Southern Cross
Health Society

The Southern Cross Medical Care Society
2012 Annual Report

Apricots are a great source of dietary fibre and also contain vitamin A, which helps promote good vision.

Contents

Overview

FOR THE YEAR ENDED 30 JUNE 2012

- The Southern Cross Medical Care Society is in a strong and stable financial position with reserves equating to approximately seven months' worth of claims.
- In February the Society received an A+ (Strong) financial strength rating from Standard and Poor's for the tenth consecutive year.
- The 2012 financial year was characterised by volatility in claiming levels, with claims reaching a record high in May after lower than expected claims costs over the first half of the year.
- Lower first half claims resulted in a higher-than-planned surplus of $39m. This surplus will be retained in the Society to mitigate future premium increases and/or increase the value of our policies' benefits and/or to maintain reserves at appropriate levels.
- Members continued to receive good value for money from their Southern Cross policies. For every dollar received in premium income, 85.7 cents was returned to members in claims for healthcare services.
- Reflecting an industry wide trend, membership decreased 1.6% over the year to 822,422 members. Market share remained steady at 61%.
- On behalf of members, the Society continued to focus on programmes to help mitigate the impact of rising claims costs. The Society now has over 300 Affiliated Provider agreements with healthcare service providers, accounting for 25% of all claims costs.

Chairman's report

The Society ended 2012 in a strong financial position. Lower than expected claims through the early part of the year resulted in a surplus of $39.0m. A significant contributor to this was lower claims costs from the Canterbury region in the first quarter, driven primarily by the temporary closure of several private surgical facilities in the city following the devastating February 2011 earthquake.

However, the latter part of 2012 proved quite a different story. Claims costs across the membership surged in the final quarter, hitting a record high for the month of May. Claims cost growth is forecast to continue at high levels during 2013.

Volatile periods such as these highlight the importance of the Society's prudent reserving and pricing approach.

In 2012, Southern Cross members continued to receive good value for money from their health insurance policies. Premium income for the year was $706.8m, while total claims reached $605.5m.

For every dollar received in premium, 85.7 cents was returned to members in claims for healthcare services. A return of around 85 cents is appropriate to ensure the on-going sustainability of the Society while maintaining value for members, so this is a pleasing result.

WORKING FOR THE BENEFIT OF MEMBERS

As a mutual organisation, any surpluses are retained in the Society for the benefit of members. This money is most commonly used to mitigate future premium increases, increase the value of our policies' benefits and maintain financial reserves at appropriate levels.

The Society regularly reviews benefits in its plans to ensure members continue to receive value for money when they claim.

Examples of enhanced benefits coming into effect in September 2012 include extending the qualifying time period for post-operative care in surgery-only plans, increased maximums for prescriptions and obstetrics care, and a new dietician benefit for members with conditions such as irritable bowel syndrome, immunodeficiency disorders and allergies, or those requiring post cardiac care.

STRENGTH AND STABILITY

Maintaining strong financial reserves is not only responsible governance - it is now a legal requirement under the Insurance (Prudential Supervision) Act. The Act requires insurers to make sufficient provision for claims liabilities, taking into account the possibility of severe and unexpected claims cost inflation over a short timeframe.

To meet this requirement, the Society has established a target solvency range for reserves. At year end, the Society's reserves sat at $373.3m, just above the mid-point of our target solvency range. This is the equivalent of around seven months of claims.

Reserves are also invested to generate income for the Society and its membership. In the 2012 financial year, the Society's $468.9m investment portfolio generated $21.9m in income.

Our strong solvency position has also helped the Society maintain an A+ financial strength rating from Standard and Poor's for 10 consecutive years, despite considerable and on-going uncertainty in financial markets.

Members can have confidence that the Society is financially stable, operating in a sustainable manner, and is meeting all regulatory requirements. To this end, the Reserve Bank of New Zealand issued the Society with a provisional licence to operate as a licensed insurer in November 2011. Full licensing will be completed by September 2013.

MEMBERSHIP LEVELS

Over the year the Society's membership decreased 1.6% to 822,422 members, reflecting an industry-wide trend in difficult economic times. Market share remained steady at 61%. The membership is expected to increase in tandem with the recovery of the wider economy.

Employers continued to see strong value for their staff in the fast access to treatment that health insurance provides. The number of employer subsidised members remained level with 2011 figures.

Interestingly, the number of Society members aged 65 and over grew by 1.6% during the year - the only age group with a notable increase in membership. Members aged 65 and over make up 12% (98,000 members) of the total Southern Cross membership and account for 32% of all claims costs. This age group continues to receive good value from their investment in health insurance – in 2012 for every dollar of premium paid by members aged 65 or over, 90 cents was returned in claims for healthcare services.

The Society offers a wide range of options, including lower-cost plans and excesses, so that people can retain their health insurance as their financial situation changes. In 2012, over 4,600 members aged 65 and over took the option to "downgrade" to a plan with a reduced level of coverage in exchange for lower premiums. We continue to urge members to work with us to find a plan that is affordable for them.

MEMBER TENURE PROJECT

At the Society's 2011 AGM, two resolutions were passed which asked the Board to look at ways to recognise members of long-standing. The issue at the heart of the resolutions was the impact of rising healthcare costs on the premiums of older members.

The resulting Member Tenure Project has encompassed member consultation, research, detailed data analysis and future projection modelling.

The project found that a discount based on tenure would raise significant questions regarding member equity and the sustainability of the Society.

A core issue is that providing a discount for one group of members, such as long-term members, must be funded by increasing premiums for others. Research conducted as part of the project found that concept to be unpopular with large parts of the membership.

While the Society feels it is not appropriate to pursue the idea of a discount based on membership tenure any further, as a result of the project we will look into extending the assessment period for Southern Cross's Low Claims Reward beyond the current two year period. This would introduce an element of tenure recognition while ultimately rewarding lower claiming members. We are exploring this in greater detail, and expect to report the outcome by year end.

The findings of the Member Tenure Project do not diminish the concern long held by the Board and management about rising healthcare costs and the high cost of premiums, especially for older members. The Society is strongly focused on solutions to help manage healthcare costs, and therefore premiums, long term. Our initiatives are making a difference, and we want to do even more to ensure our members have access to the best value healthcare.

ACKNOWLEDGEMENTS

In closing I would like to thank the Board and all Society staff for their hard work throughout the year. I would also like to welcome Greg Gent, who was elected on to the Board at the 2011 Annual General Meeting.

To our members, thank you for your continued support.

Graeme Hawkins
Chairman

Chief Executive Officer's report

Health insurance plays an incredibly important role in New Zealand's health system. In the future, personal responsibility for our elective healthcare will be even more necessary.

Some news headlines would have us believe there is no need to make personal provision for elective healthcare. The very opposite is true.

Though the number of elective surgeries provided by District Health Board funding is at "record" levels, so too is the need for these services. This heightened demand is being echoed in the private sector. For example, between April 2007 and March 2012, the number of orthopaedic procedures funded by the Society increased by 26% - though total membership remained static over the same period.

Despite a tough economic climate and the absence of any financial incentives to insure, 1.35 million New Zealanders choose to make provision for their own elective healthcare needs through health insurance.

These New Zealanders, and many of their employers, place a high value on the knowledge that should they require elective care they can access it without delay and undue financial burden.

New Zealand is fortunate to have a world-class health system. However, it's one facing a funding crisis as rapidly rising healthcare costs, high community expectations, expanded treatment options and the increased needs of an ageing population place unprecedented pressure on health budgets.

By 2036, Statistics New Zealand estimates around 23% of New Zealand's population will be aged 65 and over, up from 14% of the population today. Healthcare will consume a much larger portion of the country's finances. How we fund this increase needs to become an urgent issue. At Southern Cross 32% of our claims costs are for members aged 65 and over. This is consistent with estimates that 36% of all public health spending goes to services for people over the age of 65.

It's not just that our population will be more prone to injury and illness, and needing more care and more surgeries. As our life expectancy increases, we'll also want to stay healthier for longer – we'll want new hips, new knees, new heart valves. There will be more technology and more options.

Ever-increasing demand for healthcare services will not be the only pressure. High medical cost inflation has seen healthcare costs rise sharply right around the world.

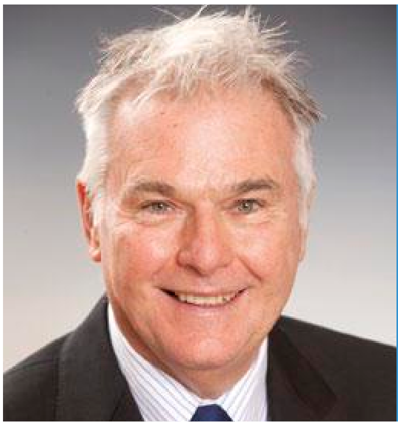
Significant change will be needed. But within crisis comes opportunity - to be smarter, more resourceful and more innovative in the use of each and every health dollar.

BETTER VALUE HEALTHCARE

To ensure a wide range of New Zealanders continue to have the option of health insurance, it's vital we ensure the cost of premiums continue to represent good value for money.

As a mutual organisation, our premiums are a direct reflection of our claims costs. We have seen the price of many surgeries increase significantly in the last decade, and this rapid escalation has been felt keenly by our members. The Society's Affiliated Provider programme is a key way we are working with the medical community to understand their pricing, to manage or moderate premiums for our members long-term, and to provide a streamlined prior approval and payment service for members – see page 6 for more information on the achievements and future direction of this programme.

When looking at ways to achieve better value we have also recognised that not all surgery needs the resources of a full hospital operating theatre. In the last year the Society has amended policy benefits to encourage more simple procedures to be done in lower-cost, quality environments



DR IAN MCPHERSON
CHIEF EXECUTIVE OFFICER
SOUTHERN CROSS MEDICAL CARE SOCIETY

such as General Practitioners' surgical rooms rather than hospitals.

Prostheses are another area of focus in the coming year. Implants and other devices can make up a large portion of the cost of some procedures – around 33% in some cases. Working with others in the health sector, we are looking at whether there are ways to achieve better value from a collective approach to purchasing, much like Pharmac does with medicines.

STRENGTH IN NUMBERS

Southern Cross Medical Care Society is a part of New Zealand's largest non-public healthcare organisation, the Southern Cross Healthcare Group. Both the Society and the Group as a whole are taking a leading role in finding solutions to New Zealand's future healthcare challenges.

The group is made up of two primary entities - the Southern Cross Health Trust (which owns Southern Cross Hospitals, Southern Cross Benefits and Southern Cross Primary Care) and the Southern Cross Medical Care Society.

Because of its size, the Group plays a very important role in the New Zealand health sector. Despite being independent, Southern Cross businesses can also work together on appropriate initiatives that meet the objectives of the parties involved. For example, extending minor surgery capabilities for qualified General Practitioners has advantages for both the Society and Southern Cross Primary Care.

The overarching purpose of the Group is achieving better value healthcare for all New Zealanders.

Meeting the country's health funding challenge will require more New Zealanders to take more personal responsibility for their elective healthcare. A previous generation believed the state would provide for their old age. Today, it's very clear that this will not be the case, and we are being incentivised and encouraged to save for our retirement. The same needs to be done for future healthcare.

There was a renewed call recently from within the health insurance industry to provide tax rebates on premiums for older New Zealanders with health insurance. However, the Minister for Health has said that there is no spare capacity to fund a rebate at this time. We accept the Government's position and, until the country's finances improve sufficiently, there is little point continuing to advocate for this option.

Going forward, the Southern Cross Healthcare Group will be talking with the Government about ways to assist all New Zealanders to access private healthcare – whether through health specific savings or other mechanisms.

I would like to thank Chief Executive Peter Tynan and his Health Society team for their efforts over this past year. Strong progress is being made in achieving better value healthcare on behalf of our members, and we plan to continue to build on this momentum.

Dr Ian McPherson
Chief Executive Officer
Southern Cross Medical Care Society

Operational report

Kiwis place a high value on being able to access private healthcare services. However, as noted in the Chairman's report, tough economic times saw a further dip in the number of New Zealanders with health insurance.

We are mindful that many of our members will have experienced some big increases in household costs such as rates and home insurance over the year.

One way we can help all our members is by keeping premiums and any increases as moderate as possible. And to do that, we must tackle claims costs.

Healthcare costs have risen dramatically in recent years, as has our members' demand for those services. Claims costs per member rose 34% over the last five years.

The rise in costs for knee replacements is a good illustration of these pressures. Between April 2007 and March 2012, the average price for this procedure rose 19%. In addition, members claimed for 22% more of these procedures.

We can't control the number of procedures our members need. Nor do we wish to challenge justifiable medical cost increases. But what we can tackle on behalf of our members is unreasonable price increases, or prices that fall outside of market norms.

DRIVING BETTER VALUE

The Society's Affiliated Provider programme is a key way we are trying to moderate claims cost inflation long-term on behalf of our members.

Affiliated Providers are specialists, surgeons and facilities that carry out certain medical procedures and healthcare services for Southern Cross members at agreed prices.

Contracts are negotiated individually with each provider. We take into consideration the procedure price relative to the regional and national market and the current and expected price inflation.

Another important aspect of the Affiliated Provider programme is the streamlined service it delivers for members and providers. The provider organises prior approval and processes the claim on the member's behalf, meaning the member does not have to complete claims forms or be out of pocket while the claim is processed. Claims are paid directly to the provider through a dedicated online system, eliminating paperwork, and enhancing administration and cash flow.

Southern Cross is the first private health insurer in New Zealand to introduce these types of agreements. In doing so we are following a well-established path. Contracting with providers is utilised by large insurers in Australia and the UK and also by the Accident Compensation Corporation.

I am pleased to report we now have over 300 Affiliated Provider agreements in place covering 20 different specialties. Claims for services from Affiliated Providers now account for 25% of the Society's total claims costs.

These agreements have helped us to secure some significant savings for our members in the initial negotiations, and to keep inflation low in subsequent contract renewals. An example of recent negotiations with a provider saw the Society achieve a $2,100 reduction per procedure on normal fees.

Driving the expansion of the programme has been a steady growth in the number of procedures specified as "Affiliated Provider-only" in Southern Cross health insurance policies. This means Southern Cross members on most plans are reimbursed for these procedures only if they are carried out by an Affiliated Provider.

From September 2012, coronary and peripheral angioplasties, coronary and peripheral angiograms,

PETER TYNAN
CHIEF EXECUTIVE
SOUTHERN CROSS HEALTH SOCIETY

catheter ablation of atrial fibrillation and endoscopic modified Lothrop (a specialist sinus procedure) will also become Affiliated Provider-only procedures.

When making a procedure available only through an Affiliated Provider, our goal is to achieve nationwide coverage of providers. Last October, intravitreal injections, Mohs surgery, PET/CT scans and certain prostate procedures became Affiliated Provider only. I am pleased to report we have agreements in place with 95% of all providers that carry out those procedures, helping to preserve choice of provider for our members.

In addition to growing our contracting in other specialties, the coming year will see a focus on orthopaedic procedures. These procedures account for over a fifth of the Society's total claims costs, and demand will only increase as the population ages. We have been working closely with the orthopaedic medical community over the year to discuss the benefits of the Affiliated Provider programme for members and providers, and to work through any questions raised.

We see the programme as a partnership with the medical community. A sustainable private healthcare sector is in everybody's interests - clinicians, hospitals, insurers, and (most of all) patients.

MORE CONVENIENT FOR MEMBERS

Another key focus for the Society is enhanced service for members.

Southern Cross Health Society Easy-claim, an electronic claiming service exclusively for Southern Cross members, experienced strong expansion over the year. The service, another first for New Zealand insurers, is currently available at over 250 pharmacies for prescription claims. Easy-claim is also now being piloted at five Southern Cross Primary Care partner practices for General Practitioner consultations and minor surgery.

The service is also currently being piloted with other healthcare providers, including optical, dental, physiotherapy and audiology services.

By presenting their Member Card, our members can claim instantly at the payment counter, eliminating the need to save receipts or submit claims forms. This automation is more convenient for members and provides the Society with efficiencies in our business processes.

The Society is also enhancing online initiatives aimed at improving member convenience and reducing business costs. More than 20,000 members have now registered to use 'My Southern Cross', a secure member portal introduced to the Southern Cross website in July 2011. Through a personal account, members are able to receive and store communications from Southern Cross, check the status of claims and benefits with annual limits, change contact details and also choose to receive certain communications online rather than by post. To register for the service, members should visit www.southerncross.co.nz/society/my-southern-cross

ASSISTING WITH ACC REVIEWS

Another service we offer members that helps mitigate claims costs (and therefore premiums) is assistance with ACC reviews for declined surgery. We assist in this way not only to ensure our members' accident and injury-related treatment costs are met by the right organisation, but also because they may have additional entitlements under their ACC cover, such as earnings compensation, rehabilitation and home help.

In 2012, the Society supported 438 members to seek review - a significant rise on the 355 members assisted in 2011. Over two thirds of the cases we supported members with in 2012 were found in favour of the member.

This work has returned over $4.5 million from ACC to the Society. A further $468,000 was saved on treatment costs that the Society did not have to fund because the review was successful before the members' surgeries had taken place.

ACKNOWLEDGEMENTS

I would like to acknowledge and thank the Society's management team and all staff for their hard work over the year on behalf of our members.

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.

BOARD OF DIRECTORS

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 2012 are:
Graeme S Hawkins (Chairman)
Dr Douglas D Baird
Carole B Durbin
Gregory W Gent
Elizabeth M Hickey
Phillip J Meyer
Keith B Taylor

All current directors have been assessed by the Board 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 independent of management and 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.

TRUSTEES

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 2012 are:
Carole Durbin, Graeme Hawkins and Phillip Meyer.

BOARD ROLE AND CHARTER

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

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.

DELEGATION FRAMEWORK

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.

COMMITTEES

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

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), Doug Baird, Greg Gent and Graeme Hawkins.

Nomination Committee

The Nomination Committee's objectives 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 currently comprises Graeme Hawkins (Chairman), Doug Baird, Carole Durbin, Greg Gent and Liz Hickey.

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 Keith Taylor.

EXTERNAL AUDIT INDEPENDENCE

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 2011 the Board supported the recommendation of the Audit Committee to re-appoint KPMG as the external auditors for the year ended 30 June 2012. Members approved the re-appointment of KPMG as auditors at the Annual General Meeting in December 2011.

LOANS TO DIRECTORS

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

Board of Directors

GRAEME HAWKINS

(BSC, BCom, ACA, FInstD)
Chairman

Graeme Hawkins has been a professional director for 19 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 of the Trust's subsidiary companies and Director of another. He is a Director of Cavalier Corporation Ltd and Ports of Auckland 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.

DR DOUGLAS BAIRD

(MBChB, DipObst, FRNZCGP)

Dr Douglas Baird was appointed to the Southern Cross Board in July 2007. He is Managing Director of Aotea Health Services, and a Trustee of the Auckland Medical Benevolent Fund. Dr Baird is a Trustee of Southern Cross Health Trust and a Director of one subsidiary company of the Trust. 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.

CAROLE DURBIN

(BCom, LLB(Hons), FInstD)

Carole Durbin was appointed to the Southern Cross Board in August 2006 and has been a Society Trustee since 2007. She is also a Trustee of Southern Cross Health Trust and a Director of two of its subsidiary companies. Ms Durbin is a Director of New Zealand-owned Fidelity Life. A part-time consultant to Simpson Grierson, one of New Zealand's leading legal firms, Ms Durbin has also held a number of previous Board appointments including DamWatch Services Ltd, Simpson Grierson, Transpower NZ, software developer Synergy International (now Fronde), and was an Earthquake Commissioner. Until October 2009 she was Chair of Mighty River Power, having been on that board since 1998. She is a Fellow of the Institute of Directors.

GREG GENT

Greg Gent was elected to the Southern Cross Board in December 2011. He is a Northland dairy farmer with a wealth of governance experience. From 2001 to 2011 he was a director of New Zealand's largest co-operative business, Fonterra. Prior to Fonterra's formation he was chairman of Northland Dairy and Kiwi Co-op Dairies. He is chairman of Farmers Mutual Group – a mutual rural insurance company - and was appointed to the Northland District Health Board by the Minister of Health in 2010. Mr Gent is also a Trustee of Southern Cross Health Trust.

Board of Directors (L to R)
Phillip Meyer, Carole Durbin, Dr Douglas Baird, Graeme Hawkins, Greg Gent, Liz Hickey, Keith Taylor

LIZ HICKEY

(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 Vice-President of the Institute of Chartered Accountants (NZICA), a co-opted member of the ASB Community Trust's Audit and Risk Committee, and a Trustee of Southern Cross Health Trust. Her past governance experience includes being a Director of Radio New Zealand, Genesis Power and Environmental Science and Research. She has served 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.

PHILLIP MEYER

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

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

KEITH TAYLOR

(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 and Speirs Group, 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 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.

Director meeting attendance for the year ended 30 June 2012

	Society Board	AGM	Trustees	Strategic Workshops	Audit Committee	Remuneration Committee	Investment Committee	Nomination Committee	Group Strategic Meetings
GS Hawkins	10	1	4	1	5	3	4	4	8
Dr DD Baird	10	1		1		3			8
Ms CB Durbin	10	1	4	1		3	4	4	8
GW Gent	4			1		2			4
Ms EM Hickey	10	1		1	5			1	8
PJ Meyer	10	1	4	1	4		4	5	8
KB Taylor	9	1		1	3		4		7
MJ Verbiest	5						2	4	3

GW Gent appointed a Director 6 December 2011
GW Gent appointed to the Remuneration and Nomination Committees 1 January 2012
MJ Verbiest retired as a Director 6 December 2011
EM Hickey appointed to the Nomination Committee 1 January 2012

Financial statements

The Southern Cross Medical Care Society

STATEMENTS OF COMPREHENSIVE INCOME
for the year ended 30 June 2012

	NOTE	GROUP 2012 $000	GROUP 2011 $000	SOCIETY 2012 $000	SOCIETY 2011 $000
Premium revenue		706,834	662,487	706,834	662,487
Net claims expense	3	605,528	577,090	605,528	577,090
Underwriting surplus		101,306	85,397	101,306	85,397
Operating expenses	4	85,937	81,332	84,254	78,919
Operating surplus		15,369	4,065	17,052	6,478
Net investment and other income	5	23,585	24,216	21,917	21,792
Surplus before taxation		38,954	28,281	38,969	28,270
Taxation	6	-	-	-	-
Surplus after taxation		38,954	28,281	38,969	28,270
Other comprehensive income		-	-	-	-
Total comprehensive surplus for the year		38,954	28,281	38,969	28,270

The accompanying notes form part of these financial statements

STATEMENTS OF CHANGES IN RESERVES
for the year ended 30 June 2012

GROUP 2012	Retained Surpluses $000	Total Reserves $000
Opening balance	334,432	334,432
Total comprehensive surplus:		
Surplus after taxation	38,954	38,954
Other comprehensive income	-	-
Total comprehensive surplus	38,954	38,954
Closing balance	373,386	373,386

GROUP 2011	Retained Surpluses $000	Total Reserves $000
Opening balance	306,151	306,151
Total comprehensive surplus:		
Surplus after taxation	28,281	28,281
Other comprehensive income	-	-
Total comprehensive surplus	28,281	28,281
Closing balance	334,432	334,432

The accompanying notes form part of these financial statements

STATEMENTS OF CHANGES IN RESERVES
for the year ended 30 June 2012 (continued)

SOCIETY 2012	Retained Surpluses $000	Total Reserves $000
Opening balance	334,299	334,299
Total comprehensive surplus:		
Surplus after taxation	38,969	38,969
Other comprehensive income	-	-
Total comprehensive surplus	38,969	38,969
Closing balance	373,268	373,268

SOCIETY 2011	Retained Surpluses $000	Total Reserves $000
Opening balance	306,029	306,029
Total comprehensive surplus:		
Surplus after taxation	28,270	28,270
Other comprehensive income	-	-
Total comprehensive surplus	28,270	28,270
Closing balance	334,299	334,299

The accompanying notes form part of these financial statements

The Southern Cross Medical Care Society

STATEMENTS OF FINANCIAL POSITION
as at 30 June 2012

	NOTE	GROUP 2012 $000	GROUP 2011 $000	SOCIETY 2012 $000	SOCIETY 2011 $000
Assets					
Cash and cash equivalents		3,692	1,238	3,586	1,160
Premium and other receivables	7	63,690	72,532	63,449	72,406
Investments	8	468,863	417,702	468,861	417,702
Investment in subsidiaries	9	-	-	-	-
Property and equipment	10	13,484	16,027	13,484	16,025
Intangible assets	11	9,142	6,562	9,142	6,559
Total assets		558,871	514,061	558,522	513,852
Liabilities					
Payables	12	22,393	20,724	22,162	20,648
Employee benefits	13	8,537	7,715	8,537	7,715
Insurance contract liabilities	14	154,555	151,190	154,555	151,190
Total liabilities		185,485	179,629	185,254	179,553
Net assets		373,386	334,432	373,268	334,299
Reserves		373,386	334,432	373,268	334,299

For and on behalf of the Board

G S Hawkins, **Chairman** Date: 4 September 2012

E M Hickey, **Director** Date: 4 September 2012

The accompanying notes form part of these financial statements

STATEMENTS OF CASH FLOWS
for the year ended 30 June 2012

	NOTE	GROUP 2012 $000	GROUP 2011 $000	SOCIETY 2012 $000	SOCIETY 2011 $000
Cash flows from/(to) operating activities					
Premium revenue		705,067	663,750	705,067	663,750
Interest received		22,457	24,069	22,435	24,063
Other income		1,983	2,473	44	44
Payment of claims		(603,322)	(581,599)	(603,322)	(581,599)
Payments to employees		(38,776)	(37,585)	(37,028)	(35,637)
Payments to suppliers		(34,772)	(39,728)	(34,495)	(38,589)
Net cash flows from/(to) operating activities	18	52,637	31,380	52,701	32,032
Cash flows from/(to) investing activities					
Proceeds from sale of property and equipment		7,952	91	7,952	91
Payments for property and equipment		(1,206)	(12,484)	(1,206)	(12,484)
Payments for intangible assets		(5,305)	(1,917)	(5,305)	(1,917)
Net payments for investments		(51,624)	(16,099)	(51,622)	(16,099)
Net advances to subsidiaries		-	-	(94)	(600)
Net cash flows from/(to) investing activities		(50,183)	(30,409)	(50,275)	(31,009)
Net increase in cash and cash equivalents		2,454	971	2,426	1,023
Opening cash and cash equivalents		1,238	267	1,160	137
Closing cash and cash equivalents		3,692	1,238	3,586	1,160

The accompanying notes form part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 30 June 2012

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 2012 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.

The Society has been granted a provisional insurance licence by the Reserve Bank of New Zealand ("RBNZ") to operate as an insurer subject to the Insurance (Prudential Supervision) Act 2010. As a consequence of being a licensed insurer, the Society will be deemed to be an issuer under the Financial Reporting Act 1993 from 1 July 2012.

BASIS OF PREPARATION

The financial statements have been prepared in accordance with New Zealand generally accepted accounting practice ("NZ GAAP").

The Directors, for financial reporting purposes, are required to assess the Society against the public benefit entity definition contained in the financial reporting standards in order to classify the Society as either a public benefit entity or a profit-oriented entity. A public benefit entity is one whose primary objective is to provide goods or services for community or social benefit. The Directors' reassessment of the Society against the public benefit entity criteria indicates that the Society is unlikely to meet the criteria and they have accordingly reclassified the Society by default as a profit-oriented entity for financial reporting purposes. The reclassification has had no impact on the recognition, measurement and note disclosures in the financial statements.

The financial statements comply with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and International Financial Reporting Standards ("IFRS").

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 4 September 2012.

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 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 14: Insurance contract liabilities
- Note 15: Actuarial information
- Note 16: 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.

1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

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".

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 16: Risk management.

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

INVESTMENT IN SUBSIDIARIES

Investment in subsidiaries is stated at cost less impairment losses.

PROPERTY AND EQUIPMENT

Items of property and equipment are measured at cost, less accumulated depreciation and impairment losses.

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

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.

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.

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.

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.

CHANGE IN PRESENTATION OF COMPARATIVES

Certain comparative figures have been reclassified to conform to the presentation adopted in the current year. Specifically, comparative figures for the statement of cash flows, Note 4: Operating expenses and Note 18: Reconciliation of net surplus with net cash flows from operating activities have been restated in the current year. The restatements have no effect on the total comprehensive surplus or net assets.

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 2012, and have not been applied in preparing these financial statements:

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

NZ IAS 1 – Presentation of Financial Statements

NZ IFRS 13 – Fair Value Measurement

NZ IAS 19 Employee Benefits

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 2015. The International Accounting Standards Board has deferred the mandatory effective date from the previous deadline of 1 January 2013. The impact of the requirements of this standard on the Group is still to be determined.

NZ IAS 1 – Presentation of Financial Statements introduces changes to the presentation of items of other comprehensive income. The impact identified from the amendments is that the title of statement of comprehensive income will be renamed to statement of profit or loss and other comprehensive income. The amendments are effective for annual reporting periods beginning on or after 1 July 2012.

NZ IFRS 13 – Fair Value Measurement – defines fair value, establishes a framework for measuring fair value and sets out related disclosure requirements. It does not give rise to any new requirements as to when fair value measurements are required, but instead provides guidance currently included in individual IFRSs, with a single source of authoritative guidance on how to measure fair value.

NZ IFRS 13 is 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.

NZ IAS 19 Employment Benefits amends the definitions of short-term and long-term employee benefits, adds additional disclosures and changes the timing of recognition and measurement basis of certain employment benefits.

The above revisions to NZ IAS 19 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.

3. NET CLAIMS EXPENSE

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Claims incurred relating to risks borne in current financial year	605,488	581,756	605,488	581,756
Claims incurred relating to risks borne in previous financial years	(1,909)	(1,041)	(1,909)	(1,041)
Movement in provision for claims handling costs	(21)	(67)	(21)	(67)
Movement in risk margin	(22)	(91)	(22)	(91)
Net claims incurred	603,536	580,557	603,536	580,557
Movement in provision for unexpired risk	1,992	(3,467)	1,992	(3,467)
	605,528	577,090	605,528	577,090

4A. OPERATING EXPENSES

Operating expenses include:	GROUP 2012 $000	GROUP 2011 $000	SOCIETY 2012 $000	SOCIETY 2011 $000
Auditor's remuneration:				
– Audit of financial statements	162	160	162	160
– Other services	145	18	145	18
Depreciation	3,208	2,392	3,206	2,391
Amortisation of intangible assets	2,738	2,114	2,735	2,081
Impairment loss on intangible assets	-	201	-	201
Directors' fees	360	360	360	360
Employee benefits expense	39,598	37,585	37,850	35,637
Contributions to defined contribution plan	52	54	52	54
Rental of premises	4,729	2,643	4,723	2,637
Provision for impairment (gain)/loss on amounts receivable from subsidiaries	-	-	(52)	647
(Gains)/losses on disposal of property and equipment, including land and buildings	(71)	713	(71)	713
(Gains)/losses on disposal of intangible assets	(329)	-	-	-

Auditor's remuneration for other services disclosed above consists of accounting and advisory services, reviewing regulatory returns and providing services at the AGM.

4B. OPERATING EXPENSES

Operating expenses consist of:	GROUP 2012 $000	GROUP 2011 $000	SOCIETY 2012 $000	SOCIETY 2011 $000
Policy acquisition	9,118	10,068	9,118	10,068
Policy administration	30,946	29,897	30,946	29,897
Claims handling	9,036	8,154	9,036	8,154
Other operating expenses	36,837	33,213	35,154	30,800
	85,937	81,332	84,254	78,919

Other operating expenses consist of information technology, human resources, occupancy, governance, finance, actuarial, clinical and management expenses.

5. NET INVESTMENT AND OTHER INCOME

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Interest income	22,358	23,142	22,336	23,136
Net losses on investments at fair value through profit or loss	(463)	(1,388)	(463)	(1,388)
Fee and other income	1,690	2,462	44	44
	23,585	24,216	21,917	21,792

6. TAXATION

Reconciliation of effective tax rate	GROUP	
	2012 $000	2011 $000
Net surplus before tax	38,954	28,281
Income tax payable at the domestic tax rate of 28% (2011: 30%)	10,907	8,484
Effect of non-deductible expenses	1	2
Effect of exempt surplus	(10,896)	(8,675)
Tax effect of change in unrecognised temporary differences	64	(9)
Tax on current year deficits/(surplus) for which no deferred tax asset was recognised	-	198
Tax effect of prior year unrecognised tax losses utilised	(76)	-
	-	-

The aggregate amount of temporary differences arising in the subsidiaries for which a deferred tax asset has not been recognised is $392,000 at 30 June 2012 (30 June 2011: $163,000).
The Group has unrecognised tax losses carried forward of $30,856,000 at 30 June 2012 (30 June 2011: $31,129,000).

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 30 June 2012 (continued)

7. PREMIUM AND OTHER RECEIVABLES

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Premium accounts receivable	53,063	49,450	53,063	49,450
Interest receivable	3,713	3,812	3,713	3,812
Other accounts receivable	6,302	11,350	5,911	10,669
Amounts owed by related parties	212	520	762	1,075
Asset disposal proceeds receivable	400	7,400	-	7,400
	63,690	72,532	63,449	72,406

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

8. INVESTMENTS

At fair value through profit or loss	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
New Zealand Government stock	547	1,519	547	1,519
State owned enterprise bonds	28,558	11,470	28,558	11,470
Local authority stock	70,575	74,748	70,575	74,748
Other bonds	69,940	94,142	69,940	94,142
Bank deposits, commercial paper and floating rate notes	299,243	235,823	299,241	235,823
	468,863	417,702	468,861	417,702
Current assets	224,800	175,216	224,798	175,216
Non-current assets	244,063	242,486	244,063	242,486
	468,863	417,702	468,861	417,702

The New Zealand Government stock is held by the Public Trustee as a deposit required under the Insurance Companies' Deposits Act 1953 (repealed on 7 March 2012).

9. 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.

On 28 June 2012, an unconditional agreement to dispose of the Care Advantage injury management business, owned by Southern Cross Health Services Limited, was entered into with Gallagher Bassett NZ Limited. Settlement occurred in early July.

10. PROPERTY AND EQUIPMENT

	GROUP				
	Computer equipment $000	Other fixed assets $000	Leasehold improvements $000	Work in progress $000	Total $000
At 30 June 2012					
Cost	23,159	2,596	8,306	481	34,542
Accumulated depreciation	(19,291)	(561)	(1,206)	-	(21,058)
Closing balance	3,868	2,035	7,100	481	13,484
Reconciliation of movement in property and equipment					
Opening balance	3,867	2,992	7,468	1,700	16,027
Additions	35	69	-	1,042	1,146
Transfers from work in progress	1,768	-	493	(2,261)	-
Disposals	-	(481)	-	-	(481)
Depreciation	(1,802)	(545)	(861)	-	(3,208)
Closing balance	3,868	2,035	7,100	481	13,484

	GROUP				
	Computer equipment $000	Other fixed assets $000	Leasehold improvements $000	Work in progress $000	Total $000
At 30 June 2011					
Cost	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
Reconciliation of movement in property and equipment					
Opening cost	19,604	5,228	1,117	1,218	27,167
Opening accumulated depreciation	(15,929)	(4,141)	(808)	-	(20,878)
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

10. PROPERTY AND EQUIPMENT (CONTINUED)

SOCIETY	Computer equipment $000	Other fixed assets $000	Leasehold improvements $000	Work in progress $000	Total $000
At 30 June 2012					
Cost	23,159	2,596	8,306	481	34,542
Accumulated depreciation	(19,291)	(561)	(1,206)	-	(21,058)
Closing balance	3,868	2,035	7,100	481	13,484
Reconciliation of movement in property and equipment					
Opening balance	3,867	2,990	7,468	1,700	16,025
Additions	35	69	-	1,042	1,146
Transfers from work in progress	1,768	-	493	(2,261)	-
Disposals	-	(481)	-	-	(481)
Depreciation	(1,802)	(543)	(861)	-	(3,206)
Closing balance	3,868	2,035	7,100	481	13,484

SOCIETY	Computer equipment $000	Other fixed assets $000	Leasehold improvements $000	Work in progress $000	Total $000
At 30 June 2011					
Cost	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
Reconciliation of movement in property and equipment					
Opening cost	19,535	5,221	1,117	1,218	27,091
Opening accumulated depreciation	(15,860)	(4,137)	(808)	-	(20,805)
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

Other fixed assets include motor vehicles and office equipment.
Property and equipment is a non-current asset.

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 30 June 2012 (continued)

11. INTANGIBLE ASSETS

	GROUP		
	Computer software $000	Work in progress $000	Total $000
At 30 June 2012			
Cost	34,025	2,275	36,300
Accumulated amortisation	(27,158)	-	(27,158)
Closing balance	6,867	2,275	9,142
Reconciliation of movement in intangible assets			
Opening balance	4,923	1,639	6,562
Additions	167	5,151	5,318
Transfers from work in progress	4,515	(4,515)	-
Amortisation	(2,738)	-	(2,738)
Closing balance	6,867	2,275	9,142

	GROUP		
	Computer software $000	Work in progress $000	Total $000
At 30 June 2011			
Cost	29,393	1,639	31,032
Accumulated amortisation	(24,470)	-	(24,470)
Closing balance	4,923	1,639	6,562
Reconciliation of movement in intangible assets			
Opening cost	27,467	1,651	29,118
Opening accumulated amortisation	(22,158)	-	(22,158)
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

11. INTANGIBLE ASSETS (CONTINUED)

	SOCIETY		
	Computer software $000	Work in progress $000	Total $000
At 30 June 2012			
Cost	33,916	2,275	36,191
Accumulated amortisation	(27,049)	-	(27,049)
Closing balance	6,867	2,275	9,142
Reconciliation of movement in intangible assets			
Opening balance	4,920	1,639	6,559
Additions	167	5,151	5,318
Transfers from work in progress	4,515	(4,515)	-
Amortisation	(2,735)	-	(2,735)
Closing balance	6,867	2,275	9,142

	SOCIETY		
	Computer software $000	Work in progress $000	Total $000
At 30 June 2011			
Cost	29,235	1,639	30,874
Accumulated amortisation	(24,315)	-	(24,315)
Closing balance	4,920	1,639	6,559
Reconciliation of movement in intangible assets			
Opening cost	27,309	1,651	28,960
Opening accumulated amortisation	(22,036)	-	(22,036)
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

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.

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 30 June 2012 (continued)

12. PAYABLES

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Accounts payable	18,167	16,476	17,936	16,390
Amounts owed to related parties	428	16	428	26
Deferred income - lease inducement	3,798	4,232	3,798	4,232
	22,393	20,724	22,162	20,648
Current	19,029	16,919	18,798	16,843
Non-current	3,364	3,805	3,364	3,805
	22,393	20,724	22,162	20,648

13. EMPLOYEE BENEFITS

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Employee entitlements	5,137	4,945	5,137	4,945
Employee benefits	1,020	830	1,020	830
Post-employment benefits	2,380	1,940	2,380	1,940
	8,537	7,715	8,537	7,715
Current	5,325	5,234	5,325	5,234
Non-current	3,212	2,481	3,212	2,481
	8,537	7,715	8,537	7,715

14. INSURANCE CONTRACT LIABILITIES

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Provision for outstanding claims (refer Note 14a)	73,608	74,077	73,608	74,077
Provision for unearned premium (refer Note 14c)	72,828	70,976	72,828	70,976
Provision for unexpired risk (refer Note 14d)	7,309	5,317	7,309	5,317
Other insurance provisions	810	820	810	820
	154,555	151,190	154,555	151,190

14. INSURANCE CONTRACT LIABILITIES (CONTINUED)

a. Provision for outstanding claims

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Central estimate of outstanding claims liability	68,040	68,466	68,040	68,466
Claims handling costs	2,063	2,084	2,063	2,084
Risk margin	3,505	3,527	3,505	3,527
Closing balance	73,608	74,077	73,608	74,077

Claims are predominantly short-term in nature and are generally settled within twelve months of being incurred. Accordingly, amounts are not discounted.

b. Reconciliation of movement in provision for outstanding claims

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Opening balance	74,077	75,973	74,077	75,973
Amounts utilised during the year	(64,790)	(67,333)	(64,790)	(67,333)
Additional provision /(reversal of unused provision)	(1,909)	(1,041)	(1,909)	(1,041)
Amounts provided during the year	66,273	66,636	66,273	66,636
Movement in claims handling costs	(21)	(67)	(21)	(67)
Movement in risk margin	(22)	(91)	(22)	(91)
Closing balance	73,608	74,077	73,608	74,077

c. Reconciliation of movement in provision for unearned premium

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Opening balance	70,976	66,779	70,976	66,779
Premiums written in the year	708,686	666,684	708,686	666,684
Premiums earned during the year	(706,834)	(662,487)	(706,834)	(662,487)
Closing balance	72,828	70,976	72,828	70,976

14. INSURANCE CONTRACT LIABILITIES (CONTINUED)

d. Provision for unexpired risk

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Present value of expected future cash flows for claims and expenses	77,493	73,001	77,493	73,001
Risk margin	3,100	3,650	3,100	3,650
Unearned premiums	(72,828)	(70,976)	(72,828)	(70,976)
Write-down of deferred acquisition costs	(456)	(358)	(456)	(358)
Closing balance	7,309	5,317	7,309	5,317

e. Reconciliation of movement in provision for unexpired risk

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Opening balance	5,317	8,784	5,317	8,784
Reversal of opening balance	(5,317)	(8,784)	(5,317)	(8,784)
Net liability for unexpired risk recognised during the year	4,665	2,025	4,665	2,025
Risk margin	3,100	3,650	3,100	3,650
Write-down of deferred acquisition costs	(456)	(358)	(456)	(358)
Closing balance	7,309	5,317	7,309	5,317

15. ACTUARIAL INFORMATION

Estimates of the outstanding claims and unexpired risk as at 30 June 2012 have been determined by John Smeed, a Fellow of the New Zealand Society of Actuaries. These were presented to the Directors of the Society in a report dated 17 August 2012. 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 assessed as the central estimate of the present value of expected future payments for claims incurred but not settled at 30 June 2012, 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 of $0.75m has been made for expected ACC recoveries as at 30 June 2012 (30 June 2011: $1.0m).

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 2012 (30 June 2011: 5%). The risk margin was determined with the objective of achieving at least 75 % probability of sufficiency of the outstanding claims provision.

15. 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 5 years' previous claims experience, and range from 73% to 113% (30 June 2011: 72% to 112%) of the monthly average.
3. Historical claims inflation 5.0% p.a. (30 June 2011: 6.5%), 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 2011: 3%) of the underlying claims amounts based on an analysis of administration expenses.

The average weighted term from 30 June 2012 to the expected settlement date for claims included in the liability for outstanding claims is 72 days (30 June 2011: 74 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 2012.

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 4% of the present value of expected future cash flows has been applied at 30 June 2012 (30 June 2011: 5%). 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 5 years' previous claims experience, and range from 73% to 109% (2011: 76% to 109%) of the monthly average.
2. Projected claims inflation of 7% p.a., plus 4% for the effect of ageing, based on current expectations (2011: 6.5% plus 4%).
3. Expenses based on the business plan for 2012/13, 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.

16. 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 RBNZ 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 RBNZ. 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 20).

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 15.

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.

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. In addition, the RBNZ has issued concentration risk limits, as part of its solvency standards. 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, comfort is obtained from their ability to levy rates. There are no concentrations of credit risk at 30 June 2012 in excess of policy.

16. RISK MANAGEMENT (CONTINUED)

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

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
AAA	438	9,035	438	9,035
AA	279,559	207,081	279,557	207,081
A	81,225	90,943	81,225	90,943
BBB	34,886	26,209	34,886	26,209
Non-rated	72,755	84,434	72,755	84,434
	468,863	417,702	468,861	417,702

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 2011: 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	
	2012 $000	2011 $000	2012 $000	2011 $000
On call	3,214	2,908	3,212	2,908
0-6 months	148,426	114,087	148,426	114,087
7-12 months	73,159	58,221	73,159	58,221
1-2 years	102,340	71,916	102,340	71,916
2-5 years	121,469	148,943	121,469	148,943
Beyond 5 years	20,255	21,627	20,255	21,627
	468,863	417,702	468,861	417,702

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.

16. RISK MANAGEMENT (CONTINUED)

c. Market risks

I. Foreign currency risk

At 30 June 2012, the Group had assets of $288,000 and no liabilities denominated in foreign currencies (30 June 2011: assets of $263,000 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 longer-term 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:

	GROUP AND SOCIETY	
	2012 $000	2011 $000
Impact of increase in interest rates by 100 basis points on cash flows	1,464	1,412
Impact of decrease in interest rates by 100 basis points on cash flows	(1,464)	(1,412)

(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:

	GROUP AND SOCIETY	
	2012 $000	2011 $000
Impact of increase in interest rates by 100 basis points on surplus before taxation	(3,375)	(3,406)
Impact of decrease in interest rates by 100 basis points on surplus before taxation	3,462	3,489

(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.

16. RISK MANAGEMENT (CONTINUED)

GROUP

30 June 2012	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
New Zealand Government stock	547	-	-	547
State owned enterprise bonds	-	28,558	-	28,558
Local authority stock	-	70,575	-	70,575
Other bonds	-	69,940	-	69,940
Bank deposits, commercial paper and floating rate notes	3,214	296,029	-	299,243
Total investments	3,761	465,102	-	468,863

30 June 2011	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
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
Total investments	4,427	413,275	-	417,702

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30 June 2012	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
New Zealand Government stock	547	-	-	547
State owned enterprise bonds	-	28,558	-	28,558
Local authority stock	-	70,575	-	70,575
Other bonds	-	69,940	-	69,940
Bank deposits, commercial paper and floating rate notes	3,212	296,029	-	299,241
Total investments	3,759	465,102	-	468,861

30 June 2011	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
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
Total investments	4,427	413,275	-	417,702

16. RISK MANAGEMENT (CONTINUED)

Investments were independently valued by Bancorp Treasury Services Limited at 30 June 2012 and 30 June 2011. 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.

Cash and cash equivalents are valued using a Level 1 basis (30 June 2011: Level 1).

17. 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.

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.

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. The provision is for $9,759,000 (30 June 2011: $9,811,000).

The amount of transactions between the Group entities are:

	PURCHASES		SALES	
	2012 $000	2011 $000	2012 $000	2011 $000
Society	2,875	2,422	77	69
Health Services	14	17	66	77
Activa	63	52	2,809	2,345

The outstanding balances between the Group entities are:

	PAYABLES		RECEIVABLES	
	2012 $000	2011 $000	2012 $000	2011 $000
Society	5	10	571	571
Health Services	508	419	5	5
Activa	63	152	-	5

17. RELATED PARTIES (CONTINUED)

The amount of transactions with other related parties are:

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Sale of services	5,680	4,048	5,650	4,013
Purchase of services	292	107	292	107

The outstanding balances with other related parties are:

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Balance outstanding on sales	212	520	197	504
Balance outstanding on purchases	428	16	428	16

b. Remuneration of Directors

Directors' fees paid by the Society for the year ended 30 June 2012 were as follows:

Director	2012 Amount $	2011 Amount $
Dr D D Baird	44,250	43,250
C B Durbin	49,000	49,000
G W Gent – appointed 6 December 2011	26,125	-
G S Hawkins (Chairman)	80,000	80,000
E M Hickey	46,000	44,375
D J May - retired 25 November 2010	-	19,792
P J Meyer	48,500	48,500
K B Taylor - appointed 25 November 2010	46,000	26,833
M J Verbiest – retired 6 December 2011	20,208	48,500
Trustee		
C B Durbin	-	-
G S Hawkins	-	-
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.

17. RELATED PARTIES (CONTINUED)

c. Remuneration of key management personnel

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Salaries and other short-term benefits	2,713	3,116	2,713	3,116
Post-employment benefits	56	70	56	70

Key management personnel include the 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.

18. RECONCILIATION OF NET SURPLUS WITH NET CASH FLOWS FROM OPERATING ACTIVITIES

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Net surplus after taxation	38,954	28,281	38,969	28,270
Add/(less) non-cash items:				
Depreciation	3,208	2,392	3,206	2,391
Amortisation of intangible assets	2,738	2,114	2,735	2,081
Impairment loss on intangible assets	-	201	-	201
Provision for impairment loss on amounts receivable from subsidiaries	-	-	(52)	647
Add items classified as investing activities :				
(Gains)/losses on disposal of property and equipment, including land and buildings	(71)	713	(71)	713
(Gains) on disposal of intangible assets	(329)	-	-	-
Net (gains)/losses on investments at fair value through profit or loss	463	1,388	463	1,388
Movement in receivables and payables relating to investing activities	(7,022)	7,400	(7,207)	8,048
Add/(less) movements in working capital items:				
Receivables	8,842	(15,761)	8,957	(16,472)
Payables	1,667	5,656	1,514	5,769
Other insurance provisions	(10)	110	(10)	110
Employee benefits	822	52	822	52
Provision for outstanding claims	(469)	(1,896)	(469)	(1,896)
Provision for unearned premium	1,852	4,197	1,852	4,197
Provision for unexpired risk	1,992	(3,467)	1,992	(3,467)
Net cash flows from operating activities	52,637	31,380	52,701	32,032

19. CREDIT RATING

On 21 February 2012 Standard & Poor's reaffirmed the Society's Insurer Financial Strength Rating of A+. This signifies the insurer "has strong financial security characteristics".

20. SOLVENCY AND CAPITAL ADEQUACY

The Society is a registered friendly society. 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 $373.3 million (2011: $334.4 million) is equal to the reserves as disclosed in the financial statements.

The Insurance (Prudential Supervision) Act 2010 ("the Act") was enacted in September 2010. The Society has been granted a provisional licence under the Act. Full licensing must be obtained by 7 September 2013. Upon full licencing, the Society will be subject to new solvency requirements issued by the RBNZ. In the interim the Society will be subject to new solvency margin requirements issued by the RBNZ from 31 December 2012.

The Society was required to deposit $500,000 with the Public Trustee in accordance with the Insurance Companies' Deposits Act 1953. This deposit will be refunded after a full license has been obtained. 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 in line with the solvency requirements issued by the RBNZ.

A calculation at 30 June 2012 showed the Society had actual solvency capital of $364.1m calculated in accordance with the solvency standard for non-life insurance business issued by the RBNZ. The Directors consider the current level of capital is sufficient for the requirement of maintaining financial soundness and will satisfy the RBNZ's solvency requirements.

21. LEASE COMMITMENTS

At 30 June 2012 commitments under operating leases in respect of payments due to be made in the following years were:

	GROUP		SOCIETY	
	2012 $000	2011 $000	2012 $000	2011 $000
Within 1 year	5,101	4,607	5,101	4,607
Between 1 and 2 years	4,677	4,475	4,677	4,475
Between 2 and 5 years	12,969	12,930	12,969	12,930
Greater than 5 years	15,798	19,927	15,798	19,927
	38,545	41,939	38,545	41,939

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. The lease agreement provides for a rental review every three years based on prevailing market rates at the time of review.

22. CAPITAL COMMITMENTS

The Group had capital commitments of $515,000 at 30 June 2012 (2011: $671,000).

23. CONTINGENT LIABILITIES

The Group had no contingent liabilities at 30 June 2012 (2011: Nil).

Independent auditor's report

To the Members of The Southern Cross Medical Care Society

KPMG

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 2012, 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 2012 and their financial performance and cash flows for the year then ended.

KPMG

11 September 2012
Auckland

Appointed actuary's report

To the Directors of The Southern Cross Medical Care Society

finity

Review of Actuarial Information contained in the Financial Statements as at 30 June 2012

Finity Consulting Pty Limited (Finity) has been asked by Southern Cross Medical Care Society (Southern Cross) to carry out a review of the 30 June 2012 actuarial information contained in the financial statements and provide an opinion as to its appropriateness. John Smeed is an employee of Finity and is the Appointed Actuary to Southern Cross. Finity has no relationship with Southern Cross apart from the Appointed Actuary role.

Southern Cross's policy is to seek and adopt the advice of the Appointed Actuary in respect of the actuarial information contained in its financial statements. We confirm that the financial statements as at 30 June 2012 have been prepared in accordance with this policy, and as such this satisfies the requirements of the Act.

Having carried out the actuarial review, nothing has come to our attention that would lead us to believe that the actuarial information used in the financial statements or the determination of Actual Solvency Capital for Southern Cross maintained as at 30 June 2012 are inappropriate. No limitations were placed on us in performing our review, and all data requested was provided.

This report is being provided for the sole use of Southern Cross for the purpose stated above. It is not intended, nor necessarily suitable, for any other purpose and should only be relied on the purpose for which it is intended.

John Smeed
Appointed Actuary
Fellow of the New Zealand
Society of Actuaries

Jamie Reid
Fellow of the Institute of Actuaries

4 September 2012

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Southern Cross
Health Society

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