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MEDICAL INSURANCE SOCIETY LIMITED

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 March 2013

	Note	2013 $	2012 $
GROSS WRITTEN PREMIUM		59,694,066	56,175,004
Less: Reinsurance Premiums		17,887,880	13,671,532
Increase in Unearned Premium Reserve		1,485,189	4,526,485
NET EARNED PREMIUM		40,320,997	37,976,987
OPERATING EXPENSES			
Claims		104,388,093	37,666,060
Reinsurance Recoveries		(67,274,370)	(3,667,421)
Other Recoveries		(5,150,733)	(5,165,865)
Net Claims Incurred	4	31,962,990	28,832,774
Administration Expenses	5	2,393,099	2,337,519
Administration Fees paid to Parent Company	6	8,853,080	7,871,811
Total Operating Expenses		43,209,169	39,042,104
DEFICIT ON UNDERWRITING		(2,888,172)	(1,065,117)
INVESTMENT INCOME			
Interest Paid on Intercompany Lending	6	(165,476)	(156,209)
Short Term Deposits		80,035	98,958
Domestic Fixed Interest		3,036,763	1,619,476
International Fixed Interest (Unit Trust)		1,304,621	1,166,043
International Equities (Exchange Traded Funds)		-	(941,212)
Net Investment Income	16	4,255,943	1,787,056
Commission and Sundry Income		130,704	31,349
NET SURPLUS BEFORE TAXATION		1,498,475	753,288
Taxation Expense	7	408,894	659,520
NET SURPLUS AFTER TAXATION FROM CONTINUING OPERATIONS		1,089,581	93,768
Surplus after Tax from Discontinued Operation	19	1,224,267	2,114,859
Other Comprehensive Income Net of Taxation		-	-
TOTAL COMPREHENSIVE INCOME		2,313,848	2,208,627

NPC# 14
16 AUG 2013

The accompanying notes form part of and should be read in conjunction with these financial statements.

MEDICAL INSURANCE SOCIETY LIMITED

STATEMENT OF CHANGES IN EQUITY

for the year ended 31 March 2013

	Note	2013 Share Capital $	2013 Retained Earnings $	2013 Total $
OPENING BALANCE 1 APRIL 2012	20	10,000,000	21,108,909	31,108,909
Current Year Surplus		-	2,313,848	2,313,848
Other Comprehensive Income		-	-	-
Total Comprehensive Income		-	2,313,848	2,313,848
CLOSING BALANCE 31 MARCH 2013		10,000,000	23,422,757	33,422,757

	Note	2012 Share Capital $	2012 Retained Earnings $	2012 Total $
OPENING BALANCE 1 APRIL 2011	20	10,000,000	18,900,282	28,900,282
Current Year Surplus		-	2,208,627	2,208,627
Other Comprehensive Income		-	-	-
Total Comprehensive Income		-	2,208,627	2,208,627
CLOSING BALANCE 31 MARCH 2012		10,000,000	21,108,909	31,108,909

The accompanying notes form part of and should be read in conjunction with these financial statements.

MEDICAL INSURANCE SOCIETY LIMITED

STATEMENT OF FINANCIAL POSITION

as at 31 March 2013

	Note	2013 $	2012 $
FUNDS EMPLOYED			
EQUITY			
10,000,000 Ordinary shares	20	10,000,000	10,000,000
Retained Earnings		23,422,757	21,108,909
Total Equity		33,422,757	31,108,909
CURRENT LIABILITIES			
Payables	8	5,199,614	4,099,808
Advance from Parent Company	6	7,076,126	6,046,689
Total Current Liabilities		12,275,740	10,146,497
DEFERRED TAX	7	87,618	554,469
PROVISIONS			
Provision for Unearned Premium	9	29,692,865	33,636,035
Provision for Outstanding Claims	4	200,814,491	188,167,672
Total Provisions		230,507,356	221,803,707
Liabilities associated with the Assets classified as Held for Sale	19	29,547,277	-
TOTAL FUNDS EMPLOYED		305,840,748	263,613,582
ASSETS			
Cash and Cash Equivalents	10	4,230,000	3,440,000
Receivables	11	8,529	8,389
Premiums Outstanding	12	14,921,877	18,521,337
Taxation Paid in Advance		877,100	218,380
Reinsurance Recoveries Outstanding	13	193,670,297	175,093,958
Claims Recoveries Outstanding	14	2,983,285	3,274,894
Deferred Acquisition Costs	15	313,414	1,981,494
Investments	16	59,288,969	61,075,130
		276,293,471	263,613,582
Assets classified as Held for Sale	19	29,547,277	-
TOTAL ASSETS		305,840,748	263,613,582

Approved for issue for and on behalf of the Board of Medical Insurance Society Limited.

Director

Director

Wellington, 26 June 2013

The accompanying notes form part of and should be read in conjunction with these financial statements.

MEDICAL INSURANCE SOCIETY LIMITED

STATEMENT OF CASH FLOWS

for the year ended 31 March 2013

	Note	2013 $	2012 $
CASH FLOWS FROM / (FOR) OPERATING ACTIVITIES			
Receipts from Policyholders		73,277,745	69,498,365
Sundry Income		130,704	37,183
Reinsurance Recoveries Received		43,780,073	66,341,648
Payment of Claims		(76,678,698)	(110,116,380)
Payments to Suppliers		(22,794,912)	(18,608,697)
Interest on Short Term Deposits		97,911	114,013
Income from Investment Funds		5,311,076	2,187,497
Administration Fees Paid to Parent Company		(12,053,317)	(11,414,390)
Interest Paid on Advances to Parent Company		(202,437)	(185,277)
(Payment of Taxation) / Taxation Refund		(1,296,505)	156,028
Net Cash Flows from / (for) Operating Activities	22	9,571,640	(1,990,010)
CASH FLOWS (FOR) / FROM INVESTING ACTIVITIES			
Contributions to Investment Funds		(30,311,077)	(15,187,496)
Withdrawals from Investment Funds		20,500,000	19,500,000
Net Cash Flows (for) / from Investing Activities		(9,811,077)	4,312,504
CASH FLOWS FROM / (FOR) FINANCING ACTIVITIES			
Advances to Parent Company		(100,375,869)	(99,308,215)
Advances from Parent Company		101,405,306	98,514,721
Net Cash Flows from / (for) Financing Activities		1,029,437	(793,494)
NET INCREASE IN CASH HELD		790,000	1,529,000
Opening Cash Balance brought forward		3,440,000	1,911,000
CASH AND CASH EQUIVALENTS CARRIED FORWARD		4,230,000	3,440,000
CASH AND CASH EQUIVALENTS COMPRISE			
Cash at Bank	10	4,230,000	3,440,000
		4,230,000	3,440,000

The accompanying notes form part of and should be read in conjunction with these financial statements.

MEDICAL INSURANCE SOCIETY LIMITED

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
for the year ended 31 March 2013

1. CORPORATE INFORMATION

REGISTERED OFFICE
19 - 21 Broderick Road
Johnsonville
Wellington

The ultimate parent of the Company is Medical Assurance Society New Zealand Limited, which owns 100% of the ordinary shares.

The Company is incorporated and domiciled in New Zealand.

Standard & Poor's has assigned Medical Insurance Society Limited an A- (Strong) insurer financial strength rating.

2. ACCOUNTING POLICIES

(a) Principal Activity

Medical Insurance Society Limited (the "Company") is a wholly owned subsidiary of Medical Assurance Society New Zealand Limited (the "Society"). It provides income protection and general insurance products to Members of the Society.

Head Office is situated in Johnsonville, Wellington and there are seven branch sites throughout New Zealand in Auckland (two), Hamilton, Palmerston North, Wellington, Christchurch and Dunedin.

(b) Basis of Preparation

These financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand and the requirements of the Companies Act 1993 and the Financial Reporting Act 1993. The financial statements have also been prepared on a historical cost basis except for assets backing insurance activities which have been measured at fair value.

The financial statements are presented in New Zealand dollars.

(c) Statement of Compliance

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

The Company has adopted the improvements to NZ IFRS arising from the Annual Improvements Project. These were issued primarily with a view to removing inconsistencies and clarifying wording.

The adoption of these improvements had no impact on the financial performance or position of the Company. They did however give rise to additional disclosures.

Applicable standards or interpretations that have not been adopted:
NZ IFRS 7 *Financial Instruments: Disclosures - Transition Disclosures.* The amendments to the standard introduce additional disclosures on transition from classification and measurement requirements of NZ IAS 39 Financial Instruments: Recognition and Measurement to NZ IFRS 9. The standard is effective for reporting periods commencing after 1 January 2013 but may be early adopted.

NZ IFRS 9 *Financial Instruments*. The standard uses a single approach to classify and measure financial assets to determine whether an asset should be measured at amortised cost or fair value. The standard is intended to reduce complexity and increase investor understanding of the accounting of financial assets. The standard is effective for reporting periods commencing after 1 January 2015 but may be early adopted.

NZ IFRS 13 *Fair Value Measurement. The standard* establishes a single source of guidance under NZ IFRS for determining the fair value of assets and liabilities. It does not change when an entity is required to use fair value, but rather, provides guidance on how to determine fair value under NZ IFRS when fair value is required or permitted by NZ IFRS. This guidance may result in different fair values being determined for the relevant assets. NZ IFRS 13 also expands the disclosure requirements for all assets or liabilities carried at fair value. This includes information about the assumptions made and the qualitative impact of those assumptions on the fair value determined.

(d) Premium Revenue and Provision for Unearned Premium

Premium revenue comprises amounts charged to policyholders for insurance policies. Premium is expressed net of levies and charges which are collected on behalf of the Fire Service and the Earthquake Commission, and net of Goods and Services Tax.

Premium revenue is recognised in the Statement of Comprehensive Income when it has been earned. That is, from the date of attachment of the risk, over the period of the policy (which is generally one year).

2. ACCOUNTING POLICIES continued...

(d) Premium Revenue and Provision for Unearned Premium continued...

Unearned premiums are those proportions of premium written in a year, that relate to periods of risk after the balance date. Unearned premiums are calculated on a daily pro rata basis. The proportion attributable to subsequent periods is deferred as a Provision for Unearned Premium.

(e) Claims and Provision for Outstanding Claims

Claims expense represents payments for claims plus the movement in the Provision for Outstanding Claims. Claims represent the benefits paid or payable to the policyholder on the occurrence of an event giving rise to loss or accident according to the terms of the policy. Claims expenses are recognised in the Statement of Comprehensive Income as losses are incurred which is usually the point in time when the event giving rise to the claim occurs.

The liability for any outstanding claims is carried in the Statement of Financial Position as the Provision for Outstanding Claims. It is measured as the central estimate of the present value of the expected future payments against all claims incurred at reporting date. A risk margin is also included over and above the central estimate, to allow for the inherent uncertainty in the central estimate of the outstanding claims liability. The details of risk margins and the process for their determination are set out in Note 4. The expected future payments includes primarily those in relation to claims reported but not yet paid, incurred but not reported ("IBNR") and the direct costs of settling those claims.

(f) Provision for Unearned Premium / Liability Adequacy Test

At each reporting date a liability adequacy test is performed to determine whether there is any overall excess of expected claims and deferred acquisition costs over unearned premiums. If these estimates show that the carrying amount of the unearned premiums (less related deferred acquisition costs) is inadequate, the deficiency is recognised in the Statement of Comprehensive Income.

The proportion of premiums not earned in the Statement of Comprehensive Income at reporting date is recognised in the Statement of Financial Position as Provision for Unearned Premium. The Provision for Unearned Premium is calculated separately for each group of contracts which are subject to broadly similar risks and managed together as a single portfolio. Any unexpired risk liability is recognised immediately.

The expected value of claims is calculated as the present value of the expected cash flows relating to future claims and includes a risk margin to reflect the inherent uncertainty in the central estimate.

(g) Payables

Payables are recognised when the entity becomes obliged to make future payments resulting from the purchases of goods and services.

Payables are carried at amortised cost. They represent liabilities for goods and services provided to the entity prior to the end of the financial year but which are unpaid at reporting date.

(h) Cash and Cash Equivalents

Cash and cash equivalents include liquid assets and amounts due from other financial institutions, with an original term to maturity of less than three months.

(i) Receivables

Receivables comprises various non-premium receivables which generally have 30-90 day terms. They are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method, less any allowances for impairment.

(j) Premiums Outstanding

A significant number of policyholders elect to spread premium payments over the term of the cover. Accordingly, at any one time there is a large balance of premiums which are outstanding but not overdue. They are initially recognised at fair value, and subsequently measured at amortised cost less any allowance for impairment.

All outstandings are constantly reviewed for collectability and immediately written off where deemed to be uncollectible.

(k) Reinsurance Recoveries and Claims Recoveries Outstanding

During the normal course of the Company's activities claims are paid which will result in a contractual right to seek recovery from its reinsurers and / or other third parties (which may include other insurers). At any point in time there will be amounts owing by these counterparties which will be represented by assets on the Statement of Financial Position.

The details of the impairment assessment relative to the third party recoveries are set out in Note 14. Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting year. The Company does not consider any of its reinsurance recoveries to be impaired.

2. ACCOUNTING POLICIES continued...

(l) Assets Backing Insurance Liabilities

All investment assets of the Company have been identified as assets backing the insurance liabilities of the Company.

(m) Investments

Investment funds, managed for the Company by several fund managers, are initially recorded at fair value. They are classified as financial assets at fair value through profit or loss ("FVTPL") and any movements in fair value are taken immediately to the Statement of Comprehensive Income.

The assets are valued at fair value each reporting date based on the current bid price where one is available. In the absence of a bid price, valuation is based on recent arms length transactions.

Interest and dividend income, fund distributions and fair value movements are recorded in the Investment Income section of the Statement of Comprehensive Income and are split by asset class.

(n) Financial Instruments

In the normal course of business, the Company's fund managers enter into transactions involving financial instruments in order to manage exposure to risk. These include foreign exchange contracts, financial futures, swaps and options. These instruments are for hedging purposes and are accounted for, at fair value, as part of the investment portfolio valuation.

(o) Income and Other Taxes, and Deferred Tax

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

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

Deferred income tax liabilities are recognised for all taxable temporary differences except:
- when the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or
- when the taxable temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, and the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilised, except:
- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or
- when the deductible temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, in which case a deferred tax asset is only recognised to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

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

Unrecognised deferred income tax assets are reassessed at each balance date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

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

Other taxes

Revenues, expenses and assets are recognised net of the amount of GST except when the GST incurred on a purchase of goods and services is not recoverable from Inland Revenue, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable.

2. ACCOUNTING POLICIES continued...

(o) Income and Other Taxes, and Deferred Tax continued ...

The net amount of GST recoverable from, or payable to, Inland Revenue is included as part of Receivables or Payables in the Statement of Financial Position.

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

(p) Policy Acquisition Costs

Policy acquisition costs comprise the costs of acquiring new business, including sales costs, underwriting costs and policy issue costs. These costs are deferred when they can be reliably measured and it is probable that they will give rise to premium revenue that will be recognised in subsequent reporting periods. Costs are amortised systematically in accordance with the expected pattern of the incidence of risk to which they relate. This pattern of amortisation corresponds to the earning pattern of the corresponding premium revenue.

An impairment review is performed at each reporting date as part of the Liability Adequacy Test. When the recoverable amount is less than the carrying value an impairment loss is recognised in the Statement of Comprehensive Income.

(q) Statement of Cash Flows

The Statement of Cash Flows has been prepared using the direct approach.

(r) Discontinued Operations

Assets and liabilities of the of the discontinued operation are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use.

Assets and liabilities of the discontinued operation are measured a the lower of carrying amount and fair value less costs to sell. In the Statement of Comprehensive Income items relating to the discontinued operation are disclosed separately. Refer to Note 19 for details of the cash flows associated with the discontinued operation.

(s) Comparatives

Where necessary, comparative information has been reclassified to achieve consistency with the current year.

The transfer of the disability business to Medical Life Assurance Society Limited requires that Statement of Comprehensive Income items to be classified into a single line titled 'Profit after Tax from Discontinued Operation'. Similarly Assets and Liabilities of the discontinued operation are classified into two lines 'Assets Classified as Held for Sale' and 'Liabilities associated with the Assets Classified as Held for Sale'.

(t) Changes in Accounting Policies

There have been no changes in accounting policies during the current reporting period other than those new standards adopted, as disclosed in Note 2(c).

3. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

These financial statements are prepared in accordance with New Zealand equivalents of the International Financial Reporting Standards and other authoritative accounting pronouncements. In applying the Company's accounting policies management continually evaluates judgements, estimates and assumptions based on experience and other factors. All judgements, estimates and assumptions are based on the most current set of circumstances available to management. Actual results may differ from the judgements, estimates and assumptions.

Significant judgements, estimates and assumptions made by management in the preparation of these financial statements are outlined below -

Outstanding claims liability.

The outstanding claims liability is measured as the central estimate of the present value of expected future claims payments (included claims incurred and not reported) plus a risk margin.

The estimated cost of claims includes expenses to be incurred in settling those claims, net of the expected value of salvage and other recoveries. The Company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. Given the uncertainty in establishing claims provisions, it is almost certain that the final outcome will prove to be different from the original liability established.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS continued...

All claims reported are estimated with due regard to the claim circumstance as reported by the insured, legal representative, assessor, loss adjuster and / or other third party, and then combined, where appropriate, with historical evidence on the cost of settling similar claims. Estimates are reviewed regularly and are updated as and when new information arises.

The ultimate net outstanding claims provision also includes an additional (risk) margin to allow for the uncertainty within the estimation process.

Reinsurance and Other Recoveries assets.
As is the case for claims, reinsurance and other recoveries must be estimated at reporting date. The recoverability of these assets is assessed on a periodic basis to ensure that as best can be determined, the balance is reflective of the amounts which will ultimately be received, taking into consideration factors such as counterparty credit risk.

Deferred Acquisition Costs.
Direct and indirect costs incurred during the year arising from the writing or renewing of insurance contracts are deferred to the extent that these costs are recoverable out of future premium. The main acquisition costs incurred by the Company are salary costs and underwriting costs.

For general insurance contracts, costs are typically deferred over a year. Costs incurred in writing disability income protection contracts are deferred over the life of the contract which is currently assessed to be 15 years. Changes in the contract life are treated as a change in accounting estimates.

4. CLAIMS

Claims Expense

	2013 $	2012 $
Claims paid during the year	76,678,695	110,116,383
Recoveries received during the year	(43,780,075)	(66,341,648)
Provision for Outstanding Claims at year end (new claims incurred during the year)	146,133,263	170,185,305
Additional Provisioning at year end for Outstanding Claims (net of reinsurance) incurred in prior years	59,691,381	1,913,926
Reinsurance and Other Recoveries Outstanding at year end	(206,647,995)	(178,368,852)
(Decrease) \ Increase in IBNR (claims incurred but not reported) Provision at year end	(11,840)	17,806
Provision for Outstanding Claims at previous year end (excluding IBNR)	(185,301,700)	(255,485,974)
Reinsurance and Other Recoveries Outstanding at previous year end	178,368,852	238,546,512
Increase in Risk Provision	14,801,520	13,202,466
Less Claims associated with Discontinued Operation	(7,969,111)	(4,953,150)
Net Claims Expense per Statement of Comprehensive Income	31,962,990	28,832,774

Provision for Outstanding Claims	2013 $	2012 $
Expected Future Claim Payments (undiscounted)	197,376,539	184,240,122
IBNR Claims at year end	2,854,132	2,865,972
Risk Margin	30,651,296	15,866,375
Discount to Present Value	(7,401,676)	(14,804,797)
Reclassified as Discontinued Operation (Note 19)	(22,665,800)	-
Provision for Outstanding Claims per Statement of Financial Position	200,814,491	188,167,672

4. CLAIMS continued...

Assumptions adopted in calculation of claim provisions
A significant portion of the general insurance claims provisions relate to earthquake claims. The claims estimate is subject to a degree of uncertainty as a number of issues are yet to be resolved.

The Company has engaged quantity surveyors to determine expected earthquake claim costs on a claim by claim basis. Where the property is deemed to require rebuilding, as opposed to repair, a detailed elemental costing has been performed to arrive at a central estimate claim cost.

The disability portion of claims is determined by actuarial valuation. The effective date of the actuarial report on the disability portion of the provision is 31 March 2013. The report was prepared by Peter Davies, FIA, a Fellow of the New Zealand Society of Actuaries ("NZSA") on 19 April 2013. He is satisfied as to the accuracy of the data upon which the calculations have been made. There were no qualifications to the report.

The amount of disability claim provisions has been determined in accordance with methods and assumptions disclosed in these financial statements and with the standards established by the NZSA.

The following key assumptions have been used in determining general insurance net outstanding claims liabilities:

	2013	2012
Risk margin - earthquake claims	17.50%	10.00%
Risk margin - non earthquake	9.08%	9.60%
Weighted average expected term to settlement - non earthquake	within 1 year	within 1 year
Weighted average expected term to settlement - earthquake	within 2 years	within 3 years
Discount rate for earthquake claims	2.43%	3.01%

The following key assumptions have been used in determining disability net outstanding claims liabilities which have been reclassified as held for sale:

	2013	2012
Risk margin	9.08%	9.60%
Weighted average expected term to settlement	5.2 years	4.9 years
Benefit escalation for qualifying claims	2.50%	2.50%
Discount rate	2.86%	3.61%

Risk margin
For both the disability and non-disability provisioning, on a case by case basis, the initial amount calculated is the central estimate (the mean of the distribution of the probable outcomes). That is, it is intended to contain no deliberate, or conscious over or under estimation. Over and above the central estimate, and to reflect the inherent uncertainty in determining it, a risk margin is added in arriving at the carrying amount of the liability. This increases the probability that the liability will ultimately prove to be sufficient. The potential uncertainties include those relating to the actuarial model and assumptions, the quality of the underlying data used, general statistical uncertainty and the insurance environment.

The risk margin is applied to the net outstanding claims for the Company as a whole. However an assessment of the uncertainty and the determination of a risk margin is done by individual class of business (Disability, Motor Vehicle, Domestic etc. ...). The entity risk margin is assessed to be less than the sum of the individual classes, reflecting the benefit of diversification in general insurance. The percentage risk margin applied is 9.08% (2012 9.60%) for non earthquake claims and 17.50% (2012: 10.00%) for earthquake claims, which results in an 80.00% (2012 80.00%) level of sufficiency or probability of adequacy.

Claims Development Table

The following table shows the development of net undiscounted outstanding claims relative to the current estimate of ultimate claims costs for the five most recent years.

				Incident Year			
	Prior	**2009**	**2010**	**2011**	**2012**	**2013**	**Total**
At end of incident year		27,927,645	36,844,278	256,420,462	42,333,624	28,906,634	
One year later		29,083,558	27,728,249	255,606,628	55,661,938		
Two years later		29,197,219	27,813,371	296,005,007			
Three years later		29,208,188	27,872,800				
Four years later		29,257,029					
Current estimated claim cost	37,322,067	29,257,029	27,872,800	296,005,007	55,661,938	28,906,634	
Payments	(37,183,230)	(29,235,762)	(27,876,129)	(151,068,337)	(35,837,285)	(21,077,253)	
Undiscounted central estimate	138,837	21,267	(3,329)	144,936,670	19,824,653	7,829,381	172,747,479
Discount to present value	-	-	-	(3,422,100)	(444,074)	-	(3,866,174)
Discounted central estimate	138,837	21,267	(3,329)	141,514,570	19,380,579	7,829,381	168,881,305
IBNR net of risk margin							2,270,280
Risk margin							29,662,966
Gross outstanding claims liabilities							200,814,551
Recoveries from reinsurers							(196,653,582)
Net outstanding claims liabilities							4,160,969

5. ADMINISTRATION EXPENSES

	2013	2012
Included within Administration Expenses are:	$	$
Auditor Remuneration		
- Auditing / Reviewing Financial Statements	50,000	45,928
- Prudential Regulation Audit (2013 year return)	10,000	-
- Prudential Regulation Audit (2012 year return)	9,200	800

No Directors' fees are provided for or are payable.

6. RELATED PARTY TRANSACTIONS

a) Details of material related party transactions are as disclosed in the Statement of Comprehensive Income and the Statement of Financial Position.

b) During the year, the related party transactions were with the parent company of the Medical Assurance Society New Zealand Limited Group ("the Group") and took the form of Advances, Administration Fees and Interest. Interest on advances is charged at the 90 day bank bill rate plus 1%. None of the amounts owing between the Company and the Group have been written off or forgiven during the year. The Administration Fees relate to management costs incurred on behalf of the Company by the Group.

c) The audit fee disclosed in the Statement of Comprehensive Income is paid for by the parent company.

d) The advance from the parent company of $7,076,126 (2012 $6,046,689) is unsecured.

No staff are directly employed by the Company. All staff including key management personnel are employees of the parent company, and the amounts detailed below have been paid by the parent company. Key management personnel is defined as directors and members of the Executive Management Team.

	2013	2012
	$	$
Salaries and other short-term employee benefits	1,940,123	1,681,917
MAS directors fees	563,875	515,000
	2,503,998	2,196,917

e) All transactions with Members and the key management personnel of the parent, are at market rates.

7. TAXATION

	2013	2012
	$	$
Net Surplus before Taxation	3,166,354	3,803,468
Taxation at 28%	886,579	1,064,971
Taxation effect of permanent differences	(28,063)	555,086
Prior period adjustment relating to Insurance Reserves and Provisions	10,303	10,677
Imputation Credits	(16,313)	(17,002)
Impact of change in income tax rate	-	459
Other	-	(19,350)
Taxation Expense for the Year	852,506	1,594,841
Taxation Expense for the Year comprises:		
Current Tax	637,785	1,397,556
Deferred Tax	214,721	197,285
	852,506	1,594,841
Taxation Expense Attributable to Continuing Operations	408,894	659,520
Taxation Expense Attributable to Discontinued Operation	443,612	935,321
	852,506	1,594,841

Deferred Taxation Liability Comprises:
Deferred Tax

31 March 2013	Opening Balance	Tax Rate Change	Prior Period Adjustment	Statement of Comprehensive Income	Total
Deferred Tax Liabilities	$	$	$	$	$
Insurance Reserves and Provisions	(555,690)	-	-	(213,500)	(769,190)
	(555,690)	-	-	(213,500)	(769,190)
Deferred Tax Assets					
Other	1,221	-	-	(1,221)	-
	1,221	-	-	(1,221)	-
Net Deferred Tax Liability	(554,469)	-	-	(214,721)	(769,190)

7. **TAXATION continued...**

	$
Deferred Tax attributable to continuing operations	(87,618)
Deferred Tax attributable to discontinued operations	(681,572)
	(769,190)

Deferred Tax

31 March 2012	Opening Balance	Tax Rate Change	Prior Period Adjustment	Statement of Comprehensive Income	Total
Deferred Tax Liabilities	$	$	$	$	$
Insurance Reserves and Provisions	(358,057)	(459)	6,883	(204,057)	(555,690)
	(358,057)	(459)	6,883	(204,057)	(555,690)
Deferred Tax Assets					
Other	872	-	-	349	1,221
	872	-	-	349	1,221
Net Deferred Tax Liability	(357,185)	(459)	6,883	(203,708)	(554,469)

Imputation Credit Account ("ICA")

	2013	2012
	$	$
Closing balance	1,983,605	1,983,605

As a member of the Medical Assurance Society Consolidated Group for tax purposes, all credits and debits in the current year are not recorded in the above ICA, but rather in the ICA of Medical Assurance Society New Zealand Limited as the nominated member of the Medical Assurance Society Consolidated Group.

8. **PAYABLES**

	2013	2012
	$	$
Government Levies	1,266,572	662,984
GST Payable	2,579,508	1,650,934
Other Payables	2,125,300	1,785,890
Reclassified as Held for Sale	(771,766)	-
	5,199,614	4,099,808

All payables are due within twelve months of balance date. The carrying amounts reasonably approximate fair value.

9. **PROVISION FOR UNEARNED PREMIUM**

The following table is a reconciliation of Unearned Premium:	2013	2012
	$	$
Unearned Premium - General Insurance		
Balance at the beginning of the financial year	28,207,676	23,681,190
Premiums written during the year	59,694,066	56,175,004
Premiums earned during the year	(58,208,877)	(51,648,518)
Balance at the end of the financial year	29,692,865	28,207,676
Unearned Premium - Disability Insurance		
Balance at the beginning of the financial year	5,428,359	5,420,390
Premiums written during the year	15,505,659	15,209,407
Premiums earned during the year	(15,505,879)	(15,201,438)
Reclassified as held for sale	(5,428,139)	-
Balance at the end of the financial year	-	5,428,359
	29,692,865	33,636,035

Liability Adequacy Test

Actuary Peter Davies, in his report dated 31 May 2013, has reported on the Liability Adequacy Test undertaken by him as at 31 March 2013. He has concluded that the Provision for Unearned Premium as at that date, is not deficient (2012 no deficiency). In forming this opinion he has assessed the current estimates of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under all current contracts. Included within the claims figure is a risk margin to reflect the inherent uncertainty in the central estimate. His conclusion is that the provision exceeds the prospective claims value. The financial statements have not been adjusted to recognise the surplus.

10. CASH AND CASH EQUIVALENTS

	2013	2012
	$	$
On Call Deposits	4,230,000	3,440,000
	4,230,000	3,440,000

All funds are held with registered banks and are available on call.

11. RECEIVABLES

	2013	2012
	$	$
Interest Due on Short Term Deposits	8,529	8,389
	8,529	8,389

The carrying amounts of receivables reasonably approximate fair value. Any past due but not impaired receivables are insignificant.

12. PREMIUMS OUTSTANDING

	2013	2012
	$	$
Premiums Owing by General Insurance Policyholders	14,921,877	13,032,673
Premiums Owing by Disability Insurance Policyholders	5,521,440	5,488,664
Reclassified as Held for Sale	(5,521,440)	-
	14,921,877	18,521,337

A significant number of policyholders elect to pay premiums in instalments spread evenly over the term of the cover. Accordingly, at any one time, including balance date, there will be large outstandings relative to premium which has been billed but not collected.

Where any instalments are overdue (direct debits dishonoured) or alternatively where annual payments are overdue, the related debts are assessed for impairment and where it is evident adjusted immediately.

The carrying amounts reasonably approximate fair value.

13. REINSURANCE RECOVERIES OUTSTANDING

	2013	2012
	$	$
General Insurance		
Gross Reinsurance Recoveries Outstanding	197,431,730	180,151,671
Discount to present value	(3,761,433)	(11,786,638)
	193,670,297	168,365,033
Disability Insurance - Held for Sale		
Gross Reinsurance Recoveries Outstanding	11,638,455	8,109,755
Discount to present value	(1,644,042)	(1,380,830)
Reclassified as Held for Sale	(9,994,413)	-
	-	6,728,925
Reinsurance Recoveries Outstanding	193,670,297	175,093,958

The Company's insurance operations are protected from the impact of large losses and catastrophic events, by way of a comprehensive reinsurance programme arranged with some of the world's strongest reinsurance companies and syndicates.

The programme is developed, once external professional advice, involving comprehensive modelling, is obtained to establish potential exposures to earthquake claims and to assess how much any claim or series of claims the Company can retain for its own account. The Company's catastrophe cover is designed to offer protection for the worst possible scenario and exceeds the Reserve Bank of New Zealand's solvency requirements for reinsurance cover for a 1 in 1,000 year event.

At any time, balance date included, the settlement of claims will have led to a receivable being created relative to the amount recoverable from the Company's reinsurers.

Such amounts due are assessed for impairment and where it is evident, adjusted immediately.

The carrying amounts reasonably approximate fair value.

14. CLAIMS RECOVERIES OUTSTANDING

	2013 $	2012 $
Claims Recoveries Owing by Third Parties	2,983,285	3,274,894
	2,983,285	3,274,894

Whilst the majority of claims recoveries come from reinsurers, the Company often has a contractual right to recover from other third parties. These third parties may be individuals or entities who were at fault and responsible for the claim made, or may be their insurers.

Such amounts are assessed for impairment on an individual basis and where it is evident, adjusted immediately. Further to that, on a collective basis, based on historical levels of impairment, impairment is recognised as follows-
-amounts owing by other insurers, nil impairment (2012 nil).
-accounts placed with a collection agency, 65.00% impairment (2012 72.00%).
-amounts for which a regular payment arrangement has been agreed with the debtor, nil impairment (2012 nil impairment).

The carrying amounts, adjusted for impairment as above, reasonably approximate fair value.

Amounts that reduce the liability to the insured such as excesses, are not claims recoveries and are offset against claims expense.

15. DEFERRED ACQUISITION COSTS

	2013 $	2012 $
Opening balance	1,981,494	1,255,835
Acquisition costs deferred during the year	1,518,292	1,484,508
Current period amortisation	(752,186)	(758,849)
Reclassified as Held for Sale	(2,434,186)	-
Closing balance	313,414	1,981,494
Represented as:		
Current	313,414	409,056
Non current	-	1,572,438
	313,414	1,981,494

16. INVESTMENTS

	2013 $	2012 $
Deposits and Short Term Securities	25,321,034	18,167,196
Domestic Fixed Interest	27,234,774	30,673,556
International Fixed Interest (Unit Trust)	18,330,399	12,234,378
Reclassified as Held for Sale	(11,597,238)	-
Total Investments	59,288,969	61,075,130
Realised Investment Income	2,313,017	1,060,976
Unrealised Investment Income	1,942,926	726,080
Total Investment Income	4,255,943	1,787,056

The Company's investment securities are all financial assets classified as fair value through profit or loss. Any changes in fair value are immediately recognised.

All funds are managed by JBWere and Bancorp Treasury Services Limited. The majority of the total sum invested, is invested into securities held in the name of the Company, via a custodian. The remaining funds are invested into unitised or pooled vehicles.

17. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair values are based on relevant information available as at balance date. While judgement is used in obtaining the fair value of financial instruments, there are inherent weaknesses in any estimation technique. Many of the estimates involve uncertainties and matters of significant judgement, and changes in underlying assumptions could significantly affect these estimates.

The methodologies and assumptions used when determining fair value depend on the terms and risk characteristics of the various instruments and include the following -

17. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES continued ...

Cash and Cash Equivalents
For cash and short term funds, balances with other financial institutions with maturities of less than three months and other types of short term financial assets, the carrying value of these financial instruments are considered to approximate their fair values as they are short term in nature or are receivable on demand.

Other Financial Assets
For all other financial assets, the carrying value is considered to be a reasonable estimate of fair value. Neither Taxation Paid in Advance, Claims Recoveries Outstanding, nor Reinsurance Recoveries Outstanding are considered to be financial assets.

Payables and Other Financial Liabilities
The carrying value of Payables, and Advance from Parent Company approximate their fair values as they are short term in nature or payable on demand. Neither Deferred Tax, nor GST, nor insurance provisions are considered to be financial liabilities.

The following table summarises the carrying amounts and fair values of each class of financial asset and financial liability:

	2013 Carrying Amount	2013 Fair Value	2012 Carrying Amount	2012 Fair Value
Financial Assets	$	$	$	$
Cash and Cash Equivalents	4,230,000	4,230,000	3,440,000	3,440,000
Receivables	8,529	8,529	8,389	8,389
Premiums Outstanding	14,921,877	14,921,877	18,521,337	18,521,337
Investments	59,288,969	59,288,969	61,075,130	61,075,130
	78,449,375	78,449,375	83,044,856	83,044,856

	2013 Carrying Amount	2013 Fair Value	2012 Carrying Amount	2012 Fair Value
Financial Liabilities	$	$	$	$
Payables	2,620,106	2,620,106	2,448,874	2,448,874
Advance from Parent Company	7,076,126	7,076,126	6,046,689	6,046,689
	9,696,232	9,696,232	8,495,563	8,495,563

Fair Value Hierarchy

The following table shows an analysis of financial instruments recorded at fair value in the Statement of Financial Position by level of the fair value hierarchy. The only assets and liabilities that the Company recognises on a fair value basis are its investments (refer to Classification of Financial Instruments on pages 19 and 20 for details of the classification categories):

	Level 1	Level 2	Level 3	Total
	$	$	$	$
31 March 2013				
Financial Assets				
Domestic Fixed Interest	-	27,234,774	-	27,234,774
International Fixed Interest (Unit Trust)	-	18,330,399	-	18,330,399
	-	45,565,173	-	45,565,173
31 March 2012				
Financial Assets				
Domestic Fixed Interest	-	30,673,556	-	30,673,556
International Fixed Interest (Unit Trust)	-	12,234,378	-	12,234,378
	-	42,907,934	-	42,907,934

A level 1 financial asset or liability comprises those assets and liabilities that are valued by reference to published quotes in an active market and the price reflects actual and regularly occurring market transactions on an arm's length basis.

A level 2 financial asset or liability is measured using industry standard valuation techniques and are based on market observable inputs but where the prices have not been determined in an active market.

A level 3 financial asset or liability value is determined in part, or in whole, using valuation techniques based on assumptions that are neither supported by prices from observable current market transactions in the same instrument, nor are they based on available market data.

There have been no transfers between Level 1 and Level 2 (2012: nil).

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's risk management is carried out in accordance with policies set by the Board. These policies provide a clear structure for managing financial and operational risks.
Whilst their review of risk is on-going, directors formally review the major risks faced by the entire Group every six months.

The entity does not directly enter into derivative financial instruments contracts. However its fund managers do, principally to protect the value of investments against adverse currency movements. They are prevented by policy guidelines established by the Group's Investment Committee from entering into such contracts for speculative purposes.

The main risks arising from the financial instruments and the business the Company engages in, are; insurance risk, credit risk, investment risk, currency risk, market risk, liquidity risk and operating risk.

Insurance Risk
Insurance risk is the risk that either inadequate or inappropriate product design, pricing, underwriting, reserving, claims management or reinsurance management will expose the Company to financial loss and, in the worst case a consequent inability to meet its liabilities when they fall due.

There are a number of key policies in place which mitigate insurance risk, including;
- the recruitment, retention and on-going training of suitably qualified personnel
- the use of management information systems that provide reliable data on the risks to which the business is exposed
- the use of external actuarial expertise to assist in determining premium levels and monitoring claims patterns
- the use of reinsurance to limit the Company's exposure to large single claims and accumulations of claims that arise from a singular event
- the monitoring of a reinsurer's credit risk rating to control exposure to reinsurance counterparty default
- the reduction in the variability in loss experience through diversification over classes of insurance business
- the modelling and monitoring of concentrations of risk which are particularly relevant in the case of natural disasters and catastrophes and accordingly must be recognised in the development of the reinsurance programme.

Credit Risk
The Company is exposed to two forms of credit risk, one in relation to its insurance operations, the other to the investments which back those insurance operations.

To the former, credit risk is the risk that policyholders, reinsurers, or other third parties which have a contractual liability to the Company, default on their financial obligations.

There are a number of key policies in place which mitigate credit risk, including;
- the use of standard credit control techniques which ensure that premium payments are made within a reasonable timeframe or cover and hence exposure to claim, cancelled
- the placement of reinsurance cover with a number of reinsurers
- the monitoring of a reinsurer's credit risk rating to control exposure to reinsurance counterparty default.

Statement of Financial Position credit exposures -

	2013 $	2012 $
Cash and Cash Equivalents	4,230,000	3,440,000
Receivables	8,529	8,389
Premiums Outstanding	14,921,877	18,521,337
Reinsurance Recoveries	193,670,297	175,093,958
Investments	59,288,969	61,075,130
	272,119,672	258,138,814

Credit risk relative to investments is the risk that movements in either interest rates or stockmarkets will have an adverse impact on the profitability and financial stability of the Company.

The investment portfolio, which potentially exposes the Company to credit risk consists of short term deposits, domestic and international fixed interest securities and international equities. The maximum exposure to credit risk is the carrying value of these financial instruments.

Investment funds in part back the insurance operations and in part support share capital and retained earnings. Investment mandates have been structured accordingly and are formalised by way of a Statement of Investment Policies and Objectives. The Investment Committee (of the Medical Assurance Society Group) meets regularly to develop and review investment strategy and monitor manager performance.

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued ...

Statement of Financial Position investment exposures -	2013	2012
	$	$
Cash and Cash Equivalents	4,230,000	3,440,000
Deposits and Short Term Securities	25,321,034	18,167,196
Domestic Fixed Interest	27,234,774	30,673,556
International Fixed Interest (Unit Trust)	18,330,399	12,234,378
	75,116,207	64,515,130

Concentration of credit risk arises when the Company has a large exposure to an individual counterparty or enters into a number of contracts or financial instruments with entities that are engaged in similar business activities or exposed to similar economic factors. Investment concentration risk is managed through credit rating limits and counterparty limits.

The Company's reinsurance programme ensures that treaties are spread over a number of reinsurers thereby spreading the counterparty risk. Credit risk relating to the amounts due from reinsurers is minimised as the Company diversifies its reinsurance treaties over a number of reinsurers all of whom hold at least an A- credit rating at the time of placement. The following table discloses the number of reinsurance counterparties the Company has an exposure to in excess of 10% of total reinsurance recoveries.

	2013	2012
10% - 20% of reinsurance recoveries	2	2
20% - 30% of reinsurance recoveries	1	1
> 30% of reinsurance recoveries	-	-
Total reinsurance recoveries	203,664,710	175,093,958

Credit risk relative to investments is the risk that movements in either interest rates or stockmarkets will have an adverse impact on the profitability and financial stability of the Company.

The following table provides information on the credit risk exposure for financial assets with external credit ratings of the Company. Investment grade financial assets are classified within the range of AAA to BBB, with AAA being the highest possible rating. The 'Not rated' column discloses those assets not rated by external ratings agencies and principally comprises fixed interest investments with local government authorities.

31 March 2013	AAA	AA	A	BBB	Below BBB	Not rated	Carrying value $
Cash and Cash Equivalents	-	100.0%	-	-	-	-	4,230,000
Deposits and Short Term Securities		100.0%	-	-	-	-	25,321,034
Domestic and International Fixed Interest	25.7%	32.0%	8.2%	17.7%	0.0%	16.4%	45,565,173
Reinsurance Recoveries	0.0%	48.2%	45.4%	4.6%	0.0%	1.8%	193,670,297

31 March 2012	AAA	AA	A	BBB	Below BBB	Not rated	Carrying value $
Cash and Cash Equivalents	-	100.0%	-	-	-	-	3,440,000
Deposits and Short Term Securities		100.0%	-	-	-	-	18,167,196
Domestic and International Fixed Interest	20.7%	48.0%	12.0%	13.5%	0.0%	5.7%	42,907,934
Reinsurance Recoveries	0.0%	38.6%	61.4%	-	-	-	175,093,958

Currency Risk

Currency risk is the risk that movements in the New Zealand dollar ("NZD") will have an adverse impact on the profitability and financial stability of the entity.

Currency movements will have a direct impact on the cost of settling claims and the value of international investments (overseas fixed interest securities and shares). The former is relatively insignificant in terms of financial impact and no effort is made to mitigate this risk. This is because any adverse impact on the cost of claims (a lower NZD) will be more than offset by the appreciation in the value of foreign currency denominated investments (unless fully hedged).

To mitigate currency risk relative to the investment portfolio, the Group's Investment Committee has developed currency hedging ranges which the respective fund managers must adhere to.

Statement of Financial Position currency exposures -	2013	2012
	$	$
Deposits and Short Term Securities (USD - unhedged)	-	4,328,806
International Fixed Interest (AUD - fully hedged)	18,330,399	12,234,378
	18,330,399	16,563,184

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued ...

Market Risk

Market risk is the risk of loss of current and future earnings from adverse moves in currency and the prices of other financial contracts.

There is a tendency for insurers operating within a specific market to be restricted to a certain extent by that market, in terms of premium increases they may wish to apply. The Company, due to the makeup of its customer base, whilst not immune, is less inclined to be restricted by such considerations. Any impact is likely to be insignificant such that premium rates is excluded from the sensitivity analysis.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its liabilities, principally claims payments, as and when they fall due. Liquidity risk is reviewed on an on-going basis.

There are a number of key policies in place which mitigate liquidity risk, including;
- the adherence to a conservative dividend policy (despite strong profitability no dividend has been paid to the parent since 2002)
- the immediate availability of significant levels of funding by way of access to inter-company accounts
- conservative reinsurance retention levels
- the ability to access investment funds via the fund managers at short notice.

The table which follows analyses the Company's financial instruments at balance date, into the relevant maturity groupings based on the remaining period to the contractual maturity date.

	0-12 months	1-2 years	2-5 years	Over 5 years	Total
	$	$	$	$	$
31 March 2013					
Financial Assets					
Cash and Cash Equivalents	4,230,000	-	-	-	4,230,000
Receivables	8,529	-	-	-	8,529
Premiums Outstanding	14,921,877	-	-	-	14,921,877
Investments	59,288,969	-	-	-	59,288,969
	78,449,375	-	-	-	78,449,375
Financial Liabilities					
Payables	2,620,106	-	-	-	2,620,106
Advance from Parent Company	7,076,126	-	-	-	7,076,126
	9,696,232	-	-	-	9,696,232

	0-12 months	1-2 years	2-5 years	Over 5 years	Total
	$	$	$	$	$
31 March 2012					
Financial Assets					
Cash and Cash Equivalents	3,440,000	-	-	-	3,440,000
Receivables	8,389	-	-	-	8,389
Premiums Outstanding	18,521,337	-	-	-	18,521,337
Investments	61,075,130	-	-	-	61,075,130
	83,044,856	-	-	-	83,044,856
Financial Liabilities					
Payables	2,248,874	-	-	-	2,248,874
Advance from Parent Company	6,046,689	-	-	-	6,046,689
	8,295,563	-	-	-	8,295,563

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued ...

Operating Risk

Operating risk is the risk of financial loss resulting from either external events, inadequate or failed systems or processes, or insufficiently skilled and trained staff.

There are a number of key policies in place which mitigate operating risk, including;

- the management and staff are responsible for identifying, assessing and managing operational risks in accordance with their roles and responsibilities.
- the Risk and Compliance team is charged with assisting staff identify risks and ensure the sufficiency of and on-going presence of suitable mitigants.

Sensitivity Analysis

The Company has two risks which are price sensitive to an extent that they may impact earnings materially - Insurance Risk and Market Risk (as it pertains to investments). These risks have been considered above.

Insurance risk exists relative to impacts on the provisioning for outstanding disability claims. Both movements in discounts rates and variations in termination rates can have a material impact on profit and equity.

The table below looks at how the direct risk variables can influence profit or loss and equity.

Risk Variable	**Movement**	**Impact on Profit and Equity** 2013 $	2012 $
Insurance Risk:			
Discount rate	Increase by 1%	335,000	304,000
	Decrease by 1%	(367,000)	(332,000)
Termination rates	Increase by 10%	593,000	580,000
	Decrease by 10%	(523,000)	(660,000)
Market Risk:			
Short term deposit rates	Increase by 1%	30,000	25,000
	Decrease by 1%	(30,000)	(25,000)
Bond interest rates	Increase by 0.50%	(170,000)	(307,000)
	Decrease by 0.50%	170,000	307,000
Unit prices	Unit price increases by 10%	2,275,000	881,000
	Unit price decreases by 10%	(2,275,000)	(881,000)
Currency rates	NZD appreciates by 10% against the USD	-	(283,000)
	NZD depreciates by 10% against the USD	-	364,000

Classification of Financial Instruments

The carrying amounts of Assets and Liabilities have been classified into the categories defined in IAS 39 in the tables below.

	Loans and Receivables $	**Fair Value Through Profit or Loss** $	**Other Financial Liabilities** $	**Total** $
31 March 2013				
Assets				
Cash and Cash Equivalents	4,230,000	-	-	4,230,000
Receivables	8,529	-	-	8,529
Reinsurance Recoveries Outstanding	193,670,297			193,670,297
Premiums Outstanding	14,921,877	-	-	14,921,877
Investments	-	59,288,969	-	59,288,969
	212,830,703	59,288,969	-	272,119,672

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued ...

	Loans and Receivables	Fair Value Through Profit or Loss	Other Financial Liabilities	Total
	$	$	$	$
31 March 2013				
Liabilities				
Payables and Provisions	-	-	5,199,614	5,199,614
Advance from Parent Company	-	-	7,076,126	7,076,126
	-	-	12,275,740	12,275,740
31 March 2012				
Assets				
Cash and Cash Equivalents	3,440,000	-	-	3,440,000
Receivables	8,389	-	-	8,389
Reinsurance Recoveries Outstanding	175,093,958			175,093,958
Premiums Outstanding	18,521,337	-	-	18,521,337
Investments	-	61,075,130	-	61,075,130
	197,063,684	61,075,130	-	258,138,814
Liabilities				
Payables and Provisions	-	-	4,099,808	4,099,808
Advance from Parent Company	-	-	6,046,689	6,046,689
	-	-	10,146,497	10,146,497

19. DISCONTINUED OPERATIONS

On 27 February 2013 the Board approved in principle the transfer of the Disability business to Medical Life Assurance Society Limited ("MLA"). Like the Company, MLA is a fully owned subsidiary of Medical Assurance Society New Zealand Limited. The transfer follows a review of the appropriateness of maintaining long term disability business within the Groups' fire and general company.

As a licensed insurer, the transfer required approval from the Reserve Bank of New Zealand ("RBNZ"). The RBNZ gave approval for the transfer on 26 March 2013.

The transfer of the Disability business is due to be completed on 1 April 2013. As at 31 March 2013 the Disability business was classified as a discontinued operation. The results of the Disability business are presented below:

	2013	2012
	$	$
Premium from Insurance Contracts	15,505,879	15,201,438
Less: Reinsurance Premiums	3,826,221	4,195,943
Net Earned Premium	11,679,658	11,005,495
Claims Expense	7,969,111	4,953,150
Administration Expenses	2,993,275	3,340,535
Total Operating Expenses	10,962,386	8,293,685
Surplus on Underwriting	717,272	2,711,810
Net Investment Income	950,607	338,370
Surplus before Taxation	1,667,879	3,050,180
Taxation Expense	443,612	935,321
Net Surplus after Taxation from Discontinued Operations	**1,224,267**	**2,114,859**

19. DISCONTINUED OPERATIONS continued...

	2013
	$
Assets	
Premiums Outstanding	5,521,440
Reinsurance Recoveries Outstanding	9,994,413
Deferred Acquisition Costs	2,434,186
Investments	11,597,238
Assets Classified as Held for Sale	29,547,277
Liabilities	
Payables	771,766
Provision for Unearned Premium	5,428,139
Provision for Outstanding Claims	22,665,800
Deferred Tax	681,572
Liabilities Directly Associated with the Assets Held for Sale	29,547,277

Cash flows of Discontinued Operations:	2013	2012
	$	$
Cash Flows from Operating Activities	4,823,237	2,064,956
Cash Flows (for) / from Investing Activities	(2,858,173)	861,693
Cash Flows from Financing Activities	-	-
Net Cash Flows from Discontinued Operations	1,965,064	2,926,649

20. CONTRIBUTED EQUITY

	2013	2012
	$	$
10,000,000 Ordinary Shares	10,000,000	10,000,000

All shares carry the same voting rights.

Ordinary shares have no par value.

Capital Management policies and objectives

When managing capital, management's objective is to ensure the entity continues as a going concern as well as to maintain optimal returns to shareholders and benefits for other stakeholders.

Directors may change the amount of dividends to be paid to shareholders (if any), return capital to shareholders, issue new shares or sell assets to reduce debt.

There are no plans to issue further shares.

At 31 March 2013 the Company held a provisional insurance licence from the Reserve Bank of New Zealand ("the Bank"). Since 18 January 2012 the Company has been required to retain minimum solvency capital of at least $5m under the Solvency Standard for Life Insurance Business issued by the Bank. From 31 December 2012 the Company has been required to maintain a solvency margin of at least $0. That is, from 31 December 2012 actual solvency capital as determined under the solvency standard should be at or above the minimum solvency capital level.

The Company has a capital management plan and reporting process in place to ensure continuous and full compliance with the solvency standard.

The minimum solvency capital the Company is required to maintain to meet the solvency standards is as follows:

	2013	2012
	$	$
Actual Solvency Capital	33,422,757	31,108,909
Minimum Solvency Capital	25,832,954	22,297,929
Solvency Margin	7,589,803	8,810,980

21. CONTINGENT LIABILITIES

The Company is subject to several legal disputes at 31 March 2013. The disputes are of a type common to any entity engaged in similar activities. Where such disputes lead to formal proceedings they will be defended by the Company. The impact of any subsequent judgements is unlikely to be significant to the financial statements.

22. RECONCILIATION OF CASH FLOWS

	2013 $	2012 $
Reported Surplus after Taxation	2,313,848	2,208,627
Add Non-Cash Items:		
Addition to Unearned Premium	1,484,969	4,534,454
Increase / (Decrease) in Outstanding Claims	35,312,619	(70,166,468)
Increase in Deferred Tax	214,721	197,284
Change in Operating Assets and Liabilities		
Provision for Taxation	(658,720)	1,553,585
Accounts Payable	1,105,466	399,137
Premiums Outstanding	(1,921,980)	(1,886,046)
Receivables, Reinsurance Recoveries Outstanding and Claims Recoveries Outstanding	(28,279,283)	61,169,417
Net Cash Flows from / (for) Operating Activities	9,571,640	(1,990,010)

23. SUBSEQUENT EVENTS

On 1 April 2013 the transfer of the Disability business to Medical Life Assurance Society Limited was effected. Refer to Note 19 - Discontinued Operations for further details of the transfer.

The Company received notification on 27 May 2013 from the Reserve Bank of New Zealand that it had obtained a licence under the Insurance (Prudential Supervision) Act 2010. Previously the Company held a provisional licence.

Independent Auditor's Report

To the Shareholders of Medical Insurance Society Limited

Report on the Financial Statements

We have audited the financial statements of Medical Insurance Society Limited on pages 1 to 22, which comprise the statement of financial position of Medical Insurance Society Limited as at 31 March 2013, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

Directors' Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

We undertake regulatory assurance work to Medical Insurance Society Limited.

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

Opinion

In our opinion, the financial statements on pages 1 to 22:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards; and
- give a true and fair view of the financial position of Medical Insurance Society Limited as at 31 March 2013 and its financial performance and cash flows for the year then ended.

Report on Other Legal and Regulatory Requirements

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

- We have obtained all the information and explanations that we have required.
- In our opinion proper accounting records have been kept by Medical Insurance Society Limited as far as appears from our examination of those records.

Ernst & Young

26 June 2013
Wellington

Davies Financial and Actuarial Limited

8th August 2013

To: The Directors
Medical Insurance Society Limited

From: Peter Davies
Appointed Actuary

Re: Medical Insurance Society Limited: Report as at 31st March 2013 under Sections 77 and 78 of the Insurance (Prudential Supervision) Act 2010

You have asked me to prepare this report in terms of the above sections of the Act, and I would like to comment further as follows:

1. I have reviewed the actuarial information included in the audited accounts for Medical Insurance Society Limited as at 31st March 2013. "Actuarial information" includes the following:

   - claim provisions and unexpired risk provisions;
   - solvency calculations in terms of the RBNZ Solvency Standard;
   - balance sheet and other information allowed for in the calculation of the company's solvency position; and
   - disclosures regarding the methodology and assumptions used for calculating claim provisions, unexpired risk provisions, and other disclosures.

2. No limitations have been placed on my work.

Level 1, 3 Shea Terrace, Takapuna 0622 Telephone (09) 489-3551 e-mail: pdavies@actuary.co.nz
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3. I am independent with respect to Medical Insurance Society Limited as defined under professional standard ISA (NZ) 620 of the New Zealand Institute of Chartered Accountants.

4. I have been provided with all information that I have requested in order to carry out this review.

5. In my view the actuarial information contained in the financial statements has been appropriately included, and the actuarial information used in the preparation of the financial statements has been appropriately used.

6. Medical Insurance Society Limited exceeded the RBNZ minimum solvency margin requirement as at 31st March 2013. The company is also projected to exceed the minimum requirement at all times over the next three years.

I would be very happy to answer any queries concerning this report.

Yours sincerely

Peter Davies B.Bus.Sc., FIA, FNZSA
Appointed Actuary

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