



**TO ALL PRINCIPAL OFFICERS, BOARDS
OF TRUSTEES OF ALL MEDICAL
SCHEMES, AND PREPARERS OF
STATUTORY RETURNS**

Ref: Annual Returns 2008
Enq: E. Figueiredo
t: 012 431 0525
f: 012 431 0625
e: e.figueiredo@medicalschemes.com
Date: 04 June 2009

Circular 11 of 2009

**GENERAL NOTIFICATION: GENERAL CONCERNS NOTED DURING THE ANALYSIS OF
THE 2008 ANNUAL FINANCIAL STATEMENTS AND STATUTORY RETURNS**

1. INTRODUCTION

1.1 Purpose

The Office of the Registrar would like to express its appreciation to the medical schemes industry with regards to your cooperation in the completion and submission of the 2008 Annual Financial Statements and Statutory Returns.

The purpose of this Circular is to:

- enhance the quality of the data submitted in the Annual Financial Statements and Statutory Returns;
- achieve standardisation and uniformity regarding proper disclosure;
- reduce or minimise errors in the Annual Statutory Returns; and
- establish good financial reporting of the entire medical schemes industry.

1.2 Background

A review of the information collected by the Office has highlighted a few discrepancies in the type of information currently being furnished by medical schemes in their Statutory Returns. The Office would therefore like to point out important matters noted during the analysis of the Annual Statutory Returns, and the preparers of statutory returns and scheme management are hereby requested to address those matters in future submissions.



2. KEY AREAS OF CONCERN

Matters concerning the Board of Trustees Report

- 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) A few schemes disclosed the Principal Officer (PO) as part of the BoT. Schemes should ensure that the PO is not disclosed as part of the BoT unless the rules of the scheme allow for such.
- 3) 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.

These differences were mainly due to the following:

- the data used in the BoT Report and Annual Statutory Return is not generated on the same date.
- 4) 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.
 - 5) Some instances were noted where schemes did not disclose the components used in the calculation of the solvency level. Schemes should in future reflect the details of the solvency calculation in the BoT Report as prescribed by Regulation 29 of the Medical Schemes Act 131 of 1998 (the Act).
 - 6) 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.

These differences were due to the following:



- unrealised losses and debit reserves were added back to the members' funds in the BoT Report. Schemes are referred to Circular 13 of 2001, paragraph 3.3, which indicates that only unrealised surpluses should be deducted; and/or
- consolidated members' funds were included in the solvency calculation. Only scheme results should be taken into account.

Matters concerning the audited Annual Financial Statements

- 1) It was noted some schemes have not complied with the full requirements of Circular 39 of 2007 in respect of the *Prescribed Income Statement Format*. Non-adherence to the prescribed income statement might warrant the rejection of the Annual Financial Statements in future.
- 2) We have noted a few instances where schemes disclosed irrelevant and/or insufficient accounting policies in their financial statements.

Some common examples are:

- available for sale accounting policy is noted under the investments accounting policy but the scheme only invests in cash and cash equivalents;
- an accounting policy for sale and leaseback transactions has been disclosed but no such transactions occurred during the year; and
- an accounting policy for intangible assets has been disclosed while no intangible assets are held by the scheme.

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.

- 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.



- 4) It was noted that a few schemes did not comply with the disclosure requirements as set out in IFRS 4 paragraphs .36 to .41.

Schemes are referred to International Financial Reporting Standards (IFRS) 4 paragraphs .36 to .41 as well as the 2008 South African Institute for Chartered Accountants (SAICA) Medical Schemes Accounting and Auditing Guide (the SAICA Guide) for disclosure requirements in respect of insurance and reinsurance contracts. It includes the following:

Paragraph 36 states: "An insurer shall disclose information that identifies and explains the amounts in its financial statements arising from insurance contracts."

The following needs to be disclosed according to paragraph 37 in order to comply with paragraph 36:

- a) its accounting policies for insurance contracts and related assets, liabilities, income and expense;
- b) the recognised assets, liabilities, income and expenses arising from the insurance contracts;
- c) the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in b). When practicable, an insurer shall also give quantified disclosure of those assumptions;
- d) the effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial statements; and
- e) reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.

Paragraph 38 states: "An insurer shall disclose information that enables users of its financial statements to evaluate the nature and extent arising from insurance contracts."

The following *inter alia* needs to be disclosed according to paragraph 39 in order to comply with paragraph 38:

- a) its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks;
- b) deleted;
- c) information about insurance risk (both before and after risk mitigation by reinsurance), including information about:
 - i) sensitivity to insurance risk (see paragraph 39A);
 - ii) concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristics that identifies each concentration (e.g. type of insured event, geographical area, or currency);
 - iii) actual claims compared with previous estimates (i.e. claims development); and
- d) Information about credit risk, liquidity risk and market risk that paragraphs 31 – 42 of IFRS 7 would require if the insurance contracts were within the scope of IFRS 7.



Paragraph 39A states that an insurer shall disclose either a) or b) as follows:

- a) a sensitivity analysis that shows how profit or loss and equity would have been affected had changes in the relevant risk variable that were reasonably possible at the balance sheet occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used; or
- b) qualitative information about sensitivity and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.

5) It was noted that in certain instances schemes did not comply with the disclosure requirements as set out in IFRS 7 paragraphs .31 to .42. You are referred to IFRS 7 paragraphs .31 to .42 as well as the 2008 SAICA Guide for disclosure requirements in respect of financial instruments. It should be noted that in terms of IFRS 4 paragraph 39(d), similar disclosures to those required in IFRS 7 paragraphs .31 to .42 should be made in respect of insurance contracts.

IFRS 7 paragraph 31 states that "An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting period".

Paragraph 32 states that "disclosures [are] required by paragraphs 33-42 on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to credit risk, liquidity risk and market risk".

Paragraph 33 provides details on the qualitative disclosures and requires that an entity discloses for each risk arising from financial instruments:

- a) the exposures to risk and how they arise;
- b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and
- c) any changes in (a) or (b) from the previous period.

Paragraph 34 requires an entity to provide the following quantitative disclosures for each type of risks arising from financial instruments:

- a) summary quantitative data about its exposure to that risk at reporting date;
- b) the disclosures required by paragraphs .36 to .42, to the extent that they are not provided in (a), unless the risk is not material; and
- c) concentration of risk if not apparent from (a) and (b).

Additionally, paragraphs .36 to .42 provide details on the disclosure requirements in respect of credit risk, liquidity risk and market risk.

6) In some instances schemes did not calculate the estimated claims and estimated recoveries in respect of other risk transfer arrangements (i.e. capitation agreements) as the information (utilisation data etc.) could not be obtained from the managed care organisation. Schemes are directed to ensure that all managed care contracts make provision for the submission of the utilisation data by the managed care organisation to the schemes, as it is a requirement of Regulations 15B(2)(d)(ii), 15D(a)(ii), (v) and (c), and also 15J(2)(c) of the Act for managed



care organisations to make such data available. Kindly also refer to Circular 49 of 2007 in this regard.

- 7) It was noted that some schemes made a note in the BoT Report or Annual Financial Statements stating that a specific risk transfer arrangement was regarded as a non-significant risk transfer arrangement with reference to the amount of claims incurred in respect of the arrangement relative to the scheme's total claims.

Schemes are referred to the following paragraphs:

- paragraph 35 of the SAICA Guide which states that "IFRS 4 requires the scheme to assess each contract separately for determining whether there is a transfer of significant risk"; and
 - IFRS 4, paragraph B25 (under *Basis of Conclusion*) which states that "An insurer shall assess the significance of insurance risk contract by contract, rather than by reference to the materiality of the financial statements".
- 8) It was noted that a scheme set off its risk transfer recoveries against the risk transfer claims. Schemes are referred to paragraph 14 of IFRS 4 which states that the income or expense from reinsurance contracts may not be offset against the expense or income from the related insurance contracts.
- 9) 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 2008 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 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.

- 10) It was noted that some schemes reclassified and/or restated comparative amounts without complying with the necessary disclosure requirements in terms of IAS 1 paragraphs .38 and .39 as well as IAS 8. Schemes should ensure that the necessary information (i.e. the nature, amount and the reason) is disclosed. Schemes should further ensure that reclassifications and prior year adjustments also be done in the Annual Statutory Return.
- 11) The following inadequate disclosure of items in terms of the Act, relevant IFRS and IAS were noted:
- sufficient details on trustee remuneration were not disclosed as required in terms of Regulation 6A;
 - disclosure requirements in respect of finance leases in terms of IAS 17 not adhered to;
 - non-adherence to disclosure requirements of IAS 38 (Intangible Assets); and
 - inadequate disclosure of defined benefit plans in terms of IAS 19.
- 12) It was noted that a scheme submitted consolidated Annual Financial Statements without separately disclosing scheme results. Schemes are requested to separately disclose scheme results from consolidated results.



Matters concerning the Annual Statutory Return

- 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. Schemes are also referred to Circular 9 of 2009 in this respect.
- 2) It was noted that some schemes did not provide a BoT resolution allowing another trustee to sign on behalf of the Principal Officer or Chairperson in their absence.
- 3) We noted that schemes did not pay particular attention to 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.
- 4) Some schemes did not accurately and completely disclose information in Parts 3.1 to 3.4. Schemes are requested to disclose accurate and complete information with regards to the different categories.
- 5) It was noted that schemes used the "other" line in parts 4.3, 4.8, 4.12 and 4.16 as a dumping ground. Please ensure that where provision was made for a specific line item, these items should not be disclosed in the "other" line provided.
- 6) It was noted that in Part 4.8 schemes provided details of every creditor outstanding at year end. Schemes are requested only to provide details of large creditors such as leave provisions, audit fees etc. Other small trade creditors can be grouped together under other trade creditors.
- 7) Schemes are requested to disclose all significant risk transfer arrangements in the Annual Statutory Return, regardless of the materiality of the amounts involved.
- 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.
- 9) A number of schemes did not complete Part 4.17 correctly according to the Annual Financial Statements. Schemes are requested to complete the Trustee Remuneration and Considerations correctly so that it agrees to the amounts as disclosed in the notes to the Annual Financial Statements.



- 10) A number of schemes did not complete the transactions in respect of the provision for impaired losses and amounts written off correctly in Part 4.18. Please refer to the Helpfile issued by the Office in future to ensure that this part is completed correctly.
- 11) 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. However, please note that 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.
- 12) It was noted that a scheme recognised its discontinued options as a discontinued operation in Part 6 of the Annual Statutory Return. Discontinued options do not necessarily meet the criteria of a discontinued operation as per IFRS 5. Schemes are requested to recognise all discontinued options under continuing operations in Part 6 unless they meet the definition of a discontinued operation as per IFRS 5.
- 13) Although there are just a few schemes that prepare annual returns on a consolidated basis, we would like to note that all consolidation income statement transactions should be disclosed in Part 6 line 6.22. Results of group companies should not form part of surplus/deficit from operations. Schemes should also ensure that the consolidated Annual Financial Statements must reflect group results separately from scheme results.
- 14) 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 Guidelines 40 – 45 of 2009 to assist you in this regard.
- 15) 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. use the look-through principle).

Matters concerning the auditors

- 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.
- 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.



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.

The following non-compliance with the provisions of the Act was noted but generally not reported in both the Annual Financial Statements and BoT Report. Some of the more common examples are:

- a. section 33(2) – self supporting benefit options;
- b. section 35(8) – investment in related parties;
- c. section 35(5) read in conjunction with Regulation 30 and Annexure B – prescribed assets;
- d. section 26(7) – contributions received later than three days after payment thereof became due;
- e. section 59 – payment of benefits within 30 days after the day on which the claim was received; and
- f. Regulation 29 read in conjunction with Regulation 30.

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.

Your cooperation will be highly appreciated.

JULINDI SCHEEPERS
ACTING HEAD: FINANCIAL SUPERVISION
COUNCIL FOR MEDICAL SCHEMES