Southern Cross Health Insurance

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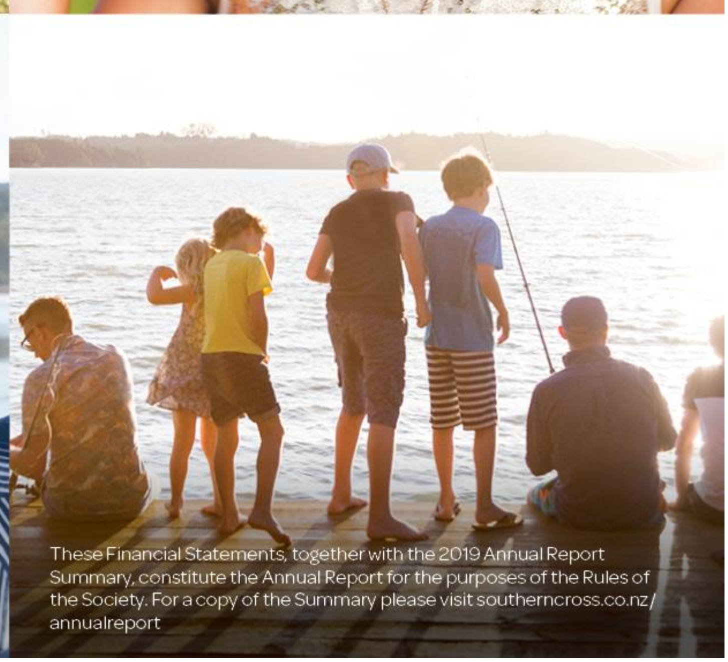
Southern Cross Medical Care Society

2019 Annual Report – Consolidated Financial Statements



These Financial Statements, together with the 2019 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

The Southern Cross Medical Care Society Group

Consolidated financial statements
for the year ended

30 June 2019

CONTENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME AND CHANGES IN RESERVES
for the year ended 30 June 2019

	Note	2019 $000	2018 $000
Premium revenue	10	1,080,364	987,840
Net claims expense	4	(963,666)	(906,640)
Underwriting surplus		**116,698**	**81,200**
Operating expenses	8	(133,916)	(118,094)
Operating deficit		**(17,218)**	**(36,894)**
Net investment and other income	7	27,942	23,596
Surplus/(deficit) before taxation		**10,724**	**(13,298)**
Taxation	14	-	-
Surplus/(deficit) after taxation		**10,724**	**(13,298)**
Other comprehensive income		-	-
Total comprehensive income/(deficit) for the year		**10,724**	**(13,298)**
Opening balance of reserves		428,027	441,325
Closing balance of reserves		**438,751**	**428,027**

The above consolidated statement of comprehensive income and changes in reserves should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 30 June 2019

	Note	2019 $000	2018 $000
Assets			
Cash and cash equivalents	9	10,034	8,525
Premium and other receivables	10	97,749	88,712
Investments	6	492,479	481,592
Property and equipment	11	7,165	11,681
Intangible assets	11	38,488	35,813
Total assets		**645,915**	**626,323**
Liabilities			
Payables and other liabilities	12	15,321	12,805
Employee benefits	13	9,297	8,489
Insurance contract liabilities	3	182,546	177,002
Total liabilities		**207,164**	**198,296**
Net assets		**438,751**	**428,027**
Reserves		**438,751**	**428,027**

For and on behalf of the Board of Directors who authorised the issue of this report on 12 September 2019.

G W Gent
Chairman of the Board

E M Hickey
Director

The above consolidated statement of financial position should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF CASH FLOWS

for the year ended 30 June 2019

	Note	2019 $000	2018 $000
Cash flows from/(to) operating activities			
Premium revenue received		1,079,762	986,792
Interest received		8,341	11,385
Other income received		5,812	4,340
Payment of claims		(964,102)	(914,260)
Payments to employees		(57,520)	(51,933)
Payments to suppliers		(53,241)	(55,191)
Net cash flows from/(to) operating activities		**19,052**	**(18,868)**
Cash flows (to)/from investing activities			
Proceeds from sale of property and equipment		-	43
Payments for property and equipment		(1,136)	(3,616)
Payments for intangible assets		(19,309)	(18,308)
Net sales/(purchases) of investments		2,902	42,386
Net cash flows (to)/from investing activities		**(17,543)**	**20,505**
Net increase in cash and cash equivalents		**1,509**	**1,637**
Opening cash and cash equivalents		8,525	6,888
Closing cash and cash equivalents	9	**10,034**	**8,525**

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

	Note	2019 $000	2018 $000
Total comprehensive income/(deficit) for the year		10,724	(13,298)
Adjustments for non-cash items included in comprehensive income/(deficit) after taxation:			
Depreciation and amortisation	8	16,235	12,254
Loss on disposal and impairment of assets	8	4,761	166
Net gains on investments at fair value through profit or loss	7	(13,460)	(9,756)
Changes in assets and liabilities:			
Premiums and other receivables		(9,037)	(9,519)
Interest receivable		(329)	1,885
Payables and other liabilities		4,614	86
Insurance contract liabilities		5,544	(686)
Net cash flows from/(to) operating activities		**19,052**	**(18,868)**

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 30 June 2019

1 BASIS OF ACCOUNTING

INTRODUCTION

The notes to the financial statements contain detailed financial information and the relevant accounting policies that are considered relevant and material to the understanding of the financial performance and financial position.

Additional signposting has been used throughout the notes to the financial statements to assist readers in understanding the key information in the financial statements.

Signpost
Basis of preparation
Accounting policy
Management judgements and estimates

REPORTING ENTITY

The Southern Cross Medical Care Society (the "Society") is a friendly society domiciled in New Zealand, registered under the Friendly Societies and Credit Unions Act 1982 ("FSCU Act"). The Society's primary activity is the provision of health insurance and its registered office is Level 1, EY Building, 2 Takutai Square 1010, Auckland.

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

The consolidated financial statements are for the Group comprising the Society and its subsidiaries: Southern Cross Insurance Services Limited, Southern Cross Health Services Limited and Southern Cross Healthcare Limited (non-trading) (the "Group"). The Group is not required to disclose geographic or operating segment information under NZ IFRS 8 *Operating Segments* .

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 $446.2 million (30 June 2018: $429.2 million) represents the retained surpluses of the Society. Capital of the Group of $438.8 million (30 June 2018: $428.0 million) includes the net equity of the Society's non-insurance subsidiaries.

BASIS OF PREPARATION

The Society is 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 ("NZD"), which is the Group's functional currency. All financial information has been rounded to the nearest thousand ($000), unless otherwise stated.
- stated net of Goods and Services Tax ("GST"), with the exception of receivables and payables, which are stated inclusive of GST where applicable. The items in the cash flow statement are shown exclusive of the amount recoverable from, or payable to, the tax authority.
- prepared using historical cost as the measurement basis except for investments and insurance contract liabilities, which are measured at fair value.

BASIS OF CONSOLIDATION

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. Subsidiaries are entities controlled by the Group. 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.

ACCOUNTING POLICIES AND STANDARDS

Accounting policies have been applied on a basis consistent with that used in the previous year, with the exception of the adoption of new standards relevant to the Group as disclosed in Note 18. The impact of adopting these new standards was not material for the Group. Certain comparative amounts have been reclassified to conform with the current year's presentation, but the effect of the reclassification is immaterial.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

1 BASIS OF ACCOUNTING (continued)

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 3: Insurance contract liabilities
- Note 5a: Insurance risk

2 SOLVENCY

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

The Directors' policy for managing capital is to have a strong capital base to establish security for members and enable the Society to conduct its business whilst maintaining financial soundness. The Society has embedded in its capital management framework the necessary tests to ensure continuous and full compliance with the Solvency Standard.

The benchmark and target range for the capital position of the Society is to hold net tangible assets equivalent to 5 to 7 months of expected annual claims. A solvency benchmark that is based on claims is relevant as the Society's reserves are used to pay claims. Net tangible assets at 30 June 2019 are equivalent to 5.0 months of claims (30 June 2018: 5.2 months of claims), which is within the target range under the benchmark. The policy in respect of capital management is regularly reviewed by the Directors in line with the guidelines issued by the RBNZ.

The Society complied with externally imposed capital requirements for the year ended 30 June 2019 (30 June 2018: In compliance).

	2019 $m	2018 $m
Disclosures of solvency required by the Solvency Standard as issued by the RBNZ		
Solvency capital	407.7	397.3
Minimum solvency capital	125.1	125.0
Solvency margin	282.6	272.3

	2019	2018
Solvency ratio	3.26	3.18

On 30 April 2019, Standard & Poor's reaffirmed the Society's Insurer Financial Strength Rating at A+ (2 May 2018: A+), under its global insurance industry rating methodology.

3 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.

Estimates of the outstanding claims and unexpired risk at 30 June 2019 have been determined by the Society's Appointed Actuary, John Smeed, a Fellow of the New Zealand Society of Actuaries. These were presented to the Directors of the Society in a report dated 21 August 2019. 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: *Valuations of General Insurance Claims*, 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.

	2019 $000	2018 $000
Insurance contract liabilities		
Provision for outstanding claims	64,399	63,196
Provision for unearned premium	104,330	97,565
Provision for unexpired risk	8,111	9,952
Other insurance provisions	625	1,410
Assessed claims payable	5,081	4,879
Total	182,546	177,002

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

3 INSURANCE CONTRACT LIABILITIES (continued)

Provision for outstanding claims

The provision for outstanding claims is 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 the provision for outstanding claims includes an allowance for claims incurred but not reported, claims incurred but not enough reported, unpaid reported claims and future claims handling costs associated with paying claims. An explicit allowance of $0.75 million has been made for expected Accident Compensation Corporation ("ACC") recoveries as at 30 June 2019, which has been netted off against liabilities (30 June 2018: $0.75 million).

A risk margin has been added to reflect the inherent uncertainty in the central estimate. The risk margin considers both historic and future sources of volatility. A risk margin of 7% of the central estimate was established as at 30 June 2019 (30 June 2018: 6%). The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the provision for outstanding claims.

Key assumptions:

i. Future patterns of claims development will be similar to historical patterns depending on the type of policy, type of claim and development month.

ii. Monthly seasonality factors used for claims incurred. These are calculated from the 5 years' previous claims experience and remain the same as the prior year, ranging from 69% to 114% (30 June 2018: 69% to 114%) of the monthly average. The provision for outstanding claims is calculated separately for different claim types and therefore has different seasonality factors than the unexpired risk provision, which is calculated at a portfolio level.

iii. Historical claims inflation 4.9% p.a. (30 June 2018: 8.2%), based on previous claims experience.

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any part of the general administrative costs directly attributable to the claims function. Claims handling costs were determined to be 4% (30 June 2018: 4%) of the underlying claims amounts based on an analysis of administration expenses.

The average weighted term from 30 June 2019 to the expected settlement date for claims included in the liability for outstanding claims is 59 days (30 June 2018: 64 days). Accordingly, expected future claims payments are not discounted due to the short tail nature of the liabilities.

	2019 $000	2018 $000
Provision for outstanding claims		
Central estimate of outstanding claims liability	57,842	57,297
Claims handling costs	2,344	2,322
Risk margin	4,213	3,577
Total	64,399	63,196
Reconciliation of movement in provision for outstanding claims		
Opening balance	63,196	75,638
Amounts utilised during the year	(56,581)	(59,800)
Additional provision	1,799	(6,505)
Amounts provided during the year	55,327	55,018
Movement in claims handling costs	22	(451)
Movement in risk margin	636	(704)
Total	64,399	63,196

Provision for unexpired risk and liability adequacy test

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

If the present value of the expected future cash outflows exceeds the provision for unearned premium then the provision for unearned premium 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 a provision of unexpired risk.

The provision for unexpired risk has been calculated as the projected premium deficiency for current in-force business until the next policy billing date on or after 1 July 2019.

The calculation of the risk margin has been based on an analysis of the volatility of historical claims experience within the time period covered by the unearned premiums together with future sources of volatility. A risk margin of 4% of the present value of expected future cash flows has been applied at 30 June 2019 (30 June 2018: 4%). The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the provision for unexpired risk.

Key assumptions:

i. Future claims development will be similar to historical patterns by the type of policy, type of claim and development month.

ii. Monthly seasonality factors used for claims incurred. These were calculated from the 5 years' previous claims experience, and remain the same as the prior year, ranging from 73% to 112% (30 June 2018: 73% to 112%) of the monthly average. The provision for outstanding claims is calculated separately for different claim types and therefore has different seasonality factors than the provision for unexpired risk, which is calculated at a portfolio level.

iii. Expenses based on the business plan for 2019/20, including allowance for amortisation of deferred acquisition costs.

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

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

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

3 INSURANCE CONTRACT LIABILITIES (continued)

	2019 $000	2018 $000
Provision for unearned premium		
Opening balance	97,565	90,808
Premiums written in the year	1,087,129	994,597
Premiums earned during the year	(1,080,364)	(987,840)
Total	104,330	97,565

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

Provision for unexpired risk		
Present value of expected future cash flows for claims and expenses	108,386	103,705
Risk margin	4,335	4,148
Unearned premiums	(104,330)	(97,565)
Write-down of deferred acquisition costs	(280)	(336)
Total	8,111	9,952

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 disclosed in Note 3.

	2019 $000	2018 $000
Net claims expense		
Claims incurred relating to risks borne in current financial year	963,050	909,610
Claims incurred relating to risks borne in previous financial years	1,799	(6,505)
Movement in provision for claims handling costs	22	(451)
Movement in risk margin	636	(704)
Net claims incurred	965,507	901,950
Movement in provision for unexpired risk	(1,841)	4,690
Total	963,666	906,640

5 RISK MANAGEMENT

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

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 the assumptions made 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:

- Each year, as part of the planning process, the Board and the Senior Leadership Team ("SLT") review the underwriting and pricing performance.
- 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 2).
- Cash flow projection model designed to forecast major inflow and outflow items.
- A minimum liquidity reserve buffer is maintained in excess of anticipated cash flow requirements.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

5 RISK MANAGEMENT (continued)

a. Insurance risk (continued)

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

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

In the normal course of its business the Group is exposed to 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. The credit quality of investment 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 2019 in excess of policy (30 June 2018: Nil).

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

	2019 $000	2018 $000
Money market		
AA	173,223	150,011
A	73,817	71,641
BBB	35,345	48,213
Non-rated	-	15,001
	282,385	284,866
Unit trusts		
Non-rated (Global bonds, weighted average rating of the underlying investments is AA-, 30 June 2018: A+)	103,233	96,816
Non-rated (Global equities)	51,255	49,473
Non-rated (Global real estate)	27,444	25,656
Non-rated (Global listed infrastructure)	28,162	24,781
	210,094	196,726
Total	492,479	481,592

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 2018: AA-).

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

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

5 RISK MANAGEMENT (continued)

b. Financial risks (continued)

ii. Liquidity risk

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

	2019	**2018**
	$000	**$000**
Contractual maturities of investments		
On call	-	9,008
0-6 months	363,973	338,531
7-12 months	122,415	105,878
Current	486,388	453,417
1-2 years	6,091	28,175
Non-current	6,091	28,175
Total	492,479	481,592

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

The 0-6 months maturity category includes unit trusts of $210.1 million (30 June 2018: $196.7 million), as these investments could be liquidated at short notice.

c. Market risks

i. Interest rate risk

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

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

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

	2019	**2018**
	$000	**$000**
	Impact on profitability	
Fair value - interest rate sensitivity on money market investments		
Impact of change in interest rates:		
Increase by 100 basis points	(1,507)	(1,038)
Decrease by 100 basis points	1,263	1,050

ii. Unit price risk

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

	2019	**2018**
	$000	**$000**
	Impact on profitability	
Fair value - unit price sensitivity on unit trust investments		
Impact of change in unit prices:		
Increase by 10%	21,009	19,673
Decrease by 10%	(21,009)	(19,673)

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2019

5 RISK MANAGEMENT (continued)

c. Market risks (continued)

iii. Foreign currency risk.

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

There are no significant liabilities denominated in foreign currencies.

iv. Fair values of financial instruments and financial liabilities

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

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

Definition of the fair value hierarchy

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

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

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

	Level 1	Level 2	Level 3	Total
	$000	$000	$000	$000
30 June 2019				
Investments	-	492,479	-	492,479
Total	-	492,479	-	492,479
30 June 2018				
Investments	-	481,592	-	481,592
Total	-	481,592	-	481,592

d. Operational risk

Operational risk is defined as the risk of loss (including financial, non-financial and lost opportunities) resulting from inadequate or failed internal processes, people and systems or from external events.

Management of the Group's operational risk is a continual cyclic process. This process is documented in the Risk Management framework, and includes risk identification, analysis, evaluation and implementation of risk controls, which results in acceptance, mitigation, or avoidance of risk.

6 INVESTMENTS

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

The Group designates its investments as "financial assets at fair value through profit or loss" at inception. Changes in fair value are recognised in the statement of comprehensive income. The credit quality, contractual maturities, categorisation of investment types and fair value hierarchies of investments are described in Note 5.

	2019	2018
	$000	$000
Investments		
Bonds	17,141	10,315
Bank deposits	236,179	181,295
Commercial paper	-	2,984
Floating rate notes	29,065	90,272
Unit trusts - global bonds	103,233	96,816
Unit trusts - global equities	51,255	49,473
Unit trusts - global real estate	27,444	25,656
Unit trusts - global listed infrastructure	28,162	24,781
Total	492,479	481,592

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2019

7 NET INVESTMENT AND OTHER INCOME

Fees and other income are recognised on an accrual basis.

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

	2019 $000	2018 $000
Net investment and other income		
Interest income	8,670	9,500
Net gains on investments at fair value through profit or loss	13,460	9,756
Net investment income	22,130	19,256
Fee and other income	5,812	4,340
Total	27,942	23,596

8 OPERATING EXPENSES

	2019 $000	2018 $000
Operating expenses consist of:		
Policy acquisition	9,400	8,508
Policy administration	49,052	46,000
Claims administration	11,213	10,628
Other operating expenses	64,251	52,958
Total	133,916	118,094

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

	2019 $000	2018 $000
Included within operating expenses are the following specific items:		
Auditor's remuneration:		
• audit of annual financial statements	176	173
• review of interim financial statements	46	45
• audit of annual insurer solvency return	39	23
• review of half year insurer solvency return	23	22
• agreed upon procedures	-	3
• accounting impact assessment	6	-
Employee benefits expense	56,882	51,467
Contributions to defined contribution plan	1,446	1,338
Operating leases	5,218	5,765
Depreciation	5,428	3,665
Amortisation	10,807	8,589
Losses/(gains) on disposal of property and equipment	50	(2)
Impairment loss on intangible assets	4,711	168
Increase in provision for bad and doubtful debts	116	3

9 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand and current account balances in bank accounts, which are readily convertible to cash, with original maturities of less than three months, and are carried at amortised cost as they are subject to an insignificant risk of changes in value.

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2019

10 PREMIUM AND OTHER RECEIVABLES

Gross earned premiums from insurance contracts are recognised evenly over the current billing period of the contract, which is considered to be in line with the pattern of the incidence of risk. Revenue is recognised on the date from which the policy is effective. Premium and other receivables are stated at their cost less any impairment losses, using the expected credit losses model from 1 July 2018. Impairment losses for uncollectible premiums are written off against premium revenue in the year in which they are incurred. Premium and other receivables are classified as financial assets at amortised cost. Refer to Note 18 for the impact of changes in financial reporting standards on assessment of impairment losses.

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

	2019	2018
	$000	$000
Premium and other receivables		
Premium receivable	84,820	78,238
Other receivables	12,929	10,474
Total	97,749	88,712

11 PROPERTY AND EQUIPMENT AND INTANGIBLE ASSETS

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

Capital expenditure on all projects is initially recorded as work in progress. On completion of the project the asset is transferred to the appropriate asset category when the project will generate future economic benefits. 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. Work in progress is not depreciated or amortised.

Depreciation and amortisation are recognised on a straight-line basis to allocate the assets' costs, net of any residual amounts, over their estimated 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.

Assets	Estimated useful lives
• Computer equipment	4 - 7 years
• Office equipment	3 - 7 years
• Leasehold improvements	2 - 12 years
• Computer software	3 - 7 years

a. Property and equipment	Computer equipment	Office equipment	Leasehold improvements	Work in progress	Total
	$000	$000	$000	$000	$000
As at 30 June 2019					
Cost	18,697	3,951	10,793	-	33,441
Accumulated depreciation	(14,222)	(3,451)	(8,603)	-	(26,276)
Total	4,475	500	2,190	-	7,165
As at 30 June 2018					
Cost	17,764	3,883	11,060	39	32,746
Accumulated depreciation	(11,496)	(3,235)	(6,334)	-	(21,065)
Total	6,268	648	4,726	39	11,681

b. Intangible assets	Computer software	Work in progress	Total
	$000	$000	$000
As at 30 June 2019			
Cost	81,243	6,442	87,685
Accumulated amortisation and impairment	(49,197)	-	(49,197)
Total	32,046	6,442	38,488
As at 30 June 2018			
Cost	65,197	4,872	70,069
Accumulated amortisation and impairment	(34,256)	-	(34,256)
Total	30,941	4,872	35,813

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

12 PAYABLES AND OTHER LIABILITIES

Payables and other liabilities are current liabilities, stated at cost.

	2019 $000	2018 $000
Payables and other liabilities		
Trade creditors and accruals	9,416	8,922
Premiums paid in advance	5,905	3,883
Total	15,321	12,805

13 EMPLOYEE BENEFITS

a. Short term benefits

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

b. Post employment benefits

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

	2019 $000	2018 $000
Employee benefits		
Short term benefits	7,396	6,849
Post employment benefits	1,901	1,640
Total	9,297	8,489

14 TAXATION

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

Tax expense comprises current and deferred tax, calculated using the tax rate enacted or substantively enacted at balance date and any adjustments to tax payable in respect of prior years. Deferred tax expense is recognised in respect of temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts used for taxation purposes. A deferred tax asset is recognised only to the extent it is probable it will be utilised. The aggregate amount of temporary differences arising in the subsidiaries for which a deferred tax asset has not been recognised is $4,129,000 (30 June 2018: $1,000 deferred tax liability). The Group has unrecognised tax losses carried forward of $35,552,000 at 30 June 2019 (30 June 2018: $33,789,000).

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

15 RELATED PARTIES

a. Identity of related parties:	Relationship	Balance Date
• The Southern Cross Medical Care Society ("Society")	Parent	30 June
• Southern Cross Health Services Limited ("Health Services")	100% subsidiary of Society	30 June
• Southern Cross Insurance Services Limited ("Insurance Services")	100% subsidiary of Society	30 June
• Southern Cross Healthcare Limited (non-trading)	100% subsidiary of Society	30 June
• Southern Cross Health Trust ("Trust")	Related party of Society	30 June
• Southern Cross Benefits Limited ("Benefits")	100% subsidiary of Trust	30 June
• Southern Cross Hospitals Limited ("Hospitals")	100% subsidiary of Trust	30 June
• Directors of The Southern Cross Medical Care Society	Certain Directors are Trustees of Trust	-

The Society and the Trust are separate legal entities. All entities provide their normal services to other group entities on normal commercial terms. However, some goods and services are purchased by the Group and other related parties on a combined basis, and are on-charged to 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, which are not included in the table below, as these are services paid on behalf of members.

Refer to Note 17b for other commitments regarding related party transactions.

All related party balances are payable on normal trading terms and unsecured. No related party transactions have taken place at nil or nominal value. No related party balances have been written off or forgiven during the year (30 June 2018: Nil).

	2019 $000	2018 $000
Total amount of transactions with other related parties		
Sale of services	7,104	5,839
Purchase of services	813	1,860
Total outstanding balances with other related parties		
Receivables	588	503
Payables	81	-

b. Remuneration of Directors

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

The Society provides trustees and directors with directors' and officers' liability insurance cover, for liabilities to other parties that may arise from their positions as trustees and directors. Other operating expenses in relation to governance are met by the Society. The Society does not provide loans or advances to directors or trustees. Where directors of the Society are also directors of the Society's subsidiaries, they do not receive any fees for these appointments.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

15 RELATED PARTIES (continued)

b. Remuneration of Directors (continued)

Director	Board Amount	Audit & Risk Committee Amount	Investment Committee Amount	Remuneration Committee Amount	Nominations Committee Amount	Total Remuneration Amount
Actual directors' remuneration paid by the Society for the year ended 30 June 2019 was as follows:						
C M Drayton	58,000	3,000	-	2,000	1,000	64,000
G W Gent [1]	116,000 Chair	-	-	-	- Chair	116,000
G R W France	58,000	-	5,000 Chair	2,000	-	65,000
E M Hickey	58,000	6,000 Chair	2,500	-	-	66,500
J M Raue	58,000	-	-	4,000 Chair	-	62,000
K B Taylor	58,000	3,000	-	-	1,000	62,000
P Leightley	58,000	-	-	-	-	58,000
Total	464,000	12,000	7,500	8,000	2,000	493,500

1 G W Gent did not receive any fees for being a member of the Audit and Risk, Investment, Remuneration or Nominations Committees.
The annual fee pool limit of $499,800 remained at the limit approved by Society members at the Annual General Meeting in December 2017.

Director	Board Amount	Audit & Risk Committee Amount	Investment Committee Amount	Remuneration Committee Amount	Nominations Committee Amount	Total Remuneration Amount
Actual directors' remuneration paid by the Society for the year ended 30 June 2018 was as follows:						
C M Drayton	56,500	3,000	-	2,750	1,000	63,250
G W Gent [1]	113,000 Chair	-	-	- Chair [2]	- Chair	113,000
G R W France	56,500	-	5,000 Chair	2,000	-	63,500
E M Hickey	56,500	6,000 Chair	2,500	-	-	65,000
J M Raue	56,500	-	-	2,500 Chair [3]	-	59,000
K B Taylor	56,500	3,000	-	-	1,000	60,500
P Leightley	56,500	-	-	-	-	56,500
Total	452,000	12,000	7,500	7,250	2,000	480,750

1 G W Gent did not receive any fees for being a member of the Audit and Risk, Investment, Remuneration or Nominations Committees.
2 Was Chair for the first three quarters of the year.
3 Was Chair for the last quarter of the year.
The annual fee pool limit of $499,800 was approved by Society members at the Annual General Meeting in December 2017.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

15 RELATED PARTIES (continued)

c. Remuneration of key management personnel

Key management personnel are the members of the Society Leadership Team. 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.

	2019 $000	2018 $000
Salaries and other short-term benefits	3,375	3,050
Post-employment benefits	89	77
Long-term employee benefits	17	9

Chief Executive Officer ("CEO") remuneration

Over the course of the financial year, the CEO of the Society earned a base salary of $719,600 (30 June 2018: $700,000). The CEO earned a total short-term performance-related incentive of $162,600. This amount is payable in the 2020 financial year (30 June 2018: $156,200 paid in the 2019 financial year). As a member of KiwiSaver, the CEO received contribution from the Society of $35,402 during 2019 (30 June 2018: $31,271). In addition, the CEO received other non-cash short-term benefits of $10,388 during 2019 (30 June 2018: $10,031).

The CEO has a long-term incentive plan relating to achieving specific performance targets by 30 June 2021 which is payable as a lump sum on achievement. Depending on the level of performance achieved against set targets, potential payments that the Board may award, at its discretion, range from 36% to 60.75% of the CEO's base salary as at 1 July 2018.

16 EMPLOYEE REMUNERATION

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

	2019	2018
$	**Number of employees**	
<100,000	641	638
100,001 - 110,000	37	33
110,001 - 120,000	18	15
120,001 - 130,000	23	16
130,001 - 140,000	17	15
140,001 - 150,000	16	11
150,001 - 160,000	7	8
160,001 - 170,000	5	7
170,001 - 180,000	7	4
180,001 - 190,000	3	1
190,001 - 200,000	2	5
200,001 - 210,000	4	1
210,001 - 220,000	1	-
220,001 - 230,000	2	-
230,001 - 240,000	1	2
240,001 - 250,000	2	1
260,001 - 270,000	-	1
280,001 - 290,000	2	2
290,001 - 300,000	1	-
300,001 - 310,000	-	1
310,001 - 320,000	1	1
320,001 - 330,000	-	1
330,001 - 340,000	2	-
780,001 - 790,000	-	1
880,001 - 890,000	1	-
Total	793	764
Headcount as at balance date	663	653

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

17 COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS

a. Operating lease commitments

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

Payments made under operating leases are recognised in the statement of comprehensive income on a straight-line basis over the term of the lease. Any inducement payments received as part of a lease agreement are deferred and recognised on a straight-line basis over the term of the lease. Refer to Note 18 for the impact of changes in financial reporting standards on leases from 1 July 2019.

	2019 $000	2018 $000
Future minimum lease payments under non-cancellable operating leases		
Within 1 year	5,942	5,875
Between 1 and 2 years	6,086	5,559
Between 2 and 5 years	15,711	14,778
Greater than 5 years	44,856	22
Total	72,595	26,234

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

The Society entered into an agreement to lease new premises in Auckland in November 2018 for a lease term of 12 years, commencing October 2020.

b. Other commitments

The Group had contractual commitments for the acquisition of property and equipment and intangible assets of $6,564,000 at 30 June 2019 (30 June 2018: $2,005,000).

On 24 June 2019, the Board of Southern Cross Healthcare Limited approved and entered into a sale and purchase agreement to purchase the relevant assets and liabilities of the Southern Cross Pet Insurance business from Southern Cross Benefits Limited, at an expected purchase price of $6,300,000. The transaction is conditional on regulatory approval by the Reserve Bank of New Zealand.

c. Contingent liabilities

The Group had no contingent liabilities at 30 June 2019 (30 June 2018: Nil).

d. Subsequent events

There were no events subsequent to the reporting period which would materially affect the financial statements.

18 CHANGES IN FINANCIAL REPORTING STANDARDS

New accounting standards adopted on 1 July 2018

The financial statements include the first time adoption of NZ IFRS 9 *Financial Instruments* ("NZ IFRS 9") and NZ IFRS 15 *Revenue from Contracts with Customers* ("NZ IFRS 15"), applicable for the Group for annual reporting periods beginning on or after 1 January 2018, and do not have a material impact to the Group.

- NZ IFRS 9 - the new standard replaces NZ IAS 39 *Financial Instruments: Recognition and Measurement* ("NZ IAS 39") relating to the classification and measurement of financial instruments.

  There is no impact to the Group on the classification and measurement of hedge accounting methodologies as the Group does not apply hedge accounting.

  The impact to the Group on the classification and measurement of other financial instruments is as follows:

Financial instruments	New classification under NZ IFRS 9	Original classification under NZ IAS 39
Cash and cash equivalents	Amortised cost	Loans and receivables
Premium and other receivables	Amortised cost	Loans and receivables
Investments	Fair value through profit or loss	Fair value through profit or loss

  The Group is impacted by a new forward-looking expected credit losses model that replaces the incurred loss impairment model for financial assets previously applied under NZ IAS 39. The expected credit losses model applies to premium and other receivables financial assets that are measured at amortised cost. The Group has applied the simplified approach as these items have no significant financing component. Macro-economic factors are not considered to be relevant to the financial assets measured at amortised cost. Historical loss rates have been used as estimates of expected future loss rates to determine the expected credit losses. The impact to the Group is not material.

- NZ IFRS 15 - the new standard replaces NZ IAS 18 *Revenue* ("NZ IAS 18") and is applicable to all entities with revenue from contracts with customers. The new standard provides a single five-step model for revenue recognition to be applied to all contracts with customers, to depict the transfer of promised goods and services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services.

  There is no material impact on the financial performance and financial position of the Group as only a small portion of the Group's revenue is within the scope of the new standard, due to the exclusion of certain types of contracts that are covered by other standards, including NZ IFRS 4 *Insurance Contracts* ("NZ IFRS 4") and NZ IFRS 9. Full disclosures as required by NZ IFRS 15 have not been presented on the basis that these are not material in the context of the Group.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2019

18 CHANGES IN FINANCIAL REPORTING STANDARDS (continued)

New accounting standards not yet effective

There are a number of standards, amendments and interpretations which have been approved but are not yet effective. The Group expects to adopt these when they become due for adoption. The impact of these is still to be determined. The most significant of these is NZ IFRS 17 *Insurance Contracts* ("NZ IFRS 17").

- NZ IFRS 17 - NZ IFRS 17 *Insurance Contracts* ("NZ IFRS 17") will replace NZ IFRS 4 *Insurance Contracts* for annual periods beginning on or after 1 January 2021, becoming mandatory for the Group's financial statements for the year ending 30 June 2022. However, in June 2019 the International Accounting Standards Board ("IASB") released an exposure draft, Amendments to IFRS 17, proposing various amendments to IFRS 17 which includes deferring the effective date by one year to 1 January 2022. The IASB aims to finalise these amendments in mid-2020, with the expectation that the XRB will also adopt this one-year deferral for NZ IFRS 17. The new standard establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. Disclosure and measurement under NZ IFRS 17 differs significantly from NZ IFRS 4, and the impact of this standard on the Group is still to be determined.

New accounting standards not yet adopted

NZ IFRS 16 *Leases* ("NZ IFRS 16") - the new standard replaces NZ IAS 17 *Leases* ("NZ IAS 17"), and is effective for annual reporting periods beginning on or after 1 January 2019. The Group is required to adopt the standard from 1 July 2019, and has not elected early adoption. The expected impacts of adoption are disclosed as follows:

Under NZ IAS 17, a lessee was required to make a distinction between finance and operating leases. Under NZ IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The new standard requires lessees to recognise a right-of-use asset (representing its right to use the underlying asset) and a liability for future payments (representing its obligation to make lease payments) arising from all lease contracts, except for optional exemptions for either certain short-term leases or leases of low value assets. Lessees are required to recognise a finance charge on the liability and a depreciation charge on the asset which may affect the timing of the recognition of expenses on leased assets. The new standard may result in a higher interest expense in the earlier years of the lease, and a lower interest expense in the later years of a lease compared to a straight-line operating lease expense. This change will mainly impact the premises and motor vehicles that the Group currently accounts for as operating leases.

At 1 July 2019, the Group will recognise new assets and liabilities for its leases of premises and motor vehicles. The nature of expenses related to those leases will now change as NZ IFRS 16 replaces the current straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities. The Group has elected to apply the new standard only to those contracts previously identified as leases under NZ IAS 17, as permitted by the practical expedient transition provisions in NZ IFRS 16.

The Group has elected to apply the new standard using the modified retrospective approach, with no restatement of comparative information. A single discount rate will be applied to a portfolio of leases with reasonably similar characteristics. The Group has applied the optional exemptions for short-term and low value asset leases, and has elected not to include at transition those leases for which the lease term ends within 12 months of the date of initial application. The costs associated with those leases will instead be included within the disclosure of short-term lease expense in the reporting period commencing 1 July 2019.

On initial application of the standard, the lease liabilities will be measured at the present value of remaining lease payments, less any lease incentives received or receivable, discounted using an incremental borrowing rate. If the interest rate implicit in the lease cannot be readily determined, the lessee uses the lessee's incremental borrowing rate. The Group expects to use an individual discount rate for each portfolio of leases with reasonably similar characteristics, representing the weighted average incremental borrowing rates applied to lease liabilities recognised at the date of initial application. The discount rate used is a proxy rate as the Society is not entitled to borrow money as a friendly society.

The Group expects to recognise approximately $43,098,000 of lease liabilities in the statement of financial position at the date of initial application, with a corresponding right-of-use asset of approximately $43,098,000. At the commencement date of any new or renewed leases, the Group will measure the lease liability at the present value of the lease payments that are not paid at that date, using the incremental borrowing rate if the interest rate implicit in the lease cannot be determined. After the commencement date, the Group intends to measure the lease liability as applicable under NZ IFRS 16, with any interest on the lease liability recognised in the statement of comprehensive income. At the commencement date, the Group will measure the right-to-use asset using the cost method, less any lease incentives received. Subsequent measurement will also apply the cost model.

Under NZ IFRS 16, right-of-use assets are tested annually in accordance with NZ IAS 36 *Impairment of Assets*. This will replace the current requirement to recognise a provision for onerous lease contracts.

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Independent Auditor's Report

To the members of The Southern Cross Medical Care Society

Report on the consolidated financial statements

Opinion

In our opinion, the accompanying consolidated financial statements of The Southern Cross Medical Care Society and its subsidiaries (the "Group") on pages 1 to 18:

i. present fairly in all material respects the Group's financial position as at 30 June 2019 and its financial performance and cash flows for the year ended on that date; and

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

We have audited the accompanying consolidated financial statements which comprise:

— the consolidated statement of financial position as at 30 June 2019;

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

— notes, including a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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

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

Our firm has also provided other services to the Group in relation to the audit of the year-end solvency return, review of the consolidated interim financial statements and the half-year solvency return, and a review of an accounting impact assessment. Subject to certain restrictions, partners and employees of our firm 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.

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Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements in the current period. We summarise below those matters and our key audit procedures to address those matters in order that the members as a body may better understand the process by which we arrived at our audit opinion. Our procedures were undertaken in the context of and solely for the purpose of our statutory audit opinion on the consolidated financial statements as a whole and we do not express discrete opinions on separate elements of the consolidated financial statements.

The key audit matter	How the matter was addressed in our audit and findings
Valuation of insurance contract liabilities	
Refer to note 3 to the consolidated financial statements. Valuation of the Group's provision for outstanding claims requires significant judgement from management and the Group's externally appointed actuarial specialist.	Our audit procedures included: — testing the Group's IT systems and controls over claims, including the reconciliation of data from underlying systems to the data used in the actuary's valuation; — testing a sample of claims to check whether they had the appropriate level of authorisation and support; — with support from our actuarial specialists, assessing the work of the Group's appointed actuary in estimating the future claims costs on claims incurred prior to 30 June 2019, including: - the appropriateness of the valuation methodology, estimates and assumptions, against relevant accounting and actuarial standards; - the appropriateness of key assumptions including claims frequency, payment patterns and claims inflation against benchmark information; and - comparing previous estimates to actual claims development in the current year (i.e. performing a hindsight analysis). We did not identify material exceptions from procedures performed, and found the judgements and assumptions to be balanced and consistent with our understanding of the Group.

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Other information

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

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

Use of this independent auditor's report

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

Responsibilities of the directors for the consolidated financial statements

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

- the preparation and fair presentation of the consolidated financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards;
- implementing necessary internal control to enable the preparation of a consolidated set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and
- assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

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

Our objective is:

- to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- to issue an independent auditor's report that includes our opinion.

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

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

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

http://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/

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

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

For and on behalf of

KPMG

KPMG
Auckland

12 September 2019

Actuarial and Insurance Consultants

12 September 2019

The Directors
Southern Cross Medical Care Society
Auckland

Dear Directors

Review of Actuarial Information Contained in Financial Statements as at 30 June 2019

Finity Consulting Pty Limited (Finity) has been asked by Southern Cross Medical Care Society (the Society) to carry out a review of the 30 June 2019 Actuarial Information contained in the financial statements and used in their preparation and to provide an opinion as to the appropriateness of this information. John Smeed is an employee of Finity and is the Appointed Actuary to the Society. Finity has no relationship with the Society apart from being a provider of actuarial services.

The Society's policy is to seek and adopt the advice of the Appointed Actuary in respect of the Actuarial Information contained in its financial statements. We confirm that the financial statements as at 30 June 2019 have been prepared in accordance with this policy, and as such this satisfies the requirements of the Insurance (Prudential Supervision) Act 2010.

Having carried out the Actuarial Review, nothing has come to our attention that would lead us to believe that the Actuarial Information used in the financial statements or their preparation, or the determination of the solvency position for the Society as at 30 June 2019 is inappropriate. No limitations were placed on us in performing our review and all data and information requested was provided.

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

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

Yours sincerely

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

Matthew Clere
Associate of the New Zealand Society of Actuaries

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