EQC
EARTHQUAKE COMMISSION
Kōmihana Rūwhenua

EARTHQUAKE COMMISSION'S

STATEMENT OF PERFORMANCE EXPECTATIONS

2018-19

This Statement of Performance Expectations (SoPE) is a formal public accountability document required under section 149C of the Crown Entities Act 2004. It outlines the Earthquake Commission's (EQC's) planned work and financial information for the period 1 July 2018 to 30 June 2019. Relevant historical and forecast comparison information is also provided for the benefit of readers.

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STATEMENT OF RESPONSIBILITY

This Statement of Performance Expectations (SoPE) sets out the intended non-financial performance and financial forecast of the Earthquake Commission (EQC) for the year 1 July 2018 to 30 June 2019 across its Output Classes. It has been prepared in accordance with the Crown Entities Act 2004.

The prospective financial statements have been prepared in accordance with PBE FRS-42 for the purposes of this SoPE.

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

Dame Annette King DNZM
Interim Board Chair
26 June 2018

Mary-Jane Daly
Commissioner
26 June 2018

INTRODUCTION AND BACKGROUND

EQC's functions are set out in section 5 of the Earthquake Commission Act 1993 ("the Act"). Those functions are:

a. To administer the insurance against natural disaster damage provided under the Act;

b. To collect premiums payable for the insurance provided under the Act;

c. To administer the Fund and, so far as is reasonably practicable, protect its value, including by the investment of money held in the Fund;

d. To obtain reinsurance in respect of the whole or part of the insurance provided under the Act;

e. To facilitate research and education about matters relevant to natural disaster damage, methods of reducing or preventing natural disaster damage, and the insurance provided under the Act;

f. Such other functions as may be conferred on it by –

i. The Act or any other Act; or

ii. The Minister, in accordance with section 112 of the Crown Entities Act 2004.

This SoPE should be read in conjunction with EQC's Statement of Intent (SOI) which contains our vision, mission and strategic intentions. EQC manages its functions and intended operations to meet these strategic intentions. The actual performance for the 2018-19 financial year in each of the outputs and measures in this SoPE will be reported in EQC's Annual Report. Our strategic intentions are supported by strategic outcomes that are also set out in the SOI.

EQC's strategic intentions are:

1. EQC is a leader in New Zealand on natural hazard risk reduction;
2. New Zealanders have access to natural disaster insurance and reinsurance; and
3. Claims made to EQC's insurance scheme are managed fairly, transparently and in a timely way.

Supporting these, EQC's strategic outcomes are:

- Increase community resilience to natural disasters;
- New Zealand has an affordable and sustainable natural disaster insurance scheme; and
- Improve customers' recovery from natural disasters.

Supporting these outcomes is the implementation of EQC's operating model focussed on putting the customer at the heart of everything we do. The output classes and capability measures in this SoPE show how we will achieve our strategic intentions and outcomes. The outputs in this SoPE are grouped into two categories or output classes:

1. Future Event Preparation; and
2. Claims Management.

For each of the output classes above this SoPE provides information on:

- What the output class is intended to achieve and associated measures;
- The expected result (if available) for the 2017-18 financial year, this is referred to as the 'Forecast Out-turn' and the target for the 2018-19 financial year, referred to as the Performance Standard.
- The expected revenue and proposed expenses for the output class; and
- How the performance of the output class will be assessed.

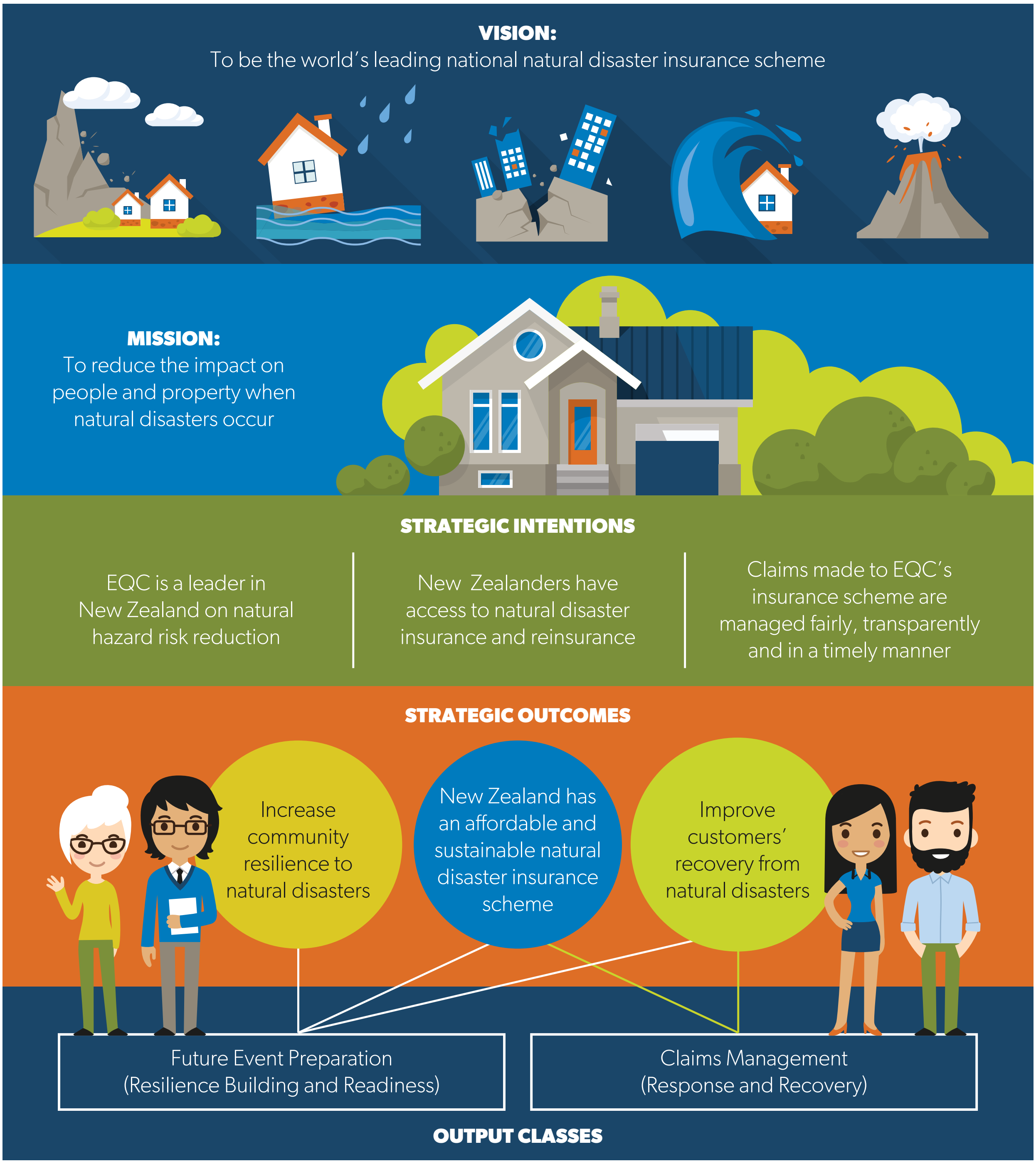
EQC will continue to consult and work closely with our monitoring agency to achieve our strategic goals.

In addition to these output classes, the SoPE also provides measures on key activities, such as the administration of the Natural Disaster Fund (NDF). While these activities may not necessarily deliver outputs, they are fundamental to the functions we are required to perform under the Act.

The SoPE also provides EQC's prospective (forecast) financial statements for the 2018-19 and 2019-20 financial years.

EQC's Strategic Map shows the alignment between the SoPE output classes and the detailed measures with the desired outcomes in EQC's strategic direction outlined in the SOI 2018-22.

EQC's strategic map



EQC'S OPERATING ENVIRONMENT

EQC is operating in a time of increased seismic activity and a growing number of weather related events. Over the last eight years, New Zealand has experienced significant earthquakes in Canterbury and Kaikoura, with less impactful ones in Cook Strait and Eketahuna. There have also been many landslip and flood events, including in Edgecumbe, Thames, the West Coast and Nelson. In our response to all these events, EQC works alongside private insurers.

EQC's vision of being the world's leading national natural disaster insurance scheme is unchanged and our mission to reduce the impact on people and property when natural disasters occur is still at the heart of what we do. EQC's operating model will strengthen our ability to reduce the impact on people while delivering the functions outlined in the EQC Act.

The Earthquake Commission Amendment Bill was introduced in March 2018. If enacted in its current form (as at the time of writing), the Bill would:

- Increase EQC's residential building cap to $150,000 (plus GST);
- Remove contents cover from EQCover;
- Extend the period when people could lodge claims to up to two years after a natural disaster; and
- Clarify EQC's authority to share information to support implementation of the Act.

An Inquiry into EQC's response to the Canterbury earthquakes will commence in 2018, which may result in further changes to our governing legislation. EQC is ready to provide its views and evidence to the Inquiry in order that further lessons learnt can be drawn to improve how we operate in the future which can be bought together with further legislative reform.

PART 1: OUTPUT CLASSES

Output One:
Future Event Preparation

The greater a community's ability to cope with a natural disaster, the more resilient it will be and the quicker it will be able to recover. EQC will continue investing in science, research and education, that can, for example, help policy-makers introduce better building practices and make better land-use decisions, and help New Zealanders take practical steps to protect their homes in anticipation of natural disaster events.

EQC will increase its capability in impact estimation and loss modelling. Modelling the potential losses from natural disasters or the benefits of risk reduction is a highly specialised requirement for insurance management. It also enables EQC and other agencies to test and plan for scenarios and to focus support in the aftermath of an event. EQC's activity in this regard will involve working closely with other stakeholders to unlock the wider benefits of the insights modelling yields for New Zealand's resilience.

The outputs in this class will also help inform our strategies for rebuilding the Natural Disaster Fund and our purchasing of reinsurance.

Output objectives

- Building knowledge and capability, including:
  - delivering EQC's Resilience Strategy, which is a multi-year programme that is continuing to evolve. The strategy will enhance the sharing and practical application of data and technical know-how, to improve New Zealand's resilience to natural hazards; and
  - enhancing impact and loss modelling tools to ensure that the relevant data and science research are translated and available to support better decision-making; and its application to risk reduction.
- Making the data and knowledge of our forecasting and modelling accessible by:
  - facilitating access to data and knowledge and raising awareness and understanding of its value to insurance planning and natural hazard risk reduction;
  - fostering networks and initiatives across the science, insurance and policy sectors of New Zealand that are focussed on natural hazard risk reduction; and
  - ensuring that the outcomes of our investment in science and research also are accessible and relevant to the public to help them make their homes more resilient to natural disasters.

How we measure performance

To measure how well prepared we are, we will conduct stakeholder surveys to understand how our outputs are perceived by stakeholders and the value that can be derived from them. We will also consider the impact that activities have on the level of house insurance and the number of New Zealanders who are taking action to prepare for natural disasters. For the 2018/19 financial year, EQC has revised some performance measures and, in these cases, this year will establish a performance benchmark against which we will measure in coming years.

2018/19 Expected revenue and proposed expenses

There is no revenue associated with Output Class One. Proposed expenses for Output Class One are $33.4 million. This relates primarily to the cost of funding research and education, including the significant investment in the GeoNet platform and loss modelling.

Linkages to Strategic Outcomes

This output class contributes to EQC's strategic outcomes of:

- Increase community resilience to natural disasters;
- Improve customers' recovery from natural disasters; and
- New Zealand has an affordable and sustainable natural disaster insurance scheme.

The activities contained within this output are centred on building resilience to ensure that both EQC and the wider community are knowledgeable, well prepared and ready to deal with a natural disaster event. Each activity has measures which set time-bound, quality or quantity criteria.

Output 1.1: A resilience programme that facilitates improved analysis and public understanding of natural hazard risk

This output is focussed on working within EQC and with stakeholders to build resilience to natural hazard events through a partnership approach using effective facilitation and engagement. EQC's focus is on those areas that are of the highest strategic value.

In building resilience to natural hazards, EQC will deliver policy advice, research findings and analysis that stakeholders see as high-quality and well-targeted. The proportion of New Zealanders who take action to prepare their home for risks from natural disasters acts as a guide to how EQC's resilience programme may positively impact New Zealanders' resilience to natural disasters. This output contributes to EQC's Strategic Intentions "EQC is a leader in New Zealand on natural hazard risk reduction" and "New Zealanders have access to natural disaster insurance and reinsurance".

PERFORMANCE MEASURES	FORECAST OUTTURN 2017/18	PERFORMANCE STANDARD 2018/19	OUTTURN 2018/19
Quality			
Stakeholders[1] surveyed[2] agree or strongly agree that the outputs of EQC's resilience strategy (advice, analysis and modelling, and research findings): • to be of good or excellent quality • to be relevant and focussed on the right issues.	New Measure	75%	
Stakeholders surveyed agree or strongly agree that the EQC's facilitation and engagement was a positive contribution toward: • improved coordination and collaboration in natural hazards science and research; • improved understanding of natural hazard risk ; and • improved coordination and collaboration in natural hazards risk management.	New Measure	75%	
Quantity			
There is a year on year increase in the proportion of New Zealanders who, when surveyed, confirm: • that they have taken action to prepare their homes for natural disasters.	45%[3]	> 45%	

Output 1.2: Insurance coverage under the EQC Act

This output is focussed on the accessibility and uptake of home insurance in New Zealand that is underpinned by the EQC natural hazard insurance scheme.

This output contributes to EQC's Strategic Intention "New Zealanders have access to natural disaster insurance and reinsurance".

PERFORMANCE MEASURES	FORECAST OUTTURN 2017/18	PERFORMANCE STANDARD 2018/19	OUTTURN 2018/19
Quality			
Maintain the high proportion of New Zealand housing stock that has house insurance	98%	98%[4]	

1 Stakeholders include Local Government and Design, Planning and Construction Professionals.
2 Surveys are undertaken by an independent organisation.
3 Based on 2017/18 Q3 result.
4 There may be other factors, beyond EQC's control, which could affect the number of New Zealanders choosing to purchase house insurance. Percentage of New Zealand homeowners claiming to hold insurance. Source: Insurance Council of New Zealand, UMR Research, February 2018

Output Two: Claims Management

Our Claims Management output class focusses on how we manage claims after an event. In recent years, claim volumes have increased as the result of greater seismic activity and the increased frequency of more extreme weather events. We aim to resolve all claims in a swift, fair and transparent way.

EQC has acknowledged that our past actions have not always been sufficiently responsive. The resolution of all outstanding Canterbury and Kaikoura claims remains our highest priority. Customers are at the heart of the EQC operating model designed to improve customer satisfaction in their interactions with us. Investment in systems, digital channels, and enhanced assessment tools will ensure a suitable claim settlement and improve the customers' journey.

EQC has increased collaboration with the private insurance industry and will continue to work closely with it. A strategic review will be undertaken of the 2016 Kaikoura earthquake response to identify lessons from the model used in that event which piloted private insurers acting as EQC's agents.

Output objectives

The output objectives of this class are:

- Responding swiftly to all customers' claims to help them recover from an event. Priorities lie with finalising all unresolved Canterbury and Kaikoura claims while responding to new claims and events as they occur;
- Improving customer experience and keeping customers better informed about the progress of their claims through the timely release of their information;
- Tracking financial efficiency in responding to events through the continued monitoring of claims handling expenses; and
- Responding to the recommendations outlined in the Independent Ministerial Advisor's Report published on 6 June 2018.

How we measure performance

Results are tracked primarily through data held within our claims management system including time to settle claims and independent customer satisfaction surveys. For the 2018/19 financial year, EQC has revised some performance measures and, in these cases, this year will establish a performance benchmark against which we will measure in coming years.

2018/19 Expected revenue and proposed expenses

There is no revenue associated with Output Class Two. Proposed expenses for Output Class Two are $34.8 million (excluding specific claims handling expense budgets) relating primarily to the cost of settling natural disaster claims and the supporting systems.

Performance Measures

EQC's highest priority is to resolve the unsettled claims from the 2010-11 Canterbury earthquake sequence and the November 2016 Kaikoura earthquake sequence. Separate performance measures are monitored for these and are represented in the tables below. In regards to the Kaikoura event, it is anticipated that materially all initial settlements will be complete by 30 June 2018.

For a claim to be settled, the customer must have received a cash settlement or had a repair completed that meets EQC's obligations under the Act. In some instances, following a settlement the claim may subsequently be requested to be reopened. This will be treated as a reopened claim and be measured accordingly.

Linkages to Strategic Outcomes

This output class contributes to the following EQC's strategic outcomes:

- Improve customers' recovery from natural disasters; and
- New Zealand has an affordable and sustainable natural disaster insurance scheme.

The activities contained within this output are directly targeted at customers who have experienced loss through a natural disaster event. Each activity has measures which set time-bound, quality or quantity criteria designed to ensure that customers are treated in a fair and timely manner. EQC will work to ensure that customers with existing outstanding claims are given a completion pathway during the 2018/19 financial year. Customer satisfaction with this process is also measured, as is EQC's ability to settle claims within the Board approved budget.

Output 2.1: Settlement of Canterbury 2010-11 Earthquake Sequence Remedial Claims

This output is focussed on providing service to EQC's customers with claims from the 2010-11 Canterbury earthquakes. The measures address both the timeliness and the quality of EQC's claims resolution. This output also includes communication with EQC's customers and surveying their overall level of satisfaction as well as how well they have been kept informed regarding progress of their claims. This output contributes to EQC's Strategic Intention "Claims made to EQC's insurance scheme are managed fairly, transparently and in a timely manner".

PERFORMANCE MEASURES	FORECAST OUTTURN 2017/18	PERFORMANCE STANDARD 2018/19	OUTTURN 2018/19
Timeliness			
Outstanding claims[5] on hand at 30 June 2018, are settled or in the process of being physically repaired by 30 June 2019.	New Measure	98%	
New inflow of accepted reopened claims[6] lodged post 30 June 2018 will be settled, or in the process of being physically repaired, within six months of reopened[7] date.	New Measure	80%	
The frequency of our communications to provide customer certainty in the progress of their claims settlements.	New Measure	All customers with an outstanding claim[8] are provided a personalised monthly communication from EQC	
Quality			
EQC settlements should be enduring. Less than 10% of claims settled between 1 May 2018[9] and 1 January 2019 are reopened by 30 June 2019.	New Measure	<10%	
The proportion of surveyed[10] customers who indicate satisfaction about their overall claim settlement process increases by 5% per annum.	37%[11]	≥42%	
The proportion of surveyed customers who indicate that they were well informed during the claims settlement process increases by 15% per annum.	23%[12]	≥38%	

5 Where EQC potentially has outstanding liability under the EQC Act. Excludes any claims that are subject to litigation or managed by Southern Response under the agreed Memorandum of Understanding.
6 Where EQC potentially has outstanding liability under the EQC Act. Excludes new litigation cases.
7 To count as reopened, EQC needs to have triaged the request and accepted the possibility of further activity being required.
8 Excluding claims in litigation.
9 Canterbury claims were transferred to a new system during April 2018 hence the 1 May 2018 date.
10 Telephone survey conducted with customers whose claims were settled the previous month.
11 Based on the Q1 – Q3 average.
12 Based on the Q1 – Q3 average.

Output 2.2: Settlement of Kaikoura 2016 Earthquake Claims

This output is focussed on settling reopened claims from the 2016 Kaikoura earthquake in a swift manner. This output contributes to EQC's Strategic Intention "Claims made to EQC's insurance scheme are managed fairly, transparently and in a timely manner".

PERFORMANCE MEASURES	FORECAST OUTTURN 2017/18	PERFORMANCE STANDARD 2018/19	OUTTURN 2018/19
Timeliness			
Outstanding claims[13] on hand at 30 June 2018, excluding any that are subject to litigation proceedings, are settled by 31 December 2018.	New Measure	95%	
Reopened[14] Kaikoura claims lodged post 30 June 2018 will be settled within 6 months of reopening.	New Measure	90%	

Output 2.3: Claims Relating to Other Natural Disaster Events (excluding Canterbury and Kaikoura)

This output is focussed on providing service to EQC's customers with claims unrelated to existing Canterbury 2010-11 or Kaikoura 2016 earthquake events. These measures address claims (including any reopened claims), and the speed, cost and quality of EQC's claims resolution – the aim being to settle claims swiftly, fairly and efficiently. This output also includes communication with these EQC customers and surveying their level of satisfaction with the claim settlement process and how well they been kept informed during it. This output contributes to EQC's Strategic Intention "Claims made to EQC's insurance scheme are managed fairly, transparently and in a timely manner".

PERFORMANCE MEASURES	FORECAST OUTTURN 2017/18	PERFORMANCE STANDARD 2018/19	OUTTURN 2018/19
Timeliness			
Claims are settled within 90 working days of assessment.	New Measure	80%	
The frequency of communications providing customer certainty in the progress of their claims settlements.	New Measure	All customers with an outstanding claim[15] is provided a personalised communication from EQC monthly	
Quality			
EQC settlements should be enduring. Less than 10% of claims resolved between 1 January 2018 and 1 January 2019 are reopened by 30 June 2019.	New Measure	<10%	
The proportion[16] of surveyed customers who indicate satisfaction about their overall claim settlement process increases by 5% per annum.	57%[17]	≥62%	
The proportion of surveyed customers who indicate they were well informed during the claims settlement process increases by 15% per annum.	45%[18]	≥60%	
Quantity			
New natural disaster event[19] claims are resolved within Board approved claims handling expense budgets[20] for those events.	New Measure	Within 10% of initial budget.	

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13 Either first time settlements or reopened claims.
14 To count as reopened, EQC needs to have triaged the request and accepted the possibility of further activity being required.
15 Excluding claims in litigation.
16 Telephone survey conducted with customers whose claims were settled the previous month.
17 Based on Q1 – Q3 average.
18 Based on Q1 – Q3 average.
19 A specific event budget may be established when there are 500 or more claims and/or the estimated total financial impact is anticipated to be above $5 million.
20 In the approval of budgets, the Board will consider the type of response required, previous costs of similar events and any available benchmarks.

PART 2: KEY ACTIVITY MEASURES

Credit: EQC, GNS Science

In addition to our output classes, we have introduced key activity measures to provide transparency on how we continually progress key activities to achieve our strategic outcomes and intentions, as well as delivering the functions set out in the Act. These key activity measures contribute to all three of EQC's strategic outcomes, and enable its strategic intentions to be realised.

Key Activity Measures objectives

EQC is committed to continually increasing capability so we are well positioned to respond to future events. This approach includes having a continued focus on our already specialised skills around obtaining reinsurance and the financial management of the Natural Disaster Fund. Key activities include:

- Purchase of reinsurance, through:
  - applying science to drive down uncertainty in reinsurance risk pricing and implementation; and
  - continuing to maintain strong relationships with the reinsurance markets and investigate other forms of financial risk transfer.
- Administration of the Natural Disaster Fund, including:
  - rebuilding the Natural Disaster Fund to the level of the current reinsurance deductible, through:
    - managing the Natural Disaster Fund in line with the relevant Ministerial Direction; and
    - providing advice and guidance to key stakeholders on key components of the EQC natural disaster insurance scheme such as premium adequacy, the legislative review of the EQC Act and any funding requirements under the Crown guarantee.
- Collection of premiums payable for the insurance payable under the Act.

2018/19 Expected revenue and proposed expenses

Expected revenue primarily from EQC premiums is $383.9 million. Budgeted expenses are $178.1 million largely relating to the purchase of reinsurance to protect against the financial consequences of future significant natural disaster events.

Key Activity Measures

The key activity measures demonstrate how EQC will increase its resilience and capability to respond to future events through the purchase of reinsurance, rebuilding and managing the Natural Disaster Fund, and the collection of premiums.

Key Activity Measure 1: A reinsurance programme that supports EQC's delivery of affordable residential natural disaster insurance protection

The purchase of reinsurance transfers an agreed amount of natural disaster risk to offshore capital providers, thereby reducing the concentration of New Zealand's financial exposure to future natural disaster events.

PERFORMANCE MEASURES	FORECAST OUTTURN 2017/18	PERFORMANCE STANDARD 2018/19	OUTTURN 2018/19
Quality			
The reinsurance programme continues to support delivery of affordable residential natural disaster insurance protection consistent with EQC's risk financing strategy.	New Measure	Reinsurance protection is obtained on terms that assure continuity of coverage for all perils, at rates that are lower than the Crown's cost of capital.	
	New Measure	Annual Consultation with the Crown on risk appetite occurs.	

Key Activity Measure 2: Managing the Natural Disaster Fund

The regrowth of the Natural Disaster Fund ensures that EQC is financially better prepared for future natural disaster events.

PERFORMANCE MEASURES	FORECAST OUTTURN 2017/18	PERFORMANCE STANDARD 2018/19	OUTTURN 2018/19
Quantity			
The long-term financial strategy of EQC enables a rebuild of the Natural Disaster Fund to reach $1.75bn[21] by 2030.	New Measure	An independently assessed model will demonstrate progress	

Key Activity Measure 3: Premium Collection

The accurate collection of premiums is crucial to ensuring the ongoing funding of the EQC natural disaster insurance scheme and rebuild of the Natural Disaster Fund.

PERFORMANCE MEASURES	FORECAST OUTTURN 2017/18	PERFORMANCE STANDARD 2018/19	OUTTURN 2018/19
Quantity			
The level of premiums collected compared to annual financial budget	108%[22]	> 97.5%	

21 This represents the current deductible (excess) for EQC's reinsurance programme.
22 This forecast is due to the increased EQC Levy (which occurred following completion of the 2017/18 budget) from 1 November 2017.

PART 3: PROSPECTIVE FINANCIAL STATEMENTS 2018-19, 2019-20

3.1 Prospective Statement of Comprehensive Revenue and Expense

	BUDGET 2019 $(000)	FORECAST 2020 $(000)
EARNED PREMIUMS		
Gross earned premiums	383,907	392,897
Outward reinsurance premium expense	(168,076)	(169,757)
Net earned premium revenue	**215,831**	**223,140**
UNDERWRITING MOVEMENTS		
Reinsurance and other recoveries	1,497	243
Claims (expense)/reduction	84,440	(9,010)
Unexpired risk liability reduction (increase)/reduction	7,421	2,048
Total underwriting movements	**93,358**	**(6,719)**
SURPLUS FROM INSURANCE ACTIVITIES	**309,189**	**216,421**
OTHER OPERATING EXPENSE		
Future Event Preparation	(33,412)	(32,862)
Claims Management	(34,752)	(28,321)
Total operating revenue and expense	**(68,164)**	**(61,183)**
Crown underwriting fee	(10,000)	(10,000)
TOTAL COMPREHENSIVE REVENUE/(EXPENSE) FOR THE PERIOD	**231,025**	**145,238**

3.2 Prospective Statement of Changes in Equity

	BUDGET 2019 $(000)	FORECAST 2020 $(000)
NATURAL DISASTER FUND		
Capitalised reverses	1,500,000	1,500,000
RETAINED EARNINGS		
Opening balance at 1 July	(2,060,881)	(1,829,856)
Net surplus/(deficit) and total comprehensive revenue/(expense) for the period	231,025	145,238
Closing balance at 30 June	**(1,829,856)**	**(1,684,618)**
Closing balance at 30 June	**(329,856)**	**(184,618)**

3.3 Prospective Statement of Financial Position

	BUDGET 2019 $(000)	FORECAST 2020 $(000)
NATURAL DISASTER FUND		
Capitalised reserves	1,500,000	1,500,000
Retained earnings	(1,829,856)	(1,684,618)
Total Equity	**(329,856)**	**(184,618)**
ASSETS		
Premiums receivable	71,946	75,881
Outstanding Reinsurance and other recoveries	40,583	2,934
Other receivables	1,742	0
Prepayments	1,434	1,434
Outward reinsurance expense asset	28,013	28,013
Investments	0	0
Property, plant and equipment	11,493	11,344
Intangible assets	16,721	16,481
Total Assets	**171,932**	**136,087**
LIABILITIES		
Bank	(76,618)	(31,102)
Trade and other payables	(12,371)	(13,629)
Provisions	(1,886)	(1,896)
Outstanding claims liability	(172,385)	(35,550)
Unearned premium liability	(204,616)	(206,664)
Unexpired risk liability	(33,912)	(31,864)
Total Liabilities	**(501,788)**	**(320,705)**
Net liabilities*	**(329,856)**	**(184,618)**

*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.

3.4 Prospective Statement of Cash Flows

	BUDGET 2019 $(000)	FORECAST 2020 $(000)
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash was provided from:		
Interest	0	0
Premiums	386,346	388,963
Reinsurance and other recoveries	86,504	37,891
Net GST	1,192	3,000
***Cash was applied to*:**		
Outward reinsurance	(168,444)	(169,757)
Crown underwriting fee	(10,000)	(10,000)
Claims settlements and handling costs	(446,762)	(143,788)
Employees and other operating expenses	(46,839)	(37,913)
GeoNet operating expense	(9,043)	(9,043)
Research grants	(4,673)	(4,673)
Net cash outflow from operating activities	**(211,719)**	**54,680**
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash was provided from:		
Sale of investments	0	0
Interest on investments	0	0
Cash was applied to:		
Purchase of property, plant and equipment	(3,875)	(3,500)
Purchase of intangibles	(7,431)	(5,664)
Net cash inflow from investing activities	**(11,306)**	**(9,164)**
Net (decrease)/increase in cash	**(223,025)**	**45,516**
Add opening cash brought forward	146,407	(76,618)
Ending cash carried forward	**(76,618)**	**(31,102)**

3.5 Notes to the Financial Statements

Note 1: Prospective Operating Expenditure Excluding Claims Costs

	BUDGET 2019 $(000)	FORECAST 2020 $(000)
Advertising and publicity	784	784
Amortisation of intangibles	3,890	5,905
Fees paid to the auditor		
Audit of the financial statements	76	76
Commissioners' fees	315	315
Consultants and contractors	16,804	10,515
Depreciation	3,690	3,649
Employee remuneration and benefits	19,005	16,664
Grants for earthquake research	4,173	4,173
GeoNet operating costs	9,043	9,043
Office rental	675	675
Sponsorships	65	65
Superannuation contribution costs	335	282
Technology costs	8,028	8,028
Other administration costs	1,281	1,009
Total operating costs (excluding claims expense and claims handling expense)	**68,164**	**61,183**

EXPENDITURE GROUPED BY FUNCTION		
Future Event Preparation	33,412	32,862
Claims Management	34,752	28,321
Total expenditure by function excluding claims costs	**68,164**	**61,183**

Note 2: Claims Expense

	2019 CURRENT YEAR $(000)	2019 PRIOR YEARS $(000)	2019 TOTAL $(000)	2020 CURRENT YEAR $(000)	2020 PRIOR YEARS $(000)	2020 TOTAL $(000)
Gross claims – undiscounted	(50,000)		(50,000)	(50,000)		(50,000)
Movement in discount		(4,240)	(4,240)		(783)	(783)
Amortisation of risk margin		138,680	138,680		41,773	41,773
Gross claims discounted	**(50,000)**	**134,440**	**84,440**	**(50,000)**	**40,990**	**(9,010)**

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.

Note 3: Contingent Liabilities

EQC received 469,472 claims from the 2010-11 Canterbury earthquake sequence. Some litigation involving EQC has arisen from disputes in respect of these claims and further litigation is inevitable. Litigation involving EQC has also arisen from disputes in relation to other natural disaster events, and further litigation in relation to these and future events is also inevitable. As at 31 May 2018, EQC had 379 open litigation cases across all events. The expectation of costs from disputes and litigation under the EQC Act is regularly considered by the actuaries in deriving the outstanding claims liability.

Included in the 379 open litigation cases, EQC has received 30 litigation cases which argue that EQC has liability outside of the EQC Act. Most of these cases relate to on-sold properties. At the time of budgeting, no separate provision has been made for these cases, although it is acknowledged that a separate provision may in the future be required as the various proceedings in this category are analysed in more detail.

3.6 Significant 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 and operates in New Zealand. The relevant legislation governing the Commission's operations includes the Crown Entities Act 2004 and the Earthquake Commission Act 1993 (EQC Act). 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 EQC 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.

The Commission has designated itself as a public benefit entity (PBE) for financial reporting purposes.

The reporting period covered by these prospective financial statements is for the years ending 30 June 2019 and 30 June 2020.

Basis of Preparation

Measurement Base

The financial statements have been prepared on an historical cost basis modified by the measurement of financial instruments at fair value through surplus or 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 is the functional currency of the Commission, and are rounded to the nearest thousand dollars.

Going Concern

Actuarial estimates of the Commission's claims liabilities indicate that total liabilities exceed its assets after accounting for reinsurance. The Crown has confirmed in writing to the Commission its intention to meet its obligation under Section 16 of the EQC 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 prospective financial statements.

Statement of Compliance

These prospective financial statements have been prepared in accordance with the requirements of the Crown Entities Act 2004, which includes the requirement to comply with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). They comply with PBE FRS 42 and other applicable financial reporting standards, as appropriate for public benefit entities.

The prospective financial statements comply with Public Benefit Entity standards.

The accounting policies set out below have been applied consistently to all periods presented in these prospective financial statements.

Accounting Judgements and Major Sources of Estimation

The preparation of financial statements in conformity with Tier 1 PBE accounting standards requires judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, revenue 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.

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

The actuarial judgements and estimations involved in measuring insurance liabilities and reinsurance recoveries are key areas of estimation where the assumptions made may have a significant effect on the financial statements, with a significant risk of material adjustment in future periods. The magnitude and number of Canterbury earthquakes, together with the impact of reopened claims in relation to remedial issues and financial reconciliations with insurers and reinsurers, have resulted in a higher than usual level of uncertainty associated with this measurement.

Insurance

Gross Earned Premiums and Unearned Premium Liability

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 Prospective Statement of Financial Position as an unearned premium liability. Premiums receivable are reported net of discounts paid to collecting agencies.

Outward Reinsurance Premium Expense

Premiums paid to reinsurers are recognised by the Commission as outward reinsurance premium expense in the Prospective Statement of Comprehensive Revenue and Expense 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 Prospective Statement of Financial Position.

Reinsurance and Other (Reductions)/Recoveries

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

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

Claims (Expense)/Reduction

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

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 expenses 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.

Outstanding Claims Liability

The outstanding claims liability is recognised at balance date as the central estimate of the present value of the expected future payments for claims incurred to balance date, with an additional risk margin to allow for the inherent uncertainty in the central estimate. The expected future payments include those in relation to claims reported but not yet paid, IBNR, IBNER and claims handling costs.

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

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

Unexpired Risk Liability (Increase)/Reduction

At balance date, the Commission assesses the adequacy of the unearned premium liability by applying the liability adequacy test as specified by PBE IFRS 4 – Insurance Contracts. The liability adequacy test determines whether the Commission's unearned premiums at balance date are sufficient to cover future claims arising from existing contracts.

The liability adequacy test compares the current estimate of the present value of the expected future cash flows relating to claims arising from the rights and obligations under current insurance contracts (with an additional risk margin included to allow for the inherent uncertainty), to the value of the unearned premium liability. If the value of the unearned premium liability is exceeded, the movement is recognised in the Prospective Statement of Comprehensive Revenue and Expense and recorded in the Prospective 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 EQC Act, which states: "All money in bank accounts established by the Commission, and all investments and other assets of the Commission, shall be deemed to form part of the Fund".

Grant Payments

The Commission provides discretionary grants for earthquake research and research dissemination. Discretionary grants are those where the Commission has no obligation to award on receipt of the grant application and are recognised as expenditure when the contract is executed to ensure the performance criteria, on which approval of the grant was based, are met.

Foreign Currency

Foreign currency transactions are translated into New Zealand dollars using the exchange rates prevailing at the transaction date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation, at year-end exchange rates, of monetary assets and liabilities, are recognised in the Prospective Statement of Comprehensive Revenue and Expense.

Taxation

The Commission is exempt from the payment of income tax in terms of the Income Tax Act 2007. Accordingly, no charge for income tax has been provided for.

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

Goods and Services Tax (GST)

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

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

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

Investments

Interest

Interest income is accrued using the effective interest method.

Realised Gains and Losses

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

Unrealised Gains and Losses

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

Financial Instruments

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

Bank

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

Investments

All investment assets held by the Commission are to meet insurance liabilities and are therefore designated at fair value through surplus or deficit.

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 is established by using valuation techniques.

Receivables

Receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Receivables are carried at amortised cost using the effective interest method less any impairment.

Other Financial Assets

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

Trade and Other Payables

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

Property, Plant and Equipment

Overview

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

Additions

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

Disposals

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the asset. Gains and losses are recognised in the Prospective Statement of Comprehensive Revenue and Expense, in the period in which the transaction occurs.

Subsequent Costs

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

The costs of day-to-day servicing of property, plant and equipment are recognised in the Prospective Statement of Comprehensive Revenue and Expense in the period in which the transaction occurs.

GeoNet Assets

GNS Science administers the design, engineering, operation and maintenance of New Zealand's geological hazard monitoring system (GeoNet) under an 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 Prospective Statement of Financial Position.

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

Depreciation

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

Furniture and equipment	2-10 years
Leasehold improvements	0-12.3 years
Computer hardware	3-10 years
Canterbury event furniture and equipment	1-11.8 years
Canterbury event motor vehicles	3 years
Canterbury event computer hardware	1.5-2.5 years
GeoNet buildings	25 years
GeoNet computer equipment	3 years
GeoNet other equipment	8 years

Intangible Assets

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

Research and Development

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

Software Acquisition and Development

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

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

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 intangible assets are recognised in the Prospective Statement of Comprehensive Revenue and Expense in the period in which the transaction occurs.

Intangible assets are amortised on a straight-line basis at rates calculated to allocate the cost or valuation of an item of intangible assets, less any estimated residual value, over its estimated useful life. The estimated useful lives of different classes of intangible assets are reviewed annually and are as follows:

Computer software	3-9 years
Canterbury event software	1.5-3 years
Claims management system v8	5 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 immediately in the Prospective Statement of Comprehensive Revenue and Expense.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. Value in use is depreciated replacement cost for an asset where the future economic benefits or service potential of the asset:

- are not primarily dependent on the asset's ability to generate net cash inflows; or
- the Commission would, if deprived of the asset, replace its remaining future economic benefits or service potential.

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

Leases

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

Liabilities (Other than Insurance)

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

Employee Entitlements

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

Other Liabilities and Provisions

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

Contingent Liabilities

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

Superannuation Schemes

Defined Contribution Schemes

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

Cost Allocation

Expenditure of the Commission is allocated across its two output classes: Future Event Preparation and Claims Management. Expenditure is allocated to these output classes by directly attributing costs as far as possible and by the apportioning of indirect costs based on the average number of full time equivalents employed in each function during the financial year.

3.7 Disclosures in Relation to Prospective Financial Statements

Major assumptions underlying the prospective financial statements

- In order to meet claims payments over the foreseeable future and continue as a going concern, it is highly probable that Section 16 of the EQC Act (or alternative agreed mechanism) will be activated for the Crown to provide guaranteed funding for cash flow requirements.
- Claims costs directly related to the occurrence of major events, and the claims they produce, have not been forecast. $50 million per annum has been provided for other claims settlements and fees.
- Growth in the residential housing stock of 1% per annum.
- No change in Government policy in respect of Crown fees, taxation or premium levy rates.
- Reinsurance costs are based on management estimates prior to the 2018/19 round of negotiations.
- Estimates for events claim expenses, liabilities and cash flows are based on the December 2017 actuarial update prepared by Melville Jessup Weaver.
- The following actuarial assumptions were used in determining the claims liability at that date:

Claims inflation rate per annum	2.5%
Demand surge per annum	15%
Discount rate per annum	1.76%-3.79%
Risk margin	53.2%
Claims handling expense ratio	16.3%

Purpose of prospective financial statements

These prospective financial statements have been prepared for internal management purposes and for inclusion in the Statement of Performance Expectation. The financial statements are not appropriate to use for purposes other than those described.

Degree of uncertainty attaching to prospective financial statement

a. No estimate for future major events, or costs directly associated with them, has been made, due to the high level of uncertainty in any estimate.

b. Some key sources of actuarial uncertainty in relation to Canterbury estimates include: the impact of reopened claims in relation to remedial issues and financial reconciliations with insurers and reinsurers.

Factors that may lead to material differences between prospective financial statements and the actual financial results prepared in future reporting period

a. The occurrence of further earthquakes or other natural disasters covered by the Commission could significantly impact on future actual financial statements.

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

c. Reinsurance premiums are based on estimates made prior to renewal of contracts for the 2018-19 year and actual premiums paid may differ from estimates due to changes in rates charged by reinsurers and levels of cover achieved.

d. Changes to the EQC Act, which may impact on the amount and type of exposure cover and rate or premium that Premiums are calculated on.

e. Further Ministerial Directions in relation to the settlement of claims for current or future events.

Cautionary Note

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

Responsibility and Approval

The prospective financial statements were approved by the Board of the Commission on 26 March 2018. The Board of the Commission is responsible for the prospective financial statements presented, including the appropriateness of the assumptions underlying the prospective financial statements and all other required disclosures.

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

EARTHQUAKE COMMISSION
Kōmihana Rūwhenua

New Zealand Government