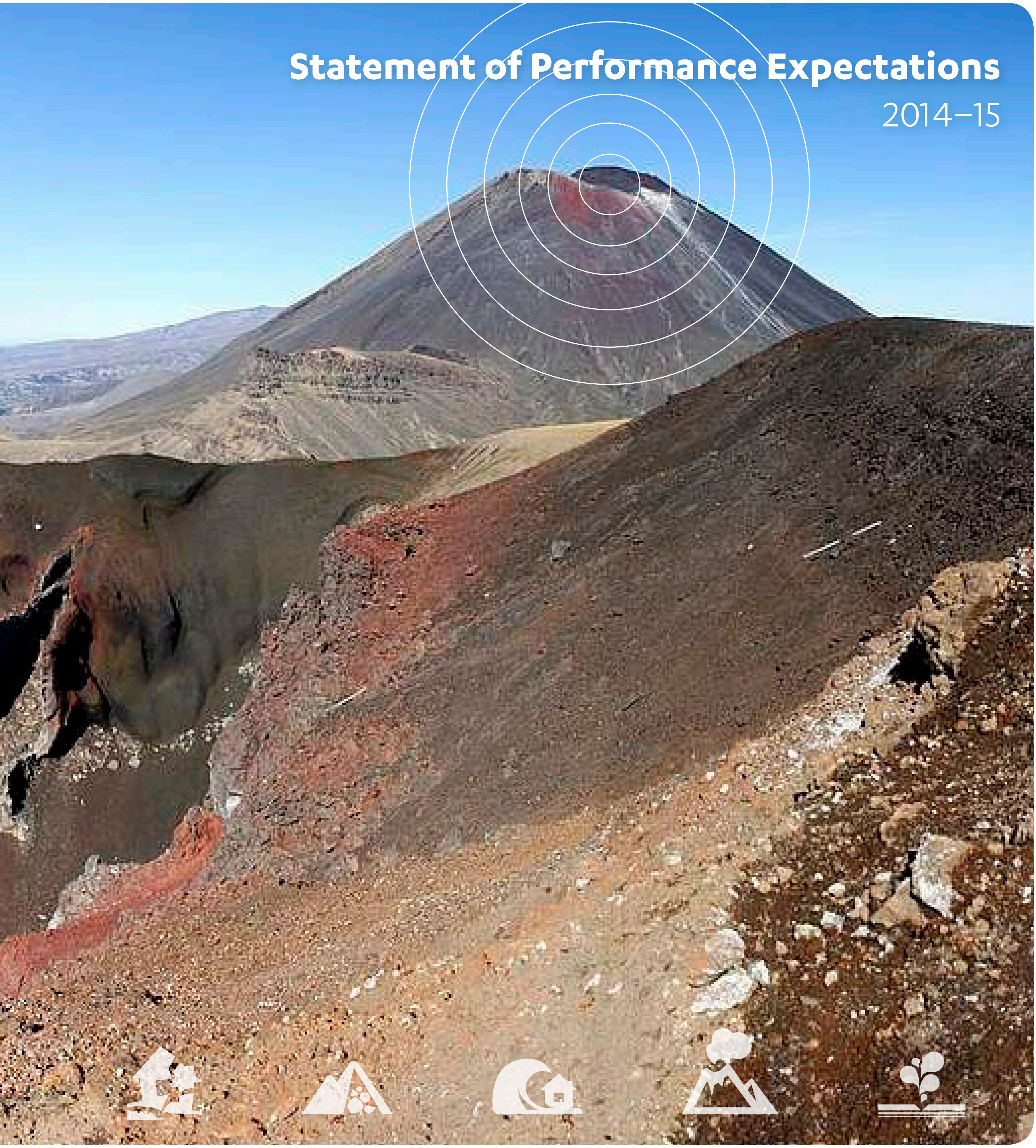
EQC
EARTHQUAKE COMMISSION
Kōmihana Rūwhenua

Statement of Performance Expectations

2014–15



This Statement of Performance Expectations is a formal public accountability document required under section 149E of the Crown Entities Act 2004. It outlines the Earthquake Commission's (EQC's) planned work and financial information for the period 1 July 2014 to 30 June 2015. Relevant historical and forecast comparison information is also provided for the benefit of readers.

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STATEMENT OF RESPONSIBILITY

This Statement of Performance Expectations (SPE) sets out EQC's intended non-financial performance and financial forecast for the year July 2014 to June 2015, and has been prepared in accordance with the Crown Entities Act 2004.

The prospective financial statements have been prepared in accordance with FRS-42 for the purposes of this SPE. The financial statements have not been audited and should not be relied upon for any other purposes. EQC is responsible for the preparation of this SPE, including the forecast financial statements and the assumptions on which they are based, the non-financial measures and for the judgments used in preparing them.

Sir Maarten Wevers KNZM
Board Chair
2 October 2014

Keith Taylor
Commissioner
2 October 2014

INTRODUCTION

This SPE should be read in conjunction with EQC's 2014–18 Statement of Intent (SOI) which provides more detailed information about our operating environment and sets out the strategic objectives that EQC intends to achieve or contribute to during the period 1 July 2014 – 30 June 2018.

The EQC SOI provides that our strategic objectives are:

» contributing to greater understanding and better management of natural disaster hazards by households and communities that may impact on EQC's future liabilities (ie. hazard and risk reduction);

» helping households and their communities recover from natural disasters; and

» contributing to efficient management of EQC's assets and liabilities.

In this strategic context, this SPE provides information in relation to the 2014–15 financial year on:

(a) Each reportable class of outputs including:

» what the class of outputs is intended to achieve;

» the expected revenue and proposed expenses for the class of outputs; and

» how the performance of the class of outputs will be assessed.

(b) Forecast financial statements.

The actual performance achieved for the 2014–15 financial year will be reported in EQC's 2014–15 Annual Report.

PART 1: OUTPUT CLASSES

EQC's functions are set out in section 5 of the Earthquake Commission Act ("the Act") as follows:

> *"The functions of the Commission are –*
>
> *(a) To administer the insurance against natural disaster damage provided under this Act:*
>
> *(b) To collect premiums payable for the insurance provided under this 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 this 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 this Act:*
>
> *(f) Such other functions as may be conferred on it by –*
>
> *(i) This Act or any other Act; or*
>
> *(ii) The Minister, in accordance with section 112 of the Crown Entities Act 2004."*

Consistent with these functions, EQC has the following four output classes:

1. Administration of the EQC Act, Insurance Scheme and Natural Disaster Fund (together, "Administration").
2. Customer services.
3. Research.
4. Education.

OUTPUT 1: ADMINISTRATION

The Natural Disaster Fund (the Fund) is the fund from which EQC pays claims for damage from specified natural disaster events. The assets in the Fund are invested and along with a reinsurance programme are intended to meet any EQC future natural disaster insurance liabilities. However, at present the costs associated with existing claims are expected to exceed the assets of the Fund. Consequently, EQC currently has a negative equity position which will be met by EQC's Crown guarantee (provided under section 16 of the Act).

An estimated 90 per cent of New Zealand's residential property owners currently have access to EQC insurance cover, as they are the holders of private dwelling and/or contents insurance with cover for fire damage. EQC cover is not available for non-residential property. Output one covers EQC's activities and services for:

» the administration of the Fund – including collection of the premiums payable;

» the investment of money held in the Fund; and

» obtaining reinsurance in respect of the whole or part of the insurance provided under the Act.

EQC's performance in other outputs also impacts on the administration of the EQC insurance scheme and the Fund. For example, obtaining adequate and affordable reinsurance is supported by the transparent and good faith portrayal of New Zealand's potential risk of damage to residential housing from natural hazards. The hazard research activities for Output 3 contribute to the understanding and assessment of this risk.

OUTPUT OBJECTIVES

The objectives for this output are to:

» administer the Fund by:

  – investing the Fund on a prudent commercial basis, in a manner consistent with best practice portfolio management; and

  – maximising returns without undue risk to the Fund as a whole while avoiding prejudice to New Zealand's reputation as a responsible member of the world community;

» ensure that premiums payable under the Act are collected in accordance with the Act; and

» obtain sufficient reinsurance cover.

EXPECTED REVENUE AND PROPOSED EXPENSES

Expected revenue from EQC premiums for Output 1 is $282.3 million. Proposed expenses for Output 1 are $171.0 million. Expenses include $10.0 million payable to the Crown for the Crown Guarantee, $160.0 million to purchase reinsurance, and $1.0 million of investment costs.

PERFORMANCE MEASURES

Table 1: Output One Performance Measures and Targets 2014–15

OUTPUTS	MEASURES	FORECAST 2014–15 (IF APPLICABLE)
Administer the Fund	» Annual investment portfolio performance in relation to 90 day bank bill rate	» 90 day bank bill rate less 25 basis points (per annum)
	» Maintain a SIPSP[1] that meets best practice	» Annual review confirms the SIPSP reflects best practice
	» No unauthorised variations from the SIPSP identified	» Any variations duly authorised
Premiums payable under the Act are collected in accordance with the Act	» Net premiums declared by insurers and brokers are collected in accordance with their obligations under the EQC Act 1993	» 98% collected
Obtaining reinsurance	» Subject to market conditions EQC obtains reinsurance consistent with the parameters set by the Board	» Cost of reinsurance programme is within the budget set by the Board
		» Nationwide coverage obtained for all perils covered under the EQC Act

1 Statement of Investment Policies, Standards and Procedures.

OUTPUT 2: CUSTOMER SERVICES

The number of claims for damage handled by EQC can vary each year from a few thousand to hundreds of thousands. As at 30 June 2014 we have received more than:

» 12,000 claims from the 2013 and 2014 Cook Strait earthquakes;

» 5,000 claims from the 2014 Eketahuna earthquake; and

» 469,000 claims from 16[2] earthquakes in Canterbury (from September 2010).

Both the efficiency of our claims handling systems and processes coupled with the manner in which customer claims are handled by EQC have a significant impact on customers' experience and perception of EQC and its service.

EQC claimants expect a consistent, timely, accurate and customer-focused settlement. Premium payers and reinsurers expect us to manage our business cost-effectively and with appropriate transparency.

Completing our response to the Canterbury earthquakes and improving EQC as a result of our experience is a key priority for this output for 2014–15.

OUTPUT OBJECTIVES

The objectives for this output are:

» to calculate and resolve claims correctly, and according to the Act; and

» to respond appropriately to customers and stakeholders.

2 There were many earthquakes in Canterbury following the September 2010 event. 16 of these were determined as events for which claims to EQC could be made.

In addition, the objectives for supporting the recovery of Canterbury for this output are to:

» complete the settlement of the Canterbury earthquake series claims;

» meet the Canterbury Home Repair Programme (CHRP) objectives, targets, and budget;

» safely repair or rebuild damaged residential properties; and

» provide timely and appropriate communication to customers and stakeholders.

EXPECTED REVENUE AND PROPOSED EXPENSES

Output 2 has no expected revenue. Proposed expenses for Output 2 are $21.4 million (subject to no new natural disaster events in the financial year).

PERFORMANCE MEASURES

The following targets and performance measures (Table 2) cover claims across the various stages of our claims process. To ensure continuity between this SPE and previous EQC Annual Reports, Canterbury specific measures for this output are included separately as Table 3.

NATURAL DISASTER MEASURES

Table 2: Output Two Performance Measures and Targets 2014–15 (Non-Catastrophe Events)

OUTPUTS	MEASURES	FORECAST 2014–15 (IF APPLICABLE)
Accurately calculate and resolve entitlements correctly, on time and according to the Act	» Event claims are paid within one year of the final assessment of damage	» 95%
	» Damage assessed (for events with fewer than 10,000 claims) no later than 90 days following the close of the claim lodgement period	» 95%
	» Damage assessed (for events with 10,000 to 100,000 claims) not later than 270 days following the close of the claim lodgement period	» 95%
	» Claims handling expenses (CHE) within Board approved budget	» CHE within 10% of Board approved budget
Respond appropriately to customers and stakeholders	» Privacy Act 1993 and Official Information Act 1982 requests met within statutory deadlines	» 98%
	» Customer satisfaction with EQC's claims handling process (30 June 2014: 32%[3])	» Year on year improvement. (The meduim term goal is to achieve or better the average of the service quality score for the SSC Kiwis Count Survey[4])
	» Abandonment of calls to EQC's Call Centre	» Less than 5%
	» Answering of calls to EQC's Call Centre	» 80% within 20 seconds
	» Customers who open monthly "EQConnects" newsletter as a percentage of those receiving it (2014: 32%)	» 40% per cent of recipients opening each newsletter

CATASTROPHE MEASURES (CANTERBURY)

Table 3: Output Two Performance Measures and Targets 2014–15 (Canterbury Earthquake Series claims)

OUTPUTS	MEASURES	FORECAST 2014–15 (IF APPLICABLE)
Complete the settlement of Canterbury earthquake series claims	» Proportion of dwelling claims from the Canterbury Earthquake Series resolved[5] by cash payment and through the managed repair programme	» 95% by December 2014
	» Proportion of land claims resolved[5] from the Canterbury earthquake series	» 75% by December 2014
	» Land damage claims from the Canterbury Earthquake Series (in aggregate) – the average variance between EQC's estimated cost of settling[6] and the actual final cost of settling claims	» Less than 20%
	» Cash settled dwelling claims – the average variance between EQC's estimated cost of settling[6] and the actual final cost of settling claims	» Less than 20%
	» Recorded complaints from Canterbury Earthquake Series customers resolved prior to third-party mediation and litigation (2014: 99%)	» 97% by 30 June 2015
	» Canterbury claims handling expenses within the Board approved budget	» Within 10% of the approved budget
	» Cumulative customer complaints as a percentage of total claims from the Canterbury Earthquake Series	» Less than 10% of total claims as at 30 June 2015

3 Quarterly telephone survery of customers conducted by UMR Research for EQC. The survey includes customer satisfaction with the overall quality of EQC's service delivery.

4 State Services Commission (SSC) Quarterly "Kiwis Count Survey". The survey measures satisfaction with Public services and identifies areas for improvement.

5 Resolved means: (a) for cash payment – where all exposures associated with the claim have been paid; (b) for properties in the managed repair programme all planned repairs are complete (but the 90 day defect liability and warranty period may not have expired).

6 Estimated cost of settling is the latest complete assessment that precedes the contractor's review of the scope and price of the repair.

OUTPUTS	MEASURES	FORECAST 2014–15 (IF APPLICABLE)
Meet the Canterbury Home Repair Programme (CHRP) objectives, targets, and budget	» Proportion of qualifying properties with repairs completed through the CHRP (from the total estimated qualifying repairs of 72,500)	» 99% by 30 June 2015
	» Customer satisfaction with the quality of repairs completed by EQR (annual average rating of customers satisfied or very satisfied with the quality of repairs. (2014: 85%))	» No less than 85%
	» Dwelling claims settled by managed repair – the average variance between EQC's estimated cost of settling[7] and the actual final cost of settling claims	» Less than 20%
	» Repair cost inflation within CHRP less than relevant Canterbury indices	» Repair cost inflation less than the movement in Statistics NZ's Canterbury CPI (Housing) Index
Safe repair or rebuild of properties (Canterbury Home Repair Programme Safe6 initiative)	» Total recorded injury frequency rate (TRIFR[8])	» No more than five injuries per million hours worked
	» Safety standards: Number of CHRP sites audited per month	» No fewer than 200 sites audited per month
Timely and appropriate communication to customers and stakeholders	» Privacy Act 1993 and Official Information Act 1982 requests met within statutory deadlines	» 98%
	» Customer satisfaction with EQC's claims handling process	» Year on year improvement
	» Answering calls to EQC's Call Centre	» 80% within 20 seconds
	» Customers who open monthly "EQConnects" newsletter as a percentage of those receiving it (2014: 32%)	» 40% of recipients opening each newsletter

7 Estimated cost of settling is the latest complete assessment that precedes the contractor's review of the scope and price of the repair.

8 The TRIFR for the Business Leader Health and Safety Forum members for 2012/13 was 4.6 (http://www.zeroharm.org.nz/assets/docs/benchmarking/Forums-Benchmark-report-2012-13.pdf)

OUTPUT 3: **RESEARCH**

Under the Act, one of EQC's statutory functions 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 the Act.

By taking an active role in national natural hazard risk management, we can contribute towards the minimisation of impacts associated with natural disasters. In addition, EQC has a contribution to make to international hazard and risk reduction knowledge and practice. Therefore, a key operating priority for this output is "EQC becoming a valued leader in natural disaster risk management nationally and internationally". In pursuing this priority through our research and education outputs we expect to be able to expand the opportunities for:

- investing in New Zealand's natural hazard risk management knowledge, science and technology. The Canterbury earthquakes have reaffirmed the importance of investing in the right type of quality research pre-event;
- engaging across the different government sectors and local authorities that have devolved local leadership responsibilities, encouraging a more integrated and well-coordinated approach to natural hazard risk management; and
- developing an improved understanding of New Zealand's natural disaster risks across sectors and disciplines through partnerships, networks, collaborative interest and local authorities by supporting the translation of science into practice – including educating and building capability.

OUTPUT OBJECTIVES

The objectives for this output are to:

- facilitate greater coordination in natural hazard risk management;
- improve capacity by working with stakeholders and contributing expert advice (turning science in to practice) and capability; and
- fund world class research.

EXPECTED REVENUE AND PROPOSED EXPENSES

Output 3 has no expected revenue. Proposed expenses for Output 3 are $18.2 million. These expenses include budgeted expenditure for GeoNet ($9.2 m).

PERFORMANCE MEASURES

Table 4: Output 3 Performance Measures and Targets 2014–15

OUTPUTS	MEASURES	FORECAST 2014–15 (IF APPLICABLE)
Facilitate greater coordination in natural hazard risk management (HRM)	» Evidence of EQC's expertise being increasingly used in national or regional HRM policy, planning, co-ordinating forums etc.	» Evidence of increased use
Improve capacity	» Industry partnership programmes for engineers, planners and for national hazard information management meet contracted objectives within expected times	» 99% of contracted objectives met
	» Partnership objectives met within contracted time frames	» 99% of contracted objectives met
	» Evidence of the direct and indirect uses of GeoNet	» Evidence of increasing direct and indirect uses
	» Funded reports are published/presented in sector print media and/or presented at conferences or stakeholder workshops	» All expected reports published
	» Engineering Lifelines Programme: participation of utility providers and local government in the annual technical forum	» Participation achieved
	» Engineering Lifelines, NZSEE and regional hazard risk management projects contracted objectives met	» All expected objectives met
Fund world class research	» Biennial grants and post-graduate student awards and research and capability grants meeting their objectives	» Objectives met or on track to be met
	» Percentage of completed research projects receiving at least one peer-review, academic paper or report within one year of completion	» 90%
	» GeoNet achieves all contracted objectives	» Objectives met or on track to be met
	» Achievement of university grants objectives met for the year (Canterbury, Auckland, Victoria and Massey universities)	» All contracted objectives met

OUTPUT 4: EDUCATION

Under the Act, one of EQC's statutory functions 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 the Act.

The prime responsibility for being prepared for natural disasters lies with homeowners. However, they need information and guidance on the most effective and prudent measures to take to mitigate the risk of damage and physical harm, 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. Instead, EQC pursues nationwide and regional initiatives educating the New Zealand public on ways to reduce and prevent natural disaster damage.

The Canterbury earthquakes have provided an opportunity to harness the lessons learned for the future and take advantage of increased public interest in natural hazards.

OUTPUT OBJECTIVES

The objectives for this output are to increase:

- public awareness of earthquake safety and natural hazard mitigation measures; and
- home owners' understanding of EQC's role should they experience natural disaster damage.

EXPECTED REVENUE AND PROPOSED EXPENSES

Output 4 has no expected revenue. Proposed expenses for Output 4 are $1.4 million.

PERFORMANCE MEASURES

Table 5: Output Four Performance Measures and Targets 2014–15

OUTPUTS	MEASURES	FORECAST 2014–15 (IF APPLICABLE)
Increase public awareness of earthquake safety and natural hazard mitigation measures	» Number of students participating in Virtual Field Trips[9]	» 2,700
	» Student participation in EQC Schools Fund (Te Papa visits)	» 500
	» Percentage of New Zealanders knowledgeable about natural hazard safety in the home (2014: 46%)	» Year on year increase
Increase home owners' understanding of EQC's roles should they experience natural disaster damage	» Use of EQC's website to obtain information about how to prepare homes or families for a damage causing natural disaster	» Year on year increasing use
	» New Zealanders are able to correctly identify EQC's roles should they experience a natural disaster[10] (2014: average able to correctly identify EQC's roles 71.5%)	» Majority of New Zealanders surveyed are able to correctly identify EQC's roles

9 Virtual field trips (VFT) help improve understanding of geo-hazards, how New Zealand manages them and EQC's role in building New Zealand's resilience. A VFT consists of a teacher and subject experts on location, communicating with students through online video and audio feeds.

10 From "Monitoring the effectiveness of the Earthquake Commission's Communcation Programme: Neilsen Quarterly survey", Neilsen.

PART 2: PROSPECTIVE FINANCIAL STATEMENTS

2.1 PROSPECTIVE STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEARS ENDING 30 JUNE 2015 AND 30 JUNE 2016

	BUDGET 2015 $(000)	FORECAST 2016 $(000)
EARNED PREMIUMS		
Gross earned premiums	282,291	285,114
Outward reinsurance premium expense	(160,000)	(165,000)
NET EARNED PREMIUM REVENUE	**122,291**	**120,114**
UNDERWRITING MOVEMENTS		
Reinsurance and other (reductions)/recoveries	14,480	711
Claims reduction/(expense)	124,420	(47,172)
Catastrophe response programme	(21,375)	(18,057)
Unexpired risk liability reduction	1,434	70,141
TOTAL UNDERWRITING MOVEMENTS	**118,959**	**5,623**
SURPLUS FROM INSURANCE ACTIVITIES	**241,250**	**125,737**
OTHER OPERATING COSTS		
Public education	(1,444)	(1,561)
Research (excluding GeoNet)	(9,002)	(9,580)
GeoNet programme	(9,221)	(9,395)
TOTAL OPERATING COSTS	**(19,667)**	**(20,536)**
INVESTMENT ACTIVITIES		
Investment income/(expense)	12,943	(44)
Investment costs	(1,040)	(547)
Interest on cash balances	–	–
SURPLUS/(DEFICIT) FROM INVESTMENT ACTIVITIES	**11,903**	**(591)**
Crown underwriting fee	**(10,000)**	**(10,000)**
NET SURPLUS AND TOTAL COMPREHENSIVE INCOME	**223,486**	**94,610**

2.2 PROSPECTIVE **STATEMENT OF CHANGES IN EQUITY**

AS AT 30 JUNE 2015 AND 30 JUNE 2016

	BUDGET 2015 $(000)	FORECAST 2016 $(000)
NATURAL DISASTER FUND		
Capitalised reserves	1,500,000	1,500,000
RETAINED EARNINGS		
Opening balance at 1 July	(2,492,767)	(2,269,281)
New surplus and total comprehensive income	223,486	94,610
CLOSING BALANCE AT 30 JUNE	**(2,269,281)**	**(2,174,671)**
CLOSING BALANCE AT 30 JUNE	**(769,281)**	**(674,671)**

2.3 PROSPECTIVE **STATEMENT OF FINANCIAL POSITION**

AS AT 30 JUNE 2015 AND 30 JUNE 2016

	BUDGET 2015 $(000)	FORECAST 2016 $(000)
NATURAL DISASTER FUND		
Capitalised reserves	1,500,000	1,500,000
Retained earnings	(2,269,281)	(2,174,671)
TOTAL EQUITY	**(769,281)**	**(674,671)**
ASSETS		
Cash at bank*	(601,133)	(629,284)
Premiums receivable	53,038	53,569
Outstanding reinsurance and other recoveries	49,815	3,455
Other receivables	39,083	19,083
Prepayments	28,328	28,973
Investments	(26)	(71)
Property, plant and equipment	22,241	21,258
Intangible assets	15,358	16,110
TOTAL ASSETS	**(393,296)**	**(486,907)**
LIABILITIES		
Trade and other payables	(10,946)	(3,946)
Provisions	(1,212)	(212)
Outstanding claims liability	(150,178)	(37,098)
Unearned premium liability	(145,008)	(146,508)
Unexpired risk liability	(68,641)	–
TOTAL LIABILITIES	**(375,985)**	**(187,764)**
NET LIABILITIES	**(769,281)**	**(674,671)**

* Cash at bank is shown in assets despite its negative balance as the Crown has confirmed, in writing to the Commission, its obligation under Section 16 of the Act.

2.4 PROSPECTIVE **STATEMENT OF CASH FLOWS**

FOR THE YEARS ENDING 30 JUNE 2015 AND 30 JUNE 2016

	BUDGET 2015 $(000)	FORECAST 2016 $(000)
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash was provided from:		
Premiums	281,765	284,583
Reinsurance and other recoveries	1,125,009	46,071
Net GST	27,000	20,000
Cash was applied to:		
Outward reinsurance	(160,630)	(165,645)
Crown underwriting fee	(10,000)	(10,000)
Claims settlements and handling costs	(3,847,886)	(162,253)
Employees and other operating expenses	(25,336)	(22,267)
GeoNet operating expense	(5,891)	(6,000)
Research grants	(5,341)	(5,341)
NET CASH OUTFLOW FROM OPERATING ACTIVITIES	**(2,621,310)**	**(20,852)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash was provided from:		
Interest on investments	35,520	1
Sale of investments	1,672,145	–
Sale of property, plant and equipment	–	–
Cash was applied to:		
Purchase of investments	–	–
Purchase of property, plant and equipment	(5,058)	(3,476)
Purchase of intangibles	(10,379)	(3,825)
NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES	**1,692,228**	**(7,300)**
NET INCREASE/(DECREASE) IN CASH	**(929,081)**	**(28,151)**
Add opening cash brought forward	327,948	(601,133)
ENDING CASH CARRIED FORWARD	**(601,133)**	**(629,284)**

2.5 NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 PROSPECTIVE OPERATING EXPENDITURE EXCLUDING CLAIMS COSTS

FOR THE YEARS ENDING 30 JUNE 2015 AND 30 JUNE 2016

	BUDGET 2015 $(000)	FORECAST 2016 $(000)
Advertising and publicity	2,188	2,189
Fees paid to the auditor		
Audit of the financial statements	128	130
Commissioners' fees	220	220
Depreciation and amortisation of intangibles	6,464	7,532
Employee remuneration and benefits	8,048	8,344
Grants for earthquake research	4,299	4,349
GeoNet operating costs	5,891	6,000
Investment and Custodial expenses – third party	50	–
Office rental	454	454
Sponsorships	450	450
Other adminstration cost	13,890	9,472
Total operating costs excluding claims costs	**42,082**	**39,140**
EXPENDITURE GROUPED BY FUNCTION		
Catastrophe response programme	21,375	18,057
Public education	1,444	1,561
Research (excluding GeoNet)	9,002	9,580
GeoNet programme	9,221	9,395
Risk funding costs	1,040	547
Total expenditure by function excluding claims costs	**42,082**	**39,140**

NOTE 2 CLAIMS EXPENSE

FOR THE YEARS ENDING 30 JUNE 2015 AND 30 JUNE 2016

	2015 CURRENT YEAR $(000)	2015 PRIOR YEARS $(000)	2015 TOTAL $(000)	2016 CURRENT YEAR $(000)	2016 PRIOR YEARS $(000)	2016 TOTAL $(000)
Gross claims expense – undiscounted	(50,000)		(50,000)	(50,000)		(50,000)
Movement in discount		(55,353)	(55,353)		(2,043)	(2,043)
Amortisation of risk margin		229,773	229,773		4,871	4,871
Gross claims – discounted	**(50,000)**	**174,420**	**124,420**	**(50,000)**	**2,828**	**(47,172)**

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 ultimate parent is the New Zealand Crown.

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

The reporting period covered by these prospective financial statements is for the years ending 30 June 2015 and 30 June 2016.

BASIS OF PREPARATION

Measurement Base

The prospective financial statements have been prepared on an historical cost basis modified by the measurement of financial instruments at fair value through profit or loss, and the measurement of insurance liabilities and reinsurance recoveries at present value as set out below.

Functional and Presentational Currency

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

Going Concern

Actuarial estimates of the Commission's claims liabilities indicate that total liabilities exceed its assets after accounting for reinsurance. The Crown has confirmed in writing to the Commission, its intention to meet its obligation under Section 16 of the Act, to ensure that the Commission can meet all its liabilities as they fall due. Section 16 states: "If the assets of the Commission (including the money for the time being in the Fund) are not sufficient to meet the liabilities of the Commission, the Minister shall, without further appropriation than this section, provide to the Commission out of public money such sums by way of grant or advance as may be necessary to meet the deficiency upon such terms and conditions as the Minister determines."

The Board of Commissioners (the Board) has therefore adopted the going concern assumption in preparing these prospective financial statements.

Statement of Compliance

These prospective financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice. They comply with FRS 42 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 prospective financial statements.

Accounting Judgements and Major Sources of Estimation

The preparation of prospective financial statements in conformity with FRS 42 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.

Where the estimates and underlying assumptions are reviewed on an on-going 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 actuarial judgements and estimations involved in measuring insurance liabilities and reinsurance recoveries are key areas of estimation where the assumptions made may have a significant effect on the prospective financial statements, with a significant risk of material adjustment in future periods. The magnitude and number of Canterbury earthquakes have resulted in a higher than usual level of uncertainty associated with this measurement.

SIGNIFICANT ACCOUNTING **POLICIES**

INSURANCE

Gross Earned Premiums

Premium income is recognised using the 24ths method to approximate the contract period over which the premiums are earned. The underlying assumption of the 24ths method is that all premiums booked during a particular month can be approximated by an annual policy that incepts during the middle of the month. Premiums not earned at balance date are disclosed in the Statement of Financial Position as an unearned premium liability. Premiums receivable are reported net of discounts paid to collecting agencies.

Outward Reinsurance Premium Expense

Premiums paid to reinsurers are recognised by the Commission as outward reinsurance premium expense in the Statement of Comprehensive Income 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.

Reinsurance and Other (Reductions)/Recoveries

Reinsurance recoveries are the expected reimbursement of claims settlements and claims handling costs that the Commission can recover under its reinsurance contracts. Other recoveries comprise of reimbursement of expenditure incurred on behalf of other parties (predominantly the Crown or Crown Entities).

Reinsurance and other recoveries received or receivable on paid claims, reported claims not yet paid, claims incurred but not reported (IBNR), and claims incurred but not enough reported (IBNER) are recognised as revenue in the Statement of Comprehensive Income. They are measured as the present value of the expected future receipts, calculated on the same basis as the liability for outstanding claims.

Claims Reduction/(Expense)

Claims expenditure represents payments for claims, claims handling costs, the movement in the liability for outstanding claims and the associated risk margin.

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. The expected future payments include those in relation to claims reported but not yet paid, IBNR, IBNER and claims handling costs.

The outstanding claims liability, comprising all unpaid claims and claims handling expenses related to claims incurred prior to the end of the reporting period, is valued in accordance with the Professional Standard No 4 (General Insurance Business) of the New Zealand Society of Actuaries and NZ IFRS 4 – Insurance Contracts.

The risk margin associated with an event is amortised over the financial year to reflect a reduction in uncertainty within the central estimate as increased numbers of claims are settled.

Unexpired Risk Liability Reduction

At balance date, the Commission assesses the adequacy of the unearned premium liability by applying the liability adequacy test. The liability adequacy test determines whether the Commission's unearned premiums at balance date are sufficient to cover future claims arising from existing contracts.

The current estimate of the present value of the expected future cash flows relating to claims arising from the rights and obligations under current insurance contracts, with an additional risk margin included to allow for the inherent uncertainty exceeds the value of the unearned premium, the movement is recognised in the Statement of Comprehensive Income and recorded in the Statement of Financial Position as an unexpired risk liability.

The Commission performs a liability adequacy test, as specified by *NZ IFRS 4 – Insurance Contracts*, to determine whether the carrying amount of the unearned premium liability is sufficient to cover estimated future claims relating to existing contracts.

ASSETS BACKING INSURANCE LIABILITIES

All assets of the Commission back its insurance liabilities in accordance with Section 13(3) of the Act, 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".

GRANT PAYMENTS

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 contract is executed to ensure the performance criteria, on which approval of the grant was based, are met.

FOREIGN CURRENCY

Foreign currency transactions are translated into New Zealand dollars using the exchange rates prevailing at the transaction date. 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, 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 2007. Accordingly, no charge for income tax has been provided for.

The Commission pays transactional taxes such as Goods and Services Tax, Fringe Benefit Tax and Non Resident Withholding Tax.

GOODS AND SERVICES TAX (GST)

All items in the prospective financial statements are presented exclusive of GST, except for receivables and payables, which are presented on a GST-inclusive basis. Where GST is not recoverable it is recognised as part of the related asset or expense.

Net GST receivable or payable at balance date is included in receivables or payables in the Statement of Financial Position as appropriate. Commitments and contingencies are disclosed exclusive of GST.

The net GST paid or received, including the GST relating to investing and financing activities, is classified as an operating cash flow in the Statement of Cash Flows.

INVESTMENTS

Interest

Interest income is accrued using the effective interest method.

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 assets.

Unrealised Gains and Losses

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

FINANCIAL INSTRUMENTS

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 asset 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 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.

Cash at bank

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

Investments

All investment assets held by the Commission are to meet 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.

Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables with a maturity date within 12 months of the reporting date are recognised in current assets in the notes to the Statement of Financial Position while those with maturities greater than 12 months are recognised as non-current. Receivables are carried at amortised cost using the effective interest method less any impairment.

Other Financial Assets

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

Trade and Other Payables

Trade and other payables are recognised when the Commission becomes obliged to make future payments resulting from the purchase of goods and services. These are measured at amortised cost.

PROPERTY, PLANT AND EQUIPMENT

Overview

Property, plant and equipment is 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 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 in the period in which the transaction occurs.

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 and are included in the Commission's property, plant and equipment in the Statement of Financial Position.

Realised gains and losses arising from the 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. The estimated useful lives of different classes of property, plant and equipment are reviewed annually and are as follows:

Furniture and equipment	2–10 years
Leasehold improvements	0–9 years
Motor vehicles	5 years
Computer hardware	3 years
Canterbury event furniture and equipment	1.5–11.8 years
Canterbury event motor vehicles	3 years
Canterbury event computer hardware	1.5–2.5 years
GeoNet buildings	25 years
GeoNet computer equipment	3 years
GeoNet other equipment	8 years

INTANGIBLE ASSETS

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

Research and Development

Expenditure on research activities, undertaken with the prospect of gaining new scientific knowledge or understanding, is recognised in the Statement of Comprehensive Income 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 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 at rates calculated to allocate the cost or valuation of an item of intangible assets, less any estimated residual value, over its estimated useful life. The estimated useful lives of different classes of intangible assets are reviewed annually and are as follows:

Computer software	3 years
Canterbury event software	1.5–3 years

In 2007 the claims management system was implemented with a useful life of nine years. Any additions which have been added have been given shorter useful lives so the claims management system will be fully amortised by February 2017.

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, the 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 the Statement of Comprehensive Income.

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; or

» 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 favourable 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 lease expense.

LIABILITIES (OTHER THAN INSURANCE)

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 and the likelihood that employees 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 disclosed 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 disclosed 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.

SUPERANNUATION SCHEMES

Defined Contribution Schemes

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

COST ALLOCATION

Expenditure of the Commission is allocated across its four main functions: claims, research (excluding GeoNet), 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 average number of full time equivalents employed in each function during the financial year.

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.

These prospective financial statements have been prepared in accordance with the new public benefit entity four tier multi-standards framework that apply to the Commission from the 30 June 2015 financial statements. Preparation under the new framework has not resulted in any material changes. There are no other accounting policy changes in these prospective financial statements.

2.6 DISCLOSURES IN RELATION TO PROSPECTIVE FINANCIAL STATEMENTS

MAJOR ASSUMPTIONS UNDERLYING THE PROSPECTIVE FINANCIAL STATEMENTS

» Cash returns of 3.5% per annum.

» In order to meet claims payments over the foreseeable future we will be facilitating the sale of New Zealand Government stock and inflation indexed bonds in the 2015 financial year.

» Claims costs directly related to the occurrence of major events, and the claims they produce, have not been forecast. $50 million per annum has been provided for other claims settlements and fees.

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

» No change in Government policy in respect of Crown fees, taxation or premium levy rates.

» Reinsurance costs are based on management estimates prior to the 2014/15 round of negotiations.

» Estimates for Canterbury events claim expenses, liabilities and cash flows are based on the December 2013 actuarial update prepared by Melville Jessup Weaver.

The following actuarial assumptions were used in determining the claims liability at that date:

Weighted average term to settlement	0.81 years
Claims inflation rate per annum	2.5%
Demand surge per annum	0% to 15%
Discount rate per annum	3.1% to 4.9%
Risk margin	8.5%
Claims handling expense ratio	7.0%

» The central estimate value plus net risk margin has been used for claims cash flows.

PURPOSE OF PROSPECTIVE FINANCIAL STATEMENTS

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

DEGREE OF UNCERTAINTY ATTACHING TO PROSPECTIVE FINANCIAL STATEMENTS

(a) 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 future major events, or costs directly associated with them, has been made, due to the high level of uncertainty in any estimate.

(c) Some key sources of actuarial uncertainty in relation to Canterbury estimates include: the impact of multiple events on Commission coverage, severe land damage, a complex claims environment from both an engineering and legal perspective, and the potential for construction costs to exceed expectations.

FACTORS THAT MAY LEAD TO MATERIAL DIFFERENCES 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 the Commission could significantly impact on future actual financial statements.

(b) Changes in any of the actuarial assumptions noted above could result in changes to the Commission's claims liability.

(c) Reinsurance premiums are based on estimates made prior to renewal of contracts for the 2014–15 year and actual premiums paid may differ from estimates due to changes in rates charged by reinsurers and levels of cover achieved.

(d) The outcome of current legal proceedings, notably a Declaratory Judgment regarding the policies and approach adopted by EQC to identify and settle certain land damage claims, have the potential to significantly increase, or decrease, the Commission's claims liability.

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 the Commission on 14 April 2014. The Board of the Commission 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. The Commission does not intend to update the prospective financial statements subsequent to presentation.

These prospective financial statements comply with FRS 42.

OUTPUT CLASS	REVENUE	EXPENDITURE
1: Administration of the EQC Act, Insurance Scheme and Natural Disaster Fund	$282.3 million	$171.0 million
2: Claims handling and the Catastrophe Response Programme (Customer Services)	Nil	$21.4 million
3: Research	Nil	$18.2 million
4: Public Education	Nil	$1.4 million

New Zealand Government