

EQC

Statement of Intent



June 2011—June 2014

STATEMENT OF INTENT

1 July 2011 - 30 June 2014

This statement is submitted by the Board of the Earthquake Commission in accordance with the Crown Entities Act 2004. It sets out the Board's overall intentions and objectives for the Commission to 30 June 2012 and the two succeeding financial years, as required by the Act.



.....
Michael Wintringham
Chairman



.....
Board Member

Date30 June 2011

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Statutory functions

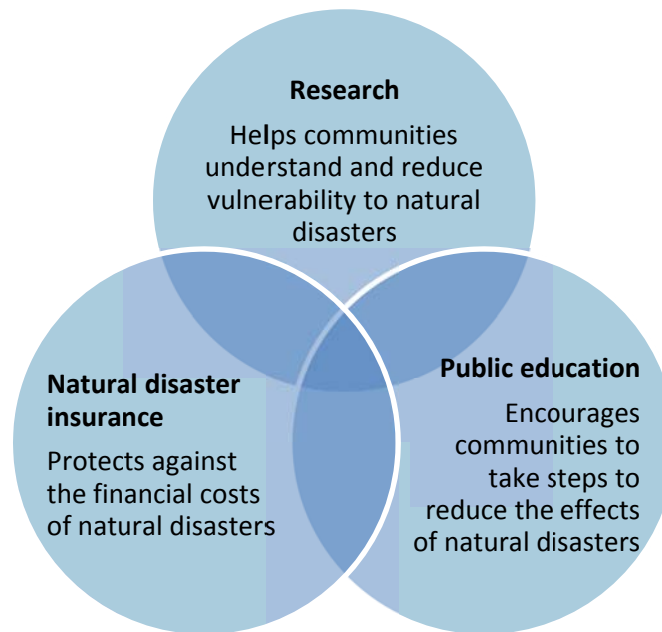
EQC is a Crown entity with statutory responsibilities set out in Section 5 of the Earthquake Commission Act 1993 (“the Act”). Those responsibilities are:

- (a) To administer the insurance against natural disaster damage provided under the Act:*
- (b) To collect premiums payable for the insurance provided under the Act:*
- (c) To administer the Fund and, so far as is reasonably practicable, protect its value, including by the investment of money held in the Fund:*
- (d) To obtain reinsurance in respect of the whole or part of the insurance provided under the Act:*
- (e) To facilitate research and education about matters relevant to natural disaster damage, methods of reducing or preventing natural disaster damage, and the insurance provided under the Act:*
- (f) Such other functions as may be conferred on it by -*
 - (i) The Act or any other Act; or*
 - (ii) The Minister, by written direction to the Commission after consultation with the Commission (in accordance with section 112 of the Crown Entities Act 2004).*

In plain language, EQC’s responsibilities are to:

- In accordance with the Act, provide insurance against loss or damage caused by earthquake, volcanic eruption, hydrothermal activity, tsunami, natural disaster fire and natural landslip, to residential property which has a contract of fire insurance in force. Residential land is also insured against the above hazards as well as storm or flood.
- Administer the Natural Disaster Fund (NDF) (including its investment) and obtain reinsurance.
- Facilitate research and education about matters relevant to natural disaster damage and its mitigation.

EQC believes there is a synergy among its three core functions – insurance scheme, research and public education – and they are all essential if New Zealand is to manage the risk of natural disasters effectively.



- Public education enables people to take practical steps to make their homes safer against earthquakes or other disasters. This reduces the impact of disasters on people’s lives and affects insurance payout levels.
- The occurrences of natural disasters in New Zealand and overseas provide opportunities for new research and for reinforcing the message of home safety.
- Research output is used to inform risk management and risk reduction by: guiding land use; building design and construction; disaster readiness; and recovery planning. Research based computer models aid decisions about responses to disasters and planning for possible future events, including the pricing of the New Zealand risk by the world's reinsurance companies.

Ministerial Directions

Under Section 12 of the Act, the Minister of Finance may give written directions in relation to the Commission’s functions under the Act.

The following Ministerial Directions have been given to the Commission:

- A Ministerial Direction taking effect as of 1 November 2001 that sets out requirements for how the Commission should invest and manage the Natural Disaster Fund (NDF), and when the Commission should consult with the Minister of Finance.

This Direction allowed the Commission to diversify the investment of NDF to include (up to certain limits) New Zealand Government securities, global equities and New Zealand bank bills.

- A Ministerial Direction taking effect as of 15 September 2010 and expiring on 14 September 2011 that modifies elements of the 1 November 2001 Ministerial Direction

on how the Commission should invest and manage the Natural Disaster Fund, and when the Commission should consult with the Minister of Finance.

This Direction enabled the Commission to modify its investment limits in order to maintain the liquidity required to meet claims arising from the Canterbury earthquakes.

- A Ministerial Direction taking effect as at 14 December 2010 that gives the Commission additional functions in relation to additional land remediation activities to certain parts of Christchurch and Waimakariri districts.

This Direction enabled the Commission to: investigate options to remediate certain land in these areas to a higher standard than the statutory minimum that the Commission must provide; to prepare a Concept Design Report for land remediation works in "Zone C" land; and to carry out works to mitigate lateral spread in certain areas of Spencerville.

- A Ministerial Direction taking effect on 22 February 2011 and expiring on 30 April 2011 that gave the Commission the ability to undertake inspections of, and emergency works to, residential properties otherwise not covered by the Earthquake Commission Act, for damage arising from the 22 February Canterbury earthquake and aftershocks.

This Direction allowed the Commission to undertake inspections of and to carry out emergency works to uninsured and otherwise ineligible residential premises in the wake of the 22 February Canterbury earthquake.

- A Ministerial Direction taking effect on 18 April 2011 that gives the Commission additional functions in relation to entering into and carrying out its roles under a Memorandum of Understanding (MoU) with the Waimakariri District Council relating to certain additional land remediation works in the District.

This Direction allowed the Commission to enter into and carry out the roles and responsibilities set out in a MoU with the Waimakariri District Council and to undertake certain land remediation works in North Kaiapoi; where these were ready to be carried out before the approval of an overall Concept Design Report.

Reporting to the Minister

Each quarter EQC will provide Treasury with a report on the performance of the Natural Disaster Fund's investments, and each month a set of financial statements, including explanations of significant budget variances. Any matters that might affect EQC's ability to carry out its statutory functions or meet the requirements of the Ministerial Directions of 1 November 2001 and 15 September 2010 will be reported.

Under the terms of the Ministerial Direction of 1 November 2001, the Commission is also required to consult with the Minister of Finance in the following circumstances:

- If it intends to modify the statement of investment policies, standards, and procedures to any substantive degree.
- If it intends to modify the portfolio composition from the following:
 - New Zealand Government securities;
 - a maximum of 35 per cent of the market value of the Fund in global equities; and
 - a maximum of \$250 million of New Zealand bank bills.

- If it forms the intention to cover its pre-disaster currency exposures (i.e. to hedge against the fluctuating NZ dollar as it affects the value of offshore investments).
- In the event of a major natural disaster likely to involve claims on the Commission in excess of \$250 million, before liquidating any part of the investment portfolio of the Fund apart from the holdings of New Zealand bank bills.

In addition, if the Commission considers at any time that any provision in this direction is inconsistent with another provision in this direction, or any other direction under Section 12 of the Act, or any provision under that Act, it shall advise the Minister of that inconsistency.

During the 2010/11 financial year the Commission:

- consulted the Minister on a proposal to modify the Ministerial Direction of 1 November 2001 to enable the Commission to modify its investment limits in order to maintain the liquidity required to meet claims arising from the Canterbury earthquakes;
- consulted the Minister prior to liquidating some investments in order to meet claims arising from the Canterbury earthquakes.

Process in relation to acquisitions

EQC is exempted from the restrictions on financial transactions set out in sections 161 to 165 of the Crown Entities Act, which relate to acquisition of securities, borrowing, offering guarantees or indemnities, and derivative transactions.

EQC is bound by:

- sections 96 to 102 of the Crown Entities Act 2003 in relation to acquisition of subsidiaries, shares or other holdings; and
- the Ministerial Directions of 1 November 2001 and 15 September 2010 in relation to investment and management of the Natural Disaster Fund.

Under the Ministerial Direction of 1 November 2001 (as amended by the Ministerial Direction of 15 September 2010), EQC is required to have a statement of investment policies, standards and procedures, and must consult with the Minister if it intends to modify the statement to any substantive degree.

Operating Environment

EQC's operating environment changed markedly following the Canterbury earthquakes of 4 September 2010 and 22 February 2011, and their aftershocks.

In terms of claims volumes, the Canterbury earthquake events combined are the largest ever insurance event in New Zealand's history. More than 360,000 claims (consisting of over 540,000 individual insurance exposures) have been lodged with EQC; a figure that easily dwarfs the previous largest event (Gisborne 2007) that produced 6,000 claims. World-wide there are very few insurers who have, on their own, handled more claims arising from a single event.

In terms of costs, the Canterbury earthquake events combined are the most expensive insurance event in New Zealand's history. The Treasury estimates the damage caused by the two earthquakes is around \$15 billion, which is about 8% of GDP. To put this in context, the March 2011 earthquake off the north-east coast of Japan is estimated to have caused damage equivalent to around 3% to 5% of Japan's GDP.

In response to the unprecedented scale of property damage, trauma, social dislocation and, tragically, the loss of life, resulting from the Canterbury events, the Government made a number of policy decisions that will have an on-going impact on the environment within which EQC will operate in the short to medium term (the next three or so years). These decisions included:

- The declaration, on 23 February 2011, of a state of national emergency. This was the first time in New Zealand history that a state of national emergency had been declared as a result of a civil defence emergency event.
- The passage initially of the Canterbury Earthquake Response and Recovery Act 2010 and then the Canterbury Earthquake Recovery Act 2011 to facilitate, co-ordinate, and direct the planning, rebuilding, and recovery work in Canterbury.
- The establishment of the Canterbury Earthquake Recovery Commission and its successor, the Canterbury Earthquake Recovery Authority (CERA) to provide leadership and coordination of the recovery effort in Canterbury.

A feature of EQC's response to recent natural disasters has been its cooperation with other government agencies to provide a rapid and coordinated response to catastrophe.

EQC has been part of a whole of government response to the Canterbury earthquakes. The Commission is working closely with CERA, so that areas of mutual interest, such as planning, mitigation and recovery, can be addressed jointly. EQC is also working closely with other agencies directly involved in the on-going recovery effort in Canterbury including the Department of Building and Housing; Housing New Zealand Corporation; the Ministry of Social Development; the Canterbury Earthquake Temporary Accommodation Service (CETAS); the Ministry of Civil Defence and Emergency Management; Inland Revenue; the Department of Internal Affairs; the Ministry for the Environment; the Department of Prime Minister and Cabinet; and the Treasury.

In addition, the Government, through the Minister of Finance, made a number of decisions which have had specific impacts on EQC's activities, role and functions. These decisions were:

- The transfer from the Minister of Finance (as the Minister Responsible for the Earthquake Commission) to the Minister for Canterbury Earthquake Recovery of powers, functions and responsibilities in relation to EQC's earthquake recovery work in Canterbury, including, where necessary, directions to EQC to extend its functions.
- The issuing of certain written directions extending EQC's role and functions as outlined on pp.2-3 of this Statement of Intent.
- The announcement of the Chimney Replacement Programme, initially managed by the Energy Efficiency and Conservation Authority (EECA), whereby insured residential premises with significant damage to chimneys from the Canterbury earthquakes could have new, efficient heating systems installed as part of settling their earthquake claim with the Commission.
- To "give confidence to affected communities, banks and insurers to rebuild" (CAB Min (10) 36/11) – which underpinned the Government's decisions around additional land remediation activities and to establish a project management office to manage residential repairs to ensure a high standard of repairs while controlling costs (construction related costs of any post-event demand surge).

The combined effect of these decisions has been, in effect, within a few months, to expand EQC's role from solely a Crown financial institution, geared to cash settling natural disaster claims, to one that now also includes:

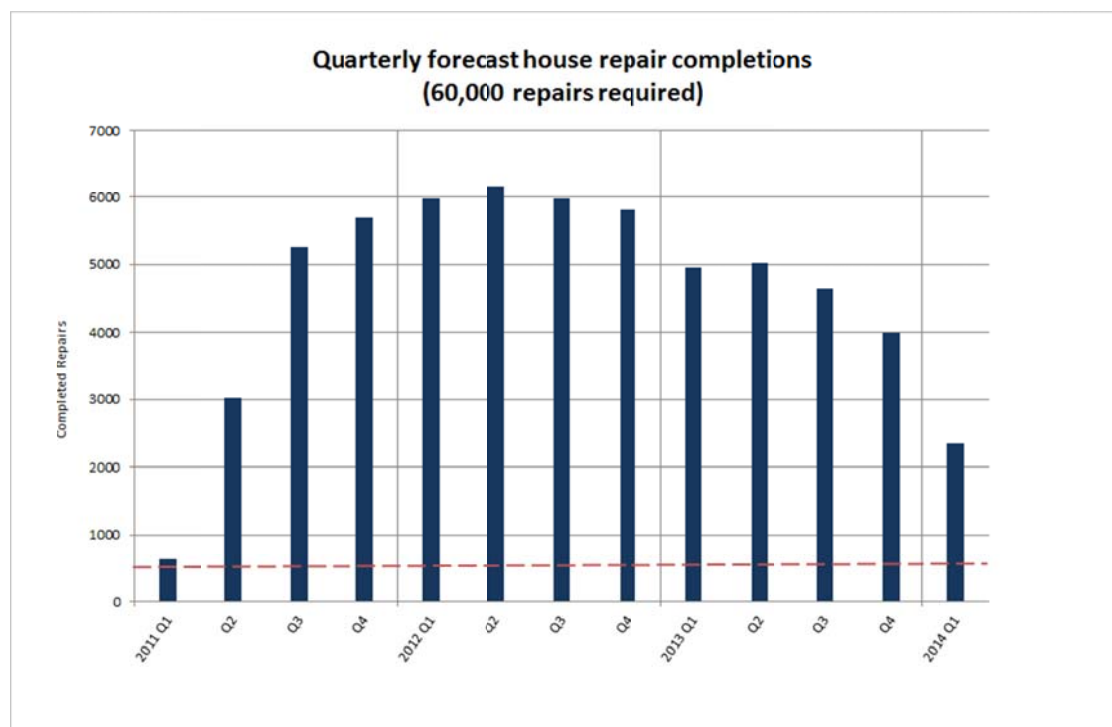
- project managing, through a contract with Fletcher Construction, a significant proportion of the physical residential repair and rebuild of Christchurch and affected areas of Canterbury ;
- designing and supervising additional land remediation activities for work separately funded by the Government;
- providing key engineering advice to the Government (as the work done by our geotechnical engineers for our claims requirements has been used for much wider policy purposes);
- a social assistance component to our response through:
 - our identification of vulnerable households and those seeking temporary accommodation as part of the rapid assessment project;
 - the expansion of our emergency repair approach to include the uninsured (but where the costs of emergency repairs for uninsured premises was funded by the Government); and
 - the Chimney Replacement Programme and Winter Heat Programme initially managed by EECA but subsequently conducted through the Fletcher Construction contract above (but also carried out as "emergency repairs").

The residential rebuild of Christchurch - the size of the EQC/Fletcher task:

The Commission's role has been expanded and now includes project managing, through a contract with Fletcher Construction, a significant proportion of the physical residential repair of Christchurch and affected areas of Canterbury.

It is difficult to get an indication of how much similar building activity (repairing houses) has occurred in Canterbury in the past. One way is to look at building consents for additions and alterations to existing houses (as a proxy for "repairs"). Although not every addition or alteration requires a building permit, to give some perspective on the size of the task faced by Fletchers, since January 1999, the average number of building consents issued for additions and alterations to residential dwellings in the Canterbury region has been just under 600 per quarter.

EQC estimates following the 4 September 2010 earthquake were that Fletcher Construction would manage the repair of up to 60,000 homes, with –at peak – about 2060 repairs being completed per month (or almost 6,200 per quarter). Even assuming that just one fifth of these repairs will require a building consent, that number would be over twice the average number of building consents issued each quarter in Canterbury for additions or alterations for the past decade.



The dotted line represents the average number of building consents issued each quarter in Canterbury between 1999 and 2010 for additions and alterations to houses.

Source: Statistics New Zealand, Fletcher EQR, EQC

Operating intentions for 2011/12

In summary, the Commission's priorities for 2011/12 will be:

- Settling all eligible claims quickly and accurately, to standards acceptable to the public and to our reinsurers, and in alignment with the social priorities of the Government for the recovery and rebuilding of Canterbury.
- Communicating clearly and promptly to claimants and others the Commission's intentions, activities and progress.
- Discharging our responsibilities, emergency and longer term, through the contract with Fletcher Construction for the repair and rebuild of a significant proportion of residential properties in Christchurch and affected areas of Canterbury.
- Ensuring appropriate progress of the additional land remediation works.
- Replacing EQC's part-exhausted reinsurance cover with new cover on conditions and at a price which is acceptable, given the Government's overall objectives for its balance sheet.

This is a complex task. In its planning and operational activities in Canterbury in support of these priorities the Commission will need to take into account the different levels of damage (both property and land) in the different suburbs (and Government policy towards land rehabilitation or retirement options); the need to coordinate with CERA, the Local Authorities and the claims settlement activities of the private insurers; the on-going need to prioritise emergency repairs and winter heating needs; and the practical requirements of managing and coordinating a large scale residential repair and rebuild programme where the cashflow and broader economic and resource impacts on the Christchurch and wider Canterbury community will also need to be considered.

The Commission will also be expected to contribute to wider policy work with information and advice, and to align with the Government's overall recovery plan for Canterbury. We anticipate that this wider policy work will also include:

- identifying legislative changes that would help improve the Commission's response to any future large scale event;
- identifying operational changes that would improve the Commission's response to any future large scale event;
- advice (in conjunction with the Treasury) on the on-going size, structure and investment profile of the NDF; and
- identifying lessons learned from the Commission's response and their potential applicability to other Government entities and functions.

Discharging our responsibilities to claimants either through cash settlement or managed repair will also necessitate the orderly sell down of NDF assets. EQC is operating to a Ministerial direction dated 15 September 2010, which requires it to hold a portfolio of New Zealand government securities, global equities and New Zealand bank securities. Under the

Ministerial direction, a maximum of 35 per cent of the market value of the fund is to be held in global equities. EQC also has a target allocation of the fund between government securities, global equities and bank securities. As it funds payments to claimants, EQC will comply with the Ministerial direction, and will endeavour to stay within its target allocation. EQC's holdings of government bonds are deemed "non-market". They are sold back to the New Zealand Debt Management Office (NZDMO) so that the NZDMO can manage any resulting re-financing as part of the Crown's overall debt requirements. The sale of the bonds to the NZDMO therefore reduces both debt (liability) and cash (asset) holdings of the NZDMO.

Against this backdrop the Commission must also maintain a "business as usual" focus. Other communities are, and will likely be, affected by natural hazard events. The severe weather events of April/May 2011 which led to flooding and large scale landslips in Hawke's Bay are a reminder that, although the Canterbury events are a significant element of current and likely future Commission activity, the Commission must maintain capability and flexibility to respond efficiently and effectively to any other natural hazard events, such as earthquake, volcanic eruption, hydrothermal activity, tsunami and natural landslip.

We need to be able to respond to the people affected by these, as well as the Canterbury earthquake, events.

Risk Management

Risk management is, to a large degree, the Commission's core business. Risk Management is a critical business discipline that reduces uncertainty in the achievement of statutory functions and business objectives, while strengthening and complementing other corporate governance initiatives.

EQC's Board, Management and Staff are guided by the following key principles that Risk Management:

- Creates and protects value.
- Is an integral part of all organisational processes, including decision making.
- Is dynamic, iterative and responsive to change.
- Facilitates continual improvement of the organisation.
- Is transparent and inclusive and tailored to EQC's requirements.

EQC's Risk Management Policy and supporting framework have been established to:

- Ensure proper risk governance.
- Focus on what matters most.
- Plan for rather than to react to risk.
- Integrate risk management into EQC's structure, policies, processes and procedures.
- Provide assurance that key risks are adequately managed.
- Share knowledge and facilitate continuous business improvement.
- Ensure the quality of decisions.
- Achieve cost and resource savings.

Key organisational risks that EQC's Risk Management Policy and framework support include:

- Our claims system is currently at capacity and under some stress. We will need to ensure its resilience.
- The need to account for the costs of two Canterbury earthquake events in a way which will satisfy our reinsurers. We also have to account for the expenditure of large sums of public money to a standard which satisfies Parliament.
- More generally, we are still filling positions in our structure to support a markedly different organisation, with different responsibilities, from that which existed pre-4 September 2010.

Evaluation

UMR Research has been commissioned by EQC to undertake a regular survey to determine the level of claimant satisfaction with EQC's claim handling process. The survey is a telephone-based survey to claimants who had their claim settled in the previous month, and the analysis is undertaken at quarterly intervals.

This information is intended as an input to future response planning and to the development and on-going refinement of EQC's public education programmes.

The Board of the Commission has been concerned to ensure the cost effectiveness of the fund management arrangements for the international equities component of the NDF. On the face of it, relatively small sums allocated to five or six fund managers, while reducing volatility, could result in a high fee structure. To obtain assurance on this, EQC participates in an international benchmarking survey, where we have rated well on cost and return against international peers.

Managing organisational health

The context of our changing environment

Since the Canterbury earthquake on 4 September 2010 and subsequent aftershocks and new events we have faced a huge increase in our claims assessments and settlements. In response, EQC has set up a number of site offices in Christchurch and has rapidly engaged a large number of contractors and temporary staff across Australia and New Zealand to assist with the EQC response to the Canterbury events.

Catastrophe Response Programme

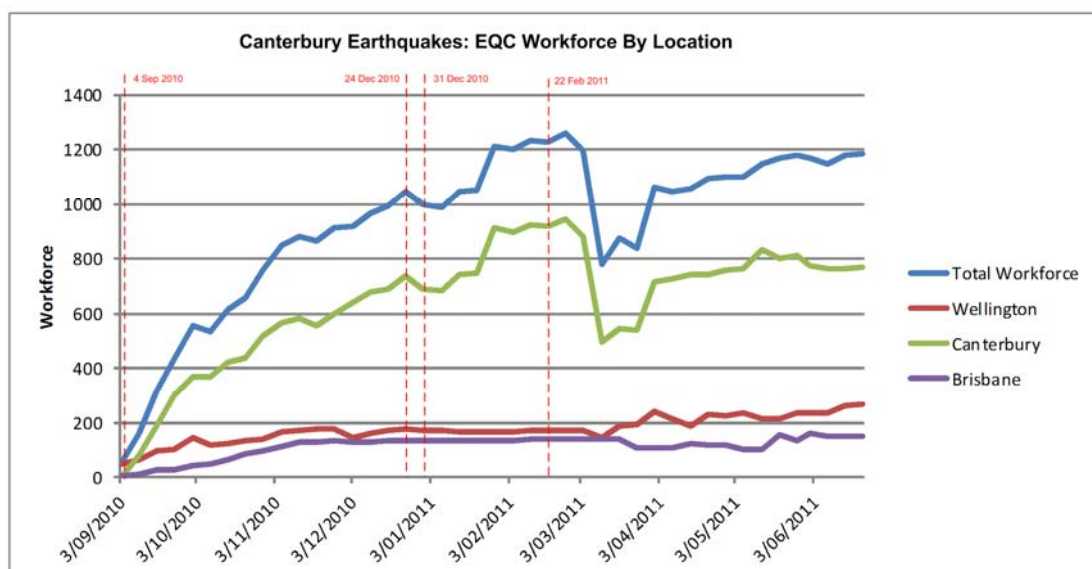
New Zealanders rely on EQC to provide efficient claims assessment and settlement in the aftermath of a disaster. This means the challenges facing EQC include:

- the need to adjust to substantially increased demands at short notice;
- the need to maintain expertise in the management of insurance, reinsurance and investments, as well as technical expertise in disaster response; and
- the need for staff and contractors to work away from home and families under stressful situations.

For these reasons, organisational health and capability are of strategic importance to EQC.

EQC addresses organisational capability and readiness to respond to crisis both through good management practices and also through its Catastrophe Response Programme.

EQC has contingency plans in place for the situation where New Zealand is affected by a major catastrophe, providing for expansion of organisational size at short notice. Following the Canterbury earthquakes, EQC successfully demonstrated the capability of its catastrophe response plans by setting up new headquarters in Christchurch along with a number of site offices shortly after the September quake. As part of this response, EQC has engaged close to 1,200 people to support our claims assessment and settlements process; Wellington (222); Christchurch (758); and Brisbane (119); and in addition, EQC has 100 contractors providing call centre services.



Source: EQC. The temporary decline immediately post 22 February 2011 represents the practical difficulties of securing sufficient accommodation for contracted assessors and loss adjustors and the priority accorded to Urban Search and Rescue and other emergency response staff.

Our People

EQC takes its role as a good employer seriously because human resources are integral to its business. To ensure that staff regard EQC as a good employer, the Commission will continue to:

- demonstrate leadership and vision that articulates EQC’s values and makes a difference to the lives of New Zealanders;
- as an Equal Employment Opportunities (EEO) employer, provide equal employment opportunities for staff ;
- encourage staff to develop through internal and external training, coaching and mentoring;
- provide opportunities for staff participation in organisational decisions;
- take account of the need for staff to balance work with the rest of their lives;
- utilise performance management practices that are transparent and fair;
- provide a working environment that is free from all forms of harassment and bullying and provide safe and fair means of dealing with complaints;
- provide a healthy and safe workplace, observing occupational health and safety requirements at the corporate office and as part of the Catastrophe Response Programme, to ensure temporary field offices and claims sites are safe for the Commission’s workers; and
- provide a confidential Employee Assistance Programme under which any staff member may seek assistance from.

Developing and supporting our leaders

The capability of our leaders within EQC is integral to our organisation delivering on its Statement of Intent and for providing a workplace environment that supports and encourages high performance.

Over the next two years EQC will develop and deliver a deliberate and structured leadership strategy and development opportunities for all its leaders.

These initiatives will include:

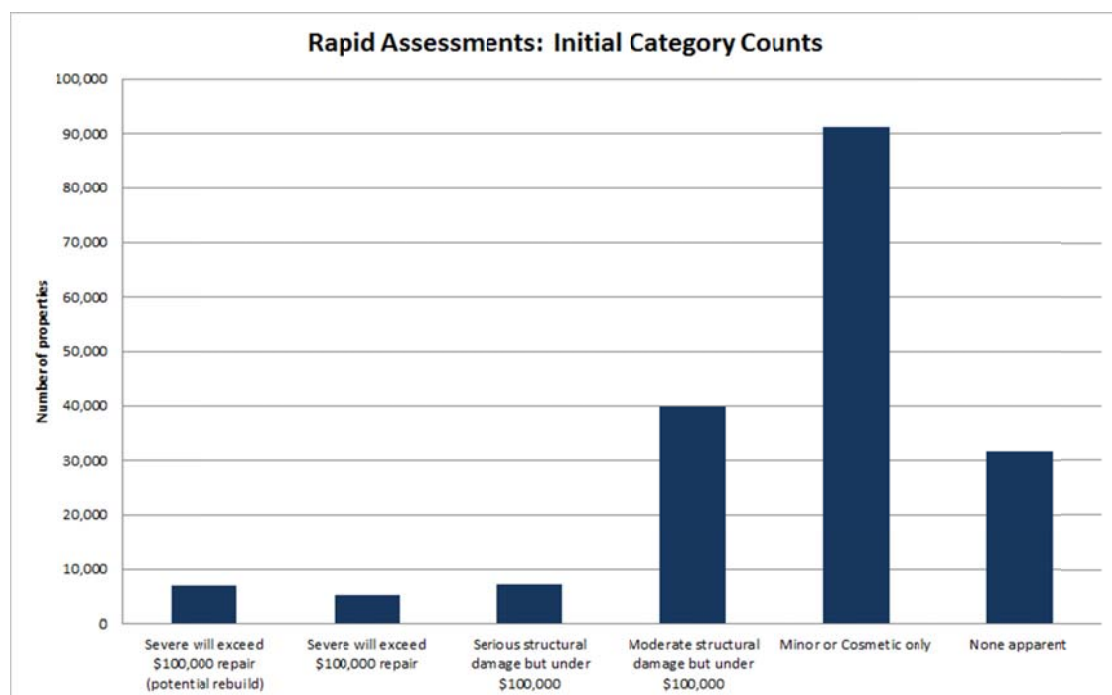
- Review and redesign of EQC's Leadership Team accountabilities and operating model.
- Develop and implement a competency framework for all leadership roles.
- Refresh and re-evaluate position descriptions.
- Develop a process for identifying potential talent.
- Agree and deliver to individual development plans.
- Support our leaders to access leadership development programmes including those provided by the Leadership Development Centre and other Public Sector leadership programmes.

The outcomes from this strategy will deliver a highly capable and high performing leadership team at all levels across the organisation.

EQC's response to the 22 February 2011 earthquake

A key indicator of organisational capability is the ability to learn from experience and to successfully innovate. EQC's response to the 22 February 2011 earthquake was based on an assessment of lessons learned from 4 September 2010 earthquake.

The most visible response to the 4 September lessons was the roll out of a triage or "rapid assessment" process. This involved the inspection of all residential properties in metropolitan Christchurch, Lyttelton, and affected parts of Selwyn and Waimakariri – irrespective of their insurance status. The primary focus of the rapid assessment process was to prioritise properties for subsequent full assessments and to identify properties needing emergency repairs. It also enabled EQC to respond to a key concern following the 4 September event - the need to provide claimants with better information and more certainty about next steps with their claims.



Source: EQC. Data as at 31 March 2011

The rapid assessment process also illustrates the expanded role expected of EQC as part of the whole-of-government response following the 4 September 2010 earthquake. During the rapid assessment process, EQC assessors also sought to identify households that had lost their sole source of heating, were seeking temporary accommodation or had "vulnerable" occupants (primarily elderly, very young or those with certain medical conditions) who may require social assistance.

This information has, on a regular basis, been passed on to relevant government agencies. For example, the contact details for those households that indicated a need for temporary accommodation are forwarded by EQC to the Canterbury Earthquake Temporary Accommodation Service (CETAS).

The rapid assessment process also utilised iPads for electronic, in-field data capture and transfer which provided for greater accuracy, easier data capture and increased efficiencies. EQC is building on this experience to use similar technology in its full assessment programme.

Our Objectives

The Government's fundamental expectations of EQC are set out in legislation and in the Directions we have been given. In addition, the Government issued an Enduring Letter of Expectations to Crown entities on 22 December 2008 that set out its expectations of all statutory Crown entities. These expectations are for:

- A more focused, efficient and productive state sector that delivers services differently and more cost effectively.
- Informative and accurate financial and non-financial performance information that will enable Crown entities to demonstrate value for money.
- High quality performance information to enable Ministers to make more informed decisions.

These expectations provide the backdrop against which we set out our objectives, and the measures, standards and other information with which we will measure and assess our performance.

EQC's activities are guided by its statutory functions, as set out in section 5 of the Act. Broadly speaking these functions contribute to three, key, high level objectives for the Commission:

- Efficient management and settlement of claims.
- Efficient pricing and financing of risk.
- Improving the current state of knowledge about New Zealand's natural hazards.

While our priority over the next three or so years will be on the efficient management and settlement of claims, in practice these objectives are intertwined. For example, an improvement in the current state of knowledge about New Zealand's natural hazards can help inform the pricing of the New Zealand risk by international reinsurance companies. The efficient management and settlement of claims can also help the pricing of the New Zealand risk by international reinsurance companies.

Objective: Efficient management and settlement of claims

New Zealanders rely on EQC to provide efficient claims assessment and settlement in the aftermath of a disaster. EQC has the option to settle claims by payment, replacement or reinstatement but, regardless of how EQC elects to settle, the settlement approach must deliver levels of service acceptable to claimants and their representatives in local and central government. This will involve a combination of timeliness and accuracy in assessing and quantifying damage, and in settling claims.

The length of time taken to settle claims can vary from a few days to years. Factors that could cause delays include the availability of specialists like engineers, legal or regulatory issues, and, if land or the Act's "imminent loss" provisions are relevant, complexity of the proposed remedy and the need for time to elapse to allow land to become sufficiently stable to be worked on.

The need to reassess claims undermines confidence in the claims settlement approach and impacts on the efficiency of claims processing by, in effect, increasing claim handling costs through re-work.

Outputs that contribute directly to this objective are:

- Claims handling.
- Public education.
- Policy advice.
- Administration of the Act Insurance Scheme and the Natural Disaster Fund.

Objective: Efficient pricing and financing of risk

Under the Act, EQC is required to administer the Natural Disaster Fund, protecting its value, and to administer the insurance against natural disaster that is provided by the Act.

In the medium term, EQC's goals are to:

- develop and maintain sufficient capacity (fund assets and reinsurance combined) to meet the obligations on EQC that will follow from a natural disaster; and
- manage the insurance scheme efficiently.

These goals link closely with the Government's long-term outcome of efficient management of the Crown's assets and liabilities, with particular emphasis on measuring and controlling the Crown's balance sheet risk.

EQC's contribution includes policy advice to the Government, when called upon, on how best to manage the Crown's liability for natural disaster insurance and improve the efficiency of the insurance scheme. It also includes efficient administration and

management of the scheme within the parameters set by the Government, including Ministerial Directions under section 12 of the Act.

The recent sequence of natural disasters around the globe (including the Canterbury earthquakes), together with the aftermath of the international financial crisis, is resulting in considerable uncertainty about the pricing of risk. We believe that EQC will continue to be able to access sufficient reinsurance capacity but that there is likely to be a change to the pricing and structure of EQC's current reinsurance programme.

Outputs that contribute directly to this objective are:

- Claims handling.
- Research.
- Policy advice.
- Administration of the Act Insurance Scheme and the Natural Disaster Fund.

Objective: Improving the current state of knowledge about New Zealand's natural hazards

One of EQC's functions under the Act is "...to facilitate research and education about matters relevant to natural disaster damage, methods of reducing or preventing natural disaster damage, and the insurance provided under this Act." EQC's leadership of the GeoNet project in association with GNS Science and Land Information New Zealand (LINZ), and co-funding of research projects like "It's Our Fault" - a reassessment of the hazard presented by the earthquake faults in the Wellington region - and DEVORA - a study of Auckland's volcanic risk - support this objective.

Outputs that contribute directly to this objective are:

- Research.
- Public education.
- Policy advice.

Statement of Service Performance

Output 1: Claims handling

The main purpose of claims handling is to repair, replace or reinstate property or land damaged by an insured peril, up to the maximum amounts set out in the Act. This involves receiving or registering a claim from the owner of damaged property, establishing entitlement and determining amount, and making settlement (by payment, replacement or reinstatement/repair – at EQC’s election).

This must be done in an efficient and fair manner in accordance with the Act. Efficient claims handling and settlement minimises the costs faced by levy payers and by international reinsurers. Fair claims handling and settlement in accordance with the Act ensures that claimants and the general public have confidence in the scheme and its administration and that third parties who also have a financial interest in the claim (for example mortgage holders, private insurers, international reinsurers) can have certainty about their costs and risks – and price this accordingly.

Catastrophe events make EQC prone to sudden surges in claims activity. In years when there is no significant event, EQC can expect to receive a few thousand claims but, as the Canterbury events have shown, a single major catastrophe can generate hundreds of thousands of claims. The rate of settlement of claims following a natural event is also dependent upon the resources that can be marshalled to investigate and handle the claims.

Claims handling is supported by several computer applications that provide management services, analysis and insight. These include the Claims Management System, the Minerva earthquake hazard model, and the Logjam systems dynamics model.

We will be successful in claims handling if:

- All claimants are able to lodge claims with EQC within the statutory period.
- Claims are determined and settled within a time frame acceptable to the public and in accordance with the Act.
- Claims are settled to standards of individual and overall fairness acceptable to the public and reinsurers and in accordance with the Act.
- Essential office services are maintained at a level commensurate with a standard of operational efficiency acceptable to the Board.
- The welfare of staff is attended to so that the risks of over-long working hours and excessive stress are avoided.

Claims handling – main performance measures and standards

Key success factor	Annual measure or standard
<p>Claims are determined and settled within a time frame acceptable to the public and in accordance with the Earthquake Commission Act.</p>	<ul style="list-style-type: none"> • For claims under the “imminent loss” provisions of the Act, 90% of claimants receive their entitlements within one year of the date claim was lodged. • For other claims, when there are less than 10,000 claims open in total, 90% of valid claims are quantified within 90 days of the date the claim was lodged. • For other claims, when there are more than 100,000 claims open in total, 90% of valid claims are quantified within 270 days of the date the claim was lodged (<i>new measure</i>).
<p>Claims are settled to standards of individual and overall fairness acceptable to the public and reinsurers.</p>	<ul style="list-style-type: none"> • The difference between EQC’s “Assessed Claim Value” and quoted repair or replacement costs is, in aggregate, less than 20% (<i>new measure</i>). • Claim handling costs (excluding project management costs where reinstatement is the chosen settlement option) are less than 10% of payout. • Claimant satisfaction is higher than KiwiCount average for public services (which was 69% in 2009 – the latest measure available) (<i>new measure</i>). • There are no findings by the Ombudsman or Courts that claims are not being processed in accordance with the Act.
<p>The Claims Management System (CMS) is maintained at a level commensurate with a standard of operational efficiency acceptable to the Board.</p>	<p>Availability</p> <ul style="list-style-type: none"> • CMS is available 99.9% of the time each month (unplanned outage is limited to 2x 4 hour outages in total, per annum) (<i>new measure</i>). <p>Capacity</p> <ul style="list-style-type: none"> • In response to a large event, the system must support 2,000 concurrent EQC users (using CMS) and 500 concurrent public users (using the Internet Claim Form) (<i>new measure</i>). • In response to a large event, the system must support a possible 300,000 new claims over a 6 week period (<i>new measure</i>). • System must support 3,000,000 total claims (<i>new measure</i>).

Output 2: Research

The main purpose of EQC’s investment in science capacity, and in hazard monitoring research is, through the encouragement of transfer and uptake into practice, to reduce damage and disruption following a natural disaster.

Risk is a multiple of hazard and vulnerability. Structures are vulnerable to hazards like earthquakes and volcanic eruptions through their siting, construction and extent of mitigation measures. EQC’s requirements for research can be summarised as being to (1) assess the hazard; (2) assess the risk posed by the hazard; (3) devise actions to mitigate the risk; and (4) develop actions to enhance recovery.

We will be successful in our research funding if:

- Revised building standards, regulations, local authority requirements, district plans and practitioner guidelines embody relevant EQC-funded research results.
- International catastrophe loss models embody relevant EQC-funded research results with corresponding reduction of uncertainty associated with New Zealand natural disaster risk.

Research – main performance measures and standards

Key success factor	Annual measure or standard
EQC invests in high quality research projects that address gaps in knowledge affecting New Zealand’s exposure to geological hazards.	<ul style="list-style-type: none"> • Contracted research projects for the year to 30 June 2012 meet all agreed budgets and timeframes for progress or completion. • Each completed project contributes to at least one peer-reviewed scientific paper or report.
EQC enables knowledge and technology transfer from basic research to professional practice to occur.	<ul style="list-style-type: none"> • “Science to Practice” initiatives meet all agreed criteria for collaboration across agency/discipline boundaries. • Project results are presented in keynote or plenary presentations and sector print media within 6 months of completion.
EQC invests in core infrastructure to support research, including databases, enabling technologies, students and academic learning and international linkages.	<ul style="list-style-type: none"> • <i>GeoNet</i> project meets agreed budget and performance criteria. • The university-based teaching and scholarship programmes sponsored by EQC meet contracted requirements for annual output and reporting.

Output 3: Public education

The main purposes of EQC’s public education activities are to: improve the levels of knowledge of and activity by New Zealanders to make their homes safer from natural perils; and to improve the levels of understanding of EQC’s role.

The prime responsibility for home safety lies with home owners but they need information and guidance on the most effective and prudent measures to take, and on what to expect of EQC should they experience natural disaster damage. EQC’s legislation does not permit EQC to carry out mitigation activities for home owners, so EQC cannot directly affect levels of disaster mitigation activity.

EQC maintains a level of nation-wide activity and regional initiatives because it believes the greater immediacy and directness these convey will have more impact on improving New Zealanders’ levels of knowledge of mitigation activities and of EQC.

We will be successful in our public education activities if:

- New Zealanders are aware of earthquake safety and natural hazard mitigation measures they could take.
- Home owners understand EQC’s role should they experience natural disaster damage.

Public education – main performance measures and standards

Key success factor	Annual measure or standard
New Zealanders are aware of earthquake safety and natural hazard mitigation measures they could take.	Schools education programme <ul style="list-style-type: none"> • EQC’s annual secondary school programme is available to all and delivered to more than 40 secondary school classes nationwide. • More than 40 schools receive the annual EQC-funded school programmes through Te Papa and Auckland Museum. • Delivery of annual regional schools earthquake education programme with uptake of 50% of schools in target region.
Homeowners understand EQC’s role should they experience natural disaster damage.	<ul style="list-style-type: none"> • Levels of awareness among surveyed homeowners of EQC’s role is at least 70% as measured in quarterly surveys

Output 4: Policy advice

The main purpose of EQC’s policy advice is to provide advice to the Government on issues related to EQC’s statutory functions, including:

- Natural disaster damage.
- Methods of reducing or preventing natural disaster damage.
- Government response to disasters.
- Relevant risk management issues.
- Management of the Natural Disaster Fund and protection of its value.
- Terms and conditions of the insurance.

EQC has a strategic role in promoting, through the provision of robust policy advice to decision-makers, the adoption of policies that help to build safer communities and contribute to the efficient management of the Crown’s assets and liabilities.

We will be successful in our policy advice if our advice meets quality standards agreed with Ministers.

To the extent to which time and cost-effectiveness considerations permit, EQC intends that its policy advice meets the following quality criteria:

Purpose: Policy papers should be short (where practicable), succinct and clearly focused on decisions required from Ministers.

Consistency: The advice takes account of other Government policies and decisions.

Logic: The assumptions behind the advice are explicit and the argument is logical and supported by facts.

Accuracy: The facts in the papers are legally and statistically accurate and all material facts and sources are included. Where appropriate, the advice includes sound legal opinion.

Options: An appropriate range of options is presented; each option is assessed in terms of the benefits and costs for the Government, and all other relevant parties. The information provided has sufficient range and depth.

Consultation: There is evidence of adequate consultation with other government agencies and other affected parties, and possible objections to proposals are identified.

Practicality: The problems of implementation, technical feasibility, timing and consistency with other policies have been considered.

Impartiality: Advice is professional, impartial and comprehensive and alerts Ministers to the possible consequences of following particular policies, whether or not such advice accords with the Ministers' views.

Policy advice – main performance measures and standards

Key success factor	Annual measure or standard
EQC produces policy advice that meets the needs of Ministers, and reflects state sector values of impartial “free and frank” advice.	Minister(s) rate their level of satisfaction with the quality of policy advice as “satisfied” or better. (<i>new measure</i>).

Output 5: Administration of the Act, Insurance Scheme and the Natural Disaster Fund

This output involves administration of the NDF, including collection of the premiums payable, and, so far as reasonably practicable, protection of the Fund's value through the investment of money held in the Fund and reinsurance in respect of the whole or part of the insurance provided under the Act. This output reflects EQC's functions as set out in section 5(1)(a), (b), (c) and (d) of the Act.

Premium is collected on behalf of the Commission by insurance companies via the fire insurance policies they issue or renew or, in rare cases, directly by the Commission for cover issued under section 22 of the Act.

EQC places a large reinsurance programme with reinsurance companies and Lloyd's syndicates. This cover protects the Fund against a payout that would threaten its viability following a major natural disaster. The programme is placed through, and with advice from, reinsurance brokers.

The investment of the Fund is controlled through a Statement of Investment Policies, Standards and Procedures, which is approved by the Minister. EQC appoints several international funds management companies to manage its global equities portfolio, and has appointed custodians to administer both the domestic and off-shore portfolios.

As with the other Crown Financial Institutions (CFIs), EQC is required to administer its funds in a manner consistent with avoiding prejudice to New Zealand's reputation as a responsible member of the world community. Whilst each CFI is an independent body, EQC supports and participates in collaborative servicing and resource provision, in order to place each CFI in a position to make its own decisions. EQC has completed its own Responsible Investment Policy, Standards and Procedures and has become a signatory to the United Nations Principles for Responsible Investment document.

EQC manages the NDF in an environment that is characterised by a number of risks and challenges over which it has little or no control. Limitations on allowable asset classes and the ratio of onshore : offshore balances are also constraints, set by Ministerial direction after consultation with EQC.

Ultimately, we will be successful in our administration of the Act, Insurance Scheme and the NDF if EQC's administration of the scheme and management of any claims against the scheme, together with EQC's research output, reduces the pricing of the New Zealand risk by the world's reinsurance companies. In practice, however, this is difficult to measure. Our measures therefore focus on whether:

- EQC's investment performance achieves the targets set in the Statement of Investment Policies, Standards and Procedures.
- EQC's investment management costs are in line with peers.
- EQC is able to renew its reinsurance programme so that, together with the NDF assets, this is sufficient to meet the maximum probable loss.

Administration of the Act, Insurance Scheme and the Natural Disaster Fund – main performance measures and standards

Key success factor	Annual measure or standard
EQC's investment performance achieves the targets set in the Statement of Investment Policies, Standards and Procedures.	<p>Global Equities</p> <ul style="list-style-type: none"> • MSCI World Index with net dividends re-invested measured in NZ dollars. <p>NZ Inflation Indexed Bonds</p> <ul style="list-style-type: none"> • NZX NZ Inflation Indexed Index. <p>NZ Government Stock</p> <ul style="list-style-type: none"> • NZX NZ Government Stock Index. <p>NZ Cash</p> <ul style="list-style-type: none"> • NZX 90-day Bank Bill Gross Return Index.
EQC's investment management costs are in line with international peers.	When adjusted for asset mix, EQC's investment management costs, as reported in the CEM Benchmarking Survey, are less than the median of its international peers.
EQC's investment management costs are in line with domestic peers.	<p>EQC's cost of fixed income management are the same or less than those of other CFIs (<i>new measure</i>).</p> <p>EQC's cost of global equities management are, when adjusted for the size of holdings, the same or less than those of other CFIs (<i>new measure</i>).</p>
EQC is acting in accordance with its Responsible Investment Policy Standards and Procedures.	There are no breaches of excluded stock holdings.
EQC is able to renew its reinsurance programme so that, together with the NDF assets, this is sufficient to meet the maximum probable loss.	Negotiation of a reinsurance programme for 2011/12 maintains the risk to the Crown of a call under section 16 of the Act at 1 in 1,000 or better.

Prospective Financial Statements

Prospective Statement of Comprehensive Income For the Year Ending 30 June 2012

	NOTES	2012 Budget \$(000)
Gross earned premiums		88,821
Outwards reinsurance premium expense		(77,500)
Net earned premium revenue		11,321
Claims Expense	1	(10,421)
Surplus from Underwriting Activities		900
Public education	1	(3,600)
Research (excluding GeoNet)	1	(3,275)
GeoNet programme	1	(8,458)
Total other operating costs		(15,333)
Investment income		219,517
Investment costs	1	(8,342)
Investment income net of costs		211,175
Crown underwriting fee		(10,000)
Net surplus for the year		186,742
Other Comprehensive Income		0
Total Comprehensive Income		186,742

Prospective Statement of Movements In Equity For the Year Ending 30 June 2012

	2012 Budget \$(000)
Natural Disaster Fund	
Issued Capital	
Opening balance as at 1 July	1,500,000
Movement for the year	0
Closing balance as at 30 June	1,500,000
Retained Earnings	
Opening balance as at 1 July	1,765,570
Net surplus for the year	186,742
Closing balance as at 30 June	1,952,312
Closing balance as at 30 June	3,452,312

**Prospective Statement of Financial Position
as at 30 June 2012**

**2012 Budget
\$(000)**

Natural Disaster Fund

Capitalised Reserves	1,500,000
Retained Surplus	1,952,312

Total Equity

3,452,312

Assets

Cash & cash equivalents	100,945
Investments	3,849,933
Premiums receivable	17,024
Other receivables	40,000
Reinsurance assets	2,200,000
Prepayments	15,000
Property, plant and equipment	16,103
Intangible assets	2,224

Total assets

6,241,229

Liabilities

Trade and other payables	3,617
Provision for employee entitlements	
Outstanding claims liability	2,700,000
Unearned premium liability	46,300
Unexpired risk liability	39,000

Total liabilities

2,788,917

Net Assets

3,452,312

**Prospective Statement of Cash Flows
For the Year Ending 30 June 2012**

	2012 Budget	
	\$(000)	
Cash flows from operating activities		
Cash was provided from:		
Premiums	88,443	
Reinsurance assets	1,000,000	
Crown Recoveries	140,000	
Interest received	107,209	
Dividends received	30,000	
		1,365,652
Cash was applied to:		
Outward reinsurance	85,775	
Crown underwriting fee	10,000	
Claims	2,200,000	
Employees and other operating expenses	21,963	
GeoNet operating expenses	5,627	
Research grants	2,502	
		(2,325,867)
Net cash outflow from operating activities		(960,215)
Cash flows from investing activities		
Cash was provided from:		
Maturity and sale of investments	1,016,650	
		1,016,650
Cash was applied to:		
Purchase of investments	51,686	
Purchase of property, plant and equipment	3,874	
Purchase of intangibles	679	
		(56,239)
Net cash inflow from investing activities		960,411
Net increase in cash and cash equivalents held		196
Add opening cash and cash equivalents brought forward		100,749
Ending cash and cash equivalents carried forward		100,945

1. Expenditure

	2012 Budget
	\$(000)
Advertising and publicity	1,520
Amortisation	696
Fees to the Auditor	
Audit of the financial statements	150
Assurance services provided by auditor	30
Catastrophe response programme*	6,058
Commissioners' fees	220
Depreciation	3,046
Employee benefits	3,484
Grants for earthquake research	2,594
GNS Science GeoNet operating costs	5,618
Investment and custodial expenses - third party	6,690
Office rental	496
Sponsorships	1,291
Other expenses	2,203
Total Operating Expenditure Excluding Reinsurance	34,096
Claims Settlements	0
Total Expenditure Excluding Reinsurance	34,096

Grouped by function per the Statement of Comprehensive Income

Claims expense	10,421
Public Education	3,600
Research (excl GeoNet)	3,275
GeoNet Programme	8,458
Investment Costs	8,342
	34,096

* excludes depreciation, amortisation and employee benefits.

Statement of Accounting Policies For the year ended 30 June 2012

Reporting Entity

The Earthquake Commission (“the Commission”) is a Crown Entity as defined by the Crown Entities Act 2004 and is domiciled in New Zealand.

The Commission’s primary objectives are to administer the insurance against natural disaster damage as provided for under the Earthquake Commission Act 1993, facilitate research and education about matters relevant to natural disaster damage, to manage the Natural Disaster Fund, and arrange reinsurance. Accordingly, for purposes of New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS), it has chosen to designate itself a public benefit entity.

The reporting period covered by these prospective financial statements is the year ended 30 June 2012. These prospective financial statements were approved by the Board on 11 April 2011.

Basis of Preparation

Measurement Base

The measurement base applied is historical cost modified by the revaluation of certain assets and liabilities as identified in this Statement of Accounting Policies.

Functional and Presentation Currency

These financial statements are presented in New Zealand dollars, which are the functional currency of the Commission and are rounded to the nearest thousand dollars.

Statement of Compliance

These financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice. They comply with NZ IFRS and other applicable financial reporting standards, as appropriate for public benefit entities. The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

Judgements and Estimations

The preparation of financial statements in conformity with NZ IFRS requires judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised (if the revision affects only that period) or in the period of the revision and future periods (if the revision affects both current and future periods).

The estimation of claims liabilities is a key area of judgement where the assumptions made may have significant effect on the financial statements and estimates, with a significant risk of material adjustment in the next year.

Significant Accounting Policies

Insurance

Premium Income

Premium income is recognised using the 24ths rule to approximate the contract period over which the premiums are earned. Premiums not earned in the Statement of Comprehensive Income at balance date are disclosed in the Statement of Financial Position as unearned premiums. Premiums receivable are reported net of applicable discounts.

Insurance Recoveries

Reinsurance and non-reinsurance recoveries received or receivable are recognised as revenue in the Statement of Comprehensive Income.

Reinsurance

Premiums paid to reinsurers are recognised by the Commission as reinsurance expense in profit or loss from the attachment date over the period of indemnity of the reinsurance contract, in accordance with the expected pattern of the incidence of risk. Prepaid reinsurance premiums are included in prepayments in the Statement of Financial position.

Claims

Claims expenditure includes claims settlements and claims handling costs.

Claims Liability and Unearned Premium Liability

The outstanding claims liability is recognised at balance date as the central estimate of the present value of the expected future payments for claims incurred to balance date, with an additional risk margin to allow for the inherent uncertainty in the central estimate.

At balance date, the Commission assesses the adequacy of the unearned premium liability. Where the current estimate of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current insurance contracts, plus an additional risk margin, exceeds the value of the unearned premium, the deficiency will be recognised in profit or loss and recorded in the Statement of Financial Position as unexpired risk liability.

Assets Backing Insurance Liabilities

All assets of the Commission back its insurance liabilities in accordance with section 13(3) of the Earthquake Commission Act 1993, which states: "All money in bank accounts

established by the Commission, and all investments and other assets of the Commission, shall be deemed to form part of the Fund.”

Grants

The Commission provides discretionary grants for earthquake research and research dissemination.

Discretionary grants are those where the Commission has no obligation to award on receipt of the grant application and are recognised as expenditure when the performance criteria, on which approval of the grant was based, are met.

Foreign Currency

Transactions in foreign currencies are initially translated at the foreign exchange rate at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation, at year-end exchange rates, of monetary assets and liabilities denominated in foreign currencies, are recognised in the Statement of Comprehensive Income.

Taxation

The Commission is exempt from the payment of income tax in terms of the Income Tax Act 2004. Accordingly, no charge for income tax has been provided for.

Goods and Services Tax (GST)

The Statement of Comprehensive Income, Statement of Movements in Equity, Statement of Cash Flows are exclusive of GST. The Statement of Financial Position is also exclusive of GST, except for trade payables and premiums receivable, which are GST inclusive.

The amount of GST owing to or from the Inland Revenue Department at balance date, being the difference between output GST and input GST, is included in payables or receivables as appropriate.

Investments

Interest

Interest income is accrued using the effective interest rate method.

Dividend

Dividend income from investments is recognised when the Commission’s rights as a shareholder to receive payment have been established.

Realised Gains and Losses

Income from investments includes realised gains and losses on all investments, including currency gains and losses, and gains and losses on the sale of investments.

Unrealised Gains and Losses

Income from investments includes unrealised gains and losses on all investments, including currency gains and losses.

Financial Instruments

Non-derivative Financial Instruments

Non-derivative financial instruments comprise investments in equity and debt securities, premiums receivable, cash and trade and other payables.

Non-derivative financial instruments at fair value through profit or loss are recognised initially at fair value. Instruments not at fair value through profit or loss are recorded at fair value plus attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Commission becomes a party to the contractual provisions of the instrument. A financial asset is derecognised if the Commission's contractual rights to the cash flows from the financial assets expire or if the Commission transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Purchases and sales of financial assets are accounted for at trade date, i.e. the date that the Commission commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Commission's obligations specified in the contract expire or are discharged or cancelled.

Financial Assets at Fair Value through Profit or Loss

An instrument is classified as at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Commission manages such instruments and makes purchase and sale decisions based on their fair value. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Cash

Cash comprises cash balances, cash in transit and bank call deposits. The carrying amount of cash approximates its fair value.

Investments

All investment assets held by the Commission back insurance liabilities and are therefore designated at fair value through profit or loss.

Fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active, fair values for initial recognition and, where appropriate, subsequent measurement are established by using valuation techniques.

Derivative Financial Instruments

The Commission uses derivative financial instruments to hedge its exposure to foreign exchange risks arising from investment activities. In accordance with its treasury policy, the Commission does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at fair value, and transaction costs are expensed immediately. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss.

Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables are recognised initially at fair value, being the present value of estimated future cash flows. They are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses. Receivables with duration of less than 12 months are not discounted.

Impairment losses are assessed by an evaluation of the recoverable amount. The recoverable amount of the Commission's receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). All individual receivables that are considered significant are subject to this approach. The impairment charge is recognised in the Statement of Comprehensive Income.

Other Financial Assets

Other non-derivative financial assets are measured at fair value and subsequently measured at amortised cost using the effective interest method, less any impairment losses.

Trade and Other Payables

Payables are non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market. Payables are recognised initially at fair value, being the present value of estimated future cash flows. They are subsequently measured at amortised cost using the effective interest rate method. Payables with duration of less than 12 months are not discounted.

Hedging

The Commission has not elected to apply hedge accounting to any derivatives for the period ending 30 June 2012.

Property, Plant and Equipment

Overview

Property, plant and equipment are recorded at cost less accumulated depreciation and accumulated impairment losses.

Additions

The cost of an item of property, plant and equipment is recognised as an asset only when it is probable that future economic benefits or service potential associated with the item will flow to the Commission and the cost of the item can be measured reliably.

Where an asset is acquired at no cost, or for a nominal cost, it is recognised at fair value when control over the asset is obtained.

Disposals

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the asset. Gains and losses are included in the Statement of Comprehensive Income.

Subsequent Costs

Costs incurred subsequent to initial acquisition cost are capitalised only when it is probable that the future economic benefits or service potential associated with the item will flow to the Commission and the cost of the item can be measured reliably.

The costs of day-to-day servicing of property, plant and equipment are recognised in the Statement of Comprehensive Income as they are incurred.

GeoNet Assets

GNS Science administers the design, engineering, operation and maintenance of New Zealand's geological hazard monitoring system (GeoNet) under a 10-year agreement with the Commission. The services performed by GNS Science include the purchase, testing, installation and commissioning of capital equipment on behalf of the Commission.

The GeoNet assets, comprising buildings, computer equipment and other equipment, remain the property of the Commission at all times and are included in the Commission's property, plant and equipment in the Statement of Financial Position.

Realised gains and losses arising from disposal of property, plant and equipment are recognised in the Statement of Comprehensive Income in the period in which the transaction occurs.

Depreciation

Depreciation is charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of property, plant and equipment, less any estimated residual value, over its estimated useful life. Typically, the estimated useful lives of different classes of property, plant and equipment are as follows:

Furniture and equipment	10 years
Leasehold improvements*	6-12 years
Motor vehicles	5 years
Computer and other electronic equipment	3 years

GeoNet buildings (mostly shelters)	25 years
GeoNet computer equipment	3 years
GeoNet equipment other than computer equipment	8 years

* The cost of leasehold improvements is capitalised and amortised over the unexpired period of the lease or the estimated remaining lives of the improvements, whichever is shorter.

Intangible Assets

Intangible assets are recorded at cost less accumulated amortisation and accumulated impairment losses.

Research and Development

Expenditure on research activities, undertaken with the prospect of gaining new scientific knowledge or understanding, is recognised in profit or loss when incurred. The Commission does not undertake development of new products or processes other than software referred to below.

Software acquisition and development

Software development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Commission intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalised includes the cost of materials, direct labour, and overhead costs that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognised in profit or loss when incurred.

Capitalised software development expenditure is measured at cost less accumulated amortisation and accumulated impairment losses.

Intangible assets are amortised on a straight-line basis over the following useful lives:

Acquired computer software licenses	1-3 years
Claims management system	6- 9 years

Impairment of Non-financial Assets

The carrying amounts of the Commission's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For intangible assets that are not yet available for use, recoverable amount is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. Value in use is depreciated replacement cost for an asset where the future economic benefits or service potential of the asset are not primarily dependent on the

asset's ability to generate net cash inflows and where the Commission would, if deprived of the asset, replace its remaining future economic benefits or service potential.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Leases

Operating leases, where the lessor substantially retains the risks and rewards of ownership, are recognised in a systematic manner over the term of the lease. Lease incentives received are recognised evenly over the term of the lease as a reduction in rental expense.

Liabilities

The Commission recognises a liability when there is a present obligation (legal or constructive) as the result of a past event, it is probable that expenditure will be required to settle the obligation, and a reliable estimate can be made of the obligation. Where the timing or amount of the obligation is uncertain the obligation is recognised as a provision.

Employee Entitlements

Employee entitlements to salaries and wages, annual leave, long service leave and other similar benefits are recognised in the Statement of Comprehensive Income when they accrue to employees. Employee entitlements to be settled within 12 months are reported at their undiscounted nominal value. The liability for long service leave is calculated based on the present value of likely future entitlements accruing to employees, based on years of service, years to entitlement, the likelihood that staff will reach entitlement and contractual entitlements information.

Other Liabilities and Provisions

Other liabilities and provisions are recorded at the estimated fair value of the expenditure required to settle the obligation. Liabilities and provisions to be settled beyond 12 months are recorded at their discounted value. The increase in a discounted provision due to the passage of time is recognised as a finance cost.

Contingent Liabilities

A contingent liability is recognised when a possible obligation arises from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Commission. A contingent liability is also recognised when a present obligation arising from past events is not recognised because it is not probable that settlement of the obligation will result in a cost to the Commission, or the amount of the obligation cannot be measured with sufficient reliability.

Changes in Accounting Policies

Accounting policies are changed only if the change is required by a standard or interpretation, or otherwise provides more reliable and more relevant information. There are no accounting policy changes in the 2012 prospective financial statements.

Commitments

Future payments are disclosed as commitments at the point a contractual obligation arises, to the extent that there are equally unperformed obligations.

Budgets

The budget figures are derived from the Statement of Intent as approved by the Board at the beginning of the financial year. The budget figures have been prepared in accordance with NZ IFRS, using accounting policies that are consistent with those adopted by the Commission for the preparation of the financial statements.

When presentation or classification of items in the financial statements is amended or accounting policies are changed voluntarily, budget figures are restated to ensure consistency with the current period unless it is impracticable to do so.

Superannuation Scheme

Defined Contribution Scheme

Obligations for contributions to the KiwiSaver and the State Sector Retirement Savings Scheme are accounted for as defined contribution superannuation schemes and are recognised as an expense in the Statement of Comprehensive Income as incurred.

Cost Allocation

Expenditure of the Commission is allocated across its four main functions: claims, research, education, and investment management. Expenditure is allocated to these functions by directly attributing costs as far as possible and by the apportioning of indirect costs based on the number of full time equivalents employed in each function.

Standards, amendments and interpretations issued that are not yet effective and have not been early adopted.

NZ IFRS 9 'Financial Instruments' issued 2009 is the first part of Phase 1 of the IASB's project to replace IAS 39 and is effective for reporting periods beginning on or after 1 January 2013. It addresses the classification and measurement of financial assets and requires all financial assets to be:

- (a) classified on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset;*
- (b) initially measured at fair value plus, in the case of a financial asset not at fair value through profit or loss, particular transaction costs; and*
- (c) subsequently measured at amortised cost or fair value.*

The requirements of NZ IFRS 9 are consistent with the policies currently applied by the Commission, and therefore the Commission expects no change in the measurement criteria of its financial assets. The Commission intends to adopt this standard for the year ending 30 June 2014.

Other standards and interpretations have been approved but are not yet effective, and are not expected to have a material impact on the Commission's financial statements.

Disclosures in relation to prospective financial statements

1) Major assumptions underlying the prospective financial statements

Return on global equity investments of 9.0% per annum.

Cash returns of 2.5% per annum.

Average government stock return of 3.4% per annum.

Claims costs directly related to the occurrence of major events, and the claims they produce, have not been forecast.

Growth in the residential housing stock of 1% per annum.

No change in Government policy in respect of Crown Fees, Taxation or Dividend.

Reinsurance cost increases are estimated based on indications from reinsurers for the 2011/12 round of negotiations.

2) Purpose of prospective financial statements

These prospective financial statements have been prepared for internal management purposes and for inclusion in the Statement of Intent.

3) Degree of uncertainty attaching to prospective financial statements

(a) The assumed returns for equity investments (provided by investment advisers) are based on long run returns. Over the short-term, the actual returns achieved can be significantly different. Return rates on New Zealand Government Securities are based on data provided by the New Zealand Treasury but actual results are subject to market variables.

(b) No estimate for claims, or costs directly associated with them, has been made, due to the high level of uncertainty in any estimate.

4) Factors that may lead to material difference between prospective financial statements and the actual financial results prepared in future reporting period.

(a) The occurrence of further earthquakes or other natural disasters covered by EQC will significantly impact on future actual financial statements.

(b) The speed at which settlement of Canterbury earthquake events claims progress, and the extent of costs not covered by reinsurance.

(c) Movements in international equity markets and domestic fixed interest market will significantly impact on future actual financial statements.

(d) Movements in the New Zealand dollar against other currencies (particularly the USD) will significantly impact on future actual financial statements.

Cautionary Note

Actual financial results achieved for the period covered are likely to vary from the information presented, and the variations may be material.

Responsibility and Approval

The prospective financial statements were approved by the Board of EQC on 11 April 2011.

The Board of EQC is responsible for the prospective financial statements presented, including the appropriateness of the assumptions underlying the prospective financial statements and all other required disclosures.

Actual financial results are not incorporated in the prospective financial statements. EQC does not intend to update the prospective financial statements subsequent to presentation.

FRS42

These prospective financial statements comply with FRS42.

Statement of Service Performance for the year ending 30 June 2012

Output Class	Revenue	Expenditure
1: Claims handling and the Catastrophe Response Programme	Nil	\$10.4million
2: Research	Nil	\$11.8million
3: Public Education	Nil	\$3.6million
4 and 5: Policy Advice and Management of the Natural Disaster Fund	\$308.3million	\$95.8million