EARTHQUAKE COMMISSION
Kōmihana Rūwhenua


Annual Report
2011–2012






Cover images:

22 February 2011, Canterbury earthquake *Photo: Margaret Low, GNS Science*	1987 Edgecumbe earthquake *Photo: Lloyd Homer, GNS Science*	
22 February 2011, Canterbury earthquake *Photo: Margaret Low, GNS Science*	1995 Ruapehu eruption *Photo: Dougall Gordon*	1968 Inangahua earthquake *Photo: Lloyd Homer, GNS Science*
2005 Matata flood *Photo: Nigel Marple, NZ Herald*	Railway lines and a locomotive affected by the Edgecumbe earthquake. Dominion post (Newspaper): Photographic negatives and prints of the Evening Post and Dominion newspapers. Ref: EP/1987/0990/9. Alexander Turnbull Library, Wellington, New Zealand. http://beta.natlib.govt.nz/records/23088924	2007 Gisborne earthquake *Photo: Dave Thomas, Gisborne Herald*

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Chairman's **Report**

As I am writing this introduction to the 7th annual report since I have been Chair of the Earthquake Commission, the Government is considering the terms of reference for its review of the Earthquake Commission Act. The review is needed.

The Earthquake Commission Act dates from 1993. For as long as I have been a Board member, EQC has made regular representations to the Government of the day on areas where the scheme could be clarified and improved. The Canterbury earthquakes have brought their own reality check to the workability of the provisions of a 20-year-old statute.

"I AM PROUD TO ACKNOWLEDGE THE ACHIEVEMENTS OF EQC'S PEOPLE IN 2011/12. IT IS SOMETIMES OVERLOOKED THAT **MANY OF OUR STAFF ARE CHRISTCHURCH PEOPLE**."

In my view, the main challenges generated by this sequence of earthquakes, for EQC especially but also for many of the private insurance companies, fall under four headings.

VOLUME

The sheer scale of these events is hard to overstate, and especially hard to convey to those who have not experienced them first-hand. At this time (September 2012) EQC has received 460,000 claims, which represent 691,000 separate exposures for buildings, land and contents. Insurance companies have their own challenges but, because EQC takes the first loss, every claim for damage to a building and contents comes to us. Because only EQC covers damage to land, the 93,000 land claims sit only with EQC.

The public policy conundrum is whether it is sensible, in anticipation of say a 1-in-300 or 1-in-500 year natural disaster, to maintain a greater (and more costly) infrastructure in place, to handle the volume of claims such an event would generate. This issue remains the same whether a government institution, or the private sector, is expected to maintain preparedness for such a response.

COMPLEXITY

There are many areas of complexity resulting from the Canterbury earthquakes. Two have been particularly challenging. First, this was not one event, but many. EQC has received claims arising from 15 separate Canterbury earthquakes. The second source of complexity comes from the changes caused by the earthquakes to some residential land. In many of these cases, land "damage" is neither physical loss of the building platform, or cracking or spreading of the land which can be readily assessed and repaired, but the increased susceptibility of the land to movement in future earthquakes – earthquakes which may, of course, never happen.

The EQC Act anticipated neither of these situations. Its general provisions are based on an assumption of a single major event. The complex changes in residential land in some Christchurch suburbs are not only technically difficult to establish, but also to relate to the provisions of the EQC Act. A major proportion of EQC's effort in claims settlement has been in apportionment of damage to events, and in the geotechnical assessment of changes to residential land. Although EQC has initiated, developed and is largely carrying out the process, apportionment is required by the insurance sector as a whole to settle claims with customers and with reinsurers. To the best of our knowledge, apportionment has not been required anywhere in the world before or, if so, on this scale.

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As a by-product, the geotechnical assessment of changes to residential land has resulted in the most comprehensive liquefaction and lateral spreading severity mapping exercise ever undertaken in New Zealand, and quite possibly anywhere in the world. The extensive use of Light Detection and Ranging (LiDAR) has also enabled the changes in land elevation as well as horizontal position to be measured for each of the main earthquake events. This mapping information, together with EQC-funded geotechnical investigations, has resulted in a comprehensive data set from which state-of-the-art prediction determinations of future liquefaction vulnerability has been developed. This state-of-the-art knowledge is not only limited to facilitate settling the land damage claims in Eastern Christchurch, but can also now be applied in other parts of New Zealand and the world to better understand risk and hazard. This improved understanding is brought about by the ability to better predict the likely liquefaction-related damage for different levels of earthquake shaking in areas with geological deposits that can theoretically liquefy.

COMMERCIAL REALITY

The cost of Canterbury insurance claims is estimated at around $30 billion (RBNZ)[1]. As recorded in the financial statements which form part of this annual report, EQC's total estimated liability (including the costs of settling claims and amounts already paid out in 2010/11) is $12.5 billion. Insurance companies are facing the costs of settling commercial as well as residential claims. By any standard, the sums involved are huge.

In this environment, there is an incentive for insurers to reduce their own liabilities by shifting costs to the Crown or to other parties. I understand this. But by the same token EQC has three responsibilities:

- EQC is governed by statute. The law determines the entitlements of our customers.
- As a Crown organisation, we stand for the tax-payer (who may well be a customer as well). In a fiscal and economic environment where many New Zealanders are being asked to make sacrifices, I and the Board are especially conscious of our responsibilities in this regard.
- Our customers in Canterbury need certainty and resolution of their claims. Resolving the respective obligations of EQC and the insurers should not burden them with additional uncertainty, nor delay the settlement of their claims.

The clearer and less ambiguous the EQC Act is on EQC's cover, the fewer the opportunities and incentives for cost-shifting.

In the meantime, I will commit EQC to doing its part to resolve our claims as expeditiously and as fairly as we are able. To this end, in 2012/13 EQC will be increasingly single-minded in resolving our own customers' claims, even if a lower priority has to be given to joint programmes and activities which may have longer term social and national benefits.

1 http://www.rbnz.govt.nz/speeches/4658917.pdf Part 2)

INSTITUTIONAL SCOPE

In the 2011 annual report I referred to the responsibilities assigned to EQC in response to the September 2010 and February 2011 earthquakes to: repair damaged houses (rather than cash settle claims); undertake emergency repairs; manage a programme to install winter heating devices; and design and oversee major land remediation programmes. None of these were "core business" for us. None had been planned for. All were important.

But planning and setting up these major programmes inevitably caused a diversion of resources from the expansion of our claims settlement system, with some impact on our customers. While I am proud of what our people have achieved in these major programmes, for the future it would be helpful if the mandate and expectations of EQC, or a successor organisation, were made more explicit in advance.

I am proud to acknowledge the achievements of EQC's people in 2011/12. It is sometimes overlooked that many of our staff are Christchurch people. Some are both customers and employees. All take their work home with them as they live and socialise in the community they are trying to serve. That's not always easy.

And as long as there are customers whose lives are still on hold, who are waiting for us to give them answers, or for whom we haven't given the best service they could fairly expect, we know there is more to do.

I anticipate that 2012/13, even more than last year, will be the major test for EQC. We have made major investments in our claims settlement and customer contact resources, including bringing back into EQC activities formerly run under contract in Australia. On the back of this investment we will accelerate the settlement of the complex building and land claims, and help bring resolution for many people who deserve our best efforts.

To my colleagues on the Board, the Chief Executive Ian Simpson, and the management and people of EQC, my sincere thanks.

Michael Wintringham
Chairman

Chief Executive's **Report**

> "WE PAID OUT **$2.8 BILLION** IN CLAIMS TO OUR CUSTOMERS AND **REPAIRED MORE THAN 17,000 HOMES** DURING THE FINANCIAL YEAR."

For EQC, 2011–2012 was another momentous year.

The Commission received more than 94,000 claims and carried out 192,000 assessments following the aftershocks that continued to damage homes and disrupt lives in Canterbury. The enormity of such a challenge is self-evident.

And as was intended when EQC was set up more than 65 years ago, we have drawn on the Natural Disaster Fund (NDF) to help people repair and rebuild their damaged property. We paid out $2.8 billion in claims to our customers and repaired more than 17,000 homes during the financial year.

However, with 80,000 more properties to repair and others to pay out on, the task we face remains immense. Our commitment to helping those with damaged homes and outstanding claims is resolute, in Canterbury and throughout New Zealand.

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CANTERBURY RESPONSE

Progress

The sequence of large earthquakes in Canterbury which began on 4 September 2010 is unprecedented. The aftershocks on 23 December 2011, some 16 months after the first quake, added 48,000 claims to the total number received. Even these less damaging quakes produced nearly five times the number of claims of EQC's largest event before the Canterbury series (10,500 claims from the 1968 Inangahua earthquake).

Prior to the Canterbury earthquakes, EQC settled most claims with payment rather than by managing repairs. Following 4 September it became clear that due to the scale of devastation and the importance of rebuilding a resilient and stable region, a different approach would be required.

To do this EQC took on Fletcher Construction to project manage structural repairs under $100,000, carry out urgent works and run the Winter Heat Programme.

The Fletcher-run Canterbury Home Repair Programme has made considerable progress during the year, completing full repairs on 17,539 homes throughout the region, about the same number of houses as in the entire Timaru district.

Our personal contact with people dealing with the effects of the quakes means we are very aware that some families are living in very challenging conditions. We prioritise the work, and this year we have paid for or carried out 25,500 urgent repairs to ensure homes are safe, sanitary, secure and weather-tight.

Through the Winter Heat Programme, Fletcher EQR put in heat sources at a rate of around 120 per day and by the end of this financial year 8,010 heating units had been installed. The Winter Heat Programme was launched last year to ensure households with an EQC claim, who had lost their primary heating source, could stay warm through winter. Priority is also given to homes with occupants who are sick, elderly or who have young children, or houses with no other heating source.

Change, adapt, improve

The Canterbury quakes have precipitated enormous and fundamental changes to both EQC's size and role and have demanded constant review of the way in which we operate. During the year we have:

- Brought our call centre in-house and are well on the way to doing the same with our claims processing centre in order to more closely manage performance and streamline processes and communications;
- Implemented improvements to the process of re-inspection of dwellings with insurers; and
- Simplified the process of opting out of the Canterbury Home Repair Programme for those customers who have the skills to project manage their own repairs.

Ground-breaking land project

The unprecedented nature of the Canterbury quake series has also necessitated innovative assessments to build a comprehensive picture of the earthquakes' impact on the land under Canterbury.

By year's end we had carried out what is thought to be the largest land damage assessment and mapping exercise ever undertaken anywhere in the world. Soil samples from 50 suburbs, tens of thousands of property visits by engineers, aerial photography, and flyovers to determine changes in land elevation were the primary data sources for our land damage reports.

In addition to area-wide land assessments, in March we started drilling on land within the Green Zone Technical Category 3 (TC3). Land in TC3 may be subject to moderate to significant damage from liquefaction in future large earthquakes and the drilling programme will provide the data necessary to specify the most suitable foundation design for houses in this area.

BEYOND CANTERBURY

Although the bulk of EQC's resources are necessarily focussed on assisting the recovery from the Canterbury earthquakes, the rest of the country has not been without natural disasters. In total we received 5,755 claims from natural disasters in other parts of New Zealand. Heavy rain just prior to Christmas caused flooding and landslip damage to properties in the Nelson/Tasman area. EQC received, processed and closed just under 1,000 claims for this event.

FINANCIAL POSITION

By year's end the estimated cost of the Commission's liabilities, in particular outstanding claims of $8.6 billion, offset by its assets, principally reinsurance recoveries, cash and investments, meant that EQC has net liabilities of $1.6 billion.

The Government guarantee ensures that despite its net liabilities, EQC will be able to pay out on all outstanding claims as they are approved.

Ratings agencies continue to provide positive reports on EQC, reflecting confidence in the organisation's financial position.

On 1 June EQC renewed its reinsurance programme and added extra cover of $500 million. The cost to renew our reinsurance increased significantly. This was expected given the impact on the reinsurance market of several natural disasters in the Asia-Pacific region during the past 18 months. Despite the market conditions, the industry continues to show confidence in EQC – in large part due to the world leading research we have provided over many decades as the basis for their risk assessments.

To help rebuild the NDF over time, EQC's premium increased from 5 cents to 15 cents per $100 sum insured from 1 February. This will increase the Commission's annual levy revenue from about $86 million to about $260 million.

The levy increase is to ensure EQC can meet its long-term costs and continue to provide disaster cover for New Zealand in a sustainable way.

It will provide additional confidence to homeowners throughout the country that EQC has the capacity to meet its obligations now and in the future.

RESEARCH & EDUCATION

EQC's research function is highly influential both inside and outside the organisation. In addition to supporting the Commission's reinsurance programme, EQC-funded natural hazards research underpins land use planning and building design as well as the Commission's public education activity.

Increasingly EQC is working with local government organisations and professional groups such as engineers and planners to ensure the research findings are embedded in land use planning, building codes and other key documents that ensure public safety.

This year EQC's research focus was on projects that would contribute to our understanding of the Canterbury earthquakes. EQC funded a major report called 'The Value of Lifeline Seismic Risk Mitigation in Christchurch' which found that the human and material cost of the Canterbury quakes could have been much higher if changes had not been made in the mid 90s to strengthen core utilities such as transport, telecommunications and electricity. The Commission has sponsored seismic risk mitigation planning in infrastructure for some years.

EQC continued its long-term funding of collaborative research into volcanic risk in Auckland. Launched in 2008, DEVORA (Determining Volcanic Risk in Auckland) is a seven-year project to better understand the geology of the Auckland Volcanic Field and the impact of a potential eruption on people and organisations.

EQC also renewed its funding of the ongoing 'It's Our Fault' research programme, launched in 2006, which aims to position Wellington as a more resilient city through

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studying the likelihood of large earthquakes and their possible effects. Research is currently focused on modelling the impact of potential large quakes on land and buildings.

Our investment of $8 million annually in the GeoNet monitoring system for some 11 years now has proved extremely valuable not just for scientists, but for the public as well. The information collected is available free on the geonet.org.nz website and since the Canterbury earthquakes the site now receives around 15,000 hits per second in the moments following a major aftershock.

EQC's public education programmes, which encourage people to take steps to prevent natural disaster damage to their homes, have been adapted to include some of the lessons learned from the Canterbury experience.

A highlight of this year's activity was the EQC-funded virtual field trip, *Canterbury earthquakes – lessons for New Zealand* which attracted 3,600 school students from 158 classes in schools throughout the country. Using technology the students 'visited' Canterbury and learnt about the science of the quakes, their consequences and how to prepare. They met earthquake experts and representatives from EQC and had the opportunity to ask questions.

We also committed to renewing our sponsorship of the *Awesome Forces* exhibition at Te Papa, the museum's most popular long-term exhibition. EQC's sponsorship of *Awesome Forces*, and the EQC kiosk mini-exhibition, has delivered the story of New Zealand's dramatic landscape and how it affects the lives of all who live here, to more than 11.6 million visitors since the museum opened in 1998.

PLANNING AHEAD

Given the size of the task EQC has faced and the changes to its role since the September 2010 Canterbury earthquake it is important that a thorough review of the Commission's scheme be undertaken.

Treasury has been commissioned to carry out a broad policy review which will consider the future of EQC and what it might become as we transition from managing the immediate response to the Canterbury earthquakes to the 'new normal'. One aspect of this review will be to consider whether the existing insurance caps and coverage are still appropriate. We are part of the review process and, while it is not an examination of EQC's operational response, our experience and expertise will provide practical lessons for the development of future policy.

TEAMWORK

Needless to say EQC's many and varied activities could not be carried out without an enormous amount of effort from our staff. EQC is today almost unrecognisable from the small team of 22 who comprised the staff of the Commission when I started as CE in March 2010. Numbers peaked in October 2011 with 1,568 people working in a variety of roles. At 30 June this had dropped to 1,154.

We have streamlined our operations in Christchurch with most staff now working from one office in Addington rather than five separate locations. This has resulted in better internal communications and integration, as well as improved access to telecommunications and email.

I would like to thank the Board and everyone at EQC for their energy, enthusiasm and above all adaptability. We operate in a fast-changing, pressured environment, but the EQC team rises to the challenge day after day. Staff join EQC because they want to make a difference. I'm very proud of this attitude.

Many of our Christchurch staff are also our customers and I want to particularly thank them for their dedication and hard-work when they themselves are personally affected by the situation.

Ian Simpson
Chief Executive

The Canterbury earthquakes' impact on EQC's accounts

THE FINANCIAL YEAR ENDING 30 JUNE 2011

At the start of the 2010/2011 financial year (two months before the first Canterbury earthquake) the Natural Disaster Fund was valued at around $6 billion, largely invested in shares and government stock. EQC had reinsurance policies in place allowing the Commission to recover claims costs up to $2.5 billion for each event, after paying the first $1.5 billion dollars.

One year later there had been three major earthquakes in Canterbury (4 September 2010, 22 February and 13 June 2011) plus numerous damage causing aftershocks. By this stage EQC had paid out $1.2 billion in claims, but this was only a small portion of the enormous number of claims to be settled. The EQC commissioned an independent insurance specialist (actuary) to estimate the total amount that it would be liable for claims settlements. The actuary estimated that as at 30 June 2011 the cost of claims was around $11.4 billion, with the EQC able to recover around $4.2 billion from its reinsurers.

THE FINANCIAL YEAR ENDING 30 JUNE 2012

In the twelve months since 30 June 2011 there have been further aftershocks, including two major ones on 23 December 2011. Many of these aftershocks increased the cost of claims to EQC. During the year $2.8 billion of claims costs were paid, and EQC started to recover money from its reinsurers.

A revised estimate by the actuary as at 30 June 2012 increased the amount owing for Canterbury claims by $1.2 billion and increased the amount due from reinsurers by $0.4 billion.

Summary of accounts

Income Statement	2012 $m	2011 $m
Income from investments and levies	320	500
Reinsurance premiums paid	(70)	(50)
Other operating costs	(40)	(40)
	210	**410**
Claims expense*	(1,190)	(11,450)
Reinsurance and other recoveries	350	4,230
Other insurance adjustments	190	(280)
	(650)	**(7,500)**
Loss for the year	**(440)**	**(7,090)**

* Includes non-Canterbury claims expense.

Balance Sheet	2012 $m	2011 $m
Investments and cash	3,120	5,170
Other assets	120	100
Other liabilities	(30)	(90)
	3,210	**5,180**
Claims payable	(8,640)	(10,200)
Reinsurance recoverable	4,080	4,230
Other insurance items	(240)	(370)
	(4,800)	**(6,340)**
Balance of the Natural Disaster FUnd	**(1,590)**	**(1,160)**

At 30 June 2011, the EQC had $5.2 billion in cash and investments and $4.2 billion to collect from insurers with an estimated $10.2 billion in claims payable.

A year later, the EQC had $3.1 billion in cash and investments and $4.1 billion to collect from insurers with an estimated $8.6 billion in claims payable.

Research **Projects**

funded 2011–2012

PRELIMINARY BROADBAND MODELLING OF AN ALPINE FAULT EARTHQUAKE IN CHRISTCHURCH

C Holden, J Zhao, GNS Science
EQC funded project 08/554

THE VERNON FAULT: ONSHORE PALEOSEISMICITY, CONSTRAINTS ON SLIP RATE, AND CONTRIBUTION TO HOLOCENE TECTONIC SUBSIDENCE OF BIG LAGOON, SOUTH ISLAND, NEW ZEALAND

K Clark, N Litchfield, R Van Dissen, GNS Science; T Bartholomew, T Little, Victoria University of Wellington
EQC funded project 10/598

STOCHASTIC MODELLING OF GEOPHYSICAL HAZARD

T Wang, M Bebbington, Massey University
EQC funded project 10/U611

NEW APPLICATIONS OF HIGH FORCE TO VOLUME (HF2V) DEVICES

J Chase, G MacRae, G Rodgers, University of Canterbury
EQC funded project 10/605

BEHAVIOUR AND DESIGN OF GENERIC BUCKLING RESTRAINED BRACE SYSTEMS

S Wijanto, University of Auckland
EQC funded project 11/U620

LIQUEFACTION CHARACTERISTICS OF PUMICE SANDS

R Orense, M Pender, University of Auckland; A O'Sullivan, Hiway Geotechnical Ltd
EQC funded project 10/589

DISASTER WASTE MANAGEMENT: NEW ZEALAND EXPERIENCES AND FUTURE PLANNING

C Brown, University of Canterbury
EQC funded project 10/U608

THE EFFECTS OF DETAILED ANALYSIS ON THE PREDICTION OF SEISMIC BUILDING POUNDING PERFORMANCE

G Cole, University of Canterbury
EQC funded project 10/U614

COLLECTION OF SEISMIC DATA FROM AFTERSHOCKS OF THE 4 SEPTEMBER 2010 M7.1 DARFIELD EARTHQUAKE

M Savage, E Smith, T Stern, J Townend, Victoria University of Wellington; C Thurber, E Syracuse, University of Wisconsin, Madison
EQC funded project 10/CE618

BOREHOLE SEISMOMETER MONITORING OF CHANGING PROPERTIES ON MT RUAPEHU VOLCANO

M Savage, T Stern, J Townend, Victoria University of Wellington; P Malin, University of Auckland; S Sherburn, GNS Science; Contributing students: J Johnson, A Shelley, Victoria University of Wellington
EQC funded project 08/546

PHYSICAL AND STATISTICAL MODELS FOR THE SEISMOLOGICAL PROPERTIES AND A TEMPORAL EVOLUTION OF EARTHQUAKE SEQUENCES (SWARMS) IN THE CENTRAL VOLCANIC REGION, NEW ZEALAND

K Jacobs, Victoria University of Wellington
EQC funded project 08/TV564

INFLUENCE OF STEEL SHIM HARDNESS ON THE SLIDING HINGE JOINT PERFORMANCE

H-S Khoo, C Clifton, J Butterworth, G Ferguson, University of Auckland; G MacRae, University of Canterbury
EQC funded project 10/U615

TIME-VARYING SEISMIC VELOCITY IN NEW ZEALAND'S VOLCANIC REGIONS: COMPARISONS BETWEEN SHEAR WAVE SPLITTING AND SURFACE WAVE NOISE CORRELATIONS

M Savage, Victoria University of Wellington; W Fry, A Jolly, GNS Science; Contributing Students: J Johnson, R Holt, B Keats
EQC funded project 10/603

INSURANCE SHOCKS: MARKET BEHAVIOUR AND GOVERNMENT RESPONSES – INTERNATIONAL CASE STUDIES WITH RELEVANCE TO NEW ZEALAND

D Middleton, Kestrel Group Ltd
EQC project 12/SP639

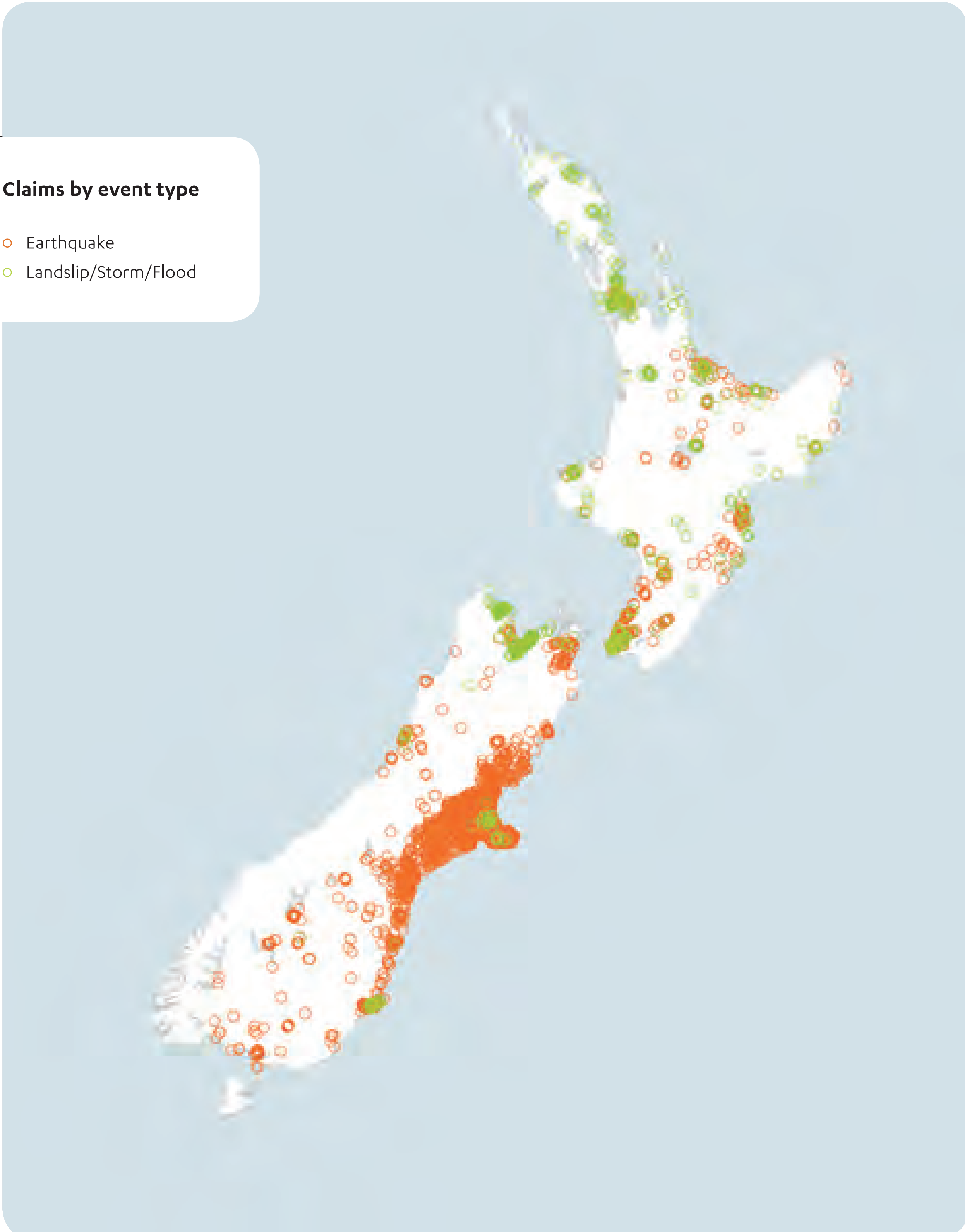
THE VALUE OF LIFELINE SEISMIC RISK MITIGATION IN CHRISTCHURCH

New Zealand Lifelines (prepared by T Fenwick)
EQC funded project 12/SP642

CHANGES IN PREPAREDNESS AND EARTHQUAKE RISK PERCEPTION: LESSONS FROM THE 2010 AND 2011 CANTERBURY EARTHQUAKES

D Johnston, Joint Centre for Disaster Research; J McClure, L Henrich, Victoria University of Wellington
EQC project 12/U641

Natural Disaster **Claims Locations**



Summary of **Claims**

CLAIMS INCURRED IN THE FINANCIAL YEAR

	2011–2012 NO. OF CLAIMS	2011–2012 PAYMENTS $(000)	2010–2011 NO. OF CLAIMS	2010–2011 PAYMENTS $(000)
Earthquake	92,753	81,029	372,102	3,360,091
Fire Following Earthquake	6	7	2	0
Landslip	1,757	23,090	2,602	53,899
Hydrothermal Activity	0	0	0	0
Volcanic Eruption	0	0	0	0
Tsunami	0	0	8	616
TOTALS	**94,516**	**104,126**	**374,941**	**3,414,404**

Note: This table discloses only those claims made in the current financial year.

Financial **Statements**

Independent **Auditor's Report**

Deloitte.

TO THE READERS OF THE EARTHQUAKE COMMISSION'S FINANCIAL STATEMENTS AND NON-FINANCIAL PERFORMANCE INFORMATION FOR THE YEAR ENDED 30 JUNE 2012

The Auditor-General is the auditor of the Earthquake Commission (the Commission). The Auditor-General has appointed me, Ian C Marshall, using the staff and resources of Deloitte, to carry out the audit of the financial statements and non-financial performance information of the Commission on her behalf.

We have audited:

- the financial statements of the Commission on pages 19 to 50, that comprise the statement of financial position as at 30 June 2012, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date and notes to the financial statements that include accounting policies and other explanatory information; and
- the non-financial performance information of the Commission that comprises the statement of service performance on pages 51 to 63.

Opinion

In our opinion:

- the financial statements of the Commission on pages 19 to 50:
    - › comply with generally accepted accounting practice in New Zealand; and
    - › fairly reflect the Commission's:
        - financial position as at 30 June 2012; and
        - financial performance and cash flows for the year ended on that date.
- the non-financial performance information of the Commission on pages 51 to 63:
    - › complies with generally accepted accounting practice in New Zealand; and
    - › fairly reflects the Commission's service performance and outcomes for the year ended 30 June 2012, including for each class of outputs:
        - its service performance compared with forecasts in the statement of forecast service performance at the start of the financial year; and
        - its actual revenue and output expenses compared with the forecasts in the statement of forecast service performance at the start of the financial year.

Emphasis of Matters – Uncertainties associated with the outstanding claims liability and reinsurance receivables, and the appropriateness of the going concern assumption

Without modifying our opinion, we draw your attention to note 2 to the financial statements about insurance liabilities, which explains how the Canterbury earthquakes have affected the outstanding claims liability and related reinsurance receivables of the Commission. It also describes the significance of the amounts of the earthquake-related outstanding claims liability and related reinsurance receivables, and the inherent uncertainties involved in estimating those amounts using actuarial assumptions. The valuation of the reinsurance receivables is subject to similar uncertainties as the valuation of the outstanding claims liability.

Also, without modifying our opinion, we draw your attention to note 1 to the financial statements about the going concern assumption, which notes that total liabilities exceed assets, and that the Crown, under Section 16 of the Earthquake Commission Act 1993, is obliged to grant or advance sufficient sums to meet any deficiencies.

We consider the disclosures about both of the above matters to be adequate.

Our audit was completed on 5 October 2012. This 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 of Commissioners and our responsibilities, and we explain our independence.

BASIS OF OPINION

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the financial statements and non-financial performance information are free from material misstatement.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements and non-financial performance information. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements and non-financial performance information. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements and non-financial performance information, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the preparation of the Commission's financial statements and non-financial performance information that fairly reflect the matters to which they relate. We consider internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control.

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Board of Commissioners;
- the appropriateness of the reported non-financial performance information within the Commission's framework for reporting performance;
- the adequacy of all disclosures in the financial statements and non-financial performance information; and
- the overall presentation of the financial statements and non-financial performance information.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and non-financial performance information. We have obtained all the information and explanations we have required and we believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Responsibilities of the Board of Commissioners

The Board of Commissioners is responsible for preparing financial statements and non-financial performance information that:

- comply with generally accepted accounting practice in New Zealand;
- fairly reflect the Commission's financial position, financial performance and cash flows; and
- fairly reflect its service performance and outcomes.

The Board of Commissioners is also responsible for such internal control as is determined necessary to enable the preparation of financial statements and non-financial performance information that are free from material misstatement, whether due to fraud or error.

The Board of Commissioners' responsibilities arise from the Crown Entities Act 2004 and the Earthquake Commission Act 1993.

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements and non-financial performance information and reporting that opinion to you based on our audit. Our 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 New Zealand Institute of Chartered Accountants.

In addition to the audit we have carried out assignments in the areas of agreed upon procedures in relation to information extracted from the actuarial report, Insurance Liability Valuation dated 1 March 2012, a review of service level agreement compliance and data analytics which are compatible with those independence requirements. In addition, principals and employees of our firm may also deal with the Commission on normal terms within the ordinary course of business of the Commission. We have no other relationship with, or interests in, the Commission.

Ian C Marshall
Deloitte
On behalf of the Auditor-General
Wellington, New Zealand

This audit report relates to the financial statements of the Earthquake Commission (the Commission) for the year ended 30 June 2012 included on the Commission's website. The Commission's Board of Commissioners is responsible for the maintenance and integrity of the Commission's website. We have not been engaged to report on the integrity of the Commission's website. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. 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 5 October 2012 to confirm the information included in the audited financial statements presented on this website. Legislation in New Zealand governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement of **Responsibility**

The Board of Commissioners (the Board) is responsible for the preparation of the Earthquake Commission's financial statements and statement of service performance, and for the judgements made in them.

The Board, through management, has the responsibility 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 and the statement of service performance for the financial year ended 30 June 2012 fairly reflect the financial position, operations and service performance of the Commission.

Signed on behalf of the Board:

Deputy Chairman
5 October 2012

Commissioner
5 October 2012

Statement of **Comprehensive Income**

FOR THE YEAR ENDED 30 JUNE 2012

	NOTE	ACTUAL 2012 $(000)	BUDGET 2012 $(000)	ACTUAL 2011 $(000)
Earned premium				
Gross earned premiums	3	107,495	88,821	87,766
Outward reinsurance premium expense		(72,335)	(77,500)	(48,660)
Net earned premium revenue		**35,160**	**11,321**	**39,106**
Underwriting costs				
Reinsurance and other recoveries	4	354,436	–	4,229,314
Claims expense	5	(1,192,665)	–	(11,448,607)
Catastrophe response programme	6	(9,823)	(10,421)	(7,456)
Movement in unexpired risk liability	18	191,546	–	(281,120)
Total underwriting costs		**(656,506)**	**(10,421)**	**(7,507,869)**
(Deficit)/surplus from underwriting activities		**(621,346)**	**900**	**(7,468,763)**
Other operating costs				
Public education	6	(1,454)	(3,600)	(1,386)
Research (excluding GeoNet)	6	(4,048)	(3,275)	(2,796)
GeoNet programme	6	(8,786)	(8,458)	(8,792)
Total operating costs		**(14,288)**	**(15,333)**	**(12,974)**
Investment activities				
Investment income	7	211,519	219,517	415,324
Investment costs	6	(4,944)	(8,342)	(7,570)
Interest on cash balances		3,386	–	1,377
Surplus from investment activities		**209,961**	**211,175**	**409,131**
Crown underwriting fee	19	(10,000)	(10,000)	(10,000)
Net (deficit)/surplus for the year and total comprehensive income		**(435,673)**	**186,742**	**(7,082,606)**

Explanations of major variances against budget are provided in Note 8.

The accompanying notes form part of these financial statements.

Statement of **Changes in Equity**

FOR THE YEAR ENDED 30 JUNE 2012

	NOTE	ACTUAL 2012 $(000)	BUDGET 2012 $(000)	ACTUAL 2011 $(000)
Natural Disaster Fund				
Capitalised reserves				
Opening balance at 1 July	9	1,500,000	1,500,000	1,500,000
Movement for the year		–	–	–
Closing balance at 30 June		**1,500,000**	**1,500,000**	**1,500,000**
Retained earnings				
Opening balance at 1 July		(2,656,401)	1,765,570	4,426,205
Net (deficit)/surplus for the year and total comprehensive income		(435,673)	186,742	(7,082,606)
Closing balance at 30 June		**(3,092,074)**	**1,952,312**	**(2,656,401)**
CLOSING BALANCE AS AT 30 JUNE		**(1,592,074)**	**3,452,312**	**(1,156,401)**

The accompanying notes form part of these financial statements.

Statement of **Financial Position**

AS AT 30 JUNE 2012

	NOTE	ACTUAL 2012 $(000)	BUDGET 2012 $(000)	ACTUAL 2011 $(000)
NATURAL DISASTER FUND				
Capitalised reserves	9	1,500,000	1,500,000	1,500,000
Retained earnings	9	(3,092,074)	1,952,312	(2,656,401)
TOTAL EQUITY	**9**	**(1,592,074)**	**3,452,312**	**(1,156,401)**
ASSETS				
Cash at bank		636,455	100,945	266,923
Premiums receivable		55,765	17,024	18,282
Reinsurance and other recoveries	10	4,074,344	2,200,000	4,229,557
Other receivables	11	16,429	40,000	46,099
Prepayments		21,252	15,000	10,578
Investments	12	2,485,024	3,849,933	4,903,564
Property, plant and equipment	13	24,329	16,103	21,561
Intangible assets	14	4,160	2,224	2,748
TOTAL ASSETS		**7,317,758**	**6,241,229**	**9,499,312**
LIABILITIES				
Trade and other payables	15	31,641	3,617	84,625
Provision for employee entitlements		1,191	–	393
Outstanding claims liability	16	8,638,000	2,700,000	10,204,135
Unearned premium liability	17	110,426	46,300	46,440
Unexpired risk liability	18	128,574	39,000	320,120
TOTAL LIABILITIES		**8,909,832**	**2,788,917**	**10,655,713**
NET (LIABILITIES*)/ASSETS		**(1,592,074)**	**3,452,312**	**(1,156,401)**

* 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. For further information refer to the *going concern* explanation under *basis of preparation* and Note 9 – *Commission Solvency*.

Explanations of major variances against budget are provided in Note 8.

The accompanying notes form part of these financial statements.

Statement of **Cash Flows**

FOR THE YEAR ENDED 30 JUNE 2012

	NOTE	ACTUAL 2012 $(000)	BUDGET 2012 $(000)	ACTUAL 2011 $(000)
Cash flows from operating activities				
Cash was provided from:				
Interest		146,418	88,443	227,149
Premiums		133,622	107,209	88,456
Dividends		13,703	30,000	32,814
Reinsurance and other recoveries		510,061	1,000,000	189
Crown recoveries	8	–	140,000	–
Net GST		29,414	–	–
Cash was disbursed to:				
Outward reinsurance		(82,660)	(85,775)	(51,855)
Crown underwriting fee		(10,000)	(10,000)	(10,000)
Claims settlements and handling costs		(2,807,246)	(2,200,000)	(1,177,594)
Employees and other operating expenses		(17,157)	(21,963)	(14,574)
GeoNet operating expense		(5,340)	(5,627)	(6,060)
Research grants		(1,964)	(2,502)	(1,851)
Net GST		–	–	(46,380)
Net cash outflow from operating activities	26	**(2,091,149)**	**(960,215)**	**(959,706)**
Cash flows from investing activities				
Cash was provided from:				
Sale of investments		2,473,543	1,016,650	1,489,459
Sale of property, plant and equipment		7	–	42
Cash was applied to:				
Purchase of investments		–	(51,686)	(263,000)
Purchase of property, plant and equipment		(10,789)	(3,874)	(10,518)
Purchase of intangibles		(2,080)	(679)	(563)
Net cash inflow from investing activities		**2,460,681**	**960,411**	**1,215,420**
Net increase in cash		**369,532**	**196**	**255,714**
Add opening cash brought forward		266,923	100,749	11,209
Ending cash carried forward		**636,455**	**100,945**	**266,923**

"Net GST" represents the net GST paid to or received from the Inland Revenue Department.

Explanations of major variances against budget are provided in Note 8.

The accompanying notes form part of these financial statements.

Notes to the **Financial Statements**

1. ACCOUNTING POLICIES

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 financial statements is the year ended 30 June 2012. These accounts were approved by the Board on 5 October 2012.

Basis of Preparation

MEASUREMENT BASE

The financial statements have been prepared on a historical cost basis modified by the measurement of financial instruments at fair value through surplus/(deficit), and the measurement of insurance liabilities and reinsurance recoveries at present value as set out below.

FUNCTIONAL AND PRESENTATIONAL CURRENCY

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

GOING CONCERN

Actuarial estimates of the Commission's claims liabilities, net of reinsurance, at 30 June 2012 indicate that total liabilities, net of reinsurance exceed its assets. 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 has therefore adopted the going concern assumption in preparing these financial statements.

STATEMENT OF COMPLIANCE

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

ACCOUNTING JUDGEMENTS AND MAJOR SOURCES OF ESTIMATION

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

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

The 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 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. These are discussed in Note 2.

Significant Accounting Policies

INSURANCE

Premium Income

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 unearned premium liability. Premiums receivable are reported net of discounts paid to collecting agencies.

Reinsurance Premiums

Premiums paid to reinsurers are recognised by the Commission as reinsurance premium expense in surplus/(deficit) 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 Recoveries

Reinsurance recoveries are the expected reimbursement of claims settlements and claims handling costs that the Commission can recover under its reinsurance contracts, and other recoveries comprises 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/or claims incurred but not enough reported (IBNER) are recognised as revenue in surplus/(deficit). They are measured as the present value of the expected future receipts, calculated on the same basis as the liability for outstanding claims.

Claims Expenses

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

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.

Unexpired Risk Liability

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

Where the current estimate of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current insurance contracts, with an additional risk margin to allow for the inherent uncertainty in the central estimate, exceeds the value of the unearned premium, the deficiency is recognised in net surplus/(deficit) and recorded in the Statement of Financial Position as an unexpired risk liability.

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 performance criteria, on which approval of the grant was based, are met.

FOREIGN CURRENCY

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

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.

GOODS AND SERVICES TAX (GST)

All items in the 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 as input tax then it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the Inland Revenue Department (IRD) is included as part of receivables or payables in the Statement of Financial Position.

Commitments and contingencies are disclosed exclusive of GST.

INVESTMENTS

Interest

Interest income is accrued using the effective interest method.

Dividends

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

Realised Gains and Losses

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

Unrealised Gains and Losses

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

FINANCIAL INSTRUMENTS

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 trade date, i.e. the date that the Commission commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Commission's obligations specified in the contract expire or are discharged or cancelled.

Non-Derivative Financial Instruments

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

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

Financial Instruments at Fair Value Through Profit or Loss

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

Cash at bank

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

Investments

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

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

Derivative Financial Instruments

The Commission uses derivative financial instruments to economically hedge its exposure to foreign exchange risks arising from investment activities. In accordance with its treasury policy, the Commission does not hold or issue derivative financial instruments for trading purposes.

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

Receivables

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

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

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

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

PROPERTY, PLANT AND EQUIPMENT

Overview

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

Additions

The cost of an item of property, plant and equipment is recognised as an asset only when it is probable that future economic benefits or service potential associated with the item will flow to the Commission and the cost of the item can be measured reliably. Where an asset is acquired at no cost, or for a nominal cost, it is recognised at fair value when control over the asset is obtained.

Disposals

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the asset. Gains and losses are included in surplus/(deficit).

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 surplus/(deficit) as they are incurred.

GeoNet Assets

GNS Science administers the design, engineering, operation and maintenance of New Zealand's geological hazard monitoring system (GeoNet) under a ten-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 surplus/(deficit) 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 typically as follows:

Furniture and equipment	3–12 years
GeoNet buildings	25 years
GeoNet computer equipment	3 years
GeoNet other equipment	8 years
Canterbury event furniture, equipment and motor vehicles*	3 years

* Canterbury event assets are capitalised and amortised over their useful lives, which is currently estimated to be 3 years.

INTANGIBLE ASSETS

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

Research and Development

Expenditure on research activities, undertaken with the prospect of gaining new scientific knowledge or understanding, is recognised in surplus/(deficit) 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 over the following useful lives:

Computer software applications and licences	2–9 years

IMPAIRMENT OF NON-FINANCIAL ASSETS

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

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. Value in use is depreciated replacement cost for an asset where the future economic benefits or service potential of the asset are not primarily dependent on the asset's ability to generate net cash inflows and where the Commission would, if deprived of the asset, replace its remaining future economic benefits or service potential.

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

LEASES

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

COMPARATIVES

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

BUDGETS

The budget figures are derived from the 2011 to 2014 Statement of Intent as approved by the Board at the beginning of the financial year. The budget figures have been prepared in accordance with NZ IFRS, using accounting policies that are consistent with those adopted by the Commission for the preparation of the financial statements.

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

SUPERANNUATION SCHEME

Defined Contribution Scheme

Obligations for contributions to the KiwiSaver and the State Sector Retirement Savings Scheme (SSRSS) are accounted for as defined contribution superannuation schemes and are recognised as an expense in surplus/(deficit) 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 number of full time equivalents employed in each function.

CHANGES IN ACCOUNTING POLICIES

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

STANDARDS, AMENDMENTS AND INTERPRETATIONS ISSUED THAT ARE NOT YET EFFECTIVE AND HAVE NOT BEEN EARLY ADOPTED

There are currently no standards, amendments and interpretations issued that are not yet effective and have not been early adopted, that would have a material effect on the financial statements of the Commission.

2. INSURANCE LIABILITIES

Actuarial Assumptions and Methods

The actuarial valuation report for 2012 was prepared by Craig Lough of Melville Jessup Weaver. Craig Lough is a Fellow of the New Zealand Society of Actuaries. The report was commissioned to provide estimates of the outstanding claims liability, reinsurance and other recoveries, and premium liabilities to be used in the liability adequacy test.

The effective date of the valuation is 30 June 2012. Craig Lough considered that overall the information and data supplied to him was adequate and appropriate for the purposes of his valuation.

Melville Jessup Weaver also performed actuarial calculations with respect to the outstanding claims liability at 30 June 2011.

Uncertainties Arising from the Canterbury Earthquakes

The Canterbury earthquakes have resulted in a higher than usual level of uncertainty associated with the valuation of the outstanding claims liability, reinsurance recoveries and unexpired risk liability. Some of the key sources of uncertainty are: the impact of multiple events on Commission coverage and reinsurance coverage; severe land damage and a complex land claims environment from both an engineering and legal perspective; and the potential for construction cost inflation to exceed expectations. As a result the actual claims outcomes may prove to be different from the liabilities that have been established.

The Act requires all claims to be reported within three months of an event, and therefore the key area of estimation risk is future development in the cost of existing claims (IBNER) rather than the future notification of claims from past events. The volatility of IBNER is partially mitigated by the maximum settlement amounts per event of $20,000 for personal property and $100,000 for dwellings. Claims in relation to residential land are not subject to a single monetary limit and are therefore subject to greater uncertainty.

Outstanding Claims Liability

To determine the outstanding claims liability, the actuarial approach adopted was to estimate the projected ultimate claims costs then deduct the payments made in relation to those claims on or before the year ended 30 June 2012. An aggregate Bayesian stochastic frequency/severity model was used to calculate the estimated ultimate claims costs. Each component of the claims liability was split into separate groups depending upon the Canterbury earthquake event grouping or other “business as usual” claims. These event groups were further split into sub-claim valuation groups being land claims, building claims or contents claims.

The following ranges of assumptions have been used in determining the outstanding claims liability:

	2012	2011
Weighted average term to settlement	1.3 years	0.3 to 1.9 years
Claims inflation rate per annum	2.5%	2.5% to 5.0%
Discount rate per annum	2.4% to 3.3%	2.84% to 6.07%
Risk margin	14.3%	10.4%
Claims handling expense ratio	7.7%	6.1%

Processes Used to Determine Assumptions

Weighted average term to settlement: the weighted average term to settlement varies by valuation groupings having regard to the estimated future patterns of gross claim payments for these groupings.

Claims inflation rate: the claims inflation rates were set having regard to Treasury’s published CPI assumptions as at 30 June 2012, with some allowance for higher levels of claims inflation for the building claims. In addition, the risk margin implicitly allows for somewhat higher levels of claims inflation.

Discount rate: projected cash flows are discounted for the time value of money using Treasury’s published discount rates as at 30 June 2012.

Risk margin: the risk margins are derived directly from the claims distributions produced by the net incurred claims cost models. In order to determine the degree of variance and hence risk margins at higher aggregated levels the variances of each component distribution are combined. Correlation is assumed at the event level but not at the sub-claim level. The risk margin is expressed as a percentage of the net discounted outstanding claims liability including claims handling expenses and is intended to achieve a 75% probability of adequacy.

Claims handling expense ratio: claims handling expenses are subdivided into event groups and estimated on a per-claim basis using per-claim assumptions derived from an analysis of expenses. Risk margins are also applied to claims handling expenses. The claims handling expense ratio is expressed as a percentage of the gross undiscounted outstanding claims liability.

Sensitivity of Assumptions

The sensitivity analysis below shows the potential impact of changes in the key assumptions on the value of the net outstanding claims liability. For example, increasing the weighted average term to settlement by 0.5 years, results in an increase to the claims liability of $14 million.

VARIABLE	MOVEMENTS IN VARIABLE	IMPACT ON NET OUTSTANDING CLAIMS LIABILITY 2012 $(000)	2011 $(000)
Weighted average term to settlement	+0.5 years	+14,000	+31,100
	-0.5 years	-35,000	-34,700
Claims inflation rate	+1.0%	+75,000	+104,700
	-1.0%	-75,000	-106,500
Discount rate	+1.0%	-75,000	-124,600
	-1.0%	+76,000	+142,600
Risk margin	+1.0%	+43,000	+54,100
	-1.0%	-43,000	-54,100
Claims handling expenses ratio	+1.0%	+67,000	+58,600
	-1.0%	-78,000	-58,600

3. PREMIUMS

	ACTUAL 2012 $(000)	BUDGET 2012 $(000)	ACTUAL 2011 $(000)
Gross premiums	175,863	91,110	90,927
Less discount	(4,382)	(2,289)	(2,267)
	171,481	**88,821**	**88,660**
Unearned premium opening	46,440	46,300	45,546
Unearned premium closing	(110,426)	(46,300)	(46,440)
	(63,986)	**–**	**(894)**
Gross earned premium	**107,495**	**88,821**	**87,766**

Premium income represents premiums collected and paid to the Commission by insurance companies and brokers. In accordance with Section 24 (2) of the Act, the Commission receives declarations provided by insurance companies and brokers that all premiums collected have been returned to the Commission. Effective from 1 February 2012 the Earthquake Commission Amendment Regulations 2011 increased the premium collected from 5 cents for every $100 of sum insured to 15 cents for every $100 of sum insured.

4. REINSURANCE AND OTHER RECOVERIES

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Gross reinsurance recoveries	98,113	4,574,700
Movement in discount	292,838	(389,738)
Discounted reinsurance recoveries	**390,951**	**4,184,962**
Crown recoveries	(37,250)	43,808
Canterbury Earthquake Recovery Authority (CERA)	735	375
Other	–	169
Total other recoveries	**(36,515)**	**44,352**
Total reinsurance and other recoveries	**354,436**	**4,229,314**

At 30 June 2011 it was expected that $4,574,700,000 would be recovered from the reinsurers for damage relating to the Canterbury earthquake sequence. At 30 June 2012 reinsurance recoveries were reassessed and it was estimated that an additional $98,113,000 was recoverable. This has been recognised in the current financial year.

Cash flow projections for reinsurance recoveries are discounted for the time value of money. The discount is reassessed at the end of each financial year to take into account changes to interest rates, payment patterns and settlement periods. At 30 June 2012, the discount for the outstanding reinsurance recoveries was reduced by $292,838,000 to $97,000,000 (refer to note 10). This adjustment increased the discounted reinsurance recoveries for the current financial year.

In 2011, the Commission expected to recover $37,250,000 from the Crown for land remediation under Section 25 of the Public Finance Act 1989 for work to be carried out in repairing land in Kaiapoi, Canterbury. During the current financial year a decision was made to classify the land as red-zone with repair no longer required. In 2012, both the receivable and the associated payable were reversed. The net impact on the deficit for the year was nil.

5. CLAIMS EXPENSE

SUMMARY	2012 CURRENT YEAR $(000)	2012 PRIOR YEARS $(000)	2012 TOTAL $(000)	2011 CURRENT YEAR $(000)	2011 PRIOR YEARS $(000)	2011 TOTAL $(000)
Gross claims – undiscounted	718,648	(146,921)	571,727	12,340,157	(612)	12,339,545
Discount	(17,000)	637,938	620,938	(890,938)	–	(890,938)
Gross claims – discounted	**701,648**	**491,017**	**1,192,665**	**11,449,219**	**(612)**	**11,448,607**

Current year claims expense comprises amounts paid (or estimates of amounts payable) in relation to natural disaster damage sustained during the current financial year. Prior years' claims expense relates to amounts paid (or estimates of amounts payable) where the damage occurred in prior financial years. Changes to prior years' claims expense occurs when the actual or estimated settlement values of claims changed during the current financial year.

At 30 June 2011, the total gross estimated cost of the Canterbury earthquake events and other non-Canterbury claims was assessed as $11,448,607,000. At 30 June 2012 the total amount paid or payable for damage incurred to 30 June 2011 was reassessed and is now expected to be $146,921,000 lower than previously expected. This reduction is recognised in the current financial year. The discount on prior year claims payable was also recalculated to take into account changes to interest rates, payment patterns and the reduced period to settlement.

During the current year, there were also further Canterbury earthquakes and other claims for which the paid and payable value was estimated to be $718,648,000.

CLAIMS EXPENDITURE BY EXPENSE TYPE	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)	CUMULATIVE TOTAL $(000)
Canterbury claims expense			
Advertising and publicity	945	3,777	4,722
Fees paid to the auditor			
Audit of the financial statements *(i)*	203	–	203
Other fees to the auditor	20	–	20
Other assurance services	245	711	956
Call centres and claims management – third party	37,505	21,293	58,798
Claims assessment fees	69,007	92,737	161,744
Commissioners' fees	30	60	90
Claims administrators and contractors *(ii)*	21,293	17,925	39,218
Depreciation	4,761	1,076	5,837
Employee remuneration and benefits	23,216	2,434	25,650
Engineers and consultants *(iii)*	41,140	21,810	62,950
Office rental	2,743	1,486	4,229
Other costs	13,376	9,462	22,838
Project management and infrastructure – rebuilding programme	63,890	23,579	87,469
Travel and accommodation *(iv)*	23,440	29,094	52,534
Canterbury claims handling expenses incurred	**301,814**	**225,444**	**527,258**
Provision for future claims handling expenses (undiscounted)	(14,900)	600,900	586,000
Claims settlements (undiscounted)	255,515	11,445,485	11,701,000
Discount	620,938	(890,938)	(270,000)
Canterbury estimated cost of earthquakes	**1,163,367**	**11,380,891**	**12,544,258**
Other (non-Canterbury) claims			
Other claims expenses *(v)*	25,022	59,516	
Other claims handling costs	4,276	8,200	
Claims expense	**1,192,665**	**11,448,607**	

(i) *Prior year expenses are recognised in business as usual operating expenses in note 6.*

(ii) *This consists predominantly of claims processing costs, and administrative functions supporting that work, but also includes additional accounting staff, communications and information analysts engaged as a result of the Canterbury earthquake events.*

(iii) *In addition to engineering consultancy of $30.2 million, this also includes valuation, legal and assurance services.*

(iv) *This is primarily travel and accommodation for assessors and estimators, but also includes the rental and operating costs of vehicles for assessment work.*

(v) *This consists predominantly of landslip claims.*

6. OPERATING EXPENDITURE EXCLUDING CLAIMS EXPENSE

	ACTUAL 2012 $(000)	BUDGET 2012 $(000)	ACTUAL 2011 $(000)
Expenditure grouped by function*			
Catastrophe response programme	9,823	10,421	7,456
Public education	1,454	3,600	1,386
Research (excluding GeoNet)	4,048	3,275	2,796
GeoNet programme	8,786	8,458	8,792
Investment costs	4,944	8,342	7,570
Total expenditure by function excluding claims expense	**29,055**	**34,096**	**28,000**
Expenditure grouped by expense type			
Advertising and publicity	333	1,404	487
Amortisation of intangibles	642	696	433
Fees paid to the auditor			
Audit of the financial statements	123	150	156
Contract compliance and other assurance services	120	150	29
Commissioners' fees	204	220	172
Depreciation	3,279	3,046	3,018
Employee remuneration and benefits	4,012	3,483	2,425
Grants for earthquake research	2,020	2,502	2,187
GeoNet operating costs	5,665	5,618	5,908
Investment and custodial expenses – third party	3,150	6,660	6,106
Office rental	471	496	451
Sponsorships	567	1,291	532
Other administration costs	8,469	8,380	6,096
Total operating expenditure excluding claims expense	**29,055**	**34,096**	**28,000**

* Total expense for each function, as reported in the Statement of Comprehensive Income, including employee remuneration and the allocation of overheads.

7. INVESTMENT INCOME

	ACTUAL 2012 $(000)	BUDGET 2012 $(000)	ACTUAL 2011 $(000)
Global equities			
Equity (losses)/gains	(61,706)	120,100	271,301
Foreign exchange gains/(losses)	9,448	–	(162,425)
Dividend income	12,647	–	32,299
	(39,611)	**120,100**	**141,175**
NZ Government stock			
Interest and discount income	119,941	94,337	197,961
Price revaluation (losses)/gains	(40,052)	–	34,741
Realised gains on disposal	161,421	–	31,237
	241,310	**94,337**	**263,939**
Other short-term investments			
Interest income	9,820	5,080	10,210
Total investment income	**211,519**	**219,517**	**415,324**

8. MAJOR BUDGET VARIANCES

Statement of Comprehensive Income

EARNED PREMIUM

Premium levies were increased from the rate of 5 cents for every $100 of sum insured to the rate of 15 cents for every $100 of sum insured (Earthquake Commission Amendment Regulations 2011). The increase applied to contracts of insurance that provided cover for periods commencing on or after 1 February 2012. This increase was not foreseen at the time the budget was prepared.

REINSURANCE RECOVERIES

Reinsurance recoveries relating to Canterbury earthquakes were re-estimated by the Commission's actuaries and increased by $98 million. The discount for the time value of money was also reassessed to take into account changes to interest rates, payment patterns and settlement periods. It is not possible to budget for the impact of these reassessments.

CLAIMS EXPENSE

The claims liability for Canterbury earthquakes was increased by $1,193 million, reflecting a re-estimation of the prior year's claims liabilities, new claims arising from current year aftershocks and a recalculation of the discount. The discount was recalculated to take into account changes to interest rates, payment patterns and the reduced period to settlement. It is not possible to budget for future earthquakes and the impact of reassessments of prior year events.

MOVEMENT IN UNEXPIRED RISK LIABILITY

The adequacy of unearned premiums and the associated level of unexpired risk liability is reviewed each year. At 30 June 2012 the unexpired risk liability was reassessed in light of higher premium rates and higher unearned premiums, increased reinsurance costs and the decreased probability of significant damage-causing earthquakes in the Canterbury region. It is not possible to budget for the full impact of this reassessment.

INVESTMENT RETURNS

Investment returns were close to budget for the year due to Government stock valuation gains, resulting from a fall in average yields, offsetting poor global equity returns. Returns for 2011/12 were budgeted at significantly lower levels than previous years due to the expected liquidation of investments to cover claims settlements.

Statement of Financial Position

REINSURANCE AND OTHER RECOVERIES, OUTSTANDING CLAIMS LIABILITY

The significant variance to budget reflects the timing of the 2011/12 budget preparation. At the time of preparation, the impacts of the September 2010 and February 2011 Canterbury earthquakes and the significant aftershocks that have occurred since could not be reasonably estimated. As a result, variances to the outstanding claims liability and reinsurance recoveries budgets were expected.

INVESTMENT ASSETS, CASH AT BANK

The Commission's cash holdings have increased to enable it to pay claims as they fall due. To enable this, the Commission liquidated global equities, bank securities and New Zealand Government stock. The budget could not anticipate all of the Canterbury earthquakes and the timing of associated settlements that resulted in the accelerated liquidation of investments.

UNEXPIRED RISK LIABILITY

These are explained by the comments on the movement in unexpired risk liability above.

Statement of Cash Flows

CROWN RECOVERIES

The budget included reimbursement from the Crown for land remediation activities to certain parts of Christchurch and Waimakariri. Following the February 2011 earthquake this work was put on hold due to land zoning decisions and most of the work was subsequently cancelled.

SALE OF INVESTMENTS

More investments have been liquidated than was budgeted due to the additional Canterbury earthquakes.

REINSURANCE RECOVERIES AND CLAIMS SETTLEMENT AND HANDLING EXPENSES

These are explained by the comments on reinsurance recoveries and the outstanding claims liability above.

9. NATURAL DISASTER FUND

	ACTUAL 2012 $(000)	BUDGET 2012 $(000)	ACTUAL 2011 $(000)
Capitalised reserves	**1,500,000**	**1,500,000**	**1,500,000**
Retained earnings			
Balance as at 1 July	(2,656,401)	1,765,570	4,426,205
Net (deficit)/surplus for the year and total comprehensive income	(435,673)	186,742	(7,082,606)
Balance as at 30 June	**(3,092,074)**	**1,952,312**	**(2,656,401)**
Closing balance of the Natural Disaster Fund	**(1,592,074)**	**3,452,312**	**(1,156,401)**

Capitalised Reserves

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.

Capital Management

The Natural Disaster Fund comprises retained surpluses, deficits and capitalised reserves. The Commission is subject to the financial management and accountability provisions of the Crown Entities Act 2004, which impose restrictions in relation to borrowings, acquisition of securities, issuing guarantees and indemnities and the use of derivatives.

The Commission manages its equity by prudently managing reinsurance, revenues, expenses, assets, liabilities, investments and general financial dealings to ensure it effectively achieves its objectives and purpose, whilst remaining a going concern.

Commission Solvency

The Commission has exposure to liabilities in excess of its current level of assets. In the event that the Commission's assets are insufficient to meet its liabilities, the Crown, under Section 16 of the Act, is obliged to provide, by way of grant or advance, sufficient funds to meet the shortfall (refer also Note 1 page 23). The Crown has confirmed, in writing, its commitment to meet this obligation.

10. REINSURANCE AND OTHER RECOVERIES

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Gross reinsurance receivable	4,163,000	4,574,700
Discount	(97,000)	(389,738)
Discounted reinsurance receivable	**4,066,000**	**4,184,962**
Other recoveries		
Crown	7,500	44,163
CERA	844	432
Total other recoveries	**8,344**	**44,595**
Total reinsurance and other recoveries	**4,074,344**	**4,229,557**
Current	2,395,425	1,206,035
Non-current	1,678,919	3,023,522
	4,074,344	**4,229,557**
Reconciliation of movement in outstanding reinsurance and other recoveries		
Outstanding reinsurance and other recoveries at 1 July	4,229,557	–
Add income from reinsurance and other recoveries	354,436	4,229,314
Add GST adjustment	412	432
Less reinsurance and other recoveries received during the year	(510,061)	(189)
Outstanding reinsurance and other recoveries at 30 June	**4,074,344**	**4,229,557**

11. OTHER RECEIVABLES

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Goods and Services Tax	16,326	45,741
Other	103	358
Total receivables	**16,429**	**46,099**

12. FINANCIAL INSTRUMENTS

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Financial assets designated at fair value* through profit or loss		
NZ Government securities	2,083,083	3,529,820
NZ bank securities	401,941	–
Global equities	–	1,373,744
	2,485,024	**4,903,564**
Loans and receivables measured at fair value		
Cash at bank	636,455	266,923
Premiums receivable	55,765	18,282
Other receivables	16,429	46,099
Reinsurance and other recoveries	4,074,344	4,229,557
	4,782,993	**4,560,861**
Financial liabilities measured at amortised cost		
Trade and other payables	(31,641)	(84,625)
Provision for employee entitlements	(1,191)	(393)
	(32,832)	**(85,018)**
Outstanding claims liability	**(8,638,000)**	**(10,204,135)**

* Fair value

Financial instruments that are measured subsequent to initial recognition at fair value are grouped into levels 1 to 3 based on the degree to which the fair value is observable:

- level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

All of the Commission's financial instruments that are measured at fair value are classified within level 1, for the current and prior years.

12A. FINANCIAL INSTRUMENTS – INVESTMENTS

Section 12 of the Act 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 securities (maximum $250 million) and global equities up to a maximum of 35% of total investments. All investments in New Zealand Government securities are only tradable with the New Zealand Debt Management Office (NZDMO).

A direction from the Minister of Finance was issued on 13 September 2010 permitting investments to be held in New Zealand bank securities up to a maximum of $2 billion. A new Ministerial direction, endorsing the 2010 direction, was issued on 15 September 2011.

At 30 June 2012 the fair values and concentrations of the Commission's investments were as follows:

	2012 FAIR VALUE $(000)	2012 % OF TOTAL INVESTMENT	2011 FAIR VALUE $(000)	2011 % OF TOTAL INVESTMENT
NZ Government stock	1,709,186	68.8	2,913,003	59.4
NZ Government inflation-indexed stock	373,897	15.0	566,837	11.6
NZ Government Treasury bills	–	–	49,980	1.0
Total Government securities	**2,083,083**	**83.8**	**3,529,820**	**72.0**
NZ bank securities	**401,941**	**16.2**	**–**	**–**
Global equities – active	–	–	781,392	15.9
Global equities – passive	–	–	592,352	12.1
Total global equities	**–**	**–**	**1,373,744**	**28.0**
Total investments	**2,485,024**	**100.0**	**4,903,564**	**100.0**
Current*	923,414	37.2	299,980	6.1
Non-current*	1,561,610	62.8	4,603,584	93.9
	2,485,024	**100.0**	**4,903,564**	**100.0**

* Classification as current or non-current is based on the contractual period of the instrument.

Interest Rate Risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Commission's investments in Government stock, Treasury bills and New Zealand bank securities expose it to interest rate risk.

The Commission passively manages its Government stock portfolio. This means that the portfolio is exposed to an interest rate risk identical to the New Zealand Government stock index.

In the event of a major catastrophe, and the need to immediately sell Government stock, the NZDMO has agreed to buy back the Commission's Government stock at pre-catastrophe prices. In practice, following the Canterbury earthquakes, sales of Government stock have been (and will continue to be) spread out over many months, and as market prices have been favourable this facility has not been required.

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

	2012 YIELD	2012 DURATION	2011 YIELD	2011 DURATION
NZ Government stock	2.88%	4.33 yrs	4.08%	4.21 yrs
NZ Government inflation-indexed stock	1.07%	3.46 yrs	1.67%	4.31 yrs
NZ Government Treasury bills	n/a	n/a	2.48%	6 days
NZ bank securities	2.63%	35 days	n/a	n/a
Term deposits	3.10%	27 days	n/a	n/a
On-call funds	2.55%	n/a	2.92%	n/a

Interest Rate Risk Sensitivity

A change in interest rates (yields) affects the price (fair value) that the Commission would receive upon the sale of a security.

The fair value is arrived at by discounting the cash flows arising from a financial instrument at the market yield and recognising in surplus/(deficit). An identical increase or decrease in interest rates will therefore not produce an identical outcome. A 50 basis point increase in interest rates would increase the deficit at balance date by $42,084,359 (2011: $70,811,741). A 50 basis point decrease would decrease the deficit by $43,528,134 (2011:$73,105,409).

Cash Flow Interest Rate Risk

The Commission does not invest in variable rate instruments, and is therefore not subject to cash flow interest rate risk.

Credit Risk

The Commission is exposed to the credit risk of a bank or the Crown defaulting on an investment. The Commission reduces credit risk by investing funds only in securities issued by approved New Zealand banks that have a short-term credit rating of A-1 or higher from Standard and Poor's. Exposure to any one bank with a rating of less than A-1+ is restricted to a maximum of 15% of total bank securities, but for banks with a rating of A-1+, the exposure may be extended to 25%. No collateral is held by the Commission in respect of bank balances or short-term securities due to the credit rating of financial institutions with whom the Commission transacts business. At balance date the Commission held short-term securities with seven registered banks. $602,714,636 was held on-call, $302,196,973 was held in term deposits, and $99,744,011 was held in bank bills (RCDs) (2011 short-term securities: nil, bank bills: nil, on-call: $228,760,768).

12B. FINANCIAL INSTRUMENTS – OTHER

Credit Risk

The Commission limits its exposure to very large-scale natural disasters through the purchase of reinsurance. The Commission is exposed to the credit risk of a reinsurer defaulting on its obligations. Note 19 explains how the Commission minimises the risk of default. The Commission reduces credit risk by placing reinsurance with counterparties who have a credit rating of AAA to A- from Standard and Poor's (i.e. from "extremely strong" to "strong") and limiting its exposure to any one reinsurer or related group of reinsurers.

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to Standard and Poor's credit ratings (if available) or to historical information about counterparty default rates:

CREDIT RATINGS – FINANCIAL INSTRUMENTS	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Counterparties with credit ratings		
Cash at bank and on-call deposits		
AA	130,082	229,923
AA-	908,313	37,000
Total	**1,038,395**	**266,923**
Reinsurance recoveries		
AA	238,507	252,848
AA-	1,115,706	1,497,076
A+	1,911,723	1,650,728
A	547,505	622,118
A-	252,559	162,192
	4,066,000	**4,184,962**
Crown recoveries		
AA+	8,344	44,595
GST receivable		
AA+	16,326	45,741
Premiums receivable		
AA-	19,387	6,578
A+	13,315	4,234
A	3,761	1,041
A-	19,277	6,404
Other	25	25
	55,765	**18,282**
Counterparties without credit ratings		
Other receivables	103	358

Liquidity Risk

The Commission's financial liabilities consist of claims payable, and trade and other payables. It is expected that the majority of trade payables outstanding at balance date will be settled within 12 months (2011: 12 months). Claims payable at balance date will be settled within the next five years.

The Commission's liquidity risk is the risk of having insufficient liquid funds available to meet claims, and trade and other payables as they fall due. To manage this risk, the Commission has increased the strategic allocation of investments invested in bank securities to 5–35% or up to an absolute amount of $1 billion (a temporary increase to $1.25 billion was approved by the EQC Board in June 2012) with the duration of the bank and term deposits not exceeding 90 days. Bank securities' maturity dates have been spread to ensure that at least $50 million is available each week to meet operational requirements. Following the Canterbury earthquakes, cash at bank has been held at higher levels to provide for claims expenses and settlements.

All other financial instruments are highly liquid and can be sold in a relatively short time-frame to meet any operational requirements.

13. PROPERTY, PLANT AND EQUIPMENT

2012	FURNITURE AND EQUIPMENT $(000)	CANTERBURY EARTHQUAKES FURNITURE EQUIPMENT AND MOTOR VEHICLES $(000)	GEONET BUILDINGS $(000)	GEONET COMPUTER EQUIPMENT $(000)	GEONET OTHER EQUIPMENT $(000)	TOTAL $(000)
COST						
At 1 July 2011	1,324	7,655	1,361	1,893	25,863	**38,096**
Additions	223	6,899	–	437	3,303	**10,862**
Disposals	(25)	(12)	–	(209)	(31)	**(277)**
At 30 June 2012	**1,522**	**14,542**	**1,361**	**2,121**	**29,135**	**48,681**
Accumulated depreciation						
At 1 July 2011	979	1,076	147	1,342	12,991	**16,535**
Depreciation charge	151	4,761	29	220	2,879	**8,040**
Disposals	–	–	–	(209)	(14)	**(223)**
At 30 June 2012	1,130	5,837	176	1,353	15,856	**24,352**
Carrying amounts at 30 June 2012	**392**	**8,705**	**1,185**	**768**	**13,279**	**24,329**

2011	FURNITURE AND EQUIPMENT $(000)	CANTERBURY EARTHQUAKES FURNITURE EQUIPMENT AND MOTOR VEHICLES $(000)	GEONET BUILDINGS $(000)	GEONET COMPUTER EQUIPMENT $(000)	GEONET OTHER EQUIPMENT $(000)	TOTAL $(000)
Cost						
At 1 July 2010	1,200	–	1,361	1,895	23,055	**27,511**
Additions	183	7,655	–	214	2,808	**10,860**
Disposals	(59)	–	–	(216)	–	**(275)**
At 30 June 2011	**1,324**	**7,655**	**1,361**	**1,893**	**25,863**	**38,096**
Accumulated depreciation						
At 1 July 2010	871	–	118	1,355	10,339	**12,683**
Depreciation charge	135	1,076	29	203	2,652	**4,095**
Disposals	(27)	–	–	(216)	–	**(243)**
At 30 June 2011	979	1,076	147	1,342	12,991	**16,535**
Carrying amounts at 30 June 2011	**345**	**6,579**	**1,214**	**551**	**12,872**	**21,561**

14. INTANGIBLE ASSETS

COMPUTER SOFTWARE	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Cost		
At 1 July	3,981	3,418
Additions	2,054	563
At 30 June	6,035	3,981
Accumulated amortisation		
At 1 July	1,233	800
Depreciation charge	642	433
At 30 June	1,875	1,233
Carrying amounts at 30 June	**4,160**	**2,748**

15. TRADE AND OTHER PAYABLES

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Trade payables	11,700	77,716
Tax on reinsurance	2,409	1,723
GST payable	–	–
Accruals	17,532	5,186
	31,641	**84,625**

Trade and other payables are non-interest bearing and are normally settled on 30-day terms, therefore the carrying value of trade and other payables approximates their fair value.

16. INSURANCE LIABILITIES

The Commission covers the following types of hazard: earthquake, natural landslip, volcanic eruption, hydrothermal activity and tsunami, as well as fire caused by any of the above. At balance date, the Commission recognises a liability in respect of outstanding claims, including amounts in relation to claims reported but not yet paid, claims incurred but not reported, claims incurred but not enough reported and costs including claims handling expenses. The Commission also assesses the adequacy of the unearned premium liability.

As explained in Note 2, the Canterbury earthquakes have resulted in a higher than usual level of uncertainty associated with the valuation of the outstanding claims liability. The actual claims outcome may prove to be different from the liabilities that have been established.

Outstanding Claims Liability

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Central estimate of outstanding claims liability	7,706,000	9,925,673
Claims handling expenses	592,000	609,100
Risk margin	610,000	560,300
Gross outstanding claims liability	**8,908,000**	**11,095,073**
Discount	(270,000)	(890,938)
Discounted outstanding claims liability	**8,638,000**	**10,204,135**
Current	3,335,000	3,530,400
Non-current	5,303,000	6,673,735
	8,638,000	**10,204,135**
Probability of adequacy	75.0%	75.0%
Reconciliation of movement in outstanding claims liability		
Outstanding claims liability at 1 July	10,204,135	11,845
Add claims expense	1,192,665	11,448,607
Less non-cash items in claims expense	(4,761)	(1,077)
Less claims payments during the year	(2,807,246)	(1,177,594)
Less claims handling expense in trade and other payables	53,207	(77,646)
Outstanding claims liability at 30 June	**8,638,000**	**10,204,135**

DEVELOPMENT OF CLAIMS FOR CANTERBURY EARTHQUAKE EVENTS

The following table shows the development of the outstanding claims liability relative to the current estimate of ultimate claims expense for the last two years relating to Canterbury earthquakes occurring since 4 September 2010.

ULTIMATE CLAIMS EXPENSE ESTIMATE	ACTUAL 2012 $000	ACTUAL 2011 $000	ACTUAL TOTAL $000
At end of incident year	611,000	11,711,529	n/a
One year later	n/a	11,594,000	n/a
Current estimate of ultimate claims expense	**611,000**	**11,594,000**	**12,205,000**
Cumulative payments	59,000	3,860,000	3,919,000
Outstanding claims liability (undiscounted)	**552,000**	**7,734,000**	**8,286,000**
Discount to present value	(17,000)	(253,000)	(270,000)
Outstanding claims liability (discounted)	**535,000**	**7,481,000**	**8,016,000**
Risk margin			610,000
Other claims (expected to be settled within a year)			12,000
Outstanding claims liability (75% probability of adequacy, discounted)			**8,638,000**

17. UNEARNED PREMIUM LIABILITY

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Unearned premium liability at 1 July	46,440	45,546
Deferral of premiums on contracts written in the period	110,426	46,440
Earning of premiums written in previous periods	(46,440)	(45,546)
Unearned premium liability at 30 June	**110,426**	**46,440**

18. UNEXPIRED RISK LIABILITY

The unexpired risk liability was determined as follows:

CALCULATION OF DEFICIENCY	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Unearned premium liability	110,426	46,440
Central estimate of present value of expected future cash flows arising from future claims on general contracts issued	(264,000)	(313,450)
Risk margin	–	(64,200)
Gross deficiency	(153,574)	(331,210)
Present value of expected future cash inflows arising from reinsurance recoveries on future claims on general contracts issued	25,000	11,090
Net deficiency	**(128,574)**	**(320,120)**

UNEXPIRED RISK LIABILITY	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Unexpired risk liability balance at 1 July	320,120	39,000
Movement for the year	(191,546)	281,120
Unexpired risk liability at 30 June	**128,574**	**320,120**

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.

Legislation recognises that the Commission's premiums may be inadequate to meet its liabilities in any one year by enabling it to set aside any annual surplus free of tax in the Natural Disaster Fund and, in the case of a very severe catastrophe (that exceeds both the Fund and reinsurance recoveries) by providing for a Crown Guarantee.

19. INSURANCE RISKS

The Commission must accept exposure to claims for the natural catastrophes as specified in the Act and therefore may not seek to reduce its claims exposure by diversification of its business over classes of insurance or geographical region. The premium level is set by the Earthquake Commission Amendment Regulations 2011.

Reinsurance Programme

The Commission limits its exposure to a very large-scale natural disaster through the purchase of reinsurance with the objectives of:

(i) minimising the overall cost to secure mandated protection to New Zealand homeowners;
(ii) implementing a reinsurance programme that provides stability over time against reasonably foreseeable events;
(iii) providing flexibility in the reinsurance agreement terms and conditions should the Crown determine a different risk profile under the natural disaster insurance scheme; and
(iv) minimising the risk of default amongst reinsurers by limiting its exposure to any one reinsurer or related group of reinsurers, by applying the following policies:
  - setting a target for the overall programme at placement that achieves a weighted average score of Standard & Poor's (S&P) financial strength rating of A or better;
  - normally placing reinsurance with organisations who have the following security ratings:
    S&P: AAA to A- (i.e. from "extremely strong" to "strong"); or
    Best's: A++ to A- (i.e. from "superior" to "excellent"); and
  - diligent examination by the Commission's management of the case for inclusion of a non-complying reinsurer, with the assistance of its reinsurance broker, and obtaining Board approval of any decision to include such reinsurers.

Crown Underwriting Fee

Pursuant to Section 17 of the Act, the Commission is required to pay a fee to the Crown as determined by the Minister of Finance, for the guarantee provided under Section 16 of the Act (refer Notes 1 and 9). The Minister of Finance determined that $10 million be paid for the year ended 30 June 2012 (2011: $10 million).

Interest Rate Risk and Credit Risk

No direct exposure to interest rate risk results from the financial assets or liabilities arising from insurance or reinsurance contracts. Financial assets and liabilities arising from insurance or reinsurance contracts are stated in the Statement of Financial Position at the amount that best represents the maximum credit risk exposure at balance date. Refer to Note 12B for concentrations of credit risk.

Research and Education

The Commission seeks to indirectly reduce the extent of claims incurred by the dissemination of research and through public education programmes.

20. CREDIT RATING

The Commission was assigned an insurer financial strength rating of AA+ (very strong) as accorded by international rating agency Standard & Poor's on 30 September 2011. (2011: On 25 September 2011, the Commission was assigned an insurer financial strength rating of AAA (extremely strong) by Standard & Poor's but this was downgraded to AA+ on 30 September 2011)

21. CONTINGENT LIABILITIES AND ASSETS

EQC is presently subject to several hundred thousand claims arising out of the Canterbury earthquakes, of which some disputes and the possibility of lawsuits is inevitable. However EQC is currently only dealing with a small number (less than 10) of potential, pending or existing lawsuits relating to claims under the Earthquake Commission Act 1993. EQC is also dealing with one low-risk unresolved personal grievance claim. None of these are considered significant in potential amount.

EQC is presently pursuing two subrogated recovery claims (2011: none).

22. COMMITMENTS

ClaimCenter Services Contract

In 2007, the Commission entered into a services contract for the provision of a computer system for claims handling, processing and allocation.

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Operating Commitment		
(a) Not later than one year	3,268	1,959
(b) Later than one year but not later than two years	2,787	1,959
(c) Later than two years but not later than five years	6,520	5,878
(d) Later than five years	–	1,306
Total ClaimCenter commitment	**12,575**	**11,102**

Reinsurance Contracts

The Commission has signed contracts for reinsurance in the international market.

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Operating commitment		
(a) Not later than one year	110,662	49,420
(b) Later than one year but not later than two years	27,500	7,998
(c) Later than two years but not later than five years	25,208	–
Total reinsurance commitments	**163,370**	**57,418**

Te Papa Tongarewa, Museum of New Zealand

In 2012, the Commission signed a contract with Te Papa extending the sponsorship for a further year. The sponsorship relationship is linked to the *Awesome Forces* and *Quake Braker* exhibitions at Te Papa, which provide a mechanism to communicate the Commission's key messages to a broad audience and meet its educational and research objectives.

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Operating commitment		
(a) Not later than one year	300	500
Total Te Papa Tongarewa, Museum of New Zealand commitment	**300**	**500**

GNS Science

The Commission has a contract with GNS Science for the development and implementation of a seismic monitoring and reporting network (GeoNet). The term of the GeoNet agreement, dated December 2009, is for 10 years, but provides for a funding commitment from EQC only for the first five years of the term. The Commission's funding commitment beyond 30 June 2015 must be agreed between the parties.

	ACTUAL 2012 $(000)	ACTUAL 2011* $(000)
Capital commitment		
(a) Not later than one year	3,537	3,498
(b) Later than one year but not later than two years	3,250	3,537
(c) Later than two years but not later than five years	3,274	6,254
Operating commitment		
(a) Not later than one year	5,681	5,580
(b) Later than one year but not later than two years	5,818	5,681
(c) Later than two years but not later than five years	5,890	11,709
Total GNS Science commitments	**27,450**	**36,259**

*The commitment at 30 June 2011 has been restated to correctly show the remaining contract period as four years rather than five years. The impact of this change is $9,431,000.

Research Grants

Future research grants approved by the Board.

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Operating commitment		
(a) Not later than one year	1,937	1,992
(b) Later than one year but not later than two years	1,403	1,255
(c) Later than two years but not later than five years	859	1,868
Total research grant commitments	**4,199**	**5,115**

Building Leases

The Commission has a non-cancellable long-term lease on premises in Wellington, plus other shorter term leases in Wellington and Christchurch to provide premises for Canterbury earthquake operations. The annual lease payments on the long-term lease are subject to three-yearly reviews, but are included below based on current rates.

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Operating commitment		
(a) Not later than one year	796	1,538
(b) Later than one year but not later than two years	645	591
(c) Later than two years but not later than five years	1,440	1,481
(d) Later than five years	–	494
Total building lease commitment	**2,881**	**4,104**

23. 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.

Key Management Personnel Compensation

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Salaries and other employee benefits	**1,955**	**1,123**

Key management personnel for the 2012 year included all Commissioners, the Chief Executive and six senior managers (2011: all Commissioners, the Chief Executive and five senior managers).

- M Wintringham has close relatives who have an outstanding claim lodged with the Commission for earthquake damage. No payments have been made in the current financial year (2011: $3,432).
- KB Taylor has an associated entity that has lodged claims with the Commission. The Commission paid $797.65 in relation to claims from this entity in the current financial year (2011: nil).
- T Burt has an associated entity that has lodged claims with the Commission. The Commission paid $7,798 to the entity in the current financial year (2011: $114,074).
- The Commission purchased services of $21,792 from Tower Group, a company of which Commissioner P Hughes is a shareholder. The services purchased relate to income protection insurance (2011: $16,610).
- The Commission purchased services of $543 from Mainpower Ltd, a company of which Commissioner T Burt is a director (2011: $830).
- The Commission purchased services of $499,865 from Kiwi Income Property Trust, a company of which a close relative of KB Taylor is a shareholder. The services purchased relate to office rental (2011: $536,336).
- The Commission purchased services of $499,865 from Kiwi Income Property Trust, a company of which P Hughes is a shareholder. The services purchased relate to office rental (2011: $536,336).

- The Commission purchased services of $59,824 from and paid claims of $128,915 to Ngai Tahu Property Ltd, a company of which T Burt is a director (Chairman). The services purchased relate to car park rental (2011: $20,834).
- The Commission purchased insurance of $35,969 from Southern Cross Medical Care Society, an organisation of which KB Taylor is a director (2011: $31,463).
- B Emson, a member of the senior management team, has an associated entity that has lodged claims with the Commission. The Commission paid $3,459 in relation to claims from this entity in the current financial year (2011: $1,498).
- A small number of personnel employed by the Commission during the year were close family members of key management personnel. The terms and conditions of their employment arrangements were no more favourable than the Commission would have adopted if there were no relationship to key management personnel. At 30 June 2012, only one employee fell into this category.

Collectively, but not individually significant, transactions with government-related entities

In conducting its activities, the Commission is required to pay various taxes and levies (such as GST, FBT, PAYE and ACC levies) to the Crown and entities related to the Crown. The payment of these taxes and levies, other than income tax, is based on the standard terms and conditions that apply to all tax and levy payers. The Commission is exempt from paying income tax.

The Commission also purchases goods and services from entities controlled, significantly influenced, or jointly owned by the Crown. Purchases from these government-related entities for the year ended 30 June 2012 totalled $28.3 million (2011: $24.5 million) and included the following items:

Crown	Crown underwriting fee (refer note 19)
GNS Science	Geonet seismic monitoring programme (refer note 22)
Energy Efficiency Conservation Authority (EECA)	Chimney replacement programme
Department of Conservation	Claims settlements
Te Papa Tongarewa	Public education grant (refer note 22)
Inland Revenue Department	Canterbury disaster response assistance
AMI/Southern Response Earthquake Services Ltd	Claims settlements

The Commission supported geological research at New Zealand universities and paid State-owned enterprises for postage, air-travel and power. Commission for the collection of premiums was also paid to AMI and Southern Response Earthquake Services Limited.

As at 30 June 2012, the Commission has unsettled claims with the Canterbury Earthquake Recovery Authority (CERA) as a result of the Crown's Red Zone offer to property owners. Under the sale and purchase arrangement with property owners in the Red Zone, CERA becomes the beneficiary for some or all of the proceeds of the submitted claims. While the value of the settlement with CERA has not been estimated, the value of this claim is included in the actuarial valuation of the Commission's total liability and accounted for in the financial statements.

During the year, the Commission earned interest of $1,013,264 from bank bills and call deposits with Kiwibank (2011: $1,621,882). The balance of deposits at 30 June 2012 was $85,000,000 (2011: $37,000,000).

24. BOARD MEMBER REMUNERATION

The total value of remuneration paid to each Board member during the year was:

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)	
MC Wintringham	61	60	Appointed Deputy Chairman 1 June 2004, as Chairman 26 July 2006
KB Taylor	36	33	Appointed 18 August 2006, as Deputy Chairman 1 May 2009
G McLachlan	32	27	Appointed 1 May 2009
D Bovaird	32	26	Appointed 1 January 2010
R Black	30	15	Appointed 1 December 2010
T Burt	30	15	Appointed 1 December 2010
P Hughes	18	–	Appointed 1 October 2011
G Smith	18	–	Appointed 1 October 2011
L Robertson	7	26	Term concluded 10 August 2011
Total	**264**	**202**	

Additional allowances for Board members were approved by the Government to recognise the significantly increased time commitment required following the Canterbury earthquakes. Of the $90,000 approved, $60,000 was allocated to Board members in the year ended 30 June 2012 and $30,000 was allocated in the prior year.

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 Commission functions.

The Commission 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.

25. EMPLOYEE REMUNERATION

The numbers of employees whose total remuneration paid or payable for the financial year was in excess of $100,000, in $10,000 bands, are as follows:

$(000)	ACTUAL 2012	ACTUAL 2011
100–110	4	3
110–120	3	2
120–130	1	–
130–140	2	1
140–150	3	–
150–160	1	2
160–170	2	–
170–180	3	2
180–190	1	–
190–200	2	–
200–210	1	–
210–220	–	1
230–240	–	1
240–250	1	–
250–260	1	–
340–350	–	1
400–410	1	–
	26	**13**

In addition to the above, and in accordance with confidential contractural agreements, severance pay of $558,083 was paid during the year (2011:Nil).

26. RECONCILIATION OF OPERATING SURPLUS TO NET CASH FLOW FROM OPERATING ACTIVITIES

	ACTUAL 2012 $(000)	ACTUAL 2011 $(000)
Net deficit	**(435,673)**	**(7,082,606)**
Add non-cash items:		
Depreciation and amortisation	8,682	4,528
Total non-cash items	**8,682**	**4,528**
Less items classified as investing activities		
Discount income and investment price revaluations	(54,997)	(156,756)
Gain on disposal of property, plant and equipment	(7)	(10)
Total items classified as investing activities	**(55,004)**	**(156,766)**
Add/(less) movements in Statement of Financial Position items:		
Premiums receivable	(37,483)	82
Reinsurance and other recoveries	155,213	(4,229,557)
Other receivables	29,670	(45,910)
Prepayments	(10,673)	(3,853)
Trade and other payables	(52,984)	79,889
Provision for employee entitlements	798	183
Outstanding claims liability	(1,566,135)	10,192,290
Unearned premium liability	63,986	894
Movement in unexpired risk liability	(191,546)	281,120
Net movements in working capital items	(1,609,154)	6,275,138
Net cash flow from operating activities	**(2,091,149)**	**(959,706)**

27. EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE

There were no significant events after the Statement of FInancial Position date requiring adjustment to the financial statements.

Statement of Service Performance

OVERVIEW

EQC's operations in the 2011–2012 financial year continued to be dominated by the Canterbury earthquakes. Although the most devastating earthquakes occurred in the 2010–2011 financial year, three damaging earthquakes also occurred in the 2011–2012 financial year – a magnitude (**M**) 5.5 on 9 October 2011 and the **M** 5.8 and **M** 6.0 earthquakes of 23 December 2011.

The 15 significant earthquake events in Canterbury over these two financial years have produced around 459,000 claims and 690,000 exposures[2]. This places the total number of insurance exposures close to that of Hurricane Katrina (USA, 2005) which is the most expensive global insurance event to date. Almost $3.4 billion (excluding GST) has been paid in claim settlements (including the project managed repairs) in Canterbury, with the final settlement figure expected to be about $12 billion.

A summary of claims processing activity across all Canterbury events is reported in the following table:

CLAIMS PROCESSING FOR CANTERBURY EARTHQUAKES, 2010–2011 AND 2011–2012 FINANCIAL YEARS (COMBINED DATA AS AT 30 JUNE 2012)

CATEGORY	REPORTED	OPEN	CLOSED	PAID TO DATE (GST exclusive)
Building Exposures (including Fletcher EQR)	413,967	299,394	114,573	$3,010,542,909
Land Exposures	93,010	70,531	22,479	$15,061,116
Contents Exposures	183,007	46,392	136,615	$368,085,230
Total Exposures	689,984	416,317	273,667	$3,393,689,255
TOTAL CLAIMS	**459,198**	**357,296**	**101,902**	**$3,393,689,255**

The sequence of large earthquakes seen in Canterbury is unique in world insurance history. The 2011–2014 Statement of Intent, which identifies the targets for EQC's reporting in this Statement of Service Performance, could not have anticipated many of the complex technical, operational and policy challenges that resulted from the earthquake sequence. From a claims processing perspective, the events of the 2011–2012 financial year cannot be considered in isolation from the events that occurred in Canterbury in the 2010–2011 financial year since the timeframes involved overlap both financial years. The Statement of Service Performance includes an explanation of some of the complexities that have arisen under the appropriate output headings to better reflect its performance within this complex operating environment.

In addition to claims arising from Canterbury's earthquakes, EQC has attended to claims nationwide arising from other natural disaster events in 2011–2012. The most significant of these were the Nelson storm in mid-December 2011 and the M 5.7 earthquake near Picton on 3 December 2011. In total, EQC received approximately 94,500 claims from natural disaster events during this financial year.

Although the Natural Disaster Fund (the Fund) will be depleted by the recent natural disaster events in New Zealand, the scale of the damage incurred has highlighted the importance of EQC meeting its financial obligations through the sound administration and investment of the Fund. Despite the continuing earthquake sequence in Canterbury, EQC has been successful in securing its core reinsurance programme and reinstatement premium protection, as well as obtaining additional protection of $500 million.

EQC continues to raise awareness of natural hazard risk in New Zealand through its advocacy of, and investment in, science and engineering research. In the 2011–2012 financial year, EQC funded 54 projects, with 14 of these now complete. Alongside the research programme, EQC maintains its public education function, with particular focus on improving New Zealanders' understanding of EQC's functions through school and museum programmes.

OUTPUT 1: CLAIMS HANDLING

This output class addresses EQC's ability to quickly and accurately settle claims from insured residential property owners following a natural disaster. EQC's achievements in this regard support community economic, social and psychological recovery. The claims handling process must also appropriately manage liabilities for the Crown and for reinsurers arising from natural hazard events.

During the 1 July 2011 to 30 June 2012 reporting period, EQC received just over 94,500 claims from natural disaster events. The Canterbury earthquake sequence on 23 December 2011 generated over 48,000 claims. The most significant non-Canterbury events during the period were the M 5.7 Picton earthquake on 3 December (461 claims) and Nelson's storm event in mid-December (985 claims).

2 Each claim can consist of land, dwelling and contents exposures.

EQC's annual reporting is complicated by the need to address timeframes for the lodgement, assessment and settlement of claims within the context of events that occur sporadically and unpredictably throughout the reporting period. Although timeframes for claim lodgement and settlement are specified in the Earthquake Commission Act, deadlines for these may fall within a different reporting period from the event itself. For example:

- The one-year time limit for claim settlement (after the amount of damage has been determined), as specified in section 29(4) of the Earthquake Commission Act 1993, invariably falls in the next reporting year[3]; or
- The Canterbury earthquake of 13 June 2011 occurred in the 2010–2011 reporting year, whereas the deadline for claim lodgement falls into the 2011–2012 reporting year.

Detailed information about the lodgement and processing of claims in the 2011–2012 financial year is given in the following tables:

Summary of claims lodged during the 2011–2012 financial year (combined data for 1 July 2011–30 June 2012)

CATEGORY	REPORTED	OPEN	CLOSED	PAID TO DATE (GST exclusive)
Building Exposures (including Fletcher EQR)	84,181	70,805	13, 376	$81,452,419
Land Exposures	15,479	12,963	2,516	$8,492,870
Contents Exposures	23,214	12,702	10,512	$14,180,545
Total Exposures	122, 874	96,470	26,404	$104,125,834
TOTAL CLAIMS	**94,516**	**79,408**	**15,108**	**$104,125,834**

Summary of claims arising from the two Canterbury earthquakes of 23 December 2011 (1 July 2011–30 June 2012)

CATEGORY	REPORTED	OPEN	CLOSED	PAID TO DATE (GST exclusive)
Building Exposures (including Fletcher EQR)	43,573	35,985	7,588	$9,234,176
Land Exposures	7,032	6,576	456	$1,165
Contents Exposures	12,047	7,325	4,722	$6,168,568
Total Exposures	62,652	49,886	12,766	$15,403,909
TOTAL CLAIMS	**48,723**	**44,001**	**4,722**	**$15,403,909**

Summary of claims arising from the Picton earthquake of 3 December 2011 (1 July 2011–30 June 2012)

CATEGORY	REPORTED	OPEN	CLOSED	PAID TO DATE (GST exclusive)
Building Exposures	432	16	416	$531,357
Land Exposures	46	3	43	$ –
Contents Exposures	37	1	36	$6,603
Total Exposures	515	20	495	$537,960
TOTAL CLAIMS	**461**	**30**	**431**	**$537,960**

Summary of claims arising from the Nelson storm event in mid-December 2011 (1 July 2011–30 June 2012)

CATEGORY	REPORTED	OPEN	CLOSED	PAID TO DATE (GST exclusive)
Building Exposures	543	94	449	$2,256,617
Land Exposures	932	138	794	$3,951,632
Contents Exposures	137	19	118	$240,903
Total Exposures	1,612	251	1,361	$6,449,152
TOTAL CLAIMS	**985**	**333**	**652**	**$6,449,152**

3 Where a claim relates to a residential building or residential land affected by the Canterbury earthquakes, the Canterbury Earthquake (Earthquake Commission Act) Order 2012 provides an exemption from this one-year timeframe where settlement is to be by reinstatement.

With the exception of those arising from Canterbury's seismic sequence, claims continue to be assessed and settled using operational processes that are consistent with those of previous reporting years, with EQC's settlement generally taking the form of a payment to the property owner or, in rare cases, managed repairs to land.

With the agreement of the Government, EQC took a new approach to the repair of homes in Canterbury where damage was estimated to be $10,000 to $100,000 (GST exclusive). This approach sought to reduce the potential for the South Island's largest city to end up with a substandard housing stock should EQC's settlement payments not be used for earthquake repairs, while also ensuring that demand for and supply of building services in the region was managed appropriately. The resultant Canterbury Home Repair Programme involves EQC managing each claim to the point where repairs can be undertaken, with Fletcher Construction Company's Earthquake Recovery division (known as Fletcher EQR) being contracted to project manage the repairs. This is a large undertaking, involving around 14,500 tradespeople.

The biggest challenges faced by EQC in 2011–2012 were the technical and legal complexities associated with the home repair programme and the settlement of land claims.

As at mid-June 2012, over 18,000 full-scope home repairs had been completed, along with over 44,000 emergency repairs and 15,000 installations of heating appliances.

Aside from the sheer scale of the task, EQC is also working with incomplete and fluid information caused by multiple earthquakes, the type of damage being sustained and the evolving policies of other government agencies in regard to land use and building requirements. Information and assumptions that seem reasonable at a given point in time can be overtaken by new knowledge and the developing awareness of its consequences. Two notable examples include:

- Initial uncertainty about what land in Christchurch was suitable for continued habitation, the subsequent Crown purchase offer for property in the residential Red Zone and the eventual application of three technical categories (TCs) to Green Zone land in Christchurch. The Department of Building and Housing has needed time to develop, test and publish guidance on foundation designs for the different soil conditions that have arisen; and
- Developing from the High Court ruling in 2011, the judgement that EQC's cover reinstates after each natural hazard event, so there is a need to attribute (apportion) damage to each specific earthquake event and manage it as a separate insurance claim. This has meant that, if a house and/or land is damaged by more than one earthquake and a claim is made each time, EQC needs to determine the damage caused to both the house and land by each earthquake. The need to apportion damage to each event is a challenge never faced by the insurance industry anywhere in the world before, and has added substantially to processing and timeframes for claim settlement.

Defining, controlling and communicating to claimants about timeframes and processes for house repairs, assessments and claim settlements has been difficult due to the challenges outlined above. The consequent frustration for many of EQC's customers is reflected in the poor results of EQC's client satisfaction survey.

Processes and systems adopted by EQC in Canterbury are under constant review. Improvements undertaken since 1 July 2011 or currently underway include:

- Managing the repair process centrally, so that work is allocated to contractors in different areas on a more consistent basis;
- Implementing and upgrading a process of joint re-inspection of dwellings with insurers;
- Streamlining the process for opting out of the Canterbury Home Repair Programme for customers with the skills needed to project manage their own repairs; and
- Refining the complaints process and establishing a mediation service for claimants from August 2012.

EQC's performance for the 1 July 2011–30 June 2012 financial year against the Output 1 targets specified in the Statement of Intent are described in the following table.

KEY SUCCESS FACTOR AND MEASURE	RESULT
CLAIMS LODGEMENT **EQC requires that its claims be determined and settled within a timeframe acceptable to the public and in accordance with the Act.** This target is reached when:	
For claims under the 'imminent loss' provisions of the Act, 90% of claimants receive their entitlements within one year of the claim lodgement date.	**NOT ACHIEVED** Of the total of 165 claims that gave rise to an 'imminent loss' settlement, 36% were settled within one year. Although not covered by the imminent loss provisions, over 44,000 emergency repairs were conducted by EQC since the first of the Canterbury earthquakes in September 2010, and payment for a further 50,000 repairs was made to customers and tradespeople, between 1 July 2011 and 30 June 2012 for damage arising from the Canterbury earthquake sequence, where the claimant indicated that there was an urgent issue with safety, security or weather tightness of the residence.
For 'non-imminent loss' events, where there are less than 10,000 claims open in total, 90% of valid claims are quantified within 90 days of the claim lodgement date.	**NOT ACHIEVED** Recognising the duration and complexity of the Canterbury earthquake sequence, it would be misleading to define EQC's performance for the 1 July 2011 to 30 June 2012 financial year in isolation of the events that occurred in the 1 July 2010 to 30 June 2011 financial year. Claim lodgement periods and assessment, repair and settlement timeframes have generally overlapped through both financial years. Therefore Canterbury related measures include results over the entire Canterbury earthquake sequence. Non-Canterbury related measures include only results relating to the 1 July 2011 to 30 June 2012 financial year. **Canterbury claims** For claims arising from non-imminent loss events in the Canterbury earthquake sequence (1 July 2010–30 June 2012), where less than 10,000 claims were lodged, 28% were quantified within the target 90 days. **Non-Canterbury claims** Of claims arising from non-Canterbury events, where less than 10,000 claims were lodged, 20% were quantified within the target 90 days.
For 'non-imminent loss' events, where there are more than 100,000 claims open in total, 90% of valid claims are quantified within 270 days of the claim lodgement date.	**NOT ACHIEVED** Three significant events arose during the reporting period of 1 July 2011 to 30 June 2012. However, progress of claims arising from these is not able to be recorded in this report as the 270 day timeframe target has not yet expired. **Canterbury claims** Recognising the duration and complexity of the Canterbury earthquake sequence, it would be misleading to define EQC's performance for the 1 July 2011 to 30 June 2012 financial year in isolation of the events that occurred in the 1 July 2010 to 30 June 2011 financial year. Claim lodgement periods and assessment, repair and settlement timeframes have generally overlapped through both financial years. Therefore Canterbury related measures include results over the entire Canterbury earthquake sequence. For claims arising from major events in the Canterbury earthquake sequence (1 July 2010–30 June 2012), where more than 100,000 claims were lodged, 75% were quantified within 270 days. **Non-Canterbury claims** Not able to be recorded in this report as the 270 day timeframe target for the Nelson and Picton events has not yet expired.

KEY SUCCESS FACTOR AND MEASURE	RESULT
CLAIMS ASSESSMENT	
EQC strives to settle claims to standards of individual and overall fairness that are acceptable to the public and to reinsurers.	
This target is reached when:	
The difference between EQC's 'assessed claim value' and quoted repair or replacement costs is, in aggregate, less than 20%.	**ACHIEVED** A managed repair programme commenced late in 2010. As at mid-June 2012, 18,295 repairs had been completed. During the year covered by this report, 17,539 repairs were completed. In aggregate, the cost of repairs completed to date has exceeded assessed claim value by 10.8%.
Claim handling costs (excluding project management costs where reinstatement is the chosen settlement option) are less than 10% of pay-out.	**NOT ACHIEVED** The total claim handling costs (excluding project management costs) incurred to date in respect of the Canterbury event sequence is 11.8% of the value of claims settled. This increases to 13.2% where project management costs are included. These include costs in relation to claims that have not yet been settled; this claim handling cost rate is forecast to fall below 10% as settlement progresses.
Customer satisfaction is higher than the average for New Zealand public services (as noted in the most recent State Services Commission's Kiwis Count survey).	**NOT ACHIEVED** Satisfaction surveys were conducted quarterly through this financial year, with 55.5% of EQC claimants rating themselves as being either very satisfied or satisfied with its overall service delivery. This falls well below the results obtained in the 2009 Kiwis Count survey, in which 70% of respondents found public services to meet their performance expectations.
There are no findings by the Ombudsman or courts that claims are not being processed in accordance with the Earthquake Commission Act 1993.	**ACHIEVED** There have been no occasions when EQC has been found to be in breach of the Act by the courts or by the Office of the Ombudsman. The Office of the Ombudsman has raised concerns about the timeliness of responses; EQC has initiated improvements to its processes and communications in response to this feedback.[4]
CLAIMS MANAGEMENT TOOLS	
EQC requires that its computerised claims management system be maintained at a level commensurate with a standard of operational efficiency acceptable to the Board.	
This target is reached when:	
Unplanned outages do not exceed eight hours in total, per annum.	**ACHIEVED** Testing of the claims management system in the April – June 2012 quarter has demonstrated that its target of 99% availability during EQC's operating hours (7am – 11pm daily, for 7 days per week) has been exceeded. No results are available for the total financial year.
The system can support 2,000 concurrent EQC users and 500 concurrent public users (using the on-line Internet claim form).	**ACHIEVED** An upgrade of the claims management system in August 2011 has resulted in the user capacity of 2,500 concurrent users being exceeded.
The system must support 300,000 new claims over a six-week period.	**ACHIEVED** The claims management system has been tested and shown to be capable of supporting 300,000 new claims over a six-week period.
The system must support 3 million claims in total.	**ACHIEVED** The claims management system has been designed to support 3 million claims. Although testing against this measure is not feasible, EQC is confident that the system will support this required capacity.

4 (a) The Commission acknowledges that its performance under other legislation is not included within the scope of these reporting criteria. In particular, the Commission has fallen short of its obligations under the Official Information Act to release official information within 20 working days of it being requested. This situation arises from the substantial unexpected influx of these requests during the July 2011–June 2012 reporting period; during this period, EQC had received in excess of 1500 requests for release of official information, over 1200 of them between February and June 2012.

(b) The High Court's judgement of 2011 on the application of the Earthquake Commission Act 1993 to two or more events in the same region at roughly the same time provided clarification of the interpretation of the Act. This clarification was sought jointly by the private insurance industry and EQC.

OUTPUT 2: RESEARCH

Under the Earthquake Commission Act, EQC has an obligation 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.

The research output class addresses research and teaching in subjects related to natural disasters and the type of insurance provided under the Earthquake Commission Act.

EQC raises awareness of natural hazard risk and promotes disaster damage reduction through its advocacy of, and investment in, science and engineering capability and research. This mandate sustains key capabilities and expertise for hazard risk management and helps reduce the impacts and liabilities arising from such events. This includes the application of funded research to hazard assessment and risk mitigation across diverse sectors including central and local government planning infrastructure design, reinsurance pricing and by means of construction standards and land use and catastrophe risk modelling strategies for local authorities and property developers.

EQC's performance for the 1 July 2011–30 June 2012 financial year against the Output 2 targets specified in the Statement of Intent is described in the following table:

KEY SUCCESS FACTOR AND MEASURE	RESULT
EQC funds research and teaching that will address gaps in knowledge affecting New Zealand's exposure to geological hazards. This target will be successful if:	
Each completed project contributes to at least one peer-reviewed scientific paper or report.	**ACHIEVED** 14 projects have been completed and final reports received. Two of the completed projects have been part of a reviewed thesis while the others have either contributed to at least one peer-reviewed scientific paper or report or are currently in press.
Contracted research projects for the year meet all agreed budgets and timeframes for progress or completion.	**ACHIEVED** 17 projects have been granted an extension for completion of final reporting as a consequence of extra work generated by the Canterbury earthquakes. All are expected by the end of December. The remaining 23 projects in progress are meeting budgets and timeframes.
EQC invests in core infrastructure to support research, including databases, enabling technologies, students and academic learning and international linkages. EQC's targets are met when:	
The contract for the national hazard monitoring system, GeoNet, meets agreed budget and performance criteria.	**ACHIEVED** The GeoNet project, contracted to GNS Science, aims to supply data and warning information for natural hazards. GeoNet has met all of its contracted requirements within the agreed budget. Work this year has focused on the expansion of the geophysical network in the South Island, and the enhancement of volcanic surveillance systems. GeoNet data for the Canterbury region continues to be used extensively by engineers, assessors, emergency managers, reinsurers, researchers, and the general public, and during 2011 the website served more than one billion requests. A new system is soon to replace the current system to provide fast, automated estimates of the location, size and depth of significant New Zealand earthquakes.

KEY SUCCESS FACTOR AND MEASURE	RESULT
The university-based teaching and scholarship programmes sponsored by EQC meet contracted requirements for annual output and reporting.	**ACHIEVED** All contractual requirements have been met relating to EQC's funding of the research and capability programmes below. Each institute has provided an annual report and work plans for future years. • The Colleges of Engineering and Science at the University of Canterbury. • The Institute of Earth Science and Engineering at the University of Auckland. • Massey University (EQC Chair in Natural Hazards Planning). • Victoria University (EQC Fellowship in Seismic Studies).
EQC enables knowledge and technology transfer from basic research to professional practice to occur. This target is met when:	
The Science-to-Practice initiatives meet all agreed criteria for collaboration across agency/ discipline boundaries.	**ACHIEVED** EQC's sponsorship of the Science-to-Practice programme aims to foster the transfer and uptake of science research by end-users. The "It's Our Fault" study continues to deliver improved understanding of the nature and planning requirements for large earthquakes in the Wellington region. The DEVORA[5] research programme continues its assessment of volcanic hazard and risk in the Auckland metropolitan area, to inform strategy and rationale for risk assessment and mitigation. Both regional programmes are jointly funded and provide annual work plans and quarterly reports to stakeholders.
Project results are presented in keynote or plenary presentations and sector print media within 6 months of completion.	**ACHIEVED** EQC sponsors the NZ Society for Earthquake Engineering annual conference and technical bulletin, attracting a worldwide audience. The theme of this year's conference was "Implementing lessons learned from Canterbury earthquakes". The December bulletin brought together 18 technical papers about the effects of the 22 February 2011 Christchurch (Lyttelton) earthquake and its aftershocks. The National Lifelines Forum is sponsored by EQC, this year focusing on the impacts to lifeline utilities from the Canterbury earthquakes, with the objective of improving infrastructure resilience planning for New Zealand. During the reporting period two other projects funded under the Science-to-Practice programme have been published.

5 Determining Volcanic Risk in Auckland (DEVORA) is a seven-year research programme aimed at enhancing understanding of the Auckland volcanic field through an integrated, multi-disciplinary, multi-agency study. The programme endeavours to obtain an improved assessment of volcanic hazard and risk in the Auckland metropolitan area, and will provide a strategy and rationale for appropriate risk mitigation.

OUTPUT 3: EDUCATION

Under the Earthquake Commission Act, EQC has an obligation 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.

The education output class comprises:

- Education about seismic hazards and methods of reducing or preventing subsequent damage; and
- Education about EQC's role and the importance of home insurance.

EQC maintains a level of nation-wide and regional education initiatives aimed at improving New Zealanders' understanding of what to expect of EQC in a natural disaster event, thereby supporting the community's capacity for rapid recovery from natural disasters. Education also supports the efficient management of the Crown's assets and liabilities by reducing the Crown's exposure (and cost of reinsurance) to natural hazard events.

EQC employs a range of methods with which to communicate its messages, including the internet, press advertising, newsletters and museum exhibitions. Advertising is also undertaken at a targeted regional level in a range of media following significant natural disaster events.

EQC's performance for the 1 July 2011–30 June 2012 financial year against the Output 3 targets specified in the Statement of Intent is described in the following table:

KEY SUCCESS FACTOR AND MEASURE	RESULT
EQC engages in programmes to make New Zealanders aware of earthquake safety and natural hazard mitigation measures they could take. EQC meets this target when:	
EQC's annual secondary school programme is available to all secondary schools nationwide, and delivered to more than 40 classes nationwide.	**ACHIEVED** EQC has made the annual secondary school programme available to all secondary schools nationwide. The programme has been delivered to more than 158 classes nationwide.
More than 40 schools receive the annual school programmes run through Te Papa and Auckland Museum. It delivers its annual regional schools programme to at least 50% of schools in the target region.	**ACHIEVED** EQC no longer has a sponsorship arrangement with the Auckland War Memorial Museum. 110 schools went through the annual schools programme at Te Papa national museum.
EQC engages in programmes to help homeowners understand its role should they experience natural disaster damage.	**ACHIEVED** New Plymouth is the target area for the regional schools programme in this reporting period. All schools in the region agreed to participate in the regional schools programme.
EQC's target is for at least 70% of homeowners to have an awareness of EQC's role, as measured in EQC's quarterly survey of homeowners.	**ACHIEVED** EQC has met this output target, with 70% of respondents measured in EQC's survey of homeowners having an awareness of EQC's role.

OUTPUT 4: POLICY ADVICE

This output class addresses the provision of policy advice to the Government on issues related to EQC's statutory functions, including:

- Damage from natural disasters;
- Minimising Crown liabilities through the prevention or reduction of damage arising from natural disasters;
- Government response to natural hazard events;
- Relevant risk management issues;
- Management of the Natural Disaster Fund and protection of its value;
- The terms and conditions of EQC's insurance.

For the 2011–12 financial year, EQC's policy advice focused on defining and finding solutions to complex challenges arising from the Canterbury earthquakes, to expedite the settlement of claims and subsequent recovery of the region.

EQC's performance for the 1 July 2011–30 June 2012 financial year against the Output 4 targets specified in the Statement of Intent are described in the following table.[6]

KEY SUCCESS FACTOR AND MEASURE	RESULT
EQC strives to produce policy advice that is impartial, 'free and frank' and meets the quality standards agreed with ministers.	
This target is reached when the Minister Responsible for the Earthquake Commission rates his satisfaction level as 'satisfied or better'.	**ACHIEVED** EQC's policy advice to the Minister reached the agreed standard.

6 EQC will cease to report its policy advice functions as a distinct output in the 2012–2013 Statement of Service Performance. Instead, its policy advice responsibilities will be incorporated into its claims handling outputs (Output 1), in recognition of the operational focus of this advice.

OUTPUT 5: ADMINISTRATION OF THE ACT, INSURANCE SCHEME AND NATURAL DISASTER FUND

This output addresses EQC's ability to develop and maintain its financial capacity so that it can meet its obligations under the Act, thereby optimising its contribution to community recovery. This output involves administration of the Natural Disaster Fund (NDF), including collection of the premiums payable and, so far as reasonably practicable, protection of its value through prudent investment. It also includes reinsurance of whole or part of the insurance provided under the Act.

The output reflects EQC's functions as set out in sections 5(1)(b), 5(1)(c) and 5(1)(d) of the Act, and directly contributes to the Government's outcome of efficient management of the Crown's assets and liabilities.

EQC's performance for the 1 July 2011–30 June 2012 financial year against the Output 5 targets specified in the Statement of Intent are described in the following table.

KEY SUCCESS FACTOR AND MEASURE	RESULT
EQC should renew its reinsurance programme so that, together with the Natural Disaster Fund assets, this is sufficient to meet the maximum probable loss.	
This target is met when EQC is able to negotiate a reinsurance programme that maintains the risk to the Crown of a call under Section 16 of the Earthquake Commission Act at 1-in-1,000 or better.	**NOT ACHIEVED** [TARGET NO LONGER RELEVANT] EQC's target as defined in the June 2011–June 2014 Statement of Intent is no longer appropriate. Negotiation of reinsurance for 2012 took place against a backdrop of continuing seismic activity in Canterbury, and a global market hardening in the wake of 2011 catastrophe activity. The earthquakes in Christchurch produced levels of shaking with an expected frequency of less than 1-in-2,500 years. The Natural Disaster Fund which, together with reinsurance, will absorb more than 90% of EQC's forecast liabilities will be depleted.[7] Given this context, it is not practical for EQC to attempt to immediately reinstate the risk financing target of 1-in-1,000. Rather, the reinsurance programme aims to maximize the level of protection at an overall cost that balances strategic risk and ongoing operating requirements. EQC has been successful in securing its core reinsurance programme and reinstatement premium protection, and has obtained additional protection of $500 million.

7 EQC has already paid out $3.4 billion (excluding GST) to settle claims. On current actuarial forecasts this is expected to rise to a total of approximately $12 billion over the next three years. Most of this will be covered by EQC's $6 billion Natural Disaster Fund and international reinsurers, with the New Zealand Government guaranteeing any shortfall.

<table>
<tr><th>KEY SUCCESS FACTOR AND MEASURE</th><th>RESULT</th></tr>
<tr><td>EQC should have its investments achieve the performance targets set out in the Statement of Investment Policies, Standards and Procedures.</td><td></td></tr>
<tr><td>This target is met through the following measures:

Global Equities
MSCI World Index with net dividends re-invested measured in NZ dollars.

NZ Inflation-Indexed Bonds
NZX NZ Inflation-Indexed Index.

NZ Government Stock
NZX NZ Government Stock Index.

NZ Cash
NZX 90-day Bank Bill Gross Return Index.</td><td>NOT ACHIEVED [TARGET NO LONGER RELEVANT]

EQC's target as defined in the June 2011–June 2014 Statement of Intent is no longer appropriate.

The target return for the total portfolio is 1% plus the NZGS index return, over a rolling 10-year period.

A significant portion of the investment portfolio was sold down before EQC's 10-year target could be achieved. For the five years to 30 June 2012, the actual total portfolio return was 5.1% versus the target of 9.9%.

<table>
<tr><th>ASSET CLASS</th><th>ACTUAL RETURN</th><th>BENCHMARK</th></tr>
<tr><td>NZ Government Stock (NZGS)</td><td>10.9%</td><td>11.0%</td></tr>
<tr><td>NZ Inflation-Indexed Bonds</td><td>6.3%</td><td>6.2%</td></tr>
<tr><td>Cash on call/Bank Bills (RCD)/Treasury Bills/ Term Deposits</td><td>2.6%</td><td>2.5%</td></tr>
<tr><td>Total Portfolio</td><td>6.8%</td><td>6.4%</td></tr>
</table>

All active and passive equities were sold by May 2012 and accordingly are not reported in this financial year. Investment returns for other assets are reported above.</td></tr>
<tr><td>EQC must act in accordance with its responsible investment policy standards and procedures.</td><td></td></tr>
<tr><td>This target is demonstrated by the absence of breaches of excluded stock holdings.</td><td>ACHIEVED

EQC has met this target. There have been no breaches of excluded stock holdings.</td></tr>
<tr><td>EQC's investment management costs are to be in line with its international peers.</td><td></td></tr>
<tr><td>This target is reached when EQC's investment management costs reported in the CEM Benchmarking Survey are less than the median of its international peers, when adjusted for asset mix.</td><td>NOT ACHIEVED [TARGET NO LONGER RELEVANT]

EQC's target as defined in the June 2011–June 2014 Statement of Intent is no longer appropriate.

EQC sold down a significant portion of the investment portfolio to provide cash for claim settlement and did not take part in the 2011 CEM Benchmarking Survey.

EQC has achieved this target in past surveys.</td></tr>
<tr><td>EQC's investment management costs are to be in line with its domestic peers.</td><td></td></tr>
<tr><td>This target is reached when:

Its fixed income management costs are the same or less than those of other Crown financial institutions.

When adjusted for the size of the holdings, its global equities management cost is the same as or less than those of other Crown financial institutions.</td><td>NOT ACHIEVED [TARGET NO LONGER RELEVANT]

EQC's target as defined in the June 2011–June 2014 Statement of Intent is no longer appropriate.

EQC sold down a significant portion of the investment portfolio to provide cash for claim settlement, including all global equities.

Past survey results have shown EQC to achieve these targets.</td></tr>
</table>

OUTPUT EXPENDITURE FOR THE YEAR ENDED 30 JUNE 2012

OUTPUT CLASS	ACTUAL REVENUE ($ MILLION)	ACTUAL EXPENDITURE ($ MILLION)	BUDGET REVENUE ($ MILLION)	BUDGET EXPENDITURE ($ MILLION)
*Claims handling	–	9.8	–	10.4
Research	–	12.8	–	11.7
Public education	–	1.5	–	3.6
Policy advice	–	–	–	–
Administration of the Act, Insurance Scheme and the Natural Disaster Fund	322.4	87.3	308.3	95.9

* This includes only the costs of operating the Catastrophe Response Programme and excludes claims settlements and directly associated costs, including costs associated with the Canterbury earthquakes. For information on the claims handling costs relating to the Canterbury earthquakes, refer to Note 5 of the financial statements.

Other **Disclosures**

MANAGING ORGANISATIONAL HEALTH

The context of our changing environment

Since the Canterbury earthquakes on 4 September 2010 and 22 February 2011, and subsequent aftershocks, EQC has faced a huge increase in its claims assessments and settlements.

In response, EQC set up a number of site offices in Christchurch and rapidly engaged a large number of contractors and temporary staff across New Zealand and Australia to assist with the EQC response to the Canterbury events.

Catastrophe Response Programme

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

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

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

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

EQC has contingency plans in place when New Zealand is affected by a major catastrophe, providing for expansion of organisational size at short notice.

Following the Canterbury earthquakes, EQC successfully demonstrated the capability of the CRP by setting up new offices in Christchurch after the September quake. As part of this response, EQC has engaged close to 1,200 people to support its claims assessment and settlements process.

Our People

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

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

Developing and supporting our leaders

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

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

These initiatives will include:

- developing and implementing a competency framework for all leadership roles;
- developing a process for identifying potential talent;
- supporting our leaders to access leadership development programmes including those provided by the Leadership Development Centre and other public sector leadership programmes.

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

EQC Workforce by occupation and location

BY LOCATION	
Canterbury	619
Wellington	455
Australia	0
Hamilton	49
Other	31
Total	**1154**

BY WORK AREA	
Field Staff	274
Corporate/Support Staff	244
Claims Staff	636
Total	**1154**

Other **Disclosures**

INVESTMENT PROCESSES – ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Introduction

Late in the financial year EQC sold the last of the international investments (global equities) from the Natural Disaster Fund, as part of meeting Canterbury earthquake damage claims. The issues discussed below pertain to the period that global equities were actually held. As of 30 June 2012 EQC did not invest in company shares.

Principles

EQC considers that responsible investment decision-making that takes account of environmental, social and governance (ESG) considerations is part of evolving best practice. Responsible investment actions can include engagement, voting, exclusion of certain investments, and/or divestment.

EQC, at its discretion, and provided that it is consistent with its obligation to invest the Natural Disaster Fund (NDF) on a prudent, commercial basis, may consider other issues arising from the NDF's investments. In doing so, EQC may take into account factors such as whether the issue is contrary to New Zealand law and New Zealand's international agreements, or is inconsistent with Crown actions.

Implementation

If companies invested in are found to have corporate practices that breach its responsible investment policy, EQC will consider engaging with the company either directly or in conjunction with other investors, or taking other shareholder action. EQC believes that it can, in most instances, have a greater impact on company practices through dialogue with company management in conjunction with others, than through immediate divestment.

As a last resort EQC may divest of investment in companies that are found to have corporate practices that breach its responsible investment policy.

Investment Managers

EQC appoints external investment managers to manage portions of the Fund. As part of the selection process EQC assesses the overall investment management capabilities of candidate managers, including the ability to implement EQC's requirement to avoid prejudice to New Zealand's reputation as a responsible member of the world community.

Investment managers are required to be vigilant against the effects on companies' long-term performance prospects that could arise from any practices which alienate civilized society including socially and environmentally irresponsible behaviour.

Maintaining open dialogue with investment managers, including in relation to the requirement to avoid prejudice to New Zealand's reputation, is considered to be critical to the achievement of EQC's objectives.

In addition, consistent with the United Nations Principles for Responsible Investment, EQC encourages its investment managers to integrate ESG factors into evolving research and analysis and to undertake and report on ESG-related engagement. The investment managers report to EQC on their application of the responsible investment requirements, on a six-monthly basis.

Investment managers are formally instructed of any exclusion or divestment decisions by EQC.

Exclusions

In line with the obligations and responsibilities of the responsible investment policy, EQC and its investment managers do not invest the Fund in the following:

- organisations engaged in the development, production, transfer, possession, acquisition, stockpiling or use of anti-personnel mines, or
- organisations engaged in the production of cluster munitions, or
- organisations engaged in the manufacture, simulated testing and/or refurbishment of nuclear explosive devices, or
- manufacturers of cigarettes and tobacco.

Proxy Voting Policy

EQC believes that good corporate governance should maintain a balance between the rights of shareholders on one hand and the needs of the corporate board and management to direct and manage the company's affairs on the other.

Responsible governance should reinforce a culture of integrity and transparency, contribute to the achievement of strategic goals, ensure Board alignment with shareholder interests, reinforce and maintain good business ethics, and recognise environmental and social considerations.

EQC believes that good corporate governance will also maximise returns to the Fund without undue risk.

Voting rights are important to the Fund for maintaining shareholder oversight of directors and company policies. EQC will use its voting rights to encourage good corporate governance.

Voting Rights

POOLED ACCOUNTS

The Board will retain the right to exercise any vote attached to units held in a pooled account. The right to exercise any vote attached to a share or unit within a pooled account will normally rest with the manager of the account.

DIRECTLY HELD ACCOUNTS

Any voting rights attached to any securities that form part of the portfolio shall be exercised by the manager:

- as directed by EQC by written notice to the manager; or
- if no such direction is made, in accordance with the manager's duties and obligations under their agreement and in particular, avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

Directory

MINISTER RESPONSIBLE FOR THE EARTHQUAKE COMMISSION

The Hon Gerry Brownlee

COMMISSIONERS

Michael Wintringham – CNZM, BA (HONS)
Chairman – Former member of the Remuneration Authority, former State Services Commissioner, Chief Executive of the Ministry of Housing and Assistant Auditor General.

Keith Taylor – BCA, BSC, FIA(LONDON), FIAA, AFIOD
Deputy Chairman – Chair, Government Superannuation Fund and Speirs Group Limited; Director, Southern Cross Healthcare Society, Reserve Bank, Gough, Gough and Hamer Ltd, Port Marlborough Ltd and Member of the Takeover Panel; former Group Managing Director and Chief Executive Officer of TOWER Ltd.

Russell Black – BE(CIVIL)(HONS), FREng(UK), FHKEng, FIPENZ, FHKIE
Commissioner – Board Member of Northpower Ltd, Former Director of Metro Trains Melbourne Pty. Ltd, formerly on Hong Kong Government's Vocational Training Council, Construction Advisory Board and the Construction Industry Council, and former Executive Projects Director of MTR Corporation in Hong Kong.

Denise Bovaird – BCOM, FCA
Commissioner – On the Board and Chair of the Audit and Risk Committee, Real Estate Agents Authority; Past president and Board member (2001–2007) of the New Zealand Institute of Chartered Accountants.

Trevor Burt
Commissioner – Director of Lyttelton Port Company Ltd, Silver Fern Farms Ltd, Mainpower NZ Ltd and Landpower Holdings Ltd. Chair of Ngai Tahu Holdings Corporation Ltd and The New Zealand Lamb Company (North America) Ltd and advisor to NZTE Beachhead Advisory Board. Former Executive Director of The Linde Group in Munich.

Peter Hughes – CNZM, BA, PGDipBusAdmin, MPA (HARVARD), FIPANZ, FNZIM, MInstD
Commissioner – Professor and Head of the School of Government at Victoria University of Wellington; former public service chief executive; Chairman, Careers New Zealand and Director of a number of government and non-government companies including the Australia and New Zealand School of Government and the Better Public Services Advisory Board.

Giselle McLachlan – LLB
Commissioner – Former partner in Phillips Fox and General Counsel & Head of Corporate Services with IAG New Zealand Ltd.

Gordon Smith
Commissioner – Chair, Codeblue Hawkes Bay Ltd; Director, Calliden Group Ltd, Australia; Advisory Board Chair, First Star Communications Ltd, Cole Murray Group Ltd; former Chair, Agricultural Resources Ltd, Arena Manawatu, Manfeild Board of Trustees; former Director, Insurance Council of New Zealand, Farmers' Mutual Finance Ltd, 7 Farmers' Mutual Group subsidiaries; former Chief Executive Officer of Farmers' Mutual Group.

SENIOR MANAGEMENT

I Simpson – BSC (HONS), MBA
Chief Executive

P R Jacques – BSC, DIPMGT, DIPACC, CA, CFIP
GM Corporate Services

H A Cowan – PHD
GM Reinsurance, Research & Education

B P Dunne – BSC, BA (HONS), MA (DIST.), CERT MS
GM Strategy, Policy & Legal Services

H Stewart – BBS (ER), FHRINZ (FELLOW)
GM Organisational Development

B Emson
GM Customer Services

D Barber
GM Communications

J Whitfield
GM Project Portfolio Management

AUDITOR

Ian C Marshall, Deloitte
(On behalf of the Auditor-General)

BANKER

National Bank Of New Zealand, Wellington

SOLICITORS

Chapman Tripp, Wellington

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