



Southern Cross
Healthcare

your health is our business

The Southern Cross Medical Care Society
2005 Annual Report

Our Mission To provide sustainable access to value for money quality healthcare

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Annual Report
For The Year Ended
30 June 2005



Board of Directors (L to R) Jeff Todd, Dr Harley Gray, Dr John Matthews (Chairman), Bruce Davidson, Dr Susan Macken, Phillip Meyer, David May

overview of the year

- As a not-for-profit, specialising in health care, Southern Cross Medical Care Society remained on a sound financial footing with a net surplus of \$31.8 million achieved.
- Reserves strengthened to \$270.2 million, and now lie within the solvency target range adopted by the Board, based on standards used by Australian health insurers.
- This financial strength underpinned the introduction of Founding Members' Rewards and Low Claims Rewards – returning \$35 million in savings over a 12 month period.
- Premium income of \$484.6 million.
- \$378.6 million paid in claims – with an average reimbursement per Member of close to \$470.
- Premiums reduced or held for 500,000 Members, commencing from May 2005.
- **activa**; New Zealand's first Health Management Account developed to assist New Zealanders to manage their day to day health costs better.

In the 2005/06 financial year, forecast Government health spending in New Zealand at \$9.7 billion is expected to account for 20% of all state spending and will have increased by 50% since 1999.

Yet despite this increasing investment, New Zealanders' concerns are growing about access to surgery in the public system and about the costs of day-to-day medical care, making the Society's role in the health system more relevant than ever.

While health spending will always be a political football, especially in an election year, the fact that a higher investment has not necessarily meant easier, more affordable access to care highlights the very real difficulties faced by the health sector. More money does not automatically mean more care, because treatments have become more sophisticated and expensive, labour costs are increasing and we have an ageing population with more expensive health needs.

As the public sector struggles to balance the demands of population and costs fairly, the Southern Cross Medical Care Society is playing an increasingly important role in funding

Low Claims Reward scheme and a Founding Members Reward giving eligible Members a discount of up to 15% on their annual premium over two consecutive years.

Those rewards combine to give Southern Cross Members total annual savings of approximately \$35 million this year. These initiatives see our Society going against the tide of rising costs, using our strength as a not-for-profit organisation to benefit our Members.

Our Founding Members Reward in particular, sees us delivering on last year's promise to recognise the important role played by Members who have been with the Society from our earliest days. These Members were the backbone of Southern Cross in our formative years and it was their commitment that helped establish a stable foundation for the Society. Our sound financial position enables us to deliver a significant discount over two years as recognition of this early participation and it evolved as a result



chairman's report

Dr John Matthews Chairman of the Board

services for New Zealanders, whether their preference is for help in managing day-to-day health expenses, or through more traditional insurance.

Affordability

Members want premiums to be as affordable as possible. We have responded decisively this year, using our sound financial position for the benefit of Members' future health care. Our premiums for around half a million of our adult Members have either decreased or will stay the same in the current premium cycle. We have introduced an ongoing

of the very valuable work undertaken by the Actuarial Working Group.

This reward applies to Members who have had continuous Membership of the Society since before 1982. It provides discounts of five, 10 or 15% off premiums, depending on the Member's joining date, with these applying for two years. The Founding Members Reward means \$13 million will be saved by 130,000 long standing Southern Cross Members in the first year. A Member may be eligible for both the Low Claims Reward and Founding Members Reward.

As we work to increase the value received from our policies and their affordability, it is very pleasing to note this effort is being recognised by older New Zealanders concerned about their health and especially the impacts of health problems. Membership in the 65+ age group increased by 2.1% this year, or 1,493 people.

Managing Inflation

Over the last four years, annual surgical claims cost escalation has varied from six to 10% and all the projections are for continued increases. Some of these increases will be due to improved benefits being provided to our Members, such as the enhancements to many of our policies delivered during the year. However the rising costs of labour, medical technologies and procedures are also significant contributing factors.

Our first priority is to manage overheads in the business at the same time as we improve our service. Business costs as a percentage of revenue were 14%, a modest 2% increase on the prior year. This increase reflects significant activity in the organisation including projects to consolidate our IT infrastructure and implement technology support for initiatives such as reasonable charges, providing internet banking payment options for Members, the introduction of our Founding Members Reward and Low Claims Reward and the development of **activa**, New Zealand's first Health Management Account.

Our second priority is to work with external providers on initiatives that ensure our Members receive the levels of care they rightly expect, at affordable prices. Our Affiliated Provider network is one example, with providers in that network agreeing to provide services at an agreed rate should Members wish to take advantage of that option when deciding on their health care provider. The independent but complementary Southern Cross

Health Trust, which operates Southern Cross private hospitals, is an important contributor to our efforts to maintain affordability.

Last year, our analysis showed Southern Cross Hospitals are, on average, 10% less expensive than other private surgical hospitals.¹

Similarly, we are endeavouring to ensure reasonable stability in the average cost of many common procedures by identifying and working with providers on occasions where we believe charges exceed the norm on a like-for-like basis. Our concern here is that individual Members may not only have to shoulder a higher-than-expected proportion of the cost of care, but that all our Members, over the long term, may face higher premiums as average costs of some procedures rise. To achieve progress in this area it is essential that members of the medical profession and other health providers are consulted and involved. We are pleased to report the positive engagement with members of the medical profession on these matters.

Subsidies Campaign

In a year where the Society has made considerable achievements in support of our Members, we also received excellent support from them in presenting our case to Government on the introduction of tax rebates on health insurance premiums.

While our call for a subsidy, which also had support from the Health Funds Association, did not lead to any change in Government policy in the prevailing term, it is encouraging to see that it has resonated with some of the political parties.

The Society remains committed to ensuring the Government recognises the substantial role played by the private health sector and also gives recognition to the responsibility our Members are taking for their own health care costs.

activa

As a significant force in health care in New Zealand, we believe that one of our responsibilities is to identify trends in the market and use our knowledge to respond to those trends in ways that benefit our Members and all New Zealanders.

The introduction of the **activa** Health Management Account is an excellent example. We have recognised that while "traditional" health insurance continues to be popular with many New Zealanders, increasing numbers of people, especially in the younger age group, are looking for alternatives that assist them with better managing the \$2 billion spent annually on everyday health maintenance and care.

The **activa** Health Management Account enables New Zealanders to set aside funds, which earn interest, for their everyday health care costs such as GP visits, dental check-ups or purchases at pharmacies and health care outlets, and also provides them with optional insurance cover for major health concerns. It is designed to enable New Zealanders to manage their health spending more effectively and make their health dollar go further through various rewards linked to the account.

While the expression "prevention is better than a cure" is a truism, it is an unfortunate fact that people do face times when they put off a visit to a health professional because of budget worries.

A Health Management Account enables regular sums, even modest amounts, to be put aside so that concerns about costs do not stand in the way of timely access to good care. It can also complement existing health cover, particularly for those taking responsibility for their day-to-day health expenses and with cover where they share a proportion of the expenses.

Financial Stability

The Society recorded a net surplus of \$31.8 million for the year ended

¹ Based on Southern Cross Medical Care Society's analysis of its fee for service surgical claims for the period from April 2003 to March 2004. Private surgical hospital (excluding day-stay facilities) charges were compared. The comparison did not take into account surgeons' or anaesthetists' fees. Each hospital's charges for its mix of procedures were compared with the national average for the same mix of procedures to calculate a price index for each hospital.

June 30, 2005 after returning \$378.6 million to Members through claims.

The surplus maintains Southern Cross, as a not-for-profit organisation, on the sound financial footing required to honour commitments to use our financial strength to benefit Members. This stability is a very important contributor to our ability to implement the Founding Members Reward along with our Low Claims Reward which collectively will return some \$35 million in savings to Members over a 12 month period.

Higher investment and other income, at \$25.9 million compared to \$15.4 million in the prior year was a contributor to the surplus which also includes a \$12 million operating surplus, offset by \$6 million in amortised goodwill arising from the Society's acquisition of Aetna Health five years ago.

Our sound financial position had been further strengthened with reserves increasing from \$238.4 million at the beginning of the financial year to \$270.2 million at June 30, 2005. Our reserves are now well within the solvency target range adopted by the Board based on standards used by Australian health insurers.

The Society took in \$484.6 million in premiums and paid out 78% or \$378.6 million in claims.

Our claims to premium ratio was slightly lower than average this year and that was an influencing factor in the decision made in February to hold or reduce premiums for some 500,000 of our Members with effect from May of this year.

A claims to premium ratio in excess of 80% is the historical norm. The Society expects claims to return to those levels in the 05/06 financial year, particularly with the held, or decreased premiums taking effect in May and the increase in policy benefits following an extensive policy review during the year.

Governance

The Board of the Southern Cross Medical Care Society acknowledges

the special responsibilities we have as the elected representatives of the Society's more than 800,000 Members, especially in the prevailing environment where health costs are a considerable and growing concern.

The Society operates a substantial business of importance to the lives of many New Zealanders and, in many respects to the national economy. As a Board, our responsibility is to ensure our Members can have full confidence in the Society, the decisions being made in the business and the levels of accountability in it.

The Board and the Management team are united behind the Society's mission to provide sustainable access to value-for-money quality health care. That mission mirrors the expectations of our Members and is uppermost in our mind when decisions are made with regard to the Society's strategic and financial directions.

Sustainable access to private care is the primary reason why Members join the Society. The Directors have the responsibility not only to ensure that good financial management is achieved, but also that decisions are made that achieve the best health outcomes for our Members. Managing the demands of cost versus care calls for particular skills which is why the Board, since 1997, has engaged external recruitment consultants to assist in filling any casual Board vacancies.

The consultants select a panel of candidates with appropriate and relevant qualifications, enabling the Board to fill a casual vacancy in a way that maintains the balance of financial and other expertise required for good governance.

This process of selection and appointment of Directors aims to ensure that the best financial decisions are made on your behalf and that consideration is also given to the quality, affordability and sustainability of health services. Such appointments are then confirmed by

the Members at the election process associated with the Annual General Meeting.

Health insurance is a complex business and input from all of our Board members has been extremely important and valuable in setting our strategic direction for the benefit of Members.

Management and Staff

On behalf of the Board, I wish to thank Dr Ian McPherson and his team for their dedication to our Members and to the Society's Mission.

The introduction of the Low Claims Reward and Founding Members Reward, as well as the hold on premiums and the thorough review of benefits placed a considerable workload on the team this year and was met with great commitment. I know they share the Board's satisfaction in being able to achieve so much for our Members in the face of rising health costs.

I know I speak on behalf of the Board when I say that we look forward to continuing the work with management to maintain the Society's sound financial health as we continue to ensure our Members benefit from sustainable access to quality health care.

I would also like to thank all Board members who have all given freely of their time in what has been a busy and demanding year. We have called on them to attend a number of additional Board meetings and strategic planning sessions and their commitment has been much appreciated.

Dr John Matthews
Chairman

Health is a topic constantly in the public mind. How do we stay healthy? How can we access and afford the best care when our health lets us down? What can be done to make day-to-day health costs more manageable? Why are we spending more on health as a country, but seemingly getting no more in return?

Questions like these are important to Southern Cross Healthcare and as New Zealand's largest not-for-profit health care organisation, we are looking for innovative ways to ensure all New Zealanders enjoy greater access to quality, affordable health care.

This follows a tradition begun in the 1960s when the Southern Cross Medical Care Society began offering New Zealand's first private health insurance and continued in the 1970s when the Southern Cross Health Trust was established to provide a quality, not-for-profit private hospital network in New Zealand.

Our financial strength and stability is enabling us to consider how we can improve health care access and affordability for more New Zealanders, while at the same time delivering better services and benefits to our Members.

Affordability

The trend of recent years has been for health insurance costs to rise inexorably, reflecting the

not-for-profit organisation whose only concern is health. This means we can use our surplus to return benefits directly to our Members, an advantage not enjoyed by many of our competitors whose profits are distributed to shareholders.

The achievement comes in a year in which we paid \$378.6 million back to Members in claims while budgeting for increased claims to premium ratios in the coming years, reflecting the increased benefits included in policies for our Members.

Our ability to do these things in the future is dependent on our ability to work with doctors, other providers and our Members to keep the cost of treatment, and hence claims, down.

Value for Money

Medicine, surgical techniques and medical technologies improve every year. Members look to us to ensure they can benefit from these advances, without compromising



group chief executive's report

Dr Ian McPherson Group Chief Executive

increasing demand and cost of treatment services. As discussed in the Chairman's review this year, we delivered on our commitment to combat this trend by holding, or decreasing, premiums for around 500,000 of our adult Members. We also introduced new rewards, including an ongoing Low Claims Reward scheme, and a Founding Members Reward of up to 15% discount on premiums applied over two consecutive years.

We are proud of this achievement, made possible by our status as a

affordability for them. It is a constant challenge, because better levels of care often come at a higher price which will inevitably flow through into higher levels of claims and higher premiums.

Again, our sound financial position makes an important contribution to our ability to enhance Member benefits, adding value to their policies without affecting premiums in the short term. Our ongoing benefit review process is undertaken in consultation with the medical profession. This year it saw benefit

updates for many Members' plans. The value added to policies depends on the cover, but examples include:

- Higher GP consultation refund maximums across all plans that provide this cover.
- Increases to a broad range of surgery-related refund maximums for Members on shared cover plans.
- Increased refund maximums for consultations with a range of specialist medical practitioners and adding cover for these consultations to a wider range of plans.
- The introduction of further benefits that require treatment to be carried out by Affiliated Providers, enabling us to provide cover

while managing claims costs. An example is the increased payment for sclerotherapy treatment of varicose veins.

In conjunction with the benefit reviews, we took the opportunity to review our policy documents to ensure they provide clear, up-to-date information for Members. All Members received updated policy documents from April to June 2005, the first such comprehensive policy document review since 2002.

Significant progress was also made during the year towards extending enhanced benefits to former Aetna policyholders. This included their introduction to the Affiliated Provider network, enhanced policy benefits and

planning for the introduction of the Low Claims Reward.

Choice

Choice is one of the reasons New Zealanders take out private health insurance. It provides them with the reassurance that they can access the specialist of their choice in the facility of their choice and, with most procedures, at a time that suits them. At the same time, we are providing Members with the ability to take price into account when deciding on a provider by forming a network of specialists, surgeons and facilities that have contracted to provide services at an agreed price. Making these procedures available via Affiliated Providers enables Southern Cross to facilitate choice for Members while managing adverse impacts on their premiums.

Our Affiliated Provider network has grown steadily, providing greater access to more treatments and procedures in more regions in New Zealand. We are pleased with the co-operative approach shown by the medical profession.

While many Members place value on the ability to access our Affiliated Provider network and the role it plays in keeping quality care affordable, we recognise that their choice of provider will always be a personal decision.

That is why we are also responding to Members' requests to explore other ways of ensuring health insurance premiums remain affordable without limiting their rights to choose their provider.

Ensuring charges are reasonable is one of various initiatives to help achieve this in the long term. It is a process that enables us to have discussions with health service providers where their estimates or fees appear to be outside the average charges for certain procedures on a like-for-like basis.

This is particularly important to Members who have shared cover policies and pay for a proportion of their treatment. Through our Prior Approval process we can identify any



(L to R) Peter Tynan (COO, Corporate Solutions), Lisa Gunnery (COO, Insurance Operations), Craig Morrison (COO, Members' Services), Louise Kerridge (COO, activa)



(L to R) Keith Jones (Group Secretary), Dr Ian McPherson (Group Chief Executive), Michael Boerson (Group CFO), Rachel Cunningham (General Counsel), Paul Regtien (GM-Group Marketing)

shortfall between the reimbursement provided in the policy and the estimated fees proposed.

Generally, when there is a considerable potential shortfall we are able to work with a provider to reduce or remove that shortfall for a Member's benefit. By applying focus in this area, we hope to have a positive long-term influence on claims costs and premiums, while respecting the right of providers to set their own fees.

Corporate

The New Zealand labour market has tightened considerably over the last few years, with shortages being experienced for both skilled and unskilled labour. Studies by the New Zealand Institute of Economic Research in 2004 reported that almost 48% of businesses were reporting difficulty in attracting skilled staff, while 29% were having difficulty finding unskilled staff.

These trends, along with concerns around rising health costs, are making subsidised health care an increasingly attractive benefit to assist businesses to recruit and retain staff. Studies

by Southern Cross show that 89% of employees are very or somewhat positive towards their employer as a result of subsidised health care and 65% indicate they are more likely to remain with an employer as a result of it.

The research shows the benefits extend well beyond employee sentiment, with insured employees accessing specialist treatment more quickly in times of illness and suffering from less stress at these times. As a result their productivity is less likely to be affected and they are less likely to suffer from negative impacts on their financial situation and lifestyle as a result of illness. Sickness absence is also lower among insured employees.

In line with these findings and with encouragement from our corporate customers, Southern Cross has established a Corporate Solutions unit specifically to help employers in managing their workforce health risk management issues.

Many of New Zealand's large employers choose to self-insure for their workplace injuries under the ACC Partnership Programme. This

allows them to proactively manage any employee's injuries occurring at work, helping their workers make sustainable recoveries and return to work quickly, thereby minimising productivity losses. The Corporate Solutions unit is actively developing business beyond our core health insurance offering through vehicles such as Care Advantage, our ACC claims and rehabilitation management company.

Corporate Solutions also creates additional value for employers through proactive programmes that promote workplace health and early intervention strategies such as co-ordinating employers' annual flu vaccination services or organising their staff health check programme.

The Southern Cross Medical Care Society is the preferred provider of subsidised and voluntary group schemes in the New Zealand workplace.

activa

During the year we developed an entirely new way for New Zealanders to manage their own health care better and gain improved value

from this spending. Called **activa**, this is New Zealand's first Health Management Account and was launched post balance date. It is a system designed specifically for New Zealanders but based on international trends in health funding where people are increasingly investing in maintaining their own good health.

activa combines an interest bearing account with a safety net health insurance plan and a package of additional options that all work together to assist New Zealanders in managing their health dollars better.

Our new subsidiary, Aactiva Health Limited and the **activa** product underlines our commitment to making quality health care more accessible and to assist New Zealanders in better controlling their health spending. Health management accounts are a popular option internationally and we expect **activa** will perform similarly. Since launch date we have more than

doubled the number of merchants accepting the card and customer take-up of the account is meeting budget expectations.

Positive Feedback

In a year where we have made outstanding progress, it is gratifying to receive positive feedback from our Members through a survey undertaken earlier this year. The survey, conducted with a random selection of Members, showed that they consider that our performance has improved year-on-year in important areas such as pricing, policies and our ability to make Members feel cared for and valued. This improvement has been reflected in a nine point gain in our overall loyalty index which increased to 72 points, a significant achievement. Members gave positive feedback on our service, including prompt payment and ranked our people as courteous and helpful. Our thanks to Members who took the time to participate in the survey which

we regard as a valuable tool for identifying how we can improve our performance in areas that matter to the Membership. My thanks to the very dedicated team at Southern Cross who serve you, our Members.

On behalf of the management team, I thank the Board for their continued support this year and all our employees for their contribution to an outstanding year. We look forward to continuing to serve our Members and contributing to better health for all New Zealanders.



Dr Ian McPherson
Group Chief Executive

Members gave positive feedback on our service, including prompt payment and ranked our people as courteous and helpful.

statement of corporate governance

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

Board of Directors

In accordance with its Rules, The Southern Cross Medical Care Society is governed by a Board of directors, the number and composition of which, is fixed from time-to-time by the Board.

To discharge its responsibilities the Board has established a process for the nomination, selection, and appointment of directors to fill casual vacancies, and for the operation of the Board, to ensure that the Board comprises directors with an appropriate range of qualifications and expertise. The Board reviews its performance and that of all directors on an annual basis.

When a Board vacancy exists, the Board, with the help of external consultants, selects a panel of candidates with appropriate qualifications taking into account the relevance of these qualifications to the Society's operations. The Board appoints the most suitable candidate who then stands for re-election at the next Annual General Meeting of Members.

The Directors in office as at 1 July 2005 are: Dr John R D Matthews (Chairman) Jeff G Todd CBE (Deputy Chairman), Bruce N Davidson, Dr Harley Gray, Dr Susan C Macken, David J May, Phillip J Meyer.

Board Responsibilities

The Board endorses the principles set out in the Best Practice Statements for directors, as approved and adopted by the Institute of Directors in New Zealand. The Board guides and monitors the business affairs of the Society on behalf of the Members.

The Board is responsible for identifying areas of significant business risk and ensuring arrangements are in place to adequately manage those risks. In addition, the Board ensures that the affairs of the Society adhere to regulatory obligations and to high ethical standards.

All directors register, and formally record, any conflicts of interest. Should a conflict of interest arise during the course of Board business the particular director involved takes no part in that discussion or the resulting decision.

Delegation Framework

The responsibility for the day-to-day operation and administration of the Society is delegated by the Board to the Group Chief Executive and the senior management team. The Board ensures that this group is appropriately qualified and experienced to discharge their responsibilities, and has in place procedures to assess the performance of the Group Chief Executive and the management team. The Board oversees the implementation by management of operating plans and budgets, and monitors key performance indicators and progress against budget.

Board Meetings

The Board meets formally on a scheduled monthly 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 at least twice yearly.

Committees

The Board has established a number of sub-committees that meet at predetermined intervals to oversee specific business aspects.

Audit Committee

This committee operates under a charter approved by the Board. The committee is accountable to the Board for recommending the appointment of the external and

internal auditors, directing and monitoring the audit function, and reviewing the adequacy and quality of an annual audit process.

The Audit Committee is also responsible for ensuring that requirements of the Society's Auditors are met, that the Society has an effective internal control framework, ascertaining that adequate procedures are in place to keep records in a manner which will enable them to be properly audited and that appropriate ethical standards are maintained.

The Audit Committee comprises Jeff G Todd (Chairman), Dr John R D Matthews and David J May.

Remuneration Committee

This committee is responsible for reviewing the remuneration and compensation of senior management of the Society, for overseeing staff remuneration policies in general and making recommendations to the Board. This committee operates under a charter approved by the Board.

This Remuneration Committee comprises Dr Susan C Macken (Chairman), Bruce N Davidson, Dr John R D Matthews, Phillip J Meyer.

Trustees

The Rules of The Southern Cross Medical Care Society provide for the appointment of three trustees. All property belonging to the Society vests in the trustees, who hold it in trust for the Members. The trustees, together with Mr David May, also act as the Investment Committee of the Board.

The Trustees in office as at the date of this statement are Bruce N Davidson, Dr John R D Matthews and Jeff G Todd.

Summary of Meetings

This can be found on page 11.

board of directors

Dr John Matthews

(BAGSC, MB, ChB, FRACP, FRCPA)

Chairman

Dr John Matthews has served on the Board since 1994 and as Chairman since June 2004. The Society's status as a not-for-profit organisation and the important role Southern Cross plays in New Zealand's health sector both attracted him to serve on the Board.

A clinical haematologist Dr Matthews' work has included the care and treatment of patients with leukaemia and allied conditions. This has given him excellent insights into the needs of patients and their concerns which he applies at Board level.

He is committed to ensuring the sustainability of affordable health insurance and Members' continued access to high quality health care.

Dr Matthews is Chairman of the University of Auckland School of Medicine Foundation Trust and a

with the public sector, the delivery of comprehensive, quality and affordable health care to all New Zealanders.

Mr Todd has a longstanding interest in health care and health research and also serves on the Boards of the Auckland Medical Research Foundation, the Goodfellow Foundation, Christian Healthcare Trust and the National Research Centre for Growth and Development based at the Liggins Institute.

He was invited to join the Board after a lengthy period of service with Price Waterhouse (now PricewaterhouseCoopers) where he was Managing Partner for New Zealand and the Pacific before retiring in 1998.

He is Chairman of NZ Guardian Trust, Gullivers Travel Group and Dynasty Hotel Group and a director of Sanfords. Mr Todd chairs the Southern Cross Audit Committee and has a particular interest in corporate governance.

in times of changing demographics and advances in health care delivery.

He is a member and Chairman of several charitable trust boards and was active in the establishment of community based hospices in the Auckland region and in the provision of shelter and care for the needy. A former partner of Minter Ellison Rudd Watts, he has served as the President of the Auckland District Law Society and as a Councillor and Vice President of the New Zealand Law Society.

Dr Harley Gray

(CNZM, ChM, MMedSc, FRACS)

A member of the Southern Cross Board since 2004, Dr Harley Gray was an eminent orthopaedic surgeon at Auckland's Middlemore Hospital until 2000.

Dr Gray, who was made a Companion of the New Zealand Order of Merit in 2003, says an important focus for him as a Director is the

Board of Directors (L to R)
Dr John Matthews (Chairman)
Jeff Todd CBE, Bruce Davidson
Dr Harley Gray, Dr Susan Macken
David May, Phillip Meyer



trustee of the University of Auckland Foundation. He is Chairman of Proacta, which is developing anti-cancer drugs. He has also served on the boards or councils of a number of medical, research and academic bodies.

Jeff Todd

CBE (BCom, FCA)

Deputy Chairman

Jeff Todd is a Chartered Accountant, has been a member of the Board since 1998 and Deputy Chairman since 2004. He joined the Board of Southern Cross because of his belief in the critical role of the Society in supporting,

Bruce Davidson

(LLM (HONS))

Bruce Davidson has served as a Director since 1989 and through his legal career has had an association with the Society going back to the early 1960s. He is now a Consultant and Company Director.

Mr Davidson believes that health insurance and health care services are best provided to the community through not-for-profit mutuals and charitable trusts which give members and the community affordable choices alongside the public health system. He says the values inherent in the South Cross Healthcare models remain valid

engagement of health professionals in quality assurance and cost containment in the private sector. He draws on his extensive medical and surgical experience to engage health professionals in these issues.

Dr Gray is a former President of the New Zealand Orthopaedic Association and the Auckland Medico Legal Society. He has served as Vice President of the Royal Australasian College of Surgeons, as a Director of Capital Coast Health and Chair of the Clinical Board and as Chief Medical Officer for South Auckland Health. He is current Secretary of South Kaipara Landcare and a member of the Institute of Directors.

Dr Susan Macken

(BSc, BCom, PhD)

Dr Macken, Company Director and Business Consultant, has served on the Board of Southern Cross since 1997.

A non-executive director of a number of companies including the Bank of New Zealand and leading reproductive services company, Fertility Associates Limited, Dr Macken also advises on corporate strategy and governance with a broad range of industries and companies.

She has held senior executive positions in major New Zealand corporates including Fletcher Challenge and the Blue Star Group and her previous directorships include Landcare Research, NZ Racing Industry Board, Hutt Valley Health, and NZ Trade Development Board.

Dr Macken is committed to ensuring the Society is a leader in efficiency and effectiveness so that private health care is accessible and affordable to as many New Zealanders as possible.

David May

(BSc (Hons), FIA, FIAA)

David May joined the Board in 2002, attracted by the opportunity to contribute his management and financial experience to the health sector. He forecasts rapid increases in demand for health services over the next 20 years and believes that a strong, adaptable private health sector will be vital in helping the public sector meet higher demand.

An actuary for 35 years, Mr May is Chairman of the Guardians of the New Zealand Superannuation Fund (NZSF) and Deputy Chairman of the New Zealand Government Superannuation Fund (GSF) Authority. He was the former Managing Director of the Colonial Group (NZ).

He says one of the most satisfying aspects of his Directorship has been working to ensure the Society's financial stability which played an important role in the introduction of the Founders Members Reward. He says challenges remain; first to manage the costs of welcome but often expensive technology advances and second, to ensure Members still enjoy affordable options for health cover.

Phillip Meyer

(FAIM, FNZIM)

Phillip Meyer joined the Board in 2002, seeing it as a way to contribute to improving the health of New Zealanders. He believes Southern Cross plays an important role in health care, reducing anxiety about major health needs and helping to give New Zealanders lasting reassurance about access to quality health care.

He has a long interest in health governance, triggered in part by the premature loss of family members in their 50s and has served on the Development Council of the Heart Research Institute and the Executive Business Council of the New South Wales Cancer Council.

He has served as a director of a number of Australian companies and is a member of the Disciplinary Tribunal of the Institute of Chartered Accountants in New Zealand, as well as the NZX Discipline committee. Mr Meyer is a Fellow of the Australian Institute of Management and the New Zealand Institute of Management and holds a certificate in Company Direction (NZ).



Summary of Meetings for Year Ended 30 June 2005

	Society Board Meetings	AGM	Strategic Workshops	Audit Committee	Remuneration Committee	Investment Committee
BN Davidson	13	1	5		4	4
Dr DH Gray	13	1	5			
Dr SC Macken	13	1	5		4	
Dr JRD Matthews	13	1	5	4	4	4
JG Todd	13	1	5	4		4
DJ May	13	1	5	4		4
PJ Meyer	13	1	5		4	

financial statements

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CONSOLIDATED STATEMENT OF FINANCIAL PERFORMANCE

For the year ended 30 June 2005

	Note	Group		Parent	
		2005	2004	2005	2004
		\$000	\$000	\$000	\$000
Premium Revenue	3	484,569	470,346	482,106	438,137
Direct Claims		378,560	381,413	376,835	356,894
Underwriting Surplus		106,009	88,933	105,271	81,243
Operating Expenses	4	68,052	56,671	60,254	57,281
Provision for Founding Members' Reward		26,000	–	26,000	–
Operating Surplus		11,957	32,262	19,017	23,962
Investment and Other Income	5	25,873	15,367	25,804	14,667
Goodwill Amortised	10	6,000	4,000	6,000	2,333
Net Surplus before Taxation		31,830	43,629	38,821	36,296
Taxation	6	(18)	540	–	–
Net Surplus		\$31,848	\$43,089	\$38,821	\$36,296

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY

For the year ended 30 June 2005

	Note	Group		Parent	
		2005	2004	2005	2004
		\$000	\$000	\$000	\$000
Net Surplus for the Year		31,848	43,089	38,821	36,296
Reserves at Start of Year		238,363	195,274	238,363	202,067
Reserves at End of Year		\$270,211	\$238,363	\$277,184	\$238,363

The accompanying Notes form part of these Financial Statements



CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2005

	Note	Group		Parent	
		2005 \$000	2004 \$000	2005 \$000	2004 \$000
Current Assets	7	340,067	318,444	345,925	316,198
Non Current Assets:					
Investments	8	107,959	78,847	107,959	78,847
Investment in Subsidiaries	9	–	–	1,258	1,688
Goodwill	10	6,000	12,000	6,000	12,000
Fixed Assets	11	16,111	14,548	16,111	14,548
		<u>130,070</u>	<u>105,395</u>	<u>131,328</u>	<u>107,083</u>
Total Assets		470,137	423,839	477,253	423,281
Current Liabilities	12	199,926	185,476	200,069	184,918
Net Assets		<u>\$270,211</u>	<u>\$238,363</u>	<u>\$277,184</u>	<u>\$238,363</u>
Reserves		<u>\$270,211</u>	<u>\$238,363</u>	<u>\$277,184</u>	<u>\$238,363</u>

For and on behalf of the Board

Dr J R D Matthews
CHAIRMAN

6-9-05

Date

J G Todd
DIRECTOR

6-9-05

Date

The accompanying Notes form part of these Financial Statements



CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June 2005

	Note	Group		Parent	
		2005	2004	2005	2004
		\$000	\$000	\$000	\$000
Cash Flows from Operating Activities					
Cash was provided from:					
Premium Revenue		481,223	472,660	478,713	446,330
Interest Received		26,098	20,712	26,459	19,902
Dividends Received		–	–	–	21,500
Assumption of Insurance Portfolio		–	–	–	7,381
Other Income		287	267	287	267
		507,608	493,639	505,459	495,380
Cash was applied to:					
Payment of Direct Claims		382,459	371,240	380,733	336,104
Payments to Employees		28,503	24,242	27,472	23,821
Payments to Suppliers		40,823	26,833	40,968	28,586
		451,785	422,315	449,173	388,511
Net Cash Flows from Operating Activities	16	55,823	71,324	56,286	106,869
Cash Flows from Investing Activities					
Cash was provided from:					
Sale of Fixed Assets		41	64	41	64
		41	64	41	64
Cash was applied to:					
Purchase of Fixed Assets		3,991	1,804	3,991	1,859
Purchase of Goodwill from Subsidiary		–	–	–	14,333
Investments (net)		52,057	73,082	52,408	92,182
		56,048	74,886	56,399	108,374
Net Cash Flows from Investing Activities		(56,007)	(74,822)	(56,358)	(108,310)
Net Increase/(Decrease) in Cash Held		(184)	(3,498)	(72)	(1,441)
Opening Cash Balance		1,951	5,449	1,723	3,164
Closing Cash Balance	7	\$1,767	\$1,951	\$1,651	\$1,723

The accompanying Notes form part of these Financial Statements



NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

1. STATEMENT OF ACCOUNTING POLICIES

Reporting Entity

The reporting entity is The Southern Cross Medical Care Society. The Group consists of The Southern Cross Medical Care Society and its subsidiaries, Southern Cross Health Services Limited, Southern Cross Healthcare Limited and Activa Health Limited. Activa Health Limited and Southern Cross Healthcare Limited had not traded prior to balance date.

Statutory Base

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

Measurement Base

The measurement base adopted is Historical Cost, except that the following assets are stated at Valuation: Land and Buildings, Investments and Investment in Subsidiaries.

Basis of Consolidation

The Group's financial statements consolidate the subsidiaries, using the purchase method. All significant intercompany transactions are eliminated on consolidation.

Accounts Receivable

Known losses for uncollectable premiums are written off against income in the year in which they become evident. In addition a general provision is made for unidentified uncollectable premiums.

Financial Instruments

Financial instruments carried on the Statement of Financial Position include cash on hand, current accounts in banks, accounts receivable, accounts payable and investments. These instruments are generally carried at their estimated fair value. The particular recognition methods adopted are disclosed in the individual policy statement associated with each item.

Fixed Assets and Depreciation

Fixed assets other than land and buildings are recorded at cost less accumulated depreciation. Depreciation is provided on a straight line basis. The depreciation rates in use are:

Motor Vehicles	20% per annum
Plant and Equipment	15-20% per annum
Computer Equipment	25-33% per annum
Computer Software	20-33% per annum
Leasehold Improvements	20% per annum

The land and buildings are integral to the Society's insurance activities and are therefore valued at net market values each year by an independent valuer. The adjustment in value has been recognised in the Statement of Financial Performance as required under FRS-35: Financial Reporting of Insurance Activities.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

1. STATEMENT OF ACCOUNTING POLICIES (Continued)

Foreign Currencies

Transactions denominated in a foreign currency are converted at the exchange rate at the date of the transaction. Foreign currency receivables and payables at balance date are translated at exchange rates current at balance date.

Goodwill

Goodwill (either arising on consolidation or purchased), representing the excess of the purchase consideration for Southern Cross Health Services Limited over the net tangible assets acquired, is recorded as an asset in the Statement of Financial Position. This asset is amortised through the Statement of Financial Performance on a straight line basis over the period during which benefits are expected to be derived, to a maximum of 5 years, subject to the Directors assessment of any impairment of value.

Impairment

The carrying value of each asset is assessed annually. Where the estimated recoverable amount of the asset is less than its carrying amount, the asset is written down. The impairment loss is recognised in the Statement of Financial Performance.

Income Recognition

Premium Revenue represents those members' contributions relating to the year under review. The premiums billed but relating to the following financial year are not included in revenue.

Investments

Investments are purchased with the intention of being held until maturity. Any differences between purchase price and face value are amortised over the term of the investment. Investments are revalued to net market values at balance date.

Investment in Subsidiaries

Investment in subsidiaries are stated at Directors valuation in the Parent's Statement of Financial Position.

Operating Leases

Payments made under operating leases are recognised in the Statement of Financial Performance on a basis representative of the pattern of benefits expected to be derived from the lease cost.

Provisions

The Provision for Outstanding Claims includes claims incurred but not reported, and claims reported but not yet paid. Refer to the Actuarial Report (Note 13) for the methodology adopted.

The Provision for Advance Revenue represents that portion of premiums billed in the current financial year for cover beyond balance date.

The Provision for Founding Members' Reward represents the value of future premium rebates, committed to members qualifying for this reward. This is a discount provided to members who joined the Society prior to 1982 and takes into account duration of membership.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

1. STATEMENT OF ACCOUNTING POLICIES (Continued)

Statement of Cash Flows

The following are the definitions of the terms used in the Statement of Cash Flows:

Operating activities include all transactions and other events that are not investing or financing activities.

Investing activities are those activities relating to the acquisition, holding and disposal of property, plant and equipment and of investments. Investments can include securities not falling within the definition of cash.

Cash is considered to be cash on hand and current accounts in banks, net of overdrafts.

As investments are held until maturity, and then reinvested, only the net purchase or matured amount is disclosed in the Statement of Cash Flows.

Taxation

No income tax is payable by the Society due to its status as a Friendly Society, however, income tax is payable by the subsidiary companies.

The tax expense charged to the Group Statement of Financial Performance includes both the current year's provision and the tax effects of timing differences calculated using the liability method.

Tax effect accounting has been applied on a comprehensive basis to all timing differences. A debit balance in the Deferred Tax account, arising from timing differences or tax losses, is only recognised if there is virtual certainty of realisation.

Changes in Accounting Policies

Other than the treatment of goodwill, there have been no changes in accounting policies during the year. All policies have been applied on bases consistent with previous years.

Amortisation of goodwill has been accelerated in the current year, reflecting the Directors' assessment of the impaired value of this asset. The carrying value of goodwill at 30 June 2004 is now being amortised on a straight line basis over the two years to 30 June 2006.

2. ASSUMPTION OF INSURANCE PORTFOLIO

On 1 December 2003, the health insurance portfolio of Southern Cross Health Services Limited was transferred to the Society. The relevant net assets of the Subsidiary were purchased at book value.

3. PREMIUM REVENUE

	Group		Parent	
	2005	2004	2005	2004
	\$000	\$000	\$000	\$000
Premium Revenue	483,799	468,496	481,346	437,067
Decrease in Provision for Uncollectable Premiums	770	1,850	760	1,070
	\$484,569	\$470,346	\$482,106	\$438,137



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

4. OPERATING EXPENSES

Operating Expenses include:	Group		Parent	
	2005 \$000	2004 \$000	2005 \$000	2004 \$000
Auditors Remuneration – Audit Fees	117	131	117	101
– Other	18	29	18	29
Depreciation – Computer Equipment	956	2,550	956	2,550
Depreciation – Computer Software	2,062	1,874	2,062	1,874
Depreciation – Plant and Equipment	294	373	294	338
Depreciation – Motor Vehicles	78	88	78	88
Directors Fees	280	280	280	280
Activa development and pre-launch costs	6,973	–	–	–
Rental of Premises	1,237	1,004	1,228	717
Revaluation of Fixed Assets	(1,000)	(310)	(1,000)	(310)
Change in Valuation of Investment in Subsidiary	–	–	430	5,767
Loss on Disposal of Fixed Assets	9	1	9	1
(Profit) on Disposal of Fixed Assets	–	(20)	–	(20)

5. INVESTMENT AND OTHER INCOME

	Group		Parent	
	2005 \$000	2004 \$000	2005 \$000	2004 \$000
Government, Local Body and other Public Stocks and Bonds	25,634	18,960	25,565	18,260
Movement in Valuation of Investments	(48)	(3,860)	(48)	(3,860)
Other Income	287	267	287	267
	\$25,873	\$15,367	\$25,804	\$14,667

6. TAXATION

	Group		Parent	
	2005 \$000	2004 \$000	2005 \$000	2004 \$000
Net Surplus before Tax	31,830	43,629	38,821	36,296
Surplus not assessable	(32,278)	(42,063)	(38,821)	(36,296)
	(448)	1,566	–	–
Expenditure not deductible for Tax	40	1,685	–	–
Timing Differences	(5)	(1,772)	–	–
	(413)	1,479	–	–
Tax Losses utilised	–	–	–	–
Surplus subject to taxation	(413)	1,479	–	–
Tax at 33%	–	488	–	–
Prior year under/(over)-provision	(18)	52	–	–
	(\$18)	\$540	–	–


NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

7. CURRENT ASSETS

	Group		Parent	
	2005 \$000	2004 \$000	2005 \$000	2004 \$000
Cash at Bank	1,767	1,951	1,651	1,723
Investments	291,490	269,251	290,940	268,351
Amounts Owed by Related Parties	241	2	241	5
Premium Accounts Receivable	38,841	43,229	38,841	43,229
Other Accounts Receivable	7,728	4,011	14,252	2,890
	\$340,067	\$318,444	\$345,925	\$316,198

8. INVESTMENTS

	Group		Parent	
	2005 \$000 Valuation	2004 \$000 Valuation	2005 \$000 Valuation	2004 \$000 Valuation
New Zealand Government Stock				
- Face Value	2,500	2,500	2,500	2,500
- Revaluation	50	85	50	85
- Unearned Premium	14	23	14	23
	2,564	2,608	2,564	2,608
State Owned Enterprise Bonds				
- Face Value	8,000	12,000	8,000	12,000
- Revaluation	(15)	94	(15)	94
- Unearned Premium	23	56	23	56
	8,008	12,150	8,008	12,150
Local Body Stock				
- Face Value	33,000	8,000	33,000	8,000
- Revaluation	34	61	34	61
- Unearned Premium	-	-	-	-
	33,034	8,061	33,034	8,061
Other Bonds				
- Face Value	93,000	101,000	93,000	101,000
- Revaluation	554	380	554	380
- Unearned Premium	(47)	39	(47)	39
	93,507	101,419	93,507	101,419
Bank Deposits / Commercial Paper	262,336	223,860	261,786	222,960
	\$399,449	\$348,098	\$398,899	\$347,198
Current Assets	291,490	269,251	290,940	268,351
Non-Current Assets	107,959	78,847	107,959	78,847
	\$399,449	\$348,098	\$398,899	\$347,198

All investments at 30 June 2005 are stated at their net market value as determined by Forsyth Barr Limited.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

9. INVESTMENT IN SUBSIDIARIES

	Group		Parent	
	2005	2004	2005	2004
	\$000	\$000	\$000	\$000
Opening Balance	-	-	1,688	28,955
Dividends Received	-	-	-	(21,500)
Change in Valuation	-	-	(430)	(5,767)
Closing Balance	-	-	\$1,258	\$1,688

10. GOODWILL

	Group		Parent	
	2005	2004	2005	2004
	\$000	\$000	\$000	\$000
Cost	45,162	45,162	14,333	14,333
Accumulated Amortisation	(37,162)	(33,162)	(6,333)	(2,333)
Change in Valuation	(2,000)	-	(2,000)	-
	\$6,000	\$12,000	\$6,000	\$12,000

11. FIXED ASSETS

	Group 2005		
	Cost/ Valuation \$000	Accumulated Depreciation \$000	Book Value \$000
Land	4,877	-	4,877
Buildings	3,201	-	3,201
Motor Vehicles	374	152	222
Plant & Equipment, Computer Equipment and Software	35,023	27,212	7,811
	\$43,475	\$27,364	\$16,111

	Group 2004		
	Cost/ Valuation \$000	Accumulated Depreciation \$000	Book Value \$000
Land	4,034	-	4,034
Buildings	2,866	-	2,866
Motor Vehicles	436	126	310
Plant & Equipment, Computer Equipment and Software	31,242	23,904	7,338
	\$38,578	\$24,030	\$14,548



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

	Parent 2005		
	Cost/ Valuation	Accumulated Depreciation	Book Value
	\$000	\$000	\$000
Land	4,877	–	4,877
Buildings	3,201	–	3,201
Motor Vehicles	374	152	222
Plant & Equipment, Computer Equipment and Software	35,023	27,212	7,811
	\$43,475	\$27,364	\$16,111

	Parent 2004		
	Cost/ Valuation	Accumulated Depreciation	Book Value
	\$000	\$000	\$000
Land	4,034	–	4,034
Buildings	2,866	–	2,866
Motor Vehicles	436	126	310
Plant & Equipment, Computer Equipment and Software	31,242	23,904	7,338
	\$38,578	\$24,030	\$14,548

The land and buildings at 30 June 2005 are stated at their net market value as determined by Telfer Young (Auckland) Ltd, an independent Registered Valuer.

12. CURRENT LIABILITIES

	Group		Parent	
	2005	2004	2005	2004
	\$000	\$000	\$000	\$000
Accounts Payable	9,259	9,538	9,182	9,032
Amounts Owed to Related Parties	–	76	275	76
Employee Entitlements	2,632	2,147	2,577	2,097
Provision for Outstanding Claims	96,429	100,329	96,429	100,327
Provision for Advance Revenue	64,591	67,026	64,591	67,026
Provision for Founding Members' Reward	26,000	–	26,000	–
Other Provisions	1,015	6,360	1,015	6,360
	\$199,926	\$185,476	\$200,069	\$184,918



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

13. ACTUARIAL REPORT

Estimates of the outstanding claims as at 30 June 2005 have been carried out by John Feyter B.Sc, a Fellow of the New Zealand Society of Actuaries. The calculation of the provision for outstanding claims complies with FRS-35: Financial Reporting of Insurance Activities and Professional Standard No. 4 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.

The methodology adopted is a projected payment per member method, based on recent claims experience and selected to achieve a sensible progression of past incurred claims. The methodology includes an allowance for claims incurred but not reported, unpaid reported claims and future administration expenses associated with paying claims. A prudential margin has been included to allow for the inherent uncertainty in determining a central estimate of the outstanding claims liability. Assumptions were:

- Monthly seasonality factors for claims incurred were calculated from historical data.
- Claims settlement expenses of 4% of the estimated claims.
- A prudential margin equal to 18% of the central estimate of the outstanding claims liability.
- Future claims inflation of 5% or 6% p.a. depending on the class of business.

Amounts were not discounted due to their short-term nature.

14. FINANCIAL INSTRUMENTS

Credit Risks

In the normal course of its business the Parent and the Group incur credit risk from health insurance operations and from investment in securities. There are no significant concentrations of credit risk. The Parent and the Group have a credit policy which is used to manage this exposure to credit risk. As part of this policy, limits on exposures have been set and are monitored on a regular basis.

The maximum exposure to credit risk at balance date is:

	Group		Parent	
	2005 \$000	2004 \$000	2005 \$000	2004 \$000
Bank Balances	1,767	1,951	1,651	1,723
Investments	399,449	348,098	398,899	347,198
Accounts Receivable	46,810	47,242	53,334	46,124

The above maximum exposures are net of any recognised provisions for losses on these financial instruments.

The Parent and the Group do not require any collateral or security to support financial instruments due to the quality of the organisations dealt with.

Fair Values

The carrying value of cash at bank, accounts receivable, and accounts payable is equivalent to fair value.

The carrying value of term investments at 30 June 2005 is equivalent to fair value, that being net market values as supplied by Forsyth Barr Limited.

Interest Rate Risk

As the Parent and the Group hold investments to maturity, there is no risk to the maturity value of investments due to fluctuations in market interest rates. Under FRS-35: Financial Reporting of Insurance Activities, unrealised gains and losses are reflected in the Statement of Financial Performance.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

Liquidity Risk

The maturity profile of the investments of the Group and Society are as follows:

	Group		Parent	
	2005 \$000	2004 \$000	2005 \$000	2004 \$000
On Call	22,637	19,582	22,087	18,682
0-6 months	251,930	226,380	251,930	226,380
7-12 months	16,923	23,288	16,923	23,288
1-2 years	15,606	22,967	15,606	22,967
2-3 years	21,006	15,749	21,006	15,749
3-5 years	41,323	31,926	41,323	31,926
Beyond 5 years	30,024	8,206	30,024	8,206
	\$399,449	\$348,098	\$398,899	\$347,198

The net Bank Balance is available on call. All premiums receivable are due within one month of balance date. All liabilities are payable within one year of balance date.

Foreign Currency Risk

The Society and the Group had assets of \$51,000 and liabilities of \$199,000 denominated in foreign currencies at 30 June 2005 (30 June 2004 assets of \$82,000 and liabilities of \$319,000).

15. RELATED PARTIES

Identity of Related Parties

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
Directors of Southern Cross Medical Care Society	Trustees of Southern Cross Health Trust
Southern Cross Health Trust ("Trust")	Related Party to Parent
Southern Cross Benefits Limited ("Benefits")	100% Subsidiary of Trust
First Health Limited ("First Health")	100% Subsidiary of Trust
GMV Associates Limited ("GMV")	100% Subsidiary of Benefits
Primehealth Limited ("Primehealth")	50% Associate of First Health

All these related entities have 30 June balance dates.

The Society and the Trust are separate legal entities operating at "arm's length". They work together in certain areas such as information technology and human resources, under fully costed service level agreements which dictate the expectations of each entity. The Society has purchased healthcare services from all providers, including the Trust, on a contestable and contractual basis.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

Types of Related Party Transactions

- The Society incurs administration costs for the Trust, which are reimbursed monthly. The administration costs reimbursed represent 3.5% of the Society's total administration costs (2004 5.6%).
- Until August 2003, the Society settled directly with the Trust the insured portion of members' hospital accounts, on behalf of members. The hospital accounts settled represented 1.0% of total Society claims in 2004.
- The Society charges Benefits a fee for enabling marketing opportunities to the membership. The fee charged represents 87.3% of the Society's other income (2004 84.3%).
- The Society has incurred costs totalling \$6,973,000 on behalf of Activa Health Limited that will be recovered in the 2005/06 financial year.

Related Party Receivable / (Payable) Balances

	2005	2004
	\$000	\$000
Trust with Society	176	(76)
Benefits with Society	65	–
First Health with Society	–	2
Health Services with Society	(275)	3

All related party balances are repayable on normal trading terms.

No related party balances have been written off or forgiven during the year.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

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

	Group		Parent	
	2005 \$000	2004 \$000	2005 \$000	2004 \$000
Net Surplus	31,848	43,089	38,821	36,296
Add/(Less) non-cash items:				
Depreciation	3,390	4,885	3,390	4,850
Asset Revaluation	(1,000)	(310)	(1,000)	(310)
Provision for Uncollectable Premium	(770)	(1,850)	(760)	(1,070)
Amortisation of Goodwill	6,000	4,000	6,000	2,333
Change in Valuation of Investment in Subsidiary	–	–	430	5,767
Amortisation of Investment Discount / Premium	655	1,148	655	1,099
<i>Add items classified as investing activities :</i>				
(Profit)/Loss on disposal of Fixed Assets	9	(19)	9	(19)
Dividends Received	–	–	–	21,500
Movement in Valuation of Investments	48	3,860	48	3,860
Add/(Less) movements in Working Capital items:				
Accounts Receivable	1,818	3,574	(5,852)	(5,944)
Accounts Payable	(495)	2,239	223	2,958
Other Provisions	(5,345)	3,360	(5,345)	3,360
Provision for Outstanding Claims	(3,900)	8,313	(3,898)	18,931
Provision for Advance Revenue	(2,435)	(965)	(2,435)	13,258
Provision for Founding Members Reward	26,000	–	26,000	–
Net Cash Flows from Operating Activities	\$55,823	\$71,324	\$56,286	\$106,869

17. PRINCIPAL ACTIVITY

The principal activity of the Society and the Group is the provision of health insurance.

18. CREDIT RATING

On 21 February 2005 Standard & Poor's affirmed Southern Cross Medical Care Society's Insurer Financial Strength Rating of A+.

19. ACTUARIAL INFORMATION

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 28 November 2001.

20. CAPITAL ADEQUACY

Solvency is assessed regularly using accepted calculation standards.

The current level of reserves is considered sufficient for the requirement of maintaining financial soundness.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2005

21. SEGMENTAL REPORTING

The Society and the Group operate in one industry and geographic segment, that is the provision of health insurance in New Zealand.

22. LEASE COMMITMENTS

At 30 June 2005 commitments under operating leases in respect of payments due to be made in the following years were:

	Group		Parent	
	2005 \$000	2004 \$000	2005 \$000	2004 \$000
Within 1 year	820	812	820	812
Between 1 and 2 years	628	600	628	600
Between 2 and 5 years	1,356	1,013	1,356	1,013
Greater than 5 years	187	–	187	–
	\$2,991	\$2,425	\$2,991	\$2,425

23. REMUNERATION OF DIRECTORS

Directors fees paid by the Parent for the year ended 30 June 2005 were as follows:

Director	Amount (\$)
B N Davidson	35,000
Dr D H Gray	35,000
Dr S C Macken	35,000
Dr J R D Matthews (Chairman)	70,000
D J May	35,000
P J Meyer	35,000
J G Todd	35,000

Trustee

B N Davidson
Dr J R D Matthews
J G Todd

The Parent 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 Directors receive health insurance cover.

24. CAPITAL COMMITMENTS

The Parent and the Group had capital commitments of \$87,000 as at 30 June 2005 (2004 Nil).

25. CONTINGENT LIABILITIES

The Parent and the Group had no contingent liabilities as at 30 June 2005 (2004 Nil).



BDO SPICERS
Chartered Accountants & Advisers

Audit Report to the Members of Southern Cross Medical Care Society and Subsidiary

We have audited the financial statements on pages 13 to 27. The financial statements provide information about the past financial performance and financial position of the Society and Group as at 30 June 2005. This information is stated in accordance with the accounting policies set out in Note 1.

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 2005 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; and
- whether the accounting policies are appropriate to the Society's 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.

Partners and employees of our firm are members of the Group on normal terms and conditions within the ordinary course of the Group's activities. The firm has no other interests in the Group.

Unqualified Opinion

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

In our opinion:

- proper accounting records have been kept by the Society as far as appears from our examination of those records; and
- the financial statements on pages 13 to 27.
 - comply with generally accepted accounting practice in New Zealand;
 - give a true and fair view of the financial position of the Society and Group as at 30 June 2005 and the results of their operations and cash flows for the year ended on that date.

Our audit was completed on 6 September 2005 and our unqualified opinion is expressed as at that date.

BDO Spicers
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Healthcare**

