

NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED
Trading as Civic Assurance
ANNUAL REPORT
FOR THE YEAR ENDED 31 DECEMBER 2012

NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED
STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2012



| | Notes | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|--|-------|---------------------|---------------------|----------------------|----------------------|
| REVENUE | | | | | |
| Income Attributable to Insurance Business | | | | | |
| Premiums Earned | | (100,323) | 4,457,514 | (100,323) | 4,457,514 |
| Reinsurance Paid | | (169,094) | (2,827,659) | (169,094) | (2,827,659) |
| Net Claims | 3 | 84,955 | (7,382,282) | 84,955 | (7,382,282) |
| Underwriting (Deficit) | | (184,462) | (5,752,427) | (184,462) | (5,752,427) |
| Commissions & Claims Management Expenses | | - | - | - | - |
| | | (184,462) | (5,752,427) | (184,462) | (5,752,427) |
| Administration Fees | | 1,593,505 | 1,392,366 | 1,593,505 | 1,392,366 |
| Income from Investments | 9 | 415,930 | 440,289 | 415,930 | 440,289 |
| Property Income | | 761,215 | 788,609 | 761,215 | 788,609 |
| Net Operating Revenue | | 2,586,188 | (3,131,162) | 2,586,188 | (3,131,162) |
| EXPENDITURE | | | | | |
| Audit Fee | | 109,169 | 73,475 | 109,169 | 73,475 |
| Statutory Audit | | 30,850 | 36,150 | 30,850 | 36,150 |
| Other Fees Paid to Auditors re Taxation Advisory | | 21,798 | 21,611 | 21,798 | 21,611 |
| Claims Paying Ability Rating | | 143,229 | 153,898 | 143,229 | 153,898 |
| Consultants | 11 | 67,700 | 30,070 | 67,700 | 30,070 |
| Depreciation | 11 | 50,346 | 49,419 | 50,346 | 49,419 |
| Amortisation | | 8,658 | - | 8,658 | - |
| Interest Expense | | 114,900 | 114,900 | 114,900 | 114,900 |
| Directors' Remuneration | | 12,500 | 12,500 | 12,500 | 12,500 |
| Insurance Council of New Zealand | | 246,322 | 56,778 | 246,322 | 56,778 |
| Legal Fees | | 427,344 | 379,197 | 427,344 | 379,197 |
| Property Operating Expenses | | - | 107 | - | 107 |
| Bad Debts | | 1,185,933 | 985,727 | 1,185,908 | 985,657 |
| Other Expenses | | 1,431,064 | 1,293,509 | 1,431,064 | 1,293,509 |
| Employee Remuneration | | - | - | - | - |
| Total Expenditure | | 3,849,813 | 3,207,341 | 3,849,788 | 3,207,271 |
| Profit/(Deficit) Before Share of Profit from Associate, Revaluation of Investment Property and Taxation | | (1,263,625) | (6,338,503) | (1,263,600) | (6,338,433) |
| Subvention Payment | | - | - | (7) | 672 |
| Revaluation of Investment Property | 10 | (323,161) | (900,000) | (323,161) | (900,000) |
| Share of Profit of Associate | | 29,461 | 24,410 | - | - |
| Profit/(Deficit) Before Taxation | | (1,557,325) | (7,214,093) | (1,586,768) | (7,237,761) |
| Less Taxation (Credit) / Expense | 8 | (272,439) | (1,823,864) | (272,432) | (1,823,172) |
| TOTAL COMPREHENSIVE PROFIT/(LOSS) NET OF TAX | 14 | (1,284,886) | (5,390,229) | (1,314,336) | (5,414,589) |

The Notes to the Financial Statements form part of, and should be read in conjunction with, these Statements.

NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED
STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012



| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|--|------------------------------|------------------------------|-------------------------------|-------------------------------|
| OPENING EQUITY | 10,083,448 | 15,473,677 | 10,101,241 | 15,515,831 |
| Total Comprehensive Profit/(Loss) | <u>(1,284,886)</u> | <u>(5,390,229)</u> | <u>(1,314,336)</u> | <u>(5,414,589)</u> |
| Total Recognised Revenue and Expenses | (1,284,886) | (5,390,229) | (1,314,336) | (5,414,589) |
| Ordinary Shares issued during the year | 4,175,616 | - | 4,175,616 | - |
| CLOSING EQUITY | <u><u>12,974,178</u></u> | <u><u>10,083,448</u></u> | <u><u>12,962,521</u></u> | <u><u>10,101,241</u></u> |

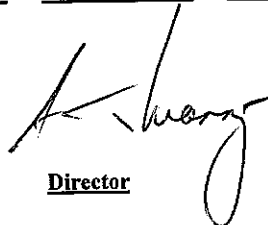
The Notes to the Financial Statements form part of, and should be read in conjunction with, these Statements.

NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED
STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2012

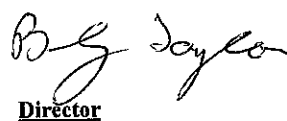


| | Notes | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|---|-------|---------------------|---------------------|----------------------|----------------------|
| SHAREHOLDERS' EQUITY | | | | | |
| Issued and Paid-Up Ordinary Shares | | | | | |
| 11,030,364 Ordinary Shares fully paid up | 20 | 10,566,406 | 6,390,790 | 10,566,406 | 6,390,790 |
| Retained Earnings | 20 | 2,407,772 | 3,692,658 | 2,396,115 | 3,710,451 |
| TOTAL EQUITY | | <u>12,974,178</u> | <u>10,083,448</u> | <u>12,962,521</u> | <u>10,101,241</u> |
| Represented By: | | | | | |
| CURRENT ASSETS | | | | | |
| Bank & Cash Equivalents | | 14,617,721 | 24,099,400 | 14,567,126 | 24,048,110 |
| Sundry Debtors and Prepayments | | 425,904 | 970,367 | 425,897 | 971,038 |
| Premiums Receivable | | 33,005 | 23,450 | 33,005 | 23,450 |
| Reinsurance Recoveries | 6 | 820,245,659 | 702,715,777 | 820,245,659 | 702,715,777 |
| Reinsurance Prepayments | 7 | 40 | 60,067 | 40 | 60,067 |
| Income Tax Receivable | 8 | 200,510 | 197,920 | 200,510 | 197,920 |
| Managed Funds | 13 | - | - | - | - |
| Total Current Assets | | <u>835,522,839</u> | <u>728,066,981</u> | <u>835,472,237</u> | <u>728,016,362</u> |
| NON CURRENT ASSETS | | | | | |
| NZ Government Stock | 13 | 107,618 | 110,374 | 107,618 | 110,374 |
| Shares in Local Government Online | | 111,224 | 81,764 | 30,000 | 30,000 |
| Property, Plant and Equipment | 11 | 286,122 | 94,460 | 286,122 | 94,460 |
| Intangible Assets (Software) | 11 | 110,245 | 159,151 | 110,245 | 159,151 |
| Deferred Tax Asset | 8 | 3,689,647 | 3,417,215 | 3,689,647 | 3,417,215 |
| Investment Property | 10 | 6,775,000 | 6,925,000 | 6,775,000 | 6,925,000 |
| Total Non Current Assets | | <u>11,079,856</u> | <u>10,787,964</u> | <u>10,998,632</u> | <u>10,736,200</u> |
| TOTAL ASSETS | | <u>846,602,695</u> | <u>738,854,945</u> | <u>846,470,869</u> | <u>738,752,562</u> |
| CURRENT LIABILITIES | | | | | |
| Sundry Creditors & Accrued Charges | | 3,076,879 | 526,675 | 3,076,886 | 526,675 |
| Reinsurance Received in Advance | | - | 14,936,206 | - | 14,936,206 |
| Accrued Holiday Pay | | 84,553 | 53,359 | 84,553 | 53,359 |
| Subordinated Debt | 16 | 120,176 | 120,176 | - | - |
| | | <u>3,281,608</u> | <u>15,636,416</u> | <u>3,161,439</u> | <u>15,516,240</u> |
| Insurance Provisions | | | | | |
| Unearned Premium Reserve | 7 | 1,040,109 | 436,081 | 1,040,109 | 436,081 |
| Outstanding Claims Liability | 3 | 829,306,800 | 712,699,000 | 829,306,800 | 712,699,000 |
| Total Insurance Provisions | | <u>830,346,909</u> | <u>713,135,081</u> | <u>830,346,909</u> | <u>713,135,081</u> |
| Total Current Liabilities | | <u>833,628,517</u> | <u>728,771,497</u> | <u>833,508,348</u> | <u>728,651,321</u> |
| TOTAL LIABILITIES | | <u>833,628,517</u> | <u>728,771,497</u> | <u>833,508,348</u> | <u>728,651,321</u> |
| EXCESS OF ASSETS OVER LIABILITIES | | <u>12,974,178</u> | <u>10,083,448</u> | <u>12,962,521</u> | <u>10,101,241</u> |

For and on behalf of the Directors


Director

Date


Director

Date

The Notes to the Financial Statements form part of, and should be read in conjunction with, these Statements.

NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED
STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2012



| | Notes | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|--|-------|---------------------|---------------------|----------------------|----------------------|
| Cash Flows from Operating Activities | | | | | |
| Cash was provided from: | | | | | |
| Premiums Received | | 585,607 | 1,589,380 | 585,607 | 1,589,380 |
| Rent Received | | 763,016 | 797,060 | 763,016 | 797,060 |
| Administration Fees Received | | 1,709,752 | 1,317,938 | 1,709,752 | 1,317,938 |
| Interest Received | | 418,685 | 438,874 | 418,685 | 438,874 |
| Reinsurance Recoveries | | 22,556,241 | 4,530,237 | 22,556,241 | 4,530,237 |
| Receipt of Reinsurance Payments | | - | 14,936,206 | - | 14,936,206 |
| | | <u>26,033,301</u> | <u>23,609,695</u> | <u>26,033,301</u> | <u>23,609,695</u> |
| Cash was applied to: | | | | | |
| Claims Expenses | | 22,888,840 | 9,743,873 | 22,888,840 | 9,743,873 |
| Taxation Paid | | 35,531 | 14,353 | 35,531 | 15,045 |
| Interest Expense | | - | - | - | - |
| Payments to Reinsurers and Suppliers | | 16,332,263 | 2,746,125 | 16,332,240 | 2,746,055 |
| | | <u>39,256,634</u> | <u>12,504,351</u> | <u>39,256,611</u> | <u>12,504,973</u> |
| Net Cash Flow from Operating Activities | 14 | (13,223,333) | 11,105,344 | (13,223,310) | 11,104,722 |
| Cash Flows from Investing Activities | | | | | |
| Cash was provided from: | | | | | |
| Managed Funds | | - | 5,012,461 | - | 5,012,461 |
| Sale of Fixed Assets | | - | 5,010 | - | 5,010 |
| | | <u>-</u> | <u>5,017,471</u> | <u>-</u> | <u>5,017,471</u> |
| Cash was applied to: | | | | | |
| Purchase of Government Stock | | - | 1,590 | - | 1,590 |
| Purchase of Fixed Assets | | 433,962 | 13,942 | 433,962 | 13,942 |
| | | <u>433,962</u> | <u>15,532</u> | <u>433,962</u> | <u>15,532</u> |
| Net Cash Flow from Investing Activities | | (433,962) | 5,001,939 | (433,962) | 5,001,939 |
| Cash Flows from Financing Activities | | | | | |
| Cash was provided from: | | | | | |
| Receipt of Subvention Payment | | - | - | 672 | - |
| Ordinary Shares issued during the year | | 4,175,616 | - | 4,175,616 | - |
| | | <u>4,175,616</u> | <u>-</u> | <u>4,176,288</u> | <u>-</u> |
| Cash was applied to: | | | | | |
| Payment of Subvention Payment | | - | - | - | 5,386 |
| | | <u>-</u> | <u>-</u> | <u>-</u> | <u>5,386</u> |
| Net Cash Flow from Financing Activities | | 4,175,616 | - | 4,176,288 | (5,386) |
| Net (Decrease)/Increase in Cash Held | | (9,481,679) | 16,107,283 | (9,480,984) | 16,101,275 |
| Opening Cash Balance as at 1 January | | 24,099,400 | 7,992,117 | 24,048,110 | 7,946,835 |
| Closing Cash Balance as at 31 December | | <u>14,617,721</u> | <u>24,099,400</u> | <u>14,567,126</u> | <u>24,048,110</u> |
| Being: | | | | | |
| Bank & Cash Equivalents | | <u>14,617,721</u> | <u>24,099,400</u> | <u>14,567,126</u> | <u>24,048,110</u> |

The Notes to the Financial Statements form part of, and should be read in conjunction with, these Statements.



NOTE 1

REPORTING ENTITY

The reporting entity is New Zealand Local Government Insurance Corporation Limited, trading as Civic Assurance (the "Company"). The Group comprises the Company and its subsidiaries listed in note 2 (p). The Group provides insurance products and other financial services principally for New Zealand local government.

The financial statements are presented in accordance with the Companies Act 1993 and have been prepared to comply with the requirements of the Financial Reporting Act 1993.

Statement of compliance

The financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand. They comply with New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS") and other applicable Financial Reporting Standards, as appropriate for profit-oriented entities. The financial statements also comply with International Financial Reporting Standards ("IFRS").

NOTE 2

STATEMENT OF ACCOUNTING POLICIES

General Accounting Policies

The measurement and reporting of profits on an historical cost basis have been followed by the Company and Group, except for specific policies as described below.

The reporting currency is New Zealand dollars.

The Group meets the definition of a financial institution under NZ IFRS 7 "Financial Instruments Disclosures" and is subject to its requirements due to New Zealand Local Government Finance Corporation Limited, a subsidiary, being an issuer.

Critical Judgements and Estimates in Applying the Accounting Policies

In the application of NZ IFRS the Directors are required to make judgements, estimates and assumptions about the carrying value of assets and liabilities that are not readily apparent from other sources. These are based on historical experience and other various factors and are reviewed on an ongoing basis.

The Directors believe that, as at the date of these financial statements, there are no significant sources of estimation uncertainty that have not been disclosed in these notes. The most significant judgements, estimates and assumptions made in the preparation of these financial statements are in respect of insurance activities (Notes 3 to 7), including recovery of reinsurance receivables and the valuation of investment property (Note 10).

Particular Accounting Policies

The following particular accounting policies which materially affect the measurement of profit and financial position have been applied.

(a) Consolidation of Subsidiaries

The Group financial statements incorporate the financial statements of the Company and its subsidiaries, which have been consolidated using the purchase method. The results of any subsidiaries acquired or disposed of during the year are consolidated from the effective dates of acquisition or until the effective dates of disposal. All inter-company transactions, balances and unrealised profits are eliminated on consolidation.

(b) Significant Accounting Policies Related to General Insurance Contracts

All of the general insurance products and reinsurance products on offer, or utilised, meet the definition of an insurance contract (a contract under which one party, the insurer, accepts significant insurance risk from another party, the policyholder, by agreeing to compensate the policyholder if a specified uncertain future event, the insured event, adversely affects the policyholder) and none of the contracts contain embedded derivatives or are required to be unbundled.

(c) Income Attributable to Insurance Business

Premium revenue comprises amounts charged to policyholders and excludes fire service and earthquake levies collected on behalf of statutory bodies. The earned portion of premium received and receivable is recognised as revenue. Premium revenue is recognised as earned from the date of attachment of risk (generally the date a contract is agreed to) over the period of the related insurance contract in accordance with the pattern of the risk expected under the contract. The unearned portion of premium is recognised as an unearned premium liability on the Statement of Financial Position.

(d) Reinsurance Expense

Premium ceded to reinsurers is recognised as an expense that is evenly spread from the date of attachment of risk to the end of the period of the reinsurance contract over the period of indemnity of the reinsurance contract in line with the expected pattern of incidence of risk.



Note 2 Statement of Accounting Policies (Cont'd)

(e) Claims

The outstanding claims liability is measured as the central estimate of expected future payments relating to claims incurred at the reporting 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 in full, claims incurred but not reported ("IBNR"), and claims incurred but not enough reported ("IBNER"). Due to the short term nature of the Company's claims these are not discounted in the financial statements.

Claims expense represents claim payments adjusted for movement in the outstanding claims liability.

The estimation of the outstanding claims liability involves a number of key assumptions and is the most critical accounting estimate. The Company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures and employs external actuarial advice. However, given the uncertainty in establishing the liability, it is likely that the final outcome will be different from the original liability established. Changes in claims estimates are recognised in profit and loss in the year in which the estimates are changed.

(f) Reinsurance and Other Recoveries

Reinsurance and other recoveries received or receivable on paid claims and on outstanding claims liabilities (notified and not yet notified) are recognised as income. Reinsurance does not relieve the originating insurer of its liabilities to policyholders.

(g) Liability Adequacy Test

The liability adequacy test is an assessment of whether the carrying amount of the unearned premium liability is adequate and is conducted at each reporting date. If current estimates of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate, exceed the unearned premium liability then the unearned premium liability is deemed to be deficient. The test is performed at the level of a portfolio of contracts that are subject to broadly similar risks and that are managed together as a single portfolio. Any deficiency arising from the test is recognised in the Statement of Comprehensive Income, with the corresponding impact on the Statement of Financial Position.

(h) Assets which back Insurance Liabilities

Ultimately all assets of the Company are available to back insurance liabilities.

(i) Investment Property

Investment property is measured at fair value, by reference to an external market valuation (performed annually), with any resulting unrealised gain or loss recognised in the Statement of Comprehensive Income.

(j) Property, Plant & Equipment and Software Intangible

Assets are depreciated on a straight line basis at rates calculated to allocate the assets' cost, in equal instalments over their estimated useful lives which are assessed and regularly reviewed.

Assets are carried at historic cost value less depreciation. The useful lives attributed to various assets are:

| | |
|--------------------------------|---------------|
| Office Furniture and Equipment | up to 5 years |
| Intangibles - Software | 5 years |

(k) Financial Instruments

(i) Classification and Measurement

Financial instruments are transacted on a commercial basis to derive an interest yield / cost with the terms and conditions having due regard to the nature of the transaction and the risks involved. Financial instruments are recognised and accounted for on a settlement date basis.

Held To Maturity Investments

NZ Government Stock is classified as Held To Maturity and is measured at amortised cost using the effective interest method.

Loans and Receivables

Other receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate.

Bank and Cash Equivalents

Bank and cash equivalents are measured at amortised cost using the effective interest rate.



Note 2 Statement of Accounting Policies (Cont'd)

Financial Liabilities

Financial liabilities include Sundry Creditors, Subordinated Debt and Outstanding Claims. Financial liabilities are recorded initially at fair value, net of transaction costs. Subsequent to initial recognition, liabilities are measured at amortised cost.

(ii) Offsetting Financial Instruments

Financial assets and liabilities are not offset as there is no legally enforceable right to set-off.

(iii) Asset Quality

Impairment of Financial Assets

Financial assets measured at amortised cost are reviewed at each balance date to determine whether there is any objective evidence of impairment. If any such condition exists, the asset's recoverable amount is estimated and provision is made for the difference between the carrying amount and the recoverable amount.

As at the date of these Financial Statements, no such evidence of impairment exists.

(iv) Fair value of financial instruments

Fair value measurements recognised in the Statement of Financial Position

Financial instruments are categorised into 3 levels:

- 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 financial instruments disclosed in these financial statements are categorised as Level 1, except for subordinated debt which is categorised as Level 3. That is, the fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices. The fair value of all financial assets is derived from quoted prices from OnePath (NZ) Ltd. There were no transfers between any of the Levels during the year.

(v) Derivatives

The Company and Group do not use any derivative financial instruments.

(l) Taxation

Current Tax

The income tax expense charged against the profit for the year is the estimated liability in respect of that profit. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for the current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable). Tax assets are offset only when there is a legally enforceable right to set off the recognised amounts, and an intention to settle on a net basis.

Deferred Tax

The liability method of accounting for deferred taxation is applied on a comprehensive balance sheet basis in respect of temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax base of those items.

Deferred tax liabilities are recognised for all temporary differences. Deferred tax assets are reviewed at each balance date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the Statement of Comprehensive Income.

(m) Goods and Services Tax (GST)

Revenue, expenses and assets are recognised net of the amount of GST except:

- When the GST incurred on a purchase of goods and services is not recoverable from the taxation authority in which case the GST is recognised as part of the cost of the acquisition of the assets or as part of the expense item as applicable.
- Receivables and payables, which are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the Statement of Financial Position.



Note 2 Statement of Accounting Policies (Cont'd)

(n) Statement of Cash Flows

The Statement of Cash Flows is prepared exclusive of GST, which is consistent with the method used in the Statement of Comprehensive Income. The GST component of cash flows arising from investing and financing activities, which is recoverable from or payable to, the taxation authority is classified as operating cash flow.

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

- Bank comprises cash on hand and demand deposits.
- Cash equivalents are short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.
- Cash flows are inflows and outflows of cash and cash equivalents.
- Operating activities are the principal revenue producing activities of the entity and other activities that are not investing or financing activities.
- Investing activities are the acquisition and disposal of long-term assets.
- Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

(o) Employee Benefits

Provision is made for benefits accruing to employees in respect of wages and salaries and annual leave when it is probable that settlement will be required and they are capable of being measured reliably. Provisions made in respect of employee benefits are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

(p) Investment in Subsidiaries

The Company has six wholly owned subsidiaries which are all incorporated in New Zealand. Five of these, Local Government Superannuation Trustee Limited, SuperEasy Limited, Local Government Finance Corporation Limited and Civic Assurance Limited with balance dates of 31 December and Local Government Mutual Funds Trustee Limited with its balance date of 30 June did not have any significant assets, liabilities, revenue or expenses during the years ended 31 December 2011 and 31 December 2012. New Zealand Local Government Finance Corporation Limited (NZLGFC) commenced business on the 29 November 1999 and had total assets of \$50,601 at 31 December 2012 (2011: \$50,668) and ceased active operations in February 2010. The five companies have been recognised in the Parent financial statements at cost less impairment and consolidated in the Group financial statements. The operating companies are subject to ongoing review of their operations to ensure they are meeting their agreed strategic objectives.

(q) Investment in Associate Company

The share of the income of the associate company, Local Government Online Limited, has been included in the consolidated Statement of Comprehensive Income and added to the cost of the investment in the consolidated Statement of Financial Position. The Parent financial statements record the investment at cost less impairment.

(r) Basis of Measuring Income and Expenses

Income and expenses are accounted for on an accruals basis.

(s) Changes in Accounting Policies

There have been no changes in the accounting policies during the year. All policies have been applied on bases consistent with those used in the prior year.



**NOTE 3
 CLAIMS**

(a) Claims

| | 2012 | 2011 | 2012 | 2011 |
|--|---------------|--------------------|---------------|--------------------|
| | Group | Group | Parent | Parent |
| | \$ | \$ | \$ | \$ |
| <i>Claims Incurred and Provision for Outstanding Claims</i> | | | | |
| Total claims incurred during the year | (140,001,168) | (634,166,382) | (140,001,168) | (634,166,382) |
| Less: Reinsurance recoveries receivable on claims incurred during the year | 140,086,123 | 626,784,100 | 140,086,123 | 626,784,100 |
| Net Claims | 84,955 | (7,382,282) | 84,955 | (7,382,282) |

Claims costs are reliably estimated and claims are usually settled within one year therefore there is no claims development from prior years' claims.

(b) Reconciliation of Movements in Gross Outstanding Claims Liability

| | 2012 | 2011 | 2012 | 2011 |
|--|--------------------|--------------------|--------------------|--------------------|
| | Group | Group | Parent | Parent |
| | \$ | \$ | \$ | \$ |
| Outstanding Claims liability at the beginning of the financial year | 712,699,000 | 88,280,226 | 712,699,000 | 88,280,226 |
| Claims Expense in the current year | 140,001,168 | 634,166,382 | 140,001,168 | 634,166,382 |
| Claims Paid | (23,393,368) | (9,747,608) | (23,393,368) | (9,747,608) |
| Outstanding Claims liability at the end of the financial year | 829,306,800 | 712,699,000 | 829,306,800 | 712,699,000 |

(c) Actuarial Methodology and Assumptions

The estimation process involves using the Company's specific data, relevant industry data and more general economic data. Each class of business is usually examined separately and the process involves consideration of a large number of factors including the risks to which the business is exposed at a point in time, claim frequencies and average claim sizes, historical trends in the incidence and development of claims reported and finalised, legal, social and economic factors that may impact upon each class of business as well as the key actuarial assumptions set out below, and the impact of reinsurance and other recoveries.

Different actuarial valuation models are used for different claims types with the results then being aggregated. This aggregation of results enhances the valuation process by allowing the use of the model best suited to particular claims types. The selection of the appropriate model takes into account the characteristics of a class of business and the extent of development of past claims periods.

The different components of the outstanding claims liability are subject to different levels of uncertainty. The estimation of the cost of claims reported but not yet paid in full is made on a case by case basis by claims personnel having regard to the facts and circumstances of the claim as reported, any information available from assessors and information on the cost of settling claims with similar characteristics in previous periods. A further amount, which may be a reduction, is included for IBNER on the basis of past experience with the accuracy of initial claims estimates. With IBNR, the estimation is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified, as no information is currently available about the claim. In calculating the estimated cost of unpaid claims a variety of estimating techniques are used generally based on statistical analysis of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made however for changes or uncertainties which may create distortions in the underlying statistics which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims.

Large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of these large claims.

Reserves are not established for catastrophes in advance of such events and so these events will cause volatility in the results for a period and in the levels of the outstanding claims liability.

The central estimate of the outstanding claims liability is an estimate which is intended to contain no deliberate or conscious over or under estimation and is commonly described as providing the mean of the distribution. It is considered appropriate for the measurement of the claims liability to represent a higher degree of certainty regarding the sufficiency of the liability over time, and so a risk margin is added to the central estimate. The risk margin refers to the amount by which the liability recognised in the financial statements is greater than the actuarial central estimate of the liability. The risk margin added to the central estimate increases the probability that the net outstanding claims liability will ultimately prove to be adequate.

The actuarial valuation net of reinsurance assumes that all reinsurance recoveries will be collected. The Company uses only reinsurers with rating "A-" or better from AM Best (or equivalent).



Note 3 Claims (Cont'd)

(d) Canterbury Earthquakes Claims

The Canterbury earthquakes have had a significant impact on the operational and financial results of the Company for the year, with over 900 claims being received. As at 31 December 2012 the Outstanding Claims Liability in relation to Canterbury earthquake claims was \$826,012,000 of which \$822,069,000 is covered by reinsurance treaties resulting in a net incurred claims liability of \$3,943,000. As a result of the Canterbury earthquake events, reinsurance cover has been less affordable than in previous years. In addition to this, the Company has faced logistical issues detailing the exposures that were to be written due to a lack of detailed information being readily available on the local government assets. As a consequence of this, the Company was unable to obtain reinsurance at an appropriate price for the reinsurance year commencing 1 July 2011 and has not accepted any new material damage risk from this date.

The principal concern in determining the outstanding claims liabilities for Canterbury earthquake claims is the unique nature of the event. Despite the material nature of the outstanding claims liability, it has been decided at this stage that no actuarial adjustment should be applied to the case estimates recorded for these claims. The reasons for this are:

- The unique and continuing nature of the Canterbury earthquake events means that at this stage there is very limited data upon which to base a meaningful actuarial analysis.
- All claims have been assessed by loss adjusters who have expertise in this area. We understand that there is no reason to believe that there is any systemic under or over estimation of reported claims.
- To date, few claims have been closed so there are unlikely to be reopened claims.

Despite the considerable gross claims costs, the financial impact on the Company has been significantly mitigated by the existing catastrophe reinsurance treaties in place until 30 June 2011. These reinsurance treaties limit the Company's net claims liability to \$3.6m net incurred claims per event (net of reinsurance). While it is expected that the gross claims will be larger than the net retention (after catastrophe reinsurance) any increase in the claims costs will be borne by the reinsurers and therefore the risk margin on the net claims liability is zero.

Although the Company's exposure to insurance risk is limited to \$3.6m net incurred claims per event, it continues to be exposed to credit risk relating to the ability of the reinsurers to pay the gross reinsurance recoveries receivable. Details of the Company's credit risk management policies are included in note 4(d).

No discounting of the outstanding claims liabilities or associated reinsurance recoveries receivable has been made on the basis of the short payment period expected in relation to the Company's net insured claims.

(e) Other Claims

As at 31 December 2012 the central estimate of the outstanding claims liability and risk margins in relation to Business as Usual and Riskpool claims was evaluated by Craig Lough and Janet Lockett (Fellows of the NZ Society of Actuaries) of Melville Jessup Weaver. The actuaries are satisfied as to the nature and accuracy of data used in the calculation of the outstanding claims liability.

The outstanding claims liability in respect of Business as Usual and Riskpool claims has been determined using the Bornhuetter-Ferguson (incurred claims) methodology. It has been assumed that future incurred claims patterns for each group of business will continue to follow observed historic patterns.

The estimation of the outstanding claims liability is based on a variety of actuarial techniques that analyse experience, trends and other relevant factors. The claims estimation process commences with the actuarial projection of the future payments relating to claims incurred at the reporting date. The expected future payments include those in relation to claims reported but not yet paid or not yet paid in full, claims incurred but not reported ("IBNR"), and claims incurred but not enough reported ("IBNER").

The overall risk margin for both outstanding claims and liability adequacy testing has been determined using stochastic techniques and have been determined allowing for diversification between groups of business and having regard to the inherent variation observed in claims development in each group of business. The undiversified risk margins for each group of business are applied to the net central estimates and the results aggregated, allowing for diversification, in order to arrive at an overall net provision that is intended to provide a probability of sufficiency of 85%. For the non Canterbury earthquake claims a risk margin of \$96,000 (2011: \$184,000) has been included in the Outstanding Claims Liability as at balance date, as required in terms of NZ IFRS 4 clause 17.2.

Risk margins are held to allow for uncertainty surrounding the outstanding claims liability estimation process. Potential uncertainties include those relating to the actuarial models and assumptions, the quality of the underlying data used in the models, general statistical uncertainty and the general insurance environment. Uncertainty from the above sources is examined for each class of business and expressed as a volatility of the net central estimate. The volatility for each class is derived after consideration of stochastic modelling and benchmarking to industry analysis.

The period between the valuation date and the settlement of most claims is short, and the valuation implicitly allows for past levels of inflation to continue in the future. Therefore, any increase in costs as a result of inflation is limited. Also due to the short settlement periods the effect of discounting expected future payments is also limited and therefore the estimates are not discounted for the time value of money.



**NOTE 4
INSURANCE CONTRACT RISK MANAGEMENT**

A key risk from operating in the general insurance industry is the exposure to insurance risk arising from underwriting general insurance contracts. The insurance contracts transfer risk to the insurer by indemnifying the policyholders against adverse affects arising from the occurrence of specified uncertain future events. The risk is that the actual claims to be paid in relation to contracts will be different to that estimated at the time a product was designed and priced. The Company is exposed to this risk because the price for a contract must be set before the losses relating to the product are known. Hence the insurance business involves inherent uncertainty. The Company also faces other risks relating to the conduct of the general insurance business including financial risks and capital risks.

A fundamental part of the overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows arising from insurance contracts.

(a) Risk Management Objectives and Policies for Mitigating Insurance Risk

The risk management activities can be broadly separated into underwriting (acceptance and pricing of risk), claims management, reserving, and investment management. The objective of these risk management functions is to enhance the longer term financial performance of the overall insurance operations.

The key policies in place to mitigate risks arising from underwriting insurance contracts include the following:

- Acceptance of risk – The Company is primarily an insurer only of risks owned or managed by local authorities. Records of results and trends exclusively in this market sector that have been built up over a number of years are available as tools for the Company's underwriter who has over 35 years experience in the industry and over ten years experience in underwriting local government risks. The portfolio was essentially property risks. A "ring fenced" maximum liability layer of liability risk has been written to support the local government liability pool, provided by New Zealand Mutual Liability Riskpool ("Riskpool").
- Pricing – Many years of underwriting results for a tight homogenous group of risks enables the Company's underwriters to calculate acceptable pricing and acceptable terms and conditions of cover.
- Reinsurance – Through reinsurance the Company, up until 30 June 2011, was able to cap its maximum liability in the event of a catastrophe to \$3.6 million. This amount was well within the Company's reserves.
- Claims management – Claims are handled inhouse by experienced claims handling staff. Staff are allocated settling limits and authorities commensurate with their levels of experience. These authority levels are reviewed regularly. Senior claims staff are very experienced, particularly in local government claims. Overall authority and claims management is provided by the Company's General Manager Insurance who has over ten years experience as a commercial claims manager in New Zealand.
- Investment management - All premium income is held in NZ Registered Bank accounts and short term deposits. The investments are regularly reviewed by the Board and is set with a low exposure to shares (less than 5%).
- Risk reduction – The Company's underwriter and its General Manager regularly analyse and review claims data with a view to educating and training insureds in recognition and prevention of manageable risks. Due to the Company being unable to reinsure risks after 1 July 2011 the risk was managed by not writing material damage cover policies.

(b) Terms and Conditions of Insurance Contracts

Almost all the Company's insurance contracts written are entered into on a standard form and on an annual basis. There are no special terms and conditions in any non standard contracts that would have a material impact on the financial statements.

(c) Concentration of Insurance Risk

Concentration risk is particularly relevant in the case of natural disasters and other catastrophes. The Company dealt with this by having uncapped reinsurance cover for the period of the insurance contract. All geographical risk is in New Zealand.

(d) Credit Risk

Financial assets or liabilities arising from insurance contracts are presented in the Statement of Financial Position. These amounts best represent the maximum credit risk exposure at reporting date.

The credit risk relating to insurance contracts relates primarily to:

- Premium receivable which is due from policyholders and intermediaries (brokers). The brokers collect premium from policyholders and remit the monies to the insurer in accordance with contractual arrangements, being held in a trust account and paid within 90 days. The recoverability of premium receivable is assessed and provision is made for impairment based on objective evidence and having regard to past default experience. Concentrations of credit risk are determined by the clients who each independently appoint their own insurance broker.
- Reinsurance recoveries receivable, which are discussed further in note 6.

(e) Interest Rate Risk

The underwriting of general insurance contracts creates no exposure to the risk that interest rate movements may impact the value of the outstanding claims liability because the outstanding claims liability is not discounted due to the short tail nature of claims.



Note 4 Insurance Contract Risk Management (Cont'd)

- (f) **Reinsurance Risk**
 Risks underwritten are reinsured in order to limit exposure to losses, stabilise earnings, protect capital resources and ensure efficient control and spread of the risks underwritten.
- (g) **Operational Risk**
 Operational risk is the risk of financial loss (including lost opportunities) resulting from external events and/or inadequate or failed internal processes, people and systems. Operational risk is identified, and assessed on an ongoing basis and the capital management strategy includes consideration of operational risk. Management and staff are responsible for identifying, assessing and managing operational risks in accordance with their roles and responsibilities.
- (h) **Liquidity Risk**
 All assets and liabilities used in relation to the liquidity of the insurance business are included in the sensitivity analysis in note 13.
- (i) **Sensitivity Analysis**
 Sensitivity of risks relates primarily to the risk margin assessments which are set out in Note 3. These are reviewed annually and change in accordance with current best estimates using advice from an actuary.

**NOTE 5
 INSURANCE PROVISIONS**

The Company had a claims payable credit rating of "BBB-" (negative outlook) issued by A M Best at 31 December 2012. The Company's reinsurance programme is structured to adequately protect the Company's solvency and capital position. It covers per risk and event losses in New Zealand. Counterparty reinsurers with credit ratings no less than "A-" (A M Best scale) participate in the reinsurance catastrophe programme.

**NOTE 6
 REINSURANCE RECEIVABLE ON OUTSTANDING CLAIMS**

(a) **Reconciliation of Movements for the Financial Year**

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|--|---------------------|---------------------|----------------------|----------------------|
| Reinsurance recoveries receivable on outstanding claims at the beginning of the year | 702,715,777 | 80,461,914 | 702,715,777 | 80,461,914 |
| Reinsurance recoveries received | (22,556,241) | (4,530,237) | (22,556,241) | (4,530,237) |
| Reinsurance recoveries receivable on claims incurred during the year | 140,086,123 | 626,784,100 | 140,086,123 | 626,784,100 |
| Reinsurance recoveries receivable on outstanding claims at the end of the year | <u>820,245,659</u> | <u>702,715,777</u> | <u>820,245,659</u> | <u>702,715,777</u> |

- (b) **Actuarial Assumptions**
 Reinsurance and other recoveries on outstanding claims are computed using actuarial assumptions and methods similar to that used for outstanding claims (refer note 3). The outstanding claims liability is calculated gross of any reinsurance recoveries and a separate estimate is then made of the amounts that are expected to be recoverable from reinsurers based upon the gross provisions.
- (c) **The Effect Of Changes In Assumption**
 The effect of changes in assumptions on the net outstanding claims liability, which incorporates the reinsurance and other recoveries receivable on outstanding claims, is disclosed in note 3.
- (d) **Risk Management**
 The Board and senior management assess the Company's reinsurance programme as existing and for the following year based on identification of the Company's exposure and its ability to meet claims from its capital base.
- (e) **Reinsurance Risk Management**
 Risks underwritten are reinsured in order to limit exposure to losses, stabilise earnings, protect capital resources and ensure efficient control and spread of the risks underwritten. The Company has its own reinsurance programme and determines its own risk limits. The Company buys reinsurance in only two forms, a quota share programme on every property risk and a catastrophe programme over its whole portfolio. These programmes are negotiated on an annual basis from 1 July to 30 June. As a consequence of the Canterbury earthquakes the Company has been unable to obtain property reinsurance from 1 July 2011 and has therefore ceased providing material damage cover since this date.

Reinsurance arrangements mitigate insurance risk but can expose the Company to credit risk. Reinsurance is placed with companies based on an evaluation of the financial strength of the reinsurers, terms of coverage, and price. The Company has clearly defined credit policies for the approval and management of credit risk in relation to reinsurers. It is Company policy to only deal with reinsurers with credit ratings of at least AM Best "A-" (or other rating agency equivalent). The Company monitors the financial condition of its reinsurers on an ongoing basis and periodically reviews reinsurers' abilities to fulfil their obligations to the Company under respective existing and future reinsurance contracts.

**NOTE 7
 UNEARNED PREMIUM LIABILITY AND REINSURANCE PREPAYMENTS**

(a) Reconciliation of Movements for the Financial Year

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|--|---------------------|---------------------|----------------------|----------------------|
| Unearned net premium liability at the beginning of the financial year | 376,014 | 1,593,651 | 376,014 | 1,593,651 |
| Deferral of gross premiums on contracts written in the year | 226,109 | 436,081 | 226,109 | 436,081 |
| Deferral of reinsurance expense payable on contracts written in the year | (40) | (60,067) | (40) | (60,067) |
| Earning of premiums written in previous years | (436,081) | (4,099,951) | (436,081) | (4,099,951) |
| Payment of reinsurance expense payable written in previous years | 60,067 | 2,506,300 | 60,067 | 2,506,300 |
| Unexpired Risk Reserve | 814,000 | - | 814,000 | - |
| Unearned net premium liability at the end of the financial year | 1,040,069 | 376,014 | 1,040,069 | 376,014 |

(b) Liability Adequacy Test

The conduct of the liability adequacy test as at 31 December 2012 identified a deficit (2011: deficit) and therefore an Unexpired Risk Reserve, that is intended to provide a probability of sufficiency of 75%, has been brought to account in the balance sheet. The deficit is a result of the Company incurring expenses including claims work related to the Canterbury earthquakes despite not providing cover for the year under review.

**NOTE 8
 TAXATION**

(a) Income tax recognised in the Statement of Comprehensive Income

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|---|---------------------|---------------------|----------------------|----------------------|
| Tax expense/(income) comprises: | | | | |
| Current tax expense | (352,698) | (1,776,329) | (352,691) | (1,776,337) |
| Adjustments recognised in the current year in relation to the current tax of prior years | 80,259 | (46,835) | 80,259 | (46,835) |
| Deferred tax (income) relating to the origination and reversal of temporary differences | - | - | - | - |
| Deferred tax expense/(income) relating to changes in tax rates or imposition of new taxes | - | - | - | - |
| Total tax expense | (272,439) | (1,823,164) | (272,432) | (1,823,172) |
| Attributable to: | | | | |
| Continuing operations | (272,439) | (1,823,164) | (272,432) | (1,823,172) |
| Discontinued operations | - | - | - | - |
| | (272,439) | (1,823,164) | (272,432) | (1,823,172) |

The prima facie income tax expense on pre-tax accounting profit from operations reconciles to the income tax expense in the financial statements as follows:

| | | | | |
|--|------------------|--------------------|------------------|--------------------|
| Profit from continuing operations | (1,263,625) | (6,338,503) | (1,263,600) | (6,338,433) |
| Profit from discontinued operations | - | - | - | - |
| Profit from operations | (1,263,625) | (6,338,503) | (1,263,600) | (6,338,433) |
| Subvention payable | - | - | (7) | 672 |
| Revaluation of Investment Property | (323,161) | (900,000) | (323,161) | (900,000) |
| | (1,586,786) | (7,238,503) | (1,586,768) | (7,237,761) |
| Income tax calculated at 28% | (444,302) | (2,026,781) | (444,295) | (2,026,573) |
| Non-deductible expenses / (taxable income) | 91,604 | 249,752 | 91,604 | 250,236 |
| Deferred tax income relating to early adoption of amendments to NZIAS 12 | - | - | - | - |
| Effect of change in corporate tax rate | (352,698) | (1,777,029) | (352,691) | (1,776,337) |
| (Over)/under provision of income tax in previous year | 80,259 | (46,835) | 80,259 | (46,835) |
| Income Tax (Credit) / Expense | (272,439) | (1,823,864) | (272,432) | (1,823,172) |

(b) Current tax assets and liabilities

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|-----------------------|---------------------|---------------------|----------------------|----------------------|
| Tax refund receivable | 200,510 | 197,920 | 200,510 | 197,920 |
| Tax payable | - | - | - | - |
| | 200,510 | 197,920 | 200,510 | 197,920 |

(c) Deferred tax balances

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|---|---------------------|---------------------|----------------------|----------------------|
| Deferred tax assets comprise: | | | | |
| Temporary differences | 4,122,775 | 3,830,067 | 4,122,775 | 3,830,067 |
| | 4,122,775 | 3,830,067 | 4,122,775 | 3,830,067 |
| Deferred tax liabilities comprise: | | | | |
| Temporary differences | (433,128) | (412,852) | (433,128) | (412,852) |
| | (433,128) | (412,852) | (433,128) | (412,852) |
| Net Deferred Tax balance | 3,689,647 | 3,417,215 | 3,689,647 | 3,417,215 |



Note 8 Taxation (Cont'd)

Gross taxable and deductible temporary differences for both the Company and Group arise from the following:

| | Opening Balance | Charged to Income | Charged to Equity | Prior Period Adjustment | Closing Balance |
|--------------------------------------|--------------------|-------------------|-------------------|-------------------------|--------------------|
| 2012 | | | | | |
| Investment gains | (40,315) | - | - | - | (40,315) |
| Building, property and equipment | (1,434,154) | (72,416) | - | - | (1,506,570) |
| Other | - | - | - | - | - |
| | <u>(1,474,469)</u> | <u>(72,416)</u> | <u>-</u> | <u>-</u> | <u>(1,546,885)</u> |
| Employee entitlements | 53,359 | 31,194 | - | - | 84,553 |
| Doubtful debts and impairment losses | - | - | - | - | - |
| Losses carried forward | 10,598,453 | 1,300,832 | - | 2,740,357 | 14,639,642 |
| Other | 3,027,000 | - | - | (3,027,000) | - |
| | <u>13,678,812</u> | <u>1,332,026</u> | <u>-</u> | <u>(286,643)</u> | <u>14,724,195</u> |
| Attributable to: | | | | | |
| Continuing operations | 12,204,343 | 1,259,610 | - | (286,643) | 13,177,310 |
| Discontinued operations | - | - | - | - | - |
| Total | <u>12,204,343</u> | <u>1,259,610</u> | <u>-</u> | <u>(286,643)</u> | <u>13,177,310</u> |
| Tax effect at 28% | <u>3,417,215</u> | <u>352,691</u> | <u>-</u> | <u>(80,259)</u> | <u>3,689,647</u> |
| 2011 | | | | | |
| Investment gains | (40,315) | - | - | - | (40,315) |
| Building, property and equipment | (1,208,099) | (95,824) | - | (130,231) | (1,434,154) |
| Other | - | - | - | - | - |
| | <u>(1,248,414)</u> | <u>(95,824)</u> | <u>-</u> | <u>(130,231)</u> | <u>(1,474,469)</u> |
| Employee entitlements | 56,776 | (3,417) | - | - | 53,359 |
| Doubtful debts and impairment losses | - | - | - | - | - |
| Losses carried forward | 4,729,053 | 5,672,020 | - | 197,380 | 10,598,453 |
| Other | 2,165,716 | 771,284 | - | 90,000 | 3,027,000 |
| | <u>6,951,545</u> | <u>6,439,887</u> | <u>-</u> | <u>287,380</u> | <u>13,678,812</u> |
| Attributable to: | | | | | |
| Continuing operations | 5,703,131 | 6,344,063 | - | 157,149 | 12,204,343 |
| Discontinued operations | - | - | - | - | - |
| Total | <u>5,703,131</u> | <u>6,344,063</u> | <u>-</u> | <u>157,149</u> | <u>12,204,343</u> |
| Tax effect at 28% | <u>1,596,876</u> | <u>1,776,338</u> | <u>-</u> | <u>44,002</u> | <u>3,417,215</u> |

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised is \$nil. No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

The deferred tax asset relating to tax losses carried forward has been recognised as the financial forecasts anticipate the Company re-entering the insurance market and returning to profits in future financial years (refer Note 23).

| (d) Imputation Credit Account | 2012 Group | 2011 Group | 2012 Parent | 2011 Parent |
|---|------------------|------------------|------------------|------------------|
| | \$ | \$ | \$ | \$ |
| Opening Balance | 5,650,387 | 5,638,291 | 5,650,387 | 5,638,291 |
| Plus Credits | - | - | - | - |
| Income Tax Paid | 119,418 | 81,094 | 119,418 | 81,094 |
| Resident Withholding Tax | - | - | - | - |
| Imputation Credits Received | <u>119,418</u> | <u>81,094</u> | <u>119,418</u> | <u>81,094</u> |
| Less Debits | 122,799 | 68,998 | 122,799 | 68,998 |
| Tax Refund | - | - | - | - |
| Imputation Credits Attached to Dividends Paid | <u>122,799</u> | <u>68,998</u> | <u>122,799</u> | <u>68,998</u> |
| Closing Balance | <u>5,647,006</u> | <u>5,650,387</u> | <u>5,647,006</u> | <u>5,650,387</u> |

NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED
NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012



NOTE 9
INCOME RELATING TO FINANCIAL INSTRUMENTS

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|--|---------------------|---------------------|----------------------|----------------------|
| Designated Fair Value through Profit or Loss | - | 156,946 | - | 156,946 |
| Managed Fund - Reinvested interest and change in value | - | - | - | - |
| Dividends Received | - | 156,946 | - | 156,946 |
| Held to Maturity | | | | |
| Interest Received - NZ Government Stock | 3,243 | 4,885 | 3,243 | 4,885 |
| Interest Received - Local Authority Stock | - | - | - | - |
| | 3,243 | 4,885 | 3,243 | 4,885 |
| Cash & Cash Equivalents | | | | |
| Interest Received - Short Term Deposits at Bank | 412,687 | 278,458 | 412,687 | 278,458 |
| | 415,930 | 440,289 | 415,930 | 440,289 |

NOTE 10
INVESTMENT PROPERTY

(Local Government Building, Lambton Quay, Wellington)

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|--|---------------------|---------------------|----------------------|----------------------|
| (a) Land valuation (Original Cost \$289,253) | 2,900,000 | 2,900,000 | 2,900,000 | 2,900,000 |
| Less decrease in value | - | - | - | - |
| Fair Value | 2,900,000 | 2,900,000 | 2,900,000 | 2,900,000 |
| (b) Building valuation (Original Cost \$860,571) | 4,000,000 | 4,900,000 | 4,000,000 | 4,900,000 |
| Refurbishment | 173,161 | - | 173,161 | - |
| Less decrease in value | (323,161) | (900,000) | (323,161) | (900,000) |
| Fair Value | 3,850,000 | 4,000,000 | 3,850,000 | 4,000,000 |
| (c) Artwork valuation (Original Cost \$8,844) | 25,000 | 25,000 | 25,000 | 25,000 |
| Plus increase in value | - | - | - | - |
| Fair Value | 25,000 | 25,000 | 25,000 | 25,000 |
| | 6,775,000 | 6,925,000 | 6,775,000 | 6,925,000 |

The investment property is revalued every year. The investment property was valued on 31 December 2012 by independent registered valuer Martin Veale (ANZIV, SPINZ) of the firm Telfer Young (Wgtn) Ltd. The property is valued in accordance with NZ Property Practice Standard 3 – valuations for Financial reporting purposes at fair value arrived at using comparable market rental information. The rental capitalisation rate adopted for the valuation as at 31 December 2012 was 9.5% (2011: 9.0%).

NOTE 11
PROPERTY, PLANT & EQUIPMENT AND INTANGIBLE ASSETS

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|---|---------------------|---------------------|----------------------|----------------------|
| Property, Plant and Equipment | | | | |
| (a) Office Furniture and Equipment - cost | 302,752 | 307,247 | 302,752 | 307,247 |
| Plus Additions | 259,362 | 4,748 | 259,362 | 4,748 |
| Less Disposals | - | (9,243) | - | (9,243) |
| Closing Value - cost | 562,114 | 302,752 | 562,114 | 302,752 |
| Office Furniture and Equipment - Accumulated Depreciation | (208,292) | (181,303) | (208,292) | (181,303) |
| Less Depreciation Charge | (67,700) | (30,070) | (67,700) | (30,070) |
| Less Disposals | - | 3,081 | - | 3,081 |
| Closing Accumulated Depreciation | (275,992) | (208,292) | (275,992) | (208,292) |
| Net Book Value | 286,122 | 94,460 | 286,122 | 94,460 |

The Net Surplus after Taxation in the Statement of Financial Performance includes a nil gain or loss on disposal of fixed assets (2011: \$1,152 loss).

| | | | | |
|-------------------------------------|-----------|-----------|-----------|-----------|
| (b) Intangible Assets | 417,291 | 408,097 | 417,291 | 408,097 |
| Software - cost | 1,440 | 9,194 | 1,440 | 9,194 |
| Plus Additions | - | - | - | - |
| Less Disposals | - | - | - | - |
| Closing Value - cost | 418,731 | 417,291 | 418,731 | 417,291 |
| Software - Accumulated Amortisation | (258,140) | (208,721) | (258,140) | (208,721) |
| Less Amortisation Charge | (50,346) | (49,419) | (50,346) | (49,419) |
| Less Disposals | - | - | - | - |
| Closing Accumulated Amortisation | (308,486) | (258,140) | (308,486) | (258,140) |
| Net Book Value | 110,245 | 159,151 | 110,245 | 159,151 |



**NOTE 12
 CONTINGENT LIABILITIES**
 There are no contingent liabilities.

**NOTE 13
 FINANCIAL INSTRUMENTS**

(1) Financial Assets and Liabilities

The carrying amounts of all financial assets and liabilities, with the exception of Subordinated Debt, are considered to be equivalent to their market value, which for these assets and liabilities is also considered to be fair value. The Subordinated Debt is measured at amortised cost.

All fixed interest investments were managed around a 90 day duration and carry a minimum Standard and Poors credit rating of "A1" or equivalent.

The cost of investments in managed funds at 31 December 2012 was nil (2011: nil).

Market value of managed funds at 31 December 2012 was nil (2011: nil).

Carrying value of Financial Assets and Financial Liabilities.

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|---|---------------------|---------------------|----------------------|----------------------|
| Financial Asset: Held to Maturity | | | | |
| NZ Government Stock | 107,618 | 110,374 | 107,618 | 110,374 |
| Total Held to Maturity | <u>107,618</u> | <u>110,374</u> | <u>107,618</u> | <u>110,374</u> |
| Financial Asset: Loans and Receivables | | | | |
| Sundry Debtors | 59,545 | 401,480 | 59,538 | 402,151 |
| Premiums Receivable | 33,005 | 23,450 | 33,005 | 23,450 |
| Reinsurance Recoveries | 820,245,659 | 702,715,777 | 820,245,659 | 702,715,777 |
| Total Loans and Receivables | <u>820,338,209</u> | <u>703,140,707</u> | <u>820,338,202</u> | <u>703,141,378</u> |
| Financial Asset: Carried at Amortised Cost | | | | |
| Bank & Cash Equivalents | 14,617,721 | 24,099,400 | 14,567,126 | 24,048,110 |
| Financial Liability: Amortised Cost | | | | |
| Subordinated Debt | 120,176 | 120,176 | - | - |
| Accounts Payable | 1,222,920 | 206,096 | 1,222,920 | 206,096 |
| Reinsurance Received in Advance | - | 14,936,206 | - | 14,936,206 |
| Outstanding Claims Liability | 829,306,800 | 712,699,000 | 829,306,800 | 712,699,000 |
| Total Amortised Cost | <u>830,649,896</u> | <u>727,961,478</u> | <u>830,529,720</u> | <u>727,841,302</u> |

(2) Financial Risk - Structure and Management

Financial instruments which potentially subject the Company & Group to a concentration of credit risk consist principally of cash, interest bearing deposits, local authority stocks and investments in managed funds.

The Company does not require collateral or other security to support financial instruments with credit risk and as such, no collateral exists for any of the investments held by the Company. The maximum credit risk exposure is the carrying amount of the individual investments.

The Company & Group has placed interest bearing deposits and funds to be managed with financial institutions and local authorities of high credit worthiness and limits its amount of credit exposure to any one such institution.

(a) Market Risk

Previously the Company & Group were indirectly exposed to interest rate and foreign currency risk through its investments in OnePath (NZ) Ltd managed funds. Since April 2011, all other financial assets and liabilities are recorded at amortised cost, therefore changes in interest rates do not impact on their carrying value.



NOTE 13 Financial Instruments (Cont'd)

(2) Financial Risk - Structure and Management (Cont'd)

(a) Market Risk (Cont'd)

(i) Interest Rate Repricing Schedule

The following tables include the Company's and Group's financial assets and liabilities at their carrying amounts, categorised by the maturity dates.

As at 31 December 2012 (Group)

| Assets | Interest Rate Spread % | Within 6 months \$ | 6 to 12 months \$ | 1 to 2 years \$ | 2 to 5 years \$ | Non Interest Bearing \$ | Total \$ |
|------------------------------------|------------------------|--------------------|-------------------|-----------------|-----------------|-------------------------|--------------------|
| Cash at Bank | 0% to 3.00% | 14,606,193 | - | - | - | 11,528 | 14,617,721 |
| Other Receivable | n/a | - | - | - | - | 92,550 | 92,550 |
| Reinsurance Recoveries | n/a | - | - | - | - | 820,245,659 | 820,245,659 |
| NZ Government Stock | 6.00% | - | - | - | 107,618 | - | 107,618 |
| Total Financial Assets | | 14,606,193 | - | - | 107,618 | 820,349,737 | 835,063,548 |
| Liabilities | | | | | | | |
| Sundry Creditors | n/a | - | - | - | - | 1,222,920 | 1,222,920 |
| Reinsurance Received in Advance | n/a | - | - | - | - | - | - |
| Outstanding Claims | n/a | - | - | - | - | 829,306,800 | 829,306,800 |
| Subordinated Debt | n/a | - | - | - | - | 120,176 | 120,176 |
| Total Financial Liabilities | | - | - | - | - | 830,649,896 | 830,649,896 |

As at 31 December 2011 (Group)

| Assets | Interest Rate Spread % | Within 6 months \$ | 6 to 12 months \$ | 1 to 2 years \$ | 2 to 5 years \$ | Non Interest Bearing \$ | Total \$ |
|------------------------------------|------------------------|--------------------|-------------------|-----------------|-----------------|-------------------------|--------------------|
| Cash at Bank | 0% to 3.06% | 24,017,133 | - | - | - | 82,267 | 24,099,400 |
| Other Receivable | n/a | - | - | - | - | 424,930 | 424,930 |
| Reinsurance Recoveries | n/a | - | - | - | - | 702,715,777 | 702,715,777 |
| NZ Government Stock | 6.00% | - | - | - | 110,374 | - | 110,374 |
| Total Financial Assets | | 24,017,133 | - | - | 110,374 | 703,222,974 | 727,350,481 |
| Liabilities | | | | | | | |
| Sundry Creditors | n/a | - | - | - | - | 206,096 | 206,096 |
| Reinsurance Received in Advance | n/a | - | - | - | - | 14,936,206 | 14,936,206 |
| Outstanding Claims | n/a | - | - | - | - | 712,699,000 | 712,699,000 |
| Subordinated Debt | n/a | - | - | - | - | 120,176 | 120,176 |
| Total Financial Liabilities | | - | - | - | - | 727,961,478 | 727,961,478 |

As at 31 December 2012 (Parent)

| Assets | Interest Rate Spread % | Within 6 months \$ | 6 to 12 months \$ | 1 to 2 years \$ | 2 to 5 years \$ | Non Interest Bearing \$ | Total \$ |
|------------------------------------|------------------------|--------------------|-------------------|-----------------|-----------------|-------------------------|--------------------|
| Cash at Bank | 0% to 3.00% | 14,555,598 | - | - | - | 11,528 | 14,567,126 |
| Other Receivable | n/a | - | - | - | - | 92,543 | 92,543 |
| Reinsurance Recoveries | n/a | - | - | - | - | 820,245,659 | 820,245,659 |
| NZ Government Stock | 6.00% | - | - | - | 107,618 | - | 107,618 |
| Total Financial Assets | | 14,555,598 | - | - | 107,618 | 820,349,730 | 835,012,946 |
| Liabilities | | | | | | | |
| Sundry Creditors | n/a | - | - | - | - | 1,222,920 | 1,222,920 |
| Reinsurance Received in Advance | n/a | - | - | - | - | - | - |
| Outstanding Claims | n/a | - | - | - | - | 829,306,800 | 829,306,800 |
| Total Financial Liabilities | | - | - | - | - | 830,529,720 | 830,529,720 |



NOTE 13 Financial Instruments (Cont'd)

(2) Financial Risk - Structure and Management (Cont'd)

(a) Market Risk (Cont'd)

(i) Interest Rate Repricing Schedule (Cont'd)

As at 31 December 2011 (Parent)

| | Interest Rate Spread % | Within 6 months \$ | 6 to 12 months \$ | 1 to 2 years \$ | 2 to 5 years \$ | Non Interest Bearing \$ | Total \$ |
|------------------------------------|------------------------|--------------------|-------------------|-----------------|-----------------|-------------------------|--------------------|
| Assets | | | | | | | |
| Cash at Bank | 0% to 3.06% | 24,017,133 | - | - | - | 30,977 | 24,048,110 |
| Other Receivable | n/a | - | - | - | - | 425,600 | 425,600 |
| Reinsurance Recoveries | n/a | - | - | - | - | 702,715,777 | 702,715,777 |
| NZ Government Stock | 6.00% | - | - | 110,374 | - | - | 110,374 |
| Total Financial Assets | | 24,017,133 | - | 110,374 | - | 703,172,354 | 727,299,861 |
| Liabilities | | | | | | | |
| Sundry Creditors | n/a | - | - | - | - | 206,096 | 206,096 |
| Reinsurance Received in Advance | n/a | - | - | - | - | 14,936,206 | 14,936,206 |
| Outstanding Claims | n/a | - | - | - | - | 712,699,000 | 712,699,000 |
| Total Financial Liabilities | | - | - | - | - | 727,841,302 | 727,841,302 |

(ii) Carrying Amount and Fair Value

| | 2012 Group | | 2011 Group | |
|------------------------------------|--------------------|--------------------|--------------------|--------------------|
| | Carrying Amount \$ | Fair Value \$ | Carrying Amount \$ | Fair Value \$ |
| Assets | | | | |
| Cash at Bank | 14,617,721 | 14,617,721 | 24,099,400 | 24,099,400 |
| Other Receivable | 92,550 | 92,550 | 424,930 | 424,930 |
| Reinsurance Recoveries | 820,245,659 | 820,245,659 | 702,715,777 | 702,715,777 |
| NZ Government Stock | 107,618 | 107,618 | 110,374 | 110,374 |
| Total Financial Assets | 835,063,548 | 835,063,548 | 727,350,481 | 727,350,481 |
| Liabilities | | | | |
| Sundry Creditors | 1,222,920 | 1,222,920 | 206,096 | 206,096 |
| Reinsurance Received in Advance | - | - | 14,936,206 | 14,936,206 |
| Outstanding Claims | 829,306,800 | 829,306,800 | 712,699,000 | 712,699,000 |
| Subordinated Debt | 120,176 | 120,176 | 120,176 | 120,176 |
| Total Financial Liabilities | 830,649,896 | 830,649,896 | 727,961,478 | 727,961,478 |

| | 2012 Parent | | 2011 Parent | |
|------------------------------------|--------------------|--------------------|--------------------|--------------------|
| | Carrying Amount \$ | Fair Value \$ | Carrying Amount \$ | Fair Value \$ |
| Assets | | | | |
| Cash at Bank | 14,567,126 | 14,567,126 | 24,048,110 | 24,048,110 |
| Other Receivable | 92,543 | 92,543 | 425,600 | 425,600 |
| Reinsurance Recoveries | 820,245,659 | 820,245,659 | 702,715,777 | 702,715,777 |
| NZ Government Stock | 107,618 | 107,618 | 110,374 | 110,374 |
| Total Financial Assets | 835,012,946 | 835,012,946 | 727,299,861 | 727,299,861 |
| Liabilities | | | | |
| Sundry Creditors | 1,222,920 | 1,222,920 | 206,096 | 206,096 |
| Reinsurance Received in Advance | - | - | 14,936,206 | 14,936,206 |
| Outstanding Claims | 829,306,800 | 829,306,800 | 712,699,000 | 712,699,000 |
| Total Financial Liabilities | 830,529,720 | 830,529,720 | 727,841,302 | 727,841,302 |



NOTE 13 Financial Instruments (Cont'd)

(2) Financial Risk - Structure and Management (Cont'd)

(b) Liquidity Risk

Liquidity Risk is the risk that the Company & Group will encounter difficulties in raising funds at short notice to meet commitments associated with financial instruments. Management of liquidity risk is designed to ensure that the Company & Group has the ability to meet financial obligations as they fall due.

The following tables include an analysis of the contractual undiscounted cash flows relating to the Company's & Group's financial assets and liabilities at their face value, categorised by the maturity dates.

**Maturity Analysis (Group)
 As at 31 December 2012**

| | Within 6 months | 6 to 12 months | 1 to 2 years | 2 to 5 years | Total |
|------------------------------------|--------------------|-------------------|--------------------|--------------------|--------------------|
| | \$ | \$ | \$ | \$ | \$ |
| Assets | | | | | |
| Cash at Bank | 14,617,721 | - | - | - | 14,617,721 |
| Other Receivable | 92,550 | - | - | - | 92,550 |
| Reinsurance Recoveries | 187,802,159 | 70,271,500 | 140,543,000 | 421,629,000 | 820,245,659 |
| NZ Government Stock | - | - | - | 100,000 | 100,000 |
| Total Financial Assets | 202,512,430 | 70,271,500 | 140,543,000 | 421,729,000 | 835,055,930 |
| Liabilities | | | | | |
| Sundry Creditors | 1,222,920 | - | - | - | 1,222,920 |
| Reinsurance Received in Advance | - | - | - | - | - |
| Outstanding Claims | 196,863,300 | 70,271,500 | 140,543,000 | 421,629,000 | 829,306,800 |
| Subordinated Debt | - | - | - | 120,176 | 120,176 |
| Total Financial Liabilities | 198,086,220 | 70,271,500 | 140,543,000 | 421,749,176 | 830,649,896 |

**Maturity Analysis (Group)
 As at 31 December 2011**

| | Within 6 months | 6 to 12 months | 1 to 2 years | 2 to 5 years | Total |
|------------------------------------|--------------------|-------------------|--------------------|--------------------|--------------------|
| | \$ | \$ | \$ | \$ | \$ |
| Assets | | | | | |
| Cash at Bank | 24,099,400 | - | - | - | 24,099,400 |
| Other Receivable | 424,930 | - | - | - | 424,930 |
| Reinsurance Recoveries | 70,272,277 | 70,271,500 | 140,543,000 | 421,629,000 | 702,715,777 |
| NZ Government Stock | - | - | - | 100,000 | 100,000 |
| Total Financial Assets | 94,796,607 | 70,271,500 | 140,543,000 | 421,729,000 | 727,340,107 |
| Liabilities | | | | | |
| Sundry Creditors | 206,096 | - | - | - | 206,096 |
| Reinsurance Received in Advance | 14,936,206 | - | - | - | 14,936,206 |
| Outstanding Claims | 80,255,500 | 70,271,500 | 140,543,000 | 421,629,000 | 712,699,000 |
| Subordinated Debt | - | - | - | 120,176 | 120,176 |
| Total Financial Liabilities | 95,397,802 | 70,271,500 | 140,543,000 | 421,749,176 | 727,961,478 |

**Maturity Analysis (Parent)
 As at 31 December 2012**

| | Within 6 months | 6 to 12 months | 1 to 2 years | 2 to 5 years | Total |
|------------------------------------|--------------------|-------------------|--------------------|--------------------|--------------------|
| | \$ | \$ | \$ | \$ | \$ |
| Assets | | | | | |
| Cash at Bank | 14,567,126 | - | - | - | 14,567,126 |
| Other Receivable | 92,542 | - | - | - | 92,542 |
| Reinsurance Recoveries | 187,802,159 | 70,271,500 | 140,543,000 | 421,629,000 | 820,245,659 |
| NZ Government Stock | - | - | - | 100,000 | 100,000 |
| Total Financial Assets | 202,461,827 | 70,271,500 | 140,543,000 | 421,729,000 | 835,005,327 |
| Liabilities | | | | | |
| Sundry Creditors | 1,222,920 | - | - | - | 1,222,920 |
| Reinsurance Received in Advance | - | - | - | - | - |
| Outstanding Claims | 196,863,300 | 70,271,500 | 140,543,000 | 421,629,000 | 829,306,800 |
| Total Financial Liabilities | 198,086,220 | 70,271,500 | 140,543,000 | 421,629,000 | 830,529,720 |



NOTE 13 Financial Instruments (Cont'd)

(2) Financial Risk - Structure and Management (Cont'd)

(b) Liquidity Risk (Cont'd)

| Maturity Analysis (Parent) As at 31 December 2011 | Within 6 months \$ | 6 to 12 months \$ | 1 to 2 years \$ | 2 to 5 years \$ | Total \$ |
|--|--------------------------|-------------------------|-----------------------|-----------------------|--------------------|
| Assets | | | | | |
| Cash at Bank | 24,048,110 | - | - | - | 24,048,110 |
| Other Receivable | 425,600 | - | - | - | 425,600 |
| Reinsurance Recoveries | 70,272,277 | 70,271,500 | 140,543,000 | 421,629,000 | 702,715,777 |
| NZ Government Stock | - | - | - | 100,000 | 100,000 |
| Total Financial Assets | 94,745,987 | 70,271,500 | 140,543,000 | 421,729,000 | 727,289,487 |
| Liabilities | | | | | |
| Sundry Creditors | 206,096 | - | - | - | 206,096 |
| Reinsurance Received in Advance | 14,936,206 | - | - | - | 14,936,206 |
| Outstanding Claims | 80,255,500 | 70,271,500 | 140,543,000 | 421,629,000 | 712,699,000 |
| Total Financial Liabilities | 95,397,802 | 70,271,500 | 140,543,000 | 421,629,000 | 727,841,302 |

(c) Credit Risk

All investments except for the \$100,000 Government Stock holding are in cash at registered banks. The registered banks have a credit rating of "AA-". All reinsurance is held with reinsurers with credit ratings no less than "A-" (AM Best scale).

(i) Concentration of Credit Risk

The following table includes the Company's & Group's assets at their carrying amounts at balance date. This equates to the Company's and Group's maximum exposure to credit risk.

| | 2012 Group \$ | 2011 Group \$ | 2012 Parent \$ | 2011 Parent \$ |
|--------------------------|---------------------|---------------------|----------------------|----------------------|
| Cash at registered Banks | 14,617,721 | 24,099,400 | 14,567,126 | 24,048,110 |
| Other Receivable | 92,550 | 424,930 | 92,542 | 425,600 |
| Reinsurance Recoveries | 820,245,659 | 702,715,777 | 820,245,659 | 702,715,777 |
| Managed Funds | - | - | - | - |
| NZ Government Stock | 107,618 | 110,374 | 107,618 | 110,374 |
| Total | 835,063,548 | 727,350,481 | 835,012,945 | 727,299,861 |

(ii) Concentration of Credit Exposure

The major credit exposure greater than 10% of total assets is with the reinsurers. All reinsurers, except Local Authority Protection Programme ("LAPP"), have claims paying ratings greater than "A". LAPP is, because of its cash holdings, expected to be able to pay its liabilities to the Company and has robust reinsurance to cover its below ground related claims.

(3) Foreign Currency Risk

Foreign currency risk is the risk that the Company and Group will incur losses through exposure to foreign exchange movements. At balance date the Company and Group had no foreign currency exposure.

NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED
 NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012



NOTE 14
 RECONCILIATION OF COMPREHENSIVE INCOME AFTER TAX WITH CASH FLOW FROM OPERATING ACTIVITIES

| | 2012 | 2011 | 2012 | 2011 |
|---|---------------|---------------|---------------|---------------|
| | Group | Group | Parent | Parent |
| | \$ | \$ | \$ | \$ |
| Total Comprehensive (Loss) / Income | (1,284,886) | (5,390,229) | (1,314,336) | (5,414,589) |
| Add/(less) non cash items | | | | |
| Depreciation | 67,700 | 30,070 | 67,700 | 30,070 |
| Amortisation | 50,346 | 49,419 | 50,346 | 49,419 |
| Movement in Insurance Provisions | 117,211,828 | 620,754,904 | 117,211,828 | 620,754,904 |
| Movement in Deferred Tax Liability | (272,432) | (1,820,339) | (272,432) | (1,820,339) |
| Effective interest rate adjustments | - | - | - | - |
| Net change in fair value of investment property | 323,161 | 900,000 | 323,161 | 900,000 |
| Share of Profit of Associate | (29,460) | (24,410) | - | - |
| Unrealised net change in value of investments | 2,757 | (1,415) | 2,757 | (1,415) |
| | 117,353,900 | 619,888,229 | 117,383,360 | 619,912,639 |
| Add/(less) movements in other working capital items | | | | |
| Accounts Receivable | (116,934,283) | (617,920,281) | (116,934,270) | (617,926,338) |
| Accounts Payable | (12,354,801) | (391,851) | (12,354,801) | (391,851) |
| Reinsurance Received in Advance | - | 14,936,206 | - | 14,936,206 |
| Maturing Local Authority Stock | - | - | - | - |
| Tax Refund Due | (2,591) | (17,880) | (2,591) | (17,880) |
| Maturing Civic Bonds | - | - | - | - |
| | (129,291,675) | (603,393,806) | (129,291,662) | (603,399,863) |
| Add/(Less) Items Classified as investing activity | - | - | - | - |
| Add/(Less) Items Classified as financing activity | (672) | 1,150 | (672) | 6,536 |
| Net Cash Inflow from Operating Activities | (13,223,333) | 11,105,344 | (13,223,310) | 11,104,723 |

NOTE 15
 OPERATING LEASE COMMITMENTS

There are the following operating lease expense commitments:

| | 2012 | 2011 | 2012 | 2011 |
|--|--------|--------|--------|--------|
| | Group | Group | Parent | Parent |
| | \$ | \$ | \$ | \$ |
| not later than one year | 15,588 | 15,808 | 15,588 | 15,808 |
| later than one year but not later than two years | 15,588 | 15,808 | 15,588 | 15,808 |
| later than two years but not later than five years | 31,380 | 16,634 | 31,380 | 16,634 |
| later than five years | - | - | - | - |
| | 62,556 | 48,250 | 62,556 | 48,250 |

There are the following operating lease income commitments:

| | 2012 | 2011 | 2012 | 2011 |
|--|-----------|---------|-----------|---------|
| | Group | Group | Parent | Parent |
| | \$ | \$ | \$ | \$ |
| not later than one year | 638,974 | 539,350 | 638,974 | 539,350 |
| later than one year but not later than two years | 499,610 | 217,600 | 499,610 | 217,600 |
| later than two years but not later than five years | 783,965 | 103,325 | 783,965 | 103,325 |
| later than five years | - | - | - | - |
| | 1,922,549 | 860,275 | 1,922,549 | 860,275 |



NOTE 16

SUBORDINATED DEBT

NZ Local Government Finance Corporation's Investment Manager's brokerage was subordinated. The subordinated loan ranks behind all other NZ Local Government Finance Corporation Limited creditors. Under the terms of the subordination, amounts payable including interest shall only be payable at such time, or times, as the Directors determine that the Company has available funds to make such payments.

NOTE 17

RELATED PARTIES

During the reporting period the Company administered risk financing products provided to Local Authorities, some of which are shareholders of the Company (shareholders are listed at the back of the annual report).

The Company is the Fund Manager and, for the period 1 July 2009 to 30 June 2011, was an insurer for New Zealand Mutual Liability Riskpool ("Riskpool"). Local Government Mutual Funds Trustee Limited ("LGMFTL") has been appointed to act as the Trustee for Riskpool. The Company holds all of the shares in LGMFTL in trust on behalf of Riskpool's members. During the year the Company charged fund management fees to Riskpool of \$438,376 (2011: \$282,800). The balance outstanding at balance date for Riskpool was \$nil (2011: \$185,640). The Company received insurance premiums of \$nil (2011: \$525,000). Claims outstanding at balance date are \$1,887,000 (2011: \$3,027,000).

The Company is the Administration Manager and was an insurer for New Zealand Local Authority Protection Programme Disaster Fund ("LAPP") up to 30 June 2011. During the year the Company charged administration fees to LAPP of \$394,423 (2011: \$390,667). The balance outstanding for administration fees at balance date for LAPP was \$nil (2011: \$130,054). The Company received insurance premiums of \$nil (2011: \$44,878) and paid reinsurance premiums of \$nil (2011: \$168,681). Claims payments made to LAPP were \$5,630,928 (2011: \$3,533,672) and claims reinsurance recovered from LAPP were \$7,302,689 (2011: \$11,383,533). Claims outstanding due as at 31 December 2012 was \$nil (2011: \$10,216,467).

Transactions with Local Authorities, Riskpool and LAPP represent in excess of 90% of total premium income recorded during the year.

The Company is the Administration and Investment Manager of Local Government Global Superannuation Scheme - SuperEasy ("SuperEasy"). Local Government Superannuation Trustee Limited ("LGSTL") has been appointed to act as the Trustee for SuperEasy. Graeme R Mitchell has been appointed to act as the Independent Trustee for SuperEasy. The Company holds all of the shares in LGSTL. During the year the Company charged administration and investment management fees to SuperEasy of \$721,717 (2011: \$607,416). The balance outstanding at balance date is \$192,013 (2011: \$160,794). The audit fee incurred by the superannuation funds of \$50,500 (2011: \$25,000) is paid by the Company out of the management fee received.

NZ Local Government Finance Corporation Limited has a subordinated debt owed to the Company of \$298,750 (2011: \$298,750).

Key Management Personnel

The compensation of the Directors and executives, being the key management personnel of the Company and Group is set out below:

| | 2012 | 2011 | 2012 | 2011 |
|------------------------------|----------------|----------------|----------------|----------------|
| | Group | Group | Parent | Parent |
| Compensation | \$ | \$ | \$ | \$ |
| Short term employee benefits | 858,590 | 787,137 | 858,590 | 787,137 |
| Post-employment benefits | - | - | - | - |
| Other long-term benefits | - | - | - | - |
| Termination benefits | - | - | - | - |
| | <u>858,590</u> | <u>787,137</u> | <u>858,590</u> | <u>787,137</u> |

NOTE 18 ANALYSIS OF FINANCIAL ASSETS NOT IMPAIRED

| 2012 | Not due | Past due | Past due + 30 | Past due + | Total |
|------------------------|--------------------|----------|---------------|------------|--------------------|
| | | | days | 60 days | |
| Trade Debtors | 59,538 | - | - | - | 59,538 |
| Premiums Receivable | 33,004 | - | - | - | 33,004 |
| Reinsurance Recoveries | 820,245,659 | - | - | - | 820,245,659 |
| | <u>820,338,201</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>820,338,201</u> |

| 2011 | Not due | Past due | Past due + 30 | Past due + | Total |
|------------------------|--------------------|---------------|---------------|--------------|--------------------|
| | | | days | 60 days | |
| Trade Debtors | 381,137 | 10,711 | 2,499 | 4,104 | 398,451 |
| Premiums Receivable | 21,020 | - | - | 2,430 | 23,450 |
| Reinsurance Recoveries | 702,715,777 | - | - | - | 702,715,777 |
| | <u>703,117,934</u> | <u>10,711</u> | <u>2,499</u> | <u>6,534</u> | <u>703,137,678</u> |

NOTE 19 STANDARDS APPROVED BUT NOT YET EFFECTIVE

Standards and Interpretations in issue not yet adopted

At the date of authorisation of the financial report, a number of Standards and Interpretations were in issue but not yet effective.

Except as noted below, initial application of the following Standards will not affect any of the amounts recognised in the financial report, change the presentation and disclosures presently made in or relation to the Company's and Group's financial report:

| | Effective for annual reporting periods beginning on or after | Expected to be initially applied in the financial year ending |
|--|--|---|
| NZ IFRS 9 'Financial Instruments' | 1 January 2013 | 31 December 2013 |
| *Revised NZ IFRS 9 'Financial Instruments' | 1 January 2013 | 31 December 2013 |
| Amendments to NZ IFRS 7 'Financial Instruments: Disclosures' | 1 July 2011 | 31 December 2012 |
| Amendments to NZ IFRS 7 – Appendix E | 1 April 2011 | 31 December 2012 |
| Amendments to New Zealand Equivalents to International Financial Reporting Standards to Harmonise with International Financial Reporting Standards and Australian Accounting Standards | 1 July 2011 | 31 December 2012 |
| FRS 44 'NZ Additional Disclosures' | 1 July 2011 | 31 December 2012 |
| Amendments to FRS 44 'NZ Additional Disclosures' | 1 July 2011 | 31 December 2012 |
| NZ IFRS 10 'Consolidated Financial Statements' | 1 January 2013 | 31 December 2013 |
| NZ IAS 28 'Investments in Associates and Joint Ventures' (revised 2011) | 1 January 2013 | 31 December 2013 |
| NZ IFRS 9 'Financial Instruments' | 1 January 2013 | 31 December 2013 |
| Revised NZ IFRS 9 'Financial Instruments' (2010) | 1 January 2013 | 31 December 2013 |
| NZ IFRS 13 'Fair Value Measurement' | 1 January 2013 | 31 December 2013 |
| NZ IAS 27 'Separate Financial Statements' (revised 2011) | 1 January 2013 | 31 December 2013 |
| Amendments to IFRS 7 'Financial Instruments: Disclosures' – Offsetting Financial Assets and Financial Liabilities | 1 January 2013 | 31 December 2013 |
| Amendments to IAS 32 'Financial Instruments: Presentation' - Offsetting Financial Assets and Financial Liabilities | 1 January 2014 | 31 December 2014 |
| Amendments to IFRS 9 and IFRS 7 Mandatory Effective Date and Transition Disclosures | 1 January 2015 | 31 December 2015 |

*the revised NZ IFRS 9 adds guidance on the classification and measurement of financial liabilities and derecognition of financial instruments. The effective date remains the same as the previous version of NZ IFRS 9, with earlier adoption permitted.



NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED
NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 20
SHAREHOLDERS EQUITY

The Share Capital of the Company and Group comprises solely authorised and issued ordinary shares with each share ranking equally in votes, dividends and surpluses. In 2011 6,390,790 were paid issued at \$1 per share. During the year 4,639,574 shares were issued at \$0.90 per share to existing shareholders.

| Retained Earnings | 2012 | 2011 | 2012 | 2011 |
|--|------------------|------------------|------------------|------------------|
| | Group | Group | Parent | Parent |
| | \$ | \$ | \$ | \$ |
| Opening Balance | 3,692,658 | 9,082,887 | 3,710,451 | 9,125,040 |
| Net Surplus After Taxation | (1,284,886) | (5,390,229) | (1,314,336) | (5,414,589) |
| Ordinary Shares issued during the year | 4,175,616 | - | 4,175,616 | - |
| Closing balance | <u>6,583,388</u> | <u>3,692,658</u> | <u>6,571,731</u> | <u>3,710,451</u> |

NOTE 21
EQUITY RETAINED FOR FINANCIAL SOUNDNESS

All shareholder equity is retained to ensure the financial soundness of the Company and Group. The high level of liquidity in fixed interest (\$9.1m) investments is retained for cash flow purposes and also to balance the funds allocated in the building investment. The Company & Group believes that a high liquidity ratio is necessary for attaining an A (Excellent) claims paying ability rating from AM Best.

NOTE 22
COMPARISON WITH STATEMENT OF INTENT

The following is a comparison of the actual performance against the Statement of Intent for the year ended 31 December 2012.

| | SI Target | Actual |
|---|-----------------|----------|
| -Annual claims paying ability rating by AM Best | "A" (Excellent) | "BBB-" |
| -To exceed the average insurance industry solvency standards as published by the NZ Insurance Council | | Exceeded |

The primary reason for the Company not meeting performance targets is due to the flow on effects of the Canterbury Earthquakes on 22 February and 13 June 2011.

NOTE 23
SUBSEQUENT EVENTS

Share Offer.

Prior to balance date the Company had issued a share offer to shareholders and other non-shareholding local authorities in New Zealand to subscribe for shares in the Company. The share offer will close on 3 May 2013 unless the closing date is extended.

NOTE 24
GOING CONCERN

The magnitude of the Canterbury events has had a significant impact on the operational and financial results of the Company, with over 900 claims being submitted. As at 31 December 2012 the Outstanding Claims Liability in relation to Canterbury earthquake claims as determined by the Company's independent actuary was in excess of \$800m. The financial impact to the Company of the considerable gross claims costs has been significantly mitigated by its catastrophe reinsurance programme, which limits the net of reinsurance claims costs to \$3.6m per event. At 31 December 2012 the Company had settled \$7.6m of its exposure leaving the Company's net outstanding claims liability at \$6.6m. Of this amount \$3.8m relates to its remaining exposure to the Canterbury earthquake claims.



NOTE 24
GOING CONCERN (Cont'd)

As a consequence of the Canterbury earthquakes and some reinsurance issues, the Company's claims payable credit rating was reduced by A M Best in 2011 to "BBB-, negative watch" which remains as at 31 December 2012. The Company had been unable to obtain property reinsurance from 1 July 2011 and for this reason the Company ceased offering material damage cover for the year 1 July 2011 to 30 June 2012. For the year commencing 30 June 2012 the Company was able to offer material damage cover however without an upgrade in the AM Best rating no cover was issued. The Reserve Bank of New Zealand has issued the Company a provisional licence under the Insurance (Prudential Supervision) Act 2010 and the Company is in the process of applying for a full licence.

The Company's reinsurers have not unanimously agreed to meet the claims made and some issues outstanding are being resolved through the court process. The Company is currently in arbitration with two of its reinsurers relating to the limits of cover under the reinsurance programme. Both these reinsurers have very favourable credit ratings which endorses their ability to pay. Based on external legal advice the Directors believe that the cases against these two reinsurers are sound and that the amounts accounted for as receivable are legally and contractually payable. The Directors are also pursuing other actions to collect the amounts currently owed by one other party.

The financial statements have been prepared on a going concern basis, the validity of which depends, inter alia, on the limitation of the net liability to \$6.6m. The resolution of the reinsurance issues referred to above is necessary to enable the Company to restore a claims payable credit rating of "A-" or better, which is a pre-requisite for the Company's clients being able to resume placing their property damage insurance with the Company. The Company expects to meet its liabilities. The Directors do acknowledge the inherent uncertainties associated with the outcome of any legal dispute and that there is uncertainty as to when the Company will resume its normal business activities.

The financial statements do not include any adjustments that would result should the aforementioned not materialise. If this occurs the Company may be unable to continue its insurance activities for the foreseeable future. Adjustments may have to be made to reflect the situation that assets may need to be realised other than in the normal course of business and at amounts which could differ significantly from the amount at which they are currently recorded in the Statement of Financial Position. In addition, the company may have to provide for further liabilities that might arise, and to reclassify non current assets and liabilities as current assets and liabilities.

The deferred tax asset has been reviewed at balance date. The Directors believe that it is probable that sufficient taxable profits will be available to allow all the asset to be recovered as the Company expects to resume its normal business activities. The amount of deferred tax assets considered realisable, however, could change in the near term if future estimates of projected taxable income during the carryforward period are revised.



INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF NEW ZEALAND LOCAL GOVERNMENT INSURANCE CORPORATION LIMITED AND GROUP'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

The Auditor-General is the auditor of New Zealand Local Government Insurance Corporation Limited (the "Company") and Group. The Auditor-General has appointed me, Dave Shadwell, using the staff and resources of Deloitte, to carry out the audit of the financial statements of the Company on her behalf.

We have audited the financial statements of the Company and Group on pages 1 to 26, that comprise the statement of financial position as at 31 December 2012, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information.

Opinion

Financial statements

In our opinion the financial statements of the Company and Group on pages 1 to 26:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards; and
- give a true and fair view of the Company and Group's:
 - financial position as at 31 December 2012; and
 - financial performance and cash flows for the year ended on that date.

Emphasis of Matter - validity of the going concern basis on which the financial statements have been prepared

Without modifying our opinion, we considered the adequacy of the disclosures made in note 24 on pages 25 and 26 about the going concern assumption, which notes that the Company's reinsurers have not unanimously agreed to meet the claims made, and the uncertainty as to when the Company will resume its normal business activities.

The outcome of the reinsurance issues and the Company's ability to continue its material damage cover insurance activities are uncertain at this stage. The validity of the going concern assumption on which the financial statements are prepared depends, inter alia, on the limitation of the Company's net outstanding claims liability to \$6.6m.

We consider the disclosures to be adequate.

Other legal requirements

In accordance with the Financial Reporting Act 1993 we report that, in our opinion, proper accounting records have been kept by the Company and Group as far as appears from an examination of those records.

Our audit was completed on 22 April 2013. 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 Directors and our responsibilities, and 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 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. 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. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation of the financial statements that give a true and fair view of 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 Company'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 Directors;
- the adequacy of all disclosures in the financial statements; and
- the overall presentation of the financial statements.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements. In accordance with the Financial Reporting Act 1993, we report that we have obtained all the information and explanations we have required. We believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Responsibilities of the Board of Directors

The Board of Directors is responsible for preparing financial statements that:

- comply with generally accepted accounting practice in New Zealand; and
- give a true and fair view of the Company and Group's financial position, financial performance and cash flows.

The Board of Directors is also responsible for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Board of Directors' responsibilities arise from the Financial Reporting Act 1993.

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you based on our audit. Our responsibility arises from section 15 of the Public Audit Act 2001.



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.

Other than the audit, and taxation compliance services, we have no relationship with or interests in the Company or any of its subsidiaries.

A handwritten signature in black ink that reads "Dave Shadwell". The signature is written in a cursive style with a large initial "D".

Dave Shadwell

Deloitte

Wellington, New Zealand

On behalf of the Auditor-General



22 April 2013

Roger Gyles
General Manager – Finance
Civic Assurance
PO Box 5521
WELLINGTON 6145

Dear Roger

Formal Statements – Section 78 Report

Section 78 of the Insurance (Prudential Supervision) Act 2010 (“Act”) requires that the Appointed Actuary make the following statements:

- This report has been completed by Craig Lough FNZSA, Appointed Actuary to Civic Assurance (‘Civic’).
- I have provided to Civic an Insurance Liability Valuation Report as at 31 December 2012 (dated 15 March 2013). In that report I provided determinations of the outstanding claims provisions and the premium liabilities for Civic. These have been used in Civic’s financial accounts.

I have also carried out an assessment of the Company’s current and expected future solvency position determined under the Solvency Standard for Non-Life Insurance Business issued by the Reserve Bank of New Zealand in October 2011 (revised to May 2012).

- There were no restrictions or limitations placed on my work or on my report.
- I have no relationship with Civic other than being its Appointed Actuary. I hold no interests in Civic.
- I obtained all of the information I required.
- In my opinion and from an actuarial perspective (and subject to the comments below):
 - the actuarial information included in the Civic financial statements as at 31 December 2012 was appropriately included in those financial statements, and
 - the actuarial information used in the preparation of the Civic financial statements as at 31 December 2012 was used appropriately.
- The solvency margin that applies to Civic under a condition imposed under section 21(2)(b) of the Insurance (Prudential Supervision) Act 2010 as at 31 December 2012 was the margin set out in the Solvency Standard for Non-Life Insurance Business issued by the Reserve Bank of New Zealand in November 2011. In my opinion and from an actuarial perspective, Civic is expected to maintain that solvency margin as at 31 December 2012.

Yours sincerely

Craig Lough FNZSA
Appointed Actuary

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