



Southern Cross
Healthcare

your health is our business

The Southern Cross Medical Care Society
2006 Annual Report

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

2006



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Annual Report
For The Year Ended
30 June 2006

overview of the year

- The Southern Cross Medical Care Society is in a sound financial position. The reserves strengthened throughout the year to reach \$280.2 million and Standard and Poor's reconfirmed the Society's 'A+' claims paying ability rating in February 2006.
- The Society produced a surplus before goodwill of \$16 million, a result that compares favourably to budget, and a net surplus of \$10 million.
- These sound financial results were achieved during a year when premiums were held or reduced for the majority of members.
- It was particularly pleasing that the number of members grew by 7,359 to reach 808,369 by the end of the financial year.
- The Society earned \$472 million in premiums and returned \$398 million to Members through payment of claims.
- The Activa health management account was launched attracting interest from corporates looking for an alternative health care benefit for staff.



chairman's report

Dr John Matthews Chairman of the Board

The health system in New Zealand is facing considerable challenges.

On the one hand, New Zealanders expect that the public system should provide the care they need, when they need it, but on the other, they do not want to see higher taxes or funds diverted from other areas, such as education, to provide the level of access they expect.

There are no simple answers, with politicians and policymakers the world over grappling with the rising cost of health care, rising expectations and, in many cases, an ageing population. Increasingly

compromises are having to be made. We are seeing budgets prioritised and the realisation coming through that the public health system simply cannot meet everyone's needs, especially in areas such as elective surgery.

These trends are being reflected in the private health sector in New Zealand. In the year to June 30, 2006, the amount paid in claims for private health care reached a new record of \$565 million, an increase of \$48 million on the prior year.

Claims by Southern Cross Medical Care Society, as the largest private health insurer, represented 71%.

These rising values reflect two facts; more people are claiming for private care and the cost of that care is increasing.

The increase in the number of people claiming means our Members are getting what they expect from their Society - access to treatment when they need it, even though the cost of that treatment has continued to rise year-on-year.

For the Society this year, our most pressing priority has been to ensure that we can continue to serve our Members well in an increasingly pressured health care environment.

Premiums

With 808,369 Members looking to us to cover their health, particularly with respect to elective surgery, Southern Cross is acutely aware of the need to ensure that the cost of this cover remains as affordable as possible, for as long as possible.

In the past year, Southern Cross' health insurance premiums for around 80% of our Members either decreased or stayed the same. The introduction of an ongoing Low Claims Reward Scheme and a two-year Founding Members Reward, provided a total savings of \$35 million for Members.

We remained focused on maintaining premium affordability and this appears to have contributed to growth in Southern Cross' membership over the past 12 months. Member numbers in the 65 plus age group have grown by 5,049 (6%) to reach 88,715. This is a pleasing trend and suggests that Southern Cross membership remains affordable for our senior members, despite a need to move away from cross-subsidisation between age groups.

Our ability to keep premiums affordable is directly linked to our status as a not-for-profit Friendly Society. We are not here to

make a profit to be returned to shareholders. We are here to achieve a responsible balance between what we earn by way of premiums and what we pay by way of claims.

The Society must continually consider claiming trends and costs alongside premiums.

Our analysis showed that medical procedures have become significantly more expensive, with medical inflation running at 8.5% per annum (comprising 5.9% of cost inflation, 2.4% greater than CPI of 3.5% and 2.6% due to increased utilisation).

As a result, the Society needed to increase premiums for the 2006/07 financial year. With base premium increases held to an average of 6.5% and claims cost escalation of 8.5%, Southern Cross has kept premium increases to the minimum level. The base rate increases we announced in May 2006 ranged from 3.5% to 17% depending on a Member's age and plan type. Taking into consideration all of the factors that affect Members' premiums this means some 64% of Members will get net increases of 10% or less, or an average \$2 per week, but 11% will get net increases of 20% or more, with the largest increase affecting people moving into the 65+ age band. Their increases will average \$10 a week.

We understand that affordability of health care is a real concern for many of our older Members. Almost one in three (29%) of our older Members claims for an operation each year. They are relying on us to help them access and pay for the elective care needed to resolve health problems that are affecting their quality of life.

However, the unfortunate fact is that premiums for health have to reflect risk in each age band in much the same way as premiums for other forms of insurance also reflect age-related risks. An older person, for example, will pay lower premiums for car insurance than a driver under the age of 25 because they are statistically safer drivers.

Health insurers in New Zealand price their policies according to relative risk-in accordance with the pricing guidelines developed by the Society of Actuaries and the Human Rights Commission.

In some countries, such as Australia, health insurers are on an equal footing competitively because they are required by legislation to spread risk across the groups of people they insure. This means younger people pay more and older people less. Such legislation is generally supported by tax incentives.

In the absence of such legislation, the Society must do what it can to keep health insurance affordable for as long as possible for our older Members. This year, we took our concerns about rising costs to Government, reasoning that the public system faces the same inflationary pressures as the private system and a collaborative approach was needed to find some solutions.

One proposal made on behalf of the Society and our Members, was that Government consider targeted subsidies for older people on fixed incomes with health insurance. Unfortunately, the Government was not receptive.

Nonetheless, we believe it is important for us to encourage Government to take a more collaborative approach. It is clear that the health budget cannot meet current or future demand and the corollary of this is that New Zealanders will be paying for more of their health care from their own pockets. More transparency around what will be funded by the state and what will not is important as it will allow people to make informed decisions.

Results

Our decision not to increase premiums for around 80% of our Members is directly reflected in our financial result. The Society also achieved a surplus before goodwill of \$16 million. We also achieved a modest surplus of

\$10 million compared to net surplus of \$31.8 million in the prior year. We have maintained our financial stability, with reserves now standing at \$280.2 million.

Our accounts this year show a write down relating to the research, technology and development costs in our subsidiaries associated with Activa. This, we believe, is a prudent treatment, given that the business is in its early stages.

Further information on our accounts is provided in the Group Chief Executive's report.

Acknowledgements

The Board and I thank Dr Ian McPherson and his management team for their professionalism during the year. They have demonstrated a continued commitment to ensuring that premiums remain as affordable as possible for our Members and

that the Society continues to improve the level of service we provide.

My thanks go to the Board for their governance support this year and their willingness to commit to additional demands on their time and expertise. In particular I would like to thank and acknowledge the considerable input of retiring director Bruce Davidson and to welcome Carole Durbin to the Board. Thanks must also be extended to medical professionals and service providers for their support. Finally, our thanks to our Members for your continued loyalty.



Dr John Matthews
Chairman



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

**Southern Cross
Medical Care Society
has had a good year
financially in 2005/06,
both compared to
budget and to the
previous year.**

As a not-for-profit, our priorities are clear. First to ensure we provide the best cover at the most affordable price and second, to manage the business responsibly to ensure it remains financially stable and sustainable.

It is good to report we have achieved both.

During the year, we continued to make progress on our ongoing review of our policies and benefits, taking every opportunity to improve our services. Medical insurance isn't like house or life insurance. It has to be reviewed constantly to ensure advances in medicine are assessed and reflected as appropriate.

Increases in cover can sometimes be overshadowed when premium rises are announced, as they were at the end of this year as a result of claims costs. However it is important to note that the enhancements made in cover over the last three years are ensuring our policies

The Society earned \$472 million in premiums and returned \$398 million to Members through payment of claims.

Our ability to hold premiums has a direct relationship with claims costs. Throughout the financial year, we saw claims costs continue to increase.

Among our older Members, the number of claims made and the amount claimed also increased. Claims from Members aged 55 and above increased by an average 9.6% over the previous year.

This is very much in line with national trends, with the Health Funds Association of New Zealand particularly noting that dollar value of claims for the over 65 age group have doubled in the last six years.

Our net result before goodwill of \$16 million compares favourably to budget. After meeting the higher cost of claims, the Society achieved a modest surplus of \$10 million.



group chief executive's report

Dr Ian McPherson Group Chief Executive

remain good value for money.

Total overheads for the Southern Cross Medical Care Society increased by 8% on the previous year, reflecting the costs associated with our subsidiary Activa. Excluding the impact of Activa, overheads for the health insurance business reduced on a like-for-like basis by \$1.136 million or 2%. This translates to a reduction in the overhead cost per member from \$76.06 to \$74.90 over the last year, a good result given growing Membership levels during the year.

Reserves are now at \$280.2 million, an increase of \$10 million on the prior year, a very healthy position confirming the financial stability of the Society.

Members will note that in our accounts this year, the Society shows a provision for Unexpired Risk Reserve of \$12.6 million. This Provision for Unexpired Risk represents a deficiency of premium income in respect of policies in force at balance date, through to the next renewal date of such policies. A deficiency exists where future

premiums are exceeded by expected claims and expenses.

Meeting New Zealanders' Needs

New Zealanders are being expected to pay out of their own pockets for more and more of their health expenses. This reflects that we have a public system which will always have difficulty balancing its responsibilities and supply with the demand. Despite increases in government funding, this tension will always be there, with higher demand leading to the need for higher funding.

Studies by Treasury, for example, predict that by 2050, total health spending will account for 10.8% of GDP, while some estimates are significantly higher. This represents a problem for New Zealand given the significant sums we already commit to public health care.

One of the influences on the need for steadily increasing funding

is that New Zealanders are living longer so demand for care in later life is increasing, along with the costs of that care.

At the same time, the public health budget has to cover a very wide portfolio of care, from preventative measures such as immunisation and education through to complex and costly trauma medicine.

Difficult decisions will always have to be made about the best use of public health funds and these decisions will inevitably have an impact on the lives of individual New Zealanders. In the past year, it has become increasingly clear that our health system simply cannot meet everyone's needs, particularly for elective surgery.

This realisation is reflected in New Zealand health insurance trends and in the Society's own experience.

For the Society, that has translated into a Membership increase of 7,359

for the year under review. Most of this increase is in surgical and specialist policies - those which provide cover primarily for specialists and hospitalisation - with most people opting to pay directly for the day-to-day health costs.

The growth we achieved this year is pleasing, but we recognise not all New Zealanders see the need for "traditional" health insurance. Younger people, for example, often see no need for it, yet they spend considerable amounts on staying healthy.

Activa

Activa, as a first for New Zealand, required an up front investment from us to develop technology and other capabilities from the ground up so that we could provide more New Zealanders with health care solutions.

Research last year indicated that New Zealanders pay for around \$2.2 billion worth of health care out of their own pockets. This includes



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

everything from regular dental checks and GP's visits to over the counter and prescribed pharmaceuticals, a sum which averages out at \$1,500 for individuals and \$2,200 for families.

We introduced the Activa health management account as a way of adding value to this spending. This was done by creating a network of health partners to provide cardholders with either something extra, or discounts on standard prices. The Activa account also provided the opportunity for people to put money aside into an interest-bearing account to cover health care and, if they want, to add optional insurance cover.

Our accounts show that the Society has written-off investments in subsidiaries. \$20 million of this relates to the research, technology and development costs for establishing Activa - costs funded from investment capital, not premiums.

Health management accounts have had considerable growth internationally. However, we have found the pick-up among individual New Zealanders considerably less than we expected. Perhaps this is a reflection of our generally poor savings habits.

However, helping to offset this has been Activa's appeal in the corporate market. With the compulsory introduction of four weeks' annual leave in 2007, many corporates have begun to look for alternative ways to provide benefits for staff, particularly those already enjoying four weeks' leave. Activa provides an ideal solution. It enables corporates to provide staff with a benefit which promotes good health, but is also very flexible in that the recipient can use money deposited in the Activa account for a variety of personal or family health needs.

As a result of this interest we have aligned the business towards the corporate market. This is enabling resourcing and financial efficiencies. For example, the sales process is simpler because rather than dealing

with a number of private individuals, we can focus on one corporate executive in each company to secure a number of Activa members through one contract.

The corporate interest is exciting but it is early days yet. When you break new ground, you cannot expect success overnight. We are monitoring progress closely.

Southern Cross's investment in Activa has equipped the Society to take a step forward with our services to Members. For example, we are now piloting technologies which have the potential to lead to greater operational efficiencies - which will benefit all of our Members. We do need to continue to look for innovative and alternative ways of making health care affordable, in order to sustain the business long-term and attract young customers.

Member Survey

Our success depends on our listening to the views of our Members. We achieve this through our annual Member survey, through our annual Member briefings and more informally through phone calls, letters and emails. We take all comments and complaints seriously and do our best to respond promptly and courteously.

Regular contact with our Members enables us to improve our services to meet their needs and we review progress by asking Members to comment on performance in our annual survey. We received positive feedback on our service, including prompt payment and it is pleasing to see our people are regarded as courteous and helpful.

Acknowledgements

My thanks to the very dedicated team at Southern Cross who helped us achieve the result discussed in this report. On behalf of the management team, I thank the Board for its wisdom and considerable time commitment 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 in what will be an exciting future.



Dr Ian McPherson
Group Chief Executive

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 2006 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 Code of Proper Practice 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.

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 trustee of the University of Auckland Foundation. He has also served on the boards or councils of a number of medical, research, academic and corporate organisations.

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, 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 Pricewaterhouse Coopers) 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 deputy Chairman of Sanfords. Mr Todd chairs the Southern Cross Audit Committee and has a particular interest in corporate governance.

Carole Durbin

Ms Carole Durbin was appointed as a Director of Southern Cross Board on 1 August 2006, filling a vacancy created by the retirement of Mr Bruce Davidson.

Ms Durbin is the current Chair of electricity generator Mighty River Power and retailer Mercury Energy which supplies over 600,000 people. She is also Chair of the Legal Services Agency. She is a Commissioner for the Earthquake Commission and since 2004 has been a director of Fidelity Life, the largest New Zealand-owned life, personal protection and business assurance operation in the country. She believes that her governance experience will be of value to Southern Cross in its endeavours to protect and improve the health of so many New Zealanders.

A consultant to Simpson Grierson, one of New Zealand's leading legal firms, Carole Durbin has also held a number of previous Board appointments including Simpson Grierson, Transpower NZ Ltd and software developer Synergy International Ltd.

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 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 Susan 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)

Mr 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.

A qualified actuary, 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, AF Inst D)

Mr 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 is an experienced company director and investment banker. He is Chairman of Australian Financial Services Group and New Zealand Institute of Management, Central Inc., a Director of Wellington Zoo Trust, Transmission Holdings Limited, Wellington Regional Orchestra Foundation Inc., New Zealand Institute of Management Inc., Enterprise New Zealand Trust, a member of the Disciplinary Tribunal of the Institute of Chartered Accountants of NZ and NZX Discipline and has served on the Development Council of the Heart Research Institute (Australia) and the Executive Business Council of the New South Wales Cancer Council.

Summary of Meetings for Year Ended 30 June 2006

| | Society Board Meetings | AGM | Strategic Workshops | Audit Committee | Remuneration Committee | Investment Committee |
|-----------------|-------------------------------|------------|----------------------------|------------------------|-------------------------------|-----------------------------|
| BN Davidson | 8 | 1 | 3 | | 6 | 3 |
| Dr DH Gray | 8 | 1 | 3 | | | |
| Dr SC Macken | 8 | 1 | 3 | | 6 | |
| Dr JRD Matthews | 8 | 1 | 3 | 3 | 5 | 2 |
| JG Todd | 8 | 1 | 3 | 4 | | 3 |
| DJ May | 8 | 1 | 3 | 4 | | 3 |
| PJ Meyer | 8 | 1 | 3 | | 6 | |

financial statements

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CONSOLIDATED STATEMENT OF FINANCIAL PERFORMANCE

For the year ended 30 June 2006

| | Note | Group | | Parent | |
|--|------|----------|----------|----------|----------|
| | | 2006 | 2005 | 2006 | 2005 |
| | | \$000 | \$000 | \$000 | \$000 |
| Premium Revenue | | 471,906 | 482,844 | 470,751 | 482,106 |
| Direct Claims Expense | 2 | 410,940 | 376,835 | 409,895 | 376,835 |
| Underwriting Surplus | | 60,966 | 106,009 | 60,856 | 105,271 |
| Operating Expenses | 3 | 73,338 | 68,052 | 79,152 | 60,254 |
| Provision for Founding Members' Reward | | – | 26,000 | – | 26,000 |
| Operating Surplus/(Deficit) | | (12,372) | 11,957 | (18,296) | 19,017 |
| Investment and Other Income | 4 | 28,388 | 25,873 | 28,342 | 25,804 |
| Goodwill Amortised | 9 | 6,000 | 6,000 | 6,000 | 6,000 |
| Net Surplus before Taxation | | 10,016 | 31,830 | 4,046 | 38,821 |
| Taxation | 5 | – | (18) | – | – |
| Net Surplus | | \$10,016 | \$31,848 | \$4,046 | \$38,821 |

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY

For the year ended 30 June 2006

| | Note | Group | | Parent | |
|----------------------------------|------|-----------|-----------|-----------|-----------|
| | | 2006 | 2005 | 2006 | 2005 |
| | | \$000 | \$000 | \$000 | \$000 |
| Net Surplus for the Year | | 10,016 | 31,848 | 4,046 | 38,821 |
| Reserves at Start of Year | | 270,211 | 238,363 | 277,184 | 238,363 |
| Reserves at End of Year | | \$280,227 | \$270,211 | \$281,230 | \$277,184 |

The accompanying Notes form part of these Financial Statements




CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2006

| | Note | Group | | Parent | |
|----------------------------|------|------------------|------------------|------------------|------------------|
| | | 2006 | 2005 | 2006 | 2005 |
| | | \$000 | \$000 | \$000 | \$000 |
| Current Assets | 6 | 286,660 | 340,067 | 290,697 | 345,925 |
| Non Current Assets: | | | | | |
| Investments | 7 | 152,044 | 107,959 | 152,044 | 107,959 |
| Investment in Subsidiaries | 8 | - | - | 787 | 1,258 |
| Goodwill | 9 | - | 6,000 | - | 6,000 |
| Fixed Assets | 10 | 20,647 | 16,111 | 16,661 | 16,111 |
| | | <u>172,691</u> | <u>130,070</u> | <u>169,492</u> | <u>131,328</u> |
| Total Assets | | 459,351 | 470,137 | 460,189 | 477,253 |
| Current Liabilities | 11 | 179,124 | 199,926 | 178,959 | 200,069 |
| Net Assets | | <u>\$280,227</u> | <u>\$270,211</u> | <u>\$281,230</u> | <u>\$277,184</u> |
| Reserves | | <u>\$280,227</u> | <u>\$270,211</u> | <u>\$281,230</u> | <u>\$277,184</u> |

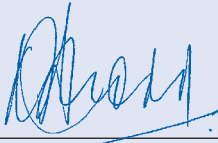
For and on behalf of the Board



 5-9-06

 Date

Dr J R D Matthews
CHAIRMAN



 5-9-06

 Date

J G Todd
DIRECTOR

The accompanying Notes form part of these Financial Statements


CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June 2006

| | Note | Group | | Parent | |
|---|------|---------|----------|----------|----------|
| | | 2006 | 2005 | 2006 | 2005 |
| | | \$000 | \$000 | \$000 | \$000 |
| Cash Flows from Operating Activities | | | | | |
| Cash was provided from: | | | | | |
| Premium Revenue | | 458,087 | 481,223 | 456,932 | 478,713 |
| Interest Received | | 26,235 | 26,098 | 26,191 | 26,459 |
| Other Income | | 280 | 287 | 280 | 287 |
| | | 484,602 | 507,608 | 483,403 | 505,459 |
| Cash was applied to: | | | | | |
| Payment of Direct Claims | | 410,067 | 382,459 | 409,022 | 380,733 |
| Payments to Employees | | 31,474 | 28,503 | 28,640 | 27,472 |
| Payments to Suppliers | | 38,274 | 40,823 | 25,895 | 40,968 |
| | | 479,815 | 451,785 | 463,557 | 449,173 |
| Net Cash Flows from Operating Activities | 15 | 4,787 | 55,823 | 19,846 | 56,286 |
| Cash Flows from Investing Activities | | | | | |
| Cash was provided from: | | | | | |
| Sale of Fixed Assets | | 74 | 41 | 74 | 41 |
| | | 74 | 41 | 74 | 41 |
| Cash was applied to: | | | | | |
| Purchase of Fixed Assets | | 8,136 | 3,991 | 3,032 | 3,991 |
| Investment in Subsidiaries | | – | – | 20,000 | – |
| Investments (net) | | (2,587) | 52,057 | (2,137) | 52,408 |
| | | 5,549 | 56,048 | 20,895 | 56,399 |
| Net Cash Flows from Investing Activities | | (5,475) | (56,007) | (20,821) | (56,358) |
| Net Increase/(Decrease) in Cash Held | | (688) | (184) | (975) | (72) |
| Opening Cash Balance | | 1,767 | 1,951 | 1,651 | 1,723 |
| Closing Cash Balance | 6 | \$1,079 | \$1,767 | \$676 | \$1,651 |

The accompanying Notes form part of these Financial Statements



NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006

1. STATEMENT OF ACCOUNTING POLICIES

Reporting Entity

The reporting entity is The Southern Cross Medical Care Society (the "Parent"). 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. Southern Cross Healthcare Limited has not traded.

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, with the following exceptions : Land and Buildings, and Investments are stated at net market value, and Investment in Subsidiaries at Directors' valuation.

Basis of Consolidation

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

Accounts Receivable

Known losses for uncollectable premiums are written off against premium revenue 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 carried at their net market 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 | 15-20% 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.

Costs incurred on assets prior to their being ready for use are recorded as work in progress. Work in progress is not depreciated until the asset is in use.

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.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

1. STATEMENT OF ACCOUNTING POLICIES (Continued)

Goodwill

Goodwill (either arising on consolidation or purchased), representing the excess of the purchase consideration for subsidiary companies 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 current financial year. The premiums billed but relating to the following financial year are not included in premium 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. All investments are integral to the Group's insurance business. Accordingly, they are revalued to net market values at balance date, with any valuation changes recorded in the Statement of Financial Performance.

Investment in Subsidiaries

Investment in subsidiaries is stated at the 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 Note 12 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 in 2005 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.

The Provision for Unexpired Risk represents any deficiency of premium income in respect of policies in force at balance date, through to the next renewal date of such policies. A deficiency exists where future premiums are exceeded by expected claims and expenses. Where a premium deficiency exists, any Deferred Acquisition Costs are first written down to zero. Provision is then made for any remaining deficiency. Refer to Note 12 for the methodology adopted.

All Provisions are classified as Current Liabilities. Due to the short-term nature of the liabilities, any amounts falling due beyond one year are not significant.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

1. STATEMENT OF ACCOUNTING POLICIES (Continued)

Deferred Acquisition Costs

Acquisition costs, incurred in obtaining insurance policies that will give rise to premium revenue in subsequent reporting periods, are recognised as an asset. The asset is amortised systematically over the reporting periods expected to benefit from the policies acquired.

Where there is a premium deficiency, the balance of Deferred Acquisition Costs is written down to their recoverable amount.

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.

Financing activities are those activities relating to changes in equity and debt capital, and to servicing the equity capital.

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 Parent 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.

Comparative Figures

Certain comparative figures have been reclassified to ensure consistency with the current year's classifications and disclosures. None of these reclassifications have had an impact on the previous year's result.

Changes in Accounting Policies

There have been no changes in accounting policies during the year. All policies have been applied on bases consistent with previous years.

2. DIRECT CLAIMS EXPENSE

| | Group | | Parent | |
|--|-----------|-----------|-----------|-----------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$000 | \$000 | \$000 | \$000 |
| Direct Claims Expense | 398,335 | 376,835 | 397,290 | 376,835 |
| Movement in Provision for Unexpired Risk | 12,605 | – | 12,605 | – |
| | \$410,940 | \$376,835 | \$409,895 | \$376,835 |

Claims are predominantly short-term in nature, and settled within twelve months of being incurred. Accordingly, any development on claims is normally limited to the year in which the claim event occurred and the year following. Any reassessment of the risks borne in the previous reporting period is not considered material and therefore not reported.

Provision for Unexpired Risk – refer Note 12.


NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

3. OPERATING EXPENSES

| Operating Expenses include: | Group | | Parent | |
|---|---------------|---------------|---------------|---------------|
| | 2006 \$000 | 2005 \$000 | 2006 \$000 | 2005 \$000 |
| Auditors Remuneration – Audit Fees | 119 | 117 | 119 | 117 |
| – Other (previous auditor) | 34 | 18 | 34 | 18 |
| Depreciation – Motor Vehicles | 92 | 78 | 91 | 78 |
| Depreciation – Furniture, Fittings and Office Equipment | 332 | 294 | 313 | 294 |
| Depreciation – Computer Equipment | 1,409 | 956 | 1,283 | 956 |
| Depreciation – Computer Software | 2,886 | 2,062 | 1,914 | 2,062 |
| Depreciation – Leasehold Improvements | 139 | – | 139 | – |
| Directors Fees | 362 | 280 | 362 | 280 |
| Activa development and pre-launch costs | – | 6,973 | – | – |
| Rental of Premises | 1,575 | 1,237 | 1,552 | 1,228 |
| Amortisation of Deferred Acquisition Costs | 1,216 | 947 | 1,216 | 947 |
| Deferred Acquisition Costs written down | 5,733 | 4,465 | 5,733 | 4,465 |
| Revaluation of Fixed Assets | (1,323) | (1,000) | (1,323) | (1,000) |
| Change in Valuation of Investment in Subsidiaries | – | – | 20,471 | 430 |
| (Profit)/Loss on Disposal of Fixed Assets | (8) | 9 | (8) | 9 |

4. INVESTMENT AND OTHER INCOME

| | Group | | Parent | |
|---|-----------------|-----------------|-----------------|-----------------|
| | 2006 \$000 | 2005 \$000 | 2006 \$000 | 2005 \$000 |
| Income from Fixed Interest and Cash Investments | 29,059 | 25,634 | 29,013 | 25,565 |
| Unrealised Movement in Valuation of Investments | (951) | (48) | (951) | (48) |
| Other Income | 280 | 287 | 280 | 287 |
| | <u>\$28,388</u> | <u>\$25,873</u> | <u>\$28,342</u> | <u>\$25,804</u> |

5. TAXATION

| | Group | | Parent | |
|--------------------------------------|---------------|---------------|---------------|---------------|
| | 2006 \$000 | 2005 \$000 | 2006 \$000 | 2005 \$000 |
| Net Surplus before Tax | 10,016 | 31,830 | 4,046 | 38,821 |
| Surplus not assessable | (31,490) | (32,278) | (4,046) | (38,821) |
| | (21,474) | (448) | – | – |
| Expenditure not deductible for Tax | 34 | 40 | – | – |
| Timing Differences | 172 | (5) | – | – |
| | (21,268) | (413) | – | – |
| Tax Losses utilised | – | – | – | – |
| Deficit (tax losses carried forward) | (21,268) | (413) | – | – |
| Tax at 33% | – | – | – | – |
| Prior year under/(over)-provision | – | (18) | – | – |
| | – | (\$18) | – | – |


NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

6. CURRENT ASSETS

| | Group | | Parent | |
|---------------------------------|------------------|------------------|------------------|------------------|
| | 2006 \$000 | 2005 \$000 | 2006 \$000 | 2005 \$000 |
| Cash at Bank | 1,079 | 1,767 | 676 | 1,651 |
| Investments | 244,544 | 291,490 | 244,444 | 290,940 |
| Amounts Owed by Related Parties | 295 | 241 | 5,221 | 241 |
| Premium Accounts Receivable | 34,514 | 38,841 | 34,514 | 38,841 |
| Deferred Acquisition Costs | - | - | - | - |
| Other Accounts Receivable | 6,228 | 7,728 | 5,842 | 14,252 |
| | \$286,660 | \$340,067 | \$290,697 | \$345,925 |

7. INVESTMENTS

| | Group | | Parent | |
|--|----------------------------|----------------------------|----------------------------|----------------------------|
| | 2006 \$000 Valuation | 2005 \$000 Valuation | 2006 \$000 Valuation | 2005 \$000 Valuation |
| New Zealand Government Stock | | | | |
| - Face Value | 2,500 | 2,500 | 2,500 | 2,500 |
| - Revaluation | 4 | 50 | 4 | 50 |
| - Unearned Premium | 4 | 14 | 4 | 14 |
| | 2,508 | 2,564 | 2,508 | 2,564 |
| State Owned Enterprise Bonds | | | | |
| - Face Value | 6,000 | 8,000 | 6,000 | 8,000 |
| - Revaluation | (45) | (15) | (45) | (15) |
| - Unearned Premium | 7 | 23 | 7 | 23 |
| | 5,962 | 8,008 | 5,962 | 8,008 |
| Local Body Stock | | | | |
| - Face Value | 16,000 | 33,000 | 16,000 | 33,000 |
| - Revaluation | (78) | 34 | (78) | 34 |
| - Unearned Premium | - | - | - | - |
| | 15,922 | 33,034 | 15,922 | 33,034 |
| Other Bonds | | | | |
| - Face Value | 152,000 | 93,000 | 152,000 | 93,000 |
| - Revaluation | (450) | 554 | (450) | 554 |
| - Unearned Premium | (183) | (47) | (183) | (47) |
| | 151,367 | 93,507 | 151,367 | 93,507 |
| Bank Deposits, Commercial Paper and Floating Rate Notes | 220,829 | 262,336 | 220,729 | 261,786 |
| | \$396,588 | \$399,449 | \$396,488 | \$398,899 |
| Current Assets | 244,544 | 291,490 | 244,444 | 290,940 |
| Non-Current Assets | 152,044 | 107,959 | 152,044 | 107,959 |
| | \$396,588 | \$399,449 | \$396,488 | \$398,899 |



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

8. INVESTMENT IN SUBSIDIARIES

| | Group | | Parent | |
|------------------------|-------|-------|----------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$000 | \$000 | \$000 | \$000 |
| Opening Balance | – | – | 1,258 | 1,688 |
| Investment during year | – | – | 20,000 | – |
| Change in Valuation | – | – | (20,471) | (430) |
| Closing Balance | – | – | \$787 | \$1,258 |

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

9. GOODWILL

| | Group | | Parent | |
|--------------------------|----------|----------|----------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$000 | \$000 | \$000 | \$000 |
| Cost | 45,162 | 45,162 | 14,333 | 14,333 |
| Accumulated Amortisation | (45,162) | (39,162) | (14,333) | (8,333) |
| | – | \$6,000 | – | \$6,000 |

10. FIXED ASSETS

| | Group 2006 | | |
|--|--------------------|-----------------------------|---------------|
| | Cost/ Valuation | Accumulated Depreciation | Book Value |
| | \$000 | \$000 | \$000 |
| Land | 6,206 | – | 6,206 |
| Buildings | 3,195 | – | 3,195 |
| Motor Vehicles | 494 | 137 | 357 |
| Furniture, Fittings and Office Equipment | 4,110 | 3,116 | 994 |
| Computer Equipment | 13,800 | 11,260 | 2,540 |
| Computer Software | 22,944 | 17,457 | 5,487 |
| Leasehold Improvements | 818 | 139 | 679 |
| Work in Progress | 1,189 | – | 1,189 |
| | \$52,756 | \$32,109 | \$20,647 |



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

10. FIXED ASSETS (Continued)

| | Group 2005 | | |
|--|-----------------------------|--------------------------------------|------------------------|
| | Cost/ Valuation \$000 | Accumulated Depreciation \$000 | Book Value \$000 |
| Land | 4,780 | – | 4,780 |
| Buildings | 3,298 | – | 3,298 |
| Motor Vehicles | 374 | 152 | 222 |
| Furniture, Fittings and Office Equipment | 3,450 | 2,769 | 681 |
| Computer Equipment | 11,992 | 9,813 | 2,179 |
| Computer Software | 17,344 | 14,630 | 2,714 |
| Leasehold Improvements | – | – | – |
| Work in Progress | 2,237 | – | 2,237 |
| | <u>\$43,475</u> | <u>\$27,364</u> | <u>\$16,111</u> |

| | Parent 2006 | | |
|--|-----------------------------|--------------------------------------|------------------------|
| | Cost/ Valuation \$000 | Accumulated Depreciation \$000 | Book Value \$000 |
| Land | 6,206 | – | 6,206 |
| Buildings | 3,195 | – | 3,195 |
| Motor Vehicles | 477 | 133 | 344 |
| Furniture, Fittings and Office Equipment | 3,980 | 3,096 | 884 |
| Computer Equipment | 13,305 | 11,136 | 2,169 |
| Computer Software | 18,706 | 16,490 | 2,216 |
| Leasehold Improvements | 818 | 139 | 679 |
| Work in Progress | 968 | – | 968 |
| | <u>\$47,655</u> | <u>\$30,994</u> | <u>\$16,661</u> |



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

10. FIXED ASSETS (Continued)

| | Cost/ Valuation \$000 | Parent 2005 | |
|--|-----------------------------|--------------------------------------|------------------------|
| | | Accumulated Depreciation \$000 | Book Value \$000 |
| Land | 4,780 | – | 4,780 |
| Buildings | 3,298 | – | 3,298 |
| Motor Vehicles | 374 | 152 | 222 |
| Furniture, Fittings and Office Equipment | 3,450 | 2,769 | 681 |
| Computer Equipment | 11,992 | 9,813 | 2,179 |
| Computer Software | 17,344 | 14,630 | 2,714 |
| Leasehold Improvements | – | – | – |
| Work in Progress | 2,237 | – | 2,237 |
| | \$43,475 | \$27,364 | \$16,111 |

The land and buildings at 30 June 2006 are stated at their investment market valuation as determined by Telfer Young (Auckland) Ltd, a qualified, independent Registered Valuer. The land and buildings are revalued annually on this basis. A surplus on revaluation of \$1,323,000 was recorded at 30 June 2006 (2005 \$1,000,000).

11. CURRENT LIABILITIES

| | Group | | Parent | |
|--|------------------|------------------|------------------|------------------|
| | 2006 \$000 | 2005 \$000 | 2006 \$000 | 2005 \$000 |
| Accounts Payable | 4,673 | 9,259 | 4,349 | 9,182 |
| Amounts Owed to Related Parties | 132 | – | 549 | 275 |
| Employee Entitlements | 3,556 | 2,632 | 3,298 | 2,577 |
| Provision for Outstanding Claims (Refer Note 12) | 84,697 | 96,429 | 84,697 | 96,429 |
| Provision for Advance Revenue | 57,011 | 64,591 | 57,011 | 64,591 |
| Provision for Founding Members' Reward | 16,100 | 26,000 | 16,100 | 26,000 |
| Provision for Unexpired Risk (Refer Note 12) | 12,605 | – | 12,605 | – |
| Other Provisions | 350 | 1,015 | 350 | 1,015 |
| | \$179,124 | \$199,926 | \$178,959 | \$200,069 |

| Movement on non insurance provisions: | Group | | Parent | |
|--|-----------------|-----------------|-----------------|-----------------|
| | 2006 \$000 | 2005 \$000 | 2006 \$000 | 2005 \$000 |
| Provision for Founding Members' Reward | | | | |
| Opening Balance | 26,000 | – | 26,000 | – |
| Provision Made | – | 26,000 | – | 26,000 |
| Amounts Utilised | 9,431 | – | 9,431 | – |
| Unused Amounts Reversed | 469 | – | 469 | – |
| Closing Balance | \$16,100 | \$26,000 | \$16,100 | \$26,000 |



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

12. ACTUARIAL INFORMATION

Estimates of the outstanding claims and unexpired risk as at 30 June 2006 have been carried out by John Feyter B.Sc, a Fellow of the New Zealand Society of Actuaries. The calculation of the provisions for outstanding claims and unexpired risk both comply 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.

Outstanding Claims Provision:

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. The risks and uncertainties that inevitably surround claims have been taken into account in reaching the best estimate of the outstanding claims liability.

Key assumptions were:

- Monthly seasonality factors for claims incurred were calculated from historical data.
- Claims settlement expenses of 4% of the estimated claims.
- Claims inflation of 0% to 6% p.a. depending on the class of business and type of claim.

Unexpired Risk Provision:

The unexpired risk liability has been calculated as the projected premium deficiency for current in-force business until the next policy renewal date on or after 1 July 2006. No provision was required at 30 June 2005.

Key assumptions were :

- Projected claims based on claims incurred for the year to 30 June 2006 plus claims inflation of 7.5% p.a., plus 4% for the effect of ageing.
- Expenses based on the business plan for 2006/7, including allowance for amortisation of deferred acquisition costs.
- No explicit allowance for cancellations or transfers. These are allowed for implicitly in the inflation assumption.

Amounts for both outstanding claims and unexpired risk were not discounted due to their short-term nature.

13. 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 | |
|---------------------|---------|---------|---------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$000 | \$000 | \$000 | \$000 |
| Bank Balances | 1,079 | 1,767 | 676 | 1,651 |
| Investments | 396,588 | 399,449 | 396,488 | 398,899 |
| Accounts Receivable | 41,037 | 46,810 | 45,577 | 53,334 |

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.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

13. FINANCIAL INSTRUMENTS (Continued)

Fair Values

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

The carrying value of investments at 30 June 2006 is equivalent to fair value, that being net market values.

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.

Liquidity Risk

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

| | Group | | Parent | |
|----------------|---------------|---------------|---------------|---------------|
| | 2006 \$000 | 2005 \$000 | 2006 \$000 | 2005 \$000 |
| On Call | 11,050 | 22,637 | 10,950 | 22,087 |
| 0-6 months | 220,519 | 279,930 | 220,519 | 279,930 |
| 7-12 months | 12,975 | 13,923 | 12,975 | 13,923 |
| 1-2 years | 54,606 | 15,606 | 54,606 | 15,606 |
| 2-3 years | 32,711 | 21,006 | 32,711 | 21,006 |
| 3-5 years | 35,917 | 36,323 | 35,917 | 36,323 |
| Beyond 5 years | 28,810 | 10,024 | 28,810 | 10,024 |
| | \$396,588 | \$399,449 | \$396,488 | \$398,899 |

The net bank balance is available on call. All premiums receivable are due within one month of balance date. Nearly all liabilities are payable within one year of balance date, with the exception of a small component of the Provisions for Founding Members' Reward and Outstanding Claims.

Foreign Currency Risk

At 30 June 2006, the Parent and the Group had assets of \$83,000 and no liabilities denominated in foreign currencies (30 June 2005 assets of \$51,000 and liabilities of \$199,000).



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

14. 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 |
| Southern Cross Healthcare Limited | 100% Subsidiary of Society |
| Directors of Southern Cross Medical Care Society | Are Trustees of Southern Cross Health Trust |
| Southern Cross Health Trust ("Trust") | Related Party to Parent |
| Southern Cross Benefits Limited ("Benefits") | 100% Subsidiary of Trust |
| GMV Associates Limited ("GMV") | 100% Subsidiary of Benefits |

All these related entities have 30 June balance dates.

The Parent and the Trust are separate legal entities operating at "arm's length". They work together in certain areas such as information technology, payroll and procurement, under fully costed service level agreements which dictate the expectations of each entity. Net costs charged to the Trust represent 2.6% of the Group's administration costs (2005 2.9%), and to Benefits 1.2% of these costs (2005 0.6%).

Any other costs incurred by one entity on behalf of another are reimbursed monthly.

The Parent purchases healthcare services from all providers, including the Trust, on a contestable and contractual basis.

The Parent charges Benefits a fee for enabling marketing opportunities to the membership. This represents 80% of the Group's other income (2005 78%).

All related party balances are repayable on normal trading terms.

No related party transactions have taken place at nil or nominal value.

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



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

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

| | Group | | Parent | |
|---|----------------|-----------------|-----------------|-----------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$000 | \$000 | \$000 | \$000 |
| Net Surplus | 10,016 | 31,848 | 4,046 | 38,821 |
| Add/(Less) non-cash items: | | | | |
| Depreciation | 4,858 | 3,390 | 3,740 | 3,390 |
| Asset Revaluation | (1,323) | (1,000) | (1,323) | (1,000) |
| Provision for Uncollectable Premiums | (1,043) | (770) | (1,043) | (760) |
| Amortisation of Goodwill | 6,000 | 6,000 | 6,000 | 6,000 |
| Change in Valuation of Investment in Subsidiaries | – | – | 20,471 | 430 |
| Amortisation of Investment Discount / Premium | (677) | 655 | (677) | 655 |
| Add items classified as investing activities: | | | | |
| (Profit)/Loss on disposal of Fixed Assets | (8) | 9 | (8) | 9 |
| Movement in Valuation of Investments | 951 | 49 | 951 | 49 |
| Add/(Less) movements in Working Capital items: | | | | |
| Accounts Receivable | 6,816 | 1,817 | 8,800 | (5,852) |
| Accounts Payable | (3,532) | (495) | (3,840) | 223 |
| Other Provisions | (665) | (5,345) | (665) | (5,345) |
| Provision for Outstanding Claims | (11,732) | (3,899) | (11,732) | (3,898) |
| Provision for Advance Revenue | (7,579) | (2,436) | (7,579) | (2,436) |
| Provision for Founding Members Reward | (9,900) | 26,000 | (9,900) | 26,000 |
| Provision for Unexpired Risk | 12,605 | – | 12,605 | – |
| Net Cash Flows from Operating Activities | \$4,787 | \$55,823 | \$19,846 | \$56,286 |

16. PRINCIPAL ACTIVITY

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

17. CREDIT RATING

On 21 February 2006 Standard & Poor's affirmed Southern Cross Medical Care Society's Insurer Financial Strength Rating of A+. This signifies the Insurer "has strong financial security characteristics".

18. ACTUARIAL REPORT

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

19. SOLVENCY AND CAPITAL ADEQUACY

Solvency is assessed regularly using recognised calculation standards. The current level of solvency excess assets is considered acceptable.

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



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

20. SEGMENTAL REPORTING

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

21. LEASE COMMITMENTS

At 30 June 2006 commitments under operating leases in respect of payments due to be made in the following years were:

| | Group | | Parent | |
|-----------------------|---------------|---------------|---------------|---------------|
| | 2006 \$000 | 2005 \$000 | 2006 \$000 | 2005 \$000 |
| Within 1 year | 1,632 | 820 | 1,632 | 820 |
| Between 1 and 2 years | 1,547 | 628 | 1,547 | 628 |
| Between 2 and 5 years | 1,018 | 1,356 | 1,018 | 1,356 |
| Greater than 5 years | 68 | 187 | 68 | 187 |
| | \$4,265 | \$2,991 | \$4,265 | \$2,991 |

22. REMUNERATION OF DIRECTORS

Directors fees paid by the Parent for the year ended 30 June 2006 were as follows:

| Director | Amount (\$) |
|--------------------------------------|-------------|
| B N Davidson - retired 1 August 2006 | 46,700 |
| C B Durbin - appointed 1 August 2006 | - |
| Dr D H Gray | 46,700 |
| Dr S C Macken | 46,700 |
| Dr J R D Matthews (Chairman) | 81,700 |
| D J May | 46,700 |
| P J Meyer | 46,700 |
| J G Todd | 46,700 |

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.



NOTES TO THE FINANCIAL STATEMENTS (CONT.)

For the year ended 30 June 2006

23. CAPITAL COMMITMENTS

The Parent and the Group had no capital commitments at 30 June 2006 (2005 \$87,000).

24. CONTINGENT LIABILITIES

The Parent and the Group had no contingent liabilities as at 30 June 2006 (2005 Nil).

25. INTERNATIONAL FINANCIAL REPORTING STANDARDS

In December 2002 the New Zealand Accounting Standards Review Board announced that New Zealand International Financial Reporting Standards ("NZ IFRS") will apply to all New Zealand reporting entities for reporting periods commencing on or after 1 January 2007. Entities have the option to adopt NZ IFRS for periods beginning on or after 1 January 2005.

The Parent and Group intend to implement NZ IFRS in the annual financial statements for the year ending 30 June 2008.

The Group has initiated a project to assess the key differences between NZ IFRS and current accounting policies, determine the impacts on the financial statements from transition, and implement processes to deal with any related business impacts.

The Group intends to provide further information, including a quantification of the impacts of transitioning to NZ IFRS, in the next annual financial statements.



Audit Report to the Members of Southern Cross Medical Care Society

We have audited the financial statements on pages 11 to 27. The financial statements provide information about the past financial performance and financial position of the Society and Group as at 30 June 2006. This information is stated in accordance with the accounting policies set out on pages 14 to 16.

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 2006 and the results of their operations and cash flows for the year ended on that date.

Auditors' Responsibilities

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

Basis of Opinion

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

- the significant estimates and judgements made by the Directors in the preparation of the financial statements;
- whether the accounting policies are appropriate to the Society'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 Society and may deal with the Society and Group on normal terms within the ordinary course of trading activities of the business of the Society and Group. These matters have not impaired our independence as auditors of the Society and Group. The firm has no other relationship with, or interest in, the Society or any of its subsidiaries.

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 these records;
- the financial statements on pages 11 to 27.
 - comply with New Zealand generally accepted accounting practice;
 - give a true and fair view of the financial position of the Society and Group as at 30 June 2006 and the results of their operations and cash flows for the year ended on that date.

Our audit was completed on 5 September 2006 and our unqualified opinion is expressed as at that date.

KPMG
AUCKLAND

directory

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Southern Cross
Healthcare