



Southern Cross  
Health Society

# The Southern Cross Medical Care Society 2011 Annual Report

+ The kiwifruit is one of the most nutritious fruits in the world. It's also high in fibre, which is great for your digestive system.



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# Overview

## FOR THE YEAR ENDED 30 JUNE 2011

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- In 2011 your not-for-profit Society returned a surplus, while also delivering a high claims to premium ratio, new customer service options and enhanced benefits to members.
- The Society is proud to continue to deliver members excellent value for money. For every \$1 of premium income, 87.1 cents was returned to members in claims for healthcare treatment.
- The Society planned for a surplus in 2011, after posting deficits of \$14.4m in 2009 and \$7.1m in 2010. The resulting \$28.3m surplus was larger than forecast due to lower-than-expected claims.
- Premium income was \$662.5m while total claims reached \$577.1m.
- With reserves (i.e. total assets less total liabilities) of \$334.4m, the Society is in a strong and fiscally responsible position. In February 2011 it received an A+ financial strength rating from Standard and Poor's for the ninth consecutive year.
- The Society's investment portfolio generated income of \$21.8m and ended the year valued at \$417.7m.
- Despite difficult economic conditions for members and employers, membership numbers were resilient, decreasing by 0.8% over the year. Southern Cross's position in the industry strengthened, with market share increasing from 60.63% to 61.13%.
- The Board and management remain focused on managing claims costs long term. Central to this is the Society's Affiliated Provider programme, which grew significantly over the year.



# Chairman's report

2011 marks a half century of Southern Cross helping New Zealanders access private healthcare. In May 1961 the Society opened for business as New Zealand's first private health insurer, reaching a membership of just under 1000 by the end of December that year. Today, nearly one in five New Zealanders is a member.

Southern Cross remains a proudly not-for-profit Friendly Society and the founding ethos of high quality service and providing the best possible value for money is central to everything we do.

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## A HEALTHY FINANCIAL POSITION

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The 2011 financial year saw the Society in a strong financial position, while continuing to deliver an excellent claims to premium ratio to its members. Premium income was \$662.5m while total claims reached \$577.1m, resulting in a ratio of 87.1 cents returned to members in claims payments for every dollar of premium income.

The Society planned for a surplus in 2011, after posting deficits in 2009 (\$14.4m) and 2010 (\$7.1m). This was necessary to restore the Society's reserves which were used in those years to help cushion members' premiums from the full impact of abnormally high claims cost inflation (fuelled by both rising healthcare costs and the greater use of health insurance benefits by members) and to operate in a sustainable manner.

The resulting 2011 surplus of \$28.3m was higher than forecast, primarily due to lower than expected claims. Consequently, the Board has been able to approve more moderate premium rate increases going forward.

We aim to continue delivering members the best possible value for their premiums. To do this responsibly, we need to ensure our premium income not only covers the cost of health insurance claims, but also provides reserves to ensure the continued sustainability of the Society,

in line with insurance industry best-practice. Under the new Insurance (Prudential Supervision) Act, all insurers will be required to be licensed by the Reserve Bank and to hold a sufficient level of reserves. Failure to do so may result in an insurer losing their licence and being unable to operate. The Board is confident that the Society's current practices in relation to reserves will satisfy Reserve Bank requirements.

When planning for a surplus, we are also mindful that the introduction of just one new technology or treatment under our policies, or a change in the priorities of the public system, can quickly result in millions of dollars worth of claims.

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## STRENGTH AND STABILITY

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With reserves of \$334.4m, the Society retained its A+ financial strength rating from Standard and Poor's for the ninth consecutive year. The Society's target reserves are calculated so that they are sufficient to sustain a period of higher than expected claims volatility to provide solvency through all parts of the insurance cycle.

The Society's investment portfolio also performed well. Income on investments was \$21.8m, a pleasing result given the impact of low interest rates. Our investment strategy aims to strike a careful balance between providing a steady, sustainable return and maintaining a low risk profile. At year end, the overall portfolio was valued at \$417.7m, up 3.6% on 2010.

Careful management of the Society's operations and an ongoing focus on efficiency saw overheads \$1.3m under budget at \$78.9m for the year.

Despite the difficult economic climate for both individuals and employers, membership numbers were resilient, decreasing by 6,659 or 0.8% over the year to 835,385 members. This decrease was felt to varying degrees right



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GRAEME HAWKINS  
CHAIRMAN OF THE BOARD

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across the health insurance sector. Pleasingly, Southern Cross' position in the industry strengthened, with market share increasing from 60.63% to 61.13%.

Though there are signs the economy may be improving, June's 21-year high in the annual rate of inflation has required many New Zealanders to reprioritise their household spending. We are also mindful that the high claims cost escalation of recent years has caused some members to experience large premium increases. These factors have been reflected in a continuing, industry-wide trend for policy downgrades from comprehensive to hospital and specialist only plans. In the year to June 2011, 27,064 Southern Cross members downgraded their policies – a 5% increase on the number that downgraded their policy in 2010.

This is a trend that is of some concern to us. On a positive note, the decision to continue a policy (albeit at a reduced level of benefits) demonstrates the high value members place on the peace of mind provided by health insurance. However, once a member is at the most minimal level of coverage, the next step down may be to relinquish health insurance altogether, placing further strain on a public health system facing ever-growing demand.

We know premiums are an area of concern for some members – especially those aged 65 and over. This is why developing options to manage the cost of healthcare remains a strong focus for the Board and management.

At last year's AGM, members voted in favour of a resolution to investigate the option of accessing surgical treatment overseas. At the time of writing, a report on overseas treatment was before the Board. Information on this topic will be posted on the Southern Cross website for members by the time this Annual Report is published.

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## ACKNOWLEDGEMENTS

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I would like to thank the Society staff and all Board members for their hard work throughout the year. I would also like to welcome new director Keith Taylor who joined the Board last November. Mr Taylor has over 30 years experience in the insurance and financial services industries as a Chief Executive, CFO and Actuary. Conversely, director Mark Verbiest has indicated he will be stepping down from the Society Board following the Annual General Meeting. I would like to take this opportunity to thank him for his dedicated contribution over the last three years.

To our members, thank you for your loyalty and interest in the Society. I look forward to seeing some of you at the Annual General Meeting on December 6.



**Graeme Hawkins**  
Chairman

# Chief Executive Officer's report

Over the last half century, the not-for-profit Southern Cross Health Society has become a large and important part of the New Zealand health system. In 2011, your Society funded 580,000 claims for healthcare, including 158,000 elective surgeries, for its 835,000 members.

The Society has consistently offered members very good value for money. In the last 40 years, for every dollar of premium income the Society has paid on average 89 cents in claims to members.

Today we are faced with a vastly different healthcare environment from that of our founders. The expansion of medical technology – such as new prostheses, robotic surgery, heart valves and PET scans – means we and our loved ones are able to live longer and fuller lives. Our treatment options are significantly greater, and we are making the most of them.

However, these options do not come cheaply. The great challenge ahead for Southern Cross is how to balance this ever-increasing demand for treatment with its associated higher cost.

The public sector is facing the same challenge. Between 1995 and 2009, growth in Government health spending exceeded growth in national income by 30%. Despite this, a report from the Office of the Auditor General in June acknowledged that, "New Zealand will always have more patients than our publicly funded non-urgent medical and surgical services can cope with at any one time."

To meet growing demand, Southern Cross believes there will need to be greater use of private contribution to treatment costs, be it through health insurance or savings schemes. Our generation once believed the Government would take care of our retirement – today that expectation is gone. Health care will likely follow a similar path.

For those, like our 835,000 members, who choose to take responsibility for their needs, health insurance offers very good value for money as well as peace of mind – just ask any member who has required major elective surgery. But we

believe Southern Cross needs to do more. Our members are asking us to be more active in finding efficiencies and better value in healthcare, and this will continue to be a priority for the Society.

Over the coming years, we will remain focused on addressing the rapidly increasing cost of healthcare services which underlies high claims growth and has impacted on members' premiums.

A key part of this work has been the expansion of our Affiliated Provider programme. Affiliated Providers include surgeons, specialists and facilities that are contracted at agreed prices to deliver certain procedures for Southern Cross members. Affiliated Providers also organise prior approval, and make the claims process easier and quicker for members.

This programme aims to deliver certainty of cost for our members, and ensure healthcare costs are sustainable in the long term. Looking ahead, we need to gain further support from the medical community around cost containment. We also need our members' help in questioning charges they believe are out of line with reasonable market rates.

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## FINDING THE RIGHT BALANCE WITH ACC

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Over the last year we have put greater resources into working with ACC to ensure our members' claims for elective surgery are handled by the right organisation. This work includes providing assistance to members with ACC reviews.

In the year to June 2011, Southern Cross assisted 355 members in reviews of ACC decisions on their claims for elective surgery. The reversal of decisions saw \$3.7 million in claims payments recovered by the Society from ACC for treatment that was related to an accident or treatment injury. We support our members in reviews not only to



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DR IAN MCPHERSON  
CHIEF EXECUTIVE OFFICER  
SOUTHERN CROSS MEDICAL CARE SOCIETY

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ensure treatment costs are met by the right insurer, but also because they may have other entitlements under ACC, such as earnings compensation, rehabilitation and home help. The number of members seeking assistance with review slowed in the last two months, which may indicate the balance is being righted in this area.

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## WORKING TOGETHER

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In the last 50 years, the Southern Cross brand has evolved into a family of health-related businesses. Also under this umbrella is the Southern Cross Health Trust which owns private hospitals, travel insurance and primary care (general practice) businesses. While Southern Cross-branded businesses operate independently from one another, they will look for new ways to work together when doing so is consistent with their core objectives (which, in the Society's case, include better health outcomes and/or moderation of costs for members).

An example of this could be GPs expanding their practice capabilities in order to provide lower-cost minor surgery, such as skin surgeries. This lower-cost option has the potential to benefit Society members – who last year claimed for over 43,000 skin surgeries worth \$36.8m in total.

New Zealand's health system has much to be proud of – high quality facilities, a skilled and hard-working health workforce, excellent access to emergency care, and a private system that complements the work done in the public system. To ensure our grandchildren have access to the same level of care, we need to look more closely at how these resources can be managed to get the best value for each and every healthcare dollar. We also need to sustain and strengthen our not for profit Society.

In closing, I would like to sincerely thank Southern Cross Health Society Chief Executive Peter Tynan and his health insurance team for their hard work and dedication throughout the year – they have kept the operations of the Society running very smoothly.



Chief Executive Officer  
Southern Cross Medical Care Society



# Operational report

The 2011 financial year saw considerable progress made in the Society's efforts to achieve better value on behalf of its members. This included a leap in growth for the Society's Affiliated Provider programme, new benefits, and e-commerce initiatives to improve efficiency and service.

In the space of a year, the Society's nationwide network of Affiliated Providers has grown by 50% - from 180 Affiliated Provider agreements accounting for around 18% of the Society's claims costs in 2010, to 270 agreements that accounted for 25% of all claims costs in 2011.

This is a fantastic result, and reflects a huge amount of effort by both Society staff and providers in forming agreements that are fair, reasonable and sustainable for our members.

We believe the Affiliated Provider programme has significant potential to moderate future cost inflation. By contracting with providers and facilities, we are better able to manage claims costs and provide certainty of any member contribution required. Using an Affiliated Provider also offers a better claiming experience for members, as the provider applies for prior approval and processes the claim on the member's behalf.

Seeking referral to an Affiliated Provider to access these benefits is an option we encourage for a broad range of procedures. There is also a growing number of procedures where reimbursement will only be made if they are delivered by an Affiliated Provider.

Looking ahead, our efforts will concentrate on making more procedures available only through an Affiliated Provider.

Last September, cataract surgery and endoscopy became procedures reimbursed only when delivered by an Affiliated Provider. In doing so, Southern Cross has established agreements with all private facilities in New Zealand that offer these services. For cataract surgery, this accounts for 16 new facility agreements including 64 specialists. For endoscopy, there are 27 new facility agreements

encompassing 183 endoscopists. Under consideration for future inclusion in this category are certain orthopaedic procedures.

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## UPCOMING CHANGES

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From October 17, intravitreal injections, Mohs surgery and certain prostate procedures will be reimbursed only when delivered by an Affiliated Provider. Like cataract surgery and endoscopy, some of these procedures have been targeted because they account for a growing number of claims and have shown large unexplained variability in price. For example, recent claims received from members for intravitreal injections have ranged from \$500 to more than \$1,200. When you consider members claimed for 2,631 of these injections last year, there is the potential to create significant savings in this area.

This change will begin with a transition period during which members will still be able to claim for these procedures in some regions on a fee-for-service basis. This will give specialists time to talk with the Society about joining the Affiliated Provider programme and for members and their referrers (such as GPs) to become familiar with the changes.

Due to the efforts being made to sign agreements with a wide range of providers, our goal is for these changes to have minimum impact on our members. The feedback from members is that they are pleased with our efforts in cost containment and with the simplified claims process available through Affiliated Providers.

The ability to access private cancer care is an area of increasing importance to our members.

From October 17, PET/CT imaging will become a new benefit for cancer treatment and will also become a procedure reimbursed only when delivered by an Affiliated Provider. The Society has established agreements with all private providers of this service.



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PETER TYNAN  
CHIEF EXECUTIVE  
SOUTHERN CROSS HEALTH SOCIETY

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The Chemotherapy benefit has also been changed to accommodate a greater range of members' circumstances and improve administrative efficiency. We are pleased to expand our members' treatment options. At the same time, we need to consider the impact on claims costs. Our aim is to find a balance between our members' desire for greater treatment options, and the potential impact on their premiums.

More detailed information about benefit updates has been sent to policy holders in recent weeks.

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## ENHANCED SERVICE

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During the 2011 financial year the Society team developed and launched two initiatives to help make health insurance easier, better value and more convenient for our members.

In November 2010, we introduced Southern Cross Easy-claim, an electronic claiming system that allows members to claim 'on the spot' for medical costs covered by their policies, simply by presenting their Southern Cross Member Card when they go to pay. Easy-claim is now available at all Radius pharmacies nationwide, and we plan to expand the service to other pharmacies and healthcare providers, including some GP clinics, in 2012.

At the end of the financial year, close to 7,000 claims had already been processed through this system. As claims are processed automatically, it also helps to improve efficiency in the Society's business operations.

The year also saw the development of 'My Southern Cross', a secure members' area on the Southern Cross website that allows policyholders to manage their health insurance online. After registering and receiving a pin number, policyholders can view their policy details, check the status of claims and benefits with annual limits, change contact details, and also choose to 'switch off' certain paper-based communications and instead view these online.

'My Southern Cross' also enables policyholders to choose to receive email or text notification when a claim has been received and assessed, and when renewal documents and new invoices or statements have been issued.

In addition to reducing mail-related costs, 'My Southern Cross' is expected to create further savings through a reduction in calls to the Society's contact centre - another way we are ensuring members receive maximum value for their premium dollar.

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## MEETING OUR OBLIGATIONS

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In April, in accordance with Financial Advisors legislation, the Society was granted Qualifying Financial Entity status, enabling it to take responsibility for the advice given by employees on products and services.

As required by the Insurance (Prudential Supervision) Act, an application for a provisional licence to operate as a licensed insurer has been lodged with the Reserve Bank of New Zealand. The provisional licensing process is expected to be completed by March 2012 and full licensing by September 2013.

As a large, long-established and reputable insurer our operations and governance were already closely aligned with the licensing requirements. We support the aims of the Reserve Bank of New Zealand in delivering greater consumer confidence in the insurance sector.

Thank you to the Society's management team and all our people for the hard work and great service delivered to members this year.

I would like to make special mention of the Society's Christchurch-based sales and Care Advantage team. Thankfully, none of them were injured in the devastating February quake. Despite upheaval in their personal situations and the loss of our central city office, our people continued to provide excellent service to members and corporate clients by working remotely. Like so many in Canterbury, their resilience throughout this time has been remarkable. The region's recovery will be a long journey - we are behind them all the way.



**Peter Tynan**  
Chief Executive  
Southern Cross Health Society

# Statement of corporate governance

The Southern Cross Medical Care Society adheres to principles designed to ensure sound corporate governance of its affairs, including Reserve Bank of New Zealand Governance Guidelines for licensed insurers issued under the Insurance (Prudential Supervision) Act 2010.

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## BOARD OF DIRECTORS

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The Southern Cross Medical Care Society is governed by a Board of Directors who are elected by members of the Society. The administration, management and control of the Society is vested in the Board.

The Directors in office as at 30 June 2011 are:

Graeme S Hawkins (Chairman)  
Dr Douglas D Baird  
Carole B Durbin  
Elizabeth M Hickey  
Phillip J Meyer  
Keith B Taylor  
Mark J Verbiest

All current directors have been assessed by the Board (as at 6 September 2011) in accordance with the Society's Fit and Proper Policy and have been certified as meeting the Reserve Bank of New Zealand's Fit and Proper Standard for directors of Licensed Insurers.

All current directors are considered to be independent, in that they are free from any associations that could materially interfere with the exercise of independent judgement. Profiles of these directors, including their relevant qualifications and experience are contained on pages 10 and 11 of this Annual Report.

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## TRUSTEES

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The Rules of The Southern Cross Medical Care Society provide for the appointment of three Trustees. All property belonging to the Society vests in the Trustees who hold it in trust for the members. As set out in the Investment Charter of Trustees, the Trustees are responsible for formulating overall investment policy (subject to approval by the Board) establishing investment guidelines, and monitoring the management of the investment portfolios. Trustees are nominated from among the Directors and elected by members of the Society.

The Trustees in office as at 30 June 2011 are:  
Carole Durbin, Graeme Hawkins, Phillip Meyer.

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## BOARD ROLE AND CHARTER

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The Board operates in accordance with the Friendly Societies and Credit Unions Act 1982, the Society's Rules and the Board Charter. The Board Charter describes the Board's role, procedures and relationship with management.

The role of the Board is to effectively represent, and promote the interests of, members. Means by which this is achieved include:

- Ensuring the Society's goals are clearly established, and that strategies and business plans are in place for achieving them
- establishing policies for enhancing the performance of the Society
- monitoring the performance of management
- appointing the CEO
- identifying steps necessary to protect the Society's financial position
- ensuring the Society's financial statements are true and fair and otherwise conform with legal requirements
- ensuring the Board and management adhere to high ethical standards
- ensuring the Society has appropriate risk management and regulatory compliance policies and procedures in place.

The Board will regularly evaluate economic, political, social and legal issues and any other relevant external matters that may influence or affect the development of the business or the interests of members and/or stakeholders and, if thought appropriate, will take outside expert advice on these matters.

The Society's Rules and Board Charter, are available to view at [www.southerncross.co.nz/board](http://www.southerncross.co.nz/board)

The Board endorses the principles set out in the Code of Practice for Directors as adopted and approved by the Institute of Directors in New Zealand Inc. The Board has also adopted its own Code of Conduct and Ethics Policy to provide guidance to the Board, management and employees on how it expects them to conduct themselves when undertaking business on behalf of the Society.

All Directors disclose any actual or potential conflicts of interest. Should a conflict of interest arise during the course of Board business the affected Director is expected to excuse him or herself from the discussion and does not vote on those matters.

The Board meets formally on a regular scheduled basis and holds additional meetings as the occasion requires. At each normal meeting the agenda will include a report from management covering operational and financial performance, capital expenditure proposals, and major issues and opportunities. At intervals of not greater than one year the Board will review the Society's goals and

strategies, approve budgets and financial statements, and undertake other activities listed in the Board Charter.

Separate strategic planning meetings are held in conjunction with the senior management team on a scheduled basis.

The Board reviews its own performance annually.

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## DELEGATION FRAMEWORK

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Responsibility for the day-to-day operation and administration of the Society is delegated by the Board to the Chief Executive Officer and senior management. The CEO is authorised to make decisions in accordance with the strategy, plans, budgets and the specific delegation framework approved by the Board.

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## COMMITTEES

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The Board has established a number of committees to assist in relation to specific business aspects. Each Board committee has a charter approved by the Board summarising the role, rights, responsibilities and membership requirements for that committee. The Board regularly reviews the charters of the Board committees and their performance against those charters. The charters are available to view at [www.southerncross.co.nz/board](http://www.southerncross.co.nz/board)

### Audit Committee

The Audit Committee's objectives are to assist the Board in discharging its responsibilities in relation to oversight of financial matters including internal and external audit functions.

Specific responsibilities include reviewing the content and disclosure of the Annual Report's financial statements; ensuring the Board makes informed decisions regarding accounting policies, practices and disclosures; recommending the appointment of external and internal auditors; reviewing the annual external and internal audit plans; ensuring that adequate internal control systems are in place; and ensuring management has established a risk management framework to effectively identify, treat, monitor and report key business risks. The Audit Committee comprises Liz Hickey (Chairman), Graeme Hawkins, Phillip Meyer and Keith Taylor.

### Remuneration Committee

The Remuneration Committee's objectives include providing advice to the Board in relation to the remuneration, employment conditions, development

and performance management of the organisation's Chief Executive Officer and senior executives, and other remuneration-related matters including standard terms and conditions of employment. The Remuneration Committee comprises Carole Durbin (Chairman), Douglas Baird and Graeme Hawkins.

### Nomination Committee

The Nomination Committee's objectives (updated as at August 2011) are to assist the Board in planning the Board's composition, evaluating the capabilities required of prospective Directors, identifying those prospective Directors, assessing Directors and relevant officers in accordance with the Society's Fit and Proper Policy, establishing the degree of Director independence, developing succession plans for the Board, and making recommendations to the Board accordingly. The Committee will consult with external advisors including executive search consultants and other independent sources of information and advice as it considers necessary for carrying out its responsibilities. The Nomination Committee is an adhoc committee and currently comprises Graeme Hawkins (Chairman), Carole Durbin, Liz Hickey and Phillip Meyer.

### Investment Committee

The Investment Committee's role is to act in an advisory capacity to the Board and Trustees in fulfilling their oversight responsibility for the investment assets of the Society. The Committee monitors, and provides advice in relation to, the management of the Society's investment portfolios. The Investment Committee comprises the Trustees – Phillip Meyer (Chairman), Carole Durbin and Graeme Hawkins - and additional Directors Keith Taylor and Mark Verbiest.

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## EXTERNAL AUDIT INDEPENDENCE

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The Board is committed to auditor independence. The Audit Committee is responsible for making recommendations to the Board concerning the appointment of external auditors and their terms of engagement. In September 2010 the Board supported the recommendation of the Audit Committee to re-appoint KPMG as the external auditors for the year ended 30 June 2011. Members approved the re-appointment of KPMG as auditors at the Annual General Meeting in November 2010.

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## LOANS TO DIRECTORS

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The Southern Cross Medical Care Society does not make loans to Directors.

# Board of Directors

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## GRAEME HAWKINS

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(BSC, BCom, ACA, FlntD)

Chairman

Graeme Hawkins has been a professional director for 18 years. He was appointed to the Southern Cross Board in October 2008, and appointed Chairman on 1 July 2009. He is Chairman of Southern Cross Health Trust, Chairman of one subsidiary company and Director of another. He is a Director of Cavalier Corporation Ltd and Ports of Auckland Ltd, and a Director and shareholder of Biomed Ltd. From 2001 to 2007 he was an appointed Director of Fonterra Co-operative Group and is a former Chairman of Auckland Healthcare, now Auckland District Health Board. Earlier in his career he held a number of strategic and financial roles at Fletcher Challenge and is a former CEO of Dominion Breweries.

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## DR DOUGLAS BAIRD

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(MBChB, DipObst, FRNZCGP)

Dr Douglas Baird was appointed to the Southern Cross Board in July 2007. He is a Director of Dr Ponsonby-White Cross, Managing Director of Aotea Health Services, a Trustee of Southern Cross Health Trust and a Director of one subsidiary, and a Trustee of the Auckland Medical Benevolent Fund. Dr Baird is a past Chairman of the Independent Practitioners Association Council (IPAC), was a founding Director of ProCARE Health (which represents more than 500 GPs in Auckland) and of BPACnz (an organisation dedicated to effective use of resources by health providers). He has served in elected and advisory roles with the Auckland District Health Board, the ACC

Medical Misadventure Unit and the Office of the Health and Disability Commissioner. Dr Baird has a Diploma of Obstetrics, is a Fellow of the Royal New Zealand College of General Practice and currently works as a primary care doctor in accident and medical clinics.

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## CAROLE DURBIN

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(BCom, LLB(Hons), FAMINZ, FlntD)

Carole Durbin was appointed to the Southern Cross Board in August 2006. She is Chair of Damwatch Services Limited (a Wellington-based dam engineering consultancy), a Director of New Zealand-owned Fidelity Life, and a Trustee of Southern Cross Health Trust and a Director of two subsidiaries. Until October 2009 she was Chair of electricity generator Mighty River Power and retailer Mercury Energy, having been on that board since 1998. A consultant to Simpson Grierson, one of New Zealand's leading legal firms, Ms Durbin has also held a number of previous Board appointments including Simpson Grierson, Transpower NZ, software developer Synergy International (now Fronde), and was an Earthquake Commissioner. She is a Fellow of the Institute of Directors.

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## LIZ HICKEY

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(MCom(Hons), FCA, MInstD, MNZM)

Liz Hickey is a chartered accountant and member of the Institute of Directors who joined the Southern Cross Board in October 2009. Ms Hickey is a Director of the Institute of Chartered Accountants (NZICA) and the Institute of Environmental Science & Research (a Crown Research Institute), a co-opted member of the ASB Community



### Board of Directors (L to R)

Mark Verbiest, Liz Hickey, Keith Taylor, Graeme Hawkins, Phillip Meyer, Carole Durbin, Dr Douglas Baird

Trust's Audit and Risk Committee, and a Trustee of Sight Loss Services Charitable Trust Board and Southern Cross Health Trust. Her past governance experience includes being a Director of Radio New Zealand and Genesis Power, and serving on both the New Zealand and international boards of the World Association of Girl Guides and Girl Scouts. She is a Fellow of the NZICA.

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## PHILLIP MEYER

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(FAIM, FNZIM, AF Inst D, F Fin)

Phillip Meyer is an experienced company director and investment banker who joined the Southern Cross Board in June 2002 and is Chairman of the Society's Investment Committee. He is Chairman of Australian Financial Services Group and Institute of Directors (Wellington Branch). He is a Trustee of Young Enterprise Trust and Crimestoppers Trust, a Trustee of Southern Cross Health Trust and a Director of two subsidiaries, a National Councillor for Institute of Directors in NZ, and a member of the Disciplinary Tribunal of the New Zealand Institute of Chartered Accountants, the New Zealand Markets Disciplinary Tribunal and the Financial Services Institute of Australia. He is also National Chairman of the Salvation Army Red Shield Appeal Committee.

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## KEITH TAYLOR

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(BSc, BCA, FIA, F Inst D)

Keith Taylor was elected to the Southern Cross Board in November 2010 and has over 30 years experience in the insurance and financial services industries as a Chief

Executive, Chief Financial Officer and Actuary. He is chair of the Government Superannuation Fund, deputy chair of the Earthquake Commission, and a director of the Reserve Bank of New Zealand, Port Marlborough, Gough Gough & Hamer and Butland Holdings. He is a member of the NZ Qualifications Authority, Takeovers Panel and Carey Baptist College Board. He has previously been a director of property, insurance, trustee and investment companies in both New Zealand and Australia. He is also a Trustee of the NZ Fire Services Superannuation Scheme and the Southern Cross Health Trust.

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## MARK VERBIEST

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(LLB)

Mark Verbiest, a lawyer and professional director, was appointed to the Southern Cross Board in October 2008. He is also a Trustee of Southern Cross Health Trust. Mr Verbiest is Chairman of Transpower New Zealand Limited and Willis Bond Capital Partners Limited, and a Director of AMP New Zealand Office Ltd and Freightways Ltd. He is also a Trustee of the Government Superannuation Fund Authority, a member of the Financial Markets Authority, and a consultant to law firm Simpson Grierson. Between 2000 and mid-2008 Mark was a senior executive of Telecom Corporation of New Zealand Limited where he was responsible for a number of corporate units and two business units. Prior to this he was a senior corporate partner in Simpson Grierson for many years.

### Director meeting attendance for the year ended 30 June 2011

	Society Board	AGM	Trustees	Strategic Workshops	Audit Committee	Remuneration Committee	Investment Committee	Nomination Committee	Constitutional Committee*	Group Strategic Meetings
GS Hawkins	8	1	4	1	6	4	4	1	1	8
Dr DD Baird	7	1		1		4		1		7
Ms CB Durbin	8	1	4	1		4	4	1	1	8
Ms EM Hickey	8	1		1	6					8
DJ May	3	1	1		2		1			3
PJ Meyer	8	1	3	1	6		4			8
KB Taylor	4			1	3		2			4
MJ Verbiest	8	1		1			4		1	8

DJ May retired as a Director and Trustee 25 November 2010

PJ Meyer appointed a Trustee 25 November 2010

KB Taylor appointed a Director 25 November 2010

KB Taylor appointed to the Audit and Investment Committees 29 November 2010

\* The Constitutional Committee was dis-established following the adoption of The Rules at the 2010 AGM.

# Financial statements

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# The Southern Cross Medical Care Society

## STATEMENTS OF COMPREHENSIVE INCOME for the year ended 30 June 2011

	NOTE	GROUP		SOCIETY	
		2011 \$000	2010 \$000	2011 \$000	2010 \$000
Premium revenue		662,487	597,345	662,487	597,345
Net claims expense	3	577,090	562,200	577,090	562,200
<b>Underwriting surplus</b>		85,397	35,145	85,397	35,145
Operating expenses	4	81,332	77,338	78,919	75,658
<b>Operating surplus/(deficit)</b>		4,065	(42,193)	6,478	(40,513)
Net investment and other income	5	24,216	35,092	21,792	33,280
<b>Surplus/(deficit) before taxation</b>		28,281	(7,101)	28,270	(7,233)
Taxation	6	-	-	-	-
<b>Surplus/(deficit) after taxation</b>		28,281	(7,101)	28,270	(7,233)
Other comprehensive income		-	-	-	-
<b>Total comprehensive surplus/(deficit) for the year</b>		28,281	(7,101)	28,270	(7,233)

The accompanying notes form part of these financial statements

# The Southern Cross Medical Care Society

## STATEMENTS OF CHANGES IN RESERVES for the year ended 30 June 2011

<b>GROUP 2011</b>	<b>Retained Surpluses \$000</b>	<b>Total Reserves \$000</b>
Opening balance	306,151	306,151
<b>Total comprehensive surplus:</b>		
Surplus after taxation	28,281	28,281
Other comprehensive income	-	-
<b>Total comprehensive surplus:</b>	<b>28,281</b>	<b>28,281</b>
Closing balance	334,432	334,432
<b>GROUP 2010</b>	<b>Retained Surpluses \$000</b>	<b>Total Reserves \$000</b>
Opening balance	313,252	313,252
<b>Total comprehensive deficit:</b>		
Deficit after taxation	(7,101)	(7,101)
Other comprehensive income	-	-
<b>Total comprehensive deficit</b>	<b>(7,101)</b>	<b>(7,101)</b>
Closing balance	306,151	306,151

The accompanying notes form part of these financial statements



# The Southern Cross Medical Care Society

## STATEMENTS OF CHANGES IN RESERVES for the year ended 30 June 2011 (continued)

<b>SOCIETY 2011</b>	<b>Retained Surpluses \$000</b>	<b>Total Reserves \$000</b>
Opening balance	306,029	306,029
<b>Total comprehensive surplus:</b>		
Surplus after taxation	28,270	28,270
Other comprehensive income	-	-
<b>Total comprehensive surplus</b>	<b>28,270</b>	<b>28,270</b>
Closing balance	334,299	334,299
<b>SOCIETY 2010</b>	<b>Retained Surpluses \$000</b>	<b>Total Reserves \$000</b>
Opening balance	313,262	313,262
<b>Total comprehensive deficit:</b>		
Deficit after taxation	(7,233)	(7,233)
Other comprehensive income	-	-
<b>Total comprehensive deficit</b>	<b>(7,233)</b>	<b>(7,233)</b>
Closing balance	306,029	306,029

The accompanying notes form part of these financial statements

# The Southern Cross Medical Care Society

## STATEMENTS OF FINANCIAL POSITION as at 30 June 2011

	NOTE	GROUP		SOCIETY	
		2011 \$000	2010 \$000	2011 \$000	2010 \$000
<b>Assets</b>					
Cash and cash equivalents		1,238	267	1,160	137
Premium and other receivables	7	72,532	56,771	72,406	56,629
Assets classified as held for sale	8	-	7,850	-	7,850
Investments	9	417,702	402,991	417,702	402,991
Investment in subsidiaries	10	-	-	-	-
Property and equipment	11	16,027	6,289	16,025	6,286
Intangible assets	12	6,562	6,960	6,559	6,924
<b>Total assets</b>		<b>514,061</b>	<b>481,128</b>	<b>513,852</b>	<b>480,817</b>
<b>Liabilities</b>					
Payables	13	20,724	15,068	20,648	14,879
Employee benefits	14	7,715	7,663	7,715	7,663
Insurance contract liabilities	15	151,190	152,246	151,190	152,246
<b>Total liabilities</b>		<b>179,629</b>	<b>174,977</b>	<b>179,553</b>	<b>174,788</b>
<b>Net assets</b>		<b>334,432</b>	<b>306,151</b>	<b>334,299</b>	<b>306,029</b>
<b>Reserves</b>		<b>334,432</b>	<b>306,151</b>	<b>334,299</b>	<b>306,029</b>

### For and on behalf of the Board

G S Hawkins, Chairman



Date: 6 September 2011

E M Hickey, Director



Date: 6 September 2011

The accompanying notes form part of these financial statements

# The Southern Cross Medical Care Society

## STATEMENTS OF CASH FLOWS for the year ended 30 June 2011

	NOTE	GROUP		SOCIETY	
		2011 \$000	2010 \$000	2011 \$000	2010 \$000
<b>Cash flows from operating activities</b>					
Premium revenue		663,750	596,903	663,750	596,903
Interest received		24,069	26,589	24,063	26,584
Other income		2,473	1,848	44	47
Payment of claims		(581,599)	(562,841)	(581,599)	(562,841)
Payments to employees		(38,801)	(36,658)	(36,847)	(34,974)
Payments to suppliers		(38,512)	(36,052)	(37,979)	(35,950)
<b>Net cash flows from operating activities</b>	19	31,380	(10,211)	31,432	(10,231)
<b>Cash flows from investing activities</b>					
Proceeds from sale of property and equipment		91	111	91	111
Payments for property and equipment		(12,484)	(3,795)	(12,484)	(3,795)
Net (payments)/proceeds for intangible assets		(1,917)	(2,677)	(1,917)	(2,669)
Net (payments)/proceeds for investments		(16,099)	15,863	(16,099)	15,863
<b>Net cash flows from investing activities</b>		(30,409)	9,502	(30,409)	9,510
<b>Net increase/(decrease) in cash and cash equivalents</b>		971	(709)	1,023	(721)
<b>Opening cash and cash equivalents</b>		267	976	137	858
<b>Closing cash and cash equivalents</b>		1,238	267	1,160	137

The accompanying notes form part of these financial statements

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011

### 1. STATEMENT OF ACCOUNTING POLICIES

#### REPORTING ENTITY

The Southern Cross Medical Care Society (the "Society") is a friendly society domiciled in New Zealand, registered under the Friendly Societies and Credit Unions Act 1982.

The Society's registered office is Level 1, Ernst & Young Building, 2 Takutai Square, Auckland.

Financial statements for the Society and consolidated financial statements are presented. The consolidated financial statements as at, and for the year ended, 30 June 2011 comprise the Society and its subsidiaries: Southern Cross Health Services Limited, Southern Cross Healthcare Limited (non-trading) and Activa Health Limited (together referred to as the "Group").

The statutory base for the Society is the Friendly Societies and Credit Unions Act 1982. The statutory base for the subsidiaries is the Companies Act 1993 and the Financial Reporting Act 1993.

The Society's primary activity is the provision of health insurance.

#### BASIS OF PREPARATION

The financial statements have been prepared in accordance with New Zealand generally accepted accounting practice ("NZ GAAP"). They comply with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS"), International Financial Reporting Standards ("IFRS"), and other applicable financial reporting standards, as appropriate for public benefit entities. NZ IFRS requires all entities to determine whether they are a public benefit entity or a profit oriented entity for reporting purposes. The Directors consider that the Society is more closely aligned with the characteristics of a public benefit entity than a profit oriented entity.

The statements of financial position have been presented in the order of decreasing liquidity.

The financial statements were approved by the Board of Directors on 6 September 2011.

#### BASIS OF MEASUREMENT

The financial statements are prepared on the historical cost basis except that the following are stated at their fair value: investments, cash, land and buildings, and insurance contract liabilities.

#### FUNCTIONAL AND PRESENTATION CURRENCY

These financial statements are presented in New Zealand dollars (\$), which is the Group's functional and presentation currency. All financial information presented in New Zealand dollars has been rounded to the nearest thousand, unless otherwise stated.

#### USE OF ESTIMATES AND JUDGEMENTS

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised.

Information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in the following notes:

- Note 15: Insurance contract liabilities
- Note 16: Actuarial information
- Note 17: Risk management

The accounting policies set out below have been applied consistently, by all Group entities, to all periods presented in these financial statements.

#### BASIS OF CONSOLIDATION

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies, generally by holding more than half of the voting rights. The financial statements of subsidiaries are included in the Group financial statements from the date that control commences until the date that control ceases.

All intra-group balances and transactions are eliminated in preparing the Group financial statements.

#### CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand and current account balances in bank accounts. Under the NZ IFRS definition of financial assets, cash and cash equivalents are classified as "financial assets at fair value through profit or loss".

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

#### PREMIUM AND OTHER RECEIVABLES

Premium and other receivables are stated at their cost less any impairment losses. Impairment losses for uncollectible premiums are written off against premium revenue in the year in which they are incurred. Under the NZ IFRS definition of financial assets, premium and other receivables are classified as "loans and receivables".

#### INVESTMENTS

Investments are purchased with the intention of being held until maturity.

All purchases of investments are recognised on the date of the trade. Transaction costs are recognised as an expense in determining the surplus or deficit before tax in the statements of comprehensive income on transaction date. Investments are de-recognised on the date of maturity or sale of an investment.

The Group designates its investments as "financial assets at fair value through profit or loss" at inception. That is, changes in fair value are recognised in determining the surplus or deficit before tax in the statements of comprehensive income.

Fair value is determined using a three-level fair value hierarchy that reflects the significance of the inputs used in measuring fair values of financial assets and liabilities. The hierarchy is described in Note 17 "Risk Management".

As investments are held to maturity, and then reinvested, only the net purchased or matured amount is disclosed in the statements of cash flows.

#### ASSETS HELD FOR SALE

Assets that are expected to be recovered primarily through sale, rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets are revalued in accordance with the Group's accounting policies.

Thereafter the assets are stated at the lower of their carrying amount or their fair value less costs to sell. Impairment losses on initial classification as held for sale and any subsequent gains and losses are recognised in determining the surplus or deficit before tax in the statements of comprehensive income. Gains are not recognised in excess of any cumulative impairment losses.

#### INVESTMENT IN SUBSIDIARIES

Investment in subsidiaries is stated at cost less impairment losses.

#### PROPERTY AND EQUIPMENT

Items of property and equipment, with the exception of land and buildings, are measured at cost, less accumulated depreciation and impairment losses.

Land and buildings are revalued to fair value as determined by an independent registered valuer. Any increase in value is recognised in other comprehensive income and held in the asset revaluation reserve. Any decrease in value is recognised in other comprehensive income until the asset revaluation reserve for that asset is exhausted, and any further decrease in value is recognised as an expense in determining the surplus or deficit before tax.

Where material components of an item of property or equipment have different useful lives, they are accounted for as separate items of property and equipment.

Subsequent expenditure that replaces a component, or enhances the item of property or equipment, is added to the carrying amount of an item of property or equipment when that cost is incurred, if it is probable that the future economic benefits embodied within the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised as an expense in determining the surplus or deficit before tax in the statements of comprehensive income.

Capital expenditure on major projects is initially recorded as work in progress. On completion of the project the asset is transferred to the appropriate asset category. Work in progress is not depreciated.

Depreciation is recognised in determining the surplus or deficit before tax in the statements of comprehensive income on a straight-line basis over the estimated useful lives of each component of property or equipment as follows:

- Computer equipment 25% - 33% per annum
- Other fixed assets 15% - 20% per annum
- Leasehold improvements 10% - 33% per annum

The estimated useful life of assets is reassessed annually.

Sales of property and equipment relate to motor vehicles traded in and replaced with new vehicles. It also includes the sale of the Grafton Road property. The sale and purchase of property and equipment are disclosed separately in the statements of cash flows.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

#### INTANGIBLE ASSETS

Computer software is recognised as an intangible asset when it is not an integral part of the computer hardware. Software development expenditure that meets the criteria for recognition as an intangible asset is capitalised and amortised over its expected useful life, subject to impairment testing. Costs incurred in researching and evaluating a project up to the point of formal commitment to a project are treated as research costs and are expensed as incurred. All capitalised costs are deemed to have an expected useful life of five years unless it can be clearly demonstrated that the net benefits are to be generated over either a longer or shorter period. The capitalised costs are amortised on a straight line basis over the period following completion of a project or implementation of part of a project.

The recoverability of the carrying amount of the asset is reviewed at each reporting date by determining whether there is an indication that the carrying value may be impaired. If any such indication exists, the item is tested for impairment by comparing the recoverable amount of the asset to its carrying value.

An impairment loss is recognised whenever the carrying value exceeds the recoverable amount. Impairment losses are recognised in determining the surplus or deficit before tax in the statements of comprehensive income and may be reversed where there has been a change in the estimates used to determine the recoverable amount.

#### FOREIGN CURRENCY TRANSACTIONS

Transactions in foreign currencies that are settled in the reporting period are translated at the settlement rate. Transactions in foreign currency that are not settled in the reporting period, resulting in monetary assets and liabilities denominated in foreign currencies at the end of the reporting period, are translated to New Zealand dollars at the foreign exchange rate ruling at the reporting date. Foreign exchange differences arising on their translation are recognised in determining the surplus or deficit before tax in the statements of comprehensive income.

#### IMPAIRMENT

The carrying amounts of assets are reviewed at the end of each reporting period to determine whether there is any objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

The estimated recoverable amount of an asset is the greater of: fair value less costs to sell, and value in use.

An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses directly reduce the carrying amount of the asset and are recognised in determining the surplus or deficit before tax in the statements of comprehensive income.

#### INSURANCE CONTRACTS

Insurance contracts are defined as those containing significant insurance risk at the inception of the contract.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during the period.

The Society has determined that all health insurance policies provided to members are insurance contracts.

#### INCOME RECOGNITION

##### *Premiums*

Gross earned premiums from insurance contracts are recognised evenly over the current billing period of the contract. Revenue is recognised on the date from which the policy is effective. Premiums billed but unearned are recorded as an unearned premium liability in the statements of financial position.

##### *Fee and other income*

Fees and other income are recognised as income evenly over the period in which the related services are performed.

##### *Investment income*

Interest income is recognised in determining the surplus or deficit before tax in the statements of comprehensive income as it accrues, and is calculated by using the effective interest rate method. Premiums and discounts that are an integral part of the effective yield of the investment are recognised as an adjustment to the effective interest rate of the instrument.

Realised and unrealised gains and losses on investments, recorded in determining the surplus or deficit before tax in the statements of comprehensive income, include gains and losses on financial assets classified as financial assets at fair value through profit or loss. Gains and losses on the sale of investments are classified as the difference between net sale proceeds and the fair value recorded at the date of the sale transaction. Unrealised gains and losses are classified as the difference between the fair value at the reporting date and the previous carrying value.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

#### LEASES

Leases are defined as an operating lease where they do not transfer substantially all the risks and rewards incidental to ownership. Payments made under operating leases are recognised in determining the surplus or deficit before tax in the statements of comprehensive income on a straight-line basis over the term of the lease.

Any inducement payments received as part of an operating lease agreement are deferred and recognised on a straight-line basis over the term of the lease.

#### POLICY ACQUISITION COSTS

The costs incurred in acquiring and recording insurance contracts may give rise to future benefits from premiums. Acquisition costs are initially recorded in determining the surplus or deficit before tax in the statements of comprehensive income. Any amounts that give rise to premiums in subsequent reporting periods are deferred as an asset and amortised over the period covered by the premium paid.

#### PAYABLES

Payables are stated at cost. Under the NZ IFRS definition of financial liabilities, payables are classified as "other liabilities at amortised cost".

#### NET CLAIMS EXPENSE

The net claims expense represents payments made on claims and the movements in the outstanding claims and unexpired risk provisions (as described below).

#### PROVISIONS

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market rates and, where appropriate, the risks specific to the obligation.

#### OUTSTANDING CLAIMS PROVISION

The liability for outstanding claims comprises claims incurred but not settled at the reporting date, whether reported or not. A central estimate is made of claims reported but not paid, claims incurred but not reported and claims incurred but not adequately reported. The central estimate includes expected claim payments plus associated claims handling costs. In addition a risk margin is added to reflect the inherent uncertainty in the estimate of claims.

#### UNEXPIRED RISK PROVISION AND LIABILITY ADEQUACY TEST

A liability adequacy test is performed to assess whether there is any deficiency in the unearned premium liability arising from expected claims and administration costs during the period covered by the unearned premium. The test is performed on all the policies as a whole as risks are broadly similar and are managed together as a single portfolio. The central estimate of claims and administration expenses is calculated. In addition, a risk margin is added to reflect the inherent uncertainty in estimating the claims. The total is compared with the unearned premium liability. Any deficiency is recognised as an expense in determining the surplus or deficit before tax in the statements of comprehensive income after first writing down any deferred acquisition costs. The deficiency in excess of deferred acquisition costs is recognised in the statements of financial position as an unexpired risk provision.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

#### EMPLOYEE BENEFITS

##### *Employee entitlements*

Employee entitlements represents the current obligation to employees in respect of outstanding salaries, leave entitlements and other short term benefits.

##### *Employee benefits*

The Group's net obligation in respect of long service leave is the amount of future benefits that employees have earned in return for their service in current and prior periods. The financial value of the obligation is calculated based on estimated future cash flows and is discounted to its present value.

In determining future cash flows, consideration is given to historical data with respect to employee departures, periods of service and estimated future increases in wage and salary rates. The discount rate is the market yield rate on relevant New Zealand Government stock at the end of the reporting period.

##### *Post employment benefits*

The Group's obligation for post employment entitlements comprises post retirement health insurance benefits. The financial value of the obligation is calculated as the present value of estimated future cash flows. In determining future cash flows, consideration is given to future increases in health insurance premiums and historical data with respect to employee departures, periods of service and mortality rates. The discount rate is the market yield rate on relevant New Zealand Government stock at the end of the reporting period.

#### INCOME TAX EXPENSE

The Society is exempt from income tax due to its status as a friendly society. However, the subsidiaries are subject to income tax.

For subsidiary companies the income tax expense comprises current and deferred tax and is recognised in the statements of comprehensive income. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Deferred tax reflects the tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary differences can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

#### GOODS AND SERVICES TAX (GST)

The statements of comprehensive income and statements of cash flows have been prepared so that all components are stated exclusive of GST. All items in the statements of financial position are stated net of GST, with the exception of receivables and payables, which include GST invoiced.

#### CHANGE IN ACCOUNTING ESTIMATES

A change in an accounting estimate that gives rise to a change in an asset or liability is recognised by adjusting the carrying amount of the related asset or liability item in the period of the change. Other changes in accounting estimates are recognised prospectively in the statements of comprehensive income in the period of the change and future periods, as applicable.



# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 2. NEW FINANCIAL REPORTING STANDARDS APPROVED BUT NOT YET EFFECTIVE

The following new or amended standards and interpretations, which are applicable to the Group, are not yet effective for the year ended 30 June 2011, and have not been applied in preparing these financial statements:

NZ IFRS 9 - Financial Instruments: Classification and Measurement (2009 and 2010)

NZ IAS 7 - Statement of Cash Flows

Improvements to NZ IFRS 2010 - NZ IFRS 7 - Financial Instruments: Disclosures

NZ IFRS 9 - Financial Instruments: Classification and Measurement (2009) is the first standard issued as part of a wider project to replace NZ IAS 39. It represents a significant change from the existing requirements in NZ IAS 39 - Financial Instruments: Recognition and Measurement, in respect of financial assets. The standard contains two primary measurement categories for financial assets (amortised cost and fair value), and eliminates the existing three NZ IAS 39 categories (held to maturity, available for sale, and loans and receivables). A financial asset would be measured at amortised cost if it is held to collect contractual cash flows of principal and interest on specified dates. All other financial assets would be measured at fair value.

NZ IFRS 9 - Financial Instruments: Classification and Measurement (2010) adds the requirements relating to classification and measurement of financial liabilities, and derecognition of financial assets and liabilities.

The above revisions to NZ IFRS 9 are effective for annual reporting periods beginning on or after 1 January 2013. The impact of the requirements of this standard on the Group is still to be determined.

The amendment to NZ IAS 7 - Statement of Cash Flows allows the use of the "indirect" method for the statement of cash flows. It removes the requirement to provide a reconciliation between the surplus / (deficit) and the cash flow from operating activities. This will be effective for the Society for the annual reporting period ending 30 June 2012.

The amendments arising from Improvements to NZ IFRS 2010 - NZ IFRS 7 - Financial Instruments: Disclosures add an explicit statement that qualitative disclosure should be made in the context of the quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments. The changes also amended and removed existing disclosure requirements. These amendments are effective for all annual reporting periods beginning on or after 1 January 2011. This will be effective for the Group for the annual reporting period ending 30 June 2012. The impact of the requirements of this standard on the Group is still to be determined.

### 3. NET CLAIMS EXPENSE

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Claims incurred relating to risks borne in current financial year	581,756	564,788	581,756	564,788
Claims incurred relating to risks borne in previous financial years	(1,041)	584	(1,041)	584
Movement in provision for claims handling costs	(67)	148	(67)	148
Movement in risk margin	(91)	279	(91)	279
Net claims incurred	580,557	565,799	580,557	565,799
Movement in provision for unexpired risk	(3,467)	(3,599)	(3,467)	(3,599)
	577,090	562,200	577,090	562,200

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

<b>4A. OPERATING EXPENSES</b>					
Operating expenses include:	<b>GROUP</b>		<b>SOCIETY</b>		
	<b>2011 \$000</b>	<b>2010 \$000</b>	<b>2011 \$000</b>	<b>2010 \$000</b>	
Auditor's remuneration:					
– Audit fees	160	155	160	155	
– Other services	18	18	18	18	
Depreciation	2,392	1,758	2,391	1,757	
Amortisation of intangible assets	2,114	1,902	2,081	1,862	
Impairment loss on intangible assets	201	-	201	-	
Directors' fees	360	362	360	362	
Employee benefits expense	38,853	37,140	36,899	35,456	
Contributions to defined contribution plan	54	62	54	62	
Rental of premises	2,643	2,107	2,637	2,100	
Provision for impairment loss on amounts receivable from subsidiaries	-	-	647	553	
(Gains)/losses on disposal of property and equipment, including land and buildings	713	(3)	713	(3)	
Revaluation of land and buildings	-	1,350	-	1,350	
Auditor's remuneration for other services disclosed above consists of accounting advisory services, reviewing regulatory returns and providing services at the AGM.					
<b>4B. OPERATING EXPENSES</b>					
Operating expenses consist of:	<b>GROUP</b>		<b>SOCIETY</b>		
	<b>2011 \$000</b>	<b>2010 \$000</b>	<b>2011 \$000</b>	<b>2010 \$000</b>	
Policy acquisition	10,068	9,558	10,068	9,558	
Policy administration	37,387	35,654	37,387	35,654	
Claims handling	7,692	7,299	7,692	7,299	
Management	26,185	24,827	23,772	23,147	
	<b>81,332</b>	<b>77,338</b>	<b>78,919</b>	<b>75,658</b>	

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 5. NET INVESTMENT AND OTHER INCOME

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Interest income	23,142	25,793	23,136	25,788
Net gains/(losses) on investments at fair value through profit or loss	(1,388)	7,445	(1,388)	7,445
Fee and other income	2,462	1,854	44	47
	24,216	35,092	21,792	33,280

### 6. TAXATION

Reconciliation of effective tax rate	GROUP	
	2011 \$000	2010 \$000
Net surplus/(deficit) before tax	28,771	(7,101)
Income tax payable at the domestic tax rate of 30%	8,631	(2,130)
Effect of non-deductible expenses	2	2
Effect of exempt surplus/(deficit)	(8,822)	2,003
Tax effect of change in unrecognised temporary differences	(9)	(66)
Tax on current year deficits for which no deferred tax asset was recognised	198	191
	-	-

The aggregate amount of temporary differences arising in the subsidiaries for which a deferred tax asset has not been recognised is \$163,000 at 30 June 2011 (30 June 2010: deferred tax asset \$192,000).

The Group has unrecognised tax losses carried forward of \$31,129,000 at 30 June 2011 (30 June 2010: \$30,483,000).

The Government has passed legislation to change the corporate tax rate to 28% from the 2011 – 2012 income year.

### 7. PREMIUM AND OTHER RECEIVABLES

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Premium accounts receivable	49,450	46,406	49,450	46,406
Interest receivable	3,812	4,739	3,812	4,739
Other accounts receivable	11,350	5,336	10,669	4,708
Amounts owed by related parties	520	290	1,075	776
Asset disposal proceeds receivable	7,400	-	7,400	-
	72,532	56,771	72,406	56,629

The fair value of premium and other receivables approximates the carrying amount.  
Premium and other receivables is a current asset.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 8. ASSETS HELD FOR SALE

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Land and buildings	-	7,850	-	7,850
	-	7,850	-	7,850

Assets held for sale is a current asset.

At 30 June 2011, the land and buildings had been sold for net proceeds of \$7,284,000, after disposal costs, with settlement on 29 July 2011.

At 30 June 2010, the land and buildings were valued at \$7,850,000 based on observable market prices, including an allowance for estimated disposal costs.

### 9. INVESTMENTS

At fair value through profit or loss	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
New Zealand Government stock	1,519	1,546	1,519	1,546
State owned enterprise bonds	11,470	11,359	11,470	11,359
Local authority stock	74,748	84,685	74,748	84,685
Other bonds	94,142	157,240	94,142	157,240
Bank deposits, commercial paper and floating rate notes	235,823	148,161	235,823	148,161
	417,702	402,991	417,702	402,991
Current assets	175,216	99,344	175,216	99,344
Non-current assets	242,486	303,647	242,486	303,647
	417,702	402,991	417,702	402,991

\$1,000,000 of New Zealand Government stock is held by the Public Trustee, of which \$500,000 is a deposit required under the Insurance Companies' Deposits Act 1953.

### 10. INVESTMENT IN SUBSIDIARIES

Investment in subsidiaries is stated at cost less impairment losses. Impairment losses arise as a result of the investment in subsidiaries being adjusted to the value of the net tangible assets of the subsidiaries. Investment in subsidiaries has now been fully impaired.

A provision for impairment has been made for loans and advances to subsidiaries to the extent the loans and advances exceed the net tangible assets of the subsidiaries.

The Directors have resolved to provide sufficient financial support as may be necessary to enable the subsidiary companies to trade as going concerns.

Investment in subsidiaries is a non-current asset.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

<b>11. PROPERTY AND EQUIPMENT</b>						
	<b>GROUP</b>					
	<b>Land and buildings \$000</b>	<b>Computer equipment \$000</b>	<b>Other fixed assets \$000</b>	<b>Leasehold improvements \$000</b>	<b>Work in progress \$000</b>	<b>Total \$000</b>
<b>At 30 June 2011</b>						
Cost / valuation	-	21,426	3,437	7,813	1,700	34,376
Accumulated depreciation	-	(17,559)	(445)	(345)	-	(18,349)
Closing balance	-	3,867	2,992	7,468	1,700	16,027
<b>Reconciliation of movement in property and equipment</b>						
Opening balance	-	3,675	1,087	309	1,218	6,289
Additions	-	41	262	-	12,181	12,484
Transfers from work in progress	-	1,786	2,399	7,514	(11,699)	-
Disposals	-	(5)	(342)	(7)	-	(354)
Depreciation	-	(1,630)	(414)	(348)	-	(2,392)
Closing balance	-	3,867	2,992	7,468	1,700	16,027
<b>GROUP</b>						
	<b>Land and buildings \$000</b>	<b>Computer equipment \$000</b>	<b>Other fixed assets \$000</b>	<b>Leasehold improvements \$000</b>	<b>Work in progress \$000</b>	<b>Total \$000</b>
<b>At 30 June 2010</b>						
Cost / valuation	-	19,604	5,228	1,117	1,218	27,167
Accumulated depreciation	-	(15,929)	(4,141)	(808)	-	(20,878)
Closing balance	-	3,675	1,087	309	1,218	6,289
<b>Reconciliation of movement in property and equipment</b>						
Opening cost	9,200	16,831	5,114	1,117	589	32,851
Opening accumulated depreciation	-	(14,692)	(3,975)	(624)	-	(19,291)
Opening balance	9,200	2,139	1,139	493	589	13,560
Additions	-	13	393	-	3,389	3,795
Transfers from work in progress	-	2,760	-	-	(2,760)	-
Disposals	-	-	(108)	-	-	(108)
Depreciation	-	(1,237)	(337)	(184)	-	(1,758)
Revaluation recognised in operating expenses	(1,350)	-	-	-	-	(1,350)
Reclassified as assets held for sale	(7,850)	-	-	-	-	(7,850)
Closing balance	-	3,675	1,087	309	1,218	6,289

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

<b>11. PROPERTY AND EQUIPMENT (CONTINUED)</b>						
	<b>SOCIETY</b>					
	<b>Land and buildings \$000</b>	<b>Computer equipment \$000</b>	<b>Other fixed assets \$000</b>	<b>Leasehold improvements \$000</b>	<b>Work in progress \$000</b>	<b>Total \$000</b>
<b>At 30 June 2011</b>						
Cost / valuation	-	21,357	3,430	7,813	1,700	34,300
Accumulated depreciation	-	(17,490)	(440)	(345)	-	(18,275)
Closing balance	-	3,867	2,990	7,468	1,700	16,025
<b>Reconciliation of movement in property and equipment</b>						
Opening balance	-	3,675	1,084	309	1,218	6,286
Additions	-	41	262	-	12,181	12,484
Transfers from work in progress	-	1,786	2,399	7,514	(11,699)	-
Disposals	-	(5)	(342)	(7)	-	(354)
Depreciation	-	(1,630)	(413)	(348)	-	(2,391)
Closing balance	-	3,867	2,990	7,468	1,700	16,025
<b>At 30 June 2010</b>						
Cost / valuation	-	19,535	5,221	1,117	1,218	27,091
Accumulated depreciation	-	(15,860)	(4,137)	(808)	-	(20,805)
Closing balance	-	3,675	1,084	309	1,218	6,286
<b>Reconciliation of movement in property and equipment</b>						
Opening cost	9,200	16,762	5,108	1,117	589	32,776
Opening accumulated depreciation	-	(14,624)	(3,972)	(624)	-	(19,220)
Opening balance	9,200	2,138	1,136	493	589	13,556
Additions	-	13	393	-	3,389	3,795
Transfers from work in progress	-	2,760	-	-	(2,760)	-
Disposals	-	-	(108)	-	-	(108)
Depreciation	-	(1,236)	(337)	(184)	-	(1,757)
Revaluation recognised in operating expenses	(1,350)	-	-	-	-	(1,350)
Reclassified as assets held for sale	(7,850)	-	-	-	-	(7,850)
Closing balance	-	3,675	1,084	309	1,218	6,286
Other fixed assets include motor vehicles and office equipment. Property and equipment is a non-current asset.						

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

<b>12. INTANGIBLE ASSETS</b>			
	<b>Computer software \$000</b>	<b>GROUP Work in progress \$000</b>	<b>Total \$000</b>
<b>At 30 June 2011</b>			
Cost / valuation	29,393	1,639	31,032
Accumulated amortisation	(24,470)	-	(24,470)
Closing balance	4,923	1,639	6,562
<b>Reconciliation of movement in intangible assets</b>			
Opening balance	5,309	1,651	6,960
Additions	471	1,476	1,947
Transfers from work in progress	1,488	(1,488)	-
Disposals	(30)	-	(30)
Amortisation	(2,114)	-	(2,114)
Impairment loss recognised	(201)	-	(201)
Closing balance	4,923	1,639	6,562
<b>At 30 June 2010</b>			
Cost / valuation	27,467	1,651	29,118
Accumulated amortisation	(22,158)	-	(22,158)
Closing balance	5,309	1,651	6,960
<b>Reconciliation of movement in intangible assets</b>			
Opening cost	24,336	2,005	26,341
Opening accumulated amortisation	(20,156)	-	(20,156)
Opening balance	4,180	2,005	6,185
Additions	2	2,675	2,677
Transfers from work in progress	3,029	(3,029)	-
Amortisation	(1,902)	-	(1,902)
Closing balance	5,309	1,651	6,960

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

<b>12. INTANGIBLE ASSETS (CONTINUED)</b>			
	<b>Computer software \$000</b>	<b>SOCIETY Work in progress \$000</b>	<b>Total \$000</b>
<b>At 30 June 2011</b>			
Cost / valuation	29,235	1,639	30,874
Accumulated amortisation	(24,315)	-	(24,315)
Closing balance	4,920	1,639	6,559
<b>Reconciliation of movement in intangible assets</b>			
Opening balance	5,273	1,651	6,924
Additions	471	1,476	1,947
Transfers from work in progress	1,488	(1,488)	-
Disposals	(30)	-	(30)
Amortisation	(2,081)	-	(2,081)
Impairment loss recognised	(201)	-	(201)
Closing balance	4,920	1,639	6,559
<b>At 30 June 2010</b>			
Cost / valuation	27,309	1,651	28,960
Accumulated amortisation	(22,036)	-	(22,036)
Closing balance	5,273	1,651	6,924
<b>Reconciliation of movement in intangible assets</b>			
Opening cost	24,186	2,005	26,191
Opening accumulated amortisation	(20,074)	-	(20,074)
Opening balance	4,112	2,005	6,117
Additions	2	2,667	2,669
Transfers from work in progress	3,021	(3,021)	-
Amortisation	(1,862)	-	(1,862)
Closing balance	5,273	1,651	6,924
Intangible assets is a non-current asset.			
The majority of the computer software and work in progress are internally generated.			
Impairment losses arise from software development projects that do not have a positive quantifiable financial benefit. Where indicators of impairment exist, the future financial benefit is recalculated using a net present value analysis. Where the net present value is not positive, impairment is recognised in determining the surplus or deficit before tax in the statements of comprehensive income.			



# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

<b>13. PAYABLES</b>				
	<b>GROUP</b>		<b>SOCIETY</b>	
	<b>2011 \$000</b>	<b>2010 \$000</b>	<b>2011 \$000</b>	<b>2010 \$000</b>
Accounts payable	16,476	15,049	16,390	14,832
Amounts owed to related parties	16	19	26	47
Deferred income - lease inducement	4,232	-	4,232	-
	20,724	15,068	20,648	14,879
Current	16,919	15,068	16,843	14,879
Non-current	3,805	-	3,805	-
	20,724	15,068	20,648	14,879
<b>14. EMPLOYEE BENEFITS</b>				
	<b>GROUP</b>		<b>SOCIETY</b>	
	<b>2011 \$000</b>	<b>2010 \$000</b>	<b>2011 \$000</b>	<b>2010 \$000</b>
Employee entitlements	4,945	4,853	4,945	4,853
Employee benefits	830	830	830	830
Post-employment benefits	1,940	1,980	1,940	1,980
	7,715	7,663	7,715	7,663
Current	5,234	5,053	5,234	5,053
Non-current	2,481	2,610	2,481	2,610
	7,715	7,663	7,715	7,663
<b>15. INSURANCE CONTRACT LIABILITIES</b>				
	<b>GROUP</b>		<b>SOCIETY</b>	
	<b>2011 \$000</b>	<b>2010 \$000</b>	<b>2011 \$000</b>	<b>2010 \$000</b>
Provision for outstanding claims (refer note 15a)	74,077	75,973	74,077	75,973
Provision for unearned premium (refer note 15c)	70,976	66,779	70,976	66,779
Provision for unexpired risk (refer note 15d)	5,317	8,784	5,317	8,784
Other insurance provisions	820	710	820	710
	151,190	152,246	151,190	152,246

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

<b>15. INSURANCE CONTRACT LIABILITIES (CONTINUED)</b>					
<b>a. Provision for outstanding claims</b>					
	<b>GROUP</b>		<b>SOCIETY</b>		
	<b>2011 \$000</b>	<b>2010 \$000</b>	<b>2011 \$000</b>	<b>2010 \$000</b>	
Central estimate of outstanding claims liability	68,466	70,204	68,466	70,204	
Claims handling costs	2,084	2,151	2,084	2,151	
Risk margin	3,527	3,618	3,527	3,618	
Closing balance	74,077	75,973	74,077	75,973	
Claims are predominantly short-term in nature and are generally settled within twelve months of being incurred. Accordingly, amounts are not discounted.					
<b>b. Reconciliation of movement in provision for outstanding claims</b>					
	<b>GROUP</b>		<b>SOCIETY</b>		
	<b>2011 \$000</b>	<b>2010 \$000</b>	<b>2011 \$000</b>	<b>2010 \$000</b>	
Opening balance	75,973	72,113	75,973	72,113	
Amounts utilised during the year	(67,333)	(65,392)	(67,333)	(65,392)	
Additional provision/(reversal of unused provision)	(1,041)	584	(1,041)	584	
Amounts provided during the year	66,636	68,241	66,636	68,241	
Movement in claims handling costs	(67)	148	(67)	148	
Movement in risk margin	(91)	279	(91)	279	
Closing balance	74,077	75,973	74,077	75,973	
<b>c. Reconciliation of movement in provision for unearned premium</b>					
	<b>GROUP</b>		<b>SOCIETY</b>		
	<b>2011 \$000</b>	<b>2010 \$000</b>	<b>2011 \$000</b>	<b>2010 \$000</b>	
Opening balance	66,779	61,578	66,779	61,578	
Premiums written in the year	666,684	602,546	666,684	602,546	
Premiums earned during the year	(662,487)	(597,345)	(662,487)	(597,345)	
Closing balance	70,976	66,779	70,976	66,779	

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 15. INSURANCE CONTRACT LIABILITIES (CONTINUED)

#### d. Provision for unexpired risk

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Present value of expected future cash flows for claims and expenses	73,001	72,833	73,001	72,833
Risk margin	3,650	2,913	3,650	2,913
Unearned premiums	(70,976)	(66,779)	(70,976)	(66,779)
Write-down of deferred acquisition costs	(358)	(183)	(358)	(183)
Closing balance	5,317	8,784	5,317	8,784

#### e. Reconciliation of movement in provision for unexpired risk

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Opening balance	8,784	12,383	8,784	12,383
Reversal of opening balance	(8,784)	(12,383)	(8,784)	(12,383)
Net liability for unexpired risk recognised during the year	2,025	6,054	2,025	6,054
Risk margin	3,650	2,913	3,650	2,913
Write-down of deferred acquisition costs	(358)	(183)	(358)	(183)
Closing balance	5,317	8,784	5,317	8,784

### 16. ACTUARIAL INFORMATION

Estimates of the outstanding claims and unexpired risk as at 30 June 2011 have been determined by John Smeed, a Fellow of the New Zealand Society of Actuaries and were presented to the directors of the Society in a report dated 26 August 2011. There were no qualifications to the report. The calculations of the provisions for outstanding claims and unexpired risk each comply with both NZ IFRS 4: Insurance Contracts, and Professional Standard No. 4: General Insurance Business, of the New Zealand Society of Actuaries. The actuary is satisfied as to the nature, sufficiency and accuracy of the data used to determine these provisions.

#### a. Outstanding claims provision

Outstanding claims liabilities are measured as the central estimate of the present value of expected future payments for claims incurred but not settled at 30 June 2011, whether reported or not, together with related claims handling costs and an additional risk margin to allow for the inherent uncertainty in the central claims estimate. The central estimate of the outstanding claims has been calculated using historical experience to determine the pattern of claims development.

A projected payment per member method has been adopted for estimating outstanding claims payments. Calculations are based on recent claims experience. Payment per member factors are selected to achieve a sensible progression of past incurred claims.

Estimation of outstanding claims liabilities includes an allowance for claims incurred but not reported, claims incurred but not adequately reported, unpaid reported claims and future claims handling costs associated with paying claims. An explicit allowance has been made for expected ACC recoveries as at 30 June 2011 similar to that made at 30 June 2010.

A risk margin has been added to reflect the inherent uncertainty in the central estimate. An analysis of the volatility of the historical experience has been used in determining the risk margin. Future volatility is assumed to be consistent with historical volatility. A risk margin of 5% of the central estimate was established at 30 June 2011 (30 June 2010: 5%). The risk margin was determined with the objective of achieving at least 75 % probability of sufficiency of the outstanding claims provision.

### 16. ACTUARIAL INFORMATION (CONTINUED)

Key assumptions:

1. Future patterns of claims development will be similar to historical patterns depending on the type of policy, type of claim and development month.
2. Monthly seasonality factors used for claims incurred. These were calculated from the 3 years' previous claims experience, and range from 72% to 112% (30 June 2010: 73% to 112%) of the monthly average.
3. Historical claims inflation 6.5% p.a. (30 June 2010: 9%), based on previous claims experience.

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any part of the general administrative costs directly attributable to the claims function. Claims handling costs were determined to be 3% (30 June 2010: 3%) of the underlying claims amounts based on an analysis of administration expenses.

The average weighted term from 30 June 2011 to the expected settlement date for claims included in the liability for outstanding claims is 74 days (30 June 2010: 75 days). Accordingly, expected future payments are not discounted due to the short tail nature of the liabilities.

#### b. Unexpired risk provision and liability adequacy test

A liability adequacy test was performed to determine whether the unearned premium liability is adequate to cover the present value of the expected future cash flows arising from rights and obligations under current insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate. The future cash flows are future claims, associated claims handling costs and other administration costs relating to the business.

If the present value of the expected future cash flows plus the additional risk margin to reflect the inherent uncertainty in the central estimate exceeds the unearned premium liability less related intangible assets and related deferred acquisition costs then the unearned premium liability is deemed to be deficient.

The unexpired risk liability has been calculated as the projected premium deficiency for current in-force business until the next policy billing date on or after 1 July 2011.

The calculation of the risk margin has been based on an analysis of the volatility of historical claims experience within the time period covered by the unearned premiums. A risk margin of 5% of the present value of expected future cash flows has been applied at 30 June 2011 (30 June 2010: 4%). The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the unexpired risk liability.

Key assumptions:

1. Monthly seasonality factors used for claims incurred. These were calculated from the 3 years' previous claims experience, and range from 76% to 109% (2010: 76% to 110%) of the monthly average.
2. Projected claims inflation of 6.5% p.a., plus 4% for the effect of ageing, based on current expectations (2010: 9% plus 4%).
3. Expenses based on the business plan for 2011/12, including allowance for amortisation of deferred acquisition costs.

No explicit allowance has been made for cancellations or transfers. These are allowed for implicitly in the inflation assumption.

Expected future payments are not discounted due to the short tail nature of the liabilities.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 17. RISK MANAGEMENT

The Group is exposed to a number of risks in the normal course of business. Primarily there are the risks associated with underwriting an insurance business (insurance risk). Other risks include financial risks (credit risk and liquidity risk), market risks (interest rate risk and foreign currency risk), and non-financial risks (operational risk and compliance risk). The Directors and management recognise the importance of having an effective risk management policy in place. The new Insurance Prudential Supervision regime requires insurers to maintain a risk management policy, which the Reserve Bank of New Zealand will assess for appropriateness. The risks and any objectives, policies and processes to manage these insurance and financial risks are described below.

#### a. Insurance risk

The Group assumes insurance risk through its health insurance activities. The key risk arises in respect of claims costs and, in particular, those costs varying from what was assumed in the setting of premium rates.

##### I. Risk management objectives, policies and processes for mitigating risk

The primary objective in managing risk is, as far as possible, to reduce the magnitude and volatility of claims costs. A secondary objective is to ensure funds are available to pay claims and maintain the solvency of the business if there is adverse deviation in experience. Key policies and methods for mitigating risk include:

- Underwriting policies and processes which evaluate new risks and offer terms that do not endanger the portfolio.
- Strict claims management procedures to ensure the payment of claims is in accordance with policy conditions.
- A long-term pricing strategy adopted by the Board which supports pricing based on underlying risk.
- Regular monitoring of financial and operating results and detailed investigations into the morbidity and persistency experience of the portfolio.
- Maintaining a target solvency margin in excess of the minimum required by the standard established by the Health Funds Association of New Zealand. The solvency margin ensures the Society is able to withstand a period of adverse insurance or investment experience and still maintain a satisfactory financial position (refer to Note 22).

##### II. Sensitivity to insurance risk

The financial results of the Society are primarily affected by the level of claims incurred relative to that implicit in the premiums. The assumptions used in the valuation of the outstanding claims provision and the liability adequacy test directly affect the level of estimated claims incurred. The key assumptions used are detailed in note 16.

The scope of insurance risk is managed by the terms and conditions of the policy. The main insurance benefit involves the reimbursement of medical and surgical expenses depending upon the plan option.

The level of benefits specified in the contract is a key determinant of the amount of future claims although the exact level of claims is uncertain.

Other variables affecting the level of claims include the underlying morbidity of the lives insured, the nature of treatment given and the costs of treatment.

##### III. Concentration of insurance risk

Management defines concentration of risk by type of insurance business and geographic region. The Society transacts health insurance business in New Zealand and, therefore, the concentration of risk by type of insurance and geographic region cannot be avoided. Insurance risks are well diversified within the health insurance portfolio with claims costs spread across many different types of surgery and medical events. There is no significant exposure to individual large claims.

#### b. Financial risks

##### I. Credit risk

In the normal course of its business the Group incurs credit risk from its health insurance operations and from investment in financial assets. There are no significant concentrations of credit risk.

The Group maintains a credit policy which is used to manage the exposure to credit risk. Limits on counter-party exposures have been set and are monitored on an ongoing basis. The credit quality of counter-parties is assessed based on published credit ratings issued by Standard & Poor's or equivalent ratings agencies. Where local authorities do not have a formal credit rating, security is obtained from their ability to levy rates.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 17. RISK MANAGEMENT (CONTINUED)

The credit quality of investment counter-parties is as follows:

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
AAA	9,035	15,108	9,035	15,108
AA	207,081	142,918	207,081	142,918
A	90,943	91,301	90,943	91,301
BBB	26,209	24,978	26,209	24,978
Below BBB	-	1,911	-	1,911
Non-rated	84,434	126,775	84,434	126,775
	417,702	402,991	417,702	402,991

The maximum exposure to credit risk at the end of the reporting period is the amount of financial assets stated in the statements of financial position.

These exposures are net of any recognised provisions for impairment losses. The Group does not require any collateral or security to support financial assets due to the quality of the counter-party organisations.

The cash and cash equivalents balances are held with a counter party rated AA (30 June 2010: AA).

Premium receivables are due from a very large number of counter-parties, ranging from large corporates to individual members. Analysing these by credit quality would not be feasible, as the majority of counter-parties will be non-rated.

#### II. Liquidity risk

The Group is exposed to daily calls on its available cash resources from claims and administration expenses. Liquidity risk is the risk that payment of obligations may not be met in a timely manner at a reasonable cost. The Directors set limits on the minimum proportion of maturing funds available to meet such calls to cover claims and expenses at unexpected levels of demand.

The contractual maturities of investments are as follows:

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
On call	2,908	2,000	2,908	2,000
0-6 months	114,087	43,971	114,087	43,971
7-12 months	58,221	53,373	58,221	53,373
1-2 years	71,916	87,717	71,916	87,717
2-5 years	148,943	198,567	148,943	198,567
Beyond 5 years	21,627	17,363	21,627	17,363
	417,702	402,991	417,702	402,991

The cash and cash equivalents are available on call. All premium receivables, and substantially all other receivables are due within one month of the end of the reporting period.

Financial liabilities are all short term or payable on demand. Investments could be liquidated at any time to settle liabilities.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 17. RISK MANAGEMENT (CONTINUED)

#### c. Market risks

##### I. Foreign currency risk

At 30 June 2011, the Group had assets of \$263,000 and no liabilities denominated in foreign currencies (30 June 2010: assets of \$210,000 and no liabilities). Given that the foreign currency risk exposure is minimal, the Group does not enter into any derivative contracts to manage this risk.

##### II. Interest rate risk

The Group invests in both fixed and variable rate financial instruments such as bonds, commercial paper and floating rate notes. There is a risk that any movement in interest rates can have an effect on the profitability and cash flows of the Group. The Group maintains a spread of investment types and maturity profiles to mitigate this risk.

##### (i) Cash flow interest rate risk

The cash flows from the Group's investments in the short term are susceptible to changes in interest rates. However, as the majority of investments are fixed rate, and these investments are held until maturity, this exposure is mitigated. The following analysis shows the impact of any changes in interest rates on the cash flows:

	<b>GROUP AND SOCIETY</b>	
	<b>2011 \$000</b>	<b>2010 \$000</b>
Impact of increase in interest rates by 100 basis points on cash flows	1,412	1,437
Impact of decrease in interest rates by 100 basis points on cash flows	(1,412)	(1,437)

##### (ii) Fair value risk

The fair value of fixed rate investments can fluctuate depending on changes in interest rates. The Group's policy is to hold all investments until maturity. This eliminates any effects of fair value changes to the investments upon realisation, however unrealised fair value changes are recognised in determining the surplus or deficit before tax in the statements of comprehensive income for each period. The following analysis shows the impact of any changes in interest rates:

	<b>GROUP AND SOCIETY</b>	
	<b>2011 \$000</b>	<b>2010 \$000</b>
Impact of increase in interest rates by 100 basis points on surplus/ (deficit) before taxation	(3,406)	(5,038)
Impact of decrease in interest rates by 100 basis points on surplus/ (deficit) before taxation	3,489	5,215

##### (iii) Fair values of financial assets and financial liabilities

All financial assets and financial liabilities included in the statements of financial position are carried at amounts that approximate fair value.

The table below analyses financial assets measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised.

#### Definition of the fair value hierarchy

Level 1: Valuation based on quoted market prices (unadjusted) in an active market.

Level 2: Valuation techniques based on observable market data, either directly (as prices) or indirectly (derived from prices).

Level 3: Valuation techniques not based on observable market data.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

<b>17. RISK MANAGEMENT (CONTINUED)</b>				
	<b>GROUP AND SOCIETY</b>			
<b>30 June 2011</b>	<b>Level 1 \$000</b>	<b>Level 2 \$000</b>	<b>Level 3 \$000</b>	<b>Total \$000</b>
New Zealand Government stock	1,519	-	-	1,519
State owned enterprise bonds	-	11,470	-	11,470
Local authority stock	-	74,748	-	74,748
Other bonds	-	94,142	-	94,142
Bank deposits, commercial paper and floating rate notes	2,908	232,915	-	235,823
<b>Total investments</b>	<b>4,427</b>	<b>413,275</b>	<b>-</b>	<b>417,702</b>
<b>30 June 2010</b>	<b>Level 1 \$000</b>	<b>Level 2 \$000</b>	<b>Level 3 \$000</b>	<b>Total \$000</b>
New Zealand Government stock	1,546	-	-	1,546
State owned enterprise bonds	-	11,359	-	11,359
Local authority stock	-	84,685	-	84,685
Other bonds	-	157,240	-	157,240
Bank deposits, commercial paper and floating rate notes	2,000	146,161	-	148,161
<b>Total investments</b>	<b>3,546</b>	<b>399,445</b>	<b>-</b>	<b>402,991</b>
<p>Investments were independently valued by Bancorp Treasury Services Limited at 30 June 2011 and 30 June 2010. Investments are valued based on closing market prices as reported to wholesale investors. Where closing market prices are not available for certain investments, for example private placements by local authorities in which the Society has participated, the value of these investments are based on observable inputs using quoted prices for similar instruments ensuring that all significant inputs are directly or indirectly observable from market data.</p> <p>Cash and cash equivalents are valued using a level 1 basis (30 June 2010: Level 1).</p>				



# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 18. RELATED PARTIES

#### a. Identity and relationship of related parties:

• The Southern Cross Medical Care Society ("Society")	Parent
• Southern Cross Health Services Limited ("Health Services")	100% subsidiary of Society
• Activa Health Limited ("Activa")	100% subsidiary of Society
• Southern Cross Healthcare Limited (non-trading)	100% subsidiary of Society
• Directors of The Southern Cross Medical Care Society	Are Trustees of Southern Cross Health Trust
• Southern Cross Health Trust ("Trust")	Related party of Society
• Southern Cross Benefits Limited ("Benefits")	100% subsidiary of Trust
• Southern Cross Hospitals Limited ("Hospitals")	100% subsidiary of Trust
• Southern Cross Primary Care Limited ("Primary Care")	100% subsidiary of Trust

The Society and its subsidiaries, and the Trust and its subsidiaries, have 30 June reporting dates.

The Society and the Trust are separate legal entities operating at "arm's length".

The Society contracts healthcare services on behalf of its members from all providers, including the Hospitals, on a contestable and contractual basis.

The Society charges Benefits a fee for enabling marketing opportunities to the membership.

All Group and related parties provide their normal services to the other Group and related parties on normal commercial terms.

*The amount of transactions between the Group entities are:*

	PURCHASES		SALES	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Society	2,422	3,540	69	79
Health Services	17	11	77	66
Activa	52	68	2,345	3,474

*The outstanding balances between the Group entities are:*

	PAYABLES		RECEIVABLES	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Society	10	28	571	496
Health Services	419	464	5	13
Activa	152	32	5	15

Some goods and services are purchased by the Group and other related parties on a combined basis. These costs are on-charged to the other related parties at cost.

*The amount of transactions with other related parties are:*

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Sale of services	4,048	3,405	4,013	3,369
Purchase of services	107	98	107	98

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 18. RELATED PARTIES (CONTINUED)

The outstanding balances with other related parties are:

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Balance outstanding on sales	520	290	504	280
Balance outstanding on purchases	16	19	16	19

All related party balances are payable on normal trading terms and unsecured. No related party transactions have taken place at nil or nominal value. No related party balances have been written off or forgiven during the year.

Included within related party receivables of the Society are amounts receivable from subsidiary companies which are payable on demand. However, these are not currently intended to be called for payment. Provision has been made for any receivables considered to be impaired.

#### b. Remuneration of Directors

Directors' fees paid by the Society for the year ended 30 June 2011 were as follows:

Director	2011 Amount \$	2010 Amount \$
Dr D D Baird	43,250	48,368
C B Durbin	49,000	48,368
G S Hawkins (Chairman)	80,000	83,367
E M Hickey - appointed 1 October 2009	44,375	36,693
D J May - retired 25 November 2010	19,792	48,368
P J Meyer	48,500	48,368
K B Taylor - appointed 25 November 2010	26,833	-
M J Verbiest	48,500	48,368
<b>Trustee</b>		
C B Durbin	-	-
G S Hawkins - appointed 26 November 2009	-	-
D J May - retired 25 November 2010	-	-
P J Meyer - appointed 25 November 2010	-	-

Where Directors are directors of subsidiary companies of the Society, they do not receive any fees for these appointments.

The Society provides Trustees and Directors with directors' and officers' liability insurance cover for liabilities to other parties that may arise from their positions as Trustees and Directors.

The Society does not provide loans or advances to Directors or Trustees.

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 18. RELATED PARTIES (CONTINUED)

#### c. Remuneration of key management personnel

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Salaries and other short-term benefits	3,186	3,095	3,186	3,095
	3,186	3,095	3,186	3,095

Key management personnel include the chief executive officer, chief executive and senior executives.

The Society does not provide loans or advances to key management personnel. At each reporting date, there are amounts outstanding to key management personnel comprising salaries, earned leave and short term incentives.

### 19. RECONCILIATION OF NET SURPLUS/(DEFICIT) WITH NET CASH FLOWS FROM OPERATING ACTIVITIES

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Net surplus/(deficit) after taxation	28,281	(7,101)	28,270	(7,233)
Add/(less) non-cash items:				
Depreciation	2,392	1,758	2,391	1,757
Amortisation of intangible assets	2,114	1,902	2,081	1,862
Impairment loss on intangible assets	201	-	201	-
Provision for impairment loss on amounts receivable from subsidiaries	-	-	647	553
Revaluation of land and buildings	-	1,350	-	1,350
Add items classified as investing activities :				
(Gains)/losses on disposal of property and equipment	713	(3)	713	(3)
Movement in valuation of investments	(385)	(8,272)	(385)	(8,272)
(Gains)/losses on disposal of investments	1,773	827	1,773	827
Add/(less) movements in working capital items:				
Receivables	(8,361)	(4,495)	(9,024)	(4,740)
Payables	5,656	(2,091)	5,769	(2,246)
Other insurance provisions	110	(30)	110	(30)
Provision for outstanding claims	(1,896)	3,860	(1,896)	3,860
Provision for unearned premium	4,197	5,201	4,197	5,201
Provision for unexpired risk	(3,467)	(3,599)	(3,467)	(3,599)
Provision for employee benefits	52	482	52	482
<b>Net cash flows from operating activities</b>	<b>31,380</b>	<b>(10,211)</b>	<b>31,432</b>	<b>(10,231)</b>

# The Southern Cross Medical Care Society

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2011 (continued)

### 20. CREDIT RATING

On 21 February 2011 Standard & Poor's reaffirmed the Society's Insurer Financial Strength Rating of A+. This signifies the insurer "has strong financial security characteristics".

### 21. ACTUARIAL REPORT

The five yearly actuarial report as required under section 74 of the Friendly Societies and Credit Unions Act 1982 was filed with the Registrar on 11 March 2011.

### 22. SOLVENCY AND CAPITAL ADEQUACY

The Society is a not-for-profit organisation. As a consequence of its legal structure the Society has no recourse to external capital and therefore internally generated capital is of paramount importance. The Society's capital of \$334.4 million (2010: \$306.0 million) is equal to the reserves as disclosed in the financial statements.

The Society is required to deposit \$500,000 with the Public Trustee in accordance with the Insurance Companies' Deposits Act 1953. The Society is not subject to any other externally imposed capital requirements.

The Directors' policy for managing capital is to have a strong capital base to establish security for members and enable the Society to conduct its business whilst maintaining financial soundness. The policy in respect of capital management is regularly reviewed by the Directors.

The Society calculates its capital adequacy requirements using the Capital Adequacy Standard issued by Australia's Private Health Insurance Administration Council (PHIAC). The PHIAC Capital Adequacy Standard has been constructed for the purpose of determining a minimum amount of capital required to support business plans and maintain financial soundness.

A calculation at 30 June 2011 showed the Society had assets in excess of the level specified by the PHIAC Capital Adequacy Standard. Accordingly, the Directors consider the current level of capital is sufficient for the requirement of maintaining financial soundness.

There have been no material changes to the Society's policy for the management of capital during the financial year.

The New Zealand authorities have developed a new regulatory regime for insurers, to be supervised by the Reserve Bank of New Zealand. The Insurance (Prudential Supervision) Bill was enacted in September 2010. In line with the Act, the Society has applied for a provisional insurance licence, to be obtained by 7 March 2012. Full licensing must be obtained by 7 September 2013. One component of the new regime is a solvency standard for non-life insurers. The new solvency regime will be incorporated into the Society's capital management policy during the 2012 financial year.

### 23. LEASE COMMITMENTS

At 30 June 2011 commitments under operating leases in respect of payments due to be made in the following years were:

	GROUP		SOCIETY	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Within 1 year	4,607	2,686	4,607	2,686
Between 1 and 2 years	4,475	4,204	4,475	4,204
Between 2 and 5 years	12,930	12,178	12,930	12,178
Greater than 5 years	19,927	21,234	19,927	21,234
	41,939	40,302	41,939	40,302

The major component of the lease commitments is the lease on the Auckland office premises.

The Society entered into this lease agreement in December 2009 for a lease term of 10 years, commencing 1 April 2011.

### 24. CAPITAL COMMITMENTS

The Group had capital commitments of \$671,000 at 30 June 2011 (2010: \$1,845,000).

### 25. CONTINGENT LIABILITIES

The Group had no contingent liabilities at 30 June 2011 (2010: Nil).

# Independent auditor's report

To the Members of The Southern Cross Medical Care Society



We have audited the accompanying financial statements of The Southern Cross Medical Care Society ("the Society") and the Group, comprising the Society and its subsidiaries, on pages 13 to 42. The financial statements comprise the statements of financial position as at 30 June 2011, the statements of comprehensive income, changes in reserves and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, for both the Society and the Group.

## Directors' Responsibility for the Society and Group Financial Statements

The Directors are responsible for the preparation of Society and Group financial statements in accordance with generally accepted accounting practice in New Zealand and International Financial Reporting Standards 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 Society and Group 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 these Society and Group financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Society and Group financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Society and Group financial statements. The procedures selected depend on the auditor's 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, the auditor considers internal control relevant to the Society and Group'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 Society and Group'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 presentation of the financial statements.

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

Our firm has also provided other services to the Society and Group in relation to general accounting and other services. Partners and employees of our firm may be members of the Society and deal with the Society and Group on normal terms within the ordinary course of trading activities of the business of the Society and Group. These matters have not impaired our independence as auditors of the Society and Group. The firm has no other relationship with, or interest in, the Society and Group.

## Opinion

In our opinion the financial statements on pages 13 to 42:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards;
- give a true and fair view of the financial position of the Society and the Group as at 30 June 2011 and their financial performance and cash flows for the year then ended.

**KPMG**

14 September 2011  
Auckland

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