



EARTHQUAKE COMMISSION
KŌMIHANA RŪWHENUA

annual report 2006-2007



contents

Highlights	2
Chairman's Report	4
General Manager's Report	6
Natural Disaster Claims Locations	10
Research Projects Completed	12
Financial Statements	14
Statement of Service Performance	35
Statement of Responsibility	39
Directory	40

2006-07
Highlights

New Claims System

The development of a new internet-based claims management system is well under way. Expected to be operational at the beginning of 2008, the new system will give EQC the reliability and ease-of-use required to deal with the enormous influx of claims that will follow a catastrophic natural disaster. Such an event could generate 100,000 claims – more than 10 times the number the Commission would usually handle in a year.

EQC-Funded QuakeTrackers Programme for Seismographs in New Zealand Schools

The QuakeTrackers schools programme, designed to educate students about seismology and to encourage further study in the field, won EQC support during the year. The innovative programme will centre on a network of simple and robust seismographs in schools, the development of educational resources and a website.

“It’s Our Fault” Research Project Launched

EQC, along with the Wellington City Council and ACC, launched “It’s Our Fault” in December. “It’s Our Fault” is a major research project to improve understanding of the Wellington region’s vulnerability to large earthquakes. The aim of the seven-year, \$3.5 million project, led by GNS Science and involving researchers from NIWA and Victoria University, is to better define Wellington’s earthquake risk using the latest geological techniques and sophisticated computer modelling.

New Research Partnership with Auckland University

This year EQC formed a new partnership with the University of Auckland to support research on volcanic hazard and risk, geotechnical engineering and earthquake engineering. The Commission will contribute \$1.3 million over five years to the interdisciplinary research that will improve New Zealand’s capacity to assess and mitigate geological risk.

Field Office Set up in Whangarei

EQC set up a field office in Whangarei to handle the 630 claims from the March storm and flooding in Northland. Around 20 loss adjusters, estimators and administration staff continue to work out of the office which is expected to stay open until October 2007. A field office in the affected area helps EQC settle claims as quickly as possible and ensures we continually improve the comprehensive arrangements we have in place to respond to natural disasters.



Chairman's report

At the close of the financial year, New Zealand's Natural Disaster Fund (NDF) stood at \$5.43 billion.

In last year's Annual Report I raised an important public policy question. The Natural Disaster Fund, supported by our reinsurance programme, could now (just about) meet the probable maximum liability which EQC could face after a natural disaster as defined in our Act. This state of affairs is the envy of other countries with institutional arrangements to reduce the financial risk, or fund the cost, of natural disasters. It has come about through the foresight of those who established the original Earthquake and War Damage scheme in 1944, combined with the good fortune that since then no catastrophic natural event has occurred in a New Zealand centre of population, and therefore devastated our built environment.

The question I raised last year was whether the Government or the New Zealand public would find it an acceptable risk that a second catastrophic event, such as an earthquake or tsunami, could occur before the NDF had adequately recovered.

During the year EQC began a programme of work to help, in part, answer this question. The question can be redefined in "lay person's" terms as:

- ✦ What is the maximum liability that EQC is likely to face in the event of a major natural disaster in New Zealand? (In effect this would be a Wellington earthquake of about magnitude 7.5.);

- ✦ After meeting this liability, what should be the residual size of the Natural Disaster Fund to enable it to be rebuilt within a reasonable time? The underlying assumption here is that the NDF is not in place for a one-time pay-out, but should be a permanent feature of this country's armoury for disaster recovery.

These questions, the responses to which require complex probability and financial analysis, do not by themselves lead to an answer on the optimal size or structure of the NDF. Since 1988 EQC has laid off a portion of its risk in the world reinsurance market. The quantum and structure of EQC's reinsurance programme needs to be factored into the analysis, as does the investment strategy for the NDF.

There are two further considerations. EQC provides cover of up to \$100,000 for residential properties, and \$20,000 for contents. These limits, or "caps" as they are commonly termed, were set in 1993. The value of this cover has eroded considerably, at the same time as residential building costs have escalated. In effect, the scheme today is not the scheme approved by the Government in 1993. In my view, whether, when, and by what amount the caps should be increased to bring the current scheme closer to its original intent require examination and an explicit Government decision.

The second consideration is one which I have raised before. Although the EQC scheme was designed around the risks to New Zealand's households of three main natural events, earthquake, volcanic eruption and tsunami,

payments for weather-related damage are the most costly of EQC's month-by-month claims settlements. Our traditional risks remain, but the combination of new patterns of urban and so-called life-style developments, and climate change, raise the question whether the mandate and coverage of the scheme is right for New Zealand in the 21st Century.

These issues are both complex and inter-related. They will form the major part of our policy work programme in 2007/08.

I referred above to EQC's investment strategy. EQC started to invest in overseas equities in 2001. Last year we began a series of reviews on how this programme was working, and how it might be improved. These included:

- + The mix of our investment managers, including their styles and relative weightings in our portfolio;
- + The governance arrangements for the portfolio, including the best balance between internal and contracted resources;
- + The provisions of EQC's agreements with our investment managers as they relate to the requirement to avoid "prejudice to New Zealand's reputation as a responsible member of the world community".

The latter are, in effect, EQC's responsible investment guidelines to the investment managers. We have come to the view that, while necessary, they are insufficient to meet the legitimate concerns of the Government and the public that our investment programme should reflect sound international practice and standards for responsible investment. Nor are they as clear as they might be for our investment managers. We have responded by:

- + Agreeing to establish a more formal and comprehensive responsible investment policy for EQC. This will be in place by the end of this calendar year;
- + Following approval of this policy, considering becoming a signatory to the United Nations Principles for Responsible Investment (UNPRI);
- + In advance of both of these, divesting of tobacco stocks. This decision was taken in June, and our investment managers were given a month to put the decision into effect. Although our preferred approach is engagement with companies where we have responsible investment concerns, the nature of this product, the history of behaviour of major tobacco companies, and the bipartisan support in

New Zealand for programmes and legislation to limit tobacco use and mitigate its harmful effects, all pointed to divestment as the sensible option;

- + Reporting more fully in the Annual Report on the way we give effect to our responsible investment policies. Readers will see the first steps in this direction on page 38.

I am sure that we will continue to refine our approach in this important area over the next year or more.

Finally I acknowledge all on the EQC Board who have served in this capacity during 2006/07, and the staff of EQC. This country is well served by the skill and dedication of these people.

Michael Wintringham
Chairman



A GPS antenna on top of a survey mark in Taihape. The antenna is one component of the EQC-funded GeoNet equipment being used to monitor an ancient landslip on the western edge of the town. Movement of the slip has been slowed by the installation of drains and monitoring continues.

General Manager's report



Helping New Zealanders recover from natural disasters is at the heart of what EQC does. In addition to the provision of insurance and public education, support for natural disaster research is a fundamental component of our work.

Employing a range of approaches to facilitate recovery and improve resilience is crucial in a country where Nature never lets us forget her power. All too often this year we've seen unrelenting rain, landslips and major damage to property. Earthquakes also damaged homes and served as frequent reminders of New Zealand's vulnerability to seismic hazards.

EQC-funded natural disaster research improves understanding of the hazards and risk we live with, it supports training and capability development, and advances technology to prevent or reduce the impact of natural disasters across a range of disciplines – earth science, civil engineering, architectural design, building technologies, social science and emergency management.

The value of this research was highlighted in June when RMS, the world's leading provider to the insurance industry of products and services for the quantification and management of catastrophe risks, released a full upgrade of their New Zealand earthquake model, with net reductions in average annual loss ranging from 20-60%.

The model utilises research largely funded by the Foundation for Research, Science and Technology and the Earthquake Commission, and carried out by GNS Science, New Zealand universities and other New Zealand research providers. It is used extensively by insurers to price natural hazard risk and incorporates a decade's advance in understanding of earthquake hazard and the availability of improved data.

Claims Handling and Catastrophe Response Programme

The first half of 2007 has seen a great deal of work put into the design and development of a new internet-based claims management system which is expected to be operational at the beginning of 2008. The Commission needs a robust, scalable application that we can rely on at our time of greatest challenge – following a catastrophic natural disaster. Whilst we normally have just a couple of thousand claims per year, we could, following a major earthquake or volcanic eruption, suddenly face over 100,000 from a single event. The new system will give us the reliability and ease-of-use required to handle the claims and quickly train the many new contractors we will need to take on at such a time.

In early April we set up a temporary field office in Whangarei to handle the claims generated by the flooding

in Northland. This is the fourth time in the past three years that the Commission has established a temporary field office (they were also set up following the Fiordland earthquake in November 2004, the Upper Hutt earthquake of January 2005 and the Bay of Plenty storm of May 2005). Once again the process has enabled us to continuously improve the arrangements that EQC has in place to respond to natural disasters.

Liaison and coordination with other agencies, particularly local authorities, remains important to the claims handling process and has continued throughout the year.

Administration of the Scheme

The Commission uses two key measures to review the administration of its scheme. The first is our programme of regular audits to ensure the integrity of premium payments from insurance companies. Of the 12 external auditors' opinions received, three identified internal control weaknesses. The necessary upgrades to the insurance companies' systems were made.

The second measure is maintenance of expenditure within agreed parameters. EQC's operating expenditure, \$27.19 million, came within the budget set for the year.

Research

"It's Our Fault", a multi-disciplinary reassessment of Wellington's seismic hazard and risk, funded by EQC, Wellington City Council and ACC, was launched in December. Led by GNS Science and including researchers from NIWA and Victoria University, the study aims to redefine our understanding of Wellington's seismic risk and represents an advance in the way EQC partners with other agencies to achieve complementary goals.

EQC invests in the development and maintenance of research capacity in New Zealand and this year a new partnership has been created with the University of Auckland. The partnership supports interdisciplinary research on volcanic hazard and risk, geotechnical engineering and earthquake engineering. The Commission will contribute \$1.3m over five years to the partnership, which will improve New Zealand's capacity to assess and mitigate geological risk.

Earthquake and volcanic activity forecasting are receiving increasing attention internationally. During June the Commission facilitated a workshop to develop a research agenda and plan for the study of these so-called time-

varying aspects of volcano and earthquake hazards in New Zealand. Researchers from GNS Science, Massey University and Victoria University attended the workshop as well as several international partners from Europe, USA and Japan. EQC's support for this initiative reflects the importance of ensuring that New Zealand builds and retains the capacity to develop accurate local hazard forecast models rather than relying on generalised global models.

Sponsorship of technical workshops, scientific conferences and seminars, and creation of a "Science to Practice" programme to improve the application of research funded by EQC, also contributed to a full and encouraging year. One highlight was a study of issues that affect landslip risk management decisions, examining such aspects as technical knowledge, professional practice and changing risk environments.

Public Education

Support for the very popular exhibitions, *Volcanoes* at the Auckland War Memorial Museum and *Awesome Forces* at Te Papa, remains a cornerstone of EQC's public education activity.

In October the *Awesome Forces* exhibition was complemented by a third successful biennial natural disaster weekend. "Earth Rocks @ Te Papa" drew crowds to the museum with exciting activities designed to raise people's awareness of what they can do to prepare for natural disasters in general and earthquakes in particular.

The Commission's second five-year sponsorship of Te Papa will come to an end in December 2007. Te Papa and the Commission have agreed terms for a new sponsorship that will deliver greater benefits to visitors, researchers, the general public and schools over the next five years.

A third museum sponsorship was confirmed in June when the Commission gave its support to the renewal of the 1931 earthquake exhibition at the Hawke's Bay Museum and Art Gallery. As the most deadly natural disaster in our history, the 1931 earthquake's role as a powerful reminder of natural disaster risk in New Zealand is compelling. Further, its location in the Hawke's Bay is consistent with EQC's plan to increase its profile throughout the country.

The QuakeTrackers programme, designed to educate school students about seismology and to encourage further study, also won EQC support during the year. The revised programme will centre on a network of simple and robust seismographs, the development of educational resources and the development of a new website.

The Commission's programme of activity to meet the needs of minority ethnic communities continues to ensure our messages reach all New Zealanders in an increasingly ethnically diverse country. This year's activity concentrated on new-migrant Chinese and Pacific Island communities and included a brochure, feature articles, web-based material and a radio interview.

Policy Advice

The Treasury review of EQC was presented to Cabinet in March as a report titled "Options to improve insurance coverage for all New Zealand households". EQC does not expect any changes to its Act or Regulations as a consequence of the report.

Management of the Natural Disaster Fund

The Natural Disaster Fund peaked at \$5.57 billion in May but the renewed strength of the New Zealand dollar in June saw the Fund close the financial year at \$5.43 billion. This is an increase of \$16 million or 0.3% over last year's total at balance date.

The return was affected by the continued rise of domestic interest rates and the strong New Zealand dollar. The high interest rates meant a low return from our large New Zealand Government stock portfolio. The surge in the New Zealand dollar saw the value of our offshore equity investments fall, despite strong underlying global equity returns. (In local currency terms the benchmark index returned 21.54%, but the currency translation meant a return of -2.40%.)

Despite the short-term noise generated by currency movements, our rolling two and three year returns continue to show that diversification into global equities is benefitting the Natural Disaster Fund. Longer term results will always be more relevant than shorter term numbers as short-term market reactions are smoothed out.

EQC does not hedge its foreign currency exposures for a number of reasons, most importantly because we do not intend to repatriate our global equities unless a major natural disaster occurs. Such an event would itself influence the value of the New Zealand dollar. The decision not to hedge was made when the Commission first diversified its investment portfolio in 2001 and is subject to review. A range of factors will be taken into consideration when we look at whether or not to continue with this policy. No change can be made to EQC's hedging policy without consulting the Minister of Finance.

About 62% of EQC's portfolio is in New Zealand Government stock (NZGS) and inflation-indexed bonds. EQC manages the bond portfolio passively because it is a significant holder of New Zealand bonds (at 29 June EQC held 12% of NZGS on issue, and 23% of inflation-indexed bonds). Our returns of 1.82% for NZGS and 2.58% for inflation-indexed bonds, though well below long run averages, were in line with the respective indices.

Treasury bills and bank bills produced the best yields for the year. We were able to take advantage of rising interest rates and as a result this class of investments returned 7.67%.

ASSET CLASS	ACTUAL RETURN	BENCHMARK/TARGET RETURN
NZ Government Stock	1.8%	1.8%
NZ Government Inflation-Indexed Bonds	2.6%	2.5%
Bank Bills (registered certificates of deposit)/Treasury Bills	7.7%	7.6%
Passive Global Equities	-2.1%	-2.4%
Active Global Equities	-4.0%	-2.4%
Total Portfolio	0.7%	2.8%*

* The target total portfolio return is 1% p.a. over the NZGS index return. The return and target return shown are for the financial year only even though the real measure is over a rolling 10-year period. The structure has not been in place long enough to compare 10-year returns. For the three years to 30 June 2007 the actual return was 6.9% versus the target return of 6.0%.

GLOBAL EQUITY ALLOCATION AS AT 30 JUNE 2007* (TARGET POSITION IN BRACKETS)	
Passive investment allocation	40.6% (40%)
Active investment allocation	59.4% (60%)
	+ Core 39.8% (40%)
	+ Value 31.5% (30%)
	+ Growth 28.7% (30%)

*Global equities comprised 30.1% of the total

The Commission's global equity structure, along with our overall strategic asset allocation, is unchanged. EQC continues to consider further diversification of its investment portfolio, and limited use of emerging market equities will be introduced in the coming financial year.

The Commission has three equally important objectives to consider when managing the Fund – to maximise returns without undue risk, to maintain best practice portfolio management and to avoid prejudice to New Zealand's reputation as a responsible member of the world community.

With over three years' experience in active global equities, we continue to evolve our thinking on responsible investment and the requirement to avoid prejudice. EQC is currently working on formalising its responsible

investment policy. When a clear case could be made for the exclusion of tobacco stocks from EQC's portfolio as being in contravention of our responsible investing duty and not prejudicing our other objectives, EQC instructed its managers to divest.

Although returns were low for the financial year, EQC is comfortable that its investment strategies, guided by investment advisors and subject to external restrictions, do not expose the Fund to undue risk. EQC keeps abreast of changes in the investment arena and adopts a fairly conservative approach, taking into account EQC's unique liability profile. As we are unable to predict when a catastrophic natural disaster may occur, and thus when funds may be needed, we don't invest directly in illiquid securities.

EQC has reinsurance cover in place to protect the Natural Disaster Fund from the full financial impact of a catastrophic disaster. The Commission's annual reinsurance negotiations in May delivered improved coverage. New Zealand's distance from other natural disaster zones (such as the United States, Japan and Europe), few major natural disasters around the world during the year and EQC's reputation in the reinsurance market all contributed to this positive outcome. (The changes to the RMS risk model were announced during the Commission's annual reinsurance negotiations and may have contributed to the result.)

EQC contracts with financially secure reinsurance entities, as assessed mainly by industry rating agencies. The ratings of several such companies, and of Lloyds, have been upgraded in the past 12 months and this in turn improves the overall security rating of the Commission's reinsurance programme.

The team at EQC is small but dedicated and loyal – the average length of service for the organisation is more than seven years. We also have our dedicated claims administration staff in Brisbane and those who have worked out of our field office during the year. I would like to thank everyone for their hard work over the past 12 months, their commitment and the empathy they have shown to claimants at times when many faced devastating loss. It is greatly appreciated.



David Middleton
General Manager

EQC received more than 600 claims from the Northland floods in March. EQC's cover provided funds for this massive slip in Opua (Bay of Islands) to be repaired.



A house severely damaged by the 1931 Hawke's Bay earthquake. EQC is supporting the renewal of the 1931 earthquake exhibition at the Hawke's Bay Museum and Art Gallery. Alexander Turnbull Library, Wellington

Natural Disaster Claims Locations

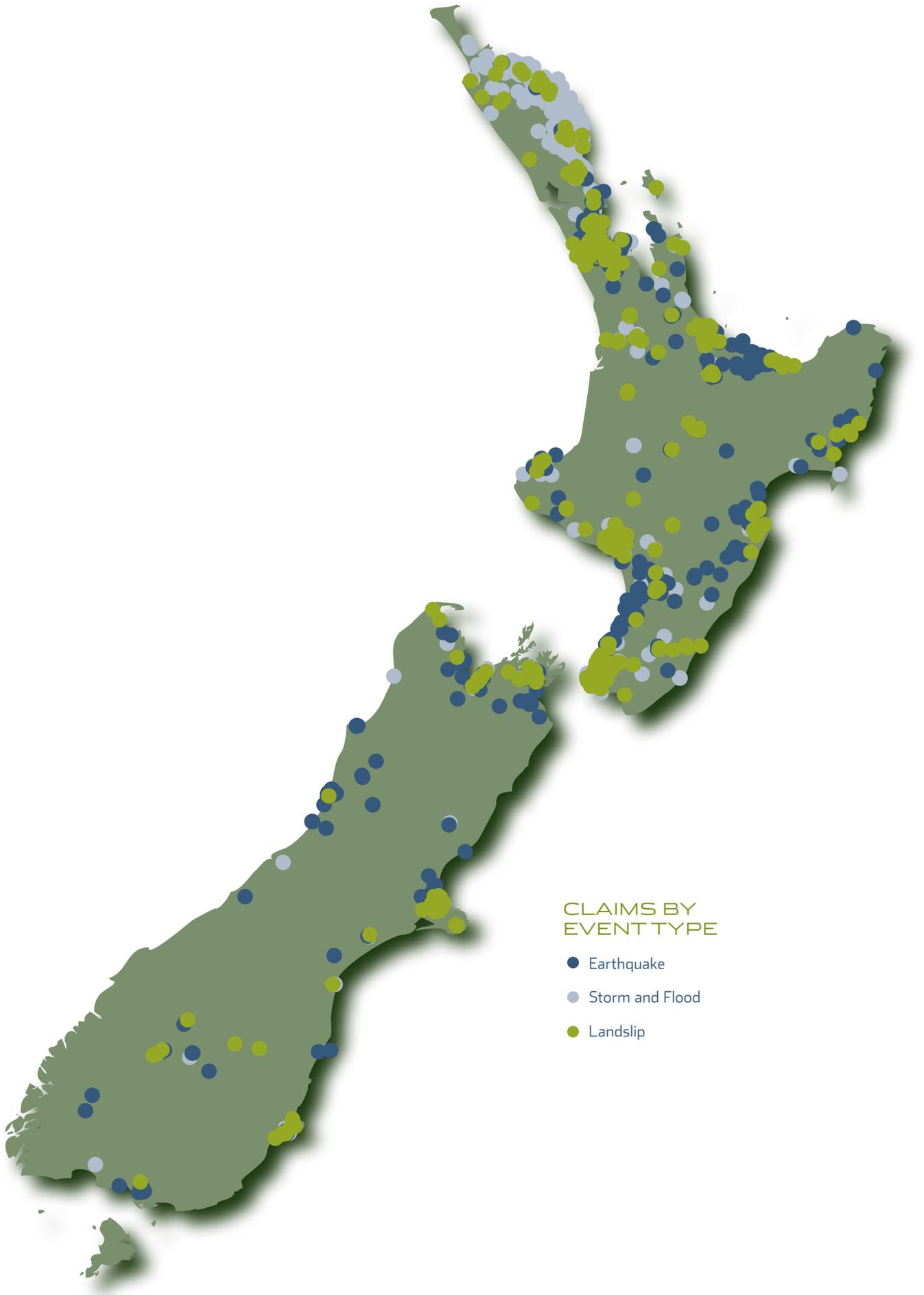
FOR CLAIMS ARISING IN THE FINANCIAL YEAR

	2006-2007		2005-2006		AVERAGE OF PRIOR 5 YEARS	
	NO. OF CLAIMS	COST (000)	NO. OF CLAIMS	COST (000)	NO. OF CLAIMS	COST (000)
Earthquake	1,522	\$2,673	662	\$1,144	2,518	\$6,654
Landslip	1,015	\$19,418	533	\$9,967	770	\$6,889
Storm and Flood	833	\$12,728	277	\$1,110	1,065	\$14,076
Hydrothermal Activity	0	\$0	1	\$0	4	\$111
Volcanic Eruption	0	\$0	0	\$0	1	\$0
Total	3,370	\$34,819	1,473	\$12,221	3,932	\$22,101

Notes:

Storm and flood were only separated out from mid-2001 onwards.

The Financial Statements disclose claims payments made and incurred, and include claims settlement costs, in the financial year, so figures are different from those in this table.



Research Projects Completed

Evaluating New Zealand models for short-term earthquake probability

T Tormann, M Savage – Victoria University of Wellington

M Stirling – GNS Science

(EQC funded project 04/OPRIA)

Role of residual displacements in performance-based seismic assessment, design and retrofit of reinforced concrete buildings and bridge structures: Assessment and mitigation strategies

S Pampanin (Editor) – University of Canterbury

(EQC funded project 05/U507)

Eruption patterns in monogenetic volcanic fields

J Cassidy – University of Auckland

(EQC funded project 03/491)

Search for temporal changes in seismic attenuation on Mt Ruapehu volcano

M Savage, T Hurst, T Kuehler – Victoria University of Wellington

(EQC funded project 04/U509)

A high frequency magnetotelluric survey of Mount Ruapehu

M Ingham – Victoria University of Wellington

H Bibby – GNS Science

(EQC funded project 06/519)

Mechanisms of late quaternary coastal uplift along the Raukumara Peninsula segment of the Hikurangi Margin, North Island, New Zealand

K Wilson, T Little – Victoria University of Wellington

K Berryman, U Cochran, N Litchfield – GNS Science

(EQC funded project 03/U501)

Indicators of paleoseismic activity along the western Hope Fault

R Langridge, R Robinson – GNS Science

R Duncan – Landcare, Lincoln University

P Almond – Lincoln University

(EQC funded project 03/487)

The adequacy of existing house foundations to resist earthquakes: Cost benefit of upgrading

G Thomas, J Irvine – Victoria University of Wellington

(EQC funded project 05/U530)

Influence of precast prestressed flooring on the seismic performance of reinforced concrete perimeter frame buildings

D Lau, R Fenwick, B Davidson – University of Auckland

(EQC funded project 01/464)

Quaternary geometry, kinematics and paleoearthquake history at the intersection of the strike-slip North Island fault system and Taupo rift, New Zealand

V Mouslopoulou – Victoria University of Wellington

(EQC funded project 03/U500)

The role of community participation in post-disaster recovery: Lessons from recent earthquakes and flood events

D Johnston – GNS Science

(EQC funded project 06/524)

From science to practice: Community-based public education initiatives

K Finnis – Joint Centre for Disaster Research, Massey University/GNS Science

(EQC funded project OPR6)

Managing landslip risk: Improving practice

T Day, B Riddolls (facilitated by CAENZ)

(EQC funded project OPR5)

Bounds on the distribution of amplitudes in ground motion prediction models

J Zhao, J Zhang – GNS Science

J Fisher, P Somerville – Risk Frontiers

(EQC funded project 06/512)

A procedure for delineating debris-flow hazards on alluvial fans

A Welsh, T Davies – University of Canterbury

(EQC funded project 06/U528)

Behaviour of piles in liquefiable deposits during strong earthquakes

M Cubrinovski, H Bowen – University of Canterbury

(EQC funded project 06/U533)

Characterisation of undrained behaviour of Christchurch soils

M Cubrinovski, S Rees, E Bowman – University of Canterbury

(EQC funded project 06/U532)

2006-07
Financial
Statements

Audit report TO THE READERS OF THE EARTHQUAKE COMMISSION'S FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION FOR THE YEAR ENDED 30 JUNE 2007

AUDIT NEW ZEALAND Mana Arotake Aotearoa

The Auditor-General is the auditor of the Earthquake Commission (the Commission). The Auditor-General has appointed me, Devan Menon, using the staff and resources of Audit New Zealand, to carry out the audit on his behalf. The audit covers the Financial Statements and Statement of Service Performance included in the Annual Report of the Commission for the year ended 30 June 2007.

UNQUALIFIED OPINION

In our opinion:

- + The Financial Statements of the Commission on pages 17 to 34:
 - comply with generally accepted accounting practice in New Zealand; and
 - fairly reflect:
 - + the Commission's financial position as at 30 June 2007; and
 - + the results of its operations and cash flows for the year ended on that date.
- + The Statement of Service Performance of the Commission on pages 35 to 38:
 - complies with generally accepted accounting practice in New Zealand; and
 - fairly reflects for each class of outputs:
 - + its standards of delivery performance achieved, as compared with the forecast standards outlined in the statement of forecast service performance adopted at the start of the financial year; and
 - + its actual revenue earned and output expenses incurred, as compared with the forecast revenues and output expenses outlined in the statement of forecast service performance adopted at the start of the financial year.

The audit was completed on 13 September 2007, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Board and the Auditor, and explain our independence.

BASIS OF OPINION

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the Financial Statements and Statement of Service Performance did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the Financial Statements and the Statement of Service Performance. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

The audit involved performing procedures to test the information presented in the Financial Statements and Statement of Service Performance. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

- + determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- + verifying samples of transactions and account balances;
- + performing analyses to identify anomalies in the reported data;
- + reviewing significant estimates and judgements made by the Board;
- + confirming year-end balances;

- + determining whether accounting policies are appropriate and consistently applied; and
- + determining whether all Financial Statement and Statement of Service Performance disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the Financial Statements or Statement of Service Performance.

We evaluated the overall adequacy of the presentation of information in the Financial Statements and Statement of Service Performance. We obtained all the information and explanations we required to support our opinion above.

RESPONSIBILITIES OF THE BOARD AND THE AUDITOR

The Board is responsible for preparing Financial Statements and a Statement of Service Performance in accordance with generally accepted accounting practice in New Zealand. The Financial Statements must fairly reflect the financial position of the Commission as at 30 June 2007 and the results of its operations and cash flows for the year ended on that date. The Statement of Service Performance must fairly reflect, for each class of outputs, the Commission's standards of delivery performance achieved and revenue earned and expenses incurred, as compared with the forecast standards, revenue and expenses adopted at the start of the financial year. The Board's responsibilities arise from the Crown Entities Act 2004 and Earthquake Commission Act 1993.

We are responsible for expressing an independent opinion on the Financial Statements and Statement of Service Performance and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and the Crown Entities Act 2004.

INDEPENDENCE

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

In addition to the audit, we carried out assurance related assignments in the area of quality assurance over the catastrophe response systems, which are compatible with those independent requirements.

Other than the audit, and these assignments, we have no relationship with or interests in the Commission.



D MENON

Audit New Zealand
On behalf of the Auditor-General
Wellington, New Zealand

MATTERS RELATING TO THE ELECTRONIC PRESENTATION OF THE AUDITED FINANCIAL STATEMENTS

This audit report relates to the financial statements of the Earthquake Commission for the year ended 30 June 2007 included on the Earthquake Commission's web site. The Earthquake Commission's Board is responsible for the maintenance and integrity of the Earthquake Commission's web site. We have not been engaged to report on the integrity of the Earthquake Commission's web site. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

The audit report refers only to the financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the audited financial statements and related audit report dated 13 September 2007 to confirm the information included in the audited financial statements presented on this web site.

Legislation in New Zealand governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement of Accounting Policies

FOR THE YEAR ENDED 30 JUNE 2007

REPORTING ENTITY

These are the Financial Statements of the Earthquake Commission, a body corporate under Section 4 of the Earthquake Commission Act 1993. They have been prepared in accordance with the Crown Entities Act 2004 and the accounting policies set out below.

MEASUREMENT SYSTEM

The Financial Statements are prepared following the general accounting principles of historic cost accounting, modified by the valuation of investments as stated in the specific accounting policies below.

The Commission has not recognised future liabilities or assets for future natural disaster events.

It is recognised that the Fund plus reinsurances may not be sufficient to cover claims arising from a major urban catastrophe and/or other losses and costs. In those events the Crown would be called upon to meet any shortfall, under Section 16 of the Earthquake Commission Act 1993.

ACCOUNTING POLICIES

REVENUE RECOGNITION

Premiums

Premium income represents premiums collected and paid to the Commission by insurance companies and brokers. In accordance with Section 24 (ii) of the Earthquake Commission Act 1993, the Commission receives declarations provided by insurance companies and brokers that all premiums collected have been returned to the Commission. It also contracts external auditors of insurance companies and brokers to review and report on those companies' internal controls and accounting systems so far as they are related to the Commission's premiums.

Premium income is recognised on an accrual basis with a liability for unearned premiums recognised using the 24ths rule.

Investment Income

Income from investments includes:

- + Full accrued interest with premium or discount arising on the purchase of investments being amortised over the life of those investments;
- + Realised gains/losses, including currency gains/losses, on sale of investments;
- + Unrealised gains/losses on all securities, including currency gains/losses.

FINANCIAL INSTRUMENTS

The Commission is party to financial instrument arrangements as part of its everyday operations. These financial instruments include bank accounts, short-term investments, Government securities, global equities, accounts receivable and accounts payable.

Revenue and expenses in relation to all financial instruments are recognised in the Statement of Financial Performance.

The Commission has not entered into transactions involving off-balance sheet instruments.

FOREIGN CURRENCY

Foreign currency transactions are converted at the New Zealand dollar exchange rate at the date of the transaction.

Monetary assets and liabilities are translated to New Zealand dollars at the closing mid-point exchange rate. The resulting unrealised exchange gain or loss is recognised in the Statement of Financial Performance.

INVESTMENTS

Investments are stated at their market value. The net change in value of these investments is recognised in the Statement of Financial Performance.

PROVISION FOR EMPLOYEE ENTITLEMENTS

Annual leave, long service leave and time off in lieu are recognised as they accrue to employees.

CLAIMS

Claims expenditure includes assessor fees and related expenses. A liability is recognised for those claims notified but not settled at balance date together with claims incurred but not reported, where such is deemed necessary.

The Commission does not budget for claims.

FIXED ASSETS

The initial cost of a fixed asset is the value of the consideration given to acquire or create the asset and any directly attributable costs of bringing the asset to working condition for its intended use.

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 fixed assets in the Statement of Financial Position.

DEPRECIATION

Depreciation of fixed assets is provided on a straight line basis so as to allocate the cost of assets, less any estimated residual value, over their economic useful lives.

The estimated economic useful lives are:

Furniture and Equipment	10 years
Motor Vehicles	5 years
Computer and other Electronic Equipment	3 years
Claims Management System Development	9 years
GeoNet Assets	3-25 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. The development cost associated with the claims management system will be amortised over the life of the associated services contract.

LEASES

The Commission leases office premises. As all the risks and rewards of ownership are retained by the lessor, these leases are classified as operating leases. Operating lease costs are expensed in the period in which they are incurred.

PREMIUMS

Premiums receivable are reported net of applicable discounts.

GRANTS FOR EARTHQUAKE RESEARCH

The Commission provides grants for earthquake research. The grants are recognised as expenditure in the period in which they are incurred since the Commission obtains no direct measurable financial benefit. The benefit to the Commission relates to possible reduction in future claims potential.

STATEMENT OF CASH FLOWS

The following are the definitions of the terms used in the Statement of Cash Flows.

- (a) Cash is considered to be cash on hand and current accounts in banks, net of bank overdrafts.
- (b) Investing activities are those activities relating to the acquisition, holding and disposal of fixed assets and of investments. Investments can include securities not falling within the definition of cash.
- (c) Financing activities are those activities which result in changes in the size and composition of the capital structure of the Commission. This includes both equity and debt not falling within the definition of cash. Dividends paid in relation to the capital structure are included in financing activities.
- (d) Operating activities include all transactions and other events that are not investing or financing activities.

GOODS AND SERVICES TAX (GST)

The Statement of Financial Performance, Statement of Movements in Equity, Statement of Cash Flows and Statement of Commitments are exclusive of GST. The Statement of Financial Position is also exclusive of GST except for payables and receivables 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 classified as a current asset or current liability as appropriate.

TAXATION

The Earthquake Commission is a public authority in terms of the Income Tax Act 2004 and consequently is exempt from income tax.

COMMITMENTS

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

CONTINGENT LIABILITIES

Contingent liabilities are disclosed at the point at which the contingency is evident.

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies since the date of the last audited Financial Statements.

All policies have been applied on a basis consistent with previous years.

Statement of Financial Performance

FOR THE YEAR ENDED 30 JUNE 2007

	(NOTES)	ACTUAL 2007 \$(000)	BUDGET 2007 \$(000)	ACTUAL 2006 \$(000)
UNDERWRITING INCOME				
Net Earned Premiums	1	83,750	83,922	82,401
Reinsurance Costs	2 & 8	(31,022)	(35,000)	(30,804)
		52,728	48,922	51,597
INVESTMENT INCOME				
Investment Income	3 & 8	46,682	356,281	691,012
		99,410	405,203	742,609
EXPENDITURE				
Advertising and Publicity		1,512	2,001	1,515
Audit Fees		79	53	50
Other Services Provided by Auditor		25	20	10
Catastrophe Response Programme		5,111	6,019	4,342
Commissioners' Fees	14	147	170	145
Communication and Computer Costs		321	317	427
Consultants		503	702	475
Depreciation	12	1,858	1,408	1,450
Grants for Earthquake Research		1,431	1,943	916
GNS Science GeoNet Operating Costs		5,266	5,190	4,586
Investment and Custodial Expenses		6,799	7,377	7,080
Office Rental		299	303	369
Salaries and Wages	14	1,862	1,916	1,775
Sponsorships		999	1,515	906
Other Expenses		979	943	1,117
		27,191	29,877	25,163
		72,219	375,326	717,446
SURPLUS AVAILABLE TO PAY CLAIMS				
CLAIMS				
Earthquake, Volcanic and Hydrothermal		3,957	0	1,476
Landslip		42,474	0	15,523
		46,431	0	16,999
		25,788	375,326	700,447
CROWN PAYMENTS				
Section 16 and 17 "Deficiency in Fund" Fee	7	10,000	10,000	10,000
		15,788	365,326	690,447

Statement of Movements in Equity

FOR THE YEAR ENDED 30 JUNE 2007

	(NOTES)	ACTUAL 2007 \$(000)	BUDGET 2007 \$(000)	ACTUAL 2006 \$(000)
NATURAL DISASTER FUND				
OPENING BALANCE AS AT 1 JULY		5,418,675	5,392,769	4,728,228
Total Recognised Revenue and Expenses for the year (Operating Surplus)		15,788	365,326	690,447
CLOSING BALANCE AS AT 30 JUNE		5,434,463	5,758,095	5,418,675

Statement of Financial Position

AS AT 30 JUNE 2007

	(NOTES)	ACTUAL 2007 \$(000)	BUDGET 2007 \$(000)	ACTUAL 2006 \$(000)
NATURAL DISASTER FUND				
Capitalised Reserves	9	1,500,000	1,500,000	1,500,000
Other Reserves		3,934,463	4,258,095	3,918,675
		5,434,463	5,758,095	5,418,675
REPRESENTED BY:				
Current Assets				
Cash		9,593	14,544	11,465
Premiums Receivable	10	17,345	15,947	17,158
Prepayments		5,564	11,792	4,774
Interest Accrued		49,896	41,603	46,156
Treasury Bills	11	183,944	75,372	122,428
Bank Investments	11	247,341	271,714	247,634
NZ Government Stock	11	0	401,000	422,365
		513,683	831,972	871,980
Non Current Assets				
NZ Government Stock	11	3,335,413	3,101,834	2,902,883
Global Equities	11	1,646,726	1,873,450	1,695,582
Fixed Assets	12	12,530	11,411	10,967
		4,994,669	4,986,695	4,609,432
TOTAL ASSETS		5,508,352	5,818,667	5,481,412
Current Liabilities				
Provision for Employee Entitlements		183	140	161
Accounts Payable		3,803	3,562	3,412
GST		292	500	746
Tax on Reinsurance		1,238	1,400	1,159
Outstanding Claims	15	24,411	11,000	14,209
Unearned Premiums		43,962	43,970	43,050
TOTAL LIABILITIES		73,889	60,572	62,737
NET ASSETS		5,434,463	5,758,095	5,418,675



CHAIRMAN

Date: 13 September 2007



COMMISSIONER

Statement of Cash Flows

FOR THE YEAR ENDED 30 JUNE 2007

	ACTUAL 2007 \$(000)	BUDGET 2007 \$(000)	ACTUAL 2006 \$(000)
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash was provided from:			
Premiums	84,475	84,479	82,506
Interest Received	200,962	238,199	188,315
Dividends Received	32,085	30,000	31,513
Net Cash Flow from GST	0	0	265
Tax on Reinsurance	79	0	0
	317,601	352,678	302,599
Cash was disbursed to:			
Reinsurers	(31,825)	(35,000)	(31,211)
Section 16 and 17 "Deficiency in Fund" Fee	(10,000)	(10,000)	(10,000)
Claimants and Assessors	(36,229)	0	(47,200)
Employees	(1,830)	(1,804)	(1,728)
GeoNet Operations	(5,107)	(5,190)	(3,612)
Research Grants	(1,268)	(1,943)	(863)
Other Operating Expenses	(16,539)	(19,531)	(15,970)
Net Cash Flow to GST	(453)	0	0
Tax on Reinsurance	0	0	(163)
	(103,251)	(73,468)	(110,747)
NET CASH INFLOW FROM OPERATING ACTIVITIES	214,350	279,210	191,852
CASH FLOWS FROM INVESTING ACTIVITIES			
Cash was provided from:			
Maturity and Sales of Investments	3,478,435	2,774,000	2,544,508
Disposal of Fixed Assets	51	0	15
	3,478,486	2,774,000	2,544,523
Cash was applied to:			
Purchase of Investments	(3,691,073)	(3,045,486)	(2,734,240)
Purchase of Fixed Assets	(3,635)	(3,180)	(2,681)
	(3,694,708)	(3,048,666)	(2,736,921)
NET CASH OUTFLOW FROM INVESTING ACTIVITIES	(216,222)	(274,666)	(192,398)
NET (DECREASE) INCREASE IN CASH HELD	(1,872)	4,544	(546)
Add Opening Cash Brought Forward	11,465	10,000	12,011
ENDING CASH CARRIED FORWARD	9,593	14,544	11,465

Reconciliation of Operating Surplus to Net Cash Flow from Operating Activities

FOR THE YEAR ENDED 30 JUNE 2007

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
OPERATING SURPLUS	15,788	690,447
Add Non-Cash Items:		
Depreciation	1,858	1,450
	17,646	691,897
Add (less) Movements in Other Working Capital Items:		
(Increase) in Premiums Receivable	(187)	(509)
(Increase) Decrease in Prepayments	(790)	1,360
(Increase) in Interest Accrued	(3,740)	(1,752)
Increase in Provision for Employee Entitlements	22	26
Increase (Decrease) in Accounts Payable	391	(288)
(Decrease) Increase in Net GST Payable	(454)	265
Increase (Decrease) in Tax on Reinsurance	79	(163)
Increase (Decrease) in Outstanding Claims	10,202	(30,199)
Increase in Unearned Premium	912	614
	6,435	(30,646)
	24,081	661,251
Add (less) Items Classified as Investing Activity:		
Discount Income and Investment Price Revaluations	190,105	(469,432)
Decrease (Increase) in Fixed Assets in Accounts Payable	103	(11)
Loss on Disposal of Fixed Assets	61	44
	190,269	(469,399)
NET CASH INFLOW FROM OPERATING ACTIVITIES (GST EXCLUSIVE)	214,350	191,852

Statement of Contingent Liabilities

AS AT 30 JUNE 2007

The Commission has an ongoing exposure for claims arising from losses due to earthquakes and certain other natural disasters. As at balance date no major events had occurred and all outstanding claims had been provided for in the accounts.

Statement of Commitments

AS AT 30 JUNE 2007

COMPUTER BUREAU OPERATING LEASE

In 2007, the Commission entered into a services contract for the provision of a new computer system for claims handling, processing and allocation. A portion of the charges payable under the new contract relate to development work on the new system and both the existing and new systems will be operating for part of the 2008 financial year.

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Capital Commitment		
(a) Not later than one year	1,150	0
Operating Commitment		
(a) Not later than one year	1,910	970
(b) Later than one year and not later than two years	1,800	0
(c) Later than two years but not later than five years	5,400	0
(d) Later than five years	8,400	0
TOTAL COMPUTER BUREAU OPERATING LEASE COMMITMENTS	18,660	970

REINSURANCE CONTRACTS

The Commission has signed contracts for reinsurance in the international market. The contracts are for terms ranging from one year to three years.

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Operating Commitment		
(a) Not later than one year	35,584	27,876
(b) Later than one year and not later than two years	22,065	15,396
(c) Later than two years but not later than five years	16,281	7,665
(d) Later than five years	0	0
TOTAL REINSURANCE COMMITMENTS	73,930	50,937

TE PAPA TONGAREWA, MUSEUM OF NEW ZEALAND

In 2003, the Commission signed a contract with Te Papa for sponsorship. The sponsorship relationship is linked to the *Awesome Forces* and *Quake Braker* exhibitions at Te Papa, which provide a mechanism to communicate EQC's key messages to a broad audience and meet its educational and research objectives. The final instalment of the current contract was paid in the 2006/07 financial year.

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Operating Commitment		
(a) Not later than one year	0	500
(b) Later than one year and not later than two years	0	0
(c) Later than two years but not later than five years	0	0
(d) Later than five years	0	0
TOTAL TE PAPA TONGAREWA, MUSEUM OF NEW ZEALAND COMMITMENTS	0	500

AUCKLAND WAR MEMORIAL MUSEUM

The Commission has signed a contract with the Auckland War Memorial Museum for sponsorship of the *Volcanoes* exhibition. The sponsorship relationship provides a mechanism to communicate EQC's key messages to a broad audience and meet its educational, research and promotional objectives.

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Operating Commitment		
(a) Not later than one year	300	300
(b) Later than one year and not later than two years	300	300
(c) Later than two years but not later than five years	0	300
(d) Later than five years	0	0
TOTAL AUCKLAND WAR MEMORIAL MUSEUM COMMITMENTS	600	900

GNS SCIENCE

The Commission has signed a contract with GNS Science for the development and implementation of a seismic monitoring and reporting network (GeoNet).

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Capital Commitment		
(a) Not later than one year	3,151	3,011
(b) Later than one year and not later than two years	3,221	2,970
(c) Later than two years but not later than five years	6,872	8,996
(d) Later than five years	0	0
Operating Commitment		
(a) Not later than one year	5,342	5,121
(b) Later than one year and not later than two years	5,561	5,402
(c) Later than two years but not later than five years	11,835	16,808
(d) Later than five years	0	0
TOTAL GNS SCIENCE COMMITMENTS	35,982	42,308

RESEARCH GRANTS

Future research grants approved by the Board.

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Operating Commitment		
(a) Not later than one year	1,228	1,003
(b) Later than one year and not later than two years	926	364
(c) Later than two years but not later than five years	1,723	475
(d) Later than five years	0	0
TOTAL RESEARCH GRANT COMMITMENTS	3,877	1,842

BUILDING LEASES

The Commission has a non-cancellable long-term lease on premises in Wellington. The annual lease payments are subject to three-yearly reviews. The amounts disclosed below as future commitments are based on the current rental rates.

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Operating Commitment		
(a) Not later than one year	377	377
(b) Later than one year and not later than two years	377	377
(c) Later than two years but not later than five years	1,132	1,132
(d) Later than five years	1,855	2,232
TOTAL BUILDING LEASE COMMITMENTS	3,741	4,118

CLAIMS MANAGEMENT SERVICES

The Commission has entered into an agreement with Gallagher Bassett Services Pty Ltd for the provision of claims management services.

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Operating Commitment		
(a) Not later than one year	765	765
(b) Later than one year and not later than two years	765	765
(c) Later than two years but not later than five years	765	1,530
(d) Later than five years	0	0
TOTAL CLAIMS MANAGEMENT SERVICES COMMITMENTS	2,295	3,060

OTHER OPERATING COMMITMENTS

The Commission has entered into agreements for the provision of equipment and services that are used in its day-to-day operations.

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
Operating Commitment		
(a) Not later than one year	357	48
(b) Later than one year and not later than two years	48	48
(c) Later than two years but not later than five years	38	85
(d) Later than five years	0	0
TOTAL OTHER OPERATING COMMITMENTS	443	181

Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2007

	ACTUAL 2007 \$(000)	BUDGET 2007 \$(000)	ACTUAL 2006 \$(000)
1 PREMIUMS			
Gross Premiums	86,820	86,958	85,141
Less Commissions Deducted by Insurance Companies	(2,158)	(2,174)	(2,126)
	84,662	84,784	83,015
Net Premiums			
Unearned Premium Opening	43,050	43,108	42,436
Less Unearned Premium Closing	(43,962)	(43,970)	(43,050)
	(912)	(862)	(614)
NET EARNED PREMIUMS	83,750	83,922	82,401

2 REINSURANCE PROGRAMME

EQC arranges reinsurance and financial protection with the objectives of:

- + Minimising the overall cost to secure mandated protection to New Zealand homeowners;
- + Implementing a reinsurance programme providing stability over time against reasonably foreseeable events;
- + Providing flexibility in the reinsurance agreement terms and conditions should the Crown determine a different risk profile under the natural disaster insurance scheme;
- + Minimising the risk of default amongst reinsurers/capital markets.

	ACTUAL 2007 \$(000)	BUDGET * 2007 \$(000)	ACTUAL 2006 \$(000)
3 INVESTMENT INCOME			
Global Equities			
- Equity Gains	249,312	149,240	250,557
- Foreign Exchange (Losses) /Gains	(331,197)	0	221,883
- Dividend Income	33,029	0	31,513
	(48,856)	149,240	503,953
NZ Government Securities			
-Price Revaluation (Losses)	(134,164)	(43,090)	(19,768)
-Interest and Discount Income	199,245	230,313	188,128
	65,081	187,223	168,360
Other Short-Term Investments	30,457	19,818	18,699
INVESTMENT INCOME	46,682	356,281	691,012

* Budgeted investment income is based on projected medium term (5 year) asset returns.

	ACTUAL 2007 \$(000)	BUDGET 2007 \$(000)	ACTUAL 2006 \$(000)
4 TOTAL REVENUE			
Gross Premiums	86,820	86,958	85,141
Investment Income	46,682	356,281	691,012
TOTAL REVENUE	133,502	443,239	776,153

	ACTUAL 2007 \$(000)	ACTUAL 2006 \$(000)
5 NET UNDERWRITING RESULT		
Underwriting Income	52,728	51,597
Less Claims Expense	(46,431)	(16,999)
NET UNDERWRITING RESULT	6,297	34,598

6 CREDIT RATING

The Commission has been assigned an insurer financial strength rating of AAA (extremely strong) as accorded by international rating agency, Standard & Poor's, on 25 September 2006.

7 SECTION 16 AND 17 "DEFICIENCY IN FUND" FEE

Pursuant to the Earthquake Commission Act 1993, the Commission is required to pay fees to the Crown as determined by the Minister of Finance. The Section 16 and 17 "Deficiency in Fund" fee relates to the Crown's obligation under Section 16 of the principal Act which 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 of Finance 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 of Finance determines."

Under Section 17 the Minister of Finance has determined that \$10 million be paid for the year ended 30 June 2007 (2006 \$10 million).

8 MAJOR BUDGET VARIANCES – STATEMENT OF FINANCIAL PERFORMANCE

Reinsurance costs are lower than budget as the amount of cover taken was less than planned.

Investment income is down due to the unprecedented high value of the New Zealand dollar and high interest rates at balance date.

9 NATURAL DISASTER FUND

(a) Capitalised Reserves

Issued capital 1,500,000,000 ordinary shares of \$1.00 each, deemed to have been issued and paid up in full from the Fund on 1 October 1988.

(b) EQC Solvency

The Commission has an exposure in excess of its current level of assets and is reliant upon the Crown to meet the Commission's obligations. In the event of the Commission's liabilities exceeding its assets (including reinsurance) the Crown, under Section 16 of the Earthquake Commission Act 1993, is obliged to provide, by way of grant or advance, sufficient funds to meet the shortfall.

10 PREMIUMS RECEIVABLE

Insurance companies and brokers are required to pay premiums within two months of the month in which they become payable in respect of residential policies. Premiums receivable represent these outstanding premiums. Based on past experience, no provision for doubtful debts is necessary.

11 FINANCIAL INSTRUMENTS

(a) Investments

Section 12 of the Earthquake Commission Act 1993 and section 103 of the Crown Entities Act 2004 give the Minister of Finance authority to issue directions to the Commission.

A direction from the Minister of Finance was issued on 1 November 2001 permitting investments to be held in New Zealand Government securities (New Zealand Government stock, inflation-indexed stock and Treasury bills), New Zealand bank investments (maximum \$250 million) and global equities up to a maximum of 35% of total investments.

(i) NEW ZEALAND GOVERNMENT STOCK AND TREASURY BILLS

The major risks associated with Government stock and Treasury bills include interest rate risk and liquidity risks.

All investments in New Zealand Government stock and Treasury bills are issued by the Reserve Bank and are only tradeable with the New Zealand Debt Management Office.

(ii) NEW ZEALAND BANK INVESTMENTS

The Commission is exposed to counterparty risk i.e. a bank defaulting on a bank investment.

The Commission reduces counterparty risk by investing funds only in securities with registered banks with satisfactory credit ratings and having a significant presence in the New Zealand market place. Exposure to any one bank is restricted in accordance with Commission investment policy.

(iii) GLOBAL EQUITIES

The Commission is exposed to global market volatility and to exchange rate fluctuations.

Managing market pricing risks associated with global equities is achieved by maintaining a tracking error against the benchmark index of not more than 0.5% per annum for passive investments. Active global equity managers are allowed a larger tracking error, but are subject to other constraints. These include their aggregated individual company exposures being limited to 5% of funds invested in global equities, investment restricted to 5% of a company's market capitalisation, and restrictions on industry and company exposures (including a restriction on the country universe) to limit sector overexposure. Holdings in illiquid securities are restricted or prohibited. The multi-manager style also enables a diversification of risk.

The Commission has adopted the policy of not hedging currency translation exposures arising through investments in global equities as global equities will only be liquidated when EQC is faced with a major natural disaster. At the time the policy was adopted, both the Reserve Bank and EQC's investment advisors were of the opinion that in such an event, the most likely scenario is for the New Zealand dollar to depreciate and inflation to rise. This would result in an increase in EQC liabilities but also an increase in EQC unhedged global investments.

(b) Fair Value

The fair value is the market value of investments at balance date including accrued interest:

	2007 \$(000)	2006 \$(000)
Domestic Securities	3,816,594	3,741,466
Global Equities	1,646,726	1,695,582
	5,463,320	5,437,048

(c) Concentrations of Credit Risk

No collateral is held by the Commission in respect of bank balances, short-term investments or accounts receivable due to the credit rating of financial institutions with whom the Commission transacts business.

(i) ACCOUNTS RECEIVABLE

The Commission allows insurance companies a specified time period to pay over the premiums received on its behalf. The Commission monitors credit risk on an ongoing basis and maintains a strict control over the timeliness of those payments.

(ii) INVESTMENTS

The Commission's investments are concentrated as follows:

	2007	2006
NZ Government Securities (including Treasury Bills)	65.33%	64.26%
Global Equities	30.14%	31.19%
NZ Bank Investments (6 registered banks)	4.53%	4.55%

(d) Investment Yields and Durations

The Commission's investments have the following average market yields and durations:

	2007		2006	
	YIELD	DURATION	YIELD	DURATION
NZ Government Stock	7.09%	4.13 yrs	6.16%	4.17 yrs
NZ Government Inflation-Indexed Stock	3.75%	7.35 yrs	3.25%	7.89 yrs
NZ Government Treasury Bills	7.66%	27 days	6.89%	25 days
NZ Bank Investments	8.26%	47 days	7.42%	47 days

12 FIXED ASSETS AND DEPRECIATION

	HISTORICAL COST 2007 \$(000)	ACCUMULATED DEPRECIATION 2007 \$(000)	BOOK VALUE 2007 \$(000)	HISTORICAL COST 2006 \$(000)	ACCUMULATED DEPRECIATION 2006 \$(000)	BOOK VALUE 2006 \$(000)
	Furniture and Equipment	427	208	219	393	175
Motor Vehicles	48	14	34	55	17	38
Computer Equipment	449	336	113	403	288	115
Catastrophe Response Equipment	304	278	26	304	249	55
Assets Under Construction*	338	0	338	0	0	0
GeoNet Assets	16,807	5,007	11,800	13,888	3,347	10,541
	18,373	5,843	12,530	15,043	4,076	10,967

* Development work related to the new claims management system installation.

13 RELATED PARTY TRANSACTIONS

The Earthquake Commission is a Crown Entity of the New Zealand Government and all significant transactions with the Crown result from Ministerial directions given under the Earthquake Commission Act 1993 or section 103 of the Crown Entities Act 2004.

The Commission enters into numerous transactions with other Crown agencies, tertiary institutions and state-owned enterprises on an arm's length basis. Where those parties are acting in the course of their normal dealings with the Commission, related party disclosures have not been made for transactions of this nature.

Apart from those transactions described above, the Commission has not entered into any related party transactions.

14 DISCLOSURES

Employee Remuneration

The number of employees whose total remuneration for the financial year was in excess of \$100,000, in \$10,000 bands, is as follows:

\$(000)	2007	2006
100-110	1	1
110-120	2	1
140-150	1	1
150-160	1	
170-180		1
180-190	1	
240-250		1
250-260	1*	

The General Manager's total remuneration is in the \$250,000-\$260,000 band (2006: \$240,000-\$250,000 band).

Note: Disclosure has been changed from previous years to include the Commission's contributions to the State Sector Retirement Savings Scheme. The comparative disclosure for 2006 has been adjusted accordingly.

* Includes backpay relating to the prior year.

Commissioners' Remuneration

Commissioners' fees paid during the year were as follows:

	FEES - 2007	FEES - 2006
NGA Young (i)	3,117	37,400
MC Wintringham (ii)	36,231	23,375
CB Durbin	18,700	18,700
JP Dwyer	0	9,350
RJ Hooper	18,700	18,700
TP McGuinness	18,700	18,700
TA Nicholas (iii)	6,233	18,700
KB Taylor (iv)	15,583	0
WN Hoadley (iv)	15,583	0
GT Muriwai (v)	14,024	0
TOTAL	146,871	144,925

No additional remuneration was paid to Commissioners.

- (i) Retired as Chairman on 25 July 2006
- (ii) Appointed as Chairman from 26 July 2006
- (iii) Retired from the Board on 30 September 2006
- (iv) Appointed 18 August 2006
- (v) Appointed 1 October 2006

Indemnity and Insurance Disclosure

The Commission has provided a deed of indemnity to each Board member in relation to certain activities undertaken in the performance or intended performance of EQC's functions.

The Commission has effected and maintained "Directors and Officers Liability" and "Professional Indemnity" insurance cover during the financial year in respect of the liability or costs of any Board member, or employee.

15 OUTSTANDING CLAIMS LIABILITY

The Commission provides for outstanding claims liabilities in respect of claims notified and claims incurred but not notified (IBNR) to the Commission at balance date.

An independent actuarial estimate of the central estimate of the liability for notified claims as at 30 June 2007 was made by Melville Jessup Weaver, led by Janet Lockett a Fellow of the New Zealand Society of Actuaries. This is a change from previous years, when the liability was based on a best estimate.

The calculation of the outstanding claims liability was based on past claims development patterns and the approach used was in accordance with the standards of the New Zealand Society of Actuaries. In determining the actuarial estimate, the actuary relied upon information supplied by the Commission and was satisfied as to the nature, sufficiency and accuracy of the information provided. As most claims are settled within one year, future claims payments were not discounted, and no adjustment was made for the effects of inflation.

16 IMPACT OF ADOPTING NEW ZEALAND EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

During 2007, the Commission continued to review its accounting policies and disclosures, in light of the Board's decision to adopt the New Zealand Equivalents of International Financial Reporting Standards (NZIFRS) for the year ending 30 June 2008.

The Commission had engaged external consultants to perform an initial impact review and has continued to use a mixture of internal and external resource to ensure compliance with the new standards. The key areas of impact identified during 2006 were not considered to have a material effect on the Commission's opening Statement of Financial Position, future results or systems. Further consideration in the past year has not changed this view, although the approach taken to estimate the claims liability will be modified. The key areas of impact are discussed below.

Public Benefit Entity

NZIFRS contains specific requirements for Public Benefit Entities. The Commission falls within the definition of Public Benefit Entity and will comply with the relevant requirements of the standards where applicable.

Insurance Contracts

NZIFRS 4 "Insurance Contracts" appendix D applies to insurance activities and reinsurance contracts.

The standard requires outstanding claims liability to be measured as the central estimate of the present value of expected future payments for claims incurred, with an additional risk margin for uncertainty. It also requires the annual application of a liability adequacy test for future claims under existing insurance contracts. The Commission is currently re-assessing the applicability and impact of this standard in light of the particular nature of the Commission's insurance activities and the International Accounting Standards Board (IASB) discussion paper on insurance contracts issued in May 2007. Therefore the impact of this standard cannot currently be quantified.

Financial Instruments

The Commission's investments are currently disclosed at market value with all changes in value taken to the Statement of Financial Performance. The Commission does not hedge its investments.

All investments are expected to be valued at "bid" price under the new standard, as opposed to the last sale or "mid" price currently used by the Commission. The impact of this on the opening balance sheet has been assessed at \$5.9 million, which is approximately 0.1% of the total investment portfolio and 0.9% of investment revenue for the 2006 year. While the Commission does not consider this to be material, it will disclose the impact of this valuation base in its Financial Statements.

The standard also requires that transaction costs are expensed on initial recognition. While the Commission does not incur transaction fees on a majority of its investments, brokerage fees currently form part of the price of shares purchased. However, as these fees are not substantial and any subsequent changes in the fair value of its shares will be taken to the Statement of Financial Performance, the impact on the Commission's surplus or deficit is likely to be minimal.

17. STATEMENT OF FINANCIAL PERFORMANCE – EXPENDITURE COMPARATIVES

Some expenditure comparatives in the Statement of Financial Performance and Statement of Cash Flows were restated to ensure consistent presentation with the current financial year. Expenditure was reclassified in the current year to improve disclosure and achieve consistency with the Statement of Intent.

Statement of Service Performance

Output Class 1 – Claims Handling and Catastrophe Response

This output class comprises the maintenance of EQC’s state of readiness to meet the requirements of the Crown for the compensation of residential property owners following a natural disaster and the incorporation of this readiness, so far as is possible, into normal daily operations.

It contributes to the impact of *Having a catastrophe response programme that delivers adequate claims handling capacity after a natural disaster*, and through that to the Government’s outcome of *Safer communities and rapid recovery from natural disaster*.

PERFORMANCE TARGETS AND RESULTS

- 1 The cost of maintaining the catastrophe response programme is kept within the authorised budget.

Achieved. *The overall catastrophe response programme came within the authorised budget. Legal and travel expenses were higher than projected due to development of the new claims management system and the travel associated with natural disaster events in Auckland and Northland.*

- 2 EQC’s systems successfully withstand a programme of capacity testing.

Achieved. *One claims computer load test was successfully conducted. Training of site managers, team leaders, loss adjusters, claims administrators, repair estimators and call centre operators carried out. The demands of both the Northland operation and the development of the new claims management system interrupted the scheduled capacity testing and training and exercise programme. However, the establishment of a temporary field office in Northland provided a real environment in which to test the programme.*

- 3 The availability of resources and contracts for post-event supply are regularly checked.

Achieved. *There are contracts in place with 15 suppliers specifically for catastrophe response purposes. Annual reviews undertaken for all contracts.*

- 4 Systems are duplicated and regularly backed up.

Achieved. *The claims and office computer systems are located in Wellington and replicated in Auckland. Both systems have internal mirroring capability which provides local redundancy. Data transfer between locations is continuous.*

Contracts are signed up with multi-site suppliers or alternative suppliers are arranged to ensure backup of goods and services.

- 5 Maintain claimant service satisfaction levels, as measured by postal surveys based on recently settled claims, at as minima:

For claimants whose claims were accepted 80%

For claimants whose claims were declined 75%

Achieved. *The Commission carries out independent satisfaction surveys of its claimants every quarter.*

Satisfaction for claimants whose claims were accepted – 83%, satisfaction for claimants whose claims were declined – 80%.

Output Class 2 – Research

This output class includes research in fields relevant to natural disaster damage, methods of reducing or preventing natural disaster damage, and the insurance provided under the Earthquake Commission Act. It reflects EQC’s functions under section 5(1)(e) of the Earthquake Commission Act.

Through its advocacy of, and investment in, science and engineering research, EQC contributes to hazard assessment and disaster prevention in New Zealand. The Commission’s research activities contribute to the impact of *Sustaining capability and completing research in order to reduce the risk of the hazards EQC insures against*. By contributing to a reduction in risk hazard, research helps to reduce the Crown’s liabilities and protect its assets and helps to make New Zealand communities safer from natural disasters. Research into construction and engineering methods can also have economic spin-offs and contribute to a knowledge-driven economy.

PERFORMANCE TARGETS AND RESULTS

- 1** The planned programme of investment in research is accomplished.

Achieved. Both the biennial and student programmes were fully subscribed. All research projects from these programmes due for completion during the year were completed.

The “It’s Our Fault” project to improve understanding of the Wellington region’s vulnerability to large earthquakes commenced with co-funding from Wellington City Council and ACC.

- 2** Peer review of completed projects results in minimum assessments of satisfactory in each case.

Achieved. Peer reviews received to date are all satisfactory or above.

- 3** Results of research funded by EQC are applied to planning, construction and recovery practices.

Achieved through workshops, conferences and seminars held; projects aimed at improving the national capability to respond; a project on improving the overall functioning of the system of landslip risk management; and support for Standards New Zealand, the New Zealand Society for Earthquake Engineering and Lifelines groups (both regional and national).

All activities met the requirements of their respective funding agreements.

- 4** Results of the university-based teaching and scholarship programmes sponsored by EQC meet agreed requirements.

Achieved. EQC’s university-based teaching and scholarship programmes have contractual arrangements specifying EQC’s requirements and these have been fulfilled.

- 5** Staffing strengths within the disciplines supported by EQC sustain the delivery of quality research and its application.

Achieved. The university-based teaching programme supports lectureships at Victoria (seismic studies), Massey (natural hazards planning) and Canterbury (earthquake engineering) universities. A new partnership with the University of Auckland that supports research on volcanic risk, geotechnical engineering and earthquake engineering was launched in April.

- 6** GNS Science annual plans for the development and utilisation of GeoNet meet agreed requirements.

The development and rollout of GeoNet is on time and on target. The workplan for 2007/08 has been received and approved. Progress achieved during the year included extension of the national seismograph network, upgrades to the national earth deformation survey network and improvements to volcano surveillance throughout the North Island.

- 7** The GeoNet project keeps to agreed time and budget criteria.

Achieved. The project has kept to agreed time criteria and has come within 1% of its agreed budget.

- 8** GeoNet outputs improve national readiness capabilities and become integral to civil defence and local authority plans and recovery processes.

Achieved. GeoNet reports are delivered via email, fax and SMS to the Ministry of Civil Defence and Emergency Management, local authorities and other interested parties. Surveillance of volcanoes and monitoring of selected large landslips is also carried out through GeoNet. The GeoNet website won the Computerworld award for Excellence in the Use of ICT in Government.

Output Class 3 – Public Education

This output class has two elements:

- + Public education about geological hazards and methods of reducing or preventing damage caused by them.
- + Public education about EQC’s role and the importance of having adequate insurance on residential and personal property.

These outputs reflect EQC’s functions under Section 5(1)(e) of the Earthquake Commission Act: “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.”

The output class contributes directly to the Government’s outcome of *Safer communities*, because it increases public awareness of New Zealand’s vulnerabilities to natural disasters and the steps that can be taken in the home to mitigate these. It also indirectly contributes to the Government’s outcome of *Efficient management of the Crown’s assets and liabilities* because the Crown’s fiscal risk is reduced as more households take precautions against damage from seismic events.

PERFORMANCE TARGETS AND RESULTS

- 1 The percentage of New Zealand households that have taken preventive steps to mitigate natural disaster damage is growing steadily.

The independent Nielsen quarterly surveys show that disaster mitigation activity (as indicated by levels of secured hotwater cylinders, tall furniture and foundations) has increased by 0.3 percentage points from 44.3% to 44.6% over the course of the year.

- 2 The percentage of New Zealanders who understand EQC's role is increasing.

The Nielsen surveys show that the percentage of New Zealanders who understand EQC's role has decreased by 0.2 percentage points during the year, moving from 66.8% to 66.6%.

- 3 Public understanding of the insurance under the Act is improving as shown by evaluation of social marketing efforts.

The Nielsen surveys show that awareness of EQC's insurance role has increased by 4% to 65% over the past year.

Output Class 4 – Policy Advice

This output class includes the provision of policy 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.

It contributes to all of EQC's impacts, and through them to the Government's outcomes of *Safer communities and rapid recovery from natural disaster* and *Efficient management of the Crown's assets and liabilities*.

PERFORMANCE TARGETS AND RESULTS

- 1 All requests for policy advice from the Minister and Treasury are met within agreed timelines.

Achieved. *All Ministerial enquiries during the year were responded to within agreed timelines.*

EQC attended meetings and proffered advice for the Treasury paper "Options to improve insurance coverage for all New Zealand households".

- 2 Feedback from stakeholders indicates that EQC's advice is effective in supporting its stated outcomes.

EQC's input into the Treasury paper received appreciative feedback.

Output Class 5 – Management of the Natural Disaster Fund

This output class involves administration of the Fund, 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. It reflects EQC's functions as set out in section 5(1)(b), (c) and (d) of the Act and contributes directly to the Government's outcome of *Efficient management of the Crown's assets and liabilities*.

PERFORMANCE TARGETS AND RESULTS

- 1 The reinsurance programme reduces the net risk to the Natural Disaster Fund and the Crown.

Achieved. *Computer modeling shows that the reinsurance programme negotiated for the 2006/7 year approximately halved the net risk (ie, reinsurance premiums less reinsurance recoveries) to both the Fund and the Crown, compared to having no reinsurance in place.*

- 2 Fund is managed in accordance with the Statement of Investment Policies, Standards and Procedures.

Achieved. *This included investing in approved asset classes only, maintaining asset classes within specified ranges, ensuring cash was invested in banks with high credit ratings, receiving compliance and audit reports from custodians and fund managers, and reporting on the Fund to the Board and investment committee.*

- 3** Return on investment meets the benchmarks set in the Statement of Investment Policies, Standards and Procedures.

Results:

ASSET CLASS	ACTUAL RETURN	BENCHMARK/TARGET RETURN
NZ Government Stock	1.8%	1.8%
NZ Government Inflation-Indexed Bonds	2.6%	2.5%
Bank Bills (registered certificates of deposit)/Treasury Bills	7.7%	7.6%
Passive Global Equities	-2.1%	-2.4%
Active Global Equities	-4.0%	-2.4%
Total Portfolio	0.7%	2.8%*

* The target total portfolio return is 1% p.a. over the NZGS index return. The return and target return shown are for the financial year only even though the real measure is over a rolling 10-year period. The structure has not been in place long enough to compare 10-year returns. For the three years to 30 June 2007 the return was 6.9% versus 6.0%.

- 4** The programme of insurance company audits and records checking is completed.

Achieved. The programme has been carried out and all premium inconsistencies discovered have been remedied.

- 5** Manage the Natural Disaster Fund so as to avoid prejudice to New Zealand's reputation as a responsible member of the world community.

Should an area of concern be identified, in most instances EQC requests that active managers engage with the companies involved and keep the Commission advised of this activity.

EQC has instructed its active managers not to invest in two sectors:

- Companies involved in the manufacture, development or use of anti-personnel mines;*
- Companies involved in the manufacture of tobacco products.*

EQC's Board will have a formal responsible investment policy for the Commission in place by the end of 2007.

GOOD EMPLOYER COMPLIANCE

Compliance with obligation to be a "good employer".

EQC has met all the requirements of its equal employment opportunity policy. In addition, as part of its requirement to be a "good employer" the Commission has in place:

- + A confidential Employee Assistance Programme provided by a specialist external provider.
- + Voluntary membership of the State Sector Retirement Savings Scheme, with the Commission providing a contribution matching any employee contribution to a maximum of 3% (net) of remuneration.

- + Allowance for expenditure on staff training based on a percentage of the staff salaries budget.
- + The Commission monitors staff turnover and average length of service as an indicator of staff satisfaction.

	THIS YEAR	LAST YEAR
Average Length of Service	7.3 years	7.4 years
Staff Turnover	2	3
Total Staff at 30 June	21	19*

*one vacancy existed at 30 June 2006.

OUTPUT EXPENDITURE FOR THE YEAR ENDED 30 JUNE 2007¹

OUTPUT CLASS	REVENUE	EXPENDITURE	REVENUE BUDGET	EXPENDITURE BUDGET
1: Claims Handling and the Catastrophe Response Programme	Nil	\$7.3 million	Nil	\$8.4 million
2: Research	Nil	\$9.0 million	Nil	\$9.0 million
3: Public Education	Nil	\$2.7 million	Nil	\$3.7 million
4: Policy Advice	Nil	Nil	Nil	Nil
5: Management of the Natural Disaster Fund	\$130.4 million	\$49.2 million	\$440.2 million	\$53.8 million

¹ EQC's Statement of Intent for the period 1 July 2006 to 30 June 2009 did not allocate forecasted revenue and expenditure by output class. The forecasted revenue and expenditure by output class, as disclosed in the above table, has been extracted from the prospective Statement of Financial Performance for the year ended 30 June 2007, as published in the Commission's Statement of Intent for the period 1 July 2006 to 30 June 2009.

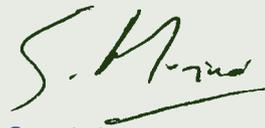
Statement of Responsibility

- + The Board and management are responsible for the preparation of the annual Financial Statements and Statement of Service Performance and the judgements used therein.
- + The Board and management are responsible for establishing and maintaining a system of internal control designed to provide reasonable assurances as to the integrity and reliability of the financial reporting.
- + In the opinion of the Board and management, the annual Financial Statements for the financial year fairly reflect the financial position and operations of the Commission.



Chairman

13 September 2007



Commissioner

13 September 2007

Directory

Minister in Charge of the Earthquake Commission

The Hon Dr Michael Cullen

Commissioners

M C WINTRINGHAM, CNZM, BA (Hons)

CHAIRMAN

Ex officio member of all committees except chairman/ deputy chairman expenses committee

C B Durbin, BCom, LLB (Hons), FlInstD, FAMINZ

Member of reinsurance (chair), catastrophe response and chairman/deputy chairman expenses committees

W N Hoadley, QSO, LLB (Hons), MA, DipTchg, AMNZPI

Member of catastrophe response (chair) and research committees

R J (George) Hooper, BE (Hons), PhD, FIPENZ

Member of research (chair) and reinsurance committees

T P McGuinness, BCA

Member of investment (chair), chairman/deputy chairman expenses (chair) and reinsurance committees

G T Muriwai, MCom (Hons)

Member of audit and reinsurance committees

K B Taylor, BSc, BCA, FIA, FNZSA, AFInstD

Member of audit (chair) and investment committees

Senior Management

D A Middleton, ANZIIF (Fellow), FCII, MBA, Chartered Insurer

GENERAL MANAGER

P R Jacques, BSc, DipMgt, DipAcc, CA, CFIP

MANAGER CORPORATE SERVICES AND INVESTMENTS

L R Dixon, GradDipBusStuds (Ins Mgt), ANZIIF (Fellow)

INSURANCE MANAGER

H A Cowan, PhD

RESEARCH MANAGER

Auditor

Audit New Zealand, Wellington

(on behalf of the Auditor-General)

Banker

National Bank of New Zealand, Wellington

Solicitors

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DLA Phillips Fox, Wellington

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EARTHQUAKE COMMISSION
KŌMIHANA RŪWHENUA

