



CIRCULAR

FOR RELEASE ON
2011/06/17

Reference : Annual returns 2010
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Date : 17 June 2011

CIRCULAR 23 OF 2011: GENERAL NOTIFICATION: GENERAL CONCERNS NOTED DURING THE ANALYSIS OF THE 2010 ANNUAL FINANCIAL STATEMENTS AND STATUTORY RETURNS (AFS)

1. INTRODUCTION

1.1 Purpose

The Office of the Registrar would like to express its appreciation to medical schemes, administrators and auditors for the co-operation provided in submitting the 2010 AFS within the period required by section 37 of the Medical Schemes Act 131 of 1998.

The purpose of this circular is to bring to your attention common problems and issues identified during the analysis of the AFS in order to:

- enhance the quality of data submitted in the AFS,
- achieve standardization and uniformity regarding proper disclosure
- reduce or minimize errors and
- establish good financial reporting for the industry.

1.2 Background

A review of the information collected by the Office has highlighted a number of discrepancies in the information currently being furnished by medical schemes in their statutory returns. The preparers of the statutory returns and scheme management are hereby requested to address these matters in future submissions.

2. KEY AREAS OF CONCERN

2.1. The Board of Trustees Report

2.1.1. Differences were noted between the number of trustees disclosed in the Board of Trustees (BoT) Report and those disclosed in the Annual Statutory Return. Schemes should ensure that the information disclosed in the BoT Report and the Annual Statutory Return corresponds.

These differences were mainly due to the following:

- alternate BoT members are not being disclosed in both reports; and/or
- BoT members who resigned during the year were not included in the Annual Statutory Return.

In this regard schemes should also note that the names of **all** the BoT members that were in office during the financial year (at any time during the year) need to be disclosed in Part 1.3 of the Annual Statutory Return.

2.1.2. Differences were noted between the number of members and/or beneficiaries disclosed in the BoT Report and those disclosed in the Annual Statutory Return. Schemes should ensure that the information disclosed in the BoT Report and the Annual Statutory Return corresponds.

2.1.3. As previously requested in Circular 14 of 2008, schemes should ensure that they disclose the number of beneficiaries and dependants in addition to the number of members in the BoT Report.

2.1.4. Some instances were noted where the solvency as per the Annual Statutory Return did not agree with the solvency as per the BoT Report. Schemes should ensure that the information disclosed in the BoT Report and the Annual Statutory Return corresponds.

2.2. The audited Annual Financial Statements

2.2.1. It was noted some schemes have not complied with the full requirements of Circular 18 of 2009 in respect of the *Format of statement of comprehensive income*. Please note that should schemes not have any items of other comprehensive income, the net surplus or deficit should be replaced by 'Total comprehensive income'.

2.2.2. We have notes a few instances where schemes disclosed irrelevant and/or insufficient accounting policies in their financial statements.

International Accounting Standard (IAS) 1 paragraphs .108 to .115 require that a scheme discloses (in the summary of significant accounting policies) the following:

- the measurement basis (or bases) used in preparing the financial statements; and
- the other accounting policies used that are relevant to an understanding of the financial statements.

In deciding whether a particular accounting policy should be disclosed, the scheme should consider whether the disclosure would assist users in understanding how transactions, other events and conditions are reflected in the reported financial performance and financial position or in the comparatives included in the financial statements. Schemes should therefore ensure that they disclose sufficient and relevant accounting policies.

An example of an accounting policy used which is not correct is in respect of the outstanding claims provision. It is stated in quite a number of schemes financial statements that the costs include ".....related internal and external claims handling expenses". This is not correct and appears to be a copy and paste from previous SAICA Accounting Guides which have since been corrected.

- 2.2.3.** We have noted a number of instances where schemes disclosed individual receivables with credit balances as receivables, and payables with debit balances as payables. Some instances were also noted where the scheme offset unallocated deposits (amounts which cannot be allocated to relevant debtors due to insufficient information) against receivable balances.

As IAS 1 paragraphs .32 to .35 does not allow for the offsetting of assets and liabilities, all credit balances that are included in receivables as well as unallocated deposits need to be reclassified to current liabilities and debit balances that are included in payables to current assets. Please take note that this paragraph is not applicable to credit amounts that are reflected in the age analysis due to the incorrect allocation of amounts received and/or that relate to debtors with an overall debit balance.

- 2.2.4.** It was noted that some schemes did not comply with the disclosure requirements as set out in IFRS 7 paragraph .27B.

IFRS 7 paragraph 27B states that for fair value measurements recognised in the statement of financial position an entity shall disclose for each class of financial instruments:

- a) The level in the fair value hierarchy into which the fair value measurements are categorised in their entirety, segregating fair value measurements in accordance with the levels defined in paragraph 27A
- b) Any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.
- c) For fair value measurements in Level 3 of the fair value hierarchy, a reconciliation from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:
 - i) Total gains or losses for the period recognised in profit or loss, and a description of where they are presented in the statement of comprehensive income or the separate income statement (if presented);
 - ii) Total gains or losses recognised in other comprehensive income;
 - iii) Purchases, sales, issues and settlements (each type of movement disclosed separately); and

- iv) Transfers into or out of Level 3 (e.g. transfers attributable to changes in the observability of market data) and the reasons for those transfers.

For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

- d) The amount of total gains or losses for the period in (c)(i) above included in profit or loss that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of comprehensive income or the separate income statement (if presented).
- e) For fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognized in other comprehensive income, total equity. An entity shall present the quantitative disclosures required by this paragraph in tabular format unless another format is more appropriate.

- 2.2.5.** It was noted that a number of schemes did not disclose all the required information in respect of IAS 24 (*Related parties*).

Please refer to the 2010 SAICA Guide as well as IAS 24. The SAICA Guide contains very relevant information in order to assist schemes in determining whether a party to a transaction meets the definition of a related party, as well as the extent of disclosure with regards to related parties. Restricted schemes are also reminded to consider whether the employer group is a related party. It was furthermore noted that in the Annual Statutory Return and in the Annual Financial Statements certain amounts were omitted and the individual totals per Part 4.26 of the Annual Statutory Return did not always agree with the note in the Annual Financial Statements with regards to related party transactions.

- 2.2.6.** It was noted that sufficient details on trustee remuneration were not disclosed as required in terms of Regulation 6A. In particular fees paid to trustees for other services, such as those related to amalgamations

and asset management, were treated as related parties but not included in the trustee remuneration note. The importance of this note is that the details are required per trustee.

2.3. The Annual Statutory Return

- 2.3.1.** It was noted that manual changes were made on Part 1 in respect of the PO, Chairperson and trustee signatories. The scheme should communicate changes to Part 1 to the Office as soon as a change has taken effect. The changes are often due to lack of planning in ensuring which trustees will be available to sign the returns. Schemes are also referred to Circular 9 of 2009 in this respect.
- 2.3.2.** It was noted that a number of questions were not correctly answered in part 1.4. We urge schemes to pay specific attention to this area in future since it is an indication that care was not taken in the completion of the return. In terms of section 57(6)(b) of the Act, the BoT shall act with due care, diligence, skill and good faith. Schemes should ensure that each question is answered correctly, that the necessary details are provided, and that these pages are signed by the relevant parties. It should further be noted that the disclosure of scheme contracts in Part 1.4 impacts on the rest of the return.
- 2.3.3.** In some instances it was noted that schemes did not accurately complete Part 2.6. Data extraction presented on Part 2.6 should be checked for accuracy as well as comparability with respective year's data. Data checks should be undertaken to ensure that the data is comparable.
- 2.3.4.** In some instances it was noted that schemes did not accurately complete Part 2.7. Schemes should ensure that data presented in Part 2.7 is of good quality. Schemes must also ensure that the prevalence rates for the respective years are comparable. Data checks should be undertaken to ensure comparability.

- 2.3.5.** In Part 3 there were significant increases in certain categories of expenses due to incorrect classification of benefits paid in the following disciplines. This yielded inconsistencies and data not comparable between the respective years:
- Dentists,
 - Medicines,
 - Dental Specialists,
 - Supplementary and Allied Health Professionals and
 - Provincial Hospitals.
- 2.3.6.** It was noted that some schemes used the “Other” lines Parts 2.8, 2.9 2.10, 3.2, 3.3 and 3.4 when specific lines appear for these items. The variable “Other” lines should not be used when a pre-defined category exists. In cases where this occurs, the Annual Statutory Return will be returned to the principle officer for correction and re-submission.
- 2.3.7.** Similarly schemes used the “other” line in parts 4.3, 4.8, 4.12 and 4.16 even where provision was made for a specific line item. These items should not be disclosed in the “other” line.
- 2.3.8.** A number of schemes indicated that they had managed care healthcare benefits and risk transfer contracts in Part 1.4, but did not complete the transactions and balances in respect of such contracts correctly in Part 4.9, Part 4.11 and Part 4.13. In most instances, the net claims incurred in respect of related risk transfer arrangements were not disclosed separately in Part 4.11 Column C. It should also be noted that managed care healthcare benefits with no transfer of risk should be disclosed in Part 4.11 Column B lines 4.11.1.4 - 4.11.1.6. Please refer to the Helpfile issued by the Office in future to ensure that these parts are completed correctly. Schemes are requested to disclose all significant risk transfer arrangements in both the Annual Financial Statements and the Annual Statutory Return, regardless of the materiality of the amounts involved.
- 2.3.9.** It was noted that schemes disclosed realised and/or unrealised gains/losses in respect of investments as part of gross investment income in the audited financial statements. These gains/losses must not be included in gross investment income but separately in Part 4.20 for statutory return purposes. This may result in differences between the Statutory Return and the Annual Financial Statements.

- 2.3.10.** It was noted that there was a general misclassification across the various categories as provided for in Part 9 of the return. In future, please ensure that the investments are classified properly. Please also refer to our website for Circular 3 of 2011 to assist you in this regard.
- 2.3.11.** It was noted that the underlying assets of portfolios, unit trusts and policies of insurance linked to the performance of the underlying assets, were not always provided by the asset managers. Schemes should ensure that they obtain the data timeously and that they split the portfolio between the relevant categories in Part 9 (i.e. apply the look-through principle).
- 2.3.12.** In some instances it was noted that schemes did not complete Part 10.1 correctly. Part 10.1 is an account whose purpose it is to keep a record of all unrealised gains and losses accounted for through profit and loss. As investments are realised the previously recorded unrealised gains and losses taken to the income statement should be removed from this account. The balance of Part 10.1.7 should only represent unrealised gains and losses (recognised through the income statement – not other comprehensive income) on investments held by the scheme at year end. All unrealised gains and losses recognised through the income statement should be recorded in this part and when sold should then be removed.

2.4. Matters concerning the auditors

- 2.4.1.** As previously communicated in Circular 14 of 2008, in instances where no management report was issued by the auditors, the Office will require official confirmation from the auditors that there were no material matters that should be reported to either the scheme or the Council for Medical Schemes. The management report requested should be the final report issued to the scheme by the auditors detailing all internal control weaknesses and housekeeping issues identified during the audit together with management comments. The report to the audit committee should not be submitted in lieu of the management report as it does not include management's comments on the matters raised.

- 2.4.2.** We have encountered a few instances where the auditors did not use the latest version of the assurance report (Part 11) as required by sections 36, 37 and 39 of the Act. Schemes should bring this matter to the attention of their auditors and ensure in future that the correct versions of the assurance reports are used.
- 2.4.3.** It was also noted that the report was not always printed on the audit firm's letterhead. Note that this is clearly indicated in a pop-up message in the return as well as the help-file.
- 2.4.4.** It was noted that schemes reported issues noted in 11b by reference to the Annual Financial Statements. Schemes should note that Part 11 is a standalone report and all items of non-compliance should be detailed within this report.

2.5. Non-compliance matters raised in the BoT Report and Annual Financial Statements

In Circular 11 of 2006, Circular 30 of 2007 and Circular 14 of 2008, we have set out how non-compliance matters should be treated in the BoT Report. We have noted that schemes did not always disclose the nature of the non-compliance matters that were raised, but only the sections from which they deviated or the specific notes in the financial statements which address their non-compliance. Section 37(5) of the Act requires that the BoT Report shall deal with every matter which is material for the appreciation by members. We consider all non-compliant matters to be of such a nature that it should be individually specified in the BoT Report.

Schemes are required to apply for exemption in terms of the Act if they do not comply with any provisions of the Act.

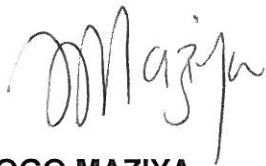
Schemes are required to disclose the following information relating to all non-compliance issues (regardless of whether the scheme has addressed the non-compliance or not):

- a)** nature and impact;
- b)** causes of the failure; and
- c)** corrective course of action (including the timeframe, where applicable).

Corrective courses of action implemented would include exemptions obtained, suspension and termination of benefits in respect of outstanding contributions, and any other actions taken.

All non-compliance matters included in the BoT Report must also be disclosed in a note to the Annual Financial Statements as well as the part 11(b) assurance report required by sections 36, 37 and 39 of the Act.

Your cooperation is highly appreciated.

A handwritten signature in black ink, appearing to read 'Maziya', with a stylized, cursive script.

TEBOGO MAZIYA
HEAD: FINANCIAL SUPERVISION
COUNCIL FOR MEDICAL SCHEMES