# LUMLEY GENERAL INSURANCE (N.Z.) LIMITED
# AND CONTROLLED ENTITIES

## ANNUAL FINANCIAL REPORT

## FOR THE YEAR ENDED 30 JUNE 2011

LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

CONTENTS

**LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES**

## Directors' report

Your directors submit their annual financial report for the year ended 30 June 2011.

### Directors

The names of the Parent's directors in office during the financial year and until the date of this report are as follows. Directors were in office for this entire period unless otherwise stated.

F J Cameron QSO
A N Gianotti
J A Lyon
R G Scott
D G Thom (resigned on 31 Mar 2011)
M B Webb

### Nature of operations and principal activities

The Parent and Group's principal activities are general insurance underwriting and related investment and finance activities.

### Operating and financial review

The net loss from ordinary activities after income tax for the year was $11,736,000 (2010: profit $14,401,000).

### Significant changes in the state of affairs

On 14th June 2011, Lumley Services Limited a subsidiary of Lumley General Insurance (NZ) Limited amalgamated with a fellow subsidiary Lumley Finance Limited.

There have been no other significant changes in the state of affairs of the Parent or Group during the year.

### Disclosures

Pursuant to Section 211 (3) of the Companies Act 1993, the shareholders have agreed that the annual report of the Parent and Group need not comply with Sections 211 (1) (e), (f), (g), (h) and (j) of the Companies Act 1993.

### Auditor

Ernst & Young was appointed to undertake the audit of the financial statements for the year ended 30 June 2011.

For and on behalf of the Board of Directors

J A LYON
Director

R G SCOTT
Director

3 August 2011

LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

**Statement of Comprehensive Income**
**For the year ended 30 June 2011**

| | *Notes* | *Consolidated* | | *Parent* | |
|---|---|---|---|---|---|
| | | *2011* | *2010* | *2011* | *2010* |
| | | *$'000* | *$'000* | *$'000* | *$'000* |
| Gross earned premium revenue | 4 | 345,073 | 329,033 | 343,697 | 327,380 |
| Outward reinsurance premium expense | 4 | (59,160) | (53,657) | (59,160) | (53,657) |
| **Net premium revenue** | 4 | 285,913 | 275,376 | 284,537 | 273,723 |
| Claims expense | 5 | (797,961) | (190,802) | (797,798) | (190,718) |
| Reinsurance and other recoveries revenue | 5 | 603,295 | 34,345 | 603,295 | 34,345 |
| **Net claims incurred** | 5 | (194,666) | (156,457) | (194,503) | (156,373) |
| **Net movement in unexpired risk liability** | 6 | (7,492) | - | (7,492) | - |
| Acquisition costs | 7 | (83,073) | (81,647) | (82,031) | (80,262) |
| Other underwriting expenses including claims management expenses | 7 | (29,439) | (25,088) | (29,234) | (24,899) |
| **Underwriting expenses** | | (112,512) | (106,735) | (111,265) | (105,161) |
| **Underwriting result** | | (28,757) | 12,184 | (28,723) | 12,189 |
| Investment income | 4 | 9,144 | 7,135 | 10,802 | 9,406 |
| Dividend income | 4 | - | - | 400 | 1,548 |
| Other income | 4 | 2,092 | 1,879 | 2,092 | 1,457 |
| Income from premium funding activities | 4 | 9,645 | 9,063 | - | - |
| Other operating expenses | 7 | (10,314) | (10,386) | (4,209) | (5,137) |
| | | 10,567 | 7,691 | 9,085 | 7,274 |
| **Profit/(Loss) before income tax** | | (18,190) | 19,875 | (19,638) | 19,463 |
| Income tax benefit/(expense) | 8 | 6,083 | (5,447) | 6,684 | (5,275) |
| Movement in tax reserves | 8 | 371 | (27) | - | - |
| **Profit/(Loss) for the year** | | (11,736) | 14,401 | (12,954) | 14,188 |
| **Other comprehensive income** | | - | - | - | - |
| **Total comprehensive income of the year, attributable to the owners of the parent** | | (11,736) | 14,401 | (12,954) | 14,188 |

*The above statement of comprehensive income should be read in conjunction with the accompanying notes.*

LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

**Statement of Financial Position**
**As at 30 June 2011**

| | *Notes* | *Consolidated* *2011* *$'000* | *2010* *$'000* | *Parent* *2011* *$'000* | *2010* *$'000* |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current assets** | | | | | |
| Cash and cash equivalents | | 7,778 | 12,335 | 5,031 | 9,152 |
| Trade and other receivables | 10 | 99,875 | 83,152 | 126,987 | 113,815 |
| Taxation receivable | 8 | 6,551 | 920 | 6,495 | - |
| Financial assets – loans and receivables | 11 | 57,728 | 51,626 | - | - |
| Financial assets – funds held with related party | 11 | 178,556 | 171,558 | 178,556 | 171,558 |
| Reinsurance and other recoveries receivable | 12 | 178,750 | 22,756 | 178,750 | 22,756 |
| Prepaid reinsurance premiums | 13 | 12,656 | 13,993 | 12,656 | 13,993 |
| Deferred acquisition costs | 14 | 18,403 | 24,880 | 18,442 | 24,990 |
| | | 560,297 | 381,220 | 526,917 | 356,264 |
| **Non-current assets** | | | | | |
| Financial assets at fair value through profit or loss | 11 | 640 | 643 | 111 | 112 |
| Investment in subsidiaries | 15 | - | - | 1,050 | 1,050 |
| Deferred tax assets | 8 | 1,904 | 2,523 | 1,855 | 2,485 |
| Reinsurance and other recoveries receivable | 12 | 392,067 | 22,441 | 392,067 | 22,441 |
| Property, plant and equipment | 16 | 5,169 | 5,292 | 5,078 | 5,222 |
| Deferred acquisition costs | 14 | 287 | 459 | 287 | 459 |
| Intangible assets | 17 | 15,841 | 10,537 | 15,518 | 10,260 |
| Goodwill | 18 | 2,000 | 2,000 | 2,000 | 2,000 |
| | | 417,908 | 43,895 | 417,966 | 44,029 |
| **Total assets** | | 978,205 | 425,115 | 944,883 | 400,293 |
| **LIABILITIES** | | | | | |
| **Current liabilities** | | | | | |
| Trade and other payables | 19 | 61,731 | 52,012 | 30,347 | 28,005 |
| Unearned premium liabilities | 20 | 128,025 | 125,438 | 128,025 | 125,438 |
| Unearned exchange commission | 21 | 1,985 | 2,713 | 1,985 | 2,713 |
| Outstanding claims liabilities | 22 | 256,349 | 78,712 | 256,349 | 78,712 |
| Taxation payable | 8 | - | 1,159 | - | 659 |
| Provisions | 23 | 181 | 156 | 174 | 149 |
| | | 448,271 | 260,190 | 416,880 | 235,676 |
| **Non-current liabilities** | | | | | |
| Unearned premium liabilities | 20 | 1,672 | 2,302 | 1,672 | 2,302 |
| Policy liability - life | 34 | 533 | 508 | - | - |
| Outstanding claims liabilities | 22 | 422,439 | 56,578 | 422,430 | 56,578 |
| Financial guarantee contracts | 24 | 1,729 | 2,129 | 1,729 | 2,129 |
| Deferred tax liabilities | 8 | 5,293 | 7,036 | 4,977 | 7,088 |
| Provisions | 23 | 47 | 44 | 43 | 43 |
| | | 431,713 | 68,597 | 430,851 | 68,140 |
| **Total liabilities** | | 879,984 | 328,787 | 847,731 | 303,816 |
| **Net assets** | | 98,221 | 96,328 | 97,152 | 96,477 |
| **Capital and reserves attributable to the owners of the parent** | | | | | |
| Contributed equity | 25 | 83,638 | 70,009 | 83,638 | 70,009 |
| Retained earnings | | 14,583 | 26,319 | 13,514 | 26,468 |
| **Total equity** | | 98,221 | 96,328 | 97,152 | 96,477 |

For and on behalf of the Board, we authorise these financial statements for issue on 3 August 2011.

J LYON
Director

R G SCOTT
Director

*The above statement of financial position should be read in conjunction with the accompanying notes.*

LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

**Statement of Changes in Equity for the year ended 30 June 2011**

| *Consolidated* | *Notes* | *Ordinary Shares* | *Retained Earnings* | *Total ordinary shareholders' equity* |
|---|---|---|---|---|
| | | *$'000* | *$'000* | *$'000* |
| **At 1 July 2009** | | 70,009 | 16,918 | 86,927 |
| Net profit as previously reported | | - | 14,401 | 14,401 |
| Other comprehensive income | | - | - | - |
| **Total comprehensive income for the year attributable to the owners of the parent** | | - | 14,401 | 14,401 |
| Dividends | 9 | - | (5,000) | (5,000) |
| **At 30 June 2010** | | 70,009 | 26,319 | 96,328 |
| Net Profit/(Loss) for the year | | - | (11,736) | (11,736) |
| Other comprehensive income | | - | - | - |
| **Total comprehensive income for the year attributable to the owners of the parent** | | - | (11,736) | (11,736) |
| Issue of ordinary shares | 25 | 13,629 | - | 13,629 |
| Dividends | 9 | - | - | - |
| **At 30 June 2011** | | 83,638 | 14,583 | 98,221 |
| | | | | |
| *Parent* | | | | |
| **At 1 July 2009** | | 70,009 | 17,280 | 87,289 |
| Net profit as previously reported | | - | 14,188 | 14,188 |
| Other comprehensive income | | - | - | - |
| **Total comprehensive income for the year attributable to the owners of the parent** | | - | 14,188 | 14,188 |
| Dividends | 9 | - | (5,000) | (5,000) |
| **At 30 June 2010** | | 70,009 | 26,468 | 96,477 |
| Net Profit/(Loss) for the year | | - | (12,954) | (12,954) |
| Other comprehensive income | | - | - | - |
| **Total comprehensive income for the year attributable to the owners of the parent** | | - | (12,954) | (12,954) |
| Issue of ordinary shares | 25 | 13,629 | - | 13,629 |
| Dividends | 9 | - | - | - |
| **At 30 June 2011** | | 83,638 | 13,514 | 97,152 |

*The above statement of changes in equity should be read in conjunction with the accompanying notes.*

## LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

### 1. Summary of significant accounting policies

#### a) Group and its operations

Lumley General Insurance (N.Z) Limited ("the Parent") is a limited liability company incorporated and domiciled in New Zealand.

The registered office of the Parent is Level 21, Lumley Centre, 88 Shortland Street, Auckland, New Zealand. The consolidated financial statements for the year ended 30 June 2011 were authorised for issue in accordance with a resolution of the directors on 3 August 2011.

The holding company of Lumley General Insurance (N.Z.) Limited is Lumley Insurance Group Limited and the ultimate controlling entity is Wesfarmers Limited. Both companies are incorporated in Western Australia.

The nature of the operations and principal activity of the Group are general insurance underwriting, and related financing activities.

#### b) Basis of preparation

This annual financial report covers both Lumley General Insurance (N.Z.) Limited as an individual entity and the consolidated group comprising Lumley General Insurance (N.Z.) Limited and its controlled entities ("the Group") and has been prepared in accordance with generally accepted accounting practice in New Zealand and the requirements of the Companies Act 1993 and the Financial Reporting Act 1993. The Group's functional and presentation currency is NZD ($) and amounts are rounded to the nearest thousand dollars ($'000) unless otherwise stated.

The Parent and the Group are non-exempt under the Financial Reporting Act 1993.

#### c) Statement of compliance

The financial statements have been prepared in accordance with NZ GAAP. They comply with Applicable Financial Reporting Standards, applying the Framework for Differential Reporting for entities adopting the New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS"), and its interpretations as appropriate to profit-oriented entities that qualify for and apply differential reporting concessions.

The Parent and Group are qualifying entities within the Framework for Differential Reporting. The Parent and Group qualify on the basis that they are not publicly accountable and all owners are represented on the Board of Directors. The Parent and Group has taken advantage of all differential reporting concessions available to it with the exception of the following:
(i) NZ IAS 12 Income Taxes that permits qualifying entities to use the taxes payable method;
(ii) NZ IAS 16 Property, plant and equipment that permits qualifying entities to adopt the same rates of depreciation for financial reporting as for income tax purposes except when assets have been revalued in accordance with the revaluation model in NZ IAS 16;
(iii) NZ IAS 18 Revenue that permits qualifying entities to recognise revenue and expenses on a GST inclusive basis; and
(iv) NZ IAS 38 Intangible assets that permits qualifying entities to adopt the same rates of amortisation for financial reporting as for income tax purposes except when assets have been revalued in accordance with the revaluation model in NZ IAS 16.

(v) NZ IAS 21 The effect of changes in Foreign Exchange Rates that permits qualifying entities to translate foreign currency transactions at the settlement rate.

This Financial report is prepared on the historical cost basis of accounting with certain exceptions as described in accounting policies (h),(j),(k),(o),(p),(t)and (w) below.

## 1. Summary of significant accounting policies (continued)

### d) New accounting standards and interpretations

The Group has adopted the following new and amended New Zealand equivalents to International Financial Reporting Standards and interpretations as of 1 July 2010.
(i) Amendments to NZ IFRS 2 - Group Cash Settled Share Based payment transactions effective 1 January 2010
(ii) Improvements to NZ IFRS May 2009 effective 1 January 2010
(iii) Improvements to NZ IFRS May 2010 effective 1 July 2010

The adoption of the above amendments did not have any impact on the accounting policies, financial position or performance of the Parent and the Group.

The accounting policies are consistent with those of the previous financial year.

### e) Basis of consolidation

The consolidated financial statements comprise the financial statements of Lumley General Insurance (N.Z) Limited and its controlled entities as at and for the year ending 30 June each year (see note 30).

Subsidiaries are all those entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities. The existence and effect of potential voting rights that are currently exercisable or convertible when assessing whether a group controls another entity.

The financial statements of the subsidiaries are prepared for the same reporting period as the Parent company, using consistent accounting policies. In preparing the consolidated financial statements, all intercompany balances and transactions, income and expenses and profit and losses resulting from intra-group transactions have been eliminated in full.

Subsidiaries are fully consolidated from the date in which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

Investments in subsidiaries held by the Parent are accounted for at cost in the separate financial statements of the Parent entity less any impairment charges. Dividends received from the subsidiaries are recorded as a component of other revenues in the statement of comprehensive income of the Parent entity, and do not impact the recorded cost of the investment. Upon receipt of dividend payments from the subsidiaries, the Parent will assess whether any indicators of impairment of the carrying value of the investment in the subsidiary exist. Where such indicators exist, to the extent that the carrying value of investment exceeds its recoverable amount, an impairment loss is recognised.

### f) Revenue

Premium revenue comprises amounts charged to policyholders, excluding taxes and levies collected on behalf of third parties. The earned portion of premium received and receivable, including unclosed business, is recognised as revenue. Premium on unclosed business is brought to account using estimates based on the prior years' actual unclosed business with due allowance made for any changes in the pattern of new business and renewals.

Interest revenue is recognised as interest accrues using the effective interest rate method. This is a method of calculating the amortised cost of a financial asset and allocating the interest income over the relevant period using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset.

### g) Borrowing costs

Borrowing costs are recognised as expenses in the period in which they are incurred.

## 1. Summary of significant accounting policies (continued)

### h) Unearned premium

Unearned premium is calculated based on the term of the risk which closely approximates the pattern of risks underwritten.

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. If the unearned premium liability, less related intangible assets and deferred acquisition costs, is deficient, then the resulting deficiency is recognised in the income statement of the Group and Parent.

### i) Reinsurance and other recoveries

Reinsurance is an agreement between insurance companies under which one company accepts all or part of a loss or risk of the other company.

The Parent cedes insurance risk in the normal course of business. Reinsurance assets represent balances due from reinsurance companies. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsurer's policies and are in accordance with the related reinsurance contract.

Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Parent may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Parent will receive from the reinsurer. The impairment loss is recorded in the statement of comprehensive income.

The Parent also assumes reinsurance risk in the normal course of business for non-life insurance contracts where applicable. Premiums and claims are recognised as revenue or expenses in the same manner as they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. Reinsurance liabilities represent balances due to reinsurance companies. Amounts payable are estimated in a manner consistent with the related reinsurance contract.

Reinsurance and other recoveries on paid claims, reported claims not yet paid, IBNR and IBNER are recognised as revenue.

Amounts recoverable are assessed in a manner similar to the assessment of outstanding claims. Recoveries are initially measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims, and subsequently measured at amortised cost.

### j) Outstanding claims liability

The liability for outstanding claims is measured as the central estimate of the present value of expected future claims payments plus a risk margin. The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not reported ("IBNR"), claims incurred but not enough reported ("IBNER"), and estimated claims handling costs.

The expected future payments are discounted to present value using a risk free rate.

A risk margin is applied to the central estimate, net of reinsurance and other recoveries, to reflect the inherent uncertainty in the central estimate. This risk margin increases the probability that the net liability is adequate to a minimum of 85 per cent.

## 1. Summary of significant accounting policies (continued)

### k) Deferred acquisition costs

Those direct and indirect costs incurred during the financial period arising from the writing or renewing of insurance contracts are deferred to the extent that these costs are recoverable out of future premiums. All other acquisition costs are recognised as an expense when incurred.

Deferred acquisition costs are amortised over the period in which the related revenues are earned. The reinsurers' share of deferred acquisition costs is amortised in the same manner as the underlying asset amortisation is recorded in the statement of comprehensive income.

An impairment review is performed at each reporting date of more frequently when an indication of impairment arises. When the recoverable amount is less than the carrying value an impairment loss is recognised in the statement of comprehensive income. Deferred acquisition costs are considered in the liability adequacy test for each reporting period.

### l) Income tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities based on the current period's taxable income. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date.

Deferred income tax is provided on all temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- when the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or

- when the taxable temporary difference is associated with investments in subsidiaries and the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilised, except:

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or

- when the deductible temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, in which case a deferred tax asset is only recognised to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

The carrying amount of deferred income tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

**1. Summary of significant accounting policies (continued)**

**l) Income tax (continued)**

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

Deferred tax assets and deferred tax liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity and the same taxation authority.

**m) Other taxes**

Revenues, 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 acquisition of the asset or as part of the expense item as applicable; and
- 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.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

**n) Trade and other receivables**

Amounts due from policyholders and intermediaries, which generally are 30-90 day terms, are initially recognised at fair value being the amounts due. They are subsequently measured at amortised cost which is approximated by taking the initially recognised amount and reducing it for impairment as appropriate.

Collectability of trade receivables is reviewed on an ongoing basis. Individual debts that are known to be uncollectible are written off when identified. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Financial difficulties of the debtor, default payments or debts more than 90 days overdue, are considered objective evidence of impairment. The amount of the provision is the difference between the asset's carrying amount and the present value of the estimated future cash flows. The impairment charge is recognised in the statement of comprehensive income.

**o) Assets backing general insurance liabilities**

As part of its investment strategy the Group and Parent actively manages its investment portfolio to ensure that investments mature in accordance with the expected pattern of future cash flows arising from general insurance liabilities.

The Group has determined that all cash and short term deposits are held to back against general insurance liabilities therefore these assets have been valued at fair value through the statement of comprehensive income.

*Recognition*

Initial recognition is at cost in the statement of financial position and subsequent measurement is at fair value with any resultant fair value gains or losses recognised in the statement of comprehensive income.

## 1. Summary of significant accounting policies (continued)

### p) Financial assets

Financial assets in the scope of NZ IAS 39 Financial Instruments: Recognition and Measurement are categorised as either financial assets at fair value through profit and loss, loans and receivables, held to maturity investments, or available-for-sale financial assets. The classification depends on the purpose for which the assets are acquired or originated. Designation is re-evaluated at each reporting date, but there are restrictions on reclassifying to other categories. When financial assets are recognised initially, they are measured at fair value, plus, in the case of assets not at fair value through the profit and loss, directly attributable transaction costs.

**Recognition and derecognition**

All regular way purchases and sales of financial assets are recognised on the trade date i.e., the date that the group commit to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets under contracts that require delivery of the assets within the period established generally by regulation or convention in the market place. Financial assets are derecognised when the right to receive cash flows from the financial assets has expired or when the entity transfers substantially all the risks and rewards of the financial assets. If the entity neither retains nor transfers substantially all the risks and rewards, it derecognises the asset if it has transferred control of the assets.

**Subsequent measurement**

*(i) Financial assets at fair value through profit and loss*

Financial assets classified as held for trading are included in the category "financial assets at fair value through the profit and loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term with the intention of making a profit. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains and losses on financial assets held for trading are recognised in the statement of comprehensive income.

*(ii) Loans and receivables*

Loans and receivables including loan notes and loans to key management personnel are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest rate method. Gains and losses are recognised in the statement of comprehensive income when the loans and receivable are derecognised or impaired. These are included in current assets, except for those with maturities greater than 12 months after balance date, which are classified as non-current.

*iii) Impairment of financial assets*

The Group assess at each reporting date whether a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only, if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Financial assets carried at amortised cost
If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the impairment loss I measured as the difference between the carrying amount of the asset and the present value of estimated future cash flows discounted at the financial asset's current effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of loss is recognised in the statement of comprehensive income.

## 1. Summary of significant accounting policies (continued)

### q) Commission expense

Commissions paid in respect of premium funding activities are amortised over the expected life of the loan using the effective interest rate method.

Commissions paid in respect of general insurance activities are capitalised as deferred acquisition costs and are amortised systematically in accordance with the expected pattern of the incidence of risk under the general insurance contracts to which they relate.

### r) Impairment of non-financial assets

Non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Group conducts an annual internal review of asset values, which is used as a source of information to assess for any indicators of impairment. External factors, such as changes in expected future processes, technology and economic conditions, are also monitored to assess for indicators of impairment. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

An impairment loss is recognised as the amount by which the asset's carrying amount exceeds its recoverable amount. An impairment loss is recognised as the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped in cash generating units which are the lowest levels for which there are separately identifiable cash flows.

### s) Trade and other payables

Trade and other payables are carried at amortised cost and due to their short-term nature they are not discounted. The represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are unsecured and are usually paid within 30 days of recognition.

### t) Provisions

Provisions are recognised when the Group and Parent has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

When the Group and Parent expect some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of financial performance net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the risks specific to the liability.

When discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

**1. Summary of significant accounting policies (continued)**

**u) Employee entitlements**

The employee benefit costs associated with services rendered during the reporting period are recognised in the income statement. An associated liability is recognised to the extent that any amount of employee benefit remains unpaid at the statement of financial position date.

*(i) Wages, salaries and annual leave*

Liabilities for wages, salaries and annual leave expected to be settled within 12 months of the reporting date are recognised and are measured at the amounts expected to be paid when the liabilities are settled.

*(ii) Long service leave*

The liability for long service leave is recognised in the provision for employee benefits and measured as the present value to be made in respect of services provided by employees up to the reporting date. Consideration is given to salary levels and periods of service.

**v) Property, Plant and Equipment**

Property, plant and equipment is stated at cost less any accumulated depreciation and accumulated impairment losses. Such cost includes the cost of replacing parts that are eligible for capitalisation when the cost of replacing the parts is incurred.

Depreciation is calculated on a straight-line basis at rates estimated to reduce the assets to their residual value by the end

| | |
|---|---|
| Office Equipment | 5 -10 years |
| EDP Hardware | 3 years |
| Motor Vehicles | 4 years |

The assets' residual values, useful lives and amortisation methods are reviewed, and adjusted if appropriate, at each financial year end.

The carrying values of plant and equipment are reviewed for impairment at each financial year end, with recoverable amount being estimated when events or changes in circumstances indicate that carrying value may be impaired. Impairment losses are recognised in the statement of comprehensive income.

An item of plant and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset is included in the statement of comprehensive income in the year the asset is derecognised.

**w) Goodwill and Intangibles**

**Goodwill**

Goodwill acquired in a business combination is initially measured at cost of the business combination being the excess of the consideration transferred over the fair value of the Group's net identifiable assets acquired and liabilities assumed. If this consideration transferred is lower than the fair value of the net identifiable assets of the subsidiary acquired, the difference is recognised in the statement of comprehensive income.

After initial recognition, goodwill is measured at the amount recognised at acquisition date less any accumulated impairment losses.

**1. Summary of significant accounting policies (continued)**

**w) Goodwill and Intangibles (continued)**

**Goodwill (continued)**

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date allocated to each of the Group's cash-generating units or groups of cash generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for the internal management purposes.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash generating units), to which the goodwill relates. The Group performs its impairment testing whenever there is an indicator that the asset identified may be impaired.

When the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. Impairment losses recognised for goodwill are not subsequently reversed.

**Intangibles**

Intangible assets acquired separately or in a business combination are initially measured at cost. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets, excluding development costs, are not capitalised.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, which is a change in accounting estimate. The amortisation expense on intangible assets with finite lives is recognised in profit or loss in the expense category with the function of the intangible asset.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed each reporting period to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is accounted for as a change in accounting estimate and thus accounted for on a prospective basis.

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Following initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure so capitalised is amortised over the period of expected benefits from the related project.

The carrying value of an intangible asset arising from development expenditure is tested for impairment annually when the asset is not yet available for use, or more frequently when an indication of impairment arises during the reporting period.

**1. Summary of significant accounting policies (continued)**

**w) Goodwill and Intangibles (continued)**

**Intangibles (continued)**

Gains or losses arising from the derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in statement of comprehensive income when the asset is derecognised.

**x) Leases**

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement at inception date, whether fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset, even if that right is not explicitly specified in an arrangement.

*(i) Group as a lessee*

Leases in which a significant portion of the risks and benefits of ownership of the leased asset are retained by the lessor are classified as operating leases.

Operating lease payments are recognised as an operating expense in the statement of comprehensive income on a straight-line basis over the lease term. Operating lease incentives are recognised as a liability when received and subsequently reduced by allocating lease payments between rental expense and reduction of the liability.

**y) Cash and cash equivalents**

Cash and short-term deposits in the statement of financial position comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

**z) Contributed equity**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

**aa) Life Insurance**

Refer to Note 34 for Life Insurance specific accounting policies.

**ab) Financial guarantee liabilities**

Financial guarantees issued by the Group are those contracts that require payment to be made to reimburse the holder for a loss it incurs because the specific debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantee contracts are recognised initially at fair value, adjusted for transaction costs that are directly attributable to the issue of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the statement of financial position and the amount initially recognised.

## 2. Actuarial assumptions and methods

### a) Methods

Significant estimates and judgments are made by the company to arrive at certain key liability amounts disclosed in the financial statements. These estimates are determined by qualified and experienced practitioners with reference to historical data and reasoned expectations of future events. The key areas in which critical estimates and judgments are applied are described below.

The actuarial reports for the current period were prepared by Neil Christie, principal in the firm of Melville Jessup Weaver, Consulting Actuaries. Neil Christie is a Fellow of the New Zealand Society of Actuaries. The Actuary has stated that Outstanding Claims have been calculated in accordance with New Zealand Society of Actuaries Professional Standard No 4: Insurance Contracts. After making appropriate checks, the Actuary was satisfied as to the accuracy of the data from which the amount of the policy liabilities has been determined.

The life insurance accounting policies and actuarial methodologies is disclosed at Note 34.

*Central estimate outstanding claims liabilities*

The estimation of outstanding claim liabilities is based largely on the assumption that past developments are an appropriate predictor of the future and involves a variety of actuarial techniques that analyse experience, trends and other relevant factors. The process commences with the actuarial projection of the future claim payments for claims incurred up to the reporting date. Each class of business is examined separately and some or all of the following will be considered for each class in projecting future claim payments:

i) Historical trends in the incidence and development of the number of claims reported, claim payments and reported incurred costs.
ii) Exposure details, including earned premiums and policy limits.
iii) Claim frequencies and average claim sizes.
iv) The legislative framework, legal and court environments and social and economic factors that may impact upon each class of business.
v) Historical and likely future trends in standard inflationary pressures relating to commodity prices and wages.
vi) Historical and likely future trends on inflationary pressures in addition to price or wage inflation, termed superimposed inflation.
vii) Historical and likely future trends of expenses associated with managing claims to finalisation.
viii) Reinsurance recoveries available under contracts entered into by the insurer.
ix) Historical and likely future trends of recoveries from sources such as subrogation and third party actions.
x) Insurer specific, relevant industry data and more general economic data utilised in the estimation process.

Projected future claim payments are discounted to a present value as required using appropriate risk free discount rates. A projection of future claims payments, both gross and net of reinsurance and other recoveries is undertaken.

This projection is typically made without bias toward over or under estimation. As such, the resulting estimate is considered to be a central estimate of outstanding claims liabilities that has an approximately equal chance of proving adequate as not.

In selecting valuation methodologies, multiple actuarial methods were considered to project future claim payments. This assists in providing a greater understanding of the trends inherent in the past data. The most appropriate method, or even a blend of methods, is selected taking into account the characteristics of the class of business and the extent of the development of each past accident period.

**2. Actuarial assumptions and methods (continued)**

***Risk margins***

As an estimate of future outcomes, the net central estimate of outstanding claims liability is subject to uncertainty. Uncertainty is examined for each class of business and expressed as the volatility of the net central estimate. The volatility for each class was derived after consideration of stochastic modelling and benchmarking to industry analysis.

The degree of volatility of the central estimate is a function of both the size of the portfolio - fewer claims leads to greater relative volatility all else being equal - and the class of business. The long tail Liability class tends to have inherently higher volatility, partly because the longer average time to settle provides a greater opportunity for sources of uncertainty to emerge. Short tail classes such as Motor, Home and Contents and Property have lower levels of volatility, all else being equal. As the volatility for each class of business is only partially correlated with other classes, when combined across the entire company, the overall volatility will be less than the sum of the individual classes. With an estimate of the overall volatility for general insurance business, a range of risk margins associated with a probability of the total net provision for outstanding claims liabilities proving adequate may be produced.

**b) Assumptions**

The following assumptions have been made in determining net outstanding claims liabilities:

| | *2011* | *2010* |
|---|---|---|
| Discount rate (average weighted by term) | 3.22% | 3.68% |
| Weighted average term to settlement (years) | 1.32 | 1.34 |
| Discounted mean term (years) | 1.24 | 1.25 |
| Assumed net loss ratio | 20% to 300% (varies by class and loss period) | 20% to 300% (varies by class and loss period) |
| Risk margin (overall diversified) | 14.40% | 17.10% |
| Claim handling expense ratio | 4.60% | 6.00% |

**Processes used to determine assumptions**

The valuations included in the reported results are calculated using assumptions including:

***i) Discount rate***
Outstanding claims liabilities for long tail claims were discounted to present value using a risk free rate based on gross yields to maturity of NZ Govt securities of appropriate terms as at 30 June 2011.

***ii) Future settlement patterns and weighted average term to settlement***
The weighted average term to settlement is an aggregate figure for all classes of business based on expected claims development patterns which are in turn derived from an analysis of historical claims patterns.

***iii) Inflation***
Insurance costs are subject to inflationary pressures over time. For the motor and property classes, claim costs are generally related to the inflationary pressures of the materials and goods insured as well as labour costs to effect repairs. It is therefore expected that these costs will increase at a level between appropriate Consumer Price Index (CPI) indices and wage inflation. The motor and property classes use an actuarial method in which the inflation assumption is implicit and incorporated in the historical level of claim development.

The liability classes in New Zealand do not cover weekly and permanent impairment benefits (that are typically indexed). Payments are related to losses suffered by claimants, although legal costs are subject to increases in the wages and disbursements of professionals in that field. The liability class uses an actuarial method in which the inflation assumption is implicit and incorporated in the historical level of claim development.

**2. Actuarial assumptions and methods (continued)**

***iv) Assumed loss ratios***

Assumed loss ratios were determined from a consideration of observed loss ratios for historical loss quarters, discussions with Lumley New Zealand portfolio managers and recent loss ratios in the Insurance Council of New Zealand quarterly report for the relevant class.

***v) Risk margin***

The overall risk margin is determined allowing for diversification between classes of business. The assumptions regarding uncertainty for each class are applied to the net central estimates and the results are aggregated, allowing for diversification, in order to arrive at an overall net provision that is intended to provide a probability of adequacy of 85 per cent.

***vi) Expense allowance***

An estimate of outstanding claims liabilities will typically incorporate an allowance for the future cost of administering the claims. This allowance was based on a company analysis of claim related expenses.

**c) Sensitivity**

The table below sets out the impact on the value of the net of reinsurance, net of non-reinsurance outstanding claims liabilities of variation in key assumptions. This illustrates exposure to the risk of changes in the underlying assumptions and experience.

| Variable<br>Recognised amounts per the financial statements | Movement in Variable | Net outstanding claims liabilities Increase/ (Decrease)<br>$ 000's |
|---|---|---|
| Discount rate | +2% | (1,616) |
| Discount rate | +1% | (819) |
| Discount rate | -1% | 840 |
| Discount rate | -2% | 1,703 |
| Assumed net loss ratio | +10 percentage points | 2,646 |
| Assumed net loss ratio | -10 percentage points | (2,646) |
| Claims handling expense ratio | +1% | 907 |
| Claims handling expense ratio | -1% | (907) |

An increase/(decrease) in net outstanding claims liability will result in a corresponding decrease/(increase) of the same amount in the statement of comprehensive income.

**d) Ultimate loss ratio**

This is the ratio of incurred losses to earned premium (both net of reinsurance) inherent in the actual experience to date plus outstanding payments. The overall ultimate loss ratios for the most recent years (to 30 June in each case) are:

| 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|
| 68.38% | 57.13% | 62.67% | 73.50% | 61.60% |

## 2. Actuarial assumptions and methods (continued)

**e) Earthquake uncertainty**
Estimation of outstanding claims and premium liabilities always contains an element of uncertainty. This is the nature of insurance and is to be expected. Usually, there is a reasonably stable and widespread portfolio of business and a body of claims history available so that estimates can be based on analyses of past experience.

However, there is no suitable body of claims experience available in relation to the development of claims arising from a severe earthquake affecting a modern city in New Zealand, such as the series of earthquakes affecting Canterbury and Christchurch during the year. There are many special circumstances applying that create an increased level of uncertainty in regard to the valuation of the gross cost of earthquake claims including:

- The relatively short claims development period to date - only a very small fraction of total claims have been paid, especially when compared to the likely timeframe to settle all claims.
- The lack of access to commercial buildings in the CBD "Red Zone" hindering assessment and demolition or repair.
- The interaction with EQC on the overall claims costs for domestic property claims.
- Special land-related issues, including treatment of the "special interest areas" (Red Zone/Orange Zone), and
- The building codes and other requirements to be complied with and the demands that will be placed on the construction industry's material and labour supplies when rebuilding gets underway.

In response to these special circumstances, considerable additional data was obtained and analysed, and the valuation methodologies and assumptions were adopted to mitigate, as far as possible, these additional sources of uncertainty.

## 3. Insurance contracts - risk management policies and procedures

The financial condition and operation of the Group and Parent are affected by a number of key risks including insurance risk, interest rate risk, currency risk, credit risk, market risk, liquidity risk, financial risk, compliance risk, fiscal risk and operational risk. The Group and Parent's policies and procedures in respect of managing these risks are set out in this note.

**a) Objectives in managing risks arising from insurance contracts and policies for mitigating those risks.**

The Group has an objective to control insurance risk thus reducing the volatility of operating profits. In addition to the inherent uncertainty of insurance risk, which can lead to significant variability in the loss experience, profits from insurance business are affected by market factors, particularly competition and movements in asset values. Short term variability is, to some extent, a feature of insurance business.

In accordance with Prudential Standards GPS 220 *Risk Management for General Insurers* and GPS 230 *Reinsurance Arrangements for General Insurers* issued by the Australian Prudential Regulation Authority (APRA), the Board and senior management of the Group have developed, implemented and maintain a sound and prudent Risk Management Strategy (RMS) and a Reinsurance Management Strategy (REMS), although there is no legislative necessity for the Group to adopt those standards.

The RMS and REMS identify the Group's policies and procedures, processes and controls that comprise its risk management and control systems. These systems address all material risks, financial and non-financial, likely to be faced by the Group.

The RMS and REMS have been approved by the Board. Key aspects of the processes established in the RMS to mitigate risks include:

i) The maintenance and use of sophisticated management information systems, which provide up to date, reliable data on the risks to which the business is exposed at any point in time.
ii) The use of actuarial models based on historical data to calculate premiums and monitor claims patterns.
iii) The setting and adherence to underwriting guidelines that determine policies and procedures for acceptance of risk.

**3. Insurance contracts - risk management policies and procedures (continued)**

**a) Objectives in managing risks arising from insurance contracts and policies for mitigating those risks (continued).**

iv) The monitoring of natural disasters such as earthquakes, floods, storms and other catastrophes. Exposure to such risks is monitored using catastrophe models.

v) The use of reinsurance to limit the Group's exposure to large single claims and accumulation of claims that arise from the same event.

vi) The monitoring of a reinsurers' credit risk policy to control exposure to reinsurance counterparty default.

vii) The management of assets and liabilities is closely monitored to attempt to match the expected pattern of claims payments with the maturity dates of assets.

viii) The reduction in variability in loss experience through diversification over classes of insurance business and geographical segments.

**b) Terms and conditions of insurance business**

The terms and conditions attaching to insurance contracts affect the level of insurance risk accepted by the Group. The majority of direct insurance contracts written are entered into on a standard form. There are no special terms and conditions in any non standard contracts that have a material impact on the financial statements.

**c) Concentration of insurance risk**

The Group's exposure is diversified across classes of business with risk spread across New Zealand. Specific processes for monitoring identified concentrations are set below:

| Risk | Source of concentration | Risk management measures |
|---|---|---|
| An accumulation of risks arising from a natural peril | Insured property concentrations | Accumulation risk modelling, reinsurance protection |
| A large property loss | Fire or collapse affecting one building or a group of adjacent buildings | Maximum acceptance limits, property risk grading, reinsurance protection |
| Inclusion of multiple classes of casualty business in the one event | Response by a multitude of the Group's policies to the one event, for example a construction liability and professional indemnity policy | Purchase of reinsurance clash cover |

**d) Financial Risk**

i. Interest rate risk

The Group is exposed to interest rate risk arising on interest bearing assets. The Group manages some of its exposure to this risk by holding the majority of such assets on short term maturities.

ii. Credit risk

The credit risk on financial assets of the Group is generally the carrying amount, net of any provisions for doubtful debts. Credit risk exposures are calculated regularly and compared to authorised credit limits before further transactions are undertaken with each counterparty. The Group does not expect any counterparties to fail to meet their obligations. In some instances collateral is required to support credit risk exposures.

iii. Market risk

The Group is exposed to market risk including fair value, interest risk and price risk. Market risks arise from open positions in interest rate products which are exposed to general and specific market movements. The market risks that the Group primarily faces are interest rate risk, due to the nature of its investments and liabilities.

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

**3. Insurance contracts - risk management policies and procedures (continued)**

**d) Financial Risk (continued)**

iv. Liquidity risk

The Group is exposed to daily calls on its available cash resources from policy claims. Liquidity risk is the risk that payment of obligations may not be met in a timely manner at a reasonable cost. The Group manages this risk by holding its investment portfolio in short term, interest bearing securities, which can be liquidated at short notice.

**e) Reinsurance Counterparty Risk**

The Parent reinsures a portion of risks underwritten to control exposure to insurance losses, reduce volatility and protect capital. The Parent's strategy in respect of the selection, approval and monitoring of reinsurance arrangements is addressed by the following protocols:

• Treaty or facultative reinsurance is placed in accordance with the requirements of the Parent's reinsurance management strategy.

• Reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical losses and potential future losses based on the Parent's Maximum Event Retention (MER).

• Exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

Strict controls are maintained over reinsurance counterparty exposures. Reinsurance is placed with counterparties that have a strong credit rating. Credit risk exposures are calculated regularly and ratings are reviewed by management on a regular basis.

LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 4. Revenue

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| *Life Insurance Activities* | | | | |
| Gross written premium | | | | |
| Direct | 1,400 | 1,574 | - | - |
| Unearned premium movement | (24) | 78 | - | - |
| **Gross earned premium revenue** | 1,376 | 1,652 | - | - |
| Outward reinsurance premium expense | - | - | - | - |
| **Net earned premium revenue** | 1,376 | 1,652 | - | - |
| *General Insurance Activities* | | | | |
| Gross written premium | | | | |
| Direct | 345,819 | 330,699 | 345,819 | 330,698 |
| Unearned premium movement | (2,122) | (3,317) | (2,122) | (3,318) |
| **Gross earned premium revenue** | 343,697 | 327,382 | 343,697 | 327,380 |
| Outward reinsurance premium expense | (59,160) | (53,657) | (59,160) | (53,657) |
| **Net earned premium revenue** | 284,537 | 273,725 | 284,537 | 273,723 |
| **Total gross earned premium revenue** | 345,073 | 329,033 | 343,697 | 327,380 |
| Total outward reinsurance premium expense | (59,160) | (53,657) | (59,160) | (53,657) |
| **Total net earned premium revenue** | 285,913 | 275,376 | 284,537 | 273,723 |
| Gross earned premium revenue | 345,073 | 329,033 | 343,697 | 327,380 |
| Investment income | 9,144 | 7,135 | 10,802 | 9,406 |
| Dividend income | - | - | 400 | 1,548 |
| Other income | 2,092 | 1,879 | 2,092 | 1,457 |
| Income from premium funding activities | 9,645 | 9,063 | - | - |
| **Total gross revenue** | 365,954 | 345,459 | 356,991 | 339,791 |

LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 5. Net claims incurred

| *Consolidated* | *2011* Risk bourne Current Year $000's | *2011* Risk bourne Prior Year $000's | *2011* Risk bourne Total $000's | *2010* Risk bourne Current Year $000's | *2010* Risk bourne Prior Year $000's | *2010* Risk bourne Total $000's |
|---|---|---|---|---|---|---|
| **Gross claims expense** | | | | | | |
| Gross claims incurred – undiscounted | 808,589 | (10,628) | 797,961 | 165,015 | 28,340 | 193,355 |
| Discount movement | - | - | - | (2,553) | - | (2,553) |
| | 808,589 | (10,628) | 797,961 | 162,462 | 28,340 | 190,802 |
| Reinsurance and other recoveries revenue | (605,080) | 1,785 | (603,295) | (29,092) | (5,253) | (34,345) |
| **Net claims incurred** | 203,509 | (8,843) | 194,666 | 133,370 | 23,087 | 156,457 |

| *Parent* | *2011* Risk bourne Current Year $000's | *2011* Risk bourne Prior Year $000's | *2011* Risk bourne Total $000's | *2010* Risk bourne Current Year $000's | *2010* Risk bourne Prior Year $000's | *2010* Risk bourne Total $000's |
|---|---|---|---|---|---|---|
| **Gross claims expense** | | | | | | |
| Gross claims incurred – undiscounted | 808,426 | (10,628) | 797,798 | 164,931 | 28,340 | 193,271 |
| Discount movement | - | - | - | (2,553) | - | (2,553) |
| | 808,426 | (10,628) | 797,798 | 162,378 | 28,340 | 190,718 |
| Reinsurance and other recoveries revenue - undiscounted | (605,080) | 1,785 | (603,295) | (29,092) | (5,253) | (34,345) |
| **Net claims incurred** | 203,346 | (8,843) | 194,503 | 133,286 | 23,087 | 156,373 |

Current year amounts relate to risks borne in the current financial year. Prior period amounts relate to a reassessment of the risks borne in all previous financial years.

Consolidated figures include the above parent figures and life policy gross claims expense of $162,543 (2010: $83,952). All life policy claims expense are current year and there are no reinsurance recoveries.

## 6. Unexpired risk liability

The Liability Adequacy Test ("LAT") has resulted in a write off to Deferred Acquistion Costs during the year of $7,492,472, which was due to the portfolio being in deficit (2010: nil).

The basis of estimation for the unexpired risk liability has not changed from the previous year. The liabilities have been grouped together to assess the unexpired risk liability.

The process of determining the overall risk margin, including the way in which diversification of risk has been allowed for, is discussed in Note 3. The overall risk margin is intended to achieve a 75 per cent probability of adequacy.

**The results of the LAT are as follows (Parent only):**

| | *2011* *$'000* |
|---|---|
| Gross unearned premium liabilities | 129,697 |
| Unearned premium - reinsurers | (12,694) |
| Net unearned premium liabilities | 117,003 |
| | |
| Acquisition costs deferred | (26,183) |
| Unearned exchange commission | 1,985 |
| Total net unearned premium liabilities | 92,805 |
| | |
| Gross discounted premium liabilities | 113,529 |
| Discounted reinsurance recoveries | (8,261) |
| Discounted non-reinsurance recoveries | (4,971) |
| Total discounted premium liabilities | 100,297 |
| | |
| **Deficiency** | (7,492) |

## 7. Underwriting and other operating expenses

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* *$'000* | *2010* *$'000* | *2011* *$'000* | *2010* *$'000* |
| **Expenses by function** | | | | |
| Acquisition costs | 83,073 | 81,647 | 82,031 | 80,262 |
| Other underwriting expenses including claims management expenses | 29,439 | 25,088 | 29,234 | 24,899 |
| Other operating expenses | 10,314 | 10,386 | 4,209 | 5,137 |
| **Total expenses** | 122,826 | 117,121 | 115,474 | 110,298 |
| | | | | |
| **Expenses by nature** | | | | |
| Depreciation & amortisation | 4,123 | 3,467 | 4,013 | 3,451 |
| Wages, salaries & other employee entitlements | 40,503 | 36,927 | 39,620 | 36,088 |
| Kiwisaver and superannuation | 1,692 | 1,663 | 1,648 | 1,621 |
| Bad and doubtful debts | (611) | (685) | (611) | (685) |
| Operating lease and rentals | 4,371 | 4,631 | 4,235 | 4,459 |
| Net commission | 53,656 | 54,909 | 47,886 | 49,959 |
| Advertising costs | 1,194 | 1,670 | 1,178 | 1,658 |
| Share based payments | 935 | 902 | 935 | 902 |
| Other expenses | 16,963 | 13,637 | 16,570 | 12,845 |
| **Total expenses** | 122,826 | 117,121 | 115,474 | 110,298 |

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 8. Income tax

### a) Income tax expenses

| The major components of income tax expense are: | Consolidated | | Parent | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| **Income Statement** | | | | |
| *Current income tax* | | | | |
| Current income tax charge | 4,584 | (4,619) | 4,816 | (4,466) |
| Adjustments in respect of current income tax of previous years | 379 | 47 | 387 | 41 |
| Change in Income tax rates on Deferred Tax | 226 | | 225 | |
| *Deferred income tax* | | | | |
| Relating to origination and reversal of temporary differences | 894 | (875) | 1,256 | (850) |
| **Income tax expense reported in the statement of comprehensive income** | 6,083 | (5,447) | 6,684 | (5,275) |
| **Movement in tax reserves reported in the statement of comprehensive income.** | 371 | (27) | - | - |

The movement in tax reserves reported in the statement of comprehensive income relates to the Life Insurance portfolio.

b) A reconciliation between tax expense and the product of accounting profit before income tax multiplied by the Parent's applicable tax rate is as follows:

| | Consolidated | | Parent | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Accounting profit before tax | (18,190) | 19,875 | (19,638) | 19,463 |
| Tax charge at the standard tax rate of 30% (2010: 30%) | 5,457 | (5,962) | 5,892 | (5,839) |
| Tax effect of non-deductible expenses | (179) | 38 | (172) | 59 |
| Adjustments in respect of Life Insurance portfolio | - | 436 | - | - |
| Adjustment for permanent differences | 200 | | 352 | - |
| Adjustment for non taxable income | - | - | - | 464 |
| Adjustments in respect of current income tax of previous years | 379 | 41 | 387 | 41 |
| Change in Income tax rates on Deferred Tax | 226 | | 225 | |
| **Income tax expense** | 6,083 | (5,447) | 6,684 | (5,275) |

LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

**8. Income tax (continued)**

**Recognised deferred tax assets and liabilities**

*Consolidated*

| | *2011* | | *2010* | |
|---|---|---|---|---|
| | *Current income tax* | *Deferred income tax* | *Current income tax* | *Deferred income tax* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Opening balance | (239) | (4,513) | 1,861 | (1,193) |
| Charged to profit or loss | 4,584 | 1,124 | (4,572) | (3,320) |
| Taxation payments | 2,206 | | 2,472 | |
| Closing balance | 6,551 | (3,389) | (239) | (4,513) |
| | | | | |
| Total charged to profit or loss | | 5,708 | | (7,892) |
| Other adjustments | | 375 | | 2,445 |
| Tax expense in statement of comprehensive income | | 6,083 | | (5,447) |
| | | | | |
| Amounts recognised in the statement of financial position: | | | | |
| Deferred tax asset | | 1,904 | | 2,523 |
| Deferred tax liability | | (5,293) | | (7,036) |
| | | (3,389) | | (4,513) |
| | | | | |
| Income tax receivable | | 7,270 | | 920 |
| Income tax payable | | (719) | | (1,159) |
| | | 6,551 | | (239) |

*Parent*

| | *2011* | | *2010* | |
|---|---|---|---|---|
| | *Current income tax* | *Deferred income tax* | *Current income tax* | *Deferred income tax* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Opening balance | (659) | (4,603) | 2,436 | (1,310) |
| Charged to profit or loss | 4,816 | 1,481 | (4,572) | (3,293) |
| Other payments | 2,338 | | 1,477 | |
| Closing balance | 6,495 | (3,122) | (659) | (4,603) |
| | | | | |
| Total charged to profit or loss | | 6,297 | | (7,865) |
| Other adjustments | | 387 | | 2,590 |
| Tax expense in statement of comprehensive income | | 6,684 | | (5,275) |
| | | | | |
| Amounts recognised in the statement of financial position: | | | | |
| Deferred tax asset | | 1,855 | | 2,485 |
| Deferred tax liability | | (4,977) | | (7,088) |
| | | (3,122) | | (4,603) |
| | | | | |
| Income tax receivable | | 6,495 | | - |
| Income tax payable | | - | | (659) |
| | | 6,495 | | (659) |

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

**8. Income tax (continued)**

**Recognised deferred tax assets and liabilities (continued)**

Deferred income tax at 30 June relates to the following:

| *Consolidated* | *Statement of Financial Position* | |
|---|---|---|
| | *2011* | *2010* |
| | *\$'000* | *\$'000* |
| *Deferred tax assets* | | |
| Employee benefits | 1,384 | 2,466 |
| Provision for impairment and accruals | 520 | 57 |
| | 1,904 | 2,523 |
| *Deferred tax liabilities* | | |
| Deferred acquisition costs | 3,731 | 6,189 |
| Prepaid Commission | 165 | - |
| Lumley Life Limited adjustment | 336 | - |
| Temporary differences between depreciation for tax and accounting purposes | 1,061 | 847 |
| | 5,293 | 7,036 |
| **Net Deferred Tax Liability** | (3,389) | (4,513) |

| *Parent* | *Statement of Financial Position* | |
|---|---|---|
| | *2011* | *2010* |
| | *\$'000* | *\$'000* |
| *Deferred tax assets* | | |
| Employee benefits | 1,335 | 2,428 |
| Provision for impairment and accruals | 520 | 57 |
| | 1,855 | 2,485 |
| *Deferred tax liabilities* | | |
| Deferred acquisition costs | 3,938 | 6,240 |
| Temporary differences between depreciation for tax and accounting purposes | 1,039 | 848 |
| | 4,977 | 7,088 |
| **Net Deferred Tax Liability** | (3,122) | (4,603) |

## 9. Dividends paid and proposed

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| **a) Declared and paid during the year** | | | | |
| Dividends on ordinary shares | - | 5,000 | - | 5,000 |
| Supplementary dividends paid | - | - | - | - |
| Total imputed dividend | - | 5,000 | - | 5,000 |
| Cents per share | - | 5.26 | - | 5.26 |

**b) Imputation credit account (Parent only)**

| | 2011 | 2010 |
|---|---|---|
| Balance brought forward | (2,877) | - |
| Imputation credits attached to dividends paid during the year | - | (2,143) |
| Income tax payments during the year | 2,271 | 3,772 |
| Refund of tax payments during the year | (812) | (4,506) |
| Transfers (to)/from Trans-Tasman Imputation Group | - | - |
| Balance carried forward | (1,418) | (2,877) |

## 10. Trade and other receivables

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| **General insurance** | | | | |
| Premium due from policyholders and intermediaries | 68,474 | 75,828 | 68,474 | 75,828 |
| Amounts due from reinsurers | 14,034 | 5,615 | 14,034 | 5,615 |
| | 82,508 | 81,443 | 82,508 | 81,443 |
| **Other receivables** | | | | |
| Related party receivables (refer to Note 30) | 14,550 | - | 41,680 | 30,678 |
| Accrued interest | 9 | 9 | 1 | 2 |
| Other | 2,808 | 1,700 | 2,798 | 1,692 |
| | 17,367 | 1,709 | 44,479 | 32,372 |
| **Total Current Trade and Other** | 99,875 | 83,152 | 126,987 | 113,815 |

Trade receivables are non-interest bearing and are generally on 30-90 day terms. An allowance for doubtful debts is made when there is evidence that a trade receivable is impaired.

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 11. Financial assets

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| **a) Financial assets** | | | | |
| **i) Financial assets - loans and receivables** | | | | |
| Debt securities | 57,728 | 51,626 | - | - |
| **Total current financial assets – loans and receivables** | 57,728 | 51,626 | - | - |
| **ii) Financial assets - funds held with related party** | | | | |
| Cash deposits with related party (refer to Note 30) | 178,556 | 171,558 | 178,556 | 171,558 |
| **Total current financial assets – funds held with related party** | 178,556 | 171,558 | 178,556 | 171,558 |
| **iii) Financial assets - at fair value through profit or loss** | | | | |
| Government stock | 640 | 643 | 111 | 112 |
| **Total financial assets – at fair value through profit or loss** | 640 | 643 | 111 | 112 |
| Current | - | - | - | - |
| Non-current | 640 | 643 | 111 | 112 |
| Total | 640 | 643 | 111 | 112 |

**b) Interest rate risk**

The Group and Parent's exposure to interest rate risk and the effective weighted average interest rate by maturity periods is set out in the following table:

*Consolidated & Parent*

| | *< 1 year* | *Total* | *Weighted Average Interest Rate* |
|---|---|---|---|
| | *$'000* | *$'000* | *%* |
| *2011* | | | |
| **Fixed rate** | | | |
| Cash deposits with related party | 178,556 | 178,556 | 4.9% |
| *Weighted average effective interest rate* | 4.9% | | |
| *2010* | | | |
| **Fixed rate** | | | |
| Cash deposits with related party | 171,558 | 171,558 | 3.9% |
| *Weighted average effective interest rate* | 3.9% | | |

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 12. Reinsurance and other recoveries

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Other recoveries | 11,780 | 11,047 | 11,780 | 11,047 |
| Expected outstanding reinsurance and other recoveries | 591,592 | 36,359 | 591,592 | 36,359 |
| Discount to present value | (32,555) | (2,209) | (32,555) | (2,209) |
| Total outstanding reinsurance and other recoveries | 570,817 | 45,197 | 570,817 | 45,197 |
| Current | 178,750 | 22,756 | 178,750 | 22,756 |
| Non-current | 392,067 | 22,441 | 392,067 | 22,441 |
| Total outstanding reinsurance and other recoveries | 570,817 | 45,197 | 570,817 | 45,197 |

## 13. Prepaid reinsurance premiums

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| **Prepaid reinsurance premium asset as at 1 July** | 13,993 | 16,635 | 13,993 | 16,635 |
| Deferral of reinsurance premiums on contracts entered into in the period | 12,656 | 13,993 | 12,656 | 13,993 |
| Earning of reinsurance premiums on contracts entered into in previous periods | (13,993) | (16,635) | (13,993) | (16,635) |
| **Prepaid reinsurance premium asset as at 30 June** | 12,656 | 13,993 | 12,656 | 13,993 |

## 14. Deferred acquisition costs

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| **Prepaid acquisitions costs as at 1 July** | 25,339 | 24,038 | 25,449 | 24,220 |
| Acquisition costs deferred | 26,182 | 25,339 | 26,221 | 25,449 |
| Amortisation charged to income | (25,339) | (24,038) | (25,449) | (24,220) |
| Write down for premium deficiency (Note 6) | (7,492) | - | (7,492) | - |
| **Deferred acquisitions costs as at 30 June** | 18,690 | 25,339 | 18,729 | 25,449 |
| Current | 18,403 | 24,880 | 18,442 | 24,990 |
| Non-current | 287 | 459 | 287 | 459 |
| **Total** | 18,690 | 25,339 | 18,729 | 25,449 |

## 15. Investments in subsidiaries

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Investments in controlled entities (Note 30) - at cost | - | - | 1,050 | 1,050 |

Lumley General Insurance (N.Z.) Limited has elected to recognise its investments in its subsidiaries at cost.

*Amalgamation of controlled entities*

On 14 June 2011, Lumley Services (N.Z.) Limited, which was a wholly owned and controlled entity of the Parent, was amalgamated with Lumley Finance (N.Z.) Limited, a wholly owned and controlled entity of the Parent, with Lumley Finance (N.Z.) Limited continuing as the amalgamated company.

## 16. Property, plant and equipment

| *Consolidated* | *EDP Hardware* *$'000* | *Office Equipment* *$'000* | *Motor Vehicles* *$'000* | *Total* *$'000* |
|---|---|---|---|---|
| **Year ended 30 June 2011** | | | | |
| At 1 July 2010 net of accumulated depreciation | 834 | 3,745 | 713 | 5,292 |
| Additions | 851 | 238 | 1,057 | 2,146 |
| Disposals | (7) | (140) | (605) | (752) |
| Depreciation charge for the year | (517) | (776) | (224) | (1,517) |
| At 30 June 2011 net of accumulated depreciation | 1,161 | 3,067 | 941 | 5,169 |
| **At 1 July 2010** | | | | |
| Cost | 1,629 | 7,582 | 827 | 10,038 |
| Accumulated depreciation | (795) | (3,837) | (114) | (4,746) |
| Net carrying amount | 834 | 3,745 | 713 | 5,292 |
| **At 30 June 2011** | | | | |
| Cost | 2,465 | 7,418 | 1,092 | 10,975 |
| Accumulated depreciation | (1,304) | (4,351) | (151) | (5,806) |
| Net carrying amount | 1,161 | 3,067 | 941 | 5,169 |
| **Year ended 30 June 2010** | | | | |
| At 1 July 2009 net of accumulated depreciation | 692 | 4,642 | 363 | 5,697 |
| Additions | 647 | 82 | 923 | 1,652 |
| Disposals | (19) | 1 | (439) | (457) |
| Depreciation charge for the year | (486) | (980) | (134) | (1,600) |
| At 30 June 2010 net of accumulated depreciation | 834 | 3,745 | 713 | 5,292 |
| **At 1 July 2009** | | | | |
| Cost | 5,419 | 7,991 | 484 | 13,894 |
| Accumulated depreciation | (4,727) | (3,349) | (121) | (8,197) |
| Net carrying amount | 692 | 4,642 | 363 | 5,697 |
| **At 30 June 2010** | | | | |
| Cost | 1,629 | 7,582 | 827 | 10,038 |
| Accumulated depreciation | (795) | (3,837) | (114) | (4,746) |
| Net carrying amount | 834 | 3,745 | 713 | 5,292 |

## 16. Property, plant and equipment (continued)

| *Parent* | *EDP Hardware $'000* | *Office Equipment $'000* | *Motor Vehicles $'000* | *Total $'000* |
|---|---|---|---|---|
| **Year ended 30 June 2011** | | | | |
| At 1 July 2010 net of accumulated depreciation | 834 | 3,745 | 643 | 5,222 |
| Additions | 848 | 238 | 978 | 2,064 |
| Disposals | (7) | (139) | (557) | (703) |
| Depreciation charge for the year | (518) | (776) | (211) | (1,505) |
| At 30 June 2011 net of accumulated depreciation | 1,157 | 3,068 | 853 | 5,078 |
| **At 1 July 2010** | | | | |
| Cost | 1,581 | 7,578 | 746 | 9,905 |
| Accumulated depreciation | (747) | (3,833) | (103) | (4,683) |
| Net carrying amount | 834 | 3,745 | 643 | 5,222 |
| **At 30 June 2011** | | | | |
| Cost | 2,412 | 7,416 | 979 | 10,807 |
| Accumulated depreciation | (1,255) | (4,348) | (126) | (5,729) |
| Net carrying amount | 1,157 | 3,068 | 853 | 5,078 |
| **Year ended 30 June 2010** | | | | |
| At 1 July 2009 net of accumulated depreciation | 687 | 4,642 | 363 | 5,692 |
| Additions | 647 | 82 | 843 | 1,572 |
| Disposals | (17) | 1 | (439) | (455) |
| Depreciation charge for the year | (483) | (980) | (124) | (1,587) |
| At 30 June 2010 net of accumulated depreciation | 834 | 3,745 | 643 | 5,222 |
| **At 1 July 2009** | | | | |
| Cost | 5,367 | 7,988 | 484 | 13,839 |
| Accumulated depreciation | (4,680) | (3,346) | (121) | (8,147) |
| Net carrying amount | 687 | 4,642 | 363 | 5,692 |
| **At 30 June 2010** | | | | |
| Cost | 1,581 | 7,578 | 746 | 9,905 |
| Accumulated depreciation | (747) | (3,833) | (103) | (4,683) |
| Net carrying amount | 834 | 3,745 | 643 | 5,222 |

Property, plant and equipment have not been pledged as security over any liabilities of the Group and have not been designated as assets backing insurance liabilities.

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 17. Intangible assets

| | *Consolidated* | | | *Parent* | | |
|---|---|---|---|---|---|---|
| | *Software $'000* | *Work In Progress $'000* | *Total $'000* | *Software $'000* | *Work in Progress $'000* | *Total $'000* |
| **Year ended 30 June 2011** | | | | | | |
| At 1 July 2010 net of accumulated amortisation | 5,110 | 5,427 | **10,537** | 5,109 | 5,151 | **10,260** |
| Additions – internal development | 11,046 | 7,712 | **18,758** | 11,046 | 7,569 | **18,615** |
| Transfers from WIP | (19) | (10,829) | **(10,848)** | (20) | (10,829) | **(10,849)** |
| Amortisation charge for the year | (2,509) | (97) | **(2,606)** | (2,508) | - | **(2,508)** |
| At 30 June 2011 net of accumulated amortisation | 13,628 | 2,213 | **15,841** | 13,627 | 1,891 | **15,518** |
| **At 1 July 2010** | | | | | | |
| Cost (gross carrying amount) | 8,972 | 5,482 | **14,454** | 8,897 | 5,151 | **14,048** |
| Accumulated amortisation | (3,862) | (55) | **(3,917)** | (3,788) | - | **(3,788)** |
| Net carrying amount | 5,110 | 5,427 | **10,537** | 5,109 | 5,151 | **10,260** |
| **At 30 June 2011** | | | | | | |
| Cost (gross carrying amount) | 19,990 | 2,365 | **22,355** | 19,914 | 1,891 | **21,805** |
| Accumulated amortisation | (6,362) | (152) | **(6,514)** | (6,287) | - | **(6,287)** |
| Net carrying amount | 13,628 | 2,213 | **15,841** | 13,627 | 1,891 | **15,518** |
| **Year ended 30 June 2010** | | | | | | |
| At 1 July 2009 net of accumulated amortisation | 4,354 | 1,684 | **6,038** | 4,350 | 1,508 | **5,858** |
| Additions – internal development | 743 | 5,623 | **6,366** | 743 | 5,523 | **6,266** |
| Transfers from WIP | 1,880 | (1,880) | **-** | 1,880 | (1,880) | **-** |
| Amortisation charge for the year | (1,867) | - | **(1,867)** | (1,864) | - | **(1,864)** |
| At 30 June 2010 net of accumulated amortisation | 5,110 | 5,427 | **10,537** | 5,109 | 5,151 | **10,260** |
| **At 1 July 2009** | | | | | | |
| Cost (gross carrying amount) | 13,823 | 1,684 | **15,507** | 13,693 | 1,508 | **15,201** |
| Accumulated amortisation | (9,469) | - | **(9,469)** | (9,343) | - | **(9,343)** |
| Net carrying amount | 4,354 | 1,684 | **6,038** | 4,350 | 1,508 | **5,858** |
| **At 30 June 2010** | | | | | | |
| Cost (gross carrying amount) | 8,972 | 5,482 | **14,454** | 8,897 | 5,151 | **14,048** |
| Accumulated amortisation | (3,862) | (55) | **(3,917)** | (3,788) | - | **(3,788)** |
| Net carrying amount | 5,110 | 5,427 | **10,537** | 5,109 | 5,151 | **10,260** |

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

### 17. Intangible assets (continued)

*(i) Software*

Software is made up of internally generated software development from various development projects and third party license fees. Software development is amortised over its expected useful life which varies between 3 and 5 years.

| Internally generated software included in this figure is listed below as follows: | *Consolidated and Parent* 2011 $'000 | 2010 $'000 |
|---|---|---|
| Cost | 16,838 | 6,349 |
| Accummulated amortisation | (4,036) | (1,935) |
| Net book value | 12,802 | 4,414 |

*(ii) Work in progress*

Work in progress relates to internal generated software development. Once operational the software development will be amortised over its useful life of between 3 and 5 years.

### 18. Goodwill

On 1 December 2009, Lumley General Insurance (N.Z.) Limited acquired the business of Australis Underwriting Agency Limited.("Australis"), an unlisted public company based in New Zealand.

At the date of acquisition Australis Underwriting Agency was the agent for the Marine business of Lumley General Insurance (N.Z.) Limited.

After initial recognition, goodwill recognised through the acquisition of Australis is measured at cost less any accumulated impairment losses. Goodwill is not amortised but is subject to impairment testing whenever there is an indication of impairment. For the purpose of impairment goodwill is allocated to the Lumley General Insurance (N.Z.) Limited cash-generating-unit.

**Reconciliation of carrying amounts at the beginning and end of the period**

| | *Consolidated* 2011 $'000 | 2010 $'000 | *Parent* 2011 $'000 | 2010 $'000 |
|---|---|---|---|---|
| Carrying amount at 1 July | 2,000 | - | 2,000 | - |
| Cost - acquisition | - | 2,000 | - | 2,000 |
| Carrying amount at 30 June | 2,000 | 2,000 | 2,000 | 2,000 |

There has been no impairment of Goodwill during the current year (2010: $Nil).

LUMLEY GENERAL INSURANCE (N.Z.) LIMITED AND CONTROLLED ENTITIES

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 19. Trade and other payables

| | | *Consolidated* | | *Parent* | |
|---|---|---|---|---|---|
| | | *2011* | *2010* | *2011* | *2010* |
| | *Note* | *$'000* | *$'000* | *$'000* | *$'000* |
| Trade creditors | (i) | 34,740 | 28,275 | 6,815 | 7,753 |
| Amounts due to reinsurers | | 8,080 | 5,470 | 8,080 | 5,470 |
| Unearned interest income | | 2,821 | 2,487 | - | - |
| Other payables | | 14,606 | 15,166 | 13,968 | 14,168 |
| | | 60,247 | 51,398 | 28,863 | 27,391 |
| Related party payables (refer to Note 30) | | 1,484 | 614 | 1,484 | 614 |
| Total trade and other payables | | 61,731 | 52,012 | 30,347 | 28,005 |

Notes:
(i) Trade creditors are non-interest bearing and are normally settled on 30 day terms.

## 20. Unearned premium liabilities

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| **Unearned premium liabilities as at 1 July** | 127,740 | 125,604 | 127,740 | 125,604 |
| Deferral of premium on contracts written during the year | 129,697 | 123,553 | 129,697 | 123,553 |
| Earning of premiums deferred in prior years | (127,740) | (121,417) | (127,740) | (121,417) |
| **Unearned premium liabilities as at 30 June** | 129,697 | 127,740 | 129,697 | 127,740 |
| Current | 128,025 | 125,438 | 128,025 | 125,438 |
| Non-current | 1,672 | 2,302 | 1,672 | 2,302 |
| **Total** | 129,697 | 127,740 | 129,697 | 127,740 |

## 21. Unearned exchange commission

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| **Unearned exchange commission as at 1 July** | 2,713 | 3,125 | 2,713 | 3,125 |
| Deferral of exchange commission on contracts written during the | 1,985 | 2,713 | 1,985 | 2,713 |
| Earning of exchange commission deferred in prior years | (2,713) | (3,125) | (2,713) | (3,125) |
| **Unearned exchange commission as at 30 June** | 1,985 | 2,713 | 1,985 | 2,713 |

## 22. Outstanding claims liability

### a) Gross outstanding claims liabilities

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Gross central estimate of outstanding claims liabilities | 672,628 | 124,521 | 672,619 | 124,521 |
| Discount to present value | (34,733) | (6,121) | (34,733) | (6,121) |
| Claim handling expenses | 27,804 | 4,406 | 27,804 | 4,406 |
| Risk margin | 13,089 | 12,484 | 13,089 | 12,484 |
| **Total current outstanding claims liabilities** | 678,788 | 135,290 | 678,779 | 135,290 |
| Current | 256,349 | 78,712 | 256,349 | 78,712 |
| Non current | 422,439 | 56,578 | 422,430 | 56,578 |
| **Total** | 678,788 | 135,290 | 678,779 | 135,290 |

### b) Risk margin

The process used to determine the risk margin is explained in note 2 (a). The probability of adequacy at 30 June 2011 is approximately 85 per cent (2010: 85 per cent).

The risk margin included in net outstanding claims is 14.4 per cent of the central estimate (2010: 17.1 per cent).

### c) Reconciliation of movement in discounted outstanding claims provision

| | | *2011* | | *2010* |
|---|---|---|---|---|
| | *Gross* | *Reinsurance* | *Net* | *Net* |
| *Consolidated* | *$'000* | *$'000* | *$'000* | *$'000* |
| **At 1 July** | 135,290 | (45,197) | 90,093 | 89,944 |
| Increase in claims incurred in current accident year | 808,589 | (605,080) | 203,509 | 133,286 |
| Movement in prior year claims provision | (10,628) | 1,785 | (8,843) | 23,087 |
| Incurred claims recognised in the income statement | 797,961 | (603,295) | 194,666 | 156,373 |
| Net claim payments | (254,463) | 77,675 | (176,788) | (156,224) |
| **At 30 June** | 678,788 | (570,817) | 107,971 | 90,093 |

| | | *2011* | | *2010* |
|---|---|---|---|---|
| | *Gross* | *Reinsurance* | *Net* | *Net* |
| *Parent* | *$'000* | *$'000* | *$'000* | *$'000* |
| **At 1 July** | 135,290 | (45,197) | 90,093 | 89,944 |
| Increase in claims incurred in current accident year | 808,426 | (605,080) | 203,346 | 133,286 |
| Movement in prior year claims provision | (10,628) | 1,785 | (8,843) | 23,087 |
| Incurred claims recognised in the income statement | 797,798 | (603,295) | 194,503 | 156,373 |
| Net claim payments | (254,309) | 77,675 | (176,634) | (156,224) |
| **At 30 June** | 678,779 | (570,817) | 107,962 | 90,093 |

## 22. Outstanding claims liability (continued)

### d) Claims development table

The following table shows the development of net undiscounted outstanding claims relative to the current estimate of ultimate claims costs for the six most recent accident years for the Portfolio's claims.

| | *Accident Year* | | | | | | |
|---|---|---|---|---|---|---|---|
| *Ultimate claims cost estimate* | *2006 & Prior $'000* | *2007 $'000* | *2008 $'000* | *2009 $'000* | *2010 $'000* | *2011 $'000* | *Total $'000* |
| At end of loss year | n.a. | n.a. | n.a. | 21,452 | 17,362 | 22,901 | 22,901 |
| One year later | n.a. | n.a. | 17,707 | 19,118 | 10,083 | - | 10,083 |
| Two years later | n.a. | 11,020 | 17,369 | 14,421 | - | - | 14,421 |
| Three years later | n.a. | 13,559 | 16,060 | - | - | - | 16,060 |
| Four years later | n.a. | 17,160 | - | - | - | - | 17,160 |
| Current estimate of ultimate claims cost | n.a. | 17,160 | 16,060 | 14,421 | 10,083 | 22,901 | 80,625 |
| Payments to 30 June 2011 | | (11,236) | (10,043) | (9,826) | (4,239) | (1,755) | (37,099) |
| Net Central Estimate - Undiscounted (excluding CHE) | 4,476 | 5,924 | 6,018 | 4,595 | 5,843 | 21,147 | 48,003 |
| Discount to present value | (72) | (196) | (253) | (249) | (411) | (1,503) | (2,684) |
| Claims handling expenses | 127 | 168 | 171 | 131 | 166 | 601 | 1,364 |
| Discounted Central Estimate -(including CHE) | 4,532 | 5,896 | 5,936 | 4,476 | 5,598 | 20,245 | 46,682 |
| Diversified risk margin (85% PoA) | 814 | 1,058 | 1,066 | 804 | 1,005 | 3,634 | 8,380 |
| **Net 85% Provision - Discounted (including CHE)** | 5,345 | 6,954 | 7,001 | 5,280 | 6,603 | 23,879 | 55,063 |

**CHE - Claims Handling Expenses** **PoA - Profitability of Adequacy**

As a result of the changes in valuation methodologies driven by the move towards compliance with *Professional Standard 300 Valuation of General Insurance Claims* of the Institute of Actuaries of Australia, the table above now incorporates the experience of all product lines in the Liability group. The comparable table in the notes to last year's accounts was based on only part of the Liability group. Further, the shift to the new valuation methodologies means that historical comparative figures are no longer available - hence the "n.a." entries shown above.

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 23. Provisions

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Long service leave | | | | |
| Current | 181 | 156 | 174 | 149 |
| Non-current | 47 | 44 | 43 | 43 |
| | 228 | 200 | 217 | 192 |

Long service leave is accrued as earned by staff that obtain 15 years continual service. It is accrued and used as and when requested by the staff.

## 24. Financial Guarantee Contracts

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Home bonds | 1,729 | 2,129 | 1,729 | 2,129 |
| Balance at end of year | 1,729 | 2,129 | 1,729 | 2,129 |

Following a review of our financial guarantees the liability for guarantees provided under the home bond scheme has been fair valued. The liability under the guarantee carries a reinsurance component. There is an asset of $849,701 (2010: $1,011,202) pertaining to Home Bonds receivable included in trade and other receivables for the reinsurance component of the liability noted above.

## 25. Contributed equity

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Issued and fully paid shares | 83,638 | 70,009 | 83,638 | 70,009 |
| **Share movement reconciliation** | | | | |
| Movement in Ordinary Shares on issue | | | | |
| At 1 July | 70,009 | 70,009 | 70,009 | 70,009 |
| 13,628,720 Ordinary Shares-issued and fully paid 11 March 2011 | 13,629 | - | 13,629 | - |
| At 30 June | 83,638 | 70,009 | 83,638 | 70,009 |

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one

## 26. Credit rating

Ratings agency Standard & Poor's (Australia) Pty Limited reaffirmed the parent company's credit rating of A- on 7 November 2010. Wesfarmers Insurance Division has ring fenced the credit rating of its insurance underwriting operations in order to maintain an A- rating.

## 27. Auditor remuneration

The Group and Parent auditor is Ernst & Young.

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Amounts received or due and receivable by Ernst & Young for: | | | | |
| i Audit of the financial statements | 159 | 148 | 101 | 126 |
| ii Other services : | | | | |
| Assurance related to regulatory requirements | 8 | 3 | 8 | 3 |
| | 167 | 151 | 109 | 129 |

## 28. Events after balance date

On 11 July 2011 Wesfarmers Limited injected $12,817,850 in lieu of an additional 12,817,850 ordinary shares in Lumley General Insurance (N.Z.) Limited.

## 29. Commitments and contingencies

### Operating lease commitments – Group as lessee

The Group and Parent has entered into operating leases of commercial premises. These leases have a life of between 1 and 6 years with no renewal options included in the contracts.

There are no restrictions placed on the lessee by entering into these leases. There are no contingent rents payable.

Future minimum rentals payable under non-cancellable operating leases as at 30 June are as follows:

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Within one year | 5,300 | 5,150 | 5,281 | 5,140 |
| After one year but not more than five years | 11,122 | 14,444 | 11,107 | 14,444 |
| More than five years | 116 | 95 | 116 | 95 |
| | 16,538 | 19,689 | 16,504 | 19,679 |

### Capital Commitments

As at 30 June 2011, the Parent and Group have no capital commitments in place (2010: $Nil).

### Guarantees

As at 30 June 2011, the Parent and Group have no other guarantees in place except for the financial guarantee contracts disclosed in note 24 (2010: $Nil).

### Contingent Liabilities

As at 30 June 2011, the Parent and Group have no contingent liabilities in place (2010: $Nil)

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

**30. Related parties**

(a) The consolidated financial statements include the financial statements of Lumley General Insurance (N.Z.) Limited and the following subsidiaries:

| *Name* | *Country of Incorporation* | *Equity Interest %* 2011 | 2010 | *Investment $'000* 2011 | 2010 |
|---|---|---|---|---|---|
| Lumley Finance (N.Z.) Limited | New Zealand | 100 | 100 | 500 | 250 |
| Lumley Life (N.Z.) Limited | New Zealand | 100 | 100 | 550 | 550 |
| Lumley Services (NZ) Limited | New Zealand | - | 100 | - | 250 |

On the 14th June 2011 Lumley Services (NZ) Limited was amalgamated with Lumley Finance (NZ) Limited.

(b) Related party transactions and balances during the year were:

| | *2011 $'000* | *2010 $'000* |
|---|---|---|
| ***Consolidated*** | | |
| Revenue from Services Rendered and Financing Activities: | | |
| - Ultimate Parent Company | - | - |
| - Other Related Parties | 9,059 | 6,301 |
| Expenses from Services Rendered and Financing Activities: | | |
| - Ultimate Parent Company | - | - |
| - Other Related Parties | (6,588) | (4,904) |
| Amounts owing from/(to): | | |
| - Ultimate Parent Company | (283) | (315) |
| - Other Related Parties | 191,905 | 178,846 |
| ***Parent*** | | |
| Revenue from Services Rendered and Financing Activities: | | |
| - Ultimate Parent Company | - | - |
| - Subsidiaries of Lumley General Insurance (N.Z.) Limited | 2,134 | 3,918 |
| - Other Related Parties | 9,059 | 6,301 |
| Expenses from Services Rendered and Financing Activities: | | |
| - Ultimate Parent Company | - | - |
| - Subsidiaries of Lumley General Insurance (N.Z.) Limited | - | - |
| - Other Related Parties | (6,588) | (4,904) |
| Amounts owing from/(to): | | |
| - Ultimate Parent Company | (283) | (315) |
| - Subsidiaries of Lumley General Insurance (N.Z.) Limited | 27,130 | 30,677 |
| - Other Related Parties | 191,905 | 178,846 |

NZ Finance Holdings Pty Ltd invests the Parent's surplus operational funds on behalf of the Parent in accordance with a service agreement that came into effect on the 26 August 2004, and was updated on 21 May 2010.

Loans to Lumley Finance (N.Z.) Limited are payable on call. The interest rate charged is based on the Reserve Bank of New Zealand 90 day bank bill rate plus 300 basis points, and is reset quarterly. No provision for doubtful debts was made at year end (2010: $Nil).

All related party transactions were made on terms equivalent to those that prevail in arm's length transactions, both at normal market prices and on normal commercial terms, and are made only if such terms can be substantiated.

**30. Related parties (continued)**

(c) Insurance of directors and officers

During or since the end of the financial year, the parent of the Group (Wesfarmers Limited) has paid or agreed to pay a premium in respect of a contract insuring all the directors and officers of the Group against a liability incurred in that capacity.

Disclosure of the nature of the liability covered by the insurance and premium paid is subject to confidentiality requirements under the contract of insurance.

**31. Average interest bearing financial assets and liabilities and related interest**

The average balances of interest bearing financial assets and liabilities during the financial year are as follows:

| *Consolidated* | *Average Balance* *$'000* | *Interest income / (expense)* *$'000* | *Average interest rate* *%* |
|---|---|---|---|
| *2011* | | | |
| **Interest-bearing assets** | | | |
| Cash assets | 177,000 | 9,059 | 4.9% |
| *2010* | | | |
| **Interest-bearing assets** | | | |
| Cash assets | 158,230 | 6,301 | 4.0% |

| *Parent* | *Average Balance* *$'000* | *Interest income / (expense)* *$'000* | *Average interest rate* *%* |
|---|---|---|---|
| *2011* | | | |
| **Interest-bearing assets** | | | |
| Cash assets | 177,000 | 9,059 | 4.9% |
| Loans and receivables | 29,529 | 1,734 | 5.9% |
| *2010* | | | |
| **Interest-bearing assets** | | | |
| Cash assets | 158,230 | 6,301 | 4.0% |
| Loans and receivables | 39,892 | 2,370 | 5.9% |

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 32. Maturity analysis of selected financial assets

The following table details the maturity distribution of related party cash deposits.

| *Consolidated* | *At Call* $'000 | *3 months or less* $'000 | *3 months to 12 months* $'000 | *No Maturity Specified* $'000 | *Total* $'000 |
|---|---|---|---|---|---|
| *2011* | | | | | |
| **Assets** | | | | | |
| Cash deposits with related parties | 55,000 | 123,556 | - | - | 178,556 |
| *2010* | | | | | |
| **Assets** | | | | | |
| Cash deposits with related parties | 55,000 | 116,558 | - | - | 171,558 |

| *Parent* | *At Call* $'000 | *3 months or less* $'000 | *3 months to 12 months* $'000 | *No Maturity Specified* $'000 | *Total* $'000 |
|---|---|---|---|---|---|
| *2011* | | | | | |
| **Assets** | | | | | |
| Cash deposits with related parties | 55,000 | 123,556 | - | - | 178,556 |
| *2010* | | | | | |
| **Assets** | | | | | |
| Cash deposits with related parties | 55,000 | 116,558 | - | - | 171,558 |

## 33. Impaired financial assets - loans and receivables

Financial assets – loans and receivables include no impaired assets (2010: $Nil).

**Notes to and forming part of the financial statements for the year ended 30 June 2011**

## 34. Life Insurance disclosures

| | *Consolidated* | | *Parent* | |
|---|---|---|---|---|
| | *2011* | *2010* | *2011* | *2010* |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| a) Life insurance premium and related revenue | | | | |
| Gross earned premium revenue | 1,375 | 1,653 | - | - |
| Investment revenue | 73 | 94 | - | - |
| **Total Gross earned premium and related revenue** | 1,448 | 1,747 | - | - |
| b) Life insurance operating expenses | | | | |
| Claims expense | (163) | (84) | - | - |
| Commissions paid | (1,042) | (1,263) | - | - |
| Actuarial fees | (24) | (8) | - | - |
| Other | (182) | (181) | - | - |
| **Total operating expenses** | (1,411) | (1,536) | - | - |
| c) Analysis of life insurance results after tax | | | | |
| Planned margins of revenue over expenses | 327 | 471 | - | - |
| Difference between actual and assumed | 42 | 48 | - | - |
| Changes to underlying assumptions/methods | (1) | - | - | - |
| Investment earnings on assets in excess of policy | 32 | 40 | - | - |
| **Net surplus for the year** | 400 | 559 | - | - |

## 34. Life Insurance - specific accounting policies

### (a) Life Premium Revenue

All premiums are recognised as revenues in the statement of comprehensive income. There is no deposit component.

### (b) Investment Revenue

Investment and other income are recognised in the statement of comprehensive income on an accruals basis. Investment income includes realised and unrealised changes in the net market value of investments.

### (c) Claims Expense and Liabilities

Provision has been made for estimated liabilities in respect of claims notified but not admitted and settled at balance date. No allowance has been made for incurred but not reported claims. All claims are recognised as expenses in the statement of comprehensive income. There is no deposit component.

**34. Life Insurance - specific accounting policies (continued)**

**(d) Investments**

Investments integral to the life insurance's activities are measured at market values as at the balance date and changes in the market values are recognised in the statement of comprehensive income.

**(e) Taxation**

The database now includes a marker to show whether each policy falls under the pre-1 July 2010 ("old") life insurance tax regime or the new regime. The provisions of the new regime allow a life insurance policy already in force on 30 June 2010 to be grandfathered so that the old regime will continue to apply, provided the policy satisfies the ongoing grandfathering requirements including the reinstatement of lapsed policies within the 90 days as provided by under the Income Tax Act 2007.

For policy under the old regime, we have assumed as in previous years' valuations that the Company's taxable income will be investment income minus expenses/commissions plus Life Underwriting Profit. Although the form of calculating the taxable income under the new tax rules is different from those under the old rules, the net outcome is to make the same calculation as before in respect of the grandfathered business.

For policies under the new regime, we have assumed that the Company's taxable income will be all policy cash flows (premiums, claims, commissions, rebates and expenses) plus changes in reserves (defined as a Reserve Adjustment in the Income Tax Act 2007). The reserving method makes no difference to the total amount of tax paid in total, although the timing may differ.

**(f) Actuarial Policies and Methods**

The actuarial reports for the current period were prepared by Linda Caradus, principal in the firm of Melville Jessup Weaver, Consulting Actuaries. Linda Caradus is a Fellow of the New Zealand Society of Actuaries. The Actuary has stated that Policy Liabilities have been calculated in accordance with New Zealand Society of Actuaries Professional Standard No 3: Determination of Life Insurance Policy Liabilities. After making appropriate checks, the Actuary was satisfied as to the accuracy of the data from which the amount of the policy liabilities has been determined.

The key assumptions used were as follows:

*(i) Policy Type*

All business relates to the death risk covering loan indebtedness. There is no Unit Linked or Participating Business. The profit carrier for all of the life insurance's business is payment of claims.

*(ii) Interest/ Discount Rate*

2.30%, being the current return on risk-free assets of the appropriate mean term (being 2-year government bonds), net of tax at 28%. (2010: 2.75% being the return at that time on 2-year government bonds, net of tax at 30%).

*(iii) Mortality*

72.6% of the NZ population table NZLT 2000-2002, being a basic mortality rate of 66% of NZLT 00-02 plus 10% as a loading for dual/ triple life policies. The 10% loading was derived from a review of the data for business written in the first 3 months of 2005.

*(iv) Cancellations*

An annual rate of 25% was assumed.

**34. Life Insurance - specific accounting policies (continued)**

**(f) Actuarial Policies and Methods (continued)**

*(v) Expenses*
Based on $1.31 per policy per month in the 12 months following the valuation, increasing by 5% in each subsequent year. (2010: $1.25)

*(vi) Taxation*
The current regime for the taxation of Life Insurance business will continue to apply to policies currently in force. The future tax rate of 28% (2010: 30%) has been assumed for the purposes of the valuation. The provisions of the new life insurance tax regime which comes into force on the 1 July 2010 allow single premium business in force at that date to be grandfathered so that the current regime will continue to apply, provided the policy is not changed and any policy that is cancelled is reinstated within a certain time.

*(vii) Effect of changes in assumptions*
The changes in assumptions this year are:
- a change in the discount rate of 0.45 per cent, which is driven by government bond rates. This change has increased Policy Liabilities by $1,135.
- a change in tax rate from 30% to the current rate of 28%. This change reduced the Best Estimate Liability by $600, with an offsetting increase to the Present Value of Profit Margins and no overall change in the Policy Liabilities.

**(g) Measurement of Policy Liabilities**

Policy liabilities in the statement of financial position have been calculated using the Margin on Services (MoS) methodology.

MoS is designed to recognise profits on life insurance as services are provided to policyholders. Profits are recognised over the life of policies, whereas losses are recognised as they arise. Policy liabilities are determined as the present value of all expected future claims, expenses, taxes and profit margins reduced by the present value of future income.

MoS profit comprises the following components:

*(i) Planned margins of revenues over expenses*

At the time of writing a policy and at each balance date, best estimate assumptions are used to determine all future payments and income. Where actual experience replicates best estimate assumptions, the expected profit margin will be released to profit over the life of the policy.

*(ii) The difference between actual and assumed experience*

Experience profits or losses arise when actual experience differs from the best estimate assumptions. Instances giving rise to such profits or losses include variances in claims, expenses, cancellations and investment returns.

*(iii) Changes to underlying assumptions*

Assumptions for measuring the policy liabilities are reviewed each year. Where the review leads to a change in assumptions, the change is deemed to have occurred from the end of the year. The financial effect of a change in discount rates is in certain circumstances recognised in the year that the change is made. Otherwise the effect is recognised over future reporting periods during which services are provided to policyholders.

**34. Life Insurance - specific accounting policies (continued)**

*(iv) Loss recognition on groups of related products*
If based on best estimate assumptions, business for a group of related products is expected to make a loss, the total expected loss for that product group is recognised in the statement of comprehensive income immediately. When loss-making business becomes profitable, previously recognised losses are reversed.

*(v)Investment earnings on assets in excess of Policy Liabilities*
Profits are generated from investment assets which are in excess of those required to meet Policy Liabilities. Investment earnings are directly influenced by market conditions and as such this component of profit will vary from year to year.

The Policy Liabilities contain the following components:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Total | Excluding Tax | Total | Excluding Tax |
| | *$'000* | *$'000* | *$'000* | *$'000* |
| Present value of benefits | 498 | 505 | 552 | 519 |
| Present value of expenses | 258 | 1 | (24) | (44) |
| Present value of margins | 241 | 27 | 480 | 33 |
| Total | 997 | 533 | 1,008 | 508 |

**(h) Solvency Reserves**

The Actuary has advised the Directors that $1,925,000 (2010: $2,468,000) is required to cover Prudential Reserves in accordance with the New Zealand Society of Actuaries Professional Standard No. 5 "Life Insurance Company Prudential Reserving", compared with actual assets of $2,911,000 (2010: $2,515,000). The solvency shortfall in the prior year was addressed on 23 July 2009 by the diversification of bank deposits as recommended by the Actuary.

**35. Share Based Payment Plans**

**(a) Wesfarmers Employee Share Acquisition Plan New Zealand**

On 16 September 2010 the Wesfarmers Board approved the November 2010 Wesfarmers Employee Share Acquisition Plan New Zealand (WESAP NZ) Award offers. The plan allows an eligible employee to receive Wesfarmers Limited ordinary shares up to $NZ750, tax free to participants, with an employee payment of $NZ1.00.

The following are the key terms and conditions of the WESAP NZ:

- Shares are restricted from being traded for three years from the date of issue or until the employee terminates by reason of death, accident, sickness, redundancy or retirement (whichever is earliest); and
- If the employee terminates (other than for reasons above) before the end of the restricting period, the shares will be sold at market price and the proceeds are paid to the employee, subject to PAYE tax.

**35. Share Based Payment Plans (continued)**

**(a) Wesfarmers Employee Share Acquisition Plan New Zealand (continued)**

Eligible employees meet all the following conditions at 1 October 2010:

- Employment contract provides for permanent conditions of employment;
- Three months continuous employment with Wesfarmers or its subsidiaries;
- 18 years or older (at 19/11/2010);
- New Zealand resident for tax purposes and;
- Are not a director of a company in the Wesfarmers Limited Group.

The plan allocation date was on the 19th of November 2010; the cost of the WESAP NZ was expensed in the year (refer note 7). 426 employees sought to participate in the WESAP NZ. Shares were issued at a share market price of $AUD 33.30 per share.

**(b) Wesfarmers Employee Share Acquisition Plan - Senior Employees New Zealand**

On 16 September 2010 the Wesfarmers Board approved the November 2010 Wesfarmers Employee Share Acquisition Plan - Senior Employees New Zealand (WESAPS NZ) Award offers. The Plan allows the award of Wesfarmers Limited ordinary shares, subject to PAYE tax, the net amount is used to purchase shares.

The following are the key terms and conditions of the WESAPS NZ:

- Gross award share value determined on executive seniority and company achieving performance hurdles
- Shares are restricted from being traded for three years from the date of issue or until the employee terminates by reason of death, accident, sickness, redundancy or retirement (whichever is earliest); and
- Shares are subject to forfeiture if the employee acts fraudulently or dishonestly or employment is terminated due to misconduct.

Eligible employees meet all the following conditions at 1 October 2010:

- Employment contract provides for permanent conditions of employment;
- Four months continuous employment with Wesfarmers or its subsidiaries;
- 18 years or older (at 19/11/2010);
- New Zealand resident for tax purposes and;
- Meets the definition of a senior employee

The plan allocation date was on the 19th of November 2010; the cost of the WESAPS NZ was expensed in the year (refer note 7). 80 employees sought to participate in the WESAPS NZ. Shares were issued at a share market price of $AUD 33.30 per share.

ERNST & YOUNG

Chartered Accountants

## Independent Auditor's Report

## To the Shareholders of Lumley General Insurance (N.Z.) Limited

## Report on the Financial Statements

We have audited the financial statements of Lumley General Insurance (N.Z.) Limited and its subsidiaries on pages 4 to 49, which comprise the statement of financial position of Lumley General Insurance (N.Z.) Limited and the group as at 30 June 2011, and the statement of comprehensive income and statement of changes in equity for the year then ended of the company and group, and a summary of significant accounting policies and other explanatory information.

This report is made solely to the company's shareholders, as a body, in accordance with section 205(1) of the Companies Act 1993. Our audit has been undertaken so that we might state to the company's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

### Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of the financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). These auditing standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected, depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we have considered the internal control relevant to the entity's preparation of the financial statements that give a true and fair view of the matters to which they relate 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

We believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Ernst and Young provides taxation advice and other assurance related services to the company and group. We have no other relationship, or interest in the company and group.

Partners and employees of our firm may deal with the company and group on normal terms within the ordinary course of trading activities of the business of the company and group.

### Opinion

In our opinion, the financial statements on pages 4 to 49:

- comply with generally accepted accounting practice in New Zealand; and
- give a true and fair view of the financial position of Lumley General Insurance (N.Z.) Limited and the group as at 30 June 2011 and the financial performance of the company and group for the year then ended.

## Report on Other Legal and Regulatory Requirements

In accordance with the Financial Reporting Act 1993, we report that:

- We have obtained all the information and explanations that we have required.
- In our opinion proper accounting records have been kept by Lumley General Insurance (N.Z.) Limited as far as appears from our examination of those records.

Ernst + Young

3 August 2011
Auckland