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THE SOUTHERN CROSS MEDICAL CARE SOCIETY

FINANCIAL STATEMENTS

FOR THE YEAR ENDED

30 June 2018

CONTENTS

THE SOUTHERN CROSS MEDICAL CARE SOCIETY

STATEMENT OF COMPREHENSIVE INCOME AND CHANGES IN RESERVES
for the year ended 30 June 2018

	NOTE	2018 $000	2017 $000
Premium revenue	6	987,840	923,442
Net claims expense	4	906,640	830,326
Underwriting surplus		**81,200**	**93,116**
Operating expenses	8	118,094	112,015
Operating deficit		**(36,894)**	**(18,899)**
Net investment and other income	7	23,596	25,066
(Deficit)/surplus before taxation		**(13,298)**	**6,167**
Taxation	11	-	-
(Deficit)/surplus after taxation		**(13,298)**	**6,167**
Other comprehensive income		-	-
Total comprehensive (deficit)/income for the year		**(13,298)**	**6,167**
Opening balance of reserves		441,325	435,158
Closing balance of reserves		**428,027**	**441,325**

The above statement should be read in conjunction with the accompanying notes.

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THE SOUTHERN CROSS MEDICAL CARE SOCIETY

STATEMENT OF FINANCIAL POSITION
as at 30 June 2018

	NOTE	2018 $000	2017 $000
Assets			
Cash and cash equivalents	9	8,525	6,888
Premium and other receivables	6	88,712	79,193
Investments	5	481,592	516,110
Property and equipment	10	11,681	11,547
Intangible assets	10	35,813	24,905
Total assets		**626,323**	**638,643**
Liabilities			
Payables		12,805	12,013
Employee benefits	12	8,489	7,617
Insurance contract liabilities	2	177,002	177,688
Total liabilities		**198,296**	**197,318**
Net assets		**428,027**	**441,325**
Reserves		**428,027**	**441,325**

Authorised on behalf of the Board of Directors on 31 August 2018

G W Gent
Chairman

E M Hickey
Director

The above statement should be read in conjunction with the accompanying notes.

THE SOUTHERN CROSS MEDICAL CARE SOCIETY

STATEMENT OF CASH FLOWS
for the year ended 30 June 2018

	NOTE	2018 $000	2017 $000
Cash flows from/(to) operating activities			
Premium revenue received		986,792	920,796
Interest received		11,385	15,239
Other income received		4,340	2,735
Payment of claims		(914,260)	(833,850)
Payments to employees		(54,730)	(52,476)
Payments to suppliers		(52,395)	(47,450)
Net cash flows (to)/from operating activities		**(18,868)**	**4,994**
Cash flows from/(to) investing activities			
Proceeds from sale of property and equipment		43	76
Payments for property and equipment		(3,616)	(3,204)
Payments for intangible assets		(18,308)	(10,652)
Net receipts from investments		42,386	13,684
Net cash flows from/(to) investing activities		**20,505**	**(96)**
Net increase in cash and cash equivalents		**1,637**	**4,898**
Opening cash and cash equivalents		6,888	1,990
Closing cash and cash equivalents		**8,525**	**6,888**

RECONCILIATION OF (DEFICIT)/SURPLUS AFTER TAX TO NET CASH FLOWS FROM OPERATING ACTIVITIES

	NOTE	2018 $000	2017 $000
(Deficit)/surplus after taxation		(13,298)	6,167
Adjustments for non-cash items included in (deficit)/surplus after taxation:			
Depreciation and amortisation	8	12,254	10,406
Loss on disposal or impairment of assets		166	660
Net gains on investments at fair value through profit or loss	7	(9,756)	(7,993)
Changes in assets and liabilities:			
Premiums and other receivables		(9,519)	(7,733)
Interest receivable		1,885	900
Payables and employee benefits		86	1,681
Insurance contract liabilities		(686)	906
Net cash flows (to)/from operating activities		**(18,868)**	**4,994**

The above statement should be read in conjunction with the accompanying notes.

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 30 June 2018

1 BASIS OF ACCOUNTING

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 ("FSCU Act"). The Society's primary activity is the provision of health insurance and its registered office is Level 1, EY Building, 2 Takutai Square, Auckland.

The Society is a licenced insurer under the Insurance (Prudential Supervision) Act 2010 ("IPS Act"). It is deemed to be a financial markets conduct reporting entity under Part 7 of the Financial Markets Conduct Act 2013 ("FMC Act") and therefore a tier 1 reporting entity for financial reporting purposes.

The financial statements are for the Group comprising the Society and its subsidiaries: Southern Cross Insurance Services Limited, Southern Cross Health Services Limited and Southern Cross Healthcare Limited (non-trading).

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 $429.2 million (30 June 2017: $441.8 million) represents the retained surpluses of the Society. Capital of the Group of $428.0 million (30 June 2017: $441.3 million) includes the reserves of the Society's non-insurance subsidiaries.

SOLVENCY

As a fully licensed insurer, the Solvency Standard for Non-life Insurance Business ("the Solvency Standard") issued by the Reserve Bank of New Zealand ("RBNZ") requires the Society to retain a positive solvency margin, meaning that the actual solvency capital position exceeds the minimum required under the Solvency Standard.

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 Society has embedded in its capital management framework the necessary tests to ensure continuous and full compliance with the Solvency Standard.

On 21 March 2018 the Board of Directors, post consultation with the Society's Appointed Actuary, approved a change to the benchmark used to monitor the Society's capital position. Following this decision, the benchmark and target range for the capital position of the Society has changed from targeting a solvency margin in the range of 30% to 40% of annualised premium income, to holding net tangible assets equivalent to 5 to 7 months of expected annual claims. A solvency benchmark that is based on claims is more relevant as the Society's reserves are used to pay claims. Using the new benchmark, net tangible assets at 30 June 2018 are equivalent to 5.2 months of claims, which is within the target range under the new benchmark. The policy in respect of capital management is regularly reviewed by the Directors in line with the guidelines issued by the RBNZ.

The Society complied with externally imposed capital requirements for the year ended 30 June 2018 (30 June 2017: In compliance).

	2018	2017
	$m	$m
Solvency capital	397.3	416.9
Minimum solvency capital	125.0	113.1
Solvency margin	272.3	303.8

	2018	2017
Solvency ratio (solvency capital divided by minimum solvency capital)	3.18	3.69

On 2 May 2018, Standard & Poor's reaffirmed the Society's Insurer Financial Strength Rating at A+ (27 April 2017: A+), under its global insurance industry rating methodology.

BASIS OF PREPARATION

Under the specific criteria and definitions of the financial reporting standards, the Directors have classified the Society as a profit-oriented entity for financial reporting purposes.

The financial statements are:

- *prepared in accordance with the statutory requirements of the FSCU Act, the FMC Act and the IPS Act.*
- prepared in accordance with New Zealand generally accepted accounting practice ("NZ GAAP").
- in compliance with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and International Financial Reporting Standards ("IFRS").
- presented in New Zealand dollars ($), which is the Group's functional currency. All financial information has been rounded to the nearest thousand ($000), unless otherwise stated.
- stated net of GST, with the exception of receivables and payables, which include GST invoiced.
- prepared using historical cost as the measurement basis except for cash and cash equivalents, investments and insurance contract liabilities, which are measured at fair value.

BASIS OF CONSOLIDATION

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

1 BASIS OF ACCOUNTING (continued)

ACCOUNTING POLICIES AND STANDARDS

No changes to accounting policies have been made during the year, and policies have been consistently applied to all periods presented in these financial statements. Certain comparative amounts have been reclassified to conform to the current year's presentation.

The following new standards relevant to the Group have been issued. The Group does not intend to adopt these standards until their effective dates.

- NZ IFRS 9 *Financial Instruments* - Effective for annual reporting periods beginning on or after 1 January 2018. This standard will have minimal impact on the Group.
- NZ IFRS 15 *Revenue from Contracts with Customers* - Effective for annual reporting periods beginning on or after 1 January 2018. This standard will have minimal impact on the Group.
- NZ IFRS 16 *Leases* - Effective for annual reporting periods beginning on or after 1 January 2019. NZ IFRS 16 removes the classification of leases as either operating or finance leases for the lessee, effectively treating all leases as finance leases. NZ IFRS 16 requires a lessee to recognise a 'right-of-use asset' and a lease liability reflecting future lease payments for virtually all lease contracts. Based on the preliminary assessment completed by the Group, the treatment of operating leases for office buildings and motor vehicles will change. The estimated financial impact is the recognition of a 'right-of-use asset' and a corresponding lease liability of approximately $16 million.
- NZ IFRS 17 *Insurance Contracts* - Effective for annual reporting periods beginning on or after 1 January 2021. The impact of this standard is still to be determined.

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 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 2: Insurance contract liabilities
- Note 3a: Insurance risk

2 INSURANCE CONTRACT LIABILITIES

Insurance contracts are defined as those containing significant insurance risk at the inception of the contract. The Society has determined that all health insurance policies provided to members are insurance contracts.

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.

Estimates of the outstanding claims and unexpired risk at 30 June 2018 have been determined by the Society's Appointed Actuary, John Smeed, a Fellow of the New Zealand Society of Actuaries. These were presented to the Directors of the Society in a report dated 14 August 2018. 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.30: *General Insurance Business*, of the New Zealand Society of Actuaries.

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

Insurance contract liabilities	**2018 $000**	**2017 $000**
Provision for outstanding claims	63,196	75,638
Provision for unearned premium	97,565	90,808
Provision for unexpired risk	9,952	5,262
Other insurance provisions	1,410	1,240
Assessed claims payable	4,879	4,740
Total	177,002	177,688

Provision for outstanding claims

Outstanding claims liabilities are the central estimate of the present value of expected future payments for claims incurred but not settled at the balance date. The central estimate has been calculated using historical experience to determine the pattern of claims development.

Estimation of outstanding claims liabilities includes an allowance for claims incurred but not reported, claims incurred but not adequately reported, unpaid reported claims and future claims handling costs associated with paying claims. An explicit allowance of $0.75 million has been made for expected ACC recoveries as at 30 June 2018, which has been netted off against liabilities (30 June 2017: $0.75 million).

A risk margin has been added to reflect the inherent uncertainty in the central estimate. The risk margin considers both historic and future sources of volatility. A risk margin of 6% of the central estimate was established as at 30 June 2018 (30 June 2017: 6%). The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the outstanding claims provision.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

2 INSURANCE CONTRACT LIABILITIES (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 are calculated from the 5 years' previous claims experience and were updated this year, ranging from 69% to 114% (30 June 2017: 68% to 115%) of the monthly average. The outstanding claims provision is calculated separately for different claim types and therefore has different seasonality factors than the unexpired risk provision, which is calculated at a portfolio level.
3. Historical claims inflation 8.2% p.a. (30 June 2017: 6.8%), based on previous claims experience.

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any part of the general administrative costs directly attributable to the claims function. Claims handling costs were determined to be 4% (30 June 2017: 4%) of the underlying claims amounts based on an analysis of administration expenses.

The average weighted term from 30 June 2018 to the expected settlement date for claims included in the liability for outstanding claims is 64 days (30 June 2017: 71 days). Accordingly, expected future claims payments are not discounted due to the short tail nature of the liabilities.

Provision for outstanding claims	**2018**	**2017**
	$000	**$000**
Central estimate of outstanding claims liability	57,297	68,584
Claims handling costs	2,322	2,773
Risk margin	3,577	4,281
Total	63,196	75,638

Reconciliation of movement in provision for outstanding claims	**2018**	**2017**
	$000	**$000**
Opening balance	75,638	76,796
Amounts utilised during the year	(59,800)	(70,559)
(Reversal of unused provision)/additional provision	(6,505)	1,401
Amounts provided during the year	55,018	65,613
Movement in claims handling costs	(451)	(142)
Movement in risk margin	(704)	529
Closing balance	63,196	75,638

Provision for unexpired risk 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, plus a risk margin, from the current insurance contracts. The future cash flows are future claims, associated claims handling costs and other administration costs.

If the present value of the expected future cash outflows exceeds the unearned premium liability then the unearned premium liability is deemed to be deficient. Any deficiency is recognised as an expense in the statement of comprehensive income after first writing down any deferred acquisition costs. The deficiency in excess of deferred acquisition costs is recognised in the statement of financial position as an unexpired risk provision.

The provision for unexpired risk has been calculated as the projected premium deficiency for current in-force business until the next policy billing date on or after 1 July 2018.

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 together with future sources of volatility. A risk margin of 4% of the present value of expected future cash flows has been applied at 30 June 2018 (30 June 2017: 4%). The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the unexpired risk provision.

Key assumptions:

1. Future claims development will be similar to historical patterns by the type of policy, type of claim and development month.
2. Monthly seasonality factors used for claims incurred. These were calculated from the 5 years' previous claims experience, and range from 73% to 112% (30 June 2017: 72% to 112%) of the monthly average. The outstanding claims provision is calculated separately for different claim types and therefore has different seasonality factors than the unexpired risk provision, which is calculated at a portfolio level.
3. Expenses based on the business plan for 2018/19, 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 claims payments are not discounted due to the short tail nature of the liabilities.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

2 INSURANCE CONTRACT LIABILITIES (continued)

Provision for unearned premium
Premiums billed but unearned are recorded as a provision for unearned premium in the statement of financial position.

	2018 $000	2017 $000
Opening balance	90,808	87,065
Premiums written in the year	994,597	927,185
Premiums earned during the year	(987,840)	(923,442)
Closing balance	97,565	90,808

Provision for unexpired risk	2018 $000	2017 $000
Present value of expected future cash flows for claims and expenses	103,705	92,701
Risk margin	4,148	3,708
Unearned premiums	(97,565)	(90,808)
Write-down of deferred acquisition costs	(336)	(339)
Total	9,952	5,262

3 RISK MANAGEMENT

The Group is exposed to a number of risks in the normal course of business, specifically insurance risk, credit risk, liquidity risk, market risk and operational risk. The Directors and management recognise the importance of having effective risk management and have put in place a comprehensive risk management programme.

a. Insurance risk

The Group is exposed to insurance risk through its health insurance activities. The key risk is that of claims costs varying significantly from what was assumed in the setting of premium rates and putting pressure on the solvency and liquidity of the Society.

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

The primary objective in managing insurance risk is 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 organisation if there is adverse deviation in experience. Key policies and methods for mitigating insurance risk include:

- Underwriting policies and processes which evaluate new risks and offer terms that do not endanger the portfolio.
- Policy terms and conditions which clearly specify which health care costs are reimbursed and claims management procedures which ensure those terms and conditions are adhered to in claims administration.
- A long-term pricing strategy and guidelines adopted by the Board which supports pricing based on underlying risk.
- Regular monitoring of financial and operating results.
- Maintaining a target solvency margin in excess of the minimum required by the standard established by the RBNZ. The solvency margin ensures the Society is able to withstand a period of adverse insurance or investment experience and still maintain a satisfactory financial position (refer to Note 1).

II. Sensitivity to insurance risk

The volatility of claims at a portfolio level has been low relative to other types of insurance contracts. The low volatility is due to:

- The benefits in the health insurance contracts providing cover primarily for medically necessary yet elective health care services.
- Obligations arise under the health insurance contracts when health care services are provided and the provision of health care services is constrained by supply of private medical practitioners and medical facilities. This constraint on claims experience is different than other forms of insurance contracts where obligations do not depend on service provision, i.e. property insurance.
- ACC and public sector health care provision of both acute, accident and elective health services. Many of the highest cost and highly variable medical care claims are funded by other sources.
- Management's policies and processes for managing insurance risk, as listed above.

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

3 RISK MANAGEMENT (continued)

b. Financial risks

i. Credit risk

Credit risk is the potential risk of loss arising from the failure of a debtor or counterparty to meet their contractual obligations.

In the normal course of its business the Group incurs credit risk from its health insurance operations and from investment in financial assets.

The Group maintains policies which are used to manage the exposure to credit risk. Limits on counter-party exposures have been set and are monitored on an ongoing basis. In addition, the RBNZ has issued concentration risk limits, as part of its solvency standards. The credit quality of counter-parties is assessed based on published credit ratings issued by Standard & Poor's or equivalent ratings agencies. Where local authorities do not have a formal credit rating, comfort is obtained from their ability to levy rates. There are no concentrations of credit risk at 30 June 2018 (2017: Nil) in excess of policy.

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

	2018 $000	2017 $000
Money market		
AA	150,011	193,546
A	71,641	93,817
BBB	48,213	35,398
Non-rated	15,001	35,035
	284,866	357,796
Unit trusts		
Non-rated (Global bonds, weighted average rating of the underlying investments is A+, 30 June 2017: AA)	96,816	81,579
Non-rated (Global equities)	49,473	56,840
Non-rated (Global real estate)	25,656	19,895
Non-rated (Global listed infrastructure)	24,781	-
	196,726	158,314
Total	481,592	516,110

The maximum exposure to credit risk at the end of the reporting period is the amount of financial assets stated in the statement of financial position. These exposures are net of any recognised provisions for impairment losses. The Group does not require any collateral or security to support financial assets due to the quality of the counter-party organisations.

The cash and cash equivalents balances are held with a counter-party rated AA- (30 June 2017: AA-).

Premium receivables are due from a very large number of counter-parties, ranging from large corporates to individual members. Analysing these by credit quality would not be feasible, as the majority of counter-parties will be non-rated. Credit risk for premium receivables is considered low as the Group is able to terminate or suspend policies for non-payment, at the Group's discretion.

ii. Liquidity risk

The Group is exposed to ongoing operational drawdowns 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 unexpected levels of claims and expenses.

The contractual maturities of investments are as follows:

	2018 $000	2017 $000
On call	9,008	5,009
0-6 months	338,531	297,752
7-12 months	105,878	117,999
Current	453,417	420,760
1-2 years	28,175	70,616
2-5 years	-	19,802
Beyond 5 years	-	4,932
Non-current	28,175	95,350
Total	481,592	516,110

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

Financial liabilities are all short term. Investments can usually be liquidated at any time, under normal market conditions to settle liabilities.

The 0-6 months maturity category includes unit trusts of $196.7 million (30 June 2017: $158.3 million), as these investments could be liquidated at short notice.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

3 RISK MANAGEMENT (continued)

c. Market risks

i. Interest rate risk

The Group invests in both fixed and variable rate investments 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.

The cash flows from the Group's investment in bank deposits, commercial paper and floating rate notes are susceptible to changes in interest rates.

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 the statement of comprehensive income for each period.

	2018	2017	2018	2017
	$000	$000	$000	$000
	On cash flows		On profitability	
Fair value - Interest rate sensitivity on money market investments				
Impact of change in interest rates				
Increase by 100 basis points	1,766	2,015	(1,036)	(936)
Decrease by 100 basis points	(1,766)	(2,015)	1,050	948

ii. Unit price risk

Unit price risk is the risk that the fair value of investments in unit trusts will change as a result of changes in unit prices. The Group holds all of its investments in unit trusts at fair value through profit and loss.

	2018	2017	2018	2017
	$000	$000	$000	$000
	On cash flows		On profitability	
Fair value - unit price sensitivity on unit trust investments				
Impact of change in unit prices				
Increase by 10%	19,673	15,831	19,673	15,831
Decrease by 10%	(19,673)	(15,831)	(19,673)	(15,831)

iii. Foreign currency risk

The Group does not have material exposure to foreign currency risk through its insurance operations. On a net basis the foreign currency risk on investments in unit trusts is substantially hedged into NZD. In operating these funds, inherent currency risk exposure arises. The Group does not apply hedge accounting.

There are no significant liabilities denominated in foreign currencies.

iv. Fair values of financial assets and financial liabilities

All financial assets and financial liabilities included in the statement 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.

	Level 1	Level 2	Level 3	Total
	$000	$000	$000	$000
30 June 2018				
Cash and Cash Equivalents	-	8,525	-	8,525
Investments	-	481,592	-	481,592
Total	-	490,117	-	490,117

	Level 1	Level 2	Level 3	Total
	$000	$000	$000	$000
30 June 2017				
Cash and Cash Equivalents	-	6,888	-	6,888
Investments	-	516,110	-	516,110
Total	-	522,998	-	522,998

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

4 NET CLAIMS EXPENSE

The net claims expense represents payments made on claims and the movements in the provisions for outstanding claims and unexpired risk. Details of processes and assumptions used in calculating the provisions are discussed in Note 2.

	2018 $000	2017 $000
Claims incurred relating to risks borne in current financial year	909,610	826,243
Claims incurred relating to risks borne in previous financial years	(6,505)	1,401
Movement in provision for claims handling costs	(451)	(142)
Movement in risk margin	(704)	529
Net claims incurred	901,950	828,031
Movement in provision for unexpired risk	4,690	2,295
Total	906,640	830,326

5 INVESTMENTS

Investments are recognised on the date they are originated and 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. Changes in fair value are recognised in the statement of comprehensive income. The credit quality, contractual maturities, categorisation of investment types and fair value hierarchies of investments are described in Note 3.

As the intention is for non unit trust investments to be held to maturity, and then reinvested, only the net purchased or matured amounts are disclosed in the statement of cash flows.

	2018 $000	2017 $000
Local authority bonds	2,042	9,967
Other bonds	8,273	28,304
Bank deposits	181,295	176,392
Commercial paper	2,984	-
Floating rate notes	90,272	143,133
Unit trusts - global bonds	98,816	81,579
Unit trusts - global equities	49,473	56,840
Unit trusts - global real estate	25,656	19,895
Unit trusts - global listed infrastructure	24,781	-
Total	481,592	516,110

6 PREMIUM AND OTHER RECEIVABLES

Gross earned premiums from insurance contracts are recognised evenly over the current billing period of the contract, which is considered to be in line with the pattern of the incidence of risk. Revenue is recognised on the date from which the policy is effective.

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. Premium and other receivables are classified as "loans and receivables".

	2018 $000	2017 $000
Premium receivable	78,238	70,263
Other receivables	10,474	8,930
Total	88,712	79,193

Premium and other receivables are current assets. The fair values of premium and other receivables approximate the carrying amounts.

7 NET INVESTMENT AND OTHER INCOME

Interest income is recognised using the effective interest rate method.

Fair value gains and losses on financial assets at fair value through profit or loss are recognised through the statement of comprehensive income in the period in which they arise.

Fees and other income are recognised on an accrual basis.

	2018 $000	2017 $000
Interest income	9,500	14,339
Net gains on investments at fair value through profit or loss	9,756	7,993
Net investment income	19,256	22,332
Fee and other income	4,340	2,734
Net investment and other income	23,596	25,066

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NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2018

8 OPERATING EXPENSES

	2018 $000	2017 $000
Operating expenses consist of		
Policy acquisition	8,508	8,495
Policy administration	46,000	43,841
Claims administration	10,628	10,677
Other operating expenses	52,958	49,002
Total	118,094	112,015

Other operating expenses consist of expenses incurred for information technology, human resources, occupancy, governance, finance, actuarial, management, depreciation and amortisation.

Operating expenses include		
Auditor's remuneration:		
– audit of financial statements	173	170
– review of interim financial statements	45	45
– review of solvency returns	45	45
– agreed upon procedures	3	-
Depreciation	3,665	3,092
Amortisation	8,589	7,314
Impairment loss on intangible assets	168	653
Employee benefits expense	55,601	51,536
Rental of premises	5,605	5,354

9 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand and current account balances in bank accounts. Cash and cash equivalents are classified as "financial assets at fair value through profit or loss".

10 PROPERTY AND EQUIPMENT AND INTANGIBLE ASSETS

Property and equipment and intangible assets are measured at cost, less accumulated depreciation or amortisation and impairment losses.

For computer software development, 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.

Capital expenditure on all 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 or amortised.

Depreciation and amortisation are recognised on a straight-line basis to allocate the assets' costs, net of any residual amounts, over their useful lives. The assets' useful lives are reviewed and adjusted if appropriate at each balance date. An asset's carrying amount is written down to its recoverable amount if it is considered that the carrying amount is greater than its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

Depreciation/amortisation rates are:

• Computer equipment	25% - 33% per annum
• Other fixed assets	15% - 20% per annum
• Leasehold improvements	10% - 46% per annum
• Computer software	14% - 33% per annum

Property and equipment and intangible assets are non-current assets. Other fixed assets include motor vehicles and office equipment.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

10 PROPERTY AND EQUIPMENT AND INTANGIBLE ASSETS (continued)

a) Property and equipment	Computer equipment	Other fixed assets	Leasehold improvements	Work in progress	Total
	$000	$000	$000	$000	$000
As at 30 June 2018					
Cost	17,764	3,883	11,060	39	32,746
Accumulated depreciation	(11,496)	(3,235)	(6,334)	-	(21,065)
	6,268	648	4,726	39	11,681
As at 30 June 2017					
Cost	14,917	3,739	10,679	743	30,078
Accumulated depreciation	(10,251)	(2,893)	(5,387)	-	(18,531)
	4,666	846	5,292	743	11,547

b) Intangible Assets	Computer software	Work in progress	Total
	$000	$000	$000
As at 30 June 2018			
Cost	65,197	4,872	70,069
Accumulated amortisation and impairment	(34,256)	-	(34,256)
	30,941	4,872	35,813
As at 30 June 2017			
Cost	49,713	2,374	52,087
Accumulated amortisation and impairment	(27,182)	-	(27,182)
	22,531	2,374	24,905

11 TAXATION

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

Tax expense comprises current and deferred tax, calculated using the tax rate enacted or substantively enacted at balance date and any adjustments to tax payable in respect of prior years. Deferred tax expense is recognised in respect of temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts used for taxation purposes. A deferred tax asset is recognised only to the extent it is probable it will be utilised.

The aggregate amount of temporary differences arising in the subsidiaries for which a deferred tax asset has not been recognised is $1,000 (30 June 2017: $5,000).

The Group has unrecognised tax losses carried forward of $33,769,000 at 30 June 2018 (30 June 2017: $32,629,000).

12 EMPLOYEE BENEFITS

Employee benefits

Employee benefits represent the current obligations to employees in respect of outstanding salaries, leave entitlements and other short term 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, with consideration 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 benefits 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.

The Group's employee benefits liability for the current year was $6.64 million (2017: $6.00 million). Post employment benefits liability was $1.64 million (2017: $1.62 million).

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

13 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
• Southern Cross Insurance Services Limited ("Insurance Services")	100% subsidiary of Society
• Southern Cross Healthcare Limited (non-trading)	100% subsidiary of Society
• Southern Cross Health Trust ("Trust")	Related party of Society
• Southern Cross Benefits Limited ("Benefits")	100% subsidiary of Trust
• Southern Cross Hospitals Limited ("Hospitals")	100% subsidiary of Trust
• Southern Cross Primary Care Limited ("Primary Care")	100% subsidiary of Trust
• Directors of The Southern Cross Medical Care Society	Certain Directors are Trustees of Trust

The Society and its subsidiaries, and the Trust and its subsidiaries, have 30 June as the balance date.

The Society and the Trust are separate legal entities operating at "arm's length". All entities provide their normal services to other group entities on normal commercial terms. Some goods and services are purchased by the Group and other related parties on a combined basis. These costs are on-charged to the other related parties at cost.

All related party balances are payable on normal trading terms and unsecured. No related party transactions have taken place at nil or nominal value. No related party balances have been written off or forgiven during the year (30 June 2017: Nil).

	2018 $000	2017 $000
The amount of transactions with other related parties		
Sale of services	5,839	4,722
Purchase of services	1,860	2,390
The outstanding balances with other related parties		
Receivables	503	265
Payables	-	262

The Society contracts healthcare services on behalf of its members from all providers, including Hospitals, on a contestable and contractual basis, which are not included in the table above, as these are services paid on behalf of members.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

13 RELATED PARTIES (continued)

b. Remuneration of Directors

Actual directors' remuneration paid by the Society for the year ended 30 June 2018 were as follows:

Director	Board fees Amount $	Audit & Risk Committee Amount $	Investment Committee Amount $	Remuneration Committee Amount $	Nominations Committee Amount $	Total remuneration Amount $
C M Drayton	56,500	3,000	-	2,750	1,000	63,250
G W Gent [1]	113,000 Chair	-	-	- Chair [2]	- Chair	113,000
G R W France	56,500	-	5,000 Chair	2,000	-	63,500
E M Hickey	56,500	6,000 Chair	2,500	-	-	65,000
J M Raue	56,500	-	-	2,500 Chair [3]	-	59,000
K B Taylor	56,500	3,000	-	-	1,000	60,500
P Leightley	56,500	-	-	-	-	56,500
	452,000	12,000	7,500	7,250	2,000	480,750

The annual fee pool limit of $499,800 was approved by Society members at the Annual General Meeting in December 2017.

1 G W Gent did not receive any fees for being a member of the Audit and Risk, Investment, Remuneration or Nominations Comittees.
2 Was Chair for the first three quarters of the year
3 Was Chair for the last quarter of the year

Actual directors' remuneration paid by the Society for the year ended 30 June 2017 were as follows:

Director	Board fees Amount $	Audit & Risk Committee Amount $	Investment Committee Amount $	Remuneration Committee Amount $	Nominations Committee Amount $	Total remuneration Amount $
Dr D Baird - retired 1 December 2016	23,016	-	-	837	-	23,853
C M Drayton	55,000	2,500	-	-	2,000	59,500
G W Gent [1]	110,000 Chair	-	-	- Chair	- Chair	110,000
G R W France	55,000	-	5,000 Chair	2,000	-	62,000
E M Hickey	55,000	5,000 Chair	2,500	-	-	62,500
J M Raue	55,000	-	-	2,000	-	57,000
K B Taylor	55,000	2,500	1,250	-	2,000	60,750
P Leightley - appointed 1 December 2016	31,984	-	-	-	-	31,984
	440,000	10,000	8,750	4,837	4,000	467,587

The annual fee pool limit of $476,000 was approved by Society members at the Annual General Meeting in December 2014.

1 G W Gent did not receive any fees for being a member of the Audit and Risk, Investment, Remuneration or Nominations Comittees.

A friendly society has trustees to hold its assets. The trustees for the year were E M Hickey, G W Gent and G R W France and they did not receive any fees for this.

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. Other operating expenses in relation to governance are met by the Society. The Society does not provide loans or advances to directors or trustees.

Where directors of the Society are also directors of the Society's subsidiaries, they do not receive any fees for these appointments.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2018

13 RELATED PARTIES (continued)

c. Remuneration of key management personnel

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

	2018 $000	2017 $000
Salaries and other short-term benefits	3,148	3,593
Post-employment benefits	77	74
Long-term employee benefits	58	49

14 EMPLOYEE REMUNERATION

The following table discloses the number of employees and former employees of the society, who received remuneration and other allowances during the financial year. Remuneration represents actual payments made during the financial year and includes base salary, bonuses, redundancy and termination payments.

	2018
<100,000	638
100,001 - 110,000	33
110,001 - 120,000	15
120,001 - 130,000	16
130,001 - 140,000	15
140,001 - 150,000	11
150,001 - 160,000	8
160,001 - 170,000	7
170,001 - 180,000	4
180,001 - 190,000	1
190,001 - 200,000	5
200,001 - 210,000	1
230,001 - 240,000	2
240,001 - 250,000	1
260,001 - 270,000	1
280,001 - 290,000	2
300,001 - 310,000	1
310,001 - 320,000	1
320,001 - 330,000	1
780,001 - 790,000	1
Total	764
Headcount as at balance date	653

15 LEASE AND CAPITAL COMMITMENTS

a) Operating lease commitments

Leases are defined as an operating lease where they do not transfer substantially all the risks and rewards incidental to ownership.

Payments made under operating leases are recognised in the statement of comprehensive income on a straight-line basis over the term of the lease. Any inducement payments received as part of an operating lease agreement are deferred and recognised on a straight-line basis over the term of the lease.

Future minimum lease payments under non-cancellable operating leases are as follows:

	2018 $000	2017 $000
Within 1 year	5,875	5,766
Between 1 and 2 years	5,559	5,618
Between 2 and 5 years	14,778	16,196
Greater than 5 years	22	3,762
Total	26,234	31,342

The major components of the operating lease commitments are the leases for the Auckland and Hamilton office premises.

b) Capital Commitments

The Group had capital commitments of $2,005,000 at 30 June 2018 (2017: $1,042,000).

16 CONTINGENT LIABILITIES

The Group had no contingent liabilities at 30 June 2018 (2017: Nil).

17 SUBSEQUENT EVENTS

On 31 August 2018, the Board approved management to finalise commercial negotiations to enter into a lease of new premises in Auckland. The disclosures in Note 1 and Note 15 have been prepared on the basis of the existing lease agreement in-force as at 30 June 2018 and do not take into consideration the financial impact of the new lease, noting the new lease has not yet been executed. The impact of this lease on the disclosures in Note 1 and Note 15 may be material for the Group.

KPMG

KPMG

Independent Auditor's Report

To the members of The Southern Cross Medical Care Society

Report on the consolidated financial statements

Opinion

In our opinion, the accompanying consolidated financial statements of The Southern Cross Medical Care Society (the Society) and its subsidiaries (the Group) on pages 1 to 15:

i. present fairly in all material respects the Group's financial position as at 30 June 2018 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

We have audited the accompanying consolidated financial statements which comprise:

— the statement of financial position as at 30 June 2018;

— the statements of comprehensive income and changes in reserves, and cash flows for the year then ended; and

— notes to the consolidated financial statements, including a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) ("ISAs (NZ)"). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Group in accordance with Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (the "IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our responsibilities under ISAs (NZ) are further described in the Auditor's Responsibilities for the audit of the consolidated financial statements section of our report.

Our firm has also provided other services to the Group in relation to the review of insurer solvency returns, review of interim financial statements, and an agreed upon procedure engagement. Subject to certain restrictions, partners and employees of our firm may also deal with the Group on normal terms within the ordinary course of trading activities of the business of the Group. These matters have not impaired our independence as auditor of the Group. The firm has no other relationship with, or interest in, the Group.

Other information

The directors, on behalf of the Group, are responsible for the other information included in the Group's consolidated financial statements. Other information includes the appointed actuary's report issued under section 78 of the Insurance (Prudential Supervision) Act 2010. Our opinion on the consolidated financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Use of this independent auditor's report

This independent auditor's report is made solely to the members as a body. Our audit work has been undertaken so that we might state to the members those matters we are required to state to them in the Independent Auditor's Report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the members as a body for our audit work, this independent auditor's report, or any of the opinions we have formed.

Responsibilities of the directors for the Consolidated Financial Statements

The directors, on behalf of the Group, are responsible for:

— the preparation and fair presentation of the consolidated financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards;

— implementing necessary internal control to enable the preparation of a consolidated set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and

— assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objective is:

— to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and

— to issue an independent auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

A further description of our responsibilities for the audit of these consolidated financial statements is located at the External Reporting Board (XRB) website at:

http://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-5/

This description forms part of our independent auditor's report.

The engagement partner on the audit resulting in this independent auditor's report is Kay Baldock.

For and on behalf of

KPMG

KPMG
Auckland

5 September 2018

Actuarial and Insurance Consultants

3 September 2018

The Directors
Southern Cross Medical Care Society
Auckland

Dear Directors

Review of Actuarial Information Contained in Financial Statements as at 30 June 2018

Finity Consulting Pty Limited (Finity) has been asked by Southern Cross Medical Care Society (the Society) to carry out a review of the 30 June 2018 Actuarial Information contained in the financial statements and used in their preparation and to provide an opinion as to the appropriateness of this information. John Smeed is an employee of Finity and is the Appointed Actuary to the Society. Finity has no relationship with the Society apart from being a provider of actuarial services.

The Society's policy is to seek and adopt the advice of the Appointed Actuary in respect of the Actuarial Information contained in its financial statements. We confirm that the financial statements as at 30 June 2018 have been prepared in accordance with this policy, and as such this satisfies the requirements of the Insurance (Prudential Supervision) Act 2010.

Having carried out the Actuarial Review, nothing has come to our attention that would lead us to believe that the Actuarial Information used in the financial statements or their preparation, or the determination of the solvency position for the Society as at 30 June 2018 is inappropriate. No limitations were placed on us in performing our review and all data and information requested was provided.

In our opinion the Society has maintained a solvency margin in excess of the minimum required as at the balance date.

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

Yours sincerely

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

Matthew Clere
Associate of the New Zealand Society of Actuaries