



Southern Cross  
Health Society

# Southern Cross Medical Care Society

## 2016 Annual Report – Financial Statements

These Financial Statements, together with the 2016 Annual Report Summary, constitute the Annual Report for the purposes of the Rules of the Society. For a copy of the Summary, please visit [southerncross.co.nz/annualreport](http://southerncross.co.nz/annualreport)

**The Southern Cross Medical Care Society**  
(trading as Southern Cross Health Society)

**Financial statements  
for the year ended  
30 June 2016**

<b>CONTENTS</b>	<b>PAGE</b>
Statement of comprehensive income and changes in reserves	1
Statement of financial position	2
Statement of cash flows	3
Notes to the financial statements	4-13
Independent auditor's report	14-15
Appointed actuary's report	16

## THE SOUTHERN CROSS MEDICAL CARE SOCIETY

### STATEMENT OF COMPREHENSIVE INCOME AND CHANGES IN RESERVES

for the year ended 30 June 2016

	NOTE	2016 \$000	2015 \$000
Premium revenue	5	871,143	817,823
Net claims expense	4	748,819	737,654
<b>Underwriting surplus</b>		<b>122,324</b>	<b>80,169</b>
Operating expenses	7	106,785	97,801
<b>Operating surplus/(deficit)</b>		<b>15,539</b>	<b>(17,632)</b>
Net investment and other income	6	19,511	23,397
<b>Surplus before taxation</b>		<b>35,050</b>	<b>5,765</b>
Taxation	10	-	-
<b>Surplus after taxation</b>		<b>35,050</b>	<b>5,765</b>
Other comprehensive income		-	-
<b>Total comprehensive surplus for the year</b>		<b>35,050</b>	<b>5,765</b>
Opening balance of reserves		400,108	394,343
<b>Closing balance of reserves</b>		<b>435,158</b>	<b>400,108</b>

*The accompanying notes form part of these financial statements*

## THE SOUTHERN CROSS MEDICAL CARE SOCIETY

### STATEMENT OF FINANCIAL POSITION

as at 30 June 2016

	NOTE	2016 \$000	2015 \$000
<b>Assets</b>			
Cash and cash equivalents	8	1,990	3,619
Premium and other receivables	5	71,460	70,161
Investments	3,6	522,701	496,747
Property and equipment	9	11,021	12,469
Intangible assets	9	22,208	19,137
<b>Total assets</b>		<b>629,380</b>	<b>602,133</b>
<b>Liabilities</b>			
Payables		16,287	21,418
Employee benefits	11	8,557	8,088
Insurance contract liabilities	2	169,378	172,519
<b>Total liabilities</b>		<b>194,222</b>	<b>202,025</b>
<b>Net assets</b>		<b>435,158</b>	<b>400,108</b>
<b>Reserves</b>		<b>435,158</b>	<b>400,108</b>

*The accompanying notes form part of these financial statements*

Authorised on behalf of the Board of Directors on 30 August 2016



G W Gent  
Chairman



E M Hickey  
Director

**THE SOUTHERN CROSS MEDICAL CARE SOCIETY**

	2016 \$000	2015 \$000
<b>STATEMENT OF CASH FLOWS</b>		
for the year ended 30 June 2016		
<b>Cash flows from/(to) operating activities</b>		
Premium revenue	873,995	817,369
Interest received	19,028	21,127
Other income	2,044	526
Payment of claims	(757,881)	(735,170)
Payments to employees	(48,168)	(46,390)
Payments to suppliers	(52,605)	(41,930)
<b>Net cash flows from operating activities</b>	<b>36,413</b>	<b>15,532</b>
<b>Cash flows from/(to) investing activities</b>		
Proceeds from sale of property and equipment	171	229
Payments for property and equipment	(1,593)	(3,087)
Payments for intangible assets	(9,105)	(9,057)
Net payments for investments	(27,515)	(1,964)
<b>Net cash flows to investing activities</b>	<b>(38,042)</b>	<b>(13,879)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(1,629)</b>	<b>1,653</b>
Opening cash and cash equivalents	3,619	1,966
<b>Closing cash and cash equivalents</b>	<b>1,990</b>	<b>3,619</b>

**RECONCILIATION OF NET SURPLUS WITH NET CASH FLOWS FROM OPERATING ACTIVITIES**

Net surplus after taxation	35,050	5,765
Adjustments for:		
Depreciation and amortisation	8,960	7,704
Loss on disposal or impairment of assets	377	740
Net losses/(gains) on investments at fair value through profit or loss	2,324	(632)
Changes in assets and liabilities:		
Receivables	(1,299)	(3,654)
Interest receivable	(764)	(1,113)
Payables and employee benefits	(5,094)	269
Insurance contract liabilities	(3,141)	6,453
<b>Net cash flows from operating activities</b>	<b>36,413</b>	<b>15,532</b>

*The accompanying notes form part of these financial statements*

**NOTES TO THE FINANCIAL STATEMENTS**

for the year ended 30 June 2016

**1 BASIS OF ACCOUNTING**

**REPORTING ENTITY**

The Southern Cross Medical Care Society (the "Society") is a friendly society domiciled in New Zealand, registered under the Friendly Societies and Credit Unions Act 1982 ("FSCU Act"). The Society's primary activity is the provision of health insurance and its registered office is Level 1, Ernst & Young Building, 2 Takutai Square, Auckland.

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

The financial statements are for the Group comprising the Society and its subsidiaries: Southern Cross Health Services Limited, Southern Cross Healthcare Limited (non-trading) and Southern Cross Insurance Services Limited (formerly Activa Health Limited), together referred to as the "Group".

The Society is a registered friendly society. As a consequence of its legal structure the Society has no recourse to external capital and therefore internally generated capital is of paramount importance. The Society's capital of \$435.5 million (30 June 2015: \$400.1 million) represents the retained surpluses of the Society. Capital of the Group of \$435.2 million (30 June 2015: \$400.1 million) includes the reserves of the Society's non-insurance subsidiaries.

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

The Directors' policy for managing capital is to have a strong capital base to establish security for members and enable the Society to conduct its business whilst maintaining financial soundness. The Society has embedded in its capital management framework the necessary tests to ensure continuous and full compliance with the solvency standard. The key internal benchmark is to maintain the solvency margin at between 35% and 45% of annualised premium income. At 30 June 2016 this margin was 37.8% of annualised premium income. The policy in respect of capital management is regularly reviewed by the Directors in line with the guidelines issued by the RBNZ.

During the current financial year the Society complied with all externally imposed capital requirements.

	2016	2015
	\$m	\$m
Solvency capital	413.3	381.0
Minimum solvency capital	73.2	76.6
Solvency margin	340.1	304.4
	<b>2016</b>	<b>2015</b>
Solvency ratio (Solvency capital divided by minimum solvency capital)	5.65	4.97

On 22 April 2016, Standard & Poor's reaffirmed the Society's Insurer Financial Strength Rating at A+ (23 April 2015: A+), under its global insurance industry rating methodology.

**BASIS OF PREPARATION**

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

The financial statements are:

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

**BASIS OF CONSOLIDATION**

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the group financial statements from the date that control commences until the date that control ceases. All intra-group balances and transactions are eliminated in preparing the group financial statements.

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

for the year ended 30 June 2016

**1 BASIS OF ACCOUNTING (continued)**

**ACCOUNTING POLICIES AND STANDARDS**

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

The impact of the following reporting standards on the Group are still to be determined.

- NZ IFRS 9 Financial Instruments - Effective for annual reporting periods beginning on or after 1 January 2018. The Group has chosen not to early adopt this standard.
- NZ IFRS 15 Revenue from Contracts with Customers - Effective for annual reporting periods beginning on or after 1 January 2018.
- NZ IFRS 16 Leases - Effective for annual reporting periods beginning on or after 1 January 2019.

**USE OF ESTIMATES AND JUDGEMENTS**

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

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

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

- Note 2: Insurance contract liabilities
- Note 3: Risk management

**2 INSURANCE CONTRACT LIABILITIES**

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

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market rates and, where appropriate, the risks specific to the obligation.

Estimates of the outstanding claims and unexpired risk as at 30 June 2016 have been determined by John Smeed, a Fellow of the New Zealand Society of Actuaries. These were presented to the Directors of the Society in a report dated 19 August 2016. There were no qualifications to the report. The calculations of the provisions for outstanding claims and unexpired risk each comply with both NZ IFRS 4: Insurance Contracts, and Professional Standard No. 30: General Insurance Business, of the New Zealand Society of Actuaries.

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

<b>Insurance contract liabilities</b>	<b>2016</b>	<b>2015</b>
	<b>\$000</b>	<b>\$000</b>
Provision for outstanding claims	78,796	80,631
Provision for unearned premium	87,065	82,545
Provision for unexpired risk	2,967	8,693
Other insurance provisions	550	650
	<b>169,378</b>	<b>172,519</b>

**Provision for outstanding claims**

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

Estimation of outstanding claims liabilities includes an allowance for claims incurred but not reported, claims incurred but not adequately reported, unpaid reported claims and future claims handling costs associated with paying claims. An explicit allowance of \$0.75m has been made for expected ACC recoveries as at 30 June 2016 (30 June 2015: \$0.75m).

A risk margin has been added to reflect the inherent uncertainty in the central estimate. An analysis of the volatility of the historical experience has been used in determining the risk margin. Future volatility is assumed to be consistent with historical volatility. A risk margin of 5% of the central estimate was established at 30 June 2016 (30 June 2015: 5%). The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the outstanding claims provision.

Key assumptions:

1. Future patterns of claims development will be similar to historical patterns depending on the type of policy, type of claim and development month.
2. Monthly seasonality factors used for claims incurred. These are calculated from the 5 years' previous claims experience and are unchanged from last year, ranging from 68% to 115% of the monthly average.
3. Historical claims inflation 4.9% p.a. (30 June 2015: 7.5%), based on previous claims experience.

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

for the year ended 30 June 2016

**2 INSURANCE CONTRACT LIABILITIES (continued)**

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any part of the general administrative costs directly attributable to the claims function. Claims handling costs were determined to be 4% (30 June 2015: 4%) of the underlying claims amounts based on an analysis of administration expenses.

The average weighted term from 30 June 2016 to the expected settlement date for claims included in the liability for outstanding claims is 70 days (30 June 2015: 69 days). Accordingly, expected future payments are not discounted due to the short tail nature of the liabilities.

<b>Provision for outstanding claims</b>	<b>2016</b>	<b>2015</b>
	<b>\$000</b>	<b>\$000</b>
Central estimate of outstanding claims liability	72,129	73,809
Claims handling costs	2,915	2,982
Risk margin	3,752	3,840
	<b>78,796</b>	<b>80,631</b>

<b>Reconciliation of movement in provision for outstanding claims</b>	<b>2016</b>	<b>2015</b>
	<b>\$000</b>	<b>\$000</b>
Opening balance	80,631	76,833
Amounts utilised during the year	(61,552)	(71,816)
Additional provision	(11,145)	2,528
Amounts provided during the year	71,017	72,766
Movement in claims handling costs	(67)	139
Movement in risk margin	(88)	181
Closing balance	<b>78,796</b>	<b>80,631</b>

**Unexpired risk provision and liability adequacy test**

A liability adequacy test was performed to determine whether the unearned premium liability is adequate to cover the present value of the expected future cash flows, plus a risk margin, from the current insurance contracts. The future cash flows are future claims, associated claims handling costs and other administration costs.

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

The unexpired risk provision has been calculated as the projected premium deficiency for current in-force business until the next policy billing date on or after 1 July 2016.

The calculation of the risk margin has been based on an analysis of the volatility of historical claims experience within the time period covered by the unearned premiums. A risk margin of 4% of the present value of expected future cash flows has been applied at 30 June 2016 (30 June 2015: 4%). The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the unexpired risk provision.

Key assumptions:

1. Future claims development will be similar to historical patterns by the type of policy, type of claim and development month.
2. Monthly seasonality factors used for claims incurred. These were calculated from the 5 years' previous claims experience, and range from 72% to 112% (30 June 2015: 73% to 112%) of the monthly average.
3. Expenses based on the business plan for 2016/17, including allowance for amortisation of deferred acquisition costs.

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

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

<b>Provision for unearned premium</b>	<b>2016</b>	<b>2015</b>
	<b>\$000</b>	<b>\$000</b>
Opening balance	82,545	79,381
Premiums written in the year	875,663	820,987
Premiums earned during the year	(871,143)	(817,823)
Closing balance	<b>87,065</b>	<b>82,545</b>



**NOTES TO THE FINANCIAL STATEMENTS (continued)**

for the year ended 30 June 2016

**2 INSURANCE CONTRACT LIABILITIES (continued)**

Provision for unexpired risk	2016 \$000	2015 \$000
Present value of expected future cash flows for claims and expenses	86,873	88,084
Risk margin	3,475	3,523
Unearned premiums	(87,065)	(82,545)
Write-down of deferred acquisition costs	(316)	(369)
	2,967	8,693

**3 RISK MANAGEMENT**

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

**a. Insurance risk**

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

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

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

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

**II. Sensitivity to insurance risk**

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

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

**III. Concentration of insurance risk**

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

**b. Financial risks**

**I. Credit risk**

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

The Group maintains policies which are used to manage the exposure to credit risk. Limits on counter-party exposures have been set and are monitored on an ongoing basis. In addition, the RBNZ has issued concentration risk limits, as part of its solvency standards. The credit quality of counter-parties is assessed based on published credit ratings issued by Standard & Poor's or equivalent ratings agencies. Where local authorities do not have a formal credit rating, comfort is obtained from their ability to levy rates. There are no concentrations of credit risk at 30 June 2016 (2015: Nil) in excess of policy.

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

for the year ended 30 June 2016

**3b RISK MANAGEMENT (continued)**

I. Credit risk (continued)

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

	2016	2015
	\$000	\$000
AA	308,241	275,809
A	132,035	109,793
BBB	39,010	64,152
Non-rated	43,415	46,993
	522,701	496,747

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

The cash and cash equivalents balances are held with a counter-party rated AA- (30 June 2015: AA-).

Premium receivables are due from a very large number of counter-parties, ranging from large corporates to individual members. Analysing these by credit quality would not be feasible, as the majority of counter-parties will be non-rated.

II. Liquidity risk

The Group is exposed to ongoing operational calls on its available cash resources from claims and administration expenses. Liquidity risk is the risk that payment of obligations may not be met in a timely manner at a reasonable cost. The Directors set limits on the minimum proportion of maturing funds available to meet such calls to cover claims and expenses at unexpected levels of demand.

The contractual maturities of investments are as follows:

	2016	2015
	\$000	\$000
On call	9,445	3,058
0-6 months	209,654	140,415
7-12 months	69,066	116,315
Current	288,165	259,788
1-2 years	141,211	81,044
2-5 years	87,385	149,830
Beyond 5 years	5,940	6,085
Non-current	234,536	236,959
Total	522,701	496,747

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

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

**c. Market risks**

I. Foreign currency risk

At 30 June 2016, the Group had assets of \$269,000 and no liabilities denominated in foreign currencies (30 June 2015: assets of \$291,000 and no liabilities). Given that the foreign currency risk exposure is minimal, the Group does not enter into any derivative contracts to manage this risk.

II. Interest rate risk

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

(i) *Cash flow interest rate risk*

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

(ii) *Fair value risk*

The fair value of fixed rate investments can fluctuate depending on changes in interest rates. The Group's policy is to hold all investments until maturity. This eliminates any effects of fair value changes to the investments upon realisation, however unrealised fair value changes are recognised in the statement of comprehensive income for each period.

	2016	2015	2016	2015
	\$000	\$000	\$000	\$000
Impact of change in interest rates				
			On cash flows	On profitability
Increase by 100 basis points	3,044	2,862	(2,236)	(2,294)
Decrease by 100 basis points	(3,044)	(2,862)	2,254	2,326

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

for the year ended 30 June 2016

**3 RISK MANAGEMENT (continued)**

(iii) Fair values of financial assets and financial liabilities

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

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

**Definition of the fair value hierarchy**

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

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

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

	Level 1 \$000	Level 2 \$000	Level 3 \$000	Total \$000
<b>30 June 2016</b>				
State owned enterprise bonds	-	7,135	-	7,135
Local authority bonds	-	18,444	-	18,444
Other bonds	-	41,324	-	41,324
Bank deposits	9,445	259,859	-	269,304
Commercial paper	-	11,453	-	11,453
Floating rate notes	-	175,041	-	175,041
<b>Total investments</b>	<b>9,445</b>	<b>513,256</b>	<b>-</b>	<b>522,701</b>
<b>30 June 2015</b>				
State owned enterprise bonds	-	7,265	-	7,265
Local authority bonds	-	17,706	-	17,706
Other bonds	-	42,638	-	42,638
Bank deposits	3,058	184,548	-	187,606
Commercial paper	-	42,285	-	42,285
Floating rate notes	-	199,247	-	199,247
<b>Total investments</b>	<b>3,058</b>	<b>493,689</b>	<b>-</b>	<b>496,747</b>

Cash and cash equivalents are valued using a Level 1 basis (30 June 2015: Level 1).

**4 NET CLAIMS EXPENSE**

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

	2016 \$000	2015 \$000
Claims incurred relating to risks borne in current financial year	765,845	735,285
Claims incurred relating to risks borne in previous financial years	(11,145)	2,528
Movement in provision for claims handling costs	(67)	139
Movement in risk margin	(88)	181
<b>Net claims incurred</b>	<b>754,545</b>	<b>738,133</b>
Movement in provision for unexpired risk	(5,726)	(479)
	<b>748,819</b>	<b>737,654</b>

**5 PREMIUM AND OTHER RECEIVABLES**

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

Premium and other receivables are stated at their cost less any impairment losses. Impairment losses for uncollectible premiums are written off against premium revenue in the year in which they are incurred. Under the NZ IFRS definition of financial assets, premium and other receivables are classified as "loans and receivables".

	2016 \$000	2015 \$000
Premium accounts receivable	63,184	61,616
Other receivables	8,276	8,545
	<b>71,460</b>	<b>70,161</b>

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

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

for the year ended 30 June 2016

**6 INVESTMENTS**

Interest income is recognised using the effective interest rate method.

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

Fees and other income are recognised on an accrual basis.

	<b>2016</b>	<b>2015</b>
	<b>\$000</b>	<b>\$000</b>
Interest income	19,791	22,240
Net (losses)/gains on investments at fair value through profit or loss	(2,324)	632
Net investment income	17,467	22,872
Fee and other income	2,044	525
Net investment and other income	19,511	23,397

Investments are recognised on the date they are originated and de-recognised on the date of maturity or sale of an investment.

The Group designates its investments as "financial assets at fair value through profit or loss" at inception. Changes in fair value are recognised in the statement of comprehensive income. Fair value is determined using a three-level fair value hierarchy that reflects the significance of the inputs used in measuring fair values of financial assets and liabilities. The credit quality, contractual maturities, categorisation of investment types and fair value hierarchies of investments are described in Note 3.

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

**7 OPERATING EXPENSES**

	<b>2016</b>	<b>2015</b>
	<b>\$000</b>	<b>\$000</b>
<b>Operating expenses consist of</b>		
Policy acquisition	9,064	9,159
Policy administration	39,141	34,671
Claims administration	11,515	11,014
Other operating	47,065	42,957
	106,785	97,801

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

**Operating expenses include**

Auditor's remuneration:

– audit and review of financial statements	211	210
– other services (review of solvency returns)	44	44
Depreciation	2,980	2,958
Amortisation of intangible assets	5,980	4,746
Impairment loss on intangible assets	351	730
Employee benefits expense	49,557	47,331
Rental of premises	5,630	5,488

**8 CASH AND CASH EQUIVALENTS**

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

**9 PROPERTY AND EQUIPMENT AND INTANGIBLE ASSETS**

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

For computer software development, costs incurred in researching and evaluating a project up to the point of formal commitment to a project are treated as research costs and are expensed as incurred.

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2016

9 PROPERTY AND EQUIPMENT AND INTANGIBLE ASSETS (continued)

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

Depreciation/amortisation rates are:

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

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

a) Property and equipment	Computer equipment	Other fixed assets	Leasehold improve ments	Work in progress	Total
	\$000	\$000	\$000	\$000	\$000
<b>As at 30 June 2016</b>					
Cost	12,586	3,717	10,680	561	27,544
Accumulated depreciation	(9,699)	(2,376)	(4,448)	-	(16,523)
	2,887	1,341	6,232	561	11,021
<b>As at 30 June 2015</b>					
Cost	22,948	3,809	10,679	394	37,830
Accumulated depreciation	(19,997)	(1,856)	(3,508)	-	(25,361)
	2,951	1,953	7,171	394	12,469
<b>b) Intangible Assets</b>					
	Computer software	Work in progress	Total		
	\$000	\$000	\$000		
<b>As at 30 June 2016</b>					
Cost	40,973	4,340	45,313		
Accumulated amortisation	(23,105)	-	(23,105)		
	17,868	4,340	22,208		
<b>As at 30 June 2015</b>					
Cost	54,444	2,768	57,212		
Accumulated amortisation	(38,075)	-	(38,075)		
	16,369	2,768	19,137		

10 TAXATION

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

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

There were no temporary differences arising in the subsidiaries, for which a deferred tax asset has not been recognised at 30 June 2016 (30 June 2015: \$119,000).

The Group has unrecognised tax losses carried forward of \$32,623,000 at 30 June 2016 (30 June 2015: \$32,297,000).

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

for the year ended 30 June 2016

**11 EMPLOYEE BENEFITS**

*Employee entitlements*

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

*Employee benefits*

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

*Post employment benefits*

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

The Group's employee entitlements and benefits liability for the current year was \$5.76 million (2015: \$5.47 million). Post employment benefits liability was \$2.80 million (2015: \$2.62 million).

**12 RELATED PARTIES**

**a. Identity and relationship of related parties:**

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

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

The Society and the Trust are separate legal entities operating at "arm's length". All Group and related parties provide their normal services to the other Group and related parties on normal commercial terms. Some goods and services are purchased by the Group and other related parties on a combined basis. These costs are on-charged to the other related parties at cost. The Society contracts healthcare services on behalf of its members from all providers, including Hospitals, on a contestable and contractual basis.

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

	<b>2016</b>	<b>2015</b>
	<b>\$000</b>	<b>\$000</b>
<i>The amount of transactions with other related parties</i>		
Sale of services	4,387	5,813
Purchase of services	2,304	1,208
<i>The outstanding balances with other related parties</i>		
Receivables	190	133
Payables	130	143

**b. Remuneration of key management personnel**

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

	<b>2016</b>	<b>2015</b>
	<b>\$000</b>	<b>\$000</b>
Salaries and other short-term benefits	2,960	2,983
Post-employment benefits	74	87

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

for the year ended 30 June 2016

**12 RELATED PARTIES (continued)**

**c. Remuneration of Directors**

Directors' fees paid by the Society for the year ended 30 June 2016 were as follows:

Director	2016 Amount \$	2015 Amount \$
Dr D D Baird	55,725	49,625
C M Drayton	55,775	48,000
C B Durbin - retired 1 December 2015	24,481	53,750
G W Gent (Chairman) - appointed Chairman 4 December 2014	105,000	75,175
G R W France - appointed 4 December 2014	57,968	29,819
G S Hawkins - retired 4 December 2014	-	34,130
E M Hickey	60,185	52,000
J M Raue - appointed 1 December 2015	32,351	-
K B Taylor	59,806	53,000
	451,291	395,499

	2016 Amount \$	2015 Amount \$
A friendly society has Trustees to hold its assets. The Trustees are:		
E M Hickey - appointed 1 December 2015	-	-
C B Durbin - retired 1 December 2015	-	-
G W Gent - appointed 4 December 2014	-	-
G S Hawkins - retired 4 December 2014	-	-
K B Taylor	-	-

The Society provides Trustees and Directors with Directors' and Officers' liability insurance cover, for liabilities to other parties that may arise from their positions as Trustees and Directors. Other operating expenses in relation to governance are met by the Society. The Society does not provide loans or advances to Directors or Trustees.

Where Directors are directors of subsidiary companies of the Society, they do not receive any fees for these appointments.

**13 LEASE AND CAPITAL COMMITMENTS**

**a) Lease Commitments**

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

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

Commitments under operating leases	2016 \$000	2015 \$000
Within 1 year	5,629	5,551
Between 1 and 2 years	5,443	5,451
Between 2 and 5 years	15,605	15,669
Greater than 5 years	8,695	13,733
	35,372	40,404

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

**b) Capital Commitments**

The Group had capital commitments of \$1,187,000 at 30 June 2016 (2015: \$639,000).

**14 CONTINGENT LIABILITIES**

The Group had no contingent liabilities at 30 June 2016 (2015: Nil).



## Independent auditor's report

### **To the members of The Southern Cross Medical Care Society**

We have audited the accompanying consolidated financial statements of The Southern Cross Medical Care Society and its subsidiaries ("the Group") on pages 1 to 13. The financial statements comprise the consolidated statement of financial position as at 30 June 2016, the consolidated statements of comprehensive income, changes in reserves and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

#### *Directors' responsibility for the consolidated financial statements*

The directors are responsible on behalf of the Society for the preparation and fair presentation of the consolidated financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement whether due to fraud or error.

#### *Auditor's responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Group's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the consolidated financial statements.

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





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

*Opinion*

In our opinion, the consolidated financial statements on pages 1 to 13 comply with generally accepted accounting practice in New Zealand and present fairly, in all material respects, the consolidated financial position of The Southern Cross Medical Care Society as at 30 June 2016 and its consolidated financial performance and cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

KPMG

31 August 2016  
Auckland

30 August 2016

The Directors  
Southern Cross Medical Care Society  
Auckland

Dear Directors

## Review of Actuarial Information Contained in Financial Statements as at 30 June 2016

Finity Consulting Pty Limited (Finity) has been asked by Southern Cross Medical Care Society (Southern Cross) to carry out a review of the 30 June 2016 Actuarial Information contained in the financial statements and provide an opinion as to its appropriateness. John Smeed is an employee of Finity and is the Appointed Actuary to Southern Cross. Finity has no relationship with Southern Cross apart from being a provider of actuarial services.

Southern Cross's policy is to seek and adopt the advice of the Appointed Actuary in respect of the Actuarial Information contained in its financial statements. We confirm that the financial statements as at 30 June 2016 have been prepared in accordance with this policy, and as such this satisfies the requirements of the Insurance (Prudential Supervision) Act 2010.

Having carried out the actuarial review, nothing has come to our attention that would lead us to believe that the Actuarial Information used in the financial statements or the determination of the solvency position for Southern Cross as at 30 June 2016 are inappropriate. No limitations were placed on us in performing our review, and all data and information requested was provided.

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

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

Yours sincerely



John Smeed  
Appointed Actuary



Anita Samu

Fellows of the New Zealand Society of Actuaries



The Southern Cross Medical Care Society  
Registered Office: Level 1, Ernst & Young Building,  
2 Takutai Square, Auckland 1010  
Private Bag 99934  
Newmarket, Auckland 1149

Visit our website  
[www.southerncross.co.nz/society](http://www.southerncross.co.nz/society)  
or call us on  
**0800 800 181**