract is dependent on the value of the underlying financial assets, are classified as investment contracts unless the contracts also contain features that transfer significant insurance risk. The Child Trust Fund, Stakeholder Pension, Anytime Access Options ISA and the Fixed Term Options ISA are categorised as investment contracts.

All with-profits contracts contain a discretionary participation feature which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses. These are likely to be a significant portion of the total contractual benefits where the amount or timing is contractually at the discretion of the Society. They will be contractually based on the performance of specified contracts, realised and/or unrealised investment returns on a specified pool of assets held by the Society or the surplus or deficit of the Society.

The Group seeks to reduce its exposure to potential losses by reinsuring certain levels of risk with a reinsurance company. These reinsurance contracts meet the classification requirements for insurance contracts and hence are classified as reinsurance contracts held.

With the exception of the Fixed Term Options ISA, all with-profits contracts are classified as insurance contracts or investment contracts with discretionary participation features. All non-unit linked non-with-profits contracts issued are insurance contracts.

(E) Premium Receipts – Earned Premiums

Premiums received and reinsurance paid relating to insurance contracts are accounted for as follows:

- Regular premium income is accounted for when due;
- Single premium income is accounted for when received; and
- Reinsurance premiums are charged in line with the income to which they relate.

(F) Payments on Investment Contracts and Investment Contracts with Discretionary Participation Features

Payments received in relation to investment contracts and investment contracts with discretionary participation features are accounted for when received. Payments relating to investment contracts with discretionary participation features are accounted for as earned premiums with movements in the liabilities on such contracts included within technical provisions. Payments on investment contracts are treated as deposits and are included in the balance sheet as liabilities.

(G) Investment Return

Investment return comprises all investment income, realised investment gains and losses, net of investment expenses, charges and interest payable on financial liabilities carried at amortised cost.

Dividends are included as investment income on the date that the shares are quoted ex-dividend. Interest and expenses are 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 represents the difference between the fair value at the balance sheet date and if acquired in the current period, their purchase price or their fair value at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in respect of investment disposals in the current period.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

1 Accounting Policies (continued)

(H) Other Technical Income and Other Technical Charges

Other technical income and other technical charges in the Consolidated Technical Account represent the income and expenditure, recognised on an accruals basis, in respect of subsidiary companies before Group charges and tax.

Management fees arising from investment contracts are recorded in Other Technical Income in the period in which the services are provided.

Income from commission is taken into account on an accruals basis. Commissions earned are subject to claw-back in the event that a policy lapses and the Group is no longer entitled to the commission. Provision is made based on historical levels of clawback as a percentage of commission earned.

(I) Claims

Claims paid and reinsurance recoverable shown in the Consolidated Technical Account and Society Technical Account relate to insurance contracts and investment contracts with discretionary participation features. Investment contract claims are included within the movement on liabilities shown on the balance sheet and are not treated as a claim expense in the Technical Account.

Death claims are recorded on the basis of notifications received. Maturities and annuity payments are recorded when due. Surrenders are recorded on the earlier of the date paid or when the policy ceased to be included within the technical provisions or technical provision for linked liabilities. Claims on participating business include bonuses payable. Claims payable include the direct costs of settlement. Reinsurance recoveries are credited to match the relevant gross amounts.

The provision for outstanding claims represents the total estimated ultimate cost to the Society of settling all incurred insurance contract claims arising from notified events that have occurred up to the end of the financial year, less amounts already paid in respect of such claims.

(J) Business Combinations and Goodwill

Business combinations are accounted for by applying the purchase method. The cost of a business combination is the fair value of the consideration given, liabilities incurred or assumed and of equity instruments issued plus the costs directly attributable to the business combination. Contingent consideration is initially recognised at the estimated amount where the consideration is probable and can be measured reliably.

On acquisition of a business, fair values are attributed to the identifiable assets, liabilities and contingent liabilities unless the fair value cannot be measured reliably, in which case the value is incorporated in goodwill. Where the fair value of contingent liabilities cannot be measured reliably they are disclosed on the same basis as other contingent liabilities.

Goodwill recognised represents the excess of the fair value and directly attributable costs of the purchase consideration over the fair values attributed to the Group's interest in the identifiable net assets, liabilities and contingent liabilities acquired.

Goodwill is amortised over its expected useful life up to a maximum of 20 years. Goodwill is assessed for impairment when there are indicators of impairment and, to the extent that the carrying amount exceeds the recoverable amount, that is the higher of the realisable value and value in use, goodwill is written down to its recoverable amount. The value in use is determined from estimated discounted future net cash flows. Any impairment is recognised immediately in the Technical Account and is not subsequently reversed.

(K) Financial Instruments

The Group has chosen to apply the measurement disclosure requirements of FRS 102 in full respect of financial instruments.

i) Financial assets

Management determines the classification of its investments at initial recognition and re-evaluates this at every reporting date. Financial assets are classified into the following categories:

- Shares, other variable yield securities, units in unit trusts, investments in subsidiaries, debt securities and other fixed-income securities – at fair value through profit or loss, where each year the value of the assets is measured as per section a below with all movements taken through the Technical Account;
- Derivatives – held for trading;
- Loans on policies and deposits with credit institutions - loans and receivables.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

1 Accounting Policies (continued)

(K) Financial Instruments (continued)

i) Financial assets (continued)

(a) Shares, other variable yield securities, units in unit trusts, investments in subsidiaries, debt securities and other fixed-income securities – at fair value through profit or loss

Financial assets are classified into this category at inception if they are acquired principally for the purpose of selling in the short term, if they form part of a portfolio of financial assets in which there is evidence of short term profit-taking, or if so designated by management to minimise any measurement or recognition inconsistency with the associated liabilities.

Fair values are determined by reference to quoted bid prices in their active markets at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Recent market transactions are used to establish fair value where financial instruments are not traded in an active market.

Valuation models are used to establish fair value where financial instruments are not traded in an active market or there are no recent market transactions available for use. These valuation models, which may include, but are not limited to, earnings multiple models, discounted cash flow techniques and underlying net asset value, calculate realisable value using known drivers of value.

Net gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are presented in the Technical Account within unrealised gains or losses on investments in the period in which they arise.

(b) Derivatives – held for trading

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value are recognised immediately in the Technical Accounts. Fair values are obtained from quoted market prices in active markets or valuation techniques. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

(c) Deposits with credit institutions and other loans - loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. When a financial asset is recognised initially it is measured at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset. Loans and receivables are subsequently measured at amortised cost using the effective interest method.

Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables. This basis of valuation is viewed by the directors as having prudent regard to the likely realisable value.

ii) Financial liabilities

Financial liabilities other than derivatives, which are detailed above, are measured at amortised cost. The amortised cost of these financial liabilities is equivalent to the amount payable on demand without penalty.

(L) Intangible assets

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

Customer lists:	5 years
Computer software and licences:	Between 3 and 6 years

The assets are reviewed for impairment if any factors come to light that indicate that the carrying value may be impaired.

(M) Impairment of Assets

For financial assets not at FVTPL, the Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be estimated reliably.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and assesses them collectively for impairment. Assets that are assessed individually for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

1 Accounting Policies (continued)

(M) Impairment of Assets (continued)

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, industry, geographical location, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed through the Technical Account for the period.

(N) Tangible Assets and Depreciation

Tangible assets are stated on the Balance Sheet at cost less accumulated depreciation. Cost comprises the purchase price and costs directly incurred in bringing the asset into use. Depreciation is charged on a straight line basis so as to write off the cost of fixed assets over their estimated useful lives or to reduce their carrying value to estimated realisable amount on disposal. The estimated useful lives are:

Office furniture and equipment:	Between 3 and 10 years
Computer equipment:	Between 3 and 6 years
Motor vehicles:	4 years

All property held is freehold and occupied by the Society. Land and buildings are held at fair value. A full external valuation of the Society's property was carried out by Kingstons, Chartered Surveyors on an existing use basis as at 31 December 2014. A directors' valuation has been carried out in 2017. No depreciation has been provided on property as it is considered that the useful lives and residual values are such that depreciation is immaterial.

The carrying value of all assets is reviewed annually to ensure that there has been no change in their expected useful lives. Where necessary additional provisions are made to reflect shortened asset lives.

(O) Surpluses from Long-Term Business and the Fund for Future Appropriations

Surpluses arising from the Society's long-term business, as a result of the annual actuarial valuations of the related assets and liabilities, are subject to appropriation by the Managing Board.

The Fund for Future Appropriations represents the part of the fund where the allocation has not been determined by the end of the financial year.

(P) Long-term business provision

The long-term business provision is determined by the Managing Board, having taken advice from the Chief Actuary.

The long-term business provision is calculated using Solvency II methodology which is also used for the Society's regulatory reporting. The long-term business provision is broadly equivalent to the Society's best estimate of its liabilities.

With-profits (participating) contracts

Actuarial best estimate assumptions are used to determine the amount and timing of future cash flows which make up the best estimate liabilities.

Provision is made for all bonus payments (declared and future, regular and final and planned enhancements) estimated, where necessary, in a manner consistent with the Principles and Practices of Financial Management. The underlying liabilities are based on the aggregate value of asset shares reflecting the premiums, investment return, expenses and charges applied to each contract. No allowance is made for future management actions.

Some with-profits contracts also contain options and guarantees that can increase the benefits payable to the policyholder. The potential liability for these options and guarantees is determined using a market consistent stochastic model, which simulates future investment returns, asset mix and bonuses. The most significant options and guarantees are:

- The sum assured and declared regular bonuses on conventional with-profits policies; and
- Unitised with-profits policies containing a guaranteed increase in the unit price or guarantees that market value reductions will not be applied at specified times.

Non with-profits contracts

For conventional non-profit contracts, the best estimate liability is calculated using a cash flow projection of all future benefit payments, future expenses and future premiums. These are adjusted for tax where applicable and discounted to give a present value.

For unit-linked contracts, the provision is based on fair value. The fair value of a unit-linked financial liability is determined using the current unit values that reflect the fair values of the financial assets contained within the Society's unitised investment funds linked to the financial liability, multiplied by the number of units attributed to the contract holder at the balance sheet date.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

1 Accounting Policies (continued)

(Q) Taxation

The current tax charge is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all material timing differences that have been originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax.

Deferred tax assets are recognised only to the extent that the Group considers that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is calculated at the rates at which it is expected that the tax will arise and is not discounted.

Where tax positions are uncertain, the Group establishes provisions based on reasonable estimates. The amount of provision recorded is based upon various factors, such as interpretation of tax regulations and external professional advice.

(R) Foreign Currencies

The primary economic environment in which the Group and Society operates is the United Kingdom, hence the functional currency is pounds sterling.

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the dates of the transactions and monetary assets and liabilities held in foreign currencies are translated to sterling at rates of exchange ruling at the end of the year. All resulting foreign exchange gains and losses are recognised in the Technical Account for the year. Non-monetary assets and liabilities are translated using the exchange rate at the date of the transaction.

(S) Operating Leases

Operating leases are leases in which a significant portion of the risks and rewards of ownership are retained by the lessor. Rentals payable under operating leases are charged to the Technical Account on a straight line basis over the period of the lease.

(T) Acquisition Expenses

Acquisition expenses comprise costs of obtaining and processing new business. For business written within the with-profits fund acquisition costs are not deferred.

(U) Staff Pensions

The Group operates both defined benefit and defined contribution pension schemes. In respect of the defined benefit pension scheme, the pension liability recognised on the Balance Sheet is the value of the scheme's assets less the present value of the scheme's liabilities.

The pension cost for the scheme is analysed between past service cost and net return on the pension scheme. Past service costs, relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in the Technical Account on a straight line basis over the period in which the increase in benefits vest.

Net interest return on the pension liability comprises the expected return on the pension scheme assets less interest on scheme liabilities. The actuarial gains or losses which arise from a valuation, or from updating the latest actuarial valuation to reflect conditions at the balance sheet date, are included in the Statement of Other Comprehensive Income for the period.

In respect of the defined contribution schemes operated by the Group, payments made into these schemes are accounted for when due. The assets of the schemes are held separately from the Group and Society in independently administered funds.

(V) Provisions

Provisions are made where an event has taken place that gives a legal or constructive obligation that probably requires settlement by a transfer of economic benefit and a reliable estimate can be made of the amount of the obligation.

Provisions are charged as an expense to the Technical Account in the year that the Society become aware of the obligation and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried on the Balance Sheet.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

2 Premium Analysis

Group and Society

All business is written in the United Kingdom and relates exclusively to individual policy holders.

(A) Earned Premiums

	2017			2016		
	Gross £'000	**Reinsurance £'000**	**Net £'000**	**Gross £'000**	**Reinsurance £'000**	**Net £'000**
Regular premiums						
Insurance contracts	73,258	(1,946)	71,312	75,132	(2,100)	73,032
Investment contracts with discretionary participation features	4,110	-	4,110	4,068	-	4,068
	77,368	**(1,946)**	**75,422**	**79,200**	**(2,100)**	**77,100**
Single premiums						
Investment contracts with discretionary participation features	23,660	-	23,660	16,444	-	16,444
Total earned premiums recognised in the Technical Account	**101,028**	**(1,946)**	**99,082**	**95,644**	**(2,100)**	**93,544**
Earned premiums on linked business	5,175	-	5,175	5,135	-	5,135
Earned premiums on non-participating investment contracts	12,646	-	12,646	39,534	-	39,534
Total	**118,849**	**(1,946)**	**116,903**	**140,313**	**(2,100)**	**138,213**

As set out in Note 1(F) the Group and Society does not account for premiums received on investment contracts (other than those with discretionary participation features) as premium income. Where these contracts are unit-linked they have been accounted for as deposits and added to the value of linked investment contract liabilities on the Balance Sheet.

Premiums earned on investment contracts without discretionary participation features are treated as deposits and included within technical provisions on the Balance Sheet.

(B) Gross New Business Premiums (Annualised)

Regular premiums are those where there is a contractual obligation or reasonable expectation to pay on a regular basis. Single premiums are those relating to products issued by the Society which provide for the payment of one premium only.

The table below includes the annual premium equivalent for all new regular premiums as well as all single premiums received during the year, including investment contracts.

	2017 £'000	**2016 £'000**
Regular Premiums		
Insurance contracts	10,344	9,458
Investment contracts	66	106
Single Premiums		
Investment contracts	13,885	40,735
Investment contracts with discretionary participation features	23,660	16,940
	47,955	**67,239**

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

3 Investment Income and Expenses

	Group		Society	
	2017 £'000	**2016 £'000**	**2017 £'000**	**2016 £'000** (as restated)
Investment income:				
- Income from financial investments	19,094	19,047	19,092	19,047
- Gains on the realisation of investments	52,889	53,457	52,889	53,457
- Net foreign exchange gains/(losses)	7,626	(47,630)	7,626	(47,630)
	79,609	**24,874**	**79,607**	**24,874**
Unrealised gains/(losses) on investments	**6,737**	**43,138**	**(21,000)**	**45,959**
Investment expenses and charges:				
- Investment management expenses	5,296	4,271	5,296	4,146
- Losses on the realisation of investments	13,783	17,681	13,783	17,681
	19,079	**21,952**	**19,079**	**21,827**
Net investment income	**67,267**	**46,060**	**39,528**	**49,006**

4 Other Technical Income

	Group		Society	
	2017 £'000	**2016 £'000**	**2017 £'000**	**2016 £'000**
Fee income on investment contracts	1,021	899	1,021	899
General insurance	24,073	22,894	-	-
Other	14,198	15,855	26	24
	39,292	**39,648**	**1,047**	**923**

5 Claims

As set out in note 1(I) the Group and Society do not account for the amounts paid out on investment contracts as a claim expense in the Technical Account. These amounts have been accounted for as deposits repaid and have been deducted from the value of investment contract liabilities on the Balance Sheet. Claims paid out on investment contracts during the year were £5,339,000 (2016: £1,782,000).

6 Long-Term Business Provision

Group and Society

The table below shows the changes in the long-term business provision in the year.

	2017 £'000	**2016 £'000**
Change in insurance contracts and investment contracts with discretionary participation features liabilities		
Gross amount	14,528	10,028
Reinsurers' share	(354)	(1,978)
	14,174	**8,050**

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

7 Net Operating Expenses

	Group	
	2017 £'000	**2016 £'000**
Acquisition costs	2,455	1,123
Goodwill and intangible asset amortisation	7,004	5,592
Administration expenses	4,123	4,724
Information technology infrastructure	4,150	3,569
Operating lease costs	648	634
	18,380	**15,642**

Society

Costs are recharged to the Society via a management recharge from a group entity.

8 Staff Costs

	Group	
	2017 £'000	**2016 £'000**
Wages and salaries	23,572	19,801
Social security costs	2,229	1,994
Other pension costs	1,226	1,028
	27,027	**22,823**

Average number of employees of the Group by activity (including executive directors) during the year:

	Group	
	2017 No.	**2016 No.**
Senior management	7	9
Sales and customer services	315	313
Support services	230	214
	552	**536**

9 Directors' emoluments

	Group	
Directors' aggregate remuneration in respect of qualifying services:	**2017 £'000**	**2016 £'000**
Aggregate fees	298	236
Aggregate emoluments	476	584
	774	**820**

Pension contributions were made on behalf of one director (2016: one) under defined contribution schemes.

The highest paid director's remuneration was aggregate emoluments of £476,000 (2016: £584,000).

Key management includes directors and members of the executive management team. The compensation of key management personnel for the year was £2,054,000 (2016: £2,063,000) in respect of salaries, pensions and other benefits.

Society

The directors receive emoluments from PM Central Services PLC for services rendered in respect of all Group entities, however, none of the directors receive remuneration specific to the directorship of the Society (2016: £Nil).

Fees paid to directors were paid by the Society.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

10 Auditors' Remuneration

During the year the Group obtained the following services from the Society's auditors at costs as detailed below:

	2017 £'000	2016 £'000
Audit Services:		
Fees payable to the Society's auditors for the audit of the Society and Consolidated Financial Statements	270	184
Audit of the Society's subsidiaries	74	118
Audit related assurance services including the audit of insurance related regulatory returns	130	402
	474	**704**
Non Audit Services:		
Fees payable to the Society's auditors for other services:		
Other services supplied pursuant to legislation, including the audit of non-insurance related regulatory returns	8	8
Services relating to corporate finance transactions	19	724
Taxation	-	20
Other	-	45
	27	**797**
	501	**1,501**

The Group's auditors charged fees in respect of the audit of the Society's pension fund of £7,725 (2016: £7,500).

11 Taxation Attributable to Long-Term Business

	Group		Society	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
UK corporation tax:				
Current tax on income for the year	-	172	-	-
Adjustment in respect of prior years	(99)	-	(54)	-
Total current tax	**(99)**	**172**	**(54)**	**-**
Deferred tax:				
Origination and reversal of timing differences	1,120	3,796	1,373	4,049
Adjustment in respect of prior years	51	(21)	51	85
Total deferred tax	**1,171**	**3,775**	**1,424**	**4,134**
Total tax attributable to long-term business	**1,072**	**3,947**	**1,370**	**4,134**

UK corporation tax in the Society Technical Account has been calculated at a rate of 20% (2016: 20%) in accordance with rates applicable to the long-term business of a long-term insurance company.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

11 Taxation Attributable to Long-Term Business (continued)

The tax assessed on the results recorded in the Technical Account for the year differs from the standard rate of tax in the UK of 20% Society / 19.25% subsidiary companies (2016: 20%, both Society and subsidiary companies). The differences are reconciled below:

	Group		Society	
	2017 £'000	**2016 £'000**	**2017 £'000**	**2016 £'000**
Movement on technical account before tax	(10,267)	(15,308)	(21,637)	899
Movement multiplied by the standard rate of tax of 19.25%/20% (2016: 20%)	(1,911)	(3,062)	(4,327)	180
Effects of:				
Adjustment to current tax in respect of prior years	(99)	-	(54)	-
Adjustment to deferred tax in respect of prior years	51	(21)	51	85
Net non taxable income	1,910	(2,618)	8,981	(2,536)
Depreciation in advance of capital allowances/ (capital allowances claimed in excess of depreciation)	244	(224)	(10)	(67)
Deferred tax on pension liability	350	(1,523)	350	(1,523)
Deferred tax on capital losses derecognised and capital losses in year	(6,537)	8,203	(6,537)	8,203
Deferred tax on acquisition costs derecognised	2,709	-	2,709	-
Losses carried forward/(utilised) in the year	3,317	2,299	207	(208)
Goodwill amortisation not tax deductible	1,038	893	-	-
Total taxation	**1,072**	**3,947**	**1,370**	**4,134**

Deferred Tax

	Group		Society	
	2017 £'000	**2016 £'000**	**2017 £'000**	**2016 £'000**
Deferred tax asset/(liability):				
On acquisition costs	267	3,125	267	3,125
On Staff Pension Scheme	1,846	2,196	1,846	2,196
On unrealised losses on investments	1,784	-	1,784	-
On customer list	(569)	(822)	-	-
	3,328	**4,499**	**3,897**	**5,321**

Movements in net deferred tax asset

	Group		Society	
	2017 £'000	**2016 £'000**	**2017 £'000**	**2016 £'000**
At 1 January	4,499	8,958	5,321	9,455
Deferred tax liability on Acquisition	-	(684)	-	-
Deferred tax charge in Technical Account	(1,171)	(3,775)	(1,424)	(4,134)
At 31 December	**3,328**	**4,499**	**3,897**	**5,321**

At 31 December 2017, the Group had an unrecognised deferred tax asset of £12,493,000 comprising acquisition expenses £2,187,000, capital losses £1,282,000, tax losses £7,431,000 and capital allowances £1,593,000. At 31 December 2016, the Group had an unrecognised deferred tax asset of £11,185,000 comprising capital losses £5,600,000, tax losses £4,923,000 and capital allowances £662,000. These assets are not recognised on the grounds that the Group is not expected to generate sufficient suitable taxable profits against which these assets can be relieved.

At 31 December 2017 the Society had an unrecognised deferred tax asset of £4,343,000 comprising acquisition expenses £2,187,000, capital losses £1,282,000, tax losses £607,000 and capital allowances £267,000. At 31 December 2016, the Society had an unrecognised deferred tax asset of £6,000,000 comprising capital losses £5,600,000 and tax losses £400,000. These assets are not recognised on the grounds that the Society is not expected to generate sufficient suitable taxable profits against which these assets can be relieved.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

11 Taxation Attributable to Long-Term Business (continued)

Factors affecting future taxation

Changes to the UK corporation tax rates for the subsidiary companies were substantively enacted as part of the Finance Bill 2016 on 15 September 2016. These include reductions to the main rate of corporation tax to 19% from 1 April 2017 and to 17% from 1 April 2020. Deferred taxes at the balance sheet date have been measured and reflected in these financial statements using these enacted tax rates. There are no changes planned to the future corporation tax rate for the Society, which remains at 20%.

In his November 2017 budget, the Chancellor announced the removal of indexation in the calculation of capital gains. At 31 December 2017, the removal of indexation had not been substantively enacted, therefore its impact had not been factored into the tax calculations. After the year end, the removal of indexation was substantively enacted, had this been the case at the year end, the Society expects that the unrecognised deferred tax asset above of £4,343,000 would be fully recognised.

12 Fund for Future Appropriations

	Group		Society	
	2017 £'000	**2016 £'000**	**2017 £'000**	**2016 £'000** (as restated)
At 1 January (as previously reported)			192,473	
Impact of prior year adjustment – note 1			(38,184)	
At 1 January (as restated)	72,452	103,666	154,289	169,483
Transfer from technical account	(11,126)	(20,778)	(22,794)	(4,758)
Transfer from other comprehensive income	1,417	(10,436)	1,417	(10,436)
At 31 December	**62,743**	**72,452**	**132,912**	**154,289**

13 Intangible Assets

Group

	Goodwill £'000	**Customer List £'000**	**Software £'000**	**Total £'000**
Cost:				
At 1 January 2017	32,916	6,846	-	39,762
Transfer from tangible assets	-	-	2,790	2,790
Disposals	-	-	(1,289)	(1,289)
At 31 December 2017	**32,916**	**6,846**	**1,501**	**41,263**
Amortisation:				
At 1 January 2017	12,254	2,353	-	14,607
Transfer from tangible assets	-	-	1,158	1,158
Charge for the year	5,336	1,369	299	7,004
Eliminated on disposal	-	-	(516)	(516)
At 31 December 2017	**17,590**	**3,722**	**941**	**22,253**
Net book value:				
At 31 December 2017	**15,326**	**3,124**	**560**	**19,010**
At 31 December 2016	20,662	4,493	-	25,155

Software assets which are classified as intangible fixed assets under FRS 102 have been transferred at their carrying value from tangible fixed assets during the year.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

13 Intangible Assets (continued)

Society

	Software £'000
Cost:	
Additions	1,632
Disposals	(945)
At 31 December 2017	**687**
Amortisation:	
Charge for the year	299
Eliminated on disposal	(172)
At 31 December 2017	**127**
Net book value:	
At 31 December 2017	**560**

14 Investments in Group Undertakings

Society

	Shares in Group undertakings £'000
At 1 January 2017 (as restated)	106,684
Share purchase	14,500
Net revaluation loss	(27,737)
At 31 December 2017	**93,447**

The restatement to the investment in shares in group undertakings is disclosed in note 1. The valuation basis used at 31 December 2017 has changed from a discounted cash flow model which was used previously, to an earnings multiple model. Had the discounted cash flow model used previously been in place at 31 December 2017, the shares in group undertakings would have been valued at £123,998,000. Had the earnings multiple model been applied at 31 December 2016, a valuation of £88,789,000 would have resulted. A 10% movement in the earnings multiple selected gives a 9.8% movement in the resulting valuation. A 10% movement in the forecast future earnings gives a 9.2% movement in the resulting valuation.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

14 Investments in Group Undertakings (continued)

Set out below are the Society's investments in subsidiary undertakings as at 31 December 2017, all of which are included in the consolidation. All of the subsidiaries are incorporated in the United Kingdom and are wholly owned.

Name of undertaking	Principal activities	Immediate parent company
PM Central Services PLC (Company number: 08752809)	Service company for the Group.	Police Mutual Assurance Society Limited
Police Mutual Investment Services Limited (Company number: 03459376)	A dormant company.	Police Mutual Assurance Society Limited
PM Holdings Limited (Company number: 09908006)	An intermediate holding company.	Police Mutual Assurance Society Limited
PMGI Limited (Company number: 01073408)	Arranges general insurance policies and acts as an introducer of third party products.	PM Holdings Limited
PM Advisory Limited (Company number: 04560462)	Offers independent financial advice and also acts as an introducer for the Police Mutual Investment Choice platform.	PM Holdings Limited
Police Mutual Financial Services Limited (Company number: 04956444)	A dormant company.	PM Advisory Limited
Police Housing Fund Limited (Company number: 05069158)	Administrator for an affordable housing scheme for the Police.	PM Holdings Limited
PMHC Limited (Company number: 03018474)	Provider of discretionary healthcare products to the Police Family.	Police Housing Fund Limited
Mortgage Excellence PLC (Company number: 03527577)	Provider of mortgage placement and related financial services.	PM Holdings Limited
Abacus Insurance Holdings Limited (Company number: 08313724)	An intermediate holding company.	PM Holdings Limited
Abacus Limited (Company number: 04207663)	Arranges general insurance policies and acts as an introducer of third party products.	Abacus Insurance Holdings Limited
Forces Insurance Limited (Company number: 04188402)	A dormant company.	Abacus Insurance Holdings Limited

PM Advisory Limited, PMGI Limited, Mortgage Excellence PLC, Abacus Limited and Forces Insurance Limited are all regulated by the Financial Conduct Authority.

PM Holdings Limited, Police Housing Fund Limited, PMHC Limited and Abacus Insurance Holdings Limited have all taken the 479A audit exemption for a subsidiary company with the Society providing the parental guarantee.

In addition, the Group owns preference shares in Pinkerton segregated account (within Artex SAC Limited) which is incorporated in Bermuda and is an investment of Police Housing Fund Limited, consolidated in accordance with FRS 102, paragraph 9.11 ("Special purpose entities"). Its principal activity is reinsurance of general insurance policies that were arranged by Group companies.

Summary financial information is provided below in relation to Pinkerton segregated account (within Artex SAC Limited) showing each main heading in the primary statements for which there is a material item included within the Group Financial Statements.

Profit and loss account

	2017 £'000
Other Technical Income	6,548
Other Technical Charges	(657)
Net profit	5,891

Balance Sheet

	2017 £'000
Current assets	7,092
Current liabilities	(85)
Net assets	7,007

Included within current assets is £4,414,000 (2016: £5,227,000) of cash, of which £3,709,000 (2016: £3,108,000) is held as collateral.

There are no other gains and losses occurring in the current period. A dividend of £4,700,000 (2016: £5,000,000) was declared during the period and £5,500,000 (2016: £4,200,000) was paid to Police Housing Fund Limited, the immediate parent undertaking.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

15 Other Financial Investments

Due to the nature of the Group and Society, financial investments are held in order to be able to meet obligations to policy holders in the future.

(A) Financial Investments

Group and Society

	2017		2016	
	Carrying Value £'000	Historical Cost £'000	Carrying Value £'000	Historical Cost £'000
Financial investments at FVTPL				
Derivatives (note 15(B) – held for trading)				
- Forward currency	3,567	-	1,060	-
- Listed Options	2,429	3,109	2,402	6,921
- Bond futures	-	(11)	-	(165)
Financial investments designated upon initial recognition as at FVTPL				
Shares and other variable yield securities:				
- United Kingdom - listed	161,224	131,382	173,931	154,913
- United Kingdom - unlisted	4,175	3,005	4,157	3,005
- Overseas - listed	187,581	160,110	201,410	161,363
Debt and other fixed income securities:				
- United Kingdom - listed	161,001	153,538	201,102	194,738
- United Kingdom - unlisted	24,784	25,192	36,157	36,780
- Overseas - listed	9,897	9,939	17,824	17,270
Total financial investments held at FVTPL	**554,658**	**486,264**	**638,043**	**574,825**
Loans and receivables at amortised cost				
Loans on policies	2,929	2,929	2,993	2,993
Deposits with credit institutions	168,671	165,848	85,281	85,281
Total financial investments	**726,258**	**655,041**	**726,317**	**663,099**

All United Kingdom listed shares and securities are listed on the London Stock Exchange or other recognised investment exchanges. Overseas investments are listed on recognised investment exchanges within the relevant domicile country. Loans and receivables at amortised cost are disclosed at carrying value which is a reasonable approximation of fair value. Investments classified as held as at FVTPL (fair value through profit and loss) are those where fair value is equal to the assets' carrying value with gains or losses being reflected in the Technical Account. In this way these gains and losses will be matched with changes in the related liabilities to policy holders, which are also reflected in the Technical Account.

(B) Derivative Financial Instruments

The Society currently uses derivative financial instruments for efficient portfolio management. The derivatives used are 'exchange-traded' (regulated by an exchange) forward currency contracts with a market quoted price. These derivatives are financial contracts obligating the buyer to purchase a financial instrument at a predetermined future date and price.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value are recognised immediately in the Technical Account. Fair values are obtained from quoted market prices in active markets, including recent market transactions. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. The fair value of derivatives held at 31 December 2017 was £5,996,000 (2016: £3,462,000), commission payable on purchase was £Nil (2016: £Nil).

(C) Collateral

At the balance sheet date the Group and Society had pledged £796,000 (2016: £817,000) of cash margin collateral in respect of futures. The net cash margin pledged is included within cash on the face of the Balance Sheets of the Group and Society.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

16 Risk Management

(A) Credit Risk

The table below shows the assets of the Group and Society that are subject to credit risk and a reconciliation to the balance sheet carrying value for that asset. For derivatives the credit rating reflects the credit rating of the counterparty. Linked assets are not subject to credit risk as this risk is borne by the holders of the contracts concerned. The directors do not consider that there is any credit risk associated with Government gilts. Non-linked assets not subject to credit risk include shares and other variable yield securities that are subject to market risk.

		Group		Society	
		2017	**2016**	**2017**	**2016**
	Rating	**£'000**	**£'000**	**£'000**	**£'000**
Non-linked assets subject to credit risk	Government	2,431	-	2,431	-
Financial investments - debt and fixed income securities	AAA	3,091	1,384	3,091	1,384
	AA	16,211	12,811	16,211	12,811
	A	46,109	36,810	46,109	36,810
	BBB and below	100,647	129,701	100,647	129,701
	Not rated	24,784	36,157	24,784	36,157
Cash and cash equivalents	AAA	-	89,882	-	89,882
	AA	195,864	5,944	195,864	5,944
	A	11,800	11,035	6,605	7,090
	BBB and below	4,218	10,721	-	7,691
	Not rated	20	350	20	350
Reinsurers' share of technical provisions	AA	8,205	7,851	8,205	7,851
Linked assets not subject to credit risk		81,673	83,364	81,673	83,364
Linked assets subject to credit risk - cash	AA	8,736	-	8,736	-
	A	10,141	-	10,141	-
Non-linked assets not subject to credit risk		433,760	496,243	474,840	541,441
Total assets		**947,690**	**922,253**	**979,357**	**960,476**

In addition to holding collateral, the intermediary company reduces Police Mutual's exposure to credit risk by ensuring that the parties involved in the derivatives have sufficient resources to meet payment requirements. This is enhanced by the requirement for parties to provide the intermediary with an additional margin payment which provides further protection against default. The types of derivatives and the terms under which Police Mutual enters into arrangements are given in note 15(B).

No financial assets are past due or impaired at the reporting date and management expects no significant losses from non-performance by these counterparties. Other assets include premium debtors all of which are less than three months old. The Society has never experienced a significant loss arising from premium debtors because the Society maintains the right to cancel a policy if premiums are not paid when due. No provision is made for impairment of these assets (2016: £Nil).

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

16 Risk Management (continued)

(B) Liquidity Risk

The analysis below provides a summary of the exposures carried in respect of liquidity risks. The earliest contractual repayment date of investment contracts with discretionary participation features and unit linked investment contracts is on demand and the undiscounted cash flows subject to liquidity risk are £235,991,000 (2016: £207,267,000) and £100,550,000 (2016: £83,364,000) respectively. Other financial liabilities are repayable between 0-5 years as follows:

	Group		Society	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Other financial liabilities	43,342	48,748	4,840	5,134

The tables below show the undiscounted expected maturity analysis of the Group's and Society's insurance contracts and investment contracts with discretionary participation features. These are the amounts that are guaranteed on maturity (or any earlier date where the surrender value is guaranteed).

Group and Society

	2017					
	0-5 years £'000	5-10 years £'000	10-15 years £'000	15-20 years £'000	Over 20 years £'000	Total £'000
Liabilities subject to liquidity risk						
Insurance contract liabilities						
- guaranteed component	272,060	365,396	107,817	6,320	1,753	753,346
Investment contract with discretionary participation features liabilities						
- guaranteed component	151,117	54,117	1,089	312	72	206,707
	423,177	**419,513**	**108,906**	**6,632**	**1,825**	**960,053**

	2016					
	0-5 years £'000	5-10 years £'000	10-15 years £'000	15-20 years £'000	Over 20 years £'000	Total £'000
Liabilities subject to liquidity risk						
Insurance contract liabilities						
- guaranteed component	287,597	373,831	98,152	6,223	1,733	767,536
Investment contract with discretionary participation features liabilities						
- guaranteed component	132,990	55,294	1,331	388	72	190,075
	420,587	**429,125**	**99,483**	**6,611**	**1,805**	**957,611**

Amounts under unit linked contracts are generally repayable on demand and the Group is responsible for ensuring there is sufficient liquidity within the asset portfolio to enable liabilities to unit linked policy holders to be met as they fall due.

(C) Operational, Strategy, Brand and Reputation Risks

Unlike financial risks, the measurement of operational, strategic and reputation risks is largely based on scenario analysis and stress testing that include reverse stress testing carried out by subject matter experts from key parts of the organisation with the involvement of the Managing Board at appropriate stages. This approach is proportionate to the size and complexity of the business. The Group uses scenario analysis and stress testing to help assess the likelihood and impact of risks on the evolving business model and strategic plans by considering the strength of systems of control and framing appropriate contingency plans and risk mitigating actions to reduce the exposure to within the Group's risk tolerances and appetite. The approach refers to industry and regulatory guidance which emphasises the use of data collected internally and external sources as applicable to the Group.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

16 Risk Management (continued)

(D) Currency Risk

The table below shows the split of denomination currencies and the extent to which there is an exposure to currency risk.

Assets

	Group		Society	
	2017 £'000	**2016 £'000**	**2017 £'000**	**2016 £'000**
Non-linked assets				
Assets denominated in Sterling	648,233	633,689	679,900	671,912
Assets denominated in US Dollars	154,817	156,979	154,817	156,979
Assets denominated in Euros	25,667	39,586	25,667	39,586
Assets denominated in other currencies	18,423	8,635	18,423	8,635
Total non-linked assets	**847,140**	**838,889**	**878,807**	**877,112**
Linked assets not exposed to currency risk	100,550	83,364	100,550	83,364
Total assets	**947,690**	**922,253**	**979,357**	**960,476**

(E) Fair value estimation

FRS 102, under paragraphs 11.41(a) and 11.41(d) requires for financial instruments held at fair value on the Balance Sheet, disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- Quoted prices (unadjusted) in active markets for identical assets and liabilities (Level 1);
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2);
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

The following table presents the Group's investments that are measured at fair value at 31 December 2017.

	Total £'000	**Level 1 £'000**	**Level 2 £'000**	**Level 3 £'000**
Derivatives				
- Forwards	5,996	5,996	-	-
Shares and other variable yield securities:				
- United Kingdom *	247,035	160,763	-	86,272
- Overseas	187,581	187,581	-	-
Debt and other fixed income securities:				
- United Kingdom	185,785	-	161,001	24,784
- Overseas	9,897	-	9,897	-
Deposits with credit institutions **	186,155	186,155	-	-
Loans on policies	2,929	-	-	2,929
	825,378	**540,495**	**170,898**	**113,985**

* includes £81,636,000 of assets held to cover linked liabilities with the Level 1 category.
** includes £17,484,000 of assets held to cover linked liabilities with the Level 1 category.

The investment in shares in group undertakings held by Society of £93,447,000 (2016: £106,684,000) is classified as level 3. There are no other differences between the Group and Society's investments.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

16 Risk Management (continued)

(E) Fair value estimation (continued)

The following table presents the Group's investments that are measured at fair value at 31 December 2016.

	Total £'000	Level 1 £'000	Level 2 £'000	Level 3 £'000
Derivatives				
- Forwards	3,462	3,462	-	-
Shares and other variable yield securities:				
- United Kingdom*	261,452	175,935	-	85,517
- Overseas	201,410	201,410	-	-
Debt and other fixed income securities:				
- United Kingdom	237,259	33,982	166,497	36,780
- Overseas	17,824	-	17,824	-
Deposits with credit institutions	85,281	85,281	-	-
Loans on policies	2,993	-	-	2,993
	809,681	**500,070**	**184,321**	**125,290**

* includes £83,364,000 of assets held to cover linked liabilities with the Level 1 category.

The Group does not have any financial liabilities that are held for trading.

The fair value of financial instruments traded in active markets is based on quoted bid prices at the balance sheet date, as described in note 1(K) to the Financial Statements. These instruments are included in Level 1 and comprise primarily listed equity and debt instruments.

The Group monitors closely the valuation of assets in markets that have become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. Where it is determined that there is no active market, fair value is established using a valuation technique. The techniques applied incorporate relevant information available and reflect appropriate adjustments for credit and liquidity risks. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. The relative weightings given to different sources of information and the determination of non-observable inputs to valuation models can require the exercise of significant judgement.

If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2. If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments include:

- The use of observable prices for recent arm's length transactions;
- Quoted market prices or dealer quotes for similar instruments. In particular, for corporate bonds for which there is no active market the fair value is based on broker/dealer price quotations. Where possible the Group seeks at least two quotations for each bond and considers whether these are representative of fair value in light of current traded levels. Where this information is not available or where it is considered to be not representative of fair value, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics; and
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

Note that all of the resulting fair value estimates are included in Level 2, except for certain asset backed securities which are included in Level 3.

The following table presents the changes in Level 3 financial instruments for the year ended 31 December 2017.

	£'000
Opening Balance	**125,290**
Net disposals	(15,097)
Unrealised gain included in the Technical Account	3,792
Closing Balance	**113,985**

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

16 Risk Management (continued)

(E) Fair value estimation (continued)

The Group has investments in property funds. These have been classified as Level 3 as there is limited observable market data for the valuation of these assets. The fair value of the property funds is based on the net asset values supplied by underlying fund managers using independent firms of valuers. Management has applied a discount factor collated from portfolio managers based on their views of the secondary unlisted market to the net asset values.

The Group has a minority equity holding in and a loan with a financial company. These have been classified as Level 3 as there is limited recent, observable market data in active markets for the valuation of these assets. The fair value of the minority equity holding has been modelled based on external transactions, however these are not in an active market. The fair value of the loan has been calculated using a discounted cash flow model, with assumptions for the level of default, the amount recovered in the event of a default, and the rates of early repayments.

17 Tangible assets

Group

	Land and Buildings £'000	Computer equipment £'000	Office furniture and equipment £'000	Motor vehicles £'000	Total £'000
Cost:					
At 1 January 2017	6,768	9,436	1,337	79	17,620
Additions	-	445	137	-	582
Transfer to intangible assets	-	(2,790)	-	-	(2,790)
Disposals	-	(551)	(29)	-	(580)
At 31 December 2017	**6,768**	**6,540**	**1,445**	**79**	**14,832**
Depreciation:					
At 1 January 2017	1,438	2,948	527	36	4,949
Charge for the year	32	1,416	93	8	1,549
Transfer to intangible assets	-	(1,158)	-	-	(1,158)
Revaluation	(32)	-	-	-	(32)
Eliminated on disposals	-	(259)	-	-	(259)
At 31 December 2017	**1,438**	**2,947**	**620**	**44**	**5,049**
Net book value:					
At 31 December 2017	**5,330**	**3,593**	**825**	**35**	**9,783**
At 31 December 2016	5,330	6,488	810	43	12,671

At the end of the year the Group had a tangible asset capital commitment of £Nil (2016: £Nil).

The land and buildings included above are owned directly by and occupied by the Society.

All properties held at 31 December 2017 are freehold. A full external professional valuation of the Society's properties was carried out during 2014 by Kingstons, Chartered Surveyors on an existing use basis as at 31 December 2014. The valuation in 2017 and 2016 was a directors' valuation.

Included in the net book value of land & buildings is £72,000 (2016: £104,000) relating to fixtures, fittings, plant and equipment.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

17 Tangible assets (continued)

Society

	Land and Buildings £'000	Computer equipment £'000	Total £'000
Cost:			
At 1 January 2017	6,768	-	6,768
Additions	-	1,017	1,017
Disposals	-	(9)	(9)
At 31 December 2017	**6,768**	**1,008**	**7,776**
Depreciation:			
At 1 January 2017	1,438	-	1,438
Charge for the year	32	147	179
Revaluation	(32)	-	(32)
Eliminated on disposals	-	(2)	(2)
At 31 December 2017	**1,438**	**145**	**1,583**
Net book value:			
At 31 December 2017	**5,330**	**863**	**6,193**
At 31 December 2016	5,330	-	5,330

18 Technical Provisions and Technical Provisions for Linked Liabilities

(A) Technical Provisions

Group and Society

	2017			2016		
	Gross £'000	Reinsurers' Share £'000	Net £'000	Gross £'000	Reinsurers' Share £'000	Net £'000
Contract liabilities						
Participating insurance contracts	424,406	-	424,406	432,709	-	432,709
Non-participating insurance contracts	8,103	(8,205)	(102)	7,303	(7,851)	(548)
	432,509	**(8,205)**	**424,304**	**440,012**	**(7,851)**	**432,161**
Investment contracts with discretionary participation features	241,041	-	241,041	212,655	-	212,655
Non-participating investment contracts	46,299	-	46,299	43,214	-	43,214
Long-term business provision	**719,849**	**(8,205)**	**711,644**	**695,881**	**(7,851)**	**688,030**
Claims outstanding	**7,065**	**(873)**	**6,192**	**5,777**	**(336)**	**5,441**

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

18 Technical Provisions and Technical Provisions for Linked Liabilities (continued)

(B) Technical Provisions for Linked Liabilities and Other Financial Liabilities

Group and Society

	2017	2016
	£'000	£'000
Non-participating investment contracts	100,550	83,364
Total technical provisions for linked liabilities	**100,550**	**83,364**

Financial liabilities in respect of unit-linked investment contracts are carried in the balance sheet at amortised cost.

Other financial liabilities of the Group including creditors payable within one year of £41,370,000 (2016: £46,528,000) are measured at amortised cost. The corresponding amounts for the Society are £4,840,000 (2016: £5,134,000).

The carrying value of unit-linked investment contracts and other financial liabilities is a reasonable approximation of fair value.

(C) Assumptions

Key assumptions used to determine insurance contract liabilities are set by the Managing Board based on advice given by the Chief Actuary and are outlined below. These assumptions are updated at least at each reporting date to reflect latest estimates.

In calculating the technical provisions no account has been taken of future management actions.

i) Demographic

- Mortality

Mortality bases are reviewed periodically to ensure that the assumptions remain appropriate, taking into account recent company and industry experience for each class of business. The mortality rates used are given below.

Class of Business	Mortality	
	2017	2016
Term assurance (smoker/non-smoker differentiated)	50% TM/F00 / 100% TM/F00	50% TM/F00 / 100% TM/F00
Term assurance	70% TM/F00	70% TM/F00
Annuities	60% AM/F00	60% AM/F00
Whole of Life business	60% AM/F00	60% AM/F00
Pension business	40% AM/F00	40% AM/F00
Unitised with-profits business	40% AM/F00	40% AM/F00
All other business	60% AM/F00	60% AM/F00

The mortality assumptions for 2017 are unchanged from 2016.

If a lower mortality rate were assumed to apply, the long-term business provision would decrease in respect of assurances and increase in respect of annuities.

- Persistency

Persistency is the extent to which policies remain in force and are not for any reason lapsed, made paid-up, surrendered or transferred prior to maturity or expiry.

An allowance has been made for lapse and withdrawal rates based on analysis of the most recent experience. The lapse rates used for 2017 are different from the 2016 assumptions reflecting variations in actual experience.

To the extent that recurring single premiums are paid under a contract, provided the terms of the payment of those single premiums are not fixed contractually, no future allowance will be made.

An increase in lapses would reduce the cost of guarantees, as fewer policy holders remain to receive the guaranteed benefits.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

18 Technical Provisions and Technical Provisions for Linked Liabilities (continued)

(C) Assumptions (continued)

ii) Expenses

Allowance is made for the best estimate of the expenses required to administer the existing life assurance business. The Transformation Programme the Society has embarked upon introduces some uncertainty as to the costs of delivering the programme and the benefits that will be realised both in terms of amount and timing. A comprehensive review of the way in which costs are allocated between businesses and products is being undertaken. The review has been started but not concluded in time for the completion of the financial statements and this introduces further uncertainty. In determining the expense assumptions some allowance for the benefits of the Transformation Programme has been made to the extent that it is reasonably expected to be realised and this is reflected in the assumptions shown below. An additional expense reserve has been created to explicitly cover the additional life maintenance costs for the in force book. The reserve is calculated on the capitalised value of the additional annual amount multiplied by the duration of the current life book.

An increase in the future expense assumption for conventional with-profits business would increase the cost of guarantees as the guaranteed benefits are more likely to apply at maturity. It would also increase the technical provisions for the other lines of business. It is estimated that a 13% increase in the future expense assumption would increase the long term business provision by £1m.

Class of Business	Expenses	
	2017	2016
Term assurance	£8.50 pa	£7.50 pa
Top up pension	£14.64 pa	£14.28 pa
Platinum Bond, GIB, GISA, OISA	£65.00 pa	£65.00 pa
Stakeholder Pension, Group Personal Pension	£67.80 pa	£60.00 pa
Child Trust Fund	£18.10 pa	£16.00 pa
Conventional with-profits	£15.25 pa	£13.50 pa

iii) Economic

For with-profits business, the majority of the liability is calculated as the aggregate asset share for the business in force. This is a retrospective calculation based on the actual experience. Asset shares have been determined in line with our Principles and Practices of Financial Management (PPFM).

The values of financial options and guarantees and future deductions from asset shares are calculated using market consistent techniques. Market consistency is achieved by running a large number of economically credible scenarios through a stochastic valuation model. Each scenario is discounted at a rate consistent with the individual simulation. Economic scenarios achieve market consistency by calibration to observed market data.

Significant assumptions impacting the cost of options and guarantees are investment volatility and correlation between different categories of asset. Asset expected returns and volatilities have been calibrated to ensure consistency with market values at an appropriate term for our anticipated liability profile. The cost of guarantees will be higher with higher investment volatility.

The liabilities for non-profit business have been calculated using the risk free term structure as specified by EIOPA. The risk discount rate varies by term. For non-profit business, the long-term business provision is calculated using the gross premium valuation method.

19 Capital Management

All Police Mutual's available capital resources are within the Life Fund. There are no shareholders' funds and there are no borrowings.

The Group and the regulated entities within it are subject to a number of regulatory capital tests. They have all met these requirements throughout the financial year. In reporting financial strength, capital and solvency, measures prescribed by the Prudential Regulation Authority (PRA) are used. These regulatory capital tests are based upon required levels of solvency capital and a series of best estimate assumptions in respect of the types of business written by the Group.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

19 Capital Management (continued)

The primary uses of Police Mutual's capital are:

- to meet statutory solvency and internal capital requirements;
- to give investment freedom for with-profits policyholders;
- to provide working capital;
- to provide capital support for guarantees;
- to finance other business ventures including providing support for benevolent activities consistent with the Society's purposes and for the overall commercial benefit and/or protection of all current and future members recognising the support the Society receives from the Police;
- to enable smoothing of investment returns and payouts;
- to meet any excess of costs over charges for business other than conventional with-profits business; and
- to meet exceptional costs in managing the business arising as a result of legislation, taxation or other circumstances which, in the opinion of the Managing Board, should not be directly charged to policyholder benefits.

Police Mutual manages its capital by any of the following or a combination of any of them: pursuing its business plan and attendant revenue and profit targets, amending investment strategy, amending charges and by controlling the addition of regular and final bonuses on with-profits policies, in order to ensure it is adequate to meet both the regulatory requirement and the internal assessment for capital as a buffer against adverse circumstances.

Police Mutual's intention is that the capital should be large enough to support the uses listed above and its risk appetite. However, it will not actively increase the amount of capital beyond the needs of ensuring it is adequate for this purpose.

The table below shows the change in Fund for Future Appropriations (FFA) over the year. The restatement to the 2016 FFA is due to the revaluation of the subsidiaries.

	2017 £'000	2016 £'000
Total Society FFA at 1 January (as previously reported)	**192,473**	**169,485**
Impact of prior year adjustment	(38,184)	-
Total Society FFA at 1 January (as restated)	**154,289**	**169,485**
Investment variations – assets	(328)	3,681
Investment variations – liabilities, plus one year ageing of policies	14,139	7,163
Change in economic conditions and economic assumptions	7,457	(6,358)
Change in value of group undertakings	(30,757)	41,005
Effect of demographic experience over the year	(2,314)	(1,150)
Expense variances	(4,942)	(2,799)
Tax variances	2,863	(3,389)
Profits on non-profit business after reinsurance	646	1,062
New business	(3,896)	(2,990)
Change in current liabilities	3,340	(12,188)
Changes in management policy	(33)	-
Change in non-economic assumptions	(4,541)	87
Modelling changes	(1,140)	(1,018)
Other variances and rounding	(1,871)	(118)
Total Society FFA at 31 December	**132,912**	**192,473**

The first two items in the table are due to the investment return on the asset share assets exceeding risk free rates in 2017. They also include the investment return earned on the remaining assets.

The change in economic conditions and economic assumptions reflects changes in interest rates and asset volatility figures, together with any change in future equity backing ratio assumption.

The change in the value of subsidiaries reflects the latest business plans for the subsidiaries but also a change in the estimation method used for the valuation.

The expense variances include items that the Managing Board agreed would be charged to the estate. It also includes the effect of support provided to new product development.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

19 Capital Management (continued)

The tax variances are due to past equity losses being used to offset gains arising in 2017 together with a change in the deferred tax asset recognised in the year in respect of other items.

The change in capital from new business comes mainly from the strain of writing with-profits business and the Fixed Term OISA product.

The main element included in the change in current liabilities is the non-cashflow item in respect of FRS 102 Pension deficit liabilities.

Police Mutual has only one with-profits fund, the Life Fund. The FFA for that fund is determined in accordance with the FRS 102 regime. Policyholder liabilities have been determined in accordance with the Solvency II PRA regulations. The FFA includes the value of the estate. The estate represents the surplus in the fund that is in excess of any constructive obligation to policyholders. It represents capital resources of the Life Fund recognisable by Solvency II regulations and is available to meet regulatory and other solvency requirements of the fund including additional liabilities recognisable under the Solvency II regime.

Restrictions on available Own Funds

In addition to the liabilities recognisable in the financial statements, Police Mutual is required to hold sufficient capital to meet the sterling reserves on non-profit business and the ‘Risk Margin’ (RM). Under Solvency II, the valuation of group undertakings is also carried out using different methodology and intangible assets are carried at nil value. The excess of assets over liabilities including these adjustments form the Solvency II Own Funds (OF).

Police Mutual is required to hold sufficient OF to meet the ‘Solvency Capital Requirement’ (SCR) determined in accordance with the PRA’s regulatory rules under the Solvency II regime, together with the capital requirement determined under the Solvency II Pillar 2 regime (P2CR) which considers more company bespoke risks. The determination of the SCR and P2CR depends on various actuarial and other assumptions about potential changes in market prices, and the actions management would take in the event of particular adverse changes in market conditions.

Management intends to maintain surplus capital in excess of the SCR and P2CR and to maintain an appropriate additional margin over this to absorb changes in both capital and capital requirements.

The items that will have affected OF are the investment performance over 2017, higher interest rates, changes in investment strategy resulting in a lower equity backing ratio, expense variances, changes in assumptions used to measure liabilities, changes in subsidiaries and their valuations, new business and other variances. These other variances include the effect of investment variations (in particular the investment return on those capital resources over the year) and differences between expected cashflows over the year and actual cashflows (for example expected claim, expense and tax payments compared to actual).

Capital resource sensitivities

The capital position is sensitive to changes in market conditions, due to both changes in the value of the assets and the effect that changes in investment conditions may have on the value of the liabilities. It is also sensitive to assumptions and experience relating to mortality, expenses and persistency.

The most significant sensitivity arises from the market risk in relation to the with-profits business, which would arise if adverse changes in the value of the assets supporting this business could not be reflected in payments to policyholders because of the effect of guarantees and options. The capital position of this business would also deteriorate if increases to the market cost of derivatives resulted in an increase in the liability for guarantees and options on the Balance Sheet.

20 Other Debtors

	Group		**Society**	
	2017 £’000	**2016 £’000**	**2017 £’000**	**2016 £’000**
Trade debtors	25,085	21,746	-	-
Amounts due from group undertakings	-	-	434	471
Other debtors	3,124	2,001	251	222
Corporation tax recoverable	183	345	183	531
	28,392	**24,092**	**868**	**1,224**

Included in amounts due from group undertakings is a subordinated loan of £434,000 (2016: £434,000) due from PM Advisory Limited. The loan is not repayable for at least 24 months from the date of issue. No repayment notice was issued as at the balance sheet date. Interest is payable quarterly in arrears at LIBOR plus 5.22%. All other amounts due from group undertakings are unsecured and repayable on demand. No impairment provision is required in either year against these balances.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

21 Other Creditors

	Group		Society	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Trade Creditors	25,791	24,069	80	192
Amounts due to group undertakings	-	-	3,680	663
Other Creditors	5,120	13,934	182	924
Tax and Social Security	606	614	-	-
Accruals and Deferred Income	9,149	4,831	561	638
Unrealised foreign exchange positions	324	2,480	324	2,480
	40,990	**45,928**	**4,827**	**4,897**

Included within the Group Other Creditors balance is an amount of £3,039,000 (2016: £6,635,000) which is payable after more than one year.

22 Other Provisions

	Clawback £'000
Group	
At 1 January 2017	2,220
Utilised in the year	(881)
Charged to the Technical Account	633
At 31 December 2017	**1,972**

Clawback provisions relate to an expected amount to be repaid to insurers in respect of commission being clawed back on cancellation of life insurance policies by customers. A provision is also established on new business written at the time the gross commission is received. The provision is expected to be utilised within four years.

There are no provisions held in the Society.

23 Operating Leases

The Group has commitments for the following future minimum lease payments under non-cancellable operating leases for each of the following periods:

	Property, plant and equipment	
	2017 £'000	2016 £'000
Within one year	460	418
Between two and five years	1,375	1,452
After five years	316	599
	2,151	**2,469**

The Society has no commitments for the future minimum lease payments under non-cancellable operating leases.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

24 Pension Commitments

The Group and Society contribute to defined contribution schemes for employees. In 2017, this contribution amounted to £859,000 (2016: £1,082,000).

The Society also operates a funded defined benefit scheme called the Police Mutual Assurance Society Staff Pension Fund ('The Fund'). This provides defined pensions and lump sum benefits payable to members on their retirement or to their dependants on death before or after retirement. All members had been transferred to deferred status by 31 December 2011, and hence there were no active members for the year ended 31 December 2017.

The contributions to The Fund are determined with the advice of independent consulting actuaries, Barnett Waddingham, on the basis of triennial valuations using the projected unit method. The valuation for the financial statements has been based on the most recent actuarial valuation for the period to 31 December 2016 and was updated for FRS 102 purposes at 31 December 2017 by Barnett Waddingham.

After the year end, agreement was reached with the Trustee of The Fund to address the deficit in the pension fund by making an annual capital contribution of £3m for each of the next six years.

The main assumptions used were:

	2017	2016
Discount rate	2.55%	2.80%
RPI inflation	3.50%	3.60%
CPI inflation	2.50%	2.60%
LPI 5% pension increases	3.50%	3.60%
Revaluation in deferment	2.50%	2.60%
Life expectancy at age 60 of male aged 45	30.5 years	30.9 years
Life expectancy at age 60 of male aged 60	28.8 years	29.2 years
Life expectancy at age 60 of female aged 45	31.7 years	32.4 years
Life expectancy at age 60 of female aged 60	29.9 years	30.6 years

The actual return of the Fund's assets during the year was 3.4% (2016: 8.2%).

The major categories of assets as a percentage of total assets and the expected long-term rate of return are as follows:

Asset Category	2017	2016
Equities	64%	64%
LDI	10%	11%
Bonds	25%	24%
Cash	1%	1%

Under FRS 102, the expected return on assets is based on the discount rate used to value the liabilities (i.e. the returns available on high quality corporate bonds) with no allowance made for any outperformance expected from the Fund's actual asset holding. The discount rate (and therefore expected return on assets) used was therefore 2.55% pa (2016: 2.80% pa). The assets do not include any investments in the Group or Society.

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

24 Pension Commitments (continued)

Amounts Recognised in the Balance Sheet at 31 December

	2017 £'000	2016 £'000
Growth assets	20,341	20,873
LDI	3,112	3,503
Bonds	8,047	7,655
Cash	257	487
Fair Value of assets	**31,757**	**32,518**
Present value of funded obligations	(45,898)	(48,549)
Deficit in the Fund	**(14,141)**	**(16,031)**

Reconciliation of Present Value of Scheme Liabilities

	2017 £'000	2016 £'000
At 1 January	48,549	35,431
Interest cost	1,324	1,387
Benefits paid	(2,578)	(1,515)
Actuarial (gain)/loss on liabilities	(1,397)	13,246
At 31 December	**45,898**	**48,549**

Reconciliation of Fair Value of Scheme Assets

	2017 £'000	2016 £'000
At 1 January	32,518	30,590
Return on scheme assets less interest	233	1,287
Contributions	859	1,042
Benefits paid	(2,578)	(1,515)
Administration costs	(159)	(98)
Interest on assets	884	1,212
At 31 December	**31,757**	**32,518**

Analysis of the Amount Charged to Technical Account

	2017 £'000	2016 £'000
Interest on assets	(884)	(1,212)
Interest on liabilities	1,324	1,387
Administration costs	159	98
Total	**599**	**273**

Notes to the Financial Statements for the year ended 31 December 2017 (continued)

24 Pension Commitments (continued)

Amounts recorded in Other Comprehensive Income

	2017 £'000	2016 £'000
Return on scheme assets less interest	(233)	(1,287)
Actuarial (gain)/loss on defined benefit obligation	(1,397)	13,246
Total actuarial (gain)/loss	**(1,630)**	**11,959**

History of Experience of Gains and Losses

	2017 £'000	2016 £'000	2015 £'000	2014 £'000	2013 £'000
Present value of defined benefit obligation	(45,898)	(48,549)	(35,431)	(37,055)	(32,055)
Fund assets	31,757	32,518	30,590	30,397	27,772
Deficit	**(14,141)**	**(16,031)**	**(4,841)**	**(6,658)**	**(4,283)**
Experience gains and losses on Fund liabilities	-	-	-	(237)	-
Changes in assumptions used to value Fund liabilities	(1,397)	13,246	(2,388)	(4,133)	(3,627)
Experience adjustments on Fund assets	(233)	(1,287)	757	1,204	(237)

25 Related Party Transactions

Police Mutual Assurance Society Limited is the ultimate holding company of the wholly owned subsidiaries as listed in note 14. It has, therefore, taken advantage of the exemption contained in Financial Reporting Standard 102, Section 33 - Related Party Disclosures and has not disclosed separately transactions or balances with those companies.

During the year members of the Committee of Management, Managing Board and their immediate families took out products offered by the Group. The annualised premium and claims paid during the year for such products are shown below:

	2017	2016
Life:		
Life products £'000	177	124
Number of members paying premiums in the year	18	20
Balance due to Group £'000	-	-
General Insurance:		
General insurance products £'000	12	17
Number of members paying premiums in the year	12	11
Balance due to Group £'000	8	1
Healthcare subscriptions:		
Healthcare products £'000	5	5
Number of members paying subscriptions in the year	2	2
Balance due to Group £'000	-	-

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