



Southern Cross
Health Society

The Southern Cross Medical Care Society 2010 Annual Report

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Oranges have long been popular as a rich source of vitamin C that can help ward off colds, assist healing and bolster the immune system.

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Overview

FOR THE YEAR ENDED 30 JUNE 2010

- In 2010 your not-for-profit Society continued to deliver its members excellent value for money, with on average 94.1 cents returned to members in claims for every dollar paid in premiums.
- In order to deliver this outstanding level of reimbursement, we deliberately set out to use our strong reserves to help meet rising claims costs. The resulting deficit of \$7.1 million was a better than forecast financial performance.
- Premium income was \$597.3 million while total claims reached \$562.2 million.
- With no debt, and reserves of \$306 million, the Society remains in a strong financial position. In February we received an A+ financial strength rating from Standard & Poor's for the eighth consecutive year.
- In 2010 income from investments was \$33.2 million. The Society's investment portfolio ended the year valued at \$403 million.
- Membership remained relatively stable in a declining New Zealand market, decreasing by just 1,078 over the year to 842,044 members. The Society's market share increased slightly to 60.63 per cent.



Chairman's report

OUR PERFORMANCE

In 2010 The Southern Cross Medical Care Society delivered better than forecast results in what remains a challenging environment for the health sector.

While the recession had officially ended by the close of the 2009 financial year, we recognised that economic difficulties are ongoing for many New Zealand businesses and individuals. In order to continue delivering the best possible value for our members' healthcare dollar, we deliberately set out to use our strong reserves to help meet rising claims costs.

Despite recording a deficit, the Society ended the financial year in a healthier position than projected. In 2010 the Society recorded a modest deficit of \$7.1 million, 40 per cent under the \$11.9 million budgeted deficit.

While the overall health insurance industry experienced a decrease of 5,200 New Zealanders covered over the year, the Society's membership has stayed relatively stable. In 2010, membership decreased by just 0.13 per cent or 1,078 to 842,044 members – a pleasing result in an economic environment marked by a static employment market, rising living costs and low business confidence. In this same period, our market share increased by 0.15 per cent to 60.63 per cent.

Despite belt-tightening in many areas, Kiwi employers continued to recognise the benefits health insurance delivers to their bottom line. The number of employer-subsidised members increased to 244,967, up 2,327 on 2009 figures.

The Society is in a robust financial state. Our reserves remain strong at \$306 million while in February the Society retained its A+ financial strength rating from Standard & Poor's for the eighth consecutive year, confirming our financial strength and stability.

This year the Society had a claims to premium ratio of 94.1 per cent – a market-leading level of reimbursement. During the year the Society earned \$597.3 million in premiums, up 9.8 per cent on 2009, and incurred \$562.2 million in claims, up 7.0 per cent.

I am pleased to report on the good performance of our investment portfolio. While the overall portfolio value was down 2 per cent on 2009 to \$403 million, income from investments of \$33.2 million exceeded budgeted expectations.

Careful management saw overheads for the year come in \$1.3 million under budget at \$77.3 million.

Perhaps due to the strained economic circumstances described earlier, the year saw a large increase in the number of members 'downgrading' their health insurance plans (i.e. reducing the range of benefits available under their policy in order to lower their premium). In 2010, 25,726 members downgraded their policy cover, a 33 per cent increase on 2009. Relative to their proportion of total Southern Cross membership, downgrades were most common among people over 60 years of age.

Amongst all members, the most common change was a downgrade in major medical extensive cover, such as switching from hospital and specialist plans to hospital-only, or adding/increasing excess levels. This is reflective of a decade-long industry trend. Elective surgical and specialist cover now accounts for 66 per cent of the 1.4 million New Zealanders with health insurance and 59 per cent of all Southern Cross members.

As both benefits and premiums are reduced simultaneously, these downgrades do not impact on the Society's financial health – rather, this trend illustrates the value our members place in health insurance. By utilising the flexibility of our policies, they are able to keep insurance for major health events, should they arise.



GRAEME HAWKINS
CHAIRMAN OF THE BOARD

Though premium growth outstripped claims growth by 2.8 per cent over the year, the fact remains that the differential between the two is simply not enough to cover the operational costs of the Society's business. In times such as these, we are able to utilise our strong reserves to absorb any losses. But in doing so, we need to be actively seeking ways to ensure the Society's not-for-profit business model is sustainable and affordable for future generations of New Zealanders.

OUR FUTURE

The combination of two key trends is placing pressure on our financial position, requiring the Society to look at a number of solutions to ensure its long-term viability.

The first pressure point is the greater utilisation of health insurance benefits by our members. Today people of all ages are less willing, and understandably so, to compromise their ongoing health and active lifestyles because of health problems. They have an expectation that they will be able to access cataract surgery to rectify their eyesight, hip replacements to enable a return to their favourite activities, and skin excisions to remove suspicious moles that may pose a risk of skin cancer. To access this treatment, they are using their health insurance. That's great, because that is what the Society is here for. But it comes at a price that must ultimately be met through premiums.

The second pressure point is a startling rise in the average price of claims. In the two years from December 2007 to December 2009 we saw the average cost of prostate surgery rise 18 per cent, gastrointestinal surgery rise 14 per cent, and gynaecological surgeries rise on average 23 per cent. An additional factor elevating costs is the growing range of options for the medical profession to treat our health problems. New treatment technologies are rapidly becoming available, many with a high price tag.

Even in a not-for-profit model, these rising claims costs will inevitably flow on to premiums. In his report, Chief Executive Officer Dr Ian McPherson elaborates on what the Society is doing to help keep premiums as affordable as possible.

To assist our long-term sustainability, the Board is focused on ensuring the Society is aligned with current best business and governance standards. In 2009 the Society began a process to update and modernise its constitution, known as the Rules. The update is intended to bring the Rules into line with our current business operations and legislative requirements in order to follow 'best practice' corporate governance. The updated Rules will be put to the membership at our Annual General Meeting in November. The Rules have been updated in consultation with members, who were notified of the process through Alive magazine, advertisements in major newspapers, and on the Southern Cross website. Members were invited to view the Draft Rules online or by requesting information packs, and then to make submissions online or by traditional means. My thanks to those members who participated in the process.

OUR THANKS

To conclude, I would like to thank all Board members for their hard work and commitment throughout the year. I would also like to take the opportunity to welcome new director Liz Hickey, who joined the Board in October last year. Conversely, long standing director David May has indicated he will be stepping down from the Society Board following the Annual General Meeting. I would like to take this opportunity to thank him for his dedicated contribution over the past eight years.

To our members, thank you for your continued support and loyalty. I look forward to seeing many of you at the Annual General Meeting on 25 November.



Graeme Hawkins
Chairman

Chief Executive Officer's report

STRATEGIC OVERVIEW

As a not-for-profit organisation, financial performance can be viewed as just one measure of success. Because the Society exists solely for the benefit of its members, more qualitative results can be equally revealing.

In the 'Attitude NZ' survey of 1000 New Zealanders released by Perceptive in May, Southern Cross was the most frequently mentioned healthcare organisation in response to the question 'What New Zealand healthcare provider do you feel you can most trust?.'

This is not a mantle we take lightly. Our members rely upon the Society to assist them to access the healthcare they need without untimely delay. They have made the decision to place their healthcare dollar with the Society, and we seek to repay this commitment by delivering excellent value in benefits and service levels. This year we returned on average 94.1 cents to members in claims for every dollar paid in premiums, representing outstanding value for money.

However, the deficits we have sustained in both 2010 and 2009 to deliver this high level of reimbursement are not sustainable in the long-term. Pro-active solutions are essential if we are to stave off the full impact of claims costs on members' premiums.

Our 2010 results show that health insurance remains a 'must have' for a huge number of New Zealanders. Contrary to the beliefs of some commentators, our 842,000 members are not the wealthy or privileged – they are everyday New Zealanders who acknowledge that the public system is unlikely to provide for all their healthcare needs, be it now or in the future.

We are seeing our members utilise their health insurance more than ever before. At the same time, many treatment costs are rising beyond normal inflation – some dramatically so. In the year ending 30 June 2010, the rise in underlying claims cost escalation – the combination

of utilisation and medical cost increases – was calculated as 8.2%. However, claims cost escalation for certain corporate groups or some age groups may far exceed this.

Affiliated Providers

One way we are working to moderate claims costs is by strengthening our Affiliated Provider network. Affiliated Providers include surgeons, specialists and facilities who deliver a range of healthcare services to our members at agreed prices, providing Southern Cross and our members with certainty of cost.

The programme is an important way the Society is addressing the issue of rising healthcare costs in order to minimise the impact on premiums. During the year we processed \$100.9 million for procedures delivered by Affiliated Providers, representing 17.9 per cent of total claims paid by Southern Cross for the year.

The Affiliated Provider programme began in 1997 and has been evolving for 13 years. On 9 September 2010, colonoscopies, gastroscopies and cataract extractions were added to the list of procedures funded only when delivered by an Affiliated Provider.

We are currently negotiating with all providers of these services who have not yet joined the programme. While negotiations are progressing, we will continue to issue prior approvals for treatment with non-Affiliated Providers until we are satisfied there are sufficient Affiliated Provider agreements in place.

Alongside cost certainty, the programme also delivers a quicker and easier service for members and providers. When a member uses an Affiliated Provider the prior approval and claims process is managed by the provider through our dedicated online system, with the additional benefit of streamlining the Society's internal business processes.

Over the coming year, the Society is working on expanding



DR IAN MCPHERSON
CHIEF EXECUTIVE OFFICER

the number of Affiliated Providers. We are also engaging with GPs to inform them of how a referral to an Affiliated Provider can benefit patients.

Delivering real value

Another way we are looking to contain rising costs is by closely monitoring the value of providing cover for new services and treatment technology. Benefits are provided in our policies to give members choice – that is what private health insurance is all about. However, we need to make our members aware that every time a treatment is introduced into the private system and added to benefits that can be claimed under a policy, this will represent a new cost to be borne by members through premiums. When situations such as these arise, we must ask ourselves a difficult but necessary question – is this the most effective way to spend our members' healthcare dollar?

Take for example our decision to fund private radiotherapy treatment in the South Island through an Affiliated Provider agreement with St George's Cancer Care Centre in Christchurch. Radiotherapy has, historically, been the domain of the public health system. However, in 2008 New Zealand's first private radiotherapy service became available in Auckland at Auckland Radiation Oncology, and St George's followed suit this year. It was apparent to us that members wanted the reassurance of access to these private options in the event the public system was unable to meet their expectations for treatment, so we decided to provide private radiotherapy benefits in our policies.

While we have sought to mitigate the impact on claims costs by entering into Affiliated Provider contracts with these facilities, the fact remains that members using these benefits to access treatment will result in increased claims costs that have to be met across the membership. Already we have seen this impact coming through with claims costs for private radiotherapy up \$3.5 million in the past financial year compared with 2008-09. Now that Affiliated Provider agreements to fund treatment at private centres in both the North and South Islands are in place, the Society is unlikely to enter into further agreements should any new private radiation centres open.

Issues that matter

With one in five New Zealanders a member of the Society, we have a significant role to play in helping to stem medical inflation and working for better health outcomes for New Zealand. We advocate a 'whole sector' approach to healthcare, whereby the private and public sector work collaboratively to create an efficient, equitable health system for all New Zealanders.

For example, since 2006 we have been vocal in our

opposition to a pilot policy, introduced by District Health Boards in the Wellington and Gisborne regions, to charge patients for lab tests referred by private specialists. Through the media and other communication channels, we urged members to voice their opposition to a policy that had the potential to penalise those who were already paying twice for their healthcare – once through health insurance and again as a taxpayer.

In 2007 the amount paid out to members for lab test charges was \$15,343. This grew to \$549,531 in 2009. The volume of these claims grew from 665 in 2007 to 9,072 in 2009, with most coming from the Wellington region.

It was a very welcome result when the Government announced an end to those charges in July. We congratulate the Minister of Health for overturning this policy.

The ability to maintain private health insurance is highly valued by a large number of New Zealanders. As such, we are committed to ensuring it remains as affordable as possible. This year we have worked closely with the Health Funds Association of New Zealand to achieve transitional arrangements deferring the impact of the increase in the rate of GST until the member's policy anniversary following 1 October 2010. If successful, this will result in a saving for members.

Two other areas we will continue to strongly advocate for on behalf of our members and all New Zealanders are a tax rebate on health insurance for those aged over 65 and the removal of fringe benefit tax on employer-subsidised health insurance. Both these measures are aimed at making health insurance more affordable for a greater number of Kiwis, with the benefit of easing the load carried by the public health system and taxpayer dollar.

OPERATIONAL REVIEW

Since 1961, The Southern Cross Medical Care Society has been caring for the health and wellbeing of generations of New Zealanders.

Today we have more than 842,000 members, 480 full time equivalent staff and are New Zealand's leading health insurer. The Society trades under the brand name Southern Cross Health Society and is led at an operational level by **Peter Tynan**. In the 2010 financial year our Hamilton-based claims centre processed over 555,000



claims, which included the funding of around 150,000 elective surgical procedures.

As a Friendly Society and a not-for-profit organisation, we exist for the benefit of our members. Over the years all money received in premiums has gone straight back into paying claims, meeting operating expenses and providing reserves for the future.

Although we are best known as New Zealand's leading health insurer, we also offer a range of health-related products and services including corporate wellness programmes such as health seminars, health checks, fitness programmes and flu vaccinations, as well as 'health management' accounts through our subsidiary Activa Health Limited. In the 2010 financial year, around 50,000 employees across New Zealand took part in our corporate wellness programmes.

When health issues arise it can be a stressful time. We aim to make the claiming process as efficient and simple as possible, setting targets and conducting monthly reviews of service levels. In the year to 30 June 2010, the average claim processing time was just 4.3 days.

Due to the high-volume and often specialised nature of our work, the Society's business processes are focused on maintaining high levels of efficiency and quality. Our Auckland-based call centre receives over 3000 calls and emails per day, with most calls answered in less than 20 seconds. In the last financial year we processed 161,748 changes to members' policies and issued 112,116 prior approvals.

We must also maintain the flexibility to respond to changes in the economic climate. In the last financial year the Society devoted extensive resources to ensuring it meets its obligations under new Insurance Prudential Supervision and Financial Advisors legislation, due for implementation later in 2010 and 2011. The purpose of these pieces of legislation is to promote the maintenance of a sound and efficient insurance sector and financial advisor services, bringing New Zealand into line with international best practice in the regulation of financial service providers.

The Society currently offers the widest range of health insurance plans in New Zealand, ranging from hospital-only to comprehensive plans, which provide cover for a wide range of surgical and specialist treatments and day-to-day healthcare. We aim to give our members maximum flexibility in managing their premiums, including the ability to choose excess levels, shared cover, or, with some plans, add-on modules such as vision, dental, and day-to-day care, covering doctor consultations, prescriptions and physiotherapy treatments.

Over half of our members are in employer schemes. Many of New Zealand's leading employers provide access to Southern Cross schemes and we are proud to have established long-standing relationships with these businesses and organisations.

Added value

We aim to deliver exceptional value for our members' healthcare dollar. In the last five years we have incurred an average claims to premium ratio of 90.1 per cent – a market-leading level of reimbursement.

We were the first health insurer to introduce a Low Claims Reward, offering a 10 per cent discount on premiums for adult members on individual or voluntary group scheme policies who stay below a specific claims threshold. Close to 70 per cent of our eligible members receive this award. We also offer a Healthy Lifestyle Reward, a premium discount of 10 per cent for up to two years upon joining, to those members who are non-smokers, who exercise regularly, eat healthily and are moderate drinkers.

Members receive added value through special offers and discounts from a wide variety of Member programme partners and through Alive magazine, published twice a year.

To ensure its long-term sustainability, it's important the Society remains responsive to the evolving needs of its members. At our members' request, we introduced two new plans in February: Critical Illness, an optional add-on to a member's existing policy which provides for a one-off lump sum payment if a member is diagnosed with a qualifying illness; and HealthAssist, a low-cost alternative to health insurance.

E-Commerce initiatives

In the new financial year we will introduce three e-commerce initiatives – e-claiming at Affiliated Providers and selected pharmacies, a 'member portal' on our website, and online health insurance applications – all aimed at enhancing convenience for current and future members and providing savings for the Society, and ultimately members, on operational costs.

We are excited by the potential of e-claiming which has commenced with a trial at selected Radius pharmacies for prescriptions only. This allows the member to claim a prescription benefit (if this is covered under their policy) directly at the till, eliminating the need for claims paperwork.

The 'member portal' on the Southern Cross website is due to be launched in coming months. Through a secure log-in entry point, policyholders will be able to update

their membership details, view the status of their annual benefits and claims, and choose to receive email and text messages when their claims are received and processed.

These technological systems remind us of how much things have changed for the Society since our humble beginnings in 1961.

Almost 50 years on the Society now forms part of the wider Southern Cross Healthcare Group, which encompasses Southern Cross Hospitals, New Zealand's largest private hospital network, and Southern Cross Travel Insurance. Sharing a common brand, each Southern Cross business operates independently and at arm's length from one another. While our business has evolved, the Society's focus remains as relevant now as it was in 1961 – to enhance the health and wellbeing of more New Zealanders.

I would like to close by thanking the Society team for their hard work and dedication throughout the year.

In 2011 we celebrate 50 years of funding healthcare for generations of Southern Cross members. It is our privilege to have touched the lives of so many New Zealanders, and we remain as committed as ever to delivering the very best for your healthcare dollar.



Dr Ian McPherson

Chief Executive Officer
The Southern Cross Medical Care Society



Statement of corporate governance

The Southern Cross Medical Care Society adheres to principles designed to ensure good corporate governance of its affairs.

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 Board is the overall and final body responsible for all decision-making within the Society.

The Board operates in accordance with the Society's Rules and the Board Charter, both of which are available to view at www.southerncross.co.nz/board.

The Board Charter describes the Board's role, procedures and relationship with management. The Board reviews its performance on an annual basis. The Board delegates a number of its responsibilities to Board Committees.

The Directors in office as at 30 June 2010 are:

Graeme S Hawkins (Chairman)

Dr Douglas D Baird

Carole B Durbin

Elizabeth (Liz) M Hickey

David J May

Phillip J Meyer

Mark J Verbiest

TRUSTEES

Consistent with the Friendly Societies and Credit Unions Act 1982, 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. Consistent with good governance principles and to ensure no confusion as to accountabilities, the Trustees are also Directors of the Society.

The Trustees in office as at 30 June 2010 are:

Carole Durbin, Graeme Hawkins and David May.

BOARD RESPONSIBILITIES

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. This

Policy is available to view at www.southerncross.co.nz/board.

The Board believes that all employees should be protected from dismissal or disadvantage if they, in good faith and by following the correct process, report their concerns about serious wrongdoing within the organisation. Accordingly the Board has adopted a Protected Disclosures Policy and through this seeks to promote an open, honest and transparent working culture.

The Board guides and monitors the business affairs of the Society on behalf of the members. It ensures that the Society complies with all legal and regulatory obligations.

The Board is responsible for identifying areas of significant business risk. Managing risk is central to the sustainability of the Society's business in order to:

- protect value for members
- fulfil governance and oversight obligations to members and regulators
- assess and manage the impacts of potential risks on members and the Society and
- support the Society in executing its strategy and achieving strategic goals.

The Board has adopted a Risk Management Framework for managing the full spectrum of risks faced by the Society. The Financial Statements contain further information on risk (refer to Note 17).

The Directors ensure that any transactions between related parties are conducted at arms length and on normal commercial terms (refer to Note 18 to the Financial Statements).

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.

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.

BOARD MEETINGS

The Board meets formally on a scheduled basis and follows guidelines that ensure all Directors have available the necessary information to participate in an informed discussion of all agenda items. Separate strategic planning meetings are held in conjunction with the senior management team on a scheduled basis.

COMMITTEES

The Board has established a number of committees that meet at predetermined intervals to oversee 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 David May (Chairman), Graeme Hawkins, Liz Hickey and Phillip Meyer.

Remuneration Committee

The Remuneration Committee's objectives include providing advice to the Board in relation to: the remuneration, employment conditions, development and performance management of the organisation's Chief Executive Officer and senior executives, and other remuneration related matters including standard terms and conditions of employment. The Remuneration Committee comprises Carole Durbin (Chairman), Douglas Baird and Graeme Hawkins.

Nominations Committee

The Nominations Committee's objectives are to assist the Board in planning the Board's composition, evaluating the competencies required of prospective Directors,

identifying those prospective Directors, establishing their degree of 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 Nominations Committee comprises Graeme Hawkins (Chairman), Douglas Baird and Carole Durbin.

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 and additional Directors Mark Verbiest and Phillip Meyer (Chairman).

Constitutional Committee

The Constitutional Committee meets on an ad hoc basis. Its objectives are to assist the Board in reviewing the Society's constitutional documentation, policies and procedures against corporate governance best practice, and to make recommendations to the Board accordingly. The Committee will make recommendations to the Board with regard to the form and content of the Society's Rules and Annual Report, and other governance matters referred to it by the Board. The Committee will be disestablished once it has discharged its function. The Constitutional Committee comprises Mark Verbiest (Chairman), Graeme Hawkins and Carole Durbin.

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 2009 the Board approved the recommendation of the Audit Committee to re-appoint KPMG as the external auditors for the year ended 30 June 2010. Members approved the re-appointment of KPMG as auditors at the Annual General Meeting in November 2009.

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 17 years. He was appointed to the Southern Cross Board in October 2008, and appointed Chairman on 1 July 2009. He is Chairman of Watercare Services, Southern Cross Health Trust and Southern Cross Benefits, a Director of Southern Cross Hospitals, Cavalier Corporation Ltd and Ports of Auckland Ltd, and a Director and shareholder of Biomed Ltd. From 2001 to 2007 he was an appointed Director of Fonterra Co-operative Group and is a former Chairman of Auckland Healthcare, now Auckland District Health Board. Earlier in his career he held a number of strategic and financial roles at Fletcher Challenge and is a former CEO of Dominion Breweries.

DR DOUGLAS BAIRD

(MBChB, DipObst, FRNZCGP)

Dr Douglas Baird was appointed to the Southern Cross Board in July 2007. He is the Chairman of Auckland Medical Benevolent Fund, a Director of Dr Ponsonby-White Cross, Managing Director of Aotea Health Services and a Trustee/Director of Southern Cross Health Trust and subsidiaries. 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 worked in general practice from the late 1970s until 2007.

CAROLE DURBIN

(BCom, LLB(Hons), FAMINZ, FInstD)

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

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 a Director of the Institute of Chartered Accountants (NZICA) and the Institute of Environmental Science & Research (a Crown Research Institute), a co-opted member of the ASB Community Trust's Audit and Risk Committee, and a Trustee of Sight



Board of Directors (L to R)

Standing (L to R)

David May, Dr Douglas Baird, Liz Hickey, Mark Verbiest

Seated (L to R)

Phillip Meyer, Carole Durbin, Graeme Hawkins

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

DAVID MAY

(BSc(Hons), FIAA)

David May joined the Southern Cross Board in June 2002, attracted by the opportunity to contribute his management and financial experience to the health sector.

A qualified actuary, Mr May has had extensive involvement in superannuation funds management in New Zealand, Australia, Asia and the UK. He is Chairman of the Guardians of the New Zealand Superannuation Fund (NZSF), Deputy Chairman of the Government Superannuation Authority and a Director of Annuitas Management. Former management roles include Managing Director of the Colonial Group (NZ), CEO of Jacques Martin in New Zealand and CEO of Colonial's regional Asian operations based in Hong Kong. He is a Trustee/Director of Southern Cross Health Trust and subsidiaries.

PHILLIP MEYER

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

Phillip Meyer is an experienced company director and investment banker who joined the Southern Cross Board in June 2002. He is Chairman of Australian Financial Services Group, the New Zealand Institute of Management Inc, the New Zealand Institute of Management Central

Inc, the Institute of Financial Advisors, Angel HQ (an angel investment network for the Wellington region), Trans-Tasman Business Circle and Deputy Chairman of the Institute of Directors (Wellington Branch). He is a Director of Kordia Group, a Trustee of Young Enterprise Trust and Crimestoppers Trust, a Trustee/Director of Southern Cross Health Trust and subsidiaries, a member of the Disciplinary Tribunal of the New Zealand Institute of Chartered Accountants and the New Zealand Markets Disciplinary Tribunal. He is also National Chairman of the Salvation Army Red Shield Appeal Committee.

MARK VERBIEST

(LLB)

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

Director meeting attendance for the year ended 30 June 2010

	Society Board	AGM	Trustees	Strategic Workshops	Audit Committee	Remuneration Committee	Investment Committee	Constitutional Committee	Group Strategic Meetings
GS Hawkins	9	1	2	2	5	4	4	6	9
Dr DD Baird	8	1		2		4			8
Ms CB Durbin	9	1	2	2		4	4	6	9
Ms EM Hickey	6	1		2	3				6
DJ May	8	1	2	2	5		4		8
PJ Meyer	8	1		2	4		4		8
MJ Verbiest	9	1		2			3	6	9

EM Hickey appointed a Director 1 October 2009

EM Hickey appointed to the Audit Committee 1 January 2010

Financial statements

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The Southern Cross Medical Care Society

STATEMENTS OF COMPREHENSIVE INCOME for the year ended 30 June 2010

	NOTE	2010 \$000	GROUP 2009 \$000	2010 \$000	SOCIETY 2009 \$000
Premium revenue		597,345	544,190	597,345	544,190
Net claims expense	3	562,200	525,553	562,200	525,553
Underwriting surplus		35,145	18,637	35,145	18,637
Operating expenses	4	77,338	72,899	75,658	70,915
Operating deficit		(42,193)	(54,262)	(40,513)	(52,278)
Investment and other income	5	35,092	39,882	33,280	38,107
Deficit before taxation		(7,101)	(14,380)	(7,233)	(14,171)
Taxation	6	-	-	-	-
Deficit after taxation		(7,101)	(14,380)	(7,233)	(14,171)
Other comprehensive income:					
Revaluation of land and buildings		-	(1,700)	-	(1,700)
Total comprehensive deficit for the year		(7,101)	(16,080)	(7,233)	(15,871)

The accompanying notes form part of these financial statements

The Southern Cross Medical Care Society

STATEMENTS OF CHANGES IN RESERVES for the year ended 30 June 2010

GROUP 2010	Retained Surpluses \$000	Asset Revaluation Reserve \$000	Total Reserves \$000
Opening balance	313,252	-	313,252
Total comprehensive deficit:			
Deficit after taxation	(7,101)	-	(7,101)
Other comprehensive income:	-	-	-
Total comprehensive deficit	(7,101)	-	(7,101)
Closing balance	306,151	-	306,151
GROUP 2009	Retained Surpluses \$000	Asset Revaluation Reserve \$000	Total Reserves \$000
Opening balance	327,632	1,700	329,332
Total comprehensive deficit:			
Deficit after taxation	(14,380)	-	(14,380)
Other comprehensive income:			
Revaluation of land and buildings	-	(1,700)	(1,700)
Total comprehensive deficit	(14,380)	(1,700)	(16,080)
Closing balance	313,252	-	313,252

The accompanying notes form part of these financial statements

The Southern Cross Medical Care Society

STATEMENTS OF CHANGES IN RESERVES for the year ended 30 June 2010 (continued)

SOCIETY 2010	Retained Surpluses \$000	Asset Revaluation Reserve \$000	Total Reserves \$000
Opening balance	313,262	-	313,262
Total comprehensive deficit:			
Deficit after taxation	(7,233)	-	(7,233)
Other comprehensive income:	-	-	-
Total comprehensive deficit	(7,233)	-	(7,233)
Closing balance	306,029	-	306,029
SOCIETY 2009	Retained Surpluses \$000	Asset Revaluation Reserve \$000	Total Reserves \$000
Opening balance	327,433	1,700	329,133
Total comprehensive deficit:			
Deficit after taxation	(14,171)	-	(14,171)
Other comprehensive income:			
Revaluation of land and buildings	-	(1,700)	(1,700)
Total comprehensive deficit	(14,171)	(1,700)	(15,871)
Closing balance	313,262	-	313,262

The accompanying notes form part of these financial statements

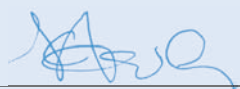
The Southern Cross Medical Care Society

STATEMENTS OF FINANCIAL POSITION as at 30 June 2010

	NOTE	2010 \$000	GROUP 2009 \$000	2010 \$000	SOCIETY 2009 \$000
Assets					
Cash and cash equivalents		267	976	137	858
Premium and other receivables	7	56,771	52,276	56,629	52,442
Assets held for sale	8	7,850	-	7,850	-
Investments	9	402,991	411,409	402,991	411,409
Investment in subsidiaries	10	-	-	-	-
Property and equipment	11	6,289	13,560	6,286	13,556
Intangible assets	12	6,960	6,185	6,924	6,117
Total assets		481,128	484,406	480,817	484,382
Liabilities					
Payables	13	15,068	17,159	14,879	17,125
Employee benefits	14	7,663	7,181	7,663	7,181
Insurance contract liabilities	15	152,246	146,814	152,246	146,814
Total liabilities		174,977	171,154	174,788	171,120
Net assets		306,151	313,252	306,029	313,262
Reserves		306,151	313,252	306,029	313,262

For and on behalf of the Board

G S Hawkins, Chairman



Date: 7 September 2010

D J May, Director



Date: 7 September 2010

The accompanying notes form part of these financial statements

The Southern Cross Medical Care Society

STATEMENTS OF CASH FLOWS for the year ended 30 June 2010

	NOTE	2010 \$000	GROUP 2009 \$000	2010 \$000	SOCIETY 2009 \$000
Cash flows from operating activities					
Premium revenue		596,903	544,662	596,903	544,662
Income from investments		26,589	31,353	26,584	31,339
Other income		1,848	2,225	47	50
Payment of claims		(562,841)	(512,207)	(562,841)	(512,207)
Payments to employees		(36,658)	(37,242)	(34,974)	(35,539)
Payments to suppliers		(36,052)	(34,000)	(35,950)	(33,519)
Net cash flows from operating activities	19	(10,211)	(5,209)	(10,231)	(5,214)
Cash flows from investing activities					
Net proceeds/(payments) for property and equipment		(3,684)	(2,397)	(3,684)	(2,403)
Payments for intangible assets		(2,677)	(2,579)	(2,669)	(2,579)
Net proceeds/(payments) for investments		15,863	10,069	15,863	10,069
Net cash flows from investing activities		9,502	5,093	9,510	5,087
Net increase/(decrease) in cash and cash equivalents		(709)	(116)	(721)	(127)
Opening cash and cash equivalents		976	1,092	858	985
Closing cash and cash equivalents		267	976	137	858

The accompanying notes form part of these financial statements

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010

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 181 Grafton Road, Auckland.

Financial statements for the Society and consolidated financial statements are presented. The consolidated financial statements of The Southern Cross Medical Care Society as at, and for the year ended, 30 June 2010 comprise the Society and its subsidiaries: Southern Cross Health Services Limited, Southern Cross Healthcare Limited (non-trading) and Activa Health Limited (together referred to as the "Group").

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

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

BASIS OF PREPARATION

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

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

The financial statements were approved by the Board of Directors on 7 September 2010.

BASIS OF MEASUREMENT

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

FUNCTIONAL AND PRESENTATION CURRENCY

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

USE OF ESTIMATES AND JUDGEMENTS

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

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

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

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

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

BASIS OF CONSOLIDATION

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

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

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

ADOPTION OF NEW ACCOUNTING STANDARDS

Presentation of financial statements

The Group has applied revised NZ IAS 1 - Presentation of Financial Statements (2007), which became effective from 1 January 2009. Comparative information has been re-presented so that it is also in conformity with the revised standard. Accordingly, the total comprehensive deficit for the year has changed to reflect the revaluation of land and buildings in other comprehensive income.

Disclosures relating to fair values

The Group has applied the Amendments to NZ IFRS 7 - Financial Instruments: Disclosures (March 2009), that require enhanced disclosures about fair value hierarchy measurements.

The amendments require that fair value measurement disclosures use a three-level fair value hierarchy that reflects the significance of the inputs used in measuring fair values of financial assets and liabilities:

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.

Specific disclosures are required when fair value measurements are categorised at level 3 (significant unobservable inputs) in the fair value hierarchy. Any significant transfers between level 1 and level 2 of the fair value hierarchy are disclosed separately, distinguishing between transfers into and out of each level. Furthermore, any changes in valuation, from one period to another, are disclosed along with the reason for the changes.

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".

ASSETS HELD FOR SALE

Assets that are expected to be recovered primarily through sale, rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets are revalued in accordance with the Group's accounting policies. Thereafter the assets are stated at the lower of their carrying amount or their fair value less costs to sell. Impairment losses on initial classification as held for sale and any subsequent gains and losses are recognised in determining the surplus or deficit before tax in the statements of comprehensive income. Gains are not recognised in excess of any cumulative impairment losses.

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 the market bid price or valuation based on market observable data.

As investments are 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.

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

PROPERTY AND EQUIPMENT

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

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

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

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

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

Depreciation is recognised in determining the surplus or deficit before tax in the statements of comprehensive income on a straight-line basis over the estimated useful lives of each component of an item of property or equipment. The estimated useful lives for the current and comparative periods are as follows:

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

The estimated useful life of assets is reassessed annually.

Sales of property and equipment relate to motor vehicles traded in and replaced with new vehicles. Therefore, only net payments are disclosed in the statements of cash flows.

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.

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

INSURANCE CONTRACTS

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

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

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

INCOME RECOGNITION

Premiums

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

Fee and other income

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

Investment income

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

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

LEASES

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.

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.

TRADE AND OTHER PAYABLES

Trade and other payables are stated at cost. Under the NZ IFRS definition of financial liabilities, trade and other 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.

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

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.

EMPLOYEE BENEFITS

Employee entitlements

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

Employee benefits

The Group's net obligation in respect of long service leave is the amount of future benefits that employees have earned in return for their service in current and prior periods. The financial value of the obligation is calculated based on estimated future cash flows and is discounted to its present value. In determining future cash flows, consideration is given to historical data with respect to employee departures, periods of service and estimated future increases in wage and salary rates. The discount rate is the market yield rate on relevant New Zealand Government stock at the end of the reporting period.

Post employment benefits

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

INCOME TAX EXPENSE

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

GOODS AND SERVICES TAX (GST)

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

CHANGE IN ACCOUNTING ESTIMATES

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

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

2. NEW FINANCIAL REPORTING STANDARDS APPROVED BUT NOT YET EFFECTIVE

The following new or amended standards and interpretations, which are applicable to the Group, are not yet effective for the year ended 30 June 2010, and have not been applied in preparing these financial statements:

NZ IAS 7 - Statement of Cash Flows

NZ IFRS 9 - Financial Instruments: Classification and Measurement

The amendment to NZ IAS 7 - Statement of Cash Flows explicitly states that only expenditure that results in a recognised asset can be classified as cash flow from investing activities. This is effective for annual reporting periods beginning on or after 1 January 2010. The Group is currently in compliance with this requirement.

The requirements of NZ IFRS 9 - Financial Instruments: Classification and Measurement represent a significant change from the existing requirements in NZ IAS 39 - Financial Instruments: Recognition and Measurement, in respect of financial assets. The standard is effective for annual reporting periods beginning on or after 1 January 2013. 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. The impact of the requirements of this standard on the Group is still to be determined.

3. NET CLAIMS EXPENSE

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Claims incurred relating to risks borne in current financial year	564,788	521,339	564,788	521,339
Claims incurred relating to risks borne in previous financial years	584	(1,752)	584	(1,752)
Movement in provision for claims handling costs	148	(467)	148	(467)
Movement in risk margin	279	127	279	127
Net claims incurred	565,799	519,247	565,799	519,247
Movement in provision for unexpired risk	(3,599)	6,306	(3,599)	6,306
	562,200	525,553	562,200	525,553

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

4. OPERATING EXPENSES					
Operating expenses include:	GROUP		SOCIETY		
	2010 \$000	2009 \$000	2010 \$000	2009 \$000	
Auditor's remuneration					
– Audit fees	155	155	155	155	
– Other services	18	10	18	10	
Depreciation	1,758	1,631	1,757	1,612	
Amortisation of intangible assets	1,902	1,167	1,862	1,123	
Impairment loss on intangible assets	-	376	-	376	
Directors' fees	362	362	362	362	
Employee benefits expense	37,140	37,638	35,456	35,936	
Contributions to defined contribution pension plan	62	63	62	63	
Rental of premises	2,107	2,203	2,100	2,203	
Policy acquisition costs	9,558	10,840	9,558	10,840	
Provision for impairment loss on amounts receivable from subsidiaries	-	-	553	650	
(Gains)/losses on disposal of property and equipment	(3)	17	(3)	17	
Revaluation of land and buildings	1,350	-	1,350	-	
Auditor's remuneration for other services disclosed above consists of accounting advisory services, reviewing regulatory returns and providing services at the AGM.					
5. INVESTMENT AND OTHER INCOME					
	GROUP		SOCIETY		
	2010 \$000	2009 \$000	2010 \$000	2009 \$000	
Interest income	25,793	30,087	25,788	30,073	
Net gains on investments at fair value through profit or loss	7,445	7,984	7,445	7,984	
Fee and other income	1,854	1,811	47	50	
	35,092	39,882	33,280	38,107	

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

6. TAXATION

Reconciliation of effective tax rate

GROUP

	2010 \$000	2009 \$000
--	---------------	---------------

Net deficit before tax	7,101	14,380
Income tax payable at the domestic tax rate of 30%	(2,130)	(4,314)
Effect of non-deductible expenses	2	1
Effect of exempt deficits	2,003	4,056
Tax effect of change in unrecognised temporary differences	(66)	(81)
Tax on current year deficits for which no deferred tax asset was recognised	191	338
	-	-

The aggregate amount of temporary differences arising in the subsidiaries for which a deferred tax asset has not been recognised is \$192,000 at 30 June 2010 (30 June 2009: deferred tax asset \$413,000).

The Group has unrecognised tax losses carried forward of \$30,483,000 at 30 June 2010 (30 June 2009: \$29,860,000).

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

7. PREMIUM AND OTHER RECEIVABLES

GROUP

	2010 \$000	2009 \$000
--	---------------	---------------

Premium accounts receivable	46,406	40,793
Interest receivable	4,739	5,535
Other accounts receivable	5,336	5,635
Amounts owed by related parties	290	313
	56,771	52,276

SOCIETY

	2010 \$000	2009 \$000
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Premium accounts receivable	46,406	40,793
Interest receivable	4,739	5,535
Other accounts receivable	4,708	5,048
Amounts owed by related parties	776	1,066
	56,629	52,442

The fair value of premium and other receivables approximates the carrying amount.

Premium and other receivables is a current asset.

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

8. ASSETS HELD FOR SALE

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Land and buildings	7,850	-	7,850	-
	7,850	-	7,850	-

A process has commenced to market the land and buildings for disposal. It is expected that the disposal will take place in the June 2011 reporting period. Accordingly, they have been classified as assets held for sale. Based on current observable market prices, the land and buildings have been valued at \$7,850,000, including an allowance for estimated disposal costs. Hence, a downward revaluation of \$1,350,000 was recorded at 30 June 2010.

Assets held for sale is a current asset.

9. INVESTMENTS

At fair value through profit or loss	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
New Zealand Government stock	1,546	1,574	1,546	1,574
State owned enterprise bonds	11,359	6,216	11,359	6,216
Local authority stock	84,685	89,745	84,685	89,745
Other bonds	157,240	190,415	157,240	190,415
Bank deposits, commercial paper and floating rate notes	148,161	123,459	148,161	123,459
	402,991	411,409	402,991	411,409
Current assets	99,344	89,401	99,344	89,401
Non-current assets	303,647	322,008	303,647	322,008
	402,991	411,409	402,991	411,409

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

10. INVESTMENT IN SUBSIDIARIES

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

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

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

Investment in subsidiaries is a non-current asset.

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

11. PROPERTY AND EQUIPMENT

	Land and buildings \$000	Computer equipment \$000	GROUP Other fixed assets \$000	Work in progress \$000	Total \$000
At 30 June 2010					
Cost / valuation	-	19,604	6,345	1,218	27,167
Accumulated depreciation	-	(15,929)	(4,949)	-	(20,878)
Closing balance	-	3,675	1,396	1,218	6,289
Reconciliation of movement in property and equipment					
Opening balance	9,200	2,139	1,632	589	13,560
Additions	-	13	393	3,389	3,795
Transfers from work in progress	-	2,760	-	(2,760)	-
Disposals	-	-	(108)	-	(108)
Depreciation	-	(1,237)	(521)	-	(1,758)
Revaluation recognised in operating expenses	(1,350)	-	-	-	(1,350)
Reclassified as assets held for sale	(7,850)	-	-	-	(7,850)
Closing balance	-	3,675	1,396	1,218	6,289
At 30 June 2009					
Cost / valuation	9,200	16,831	6,231	589	32,851
Accumulated depreciation	-	(14,692)	(4,599)	-	(19,291)
Closing balance	9,200	2,139	1,632	589	13,560
Reconciliation of movement in property and equipment					
Opening balance	10,900	1,232	2,047	332	14,511
Additions	-	105	373	2,169	2,647
Transfers from work in progress	-	1,912	-	(1,912)	-
Disposals	-	-	(267)	-	(267)
Depreciation	-	(1,110)	(521)	-	(1,631)
Revaluation recognised in other comprehensive income	(1,700)	-	-	-	(1,700)
Closing balance	9,200	2,139	1,632	589	13,560

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

11. PROPERTY AND EQUIPMENT (CONTINUED)					
	Land and buildings \$000	Computer equipment \$000	SOCIETY Other fixed assets \$000	Work in progress \$000	Total \$000
At 30 June 2010					
Cost / valuation	-	19,535	6,338	1,218	27,091
Accumulated depreciation	-	(15,860)	(4,945)	-	(20,805)
Closing balance	-	3,675	1,393	1,218	6,286
Reconciliation of movement in property and equipment					
Opening balance	9,200	2,138	1,629	589	13,556
Additions	-	13	393	3,389	3,795
Transfers from work in progress	-	2,760	-	(2,760)	-
Disposals	-	-	(108)	-	(108)
Depreciation	-	(1,236)	(521)	-	(1,757)
Revaluation recognised in operating expenses	(1,350)	-	-	-	(1,350)
Reclassified as assets held for sale	(7,850)	-	-	-	(7,850)
Closing balance	-	3,675	1,393	1,218	6,286
	Land and buildings \$000	Computer equipment \$000	SOCIETY Other fixed assets \$000	Work in progress \$000	Total \$000
At 30 June 2009					
Cost / valuation	9,200	16,762	6,225	589	32,776
Accumulated depreciation	-	(14,624)	(4,596)	-	(19,220)
Closing balance	9,200	2,138	1,629	589	13,556
Reconciliation of movement in property and equipment					
Opening balance	10,900	1,213	2,037	332	14,482
Additions	-	106	373	2,169	2,648
Transfers from work in progress	-	1,912	-	(1,912)	-
Disposals	-	-	(262)	-	(262)
Depreciation	-	(1,093)	(519)	-	(1,612)
Revaluation recognised in other comprehensive income	(1,700)	-	-	-	(1,700)
Closing balance	9,200	2,138	1,629	589	13,556
Land and buildings are classified as held for sale at 30 June 2010.					
As at 30 June 2009, land and buildings were independently valued at \$9,200,000 by Telfer Young (Auckland) Ltd, a qualified, independent registered valuer. The basis used was current investment market valuation based on an estimated market rental and capitalisation rate. The downward revaluation at 30 June 2009 was \$1,700,000.					
Other fixed assets include motor vehicles, office equipment and leasehold improvements. Property and equipment is a non-current asset.					

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

12. INTANGIBLE ASSETS			
	Computer software \$000	GROUP Work in progress \$000	Total \$000
At 30 June 2010			
Cost / valuation	27,467	1,651	29,118
Accumulated amortisation	(22,158)	-	(22,158)
Closing balance	5,309	1,651	6,960
Reconciliation of movement in intangible assets			
Opening balance	4,180	2,005	6,185
Additions	2	2,675	2,677
Transfers from work in progress	3,029	(3,029)	-
Amortisation	(1,902)	-	(1,902)
Closing balance	5,309	1,651	6,960
	Computer software \$000	GROUP Work in progress \$000	Total \$000
At 30 June 2009			
Cost / valuation	24,336	2,005	26,341
Accumulated amortisation	(20,156)	-	(20,156)
Closing balance	4,180	2,005	6,185
Reconciliation of movement in intangible assets			
Opening balance	4,089	1,060	5,149
Additions	20	2,559	2,579
Transfers from work in progress	1,238	(1,238)	-
Amortisation	(1,167)	-	(1,167)
Impairment loss	-	(376)	(376)
Closing balance	4,180	2,005	6,185

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

12. INTANGIBLE ASSETS (CONTINUED)			
	Computer software \$000	SOCIETY Work in progress \$000	Total \$000
At 30 June 2010			
Cost / valuation	27,309	1,651	28,960
Accumulated amortisation	(22,036)	-	(22,036)
Closing balance	5,273	1,651	6,924
Reconciliation of movement in intangible assets			
Opening balance	4,112	2,005	6,117
Additions	2	2,667	2,669
Transfers from work in progress	3,021	(3,021)	-
Amortisation	(1,862)	-	(1,862)
Closing balance	5,273	1,651	6,924
	Computer software \$000	SOCIETY Work in progress \$000	Total \$000
At 30 June 2009			
Cost / valuation	24,186	2,005	26,191
Accumulated amortisation	(20,074)	-	(20,074)
Closing balance	4,112	2,005	6,117
Reconciliation of movement in intangible assets			
Opening balance	3,977	1,060	5,037
Additions	20	2,559	2,579
Transfers from work in progress	1,238	(1,238)	-
Amortisation	(1,123)	-	(1,123)
Impairment loss	-	(376)	(376)
Closing balance	4,112	2,005	6,117
<p>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.</p> <p>Intangible assets is a non-current asset.</p>			

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

13. PAYABLES

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Accounts payable	15,049	17,153	14,832	17,050
Amounts owed to related parties	19	6	47	75
	15,068	17,159	14,879	17,125

Payables is a current liability.

14. EMPLOYEE BENEFITS

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Employee entitlements	4,853	5,101	4,853	5,101
Employee benefits	830	730	830	730
Post-employment benefits	1,980	1,350	1,980	1,350
	7,663	7,181	7,663	7,181
Current	5,053	5,286	5,053	5,286
Non-current	2,610	1,895	2,610	1,895
	7,663	7,181	7,663	7,181

15. INSURANCE CONTRACT LIABILITIES

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Provision for outstanding claims (refer note 15a)	75,973	72,113	75,973	72,113
Provision for unearned premium (refer note 15c)	66,779	61,578	66,779	61,578
Provision for unexpired risk (refer note 15d)	8,784	12,383	8,784	12,383
Other insurance provisions	710	740	710	740
	152,246	146,814	152,246	146,814

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

15. INSURANCE CONTRACT LIABILITIES (CONTINUED)				
a. Provision for outstanding claims				
	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Central estimate of outstanding claims liability	70,204	66,771	70,204	66,771
Claims handling costs	2,151	2,003	2,151	2,003
Risk margin	3,618	3,339	3,618	3,339
Closing balance	75,973	72,113	75,973	72,113
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	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Opening balance	72,113	67,441	72,113	67,441
Amounts utilised during the year	(65,392)	(58,249)	(65,392)	(58,249)
Additional provision / (reversal of unused provision)	584	(1,752)	584	(1,752)
Amounts provided during the year	68,241	65,013	68,241	65,013
Movement in claims handling costs	148	(467)	148	(467)
Movement in risk margin	279	127	279	127
Closing balance	75,973	72,113	75,973	72,113
c. Reconciliation of movement in provision for unearned premium				
	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Opening balance	61,578	60,306	61,578	60,306
Premiums written in the year	602,546	545,462	602,546	545,462
Premiums earned during the year	(597,345)	(544,190)	(597,345)	(544,190)
Closing balance	66,779	61,578	66,779	61,578

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

15. INSURANCE CONTRACT LIABILITIES (CONTINUED)

d. Provision for unexpired risk

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Present value of expected future cash flows for claims and expenses	72,833	71,344	72,833	71,344
Risk margin	2,913	2,853	2,913	2,853
Unearned premiums	(66,779)	(61,578)	(66,779)	(61,578)
Write-down of deferred acquisition costs	(183)	(236)	(183)	(236)
Closing balance	8,784	12,383	8,784	12,383

e. Reconciliation of movement in provision for unexpired risk

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Opening balance	12,383	6,077	12,383	6,077
Reversal of opening balance	(12,383)	(6,077)	(12,383)	(6,077)
Net liability for unexpired risk recognised during the year	6,054	9,766	6,054	9,766
Risk margin	2,913	2,853	2,913	2,853
Write-down of deferred acquisition costs	(183)	(236)	(183)	(236)
Closing balance	8,784	12,383	8,784	12,383

16. ACTUARIAL INFORMATION

Estimates of the outstanding claims and unexpired risk as at 30 June 2010 have been determined by John Feyter B.Sc, a Fellow of the New Zealand Society of Actuaries and were presented to the directors of the Society in a report dated 20 August 2010. There were no qualifications to the report. The calculations of the provisions for outstanding claims and unexpired risk each comply with both NZ IFRS 4: Insurance Contracts, and Professional Standard No. 4: General Insurance Business, of the New Zealand Society of Actuaries.

The actuary is satisfied as to the nature, sufficiency and accuracy of the data used to determine these provisions.

a. Outstanding claims provision

Outstanding claims liabilities are measured as the central estimate of the present value of expected future payments for claims incurred but not settled at 30 June 2010, whether reported or not, together with related claims handling costs and an additional risk margin to allow for the inherent uncertainty in the central claims estimate. The central estimate of the outstanding claims has been calculated using historical experience to determine the pattern of claims development.

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

Estimation of outstanding claims liabilities includes an allowance for claims incurred but not reported, claims incurred but not adequately reported, unpaid reported claims and future claims handling costs associated with paying claims. An explicit allowance has been made for expected ACC recoveries as at 30 June 2010 (30 June 2009: Nil).

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 2010 (30 June 2009: 5%). The risk margin was determined with the objective of achieving at least 75 % probability of sufficiency of the outstanding claims provision.

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

16. ACTUARIAL INFORMATION (CONTINUED)

Key assumptions:

1. Future patterns of claims development will be similar to historical patterns depending on the type of policy, type of claim and development month.
2. Monthly seasonality factors used for claims incurred. These were calculated from the 3 years' previous claims experience, and range from 73% to 112% (30 June 2009: 71% to 112%) of the monthly average.
3. Historical claims inflation 9% p.a. (30 June 2009: 0% to 5% depending on the type of policy and type of claim), based on previous claims experience.
4. No additional factor was applied to reflect a claims development trend implied from most recent payment data (30 June 2009: 6.4%).

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 2009: 3%) of the underlying claims amounts based on an analysis of administration expenses.

The average weighted term from 30 June 2010 to the expected settlement date for claims included in the liability for outstanding claims is 75 days (30 June 2009: 75 days). Accordingly, expected future payments are not discounted due to the short tail nature of the liabilities.

b. Unexpired risk provision and liability adequacy test

A liability adequacy test was performed to determine whether the unearned premium liability is adequate to cover the present value of the expected future cash flows arising from rights and obligations under current insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate. The future cashflows 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 2010.

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 2010 (30 June 2009: 4%). The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the unexpired risk liability.

Key assumptions:

1. Monthly seasonality factors used for claims incurred. These were calculated from the 3 years' previous claims experience, and range from 76% to 110% (2009: 75% to 109%) of the monthly average.
2. Projected claims inflation of 9% p.a., plus 4% for the effect of ageing, based on current expectations (2009: 11.5% plus 4% for ageing)
3. Expenses based on the business plan for 2010/11, including allowance for amortisation of deferred acquisition costs.

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

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

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

17. RISK MANAGEMENT

The Group is exposed to a number of risks in the normal course of business. Primarily there are the risks associated with underwriting an insurance business (insurance risk). Other risks include financial risks (credit risk and liquidity risk), market risks (interest rate risk and foreign currency risk), and non-financial risks (operational risk and compliance risk). The Directors and management recognise the importance of having an effective risk management policy in place. The risks and any objectives, policies and processes to manage these insurance and financial risks are described below.

a. Insurance risk

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

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

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

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

II. Sensitivity to insurance risk

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

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

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

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

III. Concentration of insurance risk

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

b. Financial risks

I. Credit risk

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

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

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

17. RISK MANAGEMENT (CONTINUED)

The credit quality of investment counter parties is as follows:

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
New Zealand Government rated:				
AAA	1,546	1,574	1,546	1,574
State owned enterprises rated:				
AA	5,151	5,180	5,151	5,180
BBB	13,063	6,036	13,063	6,036
Local authorities rated:				
AA	41,953	13,120	41,953	13,120
A	8,963	-	8,963	-
Non-rated	119,661	147,202	119,661	147,202
Corporates rated:				
AAA	13,562	17,051	13,562	17,051
AA	95,814	106,182	95,814	106,182
A	82,338	90,620	82,338	90,620
BBB	11,915	17,030	11,915	17,030
Below BBB	1,911	880	1,911	880
Non-rated	7,114	6,534	7,114	6,534
	402,991	411,409	402,991	411,409

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.

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	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
On call	2,000	1,500	2,000	1,500
0-6 months	43,971	34,857	43,971	34,857
7-12 months	53,373	53,044	53,373	53,044
1-2 years	87,717	69,369	87,717	69,369
2-5 years	198,567	222,310	198,567	222,310
Beyond 5 years	17,363	30,329	17,363	30,329
	402,991	411,409	402,991	411,409

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

17. RISK MANAGEMENT (CONTINUED)

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

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

c. Market risks

I. Foreign currency risk

At 30 June 2010, the Group had assets of \$210,000 and no liabilities denominated in foreign currencies (30 June 2009: assets of \$171,000 and no liabilities). Given that the foreign currency risk exposure is minimal, the Group does not enter into any derivative contracts to manage this risk.

II. Interest rate risk

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

(i) Cash flow interest rate risk

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

	GROUP AND SOCIETY	
	2010 \$000	2009 \$000
Impact of increase in interest rates by 100 basis points on cash flows	1,437	1,888
Impact of decrease in interest rates by 100 basis points on cash flows	(1,437)	(1,888)

(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	
	2010 \$000	2009 \$000
Impact of increase in interest rates by 100 basis points on surplus/ (deficit) before taxation	(5,038)	(6,326)
Impact of decrease in interest rates by 100 basis points on surplus/ (deficit) before taxation	5,215	6,524

(iii) Fair values of financial assets and financial liabilities

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

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

Definition of the fair value hierarchy

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

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

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

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

17. RISK MANAGEMENT (CONTINUED)

GROUP AND SOCIETY

30 June 2010	Level 1 \$000	Level 2 \$000	Level 3 \$000	Total \$000
New Zealand Government stock	1,546	-	-	1,546
State owned enterprise bonds	-	11,359	-	11,359
Local authority stock	-	84,685	-	84,685
Other bonds	-	157,240	-	157,240
Bank deposits, commercial paper and floating rate notes	2,000	146,161	-	148,161
	3,546	399,445	-	402,991
30 June 2009	Level 1 \$000	Level 2 \$000	Level 3 \$000	Total \$000
New Zealand Government stock	1,574	-	-	1,574
State owned enterprise bonds	-	6,216	-	6,216
Local authority stock	-	89,745	-	89,745
Other bonds	-	190,415	-	190,415
Bank deposits, commercial paper and floating rate notes	1,500	121,959	-	123,459
	3,074	408,335	-	411,409

Investments were independently valued by Bancorp Treasury Services Limited at 30 June 2010. Investments are valued based on closing market prices as reported to wholesale investors. Where closing market prices are not available for certain investments, for example private placements by local authorities in which the Society has participated, the value of these investments are based on observable inputs using quoted prices for similar instruments ensuring that all significant inputs are directly or indirectly observable from market data.

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

18. RELATED PARTIES

a. Identity and relationship of related parties:

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

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

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

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

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

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

The amount of transactions between the Group entities are:

	PURCHASES		SALES	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Society	3,540	2,983	79	67
Health Services	11	9	66	68
Activa	68	58	3,474	2,915

The outstanding balances between the Group entities are:

	PAYABLES		RECEIVABLES	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Society	28	69	496	759
Health Services	464	686	13	6
Activa	32	73	15	63

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

The amount of transactions with other related parties are:

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Sale of services	3,405	2,980	3,369	2,942
Purchase of services	98	92	98	92

Premiums on the Directors' health insurance amount to \$19,000 for the year ended 30 June 2010 (2009: \$18,000).

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

18. RELATED PARTIES (CONTINUED)

The outstanding balances with other related parties are:

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Balance outstanding on sales	290	313	280	307
Balance outstanding on purchases	19	6	19	6

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

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

b. Remuneration of Directors

Directors' fees paid by the Society for the year ended 30 June 2010 were as follows:

Director	2010 Amount \$	2009 Amount \$
Dr D D Baird	48,368	45,700
C B Durbin	48,368	45,700
Dr D H Gray - retired 1 September 2008	-	7,783
G S Hawkins (Chairman) - appointed 1 October 2008	83,367	34,275
E M Hickey - appointed 1 October 2009	36,693	-
Dr S C Macken - retired 30 June 2009	-	45,700
D J May	48,368	45,700
P J Meyer	48,368	45,700
J G Todd - retired 30 June 2009	-	57,060
M J Verbiest - appointed 1 October 2008	48,368	34,275
Trustee		
C B Durbin	-	-
G S Hawkins - appointed 26 November 2009	-	-
D J May	-	-
J G Todd - retired 30 June 2009	-	-

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 Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

18. RELATED PARTIES (CONTINUED)

c. Remuneration of key management personnel

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Salaries and other short-term benefits	3,095	2,974	3,095	2,974
	3,095	2,974	3,095	2,974

Key management personnel include the chief executive officer, chief executive and senior executives. Comparative information has been restated due to changes in personnel.

19. RECONCILIATION OF NET DEFICIT WITH NET CASH FLOWS FROM OPERATING ACTIVITIES

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Net deficit after taxation	(7,101)	(14,380)	(7,233)	(14,171)
Add/(less) non-cash items:				
Depreciation	1,758	1,631	1,757	1,612
Amortisation of computer software	1,902	1,167	1,862	1,123
Impairment loss on computer software	-	376	-	376
Provision for impairment loss on amounts receivable from subsidiaries	-	-	553	650
Revaluation of land and buildings	1,350	-	1,350	-
Add/(less) items classified as investing activities :				
(Gains)/losses on disposal of property and equipment	(3)	17	(3)	17
Movement in valuation of investments	(8,272)	(7,984)	(8,272)	(7,984)
(Gains)/losses on disposal of investments	827	-	827	-
Add/(less) movements in working capital items:				
Receivables	(4,495)	(575)	(4,740)	2,567
Payables	(2,091)	1,853	(2,246)	(2,091)
Other insurance provisions	(30)	40	(30)	40
Provision for outstanding claims	3,860	4,672	3,860	4,672
Provision for unearned premium	5,201	1,272	5,201	1,272
Provision for unexpired risk	(3,599)	6,306	(3,599)	6,306
Provision for employee benefits	482	396	482	397
Net cash flows from operating activities	(10,211)	(5,209)	(10,231)	(5,214)

The Southern Cross Medical Care Society

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2010 (continued)

20. CREDIT RATING

On 21 February 2010 Standard & Poor's reaffirmed the Society's Insurer Financial Strength Rating of A+. This signifies the insurer "has strong financial security characteristics".

21. ACTUARIAL REPORT

The five yearly actuarial report as required under section 74 of the Friendly Societies and Credit Unions Act 1982 was filed with the Registrar on 13 July 2006.

22. SOLVENCY AND CAPITAL ADEQUACY

The Society is a not-for-profit organisation. As a consequence of its legal structure the Society has no recourse to external capital and therefore internally generated capital is of paramount importance. The Society's capital of \$306.0 million (2009: \$313.3 million) is equal to the reserves as disclosed in the financial statements.

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

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

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

A calculation at 30 June 2010 showed the Society had assets in excess of the level specified by the PHIAC Capital Adequacy Standard. Accordingly, the Directors consider the current level of capital is sufficient for the requirement of maintaining financial soundness.

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

The New Zealand authorities have developed a new regulatory regime for insurers, to be supervised by the Reserve Bank of New Zealand. The Insurance (Prudential Supervision) Bill was enacted in August 2010. One component of the new regime is a solvency standard for non-life insurers. The new solvency regime will be incorporated into the Society's capital management policy during the next financial year.

23. LEASE COMMITMENTS

At 30 June 2010 commitments under operating leases in respect of payments due to be made in the following years were:

	GROUP		SOCIETY	
	2010 \$000	2009 \$000	2010 \$000	2009 \$000
Within 1 year	2,686	2,254	2,686	2,254
Between 1 and 2 years	4,204	1,708	4,204	1,708
Between 2 and 5 years	12,178	2,011	12,178	2,011
Greater than 5 years	21,234	2,079	21,234	2,079
	40,302	8,052	40,302	8,052

The Society entered into an agreement in December 2009 to lease new premises for 10 years, commencing April 2011.

24. CAPITAL COMMITMENTS

The Group had capital commitments of \$1,845,000 at 30 June 2010 (2009: \$1,034,000).

25. CONTINGENT LIABILITIES

The Group had no contingent liabilities at 30 June 2010 (2009: Nil).

Audit report

To the Members of The Southern Cross Medical Care Society



We have audited the financial statements on pages 13 to 42. The financial statements provide information about the past financial performance of the Society and Group and its financial position as at 30 June 2010. This information is stated in accordance with the accounting policies set out on pages 18 to 22.

Directors' responsibilities

The Directors are responsible for the preparation of financial statements which give a true and fair view of the financial position of the Society and Group as at 30 June 2010 and the results of their operations and cash flows for the year ended on that date.

Auditors' responsibilities

It is our responsibility to express an independent opinion on the financial statements presented by the Directors and report our opinion to you.

Basis of opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Directors in the preparation of the financial statements;
- whether the accounting policies are appropriate to the Society and Group's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with New Zealand Auditing Standards. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to obtain reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Our firm has also provided other services to the Society and Group in relation to accounting and Information Technology advisory 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 or Group.

Unqualified opinion

We have obtained all the information and explanations we have required.

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

- comply with New Zealand generally accepted accounting practice;
- give a true and fair view of the financial position of the Society and Group as at 30 June 2010 and the results of its operations and cash flows for the year ended on that date.

Our audit was completed on 7 September 2010 and our unqualified opinion is expressed as at that date.

kpmg

Auckland

Notes

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The Southern Cross Medical Care Society

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