



COUNCIL FOR MEDICAL SCHEMES

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TO ALL PRINCIPAL OFFICERS AND BOARDS OF TRUSTEES OF ALL MEDICAL SCHEMES

Telephone / Telefoon: 012 431 0500

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Enquiries / FT Mothobi/ M Grobler /

C Phehlukwayo

Reference / Verwysing: 29/B

Date / Datum: 16 February 2001

CIRCULAR LETTER 13 OF 2001

AUDIT AND ACCOUNTING GUIDE, AUDITED FINANCIAL STATEMENTS AND STATUTORY RETURNS, SOLVENCY AND APPOINTMENT OF AUDITORS

1. Audit and Accounting Guide

The Audit and Accounting Guide on Medical Funds has been finalised and approved by the South African Institute of Chartered Accountants (SAICA). This document is available on our website (www.medicalschemes.com) with the authority and consent of SAICA (with whom the copyright thereof vests). The guide is also available on their website (www.saica.com).

It is required that all medical schemes compile their audited financial statements with regard to the 2000 financial year onwards, in accordance with the Guide.

2. Audited Financial Statements and Statutory Returns

I would furthermore like to advise that the format of the new 2000 Statutory Return will be made available on our website from 1 March 2001. This is done in order for schemes to collect the necessary data and to acquaint themselves with the format of the return. An online database application will be published on our website on 1 April 2001. This will allow authenticated users within schemes to commence with the physical completion of the return. Please note that all returns will have to be submitted online and in final hard copy format.

Schemes are advised that in terms of Section 37 of the Medical Schemes Act, No. 131 of 1998 all documentation must be furnished to this office by no later than 30 April 2001. Any person who fails to furnish the Registrar with the prescribed documentation as required per section 37 of the Act, within the specified period

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shall be liable to a penalty of R1000.00 for every day, which the failure continues (per section 66(3) of the Act).

In order for authenticated users to access the online statutory return database, schemes must submit the details of two authorized members of personnel who will be responsible for the completion and submitting of the return. One staff member must at least be a senior responsible official. The e-mail address will be used as the username when logging on and a password will be communicated in due course. The following format should be used:

| First name | Last name | E-mail Address |
|------------|-----------|----------------|
|------------|-----------|----------------|

Names can either be faxed or e-mailed to (0120 431-0541, j.kugel@medicalschemes.com).

3. Solvency level

Regulation 29, read in conjunction with S35 of the Act, sets down the minimum accumulated funds that should be maintained by a medical scheme. This is usually referred to as a "solvency level".

It should be re-iterated that this is a legal requirement and does not derive from generally accepted accounting practice or South African Statement of Generally Accepted Accounting Practice.

3.1. Encumbrances

S35 (4) reads: "*A medical scheme shall not be deemed to hold an asset for the purposes of this Act to the extent that such asset is encumbered*".

Keeping in mind that the intention of the legislator was clearly to exclude the encumbered assets where there is a risk of loss of those encumbered assets by the scheme due to default on the secured liability, the Registrar's position is as follows:

- 3.1.1. Where the encumbered asset is in respect of a liability that is in the scheme's balance sheet, the encumbered assets should not be deducted from accumulated funds. This would be the case, for instance, in a finance lease or instalment sale type agreement where computer equipment has been purchased. If the encumbered assets were to be deducted, the net effect would be a net liability, which is tantamount to double accounting. See example 1, Annexure A.
- 3.1.2. Where a specific asset is encumbered in respect of obligations between other persons (third party liability), there is a risk of loss to the scheme. For example, a cession of share certificates or insurance policy as collateral for a third party loan. In such a case, the liability will be in the third party's books. Such encumbered assets should be deducted from the accumulated funds. See example 2, Annexure A.

3.1.3. Should other variants of encumbrances present themselves to medical schemes, the underlying principles, including risk of loss and location of liability, should be considered. The final effect should not be an iniquitous position for the scheme.

3.1.4. It should be noted that asset encumbrances requires the Registrar's approval in terms of Section 35 (6).

3.2. Funds set aside for specific purposes

Regulation 29(1) requires the exclusion of "*funds set aside for specific*

purposes and unrealized non-distributable reserves". There is an uncertainty as to what constitutes funds set aside for specific purposes that need to be excluded from accumulated funds.

One would have to look at the reserves section in the balance sheet to decide whether there are funds set aside for specific purposes. Typically the balance sheet will have Accumulated Funds and other Reserves. Other Reserves are generally given such names as "general reserves", "reserve for contingencies", "reserves for extraordinary claims", "other reserves", etc. What complicates issues is that most of these "other reserves" are generally set aside for future claims payments. To exclude such reserves from accumulated funds would be acting contrary to the intention of this Regulation.

3.2.1. All funds set aside for future claims, whatever they are called, should be included in accumulated funds. This has the effect of looking at the nature of the fund, rather than the name. This would include pre-funding reserves which legally belong to the scheme.

3.2.2. Funds "set aside for specific *non-claims* purposes" should be excluded from accumulated funds.

3.2.3. It is recommended that schemes classify their reserves properly keeping in mind the Regulation 29 prescriptions.

3.2.4. See example 3, Annexure A, for illustration of the above principles.

3.3. Unrealized non-distributable reserves

It should be noted that the intention of this prescription was to deduct any unrealized surpluses recognized in the books of a medical scheme. The effect is as follows:

3.3.1. Unrealized non-distributable reserves shown in the balance sheet should be excluded from accumulated funds.

3.3.2. If unrealized revaluation surpluses have been included in the income statement or statement of changes in equity to arrive at accumulated funds, the cumulative surplus so included should be deducted from accumulated funds

3.3.3. See example 3, Annexure A, for illustration of the above principles.

3.4. Phase in period

Regulation 29 (3) provides for the phase in period of the solvency levels prescriptions. This means that:

3.4.1. As at 31 December 2000, all medical schemes should have a 10% solvency level. This 10% level should be maintained as a minimum for the next 12 months and the schemes should not dip below this level at any time;

3.4.2. At 31 December 2001, all medical schemes should have a 13.5% solvency level.. This 13.5% level should be maintained as a minimum for the next 12 months and the schemes should not dip below this level at any time;

3.4.3. At 31 December 2002, all medical schemes should have a 17.5% solvency level. This 17.5% level should be maintained as a minimum for the next 12 months and the schemes should not dip below this level at any time;

3.4.4. At 31 December 2003, all schemes should have a 22% solvency level. This 22% level should be maintained as a minimum for the next 12 months and the schemes should not dip below this level at any time;

3.4.5. At 31 December 2004, all medical schemes should have a 25% solvency level. This 25% level should be maintained as a minimum for the next 12 months and the schemes should not dip below this level at any time thereafter.

4. Appointment of auditors

In terms of section 36(2) of the Act, the Registrar is required to approve the appointment of auditors of medical schemes. The Council for Medical Schemes approved a revised questionnaire on the 2nd November 2000 which then becomes effective immediately. This revised questionnaire is based on the original version, which was issued by The South African Institute of Chartered Accountants (SAICA) in 1999. The amendments were made in consultation with SAICA. All medical schemes are required to ensure that the questionnaire, attached as Annexure B, is completed in respect of the audit for the year ending 31 December 2001.

The basic criteria remain independence and professional proficiency. The process of revision takes into cognizance the Registrar's latest concerns in the medical

schemes industry. The intention is also to highlight specific aspects of the auditor's duty of skill and care / professional proficiency during the performance of the audit in this industry. It should be reiterated that there is no automatic qualification or disqualification criteria in the questionnaire, and that each application will be evaluated taking into account all relevant facts.

Principal Officers are required to return the completed questionnaire, attached as Annexure B, for the attention of Carmel Foster at this office by 30 June 2001. An electronic copy is available on the Council for Medical Schemes' website. The address is www.medicalschemes.com.

Your co-operation will be greatly appreciated.



TP MASOBE
REGISTRAR OF MEDICAL SCHEMES

** Where assets are encumbered in respect of the scheme's liabilities

KAROO PETROLEUM MEDICAL SCHEME

BALANCE SHEET as at 31 December 2000

ASSETS

| | |
|--------------|---------------|
| Property | 100.00 |
| Other Assets | 400.00 |
| Total Assets | <u>500.00</u> |

FUNDS AND LIABILITIES

| | |
|-----------------------------|---------------|
| Accumulated Funds | 300.00 |
| Loan ABC Bank | 100.00 |
| Other Liabilities | 100.00 |
| Total Funds and Liabilities | <u>500.00</u> |

| | |
|----------------------------|----------------|
| Gross Annual Contributions | <u>1000.00</u> |
|----------------------------|----------------|

Property has been mortgaged over the loan from ABC bank.

SOLVENCY LEVEL

| | |
|-------------------------------------|------------|
| Accumulated funds per balance sheet | 300.00 |
| Gross annual contributions | 1 000.00 |
| Solvency | <u>30%</u> |

**Where assets are encumbered in respect of third party liabilities

KAROO PETROLEUM MEDICAL SCHEME

BALANCE SHEET as at 31 December 2000

ASSETS

| | |
|---------------------|----------------------|
| Investments | 100.00 |
| Other Assets | 400.00 |
| Total Assets | <u>500.00</u> |

FUNDS AND LIABILITIES

| | |
|------------------------------------|----------------------|
| Accumulated Funds | 300.00 |
| Other Liabilities | 200.00 |
| Total Funds and Liabilities | <u>500.00</u> |

Gross Annual Contributions **1 000.00**

Notes to the Annual Financial Statements as at 31 December 2000

Investments have been ceded to ABC bank as security for a loan issued to Karoo Clinic. The amount owing at 31 December 2000 was R100.00

SOLVENCY

| | |
|-------------------------------------|----------------------|
| Accumulated funds per balance sheet | 300.00 |
| Less : Investment encumbered | 100.00 |
| | <u>200.00</u> |

| | |
|----------------------------|----------|
| Accumulated funds | 200.00 |
| Gross annual contributions | 1 000.00 |

Solvency **20%**

KAROO PETROLEUM MEDICAL SCHEME**INCOME STATEMENT for the year ended 31 December 2000**

| | |
|------------------------------|--------------|
| Net Profit for year | - |
| Property revaluation surplus | <u>80.00</u> |
| | <u>80.00</u> |

BALANCE SHEET as at 31 December 2000**FUNDS AND LIABILITIES**

| | |
|-----------------------------------|----------------------|
| Accumulated Funds | 80.00 |
| Contingency Reserves | 65.00 |
| Pre -Funding Reserves : Claims | 35.00 |
| Pre- Funding Reserves: Pensioners | 60.00 |
| Asset replacement reserves | 100.00 |
| Non Distribution Reserves | 160.00 |
| Total members funds | <u>500.00</u> |

ASSETS

| | |
|---------------------|----------------------|
| Total Assets | <u>500.00</u> |
|---------------------|----------------------|

Notes to the Annual Financial Statements as at 31 December 2000

1. Contingency reserve

- a. The contingency reserve has been created to secure the schemes ability to meet unexpected extraordinary claims in future.

| | |
|-----------------------------------|-----------------------|
| Gross Annual Contributions | <u>1000.00</u> |
|-----------------------------------|-----------------------|

SOLVENCY LEVEL

| | |
|------------------------------------|----------------------|
| Total Members Funds | 500.00 |
| Less: Property revaluation surplus | -80.00 |
| Pre-Funding Reserve: Pensioners | -60.00 |
| Assets replacement reserve | -100.00 |
| Non distributable reserve | -160.00 |
| | <u>100.00</u> |

| | |
|----------------------------|---------|
| Accumulated Funds | 100.00 |
| Gross Annual Contributions | 1000.00 |

| | |
|----------|-------------------|
| Solvency | <u>10%</u> |
|----------|-------------------|

(It is recommended that schemes classify their reserves properly keeping in mind the Regulation 29 prescriptions.)

Information required by the Registrar of Medical Schemes in considering the approval of the appointment of an auditor of a medical scheme

Instructions for completion of the questionnaire

The form consists of two parts:

Part A Applicable to the audit firm

Part B Applicable to the responsible partner

"Responsible partner" means the auditor responsible for the effective functioning of all the phases in the audit and for exercising his/her professional judgement, based on the results of the audit procedure, to express an opinion on the fair presentation of the financial statements of the medical scheme.

The responsible partner should be specifically nominated by the firm being appointed, as the responsible partner on the audit of the medical scheme.

The responsible partner should complete the questionnaire and certify the contents as set out in the declaration on the last page of this document.

When firms are appointed for the first time, both Parts A and B should be completed.

Space has been provided for any comments that the responsible partner might wish to make that could be relevant to the Registrar when considering the application for approval. Should the space provided not be sufficient, the detail can be provided on a separate page, duly cross-referenced to the relevant question.

Whilst the questions cover various criteria for qualifying or disqualifying audit firms for audit engagements of medical schemes, the criteria and replies thereto should not be regarded as an automatic qualification or disqualification or as exhaustive. The criteria have been made as objective as possible, but, naturally, a degree of subjectivity is still present in some criteria, and not all applicable criteria could be foreseen by the Registrar.

Furthermore, depending on the complexity and size of the audit of the relevant medical scheme, certain questions may not be appropriate. Where this is the case, the fact and reason for the question not being applicable should be stated.

Information required by the Registrar of Medical Schemes
in considering the approval of the appointment of an auditor
of a medical scheme

| Part A (To be completed in respect of the audit firm) | |
|--|--|
| I | General objective: Administrative and firm profile information |
| 1. | Name of firm |
| 2. | Business address (postal and physical), telephone and facsimile numbers |
| 3. | Full name of responsible partner (including any former names) (The responsible partner should complete Part B of this questionnaire) |
| 4. | Number of partners in your firm, number of partners in the office responsible for the assignment and names of key partners involved in the assignment. (Use separate page if necessary) |

| III General objective: Professional proficiency of the firm | |
|---|--|
| 10. | <p>Are you of the opinion that sufficient and relevant knowledge, skills and disciplines are available in your firm for the engagement in respect of the following:</p> <ul style="list-style-type: none">Statements of GAAPSAICA Accounting and Auditing Guide and Specimen Financial Statements of Medical FundsStatements of SAASMedical Schemes Act No 131 of 1998, Regulations in terms of the Medical Schemes Act No 131 of 1998 and Circulars issued by the Council for Medical SchemesInspection of Financial Institutions Act, 1998 <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 11. | <p>Is the responsible partner qualified to act as auditor under the Public Accountant's and Auditor's Act</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 12. | <p>Please provide details of your firm's access to a technical department capable of researching new developments, in auditing and accounting standards, relating to the <u>medical schemes industry</u></p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |

| III General objective: Professional proficiency of the firm (continued) | |
|---|--|
| 13. | <p>Please provide details of your firm's international links with auditors of similar institutions in other countries, in order to share information and expertise and to facilitate the audit of any cross-border activities of the medical scheme</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 14. | <p>Please provide details of your firm's access to adequately specialized training for auditors in the medical schemes industry</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 15. | <p>Please provide details of your firm's access to a library with up-to-date sources of all relevant statements, standards, legislation, regulations, literature, trends and developments within the medical schemes industry</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 16. | <p>Please provide details of your firm's access to a specialised unit, capable of auditing and assessing the adequacy and effectiveness of computerised systems</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |

| III General objective: Professional proficiency of the firm (continued) | |
|---|--|
| 17. | <p>Does your firm have an audit approach, techniques and procedures designed to obtain reasonable assurance that misstatements arising from fraud and error that are material to the financial statements as a whole are detected? (Please provide details)</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 18. | <p>Please provide details of your firm's procedures to ensure that its audit approach is kept up to date with regard to developments in the profession and within the <u>medical schemes industry</u></p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 19. | <p>Please provide details of your firm's competent quality-assurance process that ensures that there is compliance with the firm's internal standards and any externally imposed standards</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 20. | <p>Please provide details of your firm's feasibility plans to staff the engagement such that there is effectiveness with respect to:</p> <p style="padding-left: 40px;">Staff continuity, and</p> <p style="padding-left: 40px;">Staff rotation</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |

| IV General objective: Disqualification of the firm | |
|--|---|
| 21. | <p>Is the responsible partner qualified to act as auditor, specifically relating to the disqualification criteria stated in section 275 of the Companies Act, 1973?</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 22. | <p>Are there any pending or current lawsuits or professional liability suits against partners of the firm that the Registrar should be aware of? (Please provide details)</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 23. | <p>Has your firm previously been engaged by a regulatory authority to perform a special investigation on its behalf that failed to reveal a problem that was subsequently shown to exist? (Please provide details)</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 24. | <p>Does your firm have the knowledge to comply with all the special duties imposed by legislation on the auditor of the medical scheme, especially in terms of Chapter 7 of the Medical Schemes Act and Regulations 29 & 30 in terms of the same Act? (Please provide details)</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |

| Part B (To be completed by the responsible partner) | |
|--|---|
| I | General objective: Responsible partner information, qualifications and experience |
| 1. | Membership/reference number with SAICA and with the Public Accountants' and Auditors' Board (PAAB) |
| 2. | Professional qualifications and year in which they were obtained. Provide a copy of your <i>curriculum vitae</i> |
| 3. | Occupation and employment during the past 10 years. While in auditing, indicate types of client, in particular how many in the medical schemes industry. |
| 4 | Has your registration as a chartered accountant or professional accountant ever been suspended or have you ever been cautioned, reprimanded or fined by the PAAB or SAICA? (Please provide details) |

| II General objective: Responsible partner information, qualifications and experience (continued) | |
|--|---|
| 5. | <p>Please provide details of attendance of SAICA's workshops relating to the medical schemes industry</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> |
| 6. | <p>Are you on SAICA's mailing list for receiving documentation of the medical schemes industry?</p> <p>.....</p> <p>.....</p> |
| 7. | <p>Do you have a copy of the relevant Acts, regulations and Registrar's circulars that are in force within the medical schemes industry, and ARE YOU AWARE of the contents thereof?</p> <p>.....</p> <p>.....</p> |

| | |
|-----|--|
| II | General objective: Independence of the responsible partner |
| 8. | <p>Do you believe that you are independent from the medical scheme, or the group of which it is part, and able to maintain an objective frame of mind in fulfilling your audit responsibilities? (Please provide details)</p> <p>.....</p> <p>.....</p> |
| 8.1 | <p>Do you believe that in, your provision of other consulting services, if any, to the medical scheme, you will be able to maintain an independent frame of mind in forming an opinion regarding the institution? (Please provide details)</p> <p>.....</p> <p>.....</p> |
| 8.2 | <p>Are you involved in the management or decision making process of the medical scheme, or are you associated with a service provider of the medical scheme? If yes, kindly provide a list of other than audit services provided to the MEDICAL SCHEME AND/OR SERVICE PROVIDER (e.g. re-insurer, administrator, managed healthcare organization) to the scheme, an indication of the extent of such services, as well as whether such services are carried out independently of the responsible partner. <i>(Actions such as being engaged in the preparation of the financial statements and statutory returns, involvement in the valuation of assets or liabilities for purpose of recording them in the financial statements, acting for the medical scheme in the resolution of litigation that may have a material impact on the financial statements, the design of computer systems, the rendering of internal audit services, or performance of services having a direct impact upon senior management, such as their recruitment, which could indicate involvement in the management of the medical scheme.)</i></p> <p>.....</p> <p>.....</p> |
| 8.3 | <p>Are you a member of the medical scheme?</p> <p>.....</p> |
| 8.4 | <p>Do you, as responsible partner, have (or intend having) a direct line of communication and a working relationship with the board of directors/trustees and audit committee where required by the medical scheme?</p> <p>.....</p> |
| 8.5 | <p>Is there anything known to you that will prevent the audit relationship from continuing to exist? If yes, please provide details.</p> <p>.....</p> <p>.....</p> |

III

General objective: Professional proficiency of the responsible partner

9.

Do you, in your capacity of responsible partner, have access to the following resources:

9.1

Relevant knowledge, skills and disciplines, as contemplated in question 10 of Part A

.....

9.2

Technical department, as contemplated in question 12 of part A?

.....

9.3

International links with the auditors of similar institutions, as contemplated in question 13 of part A?

.....

9.4

A library, as contemplated in question 15 of part A?

.....

9.5

A specialised unit, as contemplated in question 16 of part A?

.....

9.6

Knowledge, as contemplated in question 24 of Part A

.....

| III General objective: Professional proficiency of the responsible partner (continued) | |
|--|---|
| 10. | Are you, as responsible partner of the engagement, subject to external practice reviews? |
| 11. | Are you, or will you be able, to show how all problems addressed in the most recent practice review reports have been subsequently resolved? |
| 12. | Are you, as responsible partner of the engagement, subject to internal peer review from time to time by your partners with appropriate industry experience? (Please provide details) |

| IV | General objective: Disqualification of the responsible partner |
|-----|---|
| 13. | Are you qualified to act as auditor specifically keeping in mind the disqualification criteria covered in section 275 of the Companies Act, 1973? |
| 14. | Are there any pending or current lawsuits or professional liability suits pending against you that the Registrar should be aware of? (Please provide details) |
| 15. | Have you ever been a responsible partner engaged by a regulatory authority to perform a special investigation on its behalf that failed to reveal a problem that was subsequently shown to exist? (Please provide details) |
| 16. | Have you ever been removed as responsible partner of a regulated institution by a regulatory authority? (Please provide details) |

DECLARATION

I, the undersigned, the responsible partner of (name of medical scheme), certify that, to the best of my knowledge, the information given in answer to the above questions in Part A and Part B (indicate as applicable) is complete and accurate and not untrue or misleading in any respect.

I undertake, as long as I continue to be the partner responsible for the audit of the medical scheme, to notify the Registrar of Medical Schemes of any material changes to the answers to the questions above, inclusive of any disciplinary action instituted against me by not later than 21 days as from the day that such changes come to my attention.

Further, I undertake to report to the Registrar, in terms of Section 36 (5) (b), any matters relating to the affairs of the medical scheme of which I become aware in the performance of my functions as auditor and which, in my opinion as auditor, may prejudice the medical scheme's ability to comply with Chapter 7 read in conjunction with the Regulations in terms of the Medical Schemes Act of 1998.

Lastly, I undertake to report to the Registrar any material internal control weaknesses identified during the performance of the audit, which have remained unresolved for more than one audit period

Name of firm or partnership

Signed:

Date: