VIRGINIA SURETY COMPANY INC – NEW ZEALAND BRANCH

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED
31 DECEMBER 2013

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DIRECTORS' REPORT

The Directors present their annual report together with the audited Financial Statements for the year ended 31 December 2013.

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.

DIVIDEND

The Directors recommend that no dividend be paid (2012: $Nil).

AUDITORS

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

RESULTS

Profit for the 2013 year after tax was $346,926 (2012: $156,675).

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 2013.

REVIEW OF OPERATIONS

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

On 27th June 2013, the New Zealand branch of Virginia Surety Company Inc was granted a full license to operate as an Insurer under the Insurance (Prudential Supervision) Act 2010 by the Reserve Bank of New Zealand.

SUBSEQUENT EVENTS

There were no events since 31st December 2013 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

Director
17th March 2014

Director
17th March 2014

Building a better working world

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Independent Auditor's Report

To the Shareholders of Virginia Surety Company, Inc.

Report on the Financial Statements

We have audited the financial statements of the New Zealand branch of Virginia Surety Company, Inc., which comprise the statement of financial position of the New Zealand branch of Virginia Surety Company Inc. as at 31 December 2013, and the statement of comprehensive income, and 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, in accordance with Section 19(3) of the Financial Reporting Act 1993. 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 for the preparation of the financial statements, in accordance with generally accepted accounting practice in New Zealand, and that give a true and fair view of the matters to which they relate 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 of the financial statements that give a true and fair view of the matters to which they relate 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.

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Opinion

In our opinion, the financial statements:

- comply with generally accepted accounting practice in New Zealand; and
- give a true and fair view of the financial position of the New Zealand branch of the company as at 31 December 2013 and its financial performance and cash flows for the year then ended.

Report on Other Legal and Regulatory Requirements

In accordance with the Financial Reporting Act 1993, we report that:

- We have obtained all the information and explanations that we have required.
- In our opinion proper accounting records have been kept by the New Zealand branch of Virginia Surety Company, Inc. as far as appears from our examination of those records.

Ernst + Young

Ernst & Young
17 March 2014
Melbourne

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2013

	Notes	2013 $	2012 $
REVENUE			
Premium revenue		3,435,914	3,242,691
Decrease/(increase) in unearned premium reserve		153,261	484,453
NET EARNED PREMIUM		**3,589,175**	**3,727,144**
EXPENSES			
Gross claims incurred	5	1,104,005	1,534,762
Acquisition costs	16	1,053,103	1,187,429
UNDERWRITING RESULT		**1.432,067**	**1,004,953**
Investment income	8	131,244	112,983
Other operating and administration expenses	7	(1,047,648)	(878,437)
(Loss)/gain on investments		(33,286)	(20,480)
PROFIT/(LOSS) BEFORE INCOME TAX		482,377	219,018
Income tax (expense) / benefit	9	(135,451)	(62,343)
PROFIT / (LOSS) AFTER INCOME TAX		346,926	156,675
Other comprehensive income		-	-
TOTAL COMPREHENSIVE INCOME/(LOSS)		346,926	156,675
Operating profit for the year attributable to:			
Non-controlling interest		-	-
Owners of the parent		346,926	156,675
Operating Profit after tax		346,926	156,675
Total comprehensive income is attributable to:			
Non-controlling interest		-	-
Owners of the parent		346,926	156,675
Operating Profit after tax		346,926	156,675

The attached notes on pages 8 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 2013

	Notes	2013 $	2012 $
ASSETS			
Current assets			
Cash and cash equivalents	10	1,560,458	3,147,271
Trade and other receivables	11	752,614	2,700,493
Deferred acquisition costs	16	2,499,766	2,394,367
Current tax asset	9	49,484	58,895
Investments	12	1,500,000	1,500,000
Total current assets		6,362,322	9,801,026
Non-current assets			
Investments	12	3,405,582	538,308
Total non-current assets		3,405,582	538,308
TOTAL ASSETS		9,767,904	10,339,334
LIABILITIES			
Current liabilities			
Trade and other payables		125,594	439,766
Outstanding claims	15	141,619	306,922
Unearned premiums		6,961,851	7,545,116
Total current liabilities		7,229,064	8,291,804
Non-current liabilities			
Deferred tax liabilities	9	341,303	196,919
Total non-current liabilities		341,303	196,919
TOTAL LIABILITIES		7,570,367	8,488,723
NET ASSETS		2,197,537	1,850,611
TOTAL EQUITY		2,197,537	1,850,611

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

____________________ Director 17th March 2014

____________________ Director 17th March 2014

The attached notes on pages 9 to 24 form part of and should to 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 2013

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2013

	2013 $	2012 $
Total Equity as at 1 January	1,850,611	1,693,936
Profit /(loss) for the year	346,926	156,675
Other comprehensive income	-	-
Total comprehensive income/(loss)	346,926	156,675
Total Equity as at 31 December	2,197,537	1,850,611

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.

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 $	2012 $
Cash flows from operating activities			
Receipts from customers		4,105,578	2,670,398
Payments to suppliers and employees		(3,675,298)	(3,457,633)
Interest (paid)/received		69,681	106,227
Net cash flows provided by/(used in) operating activities	10	499,961	(681,008)
Cash flows from investing activities			
(Purchase) / Sale of investment assets		(2,867,274)	8,630
Net cash flows used in investing activities		(2,867,274)	8,630
Cash flows from financing activities			
Capital contribution		-	-
Proceeds from related parties		780,500	119,515
Net cash flows from financing activities		780,500	119,515
Net (decrease)/increase in cash and cash equivalents		(1,586,813)	(552,863)
Cash and cash equivalents at beginning of period		3,147,271	3,700,134
Cash and cash equivalents at end of period		1,560,458	3,147,271

The statement of cash flows should be read in conjunction with the accompanying notes.

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, 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) is
359 Lincoln Road,
Christchurch,
New Zealand, 8024

Onex Corporation, incorporated in Canada, 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). For the purposes of complying with NZ GAAP the entity is a for-profit entity.

The financial statements have been prepared in accordance with NZ GAAP and the requirements of the *Companies Act 1993* and the *Financial Reporting Act 1993* on a historical cost basis.

The financial report has been prepared on an accrual basis of accounting including the historical cost convention and the going concern assumption. Notwithstanding the deficiency in net assets and the current liability deficiency, the directors have concluded the company can continue as a going concern as the creditor, being the parent company, has agreed not to call upon amounts owed for a period of 12 months. Also, notwithstanding the deficiency in the net current liability position in the consolidated Group, the directors have concluded the company can continue as a going concern as the consolidated future operating cash flows will be sufficient to cover the shortfall over the next twelve months.

The financial statements have been prepared on a going concern basis.

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) Premium 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.

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.

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

Revenues, expenses and assets are recognised net of the amount of goods and services tax (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) Investment Income

Interest is accounted for on an accrual basis.

i) 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

i) 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.

j) 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.

k) 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.

l) 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.

m) 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.

n) 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

n) 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.

o) New Accounting Standards and Interpretations

Changes in accounting policy and disclosures
The accounting policies adopted are consistent with those of the previous financial year except as follows:

The branch has adopted the following new and amended New Zealand Equivalents to International Financial Reporting Standards and interpretations as of 1 January 2013.

- *Amendments to NZ IAS 1 – Presentation of Financial Statements – Presentation of Other Comprehensive Income*
- *Amendments to NZ IAS 19 – Employee Benefits*
- *Amendments to NZ IFRS 7 Financial Instruments: Disclosures – Offsetting Financial Assets and Liabilities*
- *Amendments to NZ IFRS 13 – Fair Value Measurement*

The adoption of the standards and interpretations detailed above are not deemed to have an impact on the financial statements or performance of the branch. The branch has not elected to early adopt any new standards or interpretations that are issued but not yet effective.

New Zealand Accounting standards and interpretations that have been recently issued or amended but are not yet effective have not been adopted by the Branch for the annual reporting period ending 31 December 2013. These are outlined below and are not expected to have a material impact on the Branch:

- *IAS 19 – Narrow scope amendments to IAS 19 Employee Benefits effective 1 January 2014*
- *IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38 – Amendments to IFRSs arising from the Annual Improvements Project (2010-2012) effective 1 July 2014*
- *NZ IFRS 9 (2009, 2010, 2013) – Financial Instruments effective 1 January 2017*

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

p) 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 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 future claims liabilities is $141,619 (2012: $306,922).

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.

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.

3. RISK MANAGEMENT (continued)

(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.

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 receive 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.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Branch's exposure to the risk of changes in market interest rates relates primarily to the Branch's short term deposit with floating interest rates.

3. RISK MANAGEMENT (continued)

The following table demonstrates the sensitivity to a reasonably possible change in interest rates on that portion of deposits affected. With all other variables held constant, the branch's profit before tax is affected through the impact on floating rate short term deposit as follows:

	Increase/decrease in basis points	Effect on profit before tax
2013		$
Short Term Deposits	+100	15,000
Short Term Deposits	+200	30,000
Short Term Deposits	-100	(15,000)
Short Term Deposits	-200	(30,000)
2012		
Short Term Deposits	+100	15,000
Short Term Deposits	+200	30,000
Short Term Deposits	-100	(15,000)
Short Term Deposits	-200	(30,000)

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.

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 on related party trade receivables and payables at year-end, refer to notes 10 and 12 respectively):

		Sales to Related Parties	Purchases from Related Parties	Expenses Charged by Related Parties
Fellow subsidiaries :		$	$	$
The Warranty Group Australasia Pty Ltd - expenses paid for on behalf of fellow subsidiary	**2013**	**-**	**-**	**(1,004,072)**
	2012	-	-	(914,634)
The Warranty Group Australasia Pty Ltd - marketing & administration fees	**2013**	**-**	**-**	**(689,919)**
	2012	-	-	(539,652)

During the year, The Warranty Group Australasia Pty Ltd, paid expenses of $1,004,072 (2012: $914,634) 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 $3,303 (2012: $8,569) 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.

	2013	**2012**
	$	**$**
Current year	1,029,023	1,430,523
Prior years	74,982	104,239
Total incurred claims	1,104,005	1,534,762

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

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 2013 amounted to $20,400 (2012: $26,000).

Auditors' fees charged for the year comprises:

	2013 $	2012 $
Auditor Remuneration:		
Audit fee	20,400	26,426
Tax compliance	42,850	28,375
	63,250	54,801

7. OTHER OPERATING AND ADMINISTRATION EXPENSES

Other Operating and administration expenses comprises:

	2013 $	2012 $
Salaries & benefits	145,837	219,348
Other operating and administrative expenses recharged to the branch	672,102	489,500
Office & communication	86,317	73,957
Travel & entertainment	51,746	83,974
Bank charges	728	4,279
Bad debts	1,993	(88,140)
Legal fees	25,675	33,243
Auditors & consultants fees	63,250	62,276
	1,047,648	878,437

8. INVESTMENT INCOME

	2013 $	2012 $
Investment income comprises:		
Interest on government stock	89,899	35,117
Other interest	41,345	77,866
	131,244	112,983

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

9. CURRENT YEAR'S TAXATION

Taxation expense comprises:	2013 $	2012 $
Profit/(loss) before taxation	482,377	219,019
Current tax (expense) / benefit @ 28%	(135,066)	(61,325)
Non-deductible expenses for tax purposes	(384)	-
Adjustments recognised in the current period in relation to the current tax of prior periods	-	(1,018)
Total tax (expense) / benefit	(135,451)	(62,343)
Current tax assets and liabilities		
Tax receivable	49,484	58,895
Tax payable	-	-
Current tax asset	49,484	58,595
Deferred tax balances		
Provision for doubtful debts	185	185
Deferred acquisition costs	(699,934)	(670,422)
Carry forward tax losses	352,072	459,153
Other	6,374	14,165
Net deferred tax (liability)/asset	(341,303)	(196,919)

10. CASH AND CASH EQUIVALENTS

	2013 $	2012 $
Cash at bank and in hand	1,560,458	3,147,271

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	1,560,458	3,147,271

10. CASH AND CASH EQUIVALENTS (Continued)

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

	2013 $	2012 $
Net profit	346,926	156,675
Adjustments for:		
Changes in Assets and Liabilities:		
Decrease in trade and other receivables	1,195,655	(755,460)
(Increase) / Decrease in Investment Assets	(28,277)	7,989
(Decrease) / Increase in outstanding claims	(165,303)	39,302
(Decrease) / Increase in trade and other payables	(314,172)	100,515
Decrease / (Increase) in current tax asset	9,411	52,104
Increase in deferred tax liability	144,385	71,256
(Decrease)/Increase in deferred income	(583,265)	(484,454)
(Increase) / Decrease in deferred acquisition costs	(105,399)	131,064
Net cash flows provided by/ (used in) operating Activities	499,961	(681,009)

11. TRADE AND OTHER RECEIVABLES

	2013 **$**	**2012** **$**
Investment income receivable	34,706	6,429
Premium debtors	404,132	1,599,788
Provision for doubtful debts	(662)	(662)
Prepayments	7,000	7,000
Related party receivable	307,438	1,087,938
	752,614	2,700,493

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

	2013 **$**	**2012** **$**
<u>Current</u>		
Short term deposit	1,500,000	1,500,000
<u>Non current</u>		
Government stock	3,405,582	538,308
Total investments	4,905,582	2,038,308

13. FINANCIAL ASSETS AND LIABILITIES

a. Categories of financial assets and liabilities

	2013 $	2012 $
Cash and cash equivalents	1,560,458	3,147,271
Investments	4,905,582	2,038,308
Loans and receivables	752,614	2,329,901
Liabilities at amortised cost	(125,594)	(366,214)

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. CAPITAL COMMITMENTS

As at 31 December 2013, there were no capital commitments (2012: $Nil).

15. CLAIMS PROVISIONS

(a) Composition of claims provision

	2013 $	2012 $
Central estimate of expected future payments for claims reported including:		
Indirect claims settlement costs	141,619	306,922
Gross provision	141,619	306,922

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	2013 $	2012 $
At beginning of year	306,922	276,678
Claims incurred	1,104,005	1,534,762
Claims settled	(1,269,308)	(1,504,518)
At end of year	141,619	306,922

16. DEFERRED ACQUISITION COSTS

	2013 $	2012 $
At beginning of year	2,394,367	2,525,431
Costs incurred	1,158,502	1,056,365
Recognised in statement of comprehensive income	(1,053,103)	(1,187,429)
At end of year	2,499,766	2,394,367

17. 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.

18. 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 $1,320,560 (2012: $948,119).

	2013 $	2012 $
Insurance Portfolio		
Gross unearned premium reserve	6,961,851	7,545,116
Reinsurance	-	-
Net unearned premium	**6,961,851**	**7,545,116**
Ultimate net loss ratio	45.1%	55.7%
Risk claims (0% discount) central estimate	(3,141,525)	(4,202,630)
Claims handling costs	-	-
Risk margin	-	-
Expected future claims	**(3,141,525)**	**(4,202,630)**
Deferred acquisition costs		
Commission expense	(1,305,494)	(1,274,267)
Administration	(1,194,272)	(1,120,100)
Total deferred acquisition costs	**(2,499,766)**	**(2,394,367)**
Level of surplus / (deficiency)	**1,320,560**	**948,119**

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.

19. INSURER FINANCIAL STRENGTH RATING

Virginia Surety Company Inc has a financial strength rating of A- issued by A M Best (2012: A-)

20. 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.

21. CONTINGENT LIABILITIES

As at 31st December 2013, there were no contingent liabilities existing at balance date (2012: $Nil) not otherwise provided for in these financial statements.

Contingent liabilities are not recognised on the Statement of financial position but are required to be disclosed in the notes to the financial statements where the possibility of settlement is less than probable but more than remote. Provisions are not required with respect to such matters as it is not probable that a future sacrifice of economic benefits will be required or the amount cannot be reliably measured.

22. SUBSEQUENT EVENTS

There were no other events since 31st December 2013 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.

23. OPERATING LEASE OBLIGATIONS

As at 31st December 2013, the Branch had no obligations payable after balance date on non-cancellable operating leases.

24. FINANCE LEASE LIABILITY

As at 31st December 2013, the Branch had no obligations payable after balance date on finance leases.

25. OPERATING SEGMENTS

The whole of the Branch is considered to be an operating segment for the purposes of segment reporting.