

**VIRGINIA SURETY COMPANY INC – NEW ZEALAND BRANCH**  
**ANNUAL FINANCIAL REPORT**  
**FOR THE YEAR ENDED**  
**31 DECEMBER 2016**

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## DIRECTOR'S REPORT

The Director presents the annual report together with the audited Financial Statements for the year ended 31 December 2016.

No disclosure has been made pursuant to Section 211(1) (a) and (e) to (j) of the *Companies Act 1993* following a unanimous decision by the shareholders in accordance with Section 211 (3) of the Act.

### RESULTS

The loss for the year after income tax was \$24,408 (2015: profit \$142,057).

### DIVIDEND

The Director recommends that no dividend be paid (2015: \$Nil).

### AUDITORS

In terms of the *Companies Act 1993*, Ernst & Young are to continue in office as the Branch's auditors.

### ACTIVITIES

The principal activities during the year were those of insurance underwriting and investment.

### DIRECTORS INTERESTS IN TRANSACTIONS

Directors have no interests to declare in the transactions of the year ended 31 December 2016.


### REVIEW OF OPERATIONS

The gain for the financial year reflects the maturity of its existing earnings profile and claim experience.

### SUBSEQUENT EVENTS

There were no events since 31st December 2016 which have significantly affected, or may significantly affect, the operations of the branch in future financial years, the results of those operations, or the state of affairs of the company in future financial years.

### ON BEHALF OF THE BOARD

  
\_\_\_\_\_  
28 April 2017 Director

  
\_\_\_\_\_  
28 April 2017 Director



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## Independent Auditor's Report

### The Shareholders of Virginia Surety Company Inc. (New Zealand Branch)

#### Report on the Financial Statements

We have audited the financial statements of the New Zealand branch of Virginia Surety Company Inc. on pages 5 to 23, which comprise the statement of financial position of the New Zealand branch of Virginia Surety Company Inc. as at 31 December 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

This report is made solely to the company's shareholders, as a body. Our audit has been undertaken so that we might state to the company's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the New Zealand branch of the company and the company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

#### Directors' Responsibility for the Financial Statements

The directors are responsible on behalf of the company for the preparation and fair presentation of the financial statements in accordance with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). These auditing standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we have considered the internal control relevant to the New Zealand branch of the company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the New Zealand branch of the company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

We believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Other than in our capacity as auditor we have no relationship with, or interest in, the New Zealand branch of the company.



Partners and employees of our firm may deal with the New Zealand branch of the company on normal terms within the ordinary course of trading activities of the business of the New Zealand branch of the company.

#### Opinion

In our opinion, the financial statements on pages 5 to 23 present fairly, in all material respects, the financial position of the New Zealand branch of the company as at 31 December 2016 and its financial performance and cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

A handwritten signature in black ink that reads 'Ernst &amp; Young'.

Ernst & Young

28 April 2017

Sydney

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2016

	Notes	2016 \$	2015 \$
<b>REVENUE</b>			
Premium revenue		1,524,118	3,991,376
Decrease/(increase) in unearned premium reserve		1,957,065	(791,969)
		<u>3,481,183</u>	<u>3,199,407</u>
<b>EXPENSES</b>			
Gross claims incurred	5	806,465	880,579
Acquisition costs	15	1,950,331	1,429,808
		<u>2,756,796</u>	<u>2,310,387</u>
Investment income	8	174,482	175,213
(Loss)/gain on investments		296	53,920
		<u>174,778</u>	<u>229,133</u>
Other operating and administration expenses	7	(927,465)	(860,559)
<b>Profit/(Loss) before income tax</b>		<u>(28,300)</u>	<u>257,594</u>
Income tax (expense) / benefit	9	3,892	(115,537)
<b>Profit/(Loss) after income tax</b>		<u>(24,408)</u>	<u>142,057</u>
<b>Total comprehensive income</b>		<u>(24,408)</u>	<u>142,057</u>
Operating profit for the year attributable to:			
Non-controlling interest		-	-
Owners of the parent		(24,408)	142,057
Operating Profit after tax		(24,408)	142,057
Total comprehensive income is attributable to:			
Non-controlling interest		-	-
Owners of the parent		(24,408)	142,057
Operating Profit after tax		(24,408)	142,057

The attached notes on pages 9 to 24 form part of and should be read in conjunction with these financial statements, together with the Auditors' Report on page 3 and 4.

**VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**

**STATEMENT OF FINANCIAL POSITION**

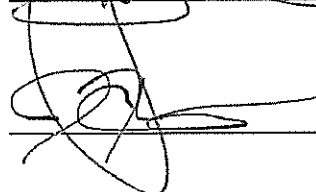
**AS AT 31 DECEMBER 2016**

	Notes	2016 \$	2015 \$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	10	1,270,576	2,090,156
Trade and other receivables	11	233,390	203,514
Deferred acquisition costs	15	3,517,170	4,628,443
Current tax asset	9	66,820	95,031
<b>Total current assets</b>		<u>5,087,956</u>	<u>7,017,144</u>
<b>Non-current assets</b>			
Investments	12	5,377,205	4,660,933
Deferred tax assets	9	71,276	67,383
<b>Total non-current assets</b>		<u>5,448,481</u>	<u>4,728,316</u>
<b>TOTAL ASSETS</b>		<u>10,536,437</u>	<u>11,745,460</u>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade and other payables		1,301,934	714,024
Outstanding claims	14	391,198	206,648
Unearned premiums	17	5,991,392	7,948,467
Current tax liabilities	9	-	-
<b>Total current liabilities</b>		<u>7,684,524</u>	<u>8,869,139</u>
<b>TOTAL LIABILITIES</b>		<u>7,684,524</u>	<u>8,869,139</u>
<b>NET ASSETS</b>		<u>2,851,913</u>	<u>2,876,321</u>
<b>TOTAL EQUITY</b>		<u>2,851,913</u>	<u>2,876,321</u>

For and on behalf of the board of directors, who authorised the issue of this financial report on the date of signing.

 Director

28 April 2017

 Director

28 April 2017

*The attached notes on pages 9 to 24 form part of and should be read in conjunction with these financial statements, together with the Auditors' Report on page 3 and 4.*

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016 \$	2015 \$
Total Equity as at 1 January	2,876,321	2,734,264
Profit /(loss) for the year	(24,408)	142,057
Total comprehensive income/(loss)	<u>(24,408)</u>	<u>142,057</u>
Total Equity as at 31 December	<u>2,851,913</u>	<u>2,876,321</u>

*The attached notes on pages 9 to 24 form part of and should be read in conjunction with these financial statements, together with the Auditors' Report on page 3 and 4.*



VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 \$	2015 \$
<b>Cash flows from operating activities</b>			
Receipts from customers		2,997,807	3,211,502
Payments to suppliers and employees		(2,622,763)	(3,119,927)
Interest received		169,601	242,958
<b>Net cash flows provided by/(used in) operating activities</b>	10	<u>544,645</u>	<u>334,533</u>
<b>Cash flows from investing activities</b>			
Purchase of investment assets		(716,272)	211,141
Payment received from investment		-	-
<b>Net cash flows used in investing activities</b>		<u>(716,272)</u>	<u>211,141</u>
<b>Cash flows from financing activities</b>			
Repayments to related parties		(647,953)	374,700
<b>Net cash flows from financing activities</b>		<u>(647,953)</u>	<u>374,700</u>
Net decrease in cash and cash equivalents		(819,580)	920,374
Cash and cash equivalents at beginning of period		2,090,156	1,169,782
<b>Cash and cash equivalents at end of period</b>		<u>1,270,576</u>	<u>2,090,156</u>

*The attached notes on pages 9 to 24 form part of and should be read in conjunction with these financial statements, together with the Auditors' Report on page 3 and 4.*

## VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

#### 1. CORPORATE INFORMATION

These financial statements have been prepared for the New Zealand branch of the Virginia Surety Company Inc., which is incorporated in the United States of America.

##### **Corporate Information**

Virginia Surety Company Inc for the year ended 31 December 2016, incorporated in the United States of America, is the Branch's immediate parent company.

The registered office of Virginia Surety Company Inc New Zealand branch (the Branch) for the year ended 31 December 2016 is  
359 Lincoln Road,  
Christchurch,  
New Zealand, 8024

TPG Capital, incorporated in U.S, is the Branch's ultimate holding company.

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### **Insurance Contract**

All of the insurance products offered or utilised by the Branch meet the definition of insurance contracts under the New Zealand equivalents to International Financial Reporting Standards, and are accounted for and reported in accordance with these standards.

These products do not contain embedded derivatives or deposits that are required to be unbundled.

##### **Basis of Preparation**

The financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand (NZ GAAP) and the requirements of the *Companies Act 1993* and the *FMC Act 2014* on a historical cost basis. For the purposes of complying with NZ GAAP the entity is a for-profit entity.

The financial report has been prepared on an accrual basis of accounting including the historical cost convention and the going concern assumption.

## **VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

The financial statements are presented in New Zealand dollars.

The following particular accounting policies have been applied:

##### **a) Revenue**

Premium revenue for insurance comprises amounts charged to policyholders. The earned portion of premium received and receivable, including unclosed business, is recognised as revenue. The pattern of recognition of income over the policy or indemnity periods is based on time, which closely approximates the pattern of risks underwritten. Unearned premium is determined by apportioning the premiums written over the period of risk from the date of attachment of risk. Interest on investment income is accounted for on an accrual basis.

##### **b) Unearned Premium**

Provisions in respect of the proportion of premiums relating to risk in future periods of account are calculated on the straight-line basis over the period of risk.

##### **c) Deferred Acquisition Expenses**

Acquisition expenses, principally comprising commissions and fees incurred on insurance contracts, are deferred and expensed over the period in which the related premiums are earned. Deferred acquisition costs are measured at the lower of cost and recoverable amount.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period and are treated as a change in an accounting estimate.

An impairment review is performed at each reporting date or more frequently when an indication of impairment arises. When the recoverable amount is less than the carrying value, an impairment loss is recognised in the statement of comprehensive income. Deferred acquisition expenses are also considered in the liability adequacy test for each reporting period.

##### **d) Outstanding Claims**

The Outstanding Claims provision comprises the estimated costs of claims incurred including indirect claims settlement costs, whether reported or not, and claims not settled at balance date. Reported claims have been assessed in the light of the information available at balance date and after taking account of present value of the expected future payments. The provision for claims incurred but not reported has been assessed having regard for the Branch's claim performance. The expected future payments include claims handling costs which are to be incurred in settling the insured claims.

##### **e) Taxation**

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

## VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

##### e) Taxation (continued)

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the asset and liability giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Branch expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax is recognised as an expense or income in the statement of comprehensive income, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity.

##### f) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except:

- where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

##### g) Investments

Financial assets at fair value through profit and loss:

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as finance costs (negative net changes in fair value) or finance income (positive net changes in fair value) in the statement of profit or loss.

##### h) Foreign Currency Translation

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

Both the functional and presentation currency of Virginia Surety Company Inc – New Zealand Branch is New Zealand dollars (\$).

###### (ii) Transactions & balances

Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the reporting date.

## **VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

##### **h) Foreign Currency Translation (continued)**

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

##### **i) Claims**

Reported claims have been assessed in the light of the information available at balance date and after taking account of expected trends in future settlements.

##### **j) Trade and other receivables**

Trade receivables, which generally have 30 day terms, are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less an allowance for impairment.

Collectability of trade receivables is reviewed on an ongoing basis at an operating unit level. Individual debts that are known to be uncollectible are written off when identified. An impairment provision is recognised when there is objective evidence that the Group will not be able to collect the receivable. Financial difficulties of the debtor, default payments or debts more than 30 days overdue are considered objective evidence of impairment. The amount of the impairment loss is the receivable carrying amount compared to the present value of estimated future cash flows discounted at the original effective interest rate.

##### **k) Trade and other payables**

Trade and other payables are carried at amortised cost and due to their short-term nature they are not discounted. They represent liabilities for goods and services provided to the Branch prior to the end of the financial year that are unpaid and arise when the Branch becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are unsecured and are usually paid within 30 days of recognition.

##### **l) Cash and cash equivalents**

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

##### **m) Impairment of assets**

At each reporting date, the Branch reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Branch estimates the recoverable amount of the cash-generating unit to which the asset belongs.

**VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**m) Impairment of assets (continued)**

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

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

**n) New Accounting Standards and Interpretations**

New Zealand Accounting standards and interpretations that have been recently issued or amended but are not yet effective have not been adopted by the group for the annual reporting period ending 31 December 2016.

## VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

##### **o) Significant Accounting Judgements, Estimates & Assumption**

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts in the financial statements. Management continually evaluates its judgements and estimates in relation to assets, liabilities, contingent liabilities, revenue and expenses. Management bases its judgements and estimates on historical experience and on other various factors it believes to be reasonable under the circumstances, the result of which form the basis of the carrying values of assets and liabilities that are not readily apparent from other sources.

##### *(i) Valuation of outstanding claims provision*

For insurance contracts, estimates have to be made both for the expected ultimate cost of claims reported at the reporting date and for the expected ultimate cost of claims incurred but not yet reported at the reporting date (IBNR). It can take a significant period of time before the ultimate claims form the majority of the liability in the statement of financial position. The IBNR included assumptions such as claims frequency, cancellations and average claim size.

The ultimate cost of outstanding claims is estimated by using a range of standard actuarial claims projection techniques, including Paid Chain Ladder, Inflation-Adjusted Payments Per Claims Incurred and Bornheutter-Ferguson method.

The main assumption underlying these techniques is that a Group's past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analysed by accident years, but can also be further analysed by geographical area, as well as by significant business lines and claim types. Large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development.

In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historical claims development data on which the projections are based. Additional qualitative judgement is used to assess the extent to which past trends may not apply in future, (e.g., to reflect one-off occurrences, changes in external or market factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy features and claims handling procedures) in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking account of all the uncertainties involved.

Similar judgements, estimates and assumptions are employed in the assessment of adequacy of provisions for unearned premium. Judgement is also required in determining whether the pattern of insurance service provided by a contract requires amortisation of unearned premium on a basis other than time apportionment.

The carrying value at the reporting date of expected claims liabilities is \$391,198 (2015: \$206,648).

Claims provisions are expected to be settled within one year. The amount of expected future payments does not differ materially from the present value; therefore the claims provision has not been discounted.

## VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

#### 3. RISK MANAGEMENT

##### (a) Risk management framework

The financial condition and operation of the branch is affected by a number of key risks including insurance risk, credit risk, market risk and liquidity risk.

The branch has developed, implemented and maintained a Risk Management Strategy (RMS) and Reinsurance Risk Management Strategy (ReMS). The RMS and ReMS identify the branch's policies and procedures, processes and controls that comprise its risk management and control systems. The RMS and ReMS have been approved by the Audit and Compliance Committee and provided to APRA.

##### (b) Insurance risk

Insurance Risk is defined as the risk of loss due to the actual experience being different than that assumed when an insurance product was designed and priced.

VSC's local underwriter is responsible for pricing the risk. When the value is above the underwriter's delegated authority it is referred to the US Underwriting Group for review and approval.

These files provide guidance on the willingness to accept risk and such issues as geographic and monetary limits.

The following processes are undertaken:

- Continuous assessment of product characteristics to ensure that pricing and outcomes remain consistent with the assumptions used in product design.
- Systems of claims categorisation and loss measurement by risk category.
- Effective correction strategies for underpricing of risk.
- Anticipation of factors leading to changes in claims incidence and claims costs.

Unless approved by the local Underwriter or confirmation is received from the US Underwriting Group, no business will be accepted nor new classes of business introduced.

In accordance with the Reinsurance Policy no liability which exceeds the maximum retention levels shall be approved by the Executive Management Committee.

The Underwriting Committee meets on a monthly basis to review and monitor portfolio performance.

On a monthly basis all product programs are reviewed by the underwriter and presented to the Underwriting Committee who review them, in particular the loss ratio.

##### (c) Credit risk

Credit risk refers to the risk that a customer or counterparty to a financial instrument fails to meet its contractual obligations resulting in financial loss to the branch and arises principally from the branch's premium receivables and investments.

VSC's exposure to credit risk is concentrated in the following key activities:

Investments: These activities involve the investment of a significant proportion of assets in fixed interest and bonds. VSC's investment policy ensures that it only invests in assets that are of investment grade A- or above and that no more than 5% is invested in the one asset.



## VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

#### (c) Credit risk (continued)

Business partner risk: Intermediaries and business partners, act on behalf of VSC in insurance sales, premium collection and remittance to VSC. To counteract counterparty risk, VSC receives monthly remittance from their business partners. If this is not received on time, investigative action is undertaken.

Intermediaries and business partners are subject to a variety of statutory regulatory controls in addition to controls within VSC management framework. Financial Institutions in general are subject to a range of regulatory control processes. Agents tend to be less subject to statutory regulatory control with greater emphasis on monitoring and supervision on the part of VSC.

The Branch does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The maximum exposure to credit risk is the amounts shown in the statement of financial condition and notes. The maximum credit risk to the Branch is the carrying value of the assets. The Branch does not have any concentration of credit exposure.

#### (d) Market risk

Market risk is the risk that changes in market prices, such as changes in interest rates and foreign exchange, will affect the branch's interest income, claims expense or the value of its holdings in financial instruments.

##### *Foreign currency risk:*

The branch has minimal exposure to foreign currency risk as all investments are undertaken in New Zealand dollars. The Branch does not undertake any transactions denominated in foreign currencies and so exposures in foreign currency do not arise. The foreign currency exposure at the year end was nil.

#### (e) Liquidity risk

Liquidity risk can be defined as the risk that the branch will not be able to meet its payment obligations as they fall due without excessive cost.

Ultimate responsibility for liquidity risk management rests with the board of directors, who have built an appropriate liquidity risk management framework for the management of the Branch's short, medium and long term funding and liquidity management requirements.

The Branch manages liquidity risk by maintaining adequate reserves and banking facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

**VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

**4. RELATED PARTY TRANSACTIONS**

The following table provides the total amount of transactions that were entered into with related parties for the relevant financial year (for information regarding outstanding balances for trade and other receivables, refer to Note 11):

		Sales to Related Parties	Purchases from Related Parties	Expenses Charged by Related Parties
		\$	\$	\$
<i>Fellow subsidiaries :</i>				
The Warranty Group				
Australasia Pty Ltd	2016	-	-	(567,961)
- expenses paid for on behalf of fellow subsidiary	2015	-	-	(435,870)
The Warranty Group				
Australasia Pty Ltd	2016	-	-	(237,523)
- marketing & administration fees	2015	-	-	(898,727)

During the year, The Warranty Group Australasia Pty Ltd, paid expenses of \$567,961 (2015: \$435,870) on behalf of the New Zealand Branch of Virginia Surety Company Inc. These expenses were recharged to the branch at year end.

During the year, the Australia branch of Virginia Surety Company Inc paid claims of \$nil (2015: \$nil) on behalf of the New Zealand branch. These claim paid were recharged to the New Zealand branch.

Unless otherwise stated, related parties are fellow subsidiaries of the ultimate parent company.

*Terms and conditions of transactions with related parties*

Sales to and purchases from related parties are made in arm's length transactions both at normal market prices and on normal commercial terms.

Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash.

**5. CLAIMS INCURRED**

Current year claims relate to risks borne in the current financial year. Prior year claims relate to a reassessment of the risks borne in all previous financial periods.

	2016	2015
	\$	\$
Current year	708,878	819,317
Prior years	97,587	61,262
Total incurred claims	<u>806,465</u>	<u>880,579</u>

**VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

**6. AUDITORS' REMUNERATION**

The auditor of the Branch is Ernst & Young.

Auditors' fees payable for the audit of the financial report of the company as at 31st December 2016 amounted to \$30,030 (2015: \$30,030).

Auditors' fees charged for the year comprises:

	<b>2016</b>	<b>2015</b>
	<b>\$</b>	<b>\$</b>
<b>Auditor Remuneration:</b>		
Audit fee	21,227	24,714
Tax compliance	28,056	32,384
	<u>49,283</u>	<u>57,098</u>

**7. OTHER OPERATING AND ADMINISTRATION EXPENSES**

Other Operating and administration expenses comprises:

	<b>2016</b>	<b>2015</b>
	<b>\$</b>	<b>\$</b>
Salaries & benefits	2,299	(32,369)
Other operating and administrative expenses recharged to the branch	657,750	498,849
Office & communication	72,486	59,405
Travel & entertainment	118,115	37,431
Bank charges	3,291	637
Bad debts	20,463	209,042
Legal fees	2,995	750
Auditors & consultants fees	49,283	57,098
Other expenses	783	29,716
	<u>927,465</u>	<u>860,559</u>

**8. INVESTMENT INCOME**

	<b>2016</b>	<b>2015</b>
	<b>\$</b>	<b>\$</b>
Investment income comprises:		
Interest on government stock	171,056	168,349
Other interest	3,426	6,864
	<u>174,482</u>	<u>175,213</u>

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

9. CURRENT YEAR'S TAXATION

	2016 \$	2015 \$
<u>Taxation expense comprises:</u>		
Profit before taxation	(28,300)	257,594
Current tax expense @ 28%	<u>7,924</u>	<u>(72,126)</u>
Non-deductible expenses for tax purposes	(756)	(511)
Adjustments recognised in the current period in relation to the current tax of prior periods	-	(42,900)
Utilisation of previously unrecognised tax losses	3,276	-
Total tax (expense) / benefit	<u>(3,892)</u>	<u>(115,537)</u>
 <u>Current tax assets and liabilities</u>		
Tax receivable	<u>66,820</u>	<u>95,031</u>
<b>Current tax asset</b>	<u><u>66,820</u></u>	<u><u>95,031</u></u>
 Tax payable	<u>-</u>	<u>-</u>
<b>Current tax liability</b>	<u><u>-</u></u>	<u><u>-</u></u>
 <u>Deferred tax balances</u>		
Provision for doubtful debts	64,204	58,528
Deferred acquisition costs	-	-
Carry forward tax losses	947	-
Other	6,125	8,855
<b>Net deferred tax (liability)/asset</b>	<u><u>71,276</u></u>	<u><u>67,383</u></u>

10. CASH AND CASH EQUIVALENTS

	2016 \$	2014 \$
Cash at bank and in hand	1,270,576	2,090,156
Reconciliation to Cash Flow Statement		
For the purpose of the Cash Flow statement, cash and cash equivalents comprise the following at 31 December:		
Cash at bank and in hand	1,270,576	2,090,156

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

10. CASH AND CASH EQUIVALENTS (Continued)

Reconciliation of net profit after tax to net cash flows from operations

	2016 \$	2015 \$
Net profit	(24,408)	142,057
Adjustments for:		
Increase/(Decrease) in allowance for doubtful debts	20,270	208,368
Changes in Assets and Liabilities:		
(Increase) / Decrease in trade and other receivables	(44,969)	107,803
(Increase) / Decrease in Investment Assets	(5,177)	13,825
Increase / (Decrease) in outstanding claims	184,550	25,115
Increase / (Decrease) in trade and other payables	1,235,863	643,517
(Increase) / Decrease in deferred tax asset	(3,893)	(56,042)
Increase / (Decrease) in current taxes	28,211	(452,367)
(Decrease) / Increase in unearned premium	1,957,075	791,965
(Increase) / Decrease in deferred acquisition cost	(1,111,273)	(1,089,708)
Net cash flows provided by/ (used in) operating activities	544,645	334,533

11. TRADE AND OTHER RECEIVABLES

	2016 \$	2015 \$
Investment income receivable	40,707	35,530
Premium debtors	421,606	377,014
Provision for doubtful debts	(229,300)	(209,030)
Prepayments	377	-
Related party receivable	-	-
	233,390	203,514

Related party receivable:

All intercompany balances are with The Warranty Group Australasia Pty Ltd and are due and payable on demand. No interest rates apply to the outstanding amounts.

12. INVESTMENTS

	2016 \$	2015 \$
<u>Non current</u>		
Government stock	5,377,205	4,660,933
Total investments	5,377,205	4,660,933

**VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

**13. FINANCIAL ASSETS AND LIABILITIES**

**Categories of financial assets and liabilities**

	<b>2016</b>	<b>2015</b>
	<b>\$</b>	<b>\$</b>
Cash and cash equivalents	1,270,576	2,090,156
Investments	5,377,205	4,660,933
Loans and receivables	233,390	203,514
Liabilities at amortised cost	(1,301,934)	(714,024)

Financial assets carried at fair value through profit or loss have been designated as such upon initial recognition.

The carrying value of all financial assets and liabilities approximate to their fair value.

**14. CLAIMS PROVISIONS**

**Composition of claims provision**

	<b>2016</b>	<b>2015</b>
	<b>\$</b>	<b>\$</b>
Central estimate of expected future payments for claims reported including:		
Indirect claims settlement costs	<u>391,198</u>	<u>206,648</u>
Gross provision	<u>391,198</u>	<u>206,648</u>

The percentage risk margin adopted in determining the outstanding claims liability is nil.

Claims provisions are expected to be settled within one year. The amount of expected future payments does not differ materially from the present value; therefore, the claims provision has not been discounted.

**CLAIMS RESERVE**

	<b>2016</b>	<b>2015</b>
	<b>\$</b>	<b>\$</b>
At beginning of year	206,648	181,533
Claims incurred	806,465	880,579
Claims settled	<u>(621,915)</u>	<u>(855,464)</u>
At end of year	<u>391,198</u>	<u>206,648</u>

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

15. DEFERRED ACQUISITION COSTS

	2016 \$	2015 \$
At beginning of year	4,628,443	3,538,735
Costs incurred	839,058	2,519,516
Recognised in statement of comprehensive income	<u>(1,950,331)</u>	<u>(1,160,730)</u>
At end of year	<u>3,517,170</u>	<u>4,628,443</u>

16. ASSETS BACKING GENERAL INSURANCE LIABILITES

In determining which assets back general insurance liabilities, a comparison between the asset values and the amount needed to meet claims liabilities and solvency requirements was carried out.

17. LIABILITY ADEQUACY TEST

The liability adequacy test carried out on the insurance portfolio in the current year in accordance with NZ IFRS 4 identified a surplus of \$977,656 (2015: \$1,323,198).

	2016 \$	2015 \$
<b><u>Insurance Portfolio</u></b>		
Gross unearned premium reserve	5,991,392	7,948,467
Reinsurance	-	-
<b>Net unearned premium</b>	<b>5,991,392</b>	<b>7,948,467</b>
Ultimate net loss ratio	25.0%	25.1%
Risk claims (0% discount) central estimate	(1,496,566)	(1,996,826)
Claims handling costs	-	-
Risk margin	-	-
<b>Expected future claims</b>	<b>(1,496,566)</b>	<b>(1,996,826)</b>
<b>Deferred acquisition costs</b>		
Commission expense	(2,601,275)	(3,356,434)
Administration	<u>(915,895)</u>	<u>(1,272,009)</u>
<b>Total deferred acquisition costs</b>	<b><u>(3,517,170)</u></b>	<b><u>(4,628,443)</u></b>
<b>Level of surplus / (deficiency)</b>	<b><u>977,656</u></b>	<b><u>1,323,198</u></b>

The liability adequacy test carried out on the insurance portfolio in the current year, as well as the liability adequacy test carried out in the prior year, identified surpluses, therefore there was no write down of any asset balances.

18. INSURER FINANCIAL STRENGTH RATING AND SOLVENCY DISCLOSURE

Virginia Surety Company Inc has a financial strength rating of A- issued by A M Best (2015: A-) and the following solvency information:

**VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

**18. INSURER FINANCIAL STRENGTH RATING AND SOLVENCY DISCLOSURE (CONTINUED)**

	2016	2015
	\$	\$
Actual solvency capital	409,997,635	363,636,160
Minimum solvency capital	98,453,185	71,595,223
Solvency margin	311,544,450	292,040,937
Solvency ratio	4.16	5.08

**19. EQUITY RETAINED FOR THE PURPOSES OF FINANCIAL SOUNDNESS**

The branch retains a level of equity and retained reserves which enable it to maintain an adequate solvency margin for ongoing ability to pay clients. These financial statements relate to a branch of an overseas company. Its assets are available to support the liabilities of the company outside of New Zealand.

**20. SUBSEQUENT EVENTS**

No matters or circumstances have arisen since the end of the financial year which has significantly affected, or may significantly affect, the operations of the branch in future financial years, the results of those operations, or the state of affairs of the branch in future financial years.