# Defence Health Limited

**(ABN 80 008 629 481 AFSL 313890)**

# Financial Statements
# for the year ended 30 June 2015

**Contents**


| | |
|---|---|
| Corporate Governance Statement | 1 |
| Directors' Report | 7 |
| Auditor's Independence Declaration | 12 |
| Consolidated Statement of Profit or Loss | 13 |
| Consolidated Statement of Financial Position | 14 |
| Consolidated Statement of Changes in Equity | 15 |
| Consolidated Statement of Cash Flows | 16 |
| Notes Accompanying Financial Statements | 17 |
| Directors' Declaration | 42 |
| Independent Auditor's Report | 43 |

## Registered Office & Principal Place of Business

Level 4 380 St Kilda Road
Melbourne VICTORIA 3004

## Corporate Governance Statement

Defence Health Limited (referred to as “Defence Health” or the “Company”) is a company limited by guarantee, incorporated and domiciled in Australia. The Company provides regular reports to the Private Health Insurance Administration Council (PHIAC) which regulates and monitors the private health insurance industry. From 1 July 2015, this regulatory responsibility has transferred to the Australian Prudential Regulation Authority (APRA).

The Company and its subsidiary, Defence Heath Foundation Pty Ltd, together are referred to as the “Group”. Defence Health Foundation Pty Ltd is the trustee of Defence Health Foundation.

## Members

The Members of Defence Health are the Directors and the persons who hold the offices of the Chief of Army and Chief of Air Force.

The Members are briefed on the Company’s performance on a regular basis and on significant financial, operational and strategic issues as they arise.

## Board of Directors

### Role and responsibilities

Directors are appointed by the Company for a term of four years after which they are eligible for reappointment.

The Board of Directors is responsible for the governance and performance of the Company and must ensure that its activities are carried out in compliance with all contractual, legal and regulatory obligations.

The powers and duties of the Board are specified in the Company’s Constitution, the *Corporations Act 2001*, the *Private Health Insurance Act 2007* and other relevant legislation and law. The Board has developed and adopted corporate governance policies which set out:

- its specific powers and responsibilities
- the matters reserved to the Board and those delegated to the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Company Secretary and Committees; and
- procedures aimed at ensuring the effective operation of the Board.

Key responsibilities of the Board include:

- determining the company’s risk appetite and strategic direction and approving corporate strategies;
- ensuring the Company is financially sound, meets prudential requirements and has appropriate financial reporting practices;
- determining the capital management requirements and approving the capital management plan, reviewing management performance against the plan and taking corrective action when required;
- receiving the Financial Condition Report from the Appointed Actuary at the Board meeting;
- ensuring the Company has adequate risk management systems in place and systems of internal controls to ensure compliance with applicable laws and regulations;
- approving operating budgets and performance indicators, reviewing performance against these, and initiating corrective action when required;
- monitoring financial and other reporting to Members and other parties to whom such reports should be provided;
- approving major capital expenditure and divestitures and monitoring the progress of such;
- ensuring policies on key issues are in place and appropriate;

- monitoring senior management's performance in implementing strategy, business plans and budgets and ensuring appropriate resources are available;
- appointing, evaluating the performance of and where appropriate, removing the Chief Executive Officer, Chief Financial Officer and the Company Secretary;
- considering the appointment and removal of Directors to and from the Board and making recommendations to the Members; and
- ensuring the business is conducted ethically and transparently.

The Chairman is responsible for ensuring the Board receives accurate, timely and clear information to enable it to evaluate the performance of management and the Company and to make informed decisions.

The Company Secretary is responsible for ensuring compliance with Board procedures and provides advice to the Board, via the Chairman, on governance matters.

**Board composition**

The Board comprises eight non-executive Directors including a non-executive Chairman. The Board has assessed that all Directors are independent.

Details of the Directors, including names and qualifications, are included in the Directors' Report.

**Director induction and continuing education**

Directors are provided with detailed briefings by management on corporate strategy and current issues affecting the Company and the private health insurance industry generally. All Directors are encouraged to meet with employees from all areas of the business.

In order to achieve continuing improvement in Board performance, all Directors are encouraged to undergo continual professional development. Directors are provided with the resources and training to address skills gaps where they are identified.

**Conflicts of interest**

Directors are required to keep the Company advised on an ongoing basis of any interest that could potentially conflict with those of the Company.

Each Director is obliged to notify other Directors of any material personal interest that they may have in a matter that relates to the affairs of the Company (subject to certain exceptions specified in the *Corporations Act 2001)*.

Directors who may have, or may be perceived to have, a material personal interest in a matter before the Board do not participate in discussions and abstain from voting on that matter.

**Independent professional advice and access to company information**

Directors may independently and collectively seek advice from independent experts whenever it is considered necessary. With the consent of the Chairman, individual Directors may seek independent professional advice at the expense of the Company on any matter connected with the discharge of their responsibilities.

Each Director has the right of access to all relevant Company information and to the Company's management.

**Directors' remuneration**

Directors' remuneration is determined each year having regard for the aggregate maximum amount advised by Members. No retirement benefits, other than superannuation, are payable to Directors upon expiry of office. Aggregate amounts of Directors' and specified executives' remuneration are set out in the notes to the Financial Statements.

**Board meetings**

The Board scheduled and met for eight Board meetings and sixteen Committee meetings during the year.

The agendas for Board and Committee meetings are prepared jointly by the relevant Chairman, the Chief Executive Officer and the Company Secretary.

Board and Committee reports are circulated in advance of meetings. Executives are involved in most Board and Committee discussions. The agenda for all Board and Committee meetings make provision for Directors to meet without executives being present.

**Board performance**

A review of the Board's effectiveness, efficiency and overall performance was conducted in 2014.

## Board Committees

The Board has established a number of Committees, being:

- Risk, Compliance and Audit Committee;
- Business Strategy Committee;
- Investment Committee; and
- Nomination and Remuneration Committee.

The Board may delegate powers and functions to these Committees, other than those imposed exclusively on the Board by the law or the Company's Constitution. Each Committee operates under a charter which is approved and periodically reviewed by the Board.

Details of Committee membership and attendance are included in the Directors' Report.

**Risk, Compliance and Audit Committee**

Four non-executive Directors are members of the Risk, Compliance and Audit Committee. The Chief Executive Officer and other executives attend meetings by invitation. The Chairman of this Committee, Mr A Beckett, is an independent non-executive Director.

The role of the Risk, Compliance & Audit Committee is to assess:

- the risks to which the Company is exposed and the effectiveness of the risk management processes;
- the capacity of the internal control framework to ensure legal and regulatory compliance, safeguard assets and maintain the integrity of financial information;
- the financial condition of the health benefits fund as determined by the company's actuary and the Appointed Actuary; and
- the annual financial statements, including the suitability of the accounting policies adopted by the Company.

Key responsibilities include:

- reviewing the annual financial report;
- approving and monitoring the annual risk assessment plan and processes;
- monitoring the activities of the internal audit and compliance functions;
- monitoring the effectiveness of the internal control framework;
- monitoring the effectiveness of the Company's fraud control policies and procedures;
- monitoring the procedures in place to ensure compliance with the legislation, regulations and codes;
- periodically meeting with the company's actuary to review the financial condition of the health benefits fund;
- the Appointed Actuary is invited to meetings if and when required;

- considering any matter brought to the attention of the Committee by the company's actuary or the Appointed Actuary;
- reviewing the performance of the Internal and External Auditors; and
- approving the fund rules.

The Committee met four times during the year. The Committee met with the Internal Auditor and the External Auditor with and without management being present.

**Business Strategy Committee**

The Business Strategy Committee comprises four non-executive Directors. The Chief Executive Officer and other executives attend meetings by invitation. The Chairman of the Committee, Mr M.J. Bassingthwaighte AM, is an independent non-executive Director.

**The Committee's role is to:**

- develop and manage the strategic planning process and routinely advise the Board on the achievement of its strategic plan;
- increase the company's understanding of the Defence organisation and needs of Defence personnel and their families; and
- advise the Board on matters of strategic importance as and when they arise.

The Committee meets as required, and met once during the year.

**Investment Committee**

The Investment Committee comprises four non-executive Directors. The Chairman of the Board is an ex-officio member. The Chief Executive Officer and other executives attend meetings by invitation. The Chairman of the Committee, Ms A Williams is an independent non-executive Director.

The primary role of the Committee is to set the investment strategy and to monitor its effectiveness in achieving targeted returns within the Board's risk appetite. The Investment Committee oversees compliance with the liquidity management requirements of the Capital Management Plan.

The Committee met five times during the year.

**Nomination and Remuneration Committee**

The Nomination and Remuneration Committee comprises the Chairman of the Board and three non-executive Directors. The Chairman of the Committee, Air Commodore P Byrne, is an independent non-executive Director.

The Committee's role is to assist the Board and the Chairman on matters relating to the Board including composition, membership renewal, skills development, remuneration, the appointment and remuneration of the CEO and executive management.

The Committee met six times during the year.

## Accountability and audit

### External audit

Deloitte Touche Tohmatsu audits the statutory Financial Statements of the Company in accordance with the *Corporations Act 2001*.

The Risk, Compliance and Audit Committee met with the External Auditors during the year to:

- review the external audit plan having regard for any significant changes in structure, operations, internal controls or accounting policies likely to impact the Financial Statements;
- consider the results and findings of the auditor, the adequacy of accounting and financial controls, and progress in implementing recommendations of the auditor; and
- review the financial report and any significant adjustments required as a result of the external audit process.

### Internal control framework

The Board is responsible for the overall internal control framework and for reviewing its effectiveness, recognising that no cost effective internal control system will preclude all errors and irregularities. The systems are intended to provide appropriate assurance on:

- accuracy and completeness of financial reporting;
- safeguarding of assets;
- maintenance of proper accounting records;
- compliance with applicable legislation, regulation and best practice; and
- identification and mitigation of business risks.

The key features of the control environment include the charters for the Board and each of its Committees, a clearly understood organisational structure with documented delegations of authority from the Board to executive management and defined procedures for the approval of major transactions and capital expenditure.

### Certification by Chief Executive Officer and Chief Financial Officer

In accordance with Board policy, the Chief Executive Officer and Chief Financial Officer provide a self-assessed certification of the controls and activities of the Company, including representations as to the Company's financial condition. The certification includes a statement that the integrity of the Company's Financial Statements are founded on sound systems of risk management, compliance and control, that the policies adopted by the Board are adhered to, and that the Company's risk management, compliance and control systems are operating efficiently and effectively in all material respects.

Based on the evaluation performed as at 30 June 2015, the Chief Executive Officer and Chief Financial Officer concluded that risk management, compliance and control systems were reasonably designed to ensure that the Financial Statements and Notes thereto are in accordance with the *Corporations Act 2001* and that there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

### Internal audit and risk management

The internal audit function is performed by KPMG Audit & Risk Advisory Services in accordance with a risk-based internal audit plan. This plan is reviewed and approved annually by the Risk, Compliance and Audit Committee. All audit reports are reviewed by the Committee.

The risk management methodology in place is based on Australian and New Zealand Risk Management Standards AS/NZS ISO 31000:2009 Risk Management. A key component of the strategic risk management planning and operational reviews is the identification and evaluation of potential business risks.

Each year a full risk assessment and mitigation plan is prepared and endorsed by the Board. The risk assessment process includes input from the Board, executive and management.

The Board regularly receives updates on the status of key business risks.

## Ethical standards

The Company's ethical conduct policy addresses, inter alia, acting within the law, maintaining consistency in dealings, respect and dignity for others, confidentiality and privacy, honesty and fairness in the promotion of products and services, fairness in competing, equal opportunity, harassment, misuse of substances, conflicts of interest, gifts and entertainment and social responsibility.

All employees understand that they are personally responsible for:

- being aware of the laws, regulations and policies that apply to their specific job function and level of responsibility;
- not compromising the Company's values or standards, regardless of the pressure from internal and external forces;
- directing their concerns to the appropriate person and offering suggestions for improvements where appropriate; and
- seeking advice and assistance regarding the application of ethical standards.

Managers are responsible for:

- acting as a positive role model;
- ensuring others have the knowledge and resources they need to adhere to the Company's standards;
- setting clear, measurable and challenging goals that promote ethical behaviour;
- enforcing the Company's standards consistently and fairly;
- responding appropriately to those who raise questions and concerns; and
- being prepared to be held personally accountable for their own integrity and shortcomings as well as those of the people they lead.

## Directors' Report for the year ended 30 June 2015

The Directors herewith submit the Financial Statements of Defence Health Limited for the financial year ended 30 June 2015.

### Members

Defence Health Limited has one class of Member. Each Member is entitled to one vote on matters determined by Members' votes and is eligible to be appointed as a Director of the Company. If the Company is wound up, each person who is a Member at the time or who was a Member within the preceding year, is liable to contribute up to one hundred dollars as necessary to meet the debts and liabilities of the Company. The total amount which Members are liable to contribute collectively is one thousand dollars.

### Directors

The names and detail of the Directors of Defence Health Limited who held office during the financial year are:

| Name | Particulars |
| --- | --- |
| Major General Gregory Howard Garde AO RFD (Ret'd)<br>BA(Hons) LLM | Appointed to the Board in April 2004 and appointed Chairman in October 2011. Current term expires at the Annual General Meeting to be held in 2015. Major General Garde was a member of the Investment Committee and the Nomination and Remuneration Committee for the entire year. Major General Garde is a Justice of the Supreme Court of Victoria, President of the Victorian Civil and Administrative Tribunal, Director of Judicial College of Victoria, President of Council of Australasian Tribunals, Victorian Chapter, and member of the Courts Council, Court Services Victoria. |
| Mr Michael John Bassingthwaighte AM<br>FAICD | Appointed to the Board in July 2001. Current term expires at the Annual General Meeting to be held in 2018. Mr Bassingthwaighte was appointed Chairman in January 2004 and retired as Chairman in October 2011. Mr Bassingthwaighte was Chairman of the Business Strategy Committee and a member of the Nomination and Remuneration Committee for the entire year. Mr Bassingthwaighte is Chairman of HAMB Systems Ltd, Director of Australian Health Service Alliance Ltd, Director of Members Own Health Funds Ltd, Director of Illawarra Business Chamber Ltd, Director of Illawarra Health and Medical Research Ltd, Director of Coordinare and Chief Executive Officer of Lysaght Peoplecare Ltd, National Health Benefits Australia Pty Ltd and the Reserve Bank Health Society Ltd. |
| Mr Alan Ian Beckett<br>BEc FCA, GAICD | Appointed to the Board in January 2006. Current term expires at the Annual General Meeting to be held in 2016. Mr Beckett was the Chairman of the Risk, Compliance and Audit Committee and a member of the Investment Committee for the entire year. Mr Beckett is a Director of Westbourne Capital Pty Ltd and Westbourne Credit Management Ltd, the Deputy Chair of the Defence Audit and Risk Committee and a member of the Audit Committee, Independent member of the Audit & Risk Committee of Note Printing Australia and Director of Meat and Livestock Australia. Mr Beckett is also a member of the Very Special Kids Foundation. |
| Ms Julie Anne Blackburn<br>BNurs GradDip Midwifery GAICD | Appointed to the Board in December 2011. Current term expires at the Annual General Meeting to be held in 2015. Mrs Blackburn was a member of the Business Strategy Committee and the Risk, Compliance and Audit Committee for the entire year. Ms Blackburn is a Director of Karralika Program Inc and Chair of the Defence Health Foundation. |

| | |
|---|---|
| Air Commodore Philip Darcy Byrne<br>BA FACDSS MAICD | Appointed to the Board in April 2005. Current term expires at the end of the Annual General Meeting to be held in 2016. Air Commodore Byrne was Chairman of the Nomination and Remuneration Committee, and a member of the Business Strategy Committee for the entire year. Air Commodore Byrne is a Director of Defence Health Foundation Pty Ltd, and the Appointee Director of Chief of Air Force. |
| Colonel Anthony Hambleton AM GAICD | Appointed to the Board in February 2014. Current term expires at the end of the Annual General Meeting to be held in 2017. Colonel Hambleton is a member of the Nomination and Remuneration Committee and Business Strategy Committee. Colonel Hambleton is a Director of Defence Health Foundation Pty Ltd. Colonel Hambleton is also a member of the Army Reserve and the Appointee Director of Chief of Army. |
| Mr Garry Richardson FAICD | Appointed to the Board in February 2011. Current term expires at the Annual General Meeting to be held in 2018. Mr Richardson was a member of the Risk, Compliance and Audit Committee and Investment Committee for the entire year. Mr Richardson is a Director of Calvary Ministries Ltd. |
| Ms Alice Joan Morrice Williams<br>BComm FCPA FAICD CFA ISFA AIF | Appointed to the Board in February 2010. Current term expires at the Annual General Meeting to be held in 2017. Ms Williams was Chairman of the Investment Committee and a member of the Risk, Compliance and Audit Committee for the entire year. Ms Williams is a Director of Equity Trustees Limited, Director of Guild Group, Director of Djerriwarrh Investments Ltd and a Council member of the Cancer Council of Victoria, Director of Port of Melbourne Corporation, Director of Cooper Energy Ltd, Director of Barristers Chambers Pty Ltd, Director of the Foreign Investment Review Board and a member of the Felton Bequest Committee. |

The above named Directors held office during the whole of the financial year.

### Company Secretary

Mr Andrew Guerin LLB, BEc, FGIA was appointed Company Secretary in September 2005. Mr Guerin is also the Company Secretary of Defence Health Foundation Pty Ltd.

## Directors' meetings

During the financial year, 24 meetings were held: 8 Board meetings, 5 Investment Committee meetings, 4 Risk, Compliance and Audit Committee meetings, 6 Nomination and Remuneration Committee meetings and 1 Business Strategy Committee meeting.

The number of Board and Committee meetings held during the financial year and the number of meetings attended by each Director (while they were a Director or a committee member), are shown below.

| | Board of Directors | | Investment Committee | | **Risk Compliance** and Audit Committee | | Nomination and Remuneration Committee | | Business Strategy Committee | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Held | Attended | Held | Attended | Held | Attended | Held | Attended | Held | Attended |
| G H Garde* | 8 | 8 | 5 | 5 | | | 6 | 4 | | |
| M J Bassingthwaighte | 8 | 7 | | | | | 6 | 6 | 1 | 1 |
| A I Beckett | 8 | 7 | 5 | 5 | 4 | 4 | | | | |
| J Blackburn | 8 | 8 | | | 4 | 4 | | | 1 | 1 |
| P D Byrne | 8 | 8 | | | | | 6 | 6 | 1 | 1 |
| A Hambleton | 8 | 8 | | | | | 6 | 6 | 1 | 1 |
| G Richardson | 8 | 7 | 5 | 5 | 4 | 4 | | | | |
| A J M Williams | 8 | 8 | 5 | 5 | 4 | 4 | | | | |

* Chairman

## Principal activities

The principal activity of Defence Health during the financial year was to operate a registered health benefits fund in accordance with the *Private Health Insurance Act 2007*. The Company provided health insurance and complementary products to members and families of the Australian Defence Force and the wider Defence community. There were no significant changes in the nature of the Company's activities during the financial year.

## Strategy

The Company's core purpose is to support members of the ADF and wider Defence community to manage their personal and family health care. The objectives for achieving this outcome over the period were:

- refresh the "Defence Health" brand;
- provide products and services that fit the needs of our chosen segments;
- deliver exceptional support and service (relevant, high quality, timely, in forms and via channels suited to members' needs);
- leverage technology to improve products and services, reduce costs and improve management understanding and decision making;
- develop, equip and empower our people and attract, recognise and retain talent; and
- be alert to opportunities and challenges and agile in responding to those which serve or threaten the vision.

The Company measures its performance against the strategic objectives. In particular, meeting the needs of the Australian Defence Force segment, members' perceptions, staff commitment, capital management and performance against underwriting objectives.

Strategic Plan 2015 and Beyond is the culmination of significant preparation and positioning in successive strategic plans. The repositioning of DHL products and its rebranding, coupled with significant capability development delivered through strategic initiatives over recent years, has laid the foundation needed to implement throughout 2016 tailored services and to broaden our integrated care offerings.

The strategy for 2015 and beyond seeks to drive and support these tailored product and service offerings in order to position the company over the next decade to be the preferred, trusted and active provider of health insurance and health services to the Defence Community.

**Review of operations**

Defence Health recorded a surplus of $22.49 million in the 12 months to 30 June 2015, an increase of $1 million on the prior year.

During the year the number of health insurance policies increased by 6%. Defence Health has 113,327 policies at 30 June 2015. During the year, premium revenue increased by 11.2% to $367.7 million and net benefits expenses increased by 12% to $346.9 million. The industry is experiencing significant upward pressure on benefits both in utilisation and underlying cost.

Total management expenses of $22.95 million were contained at 6.2% of premium income. The Company continues to have one of the lowest management expense ratios in the industry. Investment income increased by 21.2% from $18.09 million in the previous year to $21.92 million due to strong growth in the equity market and the fall in the Australian dollar increasing the market value of international investments. The return on the investment portfolio was 6.7%.

The Company invested in technology, facilities and brand to maintain a strong platform to ensure a continuation of the high standard in our service delivery in the future.

Other revenue in the 12 months to 30 June 2015 was $5.93 million, an increase of $4.37 million compared to prior year. Other revenue includes commission on life, accident and travel insurance products. $4.5 million was recognised relating to a liquidation distribution.

During the year the Company pledged a donation of $220,000 to the Defence Health Foundation.

**Dividends**

Defence Health Limited is a company limited by guarantee and is prohibited by its constitution from paying dividends.

**Significant changes in the state of affairs**

The Company revised the product suite in 2014 and closed the previous product suite to new members.

**Future developments**

Building on the significant brand and product changes implemented over this reporting period, the company intends to continue to build capability to tailor its product and service offerings to meet the needs of the Defence Community. Directors expect operating conditions in the immediate future to remain substantially unchanged.

**Subsequent events**

There has not been any matter or circumstance occurring subsequent to the end of financial year that has significantly affected, or may significantly affect, the operations of the Group.

**Environmental regulation**

The Company's operations are not significantly impacted by any environmental regulation under a law of the Commonwealth, a State or a Territory.

**Directors' benefits**

During the year, no Director received or became entitled to receive any benefit by reason of a contract made by the Company with the Director or with a firm of which the Director is a member or with a company in which the Director has a substantial financial interest, other than for Directors' fees disclosed in Note 20 and related party transactions disclosed in Note 19 to the Financial Statements.

**Indemnification of Directors and Officers**

During the year, the Company paid a premium in respect of insurance covering each of the Directors and executive officers of Defence Health against liabilities and expenses arising from any claim(s) made against them as a result of work performed in their respective capacities to the extent permitted by law.

### Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307 of the *Corporations Act 2001* is set out on page 12.

### Rounding-off of amounts

The Company is a company of the kind referred to in ASIC Class Order 98/0100, dated 10 July 1998, and in accordance with the Class Order amounts in the Directors' Report and the Financial Report are rounded off to the nearest thousand dollars, unless otherwise indicated.

| | |
|---|---|
| ..................................................... | ..................................................... |
| Mr Alan I Beckett<br>Director | Major General Gregory H Garde AO RFD (Ret'd)<br>Director |
| 16 September 2015 | 16 September 2015 |

Deloitte Touche Tohmatsu
ABN 74 490 121 060

550 Bourke Street
Melbourne VIC 3000
GPO Box 78
Melbourne VIC 3001 Australia

DX 111
Tel: +61 (0) 3 9671 7000
Fax: +61 (0) 3 9671 7001
www.deloitte.com.au

The Board of Directors
Defence Health Limited
380 St Kilda Road
MELBOURNE VIC 3000

17 September 2015

Dear Board Members

**Defence Health Limited**

In accordance with section 307C of the *Corporations Act 2001*, I am pleased to provide the following declaration of independence to the directors of Defence Health Limited.

As lead audit partner for the audit of the financial statements of Defence Health Limited for the financial year ended 30 June 2015, I declare that to the best of my knowledge and belief, there have been no contraventions of:

(i) the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

(ii) any applicable code of professional conduct in relation to the audit.

Yours sincerely

DELOITTE TOUCHE TOHMATSU

Peter A Caldwell
Partner
Chartered Accountant

Deloitte.

The Board of Directors
Defence Health Limited
380 St Kilda Road
MELBOURNE VIC 3004

Deloitte Touche Tohmatsu
ABN 74 490 121 060
550 Bourke Street Melbourne VIC 3000
GPO Box 78
Melbourne VIC 3001 Australia

DX: 111
Tel: +61 (0) 3 9671 7000
Fax: +61 (03) 9671 7001
www.deloitte.com.au

16 September 2015

Dear Board Members

**Defence Health Limited**

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the Directors of Defence Health Limited.

As lead audit partner for the audit of the financial statements of Defence Health Limited for the financial year ended 30 June 2015, I declare that to the best of my knowledge and belief, there have been no contraventions of:

(i) the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and

(ii) any applicable code of professional conduct in relation to the audit.

Yours sincerely

DELOITTE TOUCHE TOHMATSU

Peter A Caldwell
Partner
Chartered Accountants

## Consolidated statement of profit or loss and other comprehensive income

### for the financial year ended 30 June 2015

| | Notes | 2015 $'000 | 2014 $'000 |
|---|---|---|---|
| **Revenue** | | | |
| Premium revenue | 4 | 367,746 | 330,784 |
| **Benefits expense** | | | |
| Direct benefits expense | 5 | (308,296) | (267,072) |
| Health Benefits Reinsurance Trust Fund expense | | (35,318) | (39,687) |
| Ambulance Levies | | (3,258) | (3,000) |
| Net benefits expense | | (346,872) | (309,759) |
| Unexpired risk reserve | 5 | (3,064) | 267 |
| **Underwriting Result** | | **17,810** | **21,292** |
| **Expenses** | | | |
| Employee benefits expenses | 5 | (13,250) | (10,862) |
| Marketing expenses | | (2,108) | (1,301) |
| IT & Computing expenses | | (1,836) | (1,430) |
| Transaction processing costs | | (1,352) | (1,260) |
| Professional fees | | (1,005) | (1,258) |
| Occupancy expenses | | (888) | (881) |
| Industry subscriptions | | (761) | (735) |
| Depreciation and amortisation expenses | 5 | (417) | (246) |
| Agency legal costs | | (267) | (253) |
| Other management expenses | | (1,064) | (1,058) |
| Total expenses | | (22,948) | (19,284) |
| **Underwriting Result after operating expenses** | | **(5,138)** | **2,008** |
| **Other Revenue / (expense)** | | | |
| Investment income | 4 | 21,920 | 18,090 |
| Other revenues | 4 | 5,926 | 1,558 |
| **Other expenses** | | | |
| Donation to / pledge to Defence Health Foundation | | (220) | (200) |
| **Surplus for the year** | | **22,488** | **21,456** |
| Other comprehensive income | | - | - |
| **Total comprehensive income for the year** | | **22,488** | **21,456** |

The statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes.

# Consolidated statement of financial position
## as at 30 June 2015

| | Notes | 2015<br>$'000 | 2014<br>$'000 |
|---|---|---|---|
| **Current assets** | | | |
| Cash and cash equivalents | 6 | 14,038 | 9,382 |
| Trade and other receivables | 7 | 17,790 | 12,998 |
| Other financial assets | 8 | 326,124 | 302,258 |
| **Total current assets** | | **357,952** | **324,638** |
| **Non-current assets** | | | |
| Property, plant and equipment | 9(a) | 1,398 | 596 |
| Intangible assets | 9(b) | 520 | 4 |
| **Total non-current assets** | | **1,918** | **600** |
| **Total assets** | | **359,870** | **325,238** |
| **Current liabilities** | | | |
| Trade and other payables | 10(a) | 41,718 | 38,186 |
| Claim liabilities | 11 | 41,124 | 35,774 |
| Provisions | 12(a) | 9,244 | 6,312 |
| **Total current liabilities** | | **92,086** | **80,272** |
| **Non-current liabilities** | | | |
| Trade and other payables | 10(b) | 486 | 529 |
| Provisions | 12(b) | 2,150 | 1,777 |
| **Total non-current liabilities** | | **2,636** | **2,306** |
| **Total liabilities** | | **94,722** | **82,578** |
| **Net assets** | | **265,148** | **242,660** |
| **Equity** | | | |
| Contributed equity | 13 | 43,346 | 43,346 |
| Retained earnings | 14 | 221,802 | 199,314 |
| **Total equity** | | **265,148** | **242,660** |

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

# Consolidated statement of changes in equity
**for the financial year ended 30 June 2015**

| | Contributed Equity $'000 | Retained Earnings $'000 | Total Equity $'000 |
|---|---|---|---|
| **Balance at 30 June 2013** | **43,346** | **177,858** | **221,204** |
| Total comprehensive income for the year | - | 21,456 | 21,456 |
| **Balance at 30 June 2014** | **43,346** | **199,314** | **242,660** |
| Total comprehensive income for the year | - | 22,488 | 22,488 |
| **Balance at 30 June 2015** | **43,346** | **221,802** | **265,148** |

The statement of changes in equity should be read in conjunction with the accompanying notes.

# Consolidated statement of cash flows
## for the financial year ended 30 June 2015

| | Notes | 2015 $'000 | 2014 $'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Premium receipts | | 371,685 | 333,004 |
| Benefits paid to and on behalf of health fund contributors | | (302,507) | (263,262) |
| Government and other levies paid | | (3,217) | (2,976) |
| Payments to Risk Equalisation Trust Fund | | (37,527) | (39,183) |
| Payments to suppliers and employees | | (21,814) | (19,184) |
| Commission received | | 1,426 | 1,558 |
| Donations Paid | | - | (200) |
| **Net cash generated by operating activities** | **15** | **8,046** | **9,757** |
| **Cash flows from investing activities** | | | |
| Purchase of investment securities | | (310,130) | (310,904) |
| Proceeds on sale of investment securities | | 292,320 | 292,698 |
| Interest and dividends received | | 16,156 | 9,639 |
| Purchase of plant and equipment | | (1,201) | (304) |
| Payment for intangible assets | | (535) | (4) |
| **Net cash used in investing activities** | | **(3,390)** | **(8,875)** |
| **Net increase in cash and cash equivalents** | | 4,656 | 882 |
| Cash and cash equivalents at the beginning of the financial year | | 9,382 | 8,500 |
| **Cash and cash equivalents at the end of the financial year** | **6** | **14,038** | **9,382** |

## Note 1 – Summary of significant accounting policies

Defence Health Limited (referred to as "Defence Health" or the "Company") is a company limited by guarantee, incorporated and domiciled in Australia. The Company and its subsidiary, the Defence Health Foundation Pty Ltd, together are referred to as the "Group". The address of its registered office and principal place of business is Level 4, 380 St Kilda Road Melbourne Victoria 3004.

### 1.1 Statement of compliance

The financial statements are general purpose financial statements which have been prepared in accordance with the *Corporations Act 2001*, Accounting Standards and Interpretations, and comply with other requirements of law.

Accounting Standards include Australian equivalents to International Financial Reporting Standards ('A-IFRS'). Compliance with A-IFRS ensures that the financial statements and notes of the Company comply with International Financial Reporting Standards. The Company is a not-for-profit entity.

The following is a summary of the material accounting policies adopted in the preparation of the financial statements. The accounting policies have been consistently applied to all the years presented, unless otherwise stated.

The financial statements were approved by the board and authorised for issue by the Directors on 16 September 2015.

### 1.2 Basis of preparation

These general purpose financial statements have been prepared on the basis of historical cost, except for the revaluation of certain non-current assets and financial instruments which are measured at fair value. All amounts are presented in Australian dollars, unless otherwise noted.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of AASB 2, leasing transactions that are within the scope of AASB 117, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in AASB 2 or value in use in AASB 136.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities

that the entity can access at the measurement date;

Level 2 inputs are inputs, other than quoted prices included within Level 1,that are observable

for the asset or liability, either directly or indirectly; and

Level 3 inputs are unobservable inputs for the asset or liability.

The Company is a company of the kind referred to in ASIC Class Order 98/0100, dated 10 July 1998, and in accordance with that Class Order amounts in the financial report are rounded off to the nearest thousand dollars, unless otherwise indicated.

## 1.3 Critical accounting judgements and key source of estimation uncertainty

In the application of the Group's accounting policies, management is required to make judgments, estimates and assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making the judgments. Actual results may differ from these estimates.

The critical judgments that management has made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements are disclosed in note 2.

## 1.4 Revenue recognition

Revenue is recognised for the major income streams as follows:

*(i) Premium revenue*

Premium revenue is recognised in the consolidated statement of profit or loss from the attachment date, as soon as there is a basis on which it can be reliably measured. Revenue is recognised in accordance with the pattern of the incidence of risk expected over the term of the contract.

The proportion of premiums received or receivable not earned at the reporting date is recognised as an unearned premium liability.

*(ii) Life, Travel and Accident insurance commissions*

Commission revenue is recognised when a submission is lodged by the Company with the underwriter or agent of the insurance policies.

*(iii) Dividend and interest revenue*

Dividend revenue from investments is recognised when the Company's right to receive payment has been established.

Interest revenue is accrued on a time basis, by reference to the principal outstanding and the effective interest rate applicable, through the expected life of the financial asset to that asset's net carrying amount.

*(iv) Other*

All other revenue is measured at the fair value of the consideration received or receivable.

## 1.5 Receivables

*(i)* Unclosed business premiums – earned (contributions in arrears) represent amounts owing by contributors in relation to health insurance policies. Contributions in arrears are recognised when they become receivable. After 63 days the policy is cancelled.

*(ii)* Interest receivables represent an accrual calculation of interest income receivable from interest bearing securities as at balance date.

*(iii)* Health insurance rebates receivable represents the amount claimed by the Company from Medicare Australia for the Government Private Health Insurance Rebate.

*(iv)* Other receivables represent prepaid expenses and commissions due to the Company for sales of life insurance, travel and accident insurance and other amounts owing where the Company has a contractual and enforceable right to receive the amounts recognised at balance date.

## 1.6 Property, plant and equipment

Property, plant and equipment is stated at historical cost less depreciation/amortisation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

The gain or loss arising on the disposal of property, plant and equipment is determined as the difference between net proceeds and the carrying amount of the asset, at the time of disposal.

Depreciation and amortisation is calculated on a straight-line basis to write off the net cost or revalued amount of each item of property, plant and equipment over its expected useful life. Estimates of remaining useful lives are made on an annual basis for all assets. The expected useful lives are as follows:

| | |
|---|---|
| Office equipment and fittings | 5 years |
| Motor Vehicles | 5 years |
| Computer Equipment | 2 - 5 years |
| Leasehold improvements | 1 – 10 years |

## 1.8 Intangible Assets

Intangible assets with finite lives that are acquired separately are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. The expected useful lives are as follows:

| | |
|---|---|
| Licenses | 20 years |
| Trademark | 10 years |

## 1.9 Leases

Operating lease payments are recognised as expenses on a straight line basis over the lease term. Lease incentives received are recognised as an integral part of the total lease expense over the term of the lease and are recognised as a liability. The benefits of the incentives are recognised as a reduction of lease expense on a straight line basis over the term of the lease.

*(i) Make good provisions*

Make good provisions are recognised as a liability in accordance with lease terms. This includes an estimated cost of restoring leased premises to conditions as set out in the lease agreement.

*(ii) Leasehold improvements*

The cost of improvements to or on leasehold property are capitalised and amortised on a straight-line basis over the shorter of the estimated useful life of the improvements or the unexpired period of the lease term.

The Group had no finance leases during the financial year.

## 1.10 Payables

These amounts represent liabilities for goods and services provided to the Group prior to the end of the financial year and which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

## 1.11 Maintenance and repairs

Maintenance, repair costs and minor renewals are recognised as expenses as incurred.

## 1.12 Employee benefits

*(i) Wages, salaries and bonuses*

A liability is recognised for benefits accruing to employees in respect of wages and salaries, bonuses, annual leave and long service leave when it is probable that settlement will be required and they are capable of being measured reliably.

*(ii) Superannuation*

The Group makes contributions to accumulation type superannuation funds for the benefit of employees at a rate of 9.5% of each employee's salary in accordance with statutory requirements.

*(iii) Annual leave*

Liabilities recognised in respect of employee benefits expected to be settled within 12 months are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

*(iv) Long service leave*

A liability is recognised for long service leave representing the present value of the estimated future cash outflows to be made by the Group resulting from employees' service provided up to balance date.

Liabilities recognised in respect of employee benefits not expected to be settled within 12 months are discounted using the rates attaching to high quality corporate bonds at balance date which most closely match the terms to maturity of the related liabilities.

In determining the liability for employee benefits, consideration has been given to future increases in wage and salary rates, together with the Group's experience with staff departures. Related on-costs have also been included in the liability.

## 1.13 Cash and cash equivalents

Cash and cash equivalents includes cash on hand and deposits at call readily convertible to cash on hand, subject to an insignificant risk of changes in value.

## 1.14 Income tax

The Company is a not for profit entity. Its Constitution prohibits it from paying dividends and returning capital to its members. Accordingly, the Company is exempt from income tax.

## 1.15 Goods and Services Tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the Australian Taxation Office (ATO). In these circumstances, the GST is recognised as part of an item of the expense. Receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the statement of financial position. Cash flows are included in the Statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

## 1.16 Provision for Risk Equalisation

Under the provisions of the *Private Health Insurance Act 2007*, all health insurers must participate in the Health Benefits Risk Equalisation Trust Fund.

The amounts payable to and receivable from the Health Benefits Risk Equalisation Trust Fund are determined by APRA (previously PHIAC) after the end of each quarter. Estimated provisions for amounts payable and income receivable are recognised on an accruals basis.

## 1.17 Investments and other financial assets

As part of its Capital Management Plan and investment strategy, the Company manages its investment portfolio to ensure that adequate liquidity exists within the portfolio to match the expected pattern of future cash flows arising from health insurance liabilities, having regard to regular cash flows from operations. Investments comprise assets backing insurance liabilities.

All financial assets are recognised and derecognised on trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into the following specified categories: financial assets ‘at fair value through the statement of profit or loss (held for trading), ‘held-to-maturity’ investments, ‘available-for-sale’ (AFS) financial assets and ‘loans and receivables’. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

**Financial assets at fair value through the statement of profit or loss (held for trading)**

Financial assets are classified as financial assets at fair value through the statement of profit or loss where the financial asset:

(i) has been acquired principally for the purpose of selling in the near future;
(ii) is a part of an identified portfolio of financial instruments that the Company manages together and has a recent actual pattern of short-term profit-taking; or
(iii) is a derivative that is not designated and effective as a hedging instrument.

Financial assets at fair value through the statement of profit or loss are stated at fair value, with any resultant gain or loss recognised in the statement of profit or loss. The net gain or loss recognised in the statement of profit or loss incorporates any dividend or interest earned on the financial assets. Fair value is determined in the manner described in note 16.

**Held-to-maturity investments**
Financial assets with fixed or determinable payments and fixed maturity dates where the group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are recorded at amortised cost using the effective interest method less impairment, with revenue recognised on an effective yield basis.

**Available-for-sale financial assets**
The Company has investments in fixed income and equity trusts that are not traded in an active market and are classified as available for sale financial assets and stated at fair value, and are highly liquid. Gains and losses arising from changes in fair value are recognised through other comprehensive income.

**Loans and receivables**
Trade receivables, loans and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as “loans and receivables”. Loans and receivables are measured at amortised cost using the effective interest method less impairment.

**Impairment of financial assets**
Financial assets, other than those at fair value through the statement of profit or loss, are assessed for indicators of impairment at each balance date. Financial assets are impaired where there is objective evidence that as a result of one or more events that occurred after the initial recognition of the financial asset the estimated future cash flows of the investment have been impaired.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets, with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the statement of profit or loss.

## 1.17 Investments and other financial assets (cont'd)

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the statement of profit or loss to the extent the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

**Impairment of other tangible assets**
At each reporting date, the Group reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating unit for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in the statement of profit or loss immediately, unless the relevant asset is carried at fair value, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised in the statement of profit or loss immediately, unless the relevant asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

## 1.18 Assets backing insurance liabilities

Financial assets held by the Group have been determined to be assets backing insurance liabilities and accordingly are designated as "at fair value through the statement of profit or loss". These are initially recorded at cost and subsequently re-measured at fair value. Fair value has been assessed based on independent valuation for all assets held for which a secondary market exists. Cash at bank and deposit products held have been valued at cost. All related realised and unrealised gains or losses are included in investment income. Interest earned or dividends received are included in interest and dividend income respectively.

## 1.19 Product classification

Insurance contracts means a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its life, even if the insurance risk reduces significantly during this period.

The Company has determined that all current contracts with policyholders are insurance contracts.

## 1.20 Insurance contract liabilities

**Health insurance outstanding claims liabilities**
Health insurance outstanding claims liabilities are measured as the central estimate of the present value of expected future payments against claims incurred but not settled at the balance date, whether reported or not, together with related claims handling costs and an additional risk margin to allow for the inherent uncertainty in the central estimate.

## 1.20 Insurance contract liabilities (cont'd)

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.

Outstanding claims liabilities are generally fully settled within one year and are substantially settled within three months of the insurable event. Therefore, the effective discount rate is zero.

**Provision for unearned premium and unexpired risks**

The proportion of written premiums attributable to subsequent periods is deferred as unearned premium. The change in the provision for unearned premium is taken to the statement of profit or loss in the order that revenue is recognised over the period of risk. Further provisions are made to cover claims under unexpired insurance contracts which may exceed the unearned premiums and the premiums due in respect of these contracts.

The adequacy of the unearned premium liability in respect of each class of business is assessed by considering current estimates of all expected future cash flows relating to future claims covered by current insurance contracts.

If the present value of the expected future cash flows relating to future claims plus the additional risk margin to reflect the inherent uncertainty in the central estimate exceeds the unearned premium liability less related intangible assets and related deferred acquisition costs then the unearned premium liability is deemed to be deficient.

The entire deficiency is recognised immediately in the statement of profit or loss and recorded in the statement of financial position as an unexpired risk liability.

## 1.21 Accounting standards issued but not yet effective

The Group has adopted all new and revised standards and interpretations effective during the year in the preparation of the financial statements. The adoption of these standards have not affected the amounts reported in these financial statements, but have impacted the level of disclosure included in the notes to the financial statements.

At the date of authorisation of the financial report, the following Standards and Interpretations were in issue but not yet effective:

| | |
|---|---|
| • AASB 9 'Financial Instruments', and the relevant amending standards | Effective for annual reporting periods beginning on or after 1 January 2018.<br>Expected to be initially applied in financial year ending 30 June 2019. |
| • AASB 15 'Revenue from Contracts with Customers' and AASB 2014-5 Amendments to Australian Accounting Standards arising from AASB15' | Effective for annual reporting periods beginning on or after 1 January 2017.<br>Expected to be initially applied in financial year ending 30 June 2018. |
| • AASB 2014-3 'Amendments to Australian Accounting Standards – Accounting for Acquisitions of Interests in Joint Operations' | Effective for annual reporting periods beginning on or after 1 January 2016.<br>Expected to be initially applied in financial year ending 30 June 2017. |
| • AASB 2014-4 'Amendments to Australian Accounting Standards – Clarification of Acceptable Methods of Depreciation and Amortisation' | Effective for annual reporting periods beginning on or after 1 January 2016.<br>Expected to be initially applied in financial year ending 30 June 2017. |

## 1.21 Accounting standards issued but not yet effective (cont'd)

| | |
|---|---|
| • AASB 2014-9 'Amendments to Australian Accounting Standards – Equity Method in Separate Financial Statements' | Effective for annual reporting periods beginning on or after 1 January 2016. Expected to be initially applied in financial year ending 30 June 2017. |
| • AASB 2015-1 'Amendments to Australian Accounting Standards – Annual Improvements to Australian Accounting Standards 2014-2014 Cycle' | Effective for annual reporting periods beginning on or after 1 January 2016. Expected to be initially applied in financial year ending 30 June 2017. |
| • AASB 2015-2 'Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 101' | Effective for annual reporting periods beginning on or after 1 January 2016. Expected to be initially applied in financial year ending 30 June 2017. |
| • AASB 2015-3 'Amendments to Australian Accounting Standards arising from the Withdrawal of AASB 1031 Materiality' | Effective for annual reporting periods beginning on or after 1 July 2015. Expected to be initially applied in financial year ending 30 June 2016. |

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material financial impact on the financial statements of the Group.

## 1.22 New and revised accounting standards affecting amounts reported and/or disclosures in the financial statements

In the current year, the Company has applied a number of amendments to AASBs and a new Interpretation issued by the Australian Accounting Standards Board (AASB) that are mandatorily effective for an accounting period that begins on or after 1 July 2014, and therefore relevant for the current year end.

Standards affecting presentation and disclosure:

| | |
|---|---|
| • AASB 1031 'Materiality', AASB2013-9 'Amendments to Australian Accounting Standards' – Conceptual Framework, Materiality and Financial Instruments' | The revised AASB 1031 is an interim standard that cross-references to other Standards and the 'Framework for the Preparation and Presentation of Financial Statements (issued December 2013) that contain guidance on materiality. The AASB is progressively removing references to AASB 1031 in all Standards and Interpretations. Once all of these references have been removed, AASB 1031 will be withdrawn. The adoption of AASB 1031, AASB 2013-0 (Part B) and AASB 2014-1 '(Part C) does not have any material impact on the disclosures or the amounts recognised in the Company's financial statements. |
| • AASB 2012-3 'Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities' | The amendments to AASB 132 clarify the requirements relating to the offset of financial assets and financial liabilities. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off' and simultaneous realisation and settlement'.<br>The amendments to AASB 132 clarify the requirements relating to the offset of financial assets and financial liabilities. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off' and simultaneous realisation and settlement'. |

## Note 2 – Critical accounting estimates and judgements

The Company estimates certain assets and liabilities, the most material being the provision for outstanding claims liabilities.

The provision for outstanding claims is based on a central estimate of the present value of the expected future payments for claims incurred, with an additional risk margin to allow for the inherent uncertainty in the central estimate.

Because approximately 95% of claims are settled within three months of the reporting date, the expected future payments do not differ materially from the present value of those payments. Therefore a zero discount rate has been applied.

The expected future payments include amounts in relation to: reported and unpaid claims; claims incurred but not reported; claims incurred but not reported in their entirety; risk equalisation payments in respect of the foregoing; and costs, including claims handling costs, which the Company expects to incur in settling the incurred claims.

The expected payments to the Risk Equalisation Trust Fund in relation to outstanding claims are separately recognised in the financial statements.

The critical estimates and judgements are:

*(i)* *Central estimate*

The central estimate is the mean of all the possible values of expected future payments.

*(ii)* *Risk margin*

The risk margin reflects the variability of the underlying insurance risk, the reliability and volume of data available and the robustness of the valuation models.

The risk margin adopted by the Company in respect to the provision for outstanding claims, acting on the advice of the Appointed Actuary, is 4% (2014: 2.5%) and was set so as to give at least a 75% probability that the provision will be adequate.

The Unexpired risk reserve adopted by the Company, acting on the advice of the Appointed Actuary, is determined with a risk margin of 2.7%, and a 75% probability that the provision will be adequate.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The Company's obligation to participant employers is discounted at a rate set by reference to market yields at the end of the reporting period on high quality corporate bonds. In the prior period the discount rate had been determined by long-term government bonds. The change in this estimate has resulted in a decrease of the obligation to participant employers by $121,000. The impact of this change in estimate in future periods has not been able to be determined.

Management has estimated other income and other receivables of $4.5million relating to a distribution from the liquidator of Lehman Ltd after successful proof of debt. The amount recognised is based on a best estimate of distribution of liquidated assets of which $1.445m interim distribution was received subsequent to year end.

## Note 3 – Insurance contracts; risk and risk management

An important part of the Company's overall risk management framework is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows arising from insurance contracts. These risks include insurance risks, financial risks and other risks such as capital and regulatory risk.

### a) Insurance risk

***Underwriting risks***

**Risk selection and pricing**

The Company is prohibited by the *Private Health Insurance Act 2007* from taking any actions which discriminate against an existing or prospective contributor on the basis of medical condition, gender, age or any other characteristic that is likely to result in an increased requirement for services. Prohibited discriminatory actions include selecting the amount of contributions payable by the contributor, whether benefits are payable, the amount of benefits payable and whether a contributor can move between products.

Although the Company is not able to be selective in accepting individual risks and in charging risk related premiums, the individual risks are absorbed within the total portfolio which presents a relatively consistent and predictable total risk.

**Concentration risk**

Legislation prohibits the Company from adjusting the terms and premium of a health insurance policy in accordance with the assessed risk of the person or persons insured. The Company therefore has an exposure to a possible concentration of insured persons who have a higher than average likelihood of requiring frequent or high cost health care. The concentration risk is managed by regularly predicting future expected claiming patterns and where a significant change is identified, making appropriate changes to the terms or the premium or both for all insurance policies of the type in respect of which the concentration risk exists. The effectiveness of the predictive models are regularly reviewed by comparing past predictions with actual experience. The risk of a concentration of high cost claims is mitigated by the Company having access to the "high cost claims pool" administered by the Private Health Insurance Administration Council, whereby high cost claims are partially funded by all insurers.

***Claims management and claims provisioning risks***

The Company's approach to determining the outstanding claims provision is set out in Note 2. The Company seeks to ensure the adequacy of its provision for outstanding claims by reference to the following controls:

- Regular reviews of incurrence and payment patterns to ensure that the timeliness of claims notification and payment remains within the assumed twelve month period.
- External quarterly reviews by the Appointed Actuary of the financial conditions of the Company with a formal Financial Conditions Report delivered to the Board annually.
- Reviews of the effectiveness of forecasts to ensure the factors considered in making forecasts remain appropriate.

Despite the rigour involved in the establishment and review of the outstanding claims provision, the provision is subject to uncertainty for the reasons outlined in Note 2.

### b) Financial risks arising from insurance contracts

The Company is exposed to the risk that inflation within the medical services industry may be greater than that expected by the Company in setting its contribution rates and schedule of benefits. This risk is substantially reduced, however, by the existence of contracts between the Company and the majority of hospitals and medical practitioners which establish fixed charges for hospital and medical services.

## Note 3 – Insurance contracts; risk and risk management (cont'd)

### c) Capital and regulatory risks

The Company is subject to prudential regulations designed to protect contributors, primarily by ensuring the maintenance of adequate capital reserves having regard to the risks assumed by the Company. Regulations include solvency and capital adequacy requirements and continue to evolve in response to economic, political, demographic and industry developments. The Company works closely with regulators and monitors regulatory developments to assess their potential impact on the prudential management of the Company. From 1 July 2015 APRA has assumed regulatory responsibility from PHIAC. The Board does not expect that this will give rise to a significant change in regulatory risk or the capital management requirements in the coming year.

### d) Sensitivities

The interval between the provision of an insured service and the presentation of a claim is generally less than one year. Analysis of historical patterns indicates that in excess of 95% of claims for all claim types are settled within 90 days. Moreover, the nature of health insurance claims is that, once lodged and assessed, they are generally subject to little variation.

The consequence is that processed health insurance claims are not sensitive to factors such as inflation, changes in official interest rates or other time-value of money factors. Accordingly, no sensitivity analysis has been presented.

## Note 4 – Revenue

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Continuing Operations** | | |
| Premium revenue pursuant to a contract of private health insurance | 367,746 | 330,784 |
| **Investment revenue** | | |
| **Interest revenue** | | |
| Bank deposits | 302 | 293 |
| Term deposits | 6,434 | 6,588 |
| Floating rate notes | 5 | 41 |
| | 6,741 | 6,922 |
| **Dividends** | | |
| Unlisted cash trusts | 3,616 | 2,406 |
| Unlisted equity trusts | 5,507 | 1,486 |
| | 9,123 | 3,892 |
| **Realised gains/(losses) on disposal** | | |
| Fixed income trusts | (154) | 713 |
| Unlisted equity trusts | (320) | 555 |
| | (474) | 1,268 |
| **Unrealised gains/(losses) of** | | |
| Unlisted cash trusts | (745) | 949 |
| Unlisted equity trusts | 7,275 | 5,059 |
| | 6,530 | 6,008 |
| **Total Investment Revenue** | **21,920** | **18,090** |
| **Other revenue** | | |
| Commission pursuant to the sale of life and trauma insurance | 1,036 | 1,014 |
| Commission pursuant to the sale of travel insurance | 380 | 530 |
| Commission pursuant to the sale of accident insurance | 10 | 14 |
| Other revenue | 4,500 | - |
| | **5,926** | **1,558** |
| | **395,592** | **350,432** |

## Note 5 – Surplus for the year

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Surplus before income tax has been arrived at after charging the following expenses attributable to continuing operations: | | |
| Direct benefits expense | | |
| Benefits incurred this financial year | 308,303 | 268,036 |
| Under / (over) provision of prior year claims | (242) | (1,083) |
| Risk margin | 235 | 119 |
| | 308,296 | 267,072 |
| Increase / (Decrease) in provision for unexpired risk reserve (Note12) | 3,064 | (267) |
| Depreciation and amortisation of non-current assets | 417 | 246 |
| | 417 | 246 |
| Employee benefits | 12,067 | 9,876 |
| Post-employment benefits – Defined contribution plans | 1,183 | 986 |
| | 13,250 | 10,862 |
| Operating lease rental payments: | | |
| Minimum lease payments | 828 | 812 |

## Note 6 – Cash and cash equivalents

| | | |
|---|---|---|
| Cash at bank and on hand | 14,038 | 9,382 |
| **Total cash assets** | **14,038** | **9,382** |

The above figures reconcile to cash at the end of the financial year as shown in the statement of cash flows.

## Note 7 – Trade and other receivables

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Trade receivables (i) | 12,156 | 11,265 |
| Unclosed business premiums - earned | 600 | 1,043 |
| Allowance for doubtful debts | (99) | (76) |
| Unclosed business premiums - unearned | 633 | 766 |
| Other receivables | 4,500 | - |
| **Total trade and other receivables** | **17,790** | **12,998** |

**Allowance for doubtful debts summary:**

| | | |
|---|---|---|
| Balance at beginning of the year | 76 | 69 |
| Increase in allowance recognised in the statement of profit or loss | 23 | 7 |
| Balance as at 30 June | 99 | 76 |

(i) Trade receivables are usually received within 90 days.

Included in trade receivables:-

- Health insurance rebate amount claimed by the Company from Medicare Australia for the Government Private Health Insurance Rebate with a carrying amount at report date of $8.27 million (2014: $7.67 million). These amounts are settled within 45 days and are not impaired.

## Note 8 – Other financial assets

| | | |
|---|---|---|
| **Current** | | |
| Term deposits (i) | 192,339 | 176,539 |
| Units in fixed income trusts (ii) | 56,972 | 54,815 |
| Units in unlisted equity trusts (ii) | 76,813 | 70,904 |
| **Total investments** | **326,124** | **302,258** |

(i) Investments held to maturity and carried at amortised cost
(ii) Investments held for trading and carried at fair value through the statement of profit or loss

## Note 9(a) – Property, plant and equipment

| | Leasehold improvements | Plant & equipment | Total |
|---|---|---|---|
| | **$'000** | **$'000** | **$'000** |
| **Gross carrying amount** | | | |
| **Balance at 30 June 2013** | **161** | **376** | **537** |
| Additions | - | 309 | 309 |
| Disposals | - | (2) | (2) |
| Depreciation and amortisation charge | (24) | (224) | (248) |
| **Balance at 30 June 2014** | **137** | **459** | **596** |
| Additions | 126 | 1,152 | 1,278 |
| Disposals | (67) | (9) | (76) |
| Depreciation and amortisation charge | (37) | (363) | (400) |
| **Balance at 30 June 2015** | **159** | **1,239** | **1,398** |
| **Net book value** | | | |
| As at 30 June 2014 | 137 | 459 | 596 |
| As at 30 June 2015 | 159 | 1,239 | 1,398 |

## Note 9(b) – Intangible assets

| | Licenses | Trademarks | Total |
|---|---|---|---|
| | **$'000** | **$'000** | **$'000** |
| **Carrying amount** | | | |
| **Balance at 30 June 2013** | **-** | **-** | **-** |
| Additions from separate acquisitions | **-** | **4** | **4** |
| Disposals or classified as held for sale | **-** | **-** | **-** |
| Amortisation charge | **-** | **-** | **-** |
| **Balance at 30 June 2014** | **-** | **4** | **4** |
| Additions | 531 | 4 | 535 |
| Disposals | - | - | - |
| Depreciation and amortisation charge | (18) | (1) | (19) |
| **Balance at 30 June 2015** | **513** | **7** | **520** |
| **Net book value** | | | |
| As at 30 June 2014 | - | 4 | 4 |
| As at 30 June 2015 | 513 | 7 | 520 |

## Note 10 – Trade and other payables

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **a) Current** | | |
| Trade payables (i) | 2,773 | 1,895 |
| Premiums in advance | 30,744 | 26,649 |
| Risk Equalisation payable | 8,201 | 9,642 |
| Total trade and other payables - current | 41,718 | 38,186 |
| **b) Non-Current** | | |
| Lease incentive | 486 | 529 |
| Total trade and other payables – non current | 486 | 529 |
| **Total trade and other payables** | **42,204** | **38,715** |

(i) Trade payables are generally on 30 day credit terms.

## Note 11 – Claims liabilities

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Gross outstanding claims | 37,235 | 31,372 |
| Risk equalisation cost | 2,681 | 3,470 |
| Claims handling costs | 384 | 370 |
| Risk margin | 824 | 562 |
| **Gross outstanding claims liability** | **41,124** | **35,774** |

Changes in the gross outstanding claim liabilities can be analysed as follows:

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Opening balance | 35,774 | 32,434 |
| Benefits incurred during the year | 308,303 | 268,036 |
| Benefits utilised during the year | (302,198) | (263,494) |
| Unused provision from prior year | (242) | (1,083) |
| Risk equalisation cost | (789) | (270) |
| Claims handling costs | 14 | 38 |
| Risk margin | 262 | 113 |
| **Closing balance** | **41,124** | **35,774** |

The risk margin of 4% (2014: 2.5%) has been estimated to equate to a probability of adequacy of at least 75% (2014: 75%). The risk margin has been based on an analysis of the past experience of the Company. This analysis examined the volatility of past payments that has not been explained by the model adopted to determine the central estimate. This past unexplained volatility has been assumed to be indicative of future volatility.

## Note 12 - Provisions

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **a) Current** | | |
| Employee benefits (i) | 758 | 757 |
| Unearned premium liability (iii) | 633 | 766 |
| Unexpired risk reserve (ii) | 7,853 | 4,789 |
| **Total provisions – current** | **9,244** | **6,312** |
| **b) Non-current** | | |
| Employee benefits (i) | 1,925 | 1,552 |
| Make good of lease premises | 225 | 225 |
| **Total provisions – non-current** | **2,150** | **1,777** |
| (i) Total employee benefits | 2,683 | 2,309 |

(ii) A review of the liability adequacy test (note 1.19) in respect of each class of business was carried out at report date. A risk margin of 2.7% has been applied to achieve a 75% probability of sufficiency.

(iii) Changes in unearned premium liability:-

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Unearned premium liability as at 1 July | 766 | 936 |
| Premiums written in prior periods, earned in the period | (766) | (936) |
| Premiums to be earned in subsequent periods at 30 June | 633 | 766 |
| **Closing balance** | **633** | **766** |

## Note 13 – Contributed equity

| | | |
|---|---|---|
| **Contributed equity** | **43,346** | **43,346** |

The contributed equity represents the accumulated surplus of the former Defence Health Benefits Society (DHBS) prior to the corporate restructure implemented in June 2001. The restructure resulted in the incorporation of DHBS into the Company in order to comply with changes to the legislation and regulations governing the operations of registered health benefit organisations.
The Directors and the Chief of Army and the Chief of Air Force were Members of the Company during the whole of the financial year and up to the date of this report. In the event of the Company being wound up, each Member is liable to contribute to the payment of the Company's debts and liabilities, such amount as may be required, up to $100. The Members are not entitled to receive dividends or a return of capital. Any proceeds on the winding up of the Company must be transferred to an Australian institution or institutions having objects similar to the objects of the Company.

## Note 14 – Reserves and retained earnings

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Retained earnings** | | |
| Opening balance at 1 July | 199,314 | 177,858 |
| Surplus for the year | 22,488 | 21,456 |
| **Retained earnings at 30 June** | **221,802** | **199,314** |

## Note 15 – Notes to the statement of cash flows

Reconciliation of surplus for the period to net cash flows from operating activities

| | | |
|---|---|---|
| Net surplus for the year | 22,488 | 21,456 |
| Depreciation and amortisation expense | 417 | 246 |
| Realised/ Unrealised loss on revaluation of fair value through the profit or loss financial assets | (6,056) | (7,276) |
| Investment income | (15,864) | (10,781) |
| Changes in operating assets and liabilities: | | |
| (Increase) in trade and other receivables | (5,218) | (193) |
| Increase in current provisions | 8,423 | 2,443 |
| Increase in trade and other payables | 3,525 | 3,289 |
| (Decrease) in operating lease incentive deferred | (42) | (21) |
| Increase in non-current provisions | 373 | 594 |
| **Net cash inflow/ (outflow) from operating activities** | **8,046** | **9,757** |

## Note 16 – Financial instruments

The Company's principal financial instruments comprise cash, term deposits, fixed income unit trusts (the underlying assets of which are cash, interest bearing and fixed income securities), domestic and global equity trusts.

The positions in these financial instruments are determined by the Board having regard to policies determined by the Board regarding asset allocation, allowable financial instruments and allowable counterparties. Transacting in individual instruments is subject to delegated authorities and an approval process which are also established and reviewed by the Board.

The Company does not enter into or trade financial instruments, including derivatives, for speculative purposes. The use of financial derivatives is governed by the Company's policies approved by the Board, which provide written principles on the use of financial derivatives.

The Company's activities expose it to financial risks associated with the unpredictability of financial markets, most particularly debt and equity markets. The financial risk management policies and practices seek to minimise potential adverse effects on the financial performance of the Company resulting from the volatility of financial markets. These policies require the investment portfolio to be managed within pre-determined asset allocation limits and specific credit quality and liquidity requirements. The policy has been adopted by the Board of Directors and oversight of the policy is delegated to the Investment Committee.

Compliance with the investment policy is monitored and exposures and breaches are reported to the Investment Committee. The policy is reviewed regularly for changes in the capital markets, economic and risk environment.

## Note 16 – Financial instruments (cont'd)

### (a) Categories of financial instruments

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Financial assets** | | |
| Fair value through the statement of profit or loss: | | |
| Cash and cash equivalents | 14,038 | 9,382 |
| Held-to-maturity investments | 192,339 | 176,539 |
| Held for trading | 133,785 | 125,719 |
| | | |
| **Financial liabilities** | | |
| Other financial liabilities | - | - |

### (b) Capital risk management

The Directors manage capital to ensure that the entity will be able to continue as a going concern while maximising returns within acceptable risk tolerances.

The Solvency Standard requires the Company to ensure the value of capital equals or exceeds the solvency reserve, demonstrating that the Company will be able to meet all liabilities out of the Company's assets, if there was an orderly termination of the company.

The Capital Adequacy Standard requires the Company to ensure the value of capital equals or exceeds the capital adequacy reserve, which is calculated on an assessment of the financial strength of the Company assuming ongoing operations and must be sufficient for the Company to remain solvent for at least the next three years after valuation date.

The Company is required to comply with these standards at all times and results are reported to the Australian Prudential Regulation Authority, previously Private Health Insurance and Administration Council, quarterly.

Operating cash flows are reviewed on a daily basis and used to settle benefits and management expenses. Any surplus funds are invested in accordance with the Company's investment policy.

### (c) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three sources of risk: market interest rates (interest rate risk), foreign exchange rates (currency risk), and market prices (price risk). The Company is exposed primarily to interest rate risk.

The Capital Adequacy Standard requires insurance companies to perform 'resilience tests' to determine the exposure to market risk and to hold sufficient capital reserves to cover this risk.

The following policies and procedures are in place to mitigate the Group's exposure to market risk:

***i) Interest rate risk***

Interest rate risk refers to the risk that the value of future cash flows or capital value of a financial instrument will fluctuate because of changes in market interest rates. The Group's investment policies govern the extent to which the portfolio may be comprised of interest bearing securities.

## Note 16 – Financial instruments (cont'd)

The following table details the Group's exposure to interest rate risks as at the reporting date:

| **2015** | **Weighted average effective rate** | **Variable interest rate** | **Fixed interest maturity dates Less than 1 year** | **Non interest bearing** | **Total** |
|---|---|---|---|---|---|
| | **%** | **$'000** | **$'000** | **$'000** | **$'000** |
| **Financial assets** | | | | | |
| Cash assets | 2.35 | 14,038 | - | - | 14,038 |
| Trade and other receivables | - | - | - | 17,790 | 17,790 |
| Term Deposits | 3.11 | - | 192,339 | - | 192,339 |
| Units in fixed income trusts | 2.78 | 56,972 | - | - | 56,972 |
| Units in unlisted equity trusts | - | - | - | 76,813 | 76,813 |
| | - | 71,010 | 192,339 | 94,603 | 357,952 |
| **Financial liabilities** | | | | | |
| Trade payables | - | - | - | 2,773 | 2,773 |
| Premiums in advance/unearned | - | - | - | 31,377 | 31,377 |
| Risk equalisation payable | - | - | - | 8,201 | 8,201 |
| Employee benefits | - | - | - | 2,683 | 2,683 |
| | - | - | - | 45,034 | 45,034 |

| **2014** | **Weighted average effective rate** | **Variable interest rate** | **Fixed interest maturity dates Less than 1 year** | **Non interest bearing** | **Total** |
|---|---|---|---|---|---|
| | **%** | **$'000** | **$'000** | **$'000** | **$'000** |
| **Financial assets** | | | | | |
| Cash assets | 2.50 | 9,382 | - | - | 9,382 |
| Trade and other receivables | - | - | - | 12,998 | 12,998 |
| Term Deposits | 3.61 | - | 176,539 | - | 176,539 |
| Units in fixed income trusts | 4.52 | 54,815 | - | - | 54,815 |
| Units in unlisted equity trusts | - | - | - | 70,904 | 70,904 |
| | - | 64,197 | 176,539 | 83, 902 | 324,638 |
| **Financial liabilities** | | | | | |
| Trade payables | - | - | - | 1,895 | 1,895 |
| Premiums in advance/unearned | - | - | - | 27,415 | 27,415 |
| Risk equalisation payable | - | - | - | 9,642 | 9,642 |
| Employee benefits | - | - | - | 2,309 | 2,309 |
| | - | - | - | 41,261 | 41,261 |

**Interest rate sensitivity analysis**

The sensitivity analysis has been determined based on the exposure to interest rates for variable and fixed interest rate securities at the reporting date and the stipulated change taking place at the beginning of the financial year and held constant throughout the reporting period.

At reporting date, if interest rates change by 50 basis points and all other variables were held constant, the Company's surplus would change by $0.42 million (2014:$0.5 million).

## Note 16 – Financial instruments (cont'd)

***(ii) Foreign currency risk***

Foreign currency risk is the risk that the fair value of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company manages this exposure on its global equities and fixed income through the ability to invest in hedged and unhedged overseas managed funds in accordance with the company's investment policy.

At reporting date, the company held $33.05 million in unhedged investments (2014: $40.61 million) and $35.4 million in hedged investment (2014: 23.4 million). The company's sensitivity to an average increase and decrease of 10% in foreign currencies with all other variables held constant, the surplus would change by $3.1 million (2014: $4.1 million).

***(iii) Market price risk***

Market price risk is the risk that the total value of unlisted investments will fluctuate as a result of changes in unit prices, whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market. These risks include interest rate risk, equity price risk, and currency risk. The Company has investments in various managed funds which expose it to price risk.

As the majority of the Company's financial instruments are carried at fair value with changes in value recognised in the statement of profit or loss, all changes in market conditions will directly affect investment income. Price risk is mitigated by the Company's investment policy by constructing a diversified portfolio of instruments traded on various markets.

As at reporting date, if unit prices change by 10% the Company's surplus would change by $13.4 million (2014:$12.6 million).

There are no change from the prior year to the methods and assumptions used.

**(d) Credit risk management**

Credit risk arises from the financial assets of the Company, which comprise cash and cash equivalents, trade and other receivables and financial assets at fair value through the statement of profit or loss. The Company's exposure to credit risk arises from potential default of the counter-party, with a maximum exposure equal to the carrying amount of these instruments.

There are no significant concentrations of credit risk to a single entity within the Company's investment portfolio. There is a geographical concentration to Australian domiciled banks which is managed through the use of exposure limits.

The Company does not have any financial instruments to mitigate exposure against credit risk and all investments are unsecured. However, the impact of default of counter-parties is minimised through the use of Board-approved limits by counter party and rating, diversification of counter-parties, and the conservative policy to maintain investments in investment grade entities only.

The Company continuously monitors the counterparty credit ratings and ensures it maintains adequate capital reserves (note 3).

The following table provides information regarding the credit risk exposure of the Company at 30 June by classifying assets according to credit ratings of the counterparties. AAA is the highest possible rating. Assets that fall outside the range AAA to BBB- are classified as non-investment grade. The table below highlights the long-term ratings bands as per published Standard & Poor's correlations.

## Note 16 – Financial instruments (cont'd)

| 2015 | AAA Rated | AA Rated | A Rated | BBB Rated | Below BBB or Not Rated | Total |
|---|---|---|---|---|---|---|
| | $'000 | $'000 | $'000 | $'000 | $'000 | $'000 |
| **Financial assets** | | | | | | |
| Cash assets | - | 14,038 | - | - | - | 14,038 |
| Trade and other receivables | - | - | - | - | 17,790 | 17,790 |
| Term deposits | - | 119,339 | 73,000 | - | - | 192,339 |
| Units in fixed income trusts | 22,148 | 9,494 | 13,226 | 9,170 | 2,934 | 56,972 |
| Units in unlisted equity trusts | - | - | - | - | 76,813 | 76,813 |
| | 22,148 | 142,871 | 86,226 | 9,170 | 97,537 | 357,952 |

| 2014 | AAA Rated | AA Rated | A Rated | BBB Rated | Below BBB or Not Rated | Total |
|---|---|---|---|---|---|---|
| | $'000 | $'000 | $'000 | $'000 | $'000 | $'000 |
| **Financial assets** | | | | | | |
| Cash assets | - | 9,382 | - | - | - | 9,382 |
| Trade and other receivables | - | - | - | - | 12,998 | 12,998 |
| Term deposits | - | 85,039 | 91,500 | - | - | 176,539 |
| Units in fixed income trusts | 18,899 | 9,010 | 13,162 | 11,089 | 2,655 | 54,815 |
| Units in unlisted equity trusts | - | - | - | - | 70,904 | 70,904 |
| | 18,899 | 103,431 | 104,662 | 11,089 | 86,557 | 324,638 |

### (e) Liquidity risk management

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet cash commitments associated with financial instruments. It may result from either the inability to sell financial assets quickly at their fair values; the counter-party failing on repayment of a contractual obligation; or insurance liability falling due for payment earlier than expected; or the inability to generate cash inflows as anticipated.

The Company manages liquidity risk by maintaining adequate reserves of liquid financial assets and by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The following table details the company's liquidity based on maturity date, including financial assets available for sale (Note 16 (b)).

| 2015 | Less than 1 month | 1-3 months | 3 months to 1 year | 1-5 years | 5+ years | Total |
|---|---|---|---|---|---|---|
| | $'000 | $'000 | $'000 | $'000 | $'000 | |
| **Financial assets** | | | | | | |
| Cash assets | 14,038 | - | - | - | - | 14,038 |
| Trade and other receivables | 11,130 | 2,186 | 4,474 | - | - | 17,790 |
| Term deposits | 23,500 | 36,500 | 132,339 | - | - | 192,339 |
| Units in fixed income trusts | 56,972 | - | - | - | - | 56,972 |
| Units in unlisted equity trusts | 76,813 | - | - | - | - | 76,813 |
| | 186,953 | 37,241 | 133,758 | - | - | 357,952 |
| **Financial liabilities** | | | | | | |
| Trade payables | 2,773 | - | - | - | - | 2,773 |
| Risk equalisation payable | - | 8,201 | - | - | - | 8,201 |
| | 2,773 | 8,201 | - | - | - | 10,974 |

## Note 16 – Financial instruments (cont'd)

| 2014 | Less than 1 month $'000 | 1-3 months $'000 | 3 months to 1 year $'000 | 1-5 years $'000 | 5+ years $'000 | Total |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash assets | 9,382 | - | - | - | - | 9,382 |
| Trade and other receivables | 10,491 | 1,514 | 993 | - | - | 12,998 |
| Term deposits | 21,500 | 57,200 | 97,839 | - | - | 176,539 |
| Units in fixed income trusts | 54,815 | - | - | - | - | 54,815 |
| Units in unlisted equity trusts | 70,904 | - | - | - | - | 70,904 |
| | 167,092 | 58,714 | 98,832 | - | - | 324,638 |
| **Financial liabilities** | | | | | | |
| Trade payables | 1,675 | 220 | - | - | - | 1,895 |
| Risk equalisation payable | - | 9,642 | - | - | - | 9,642 |
| | 1,675 | 9,862 | - | - | - | 11,537 |

### (f) Fair value of financial instruments

The Directors consider that the carrying amount of financial assets recorded in the financial statements approximates their fair values. The fair values of financial assets are determined as follows:

- the fair value of financial assets traded on active liquid markets are determined with reference to quoted market prices; and
- the fair value of other financial assets is determined in accordance with generally accepted pricing models based on discounted cash flow analysis.

Transaction costs are not included in the determination of net fair value.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

| 2015 | Level 1 $'000 | Level 2 $'000 | Level 3 $'000 | Total $'000 |
|---|---|---|---|---|
| **Financial assets at fair value through profit or loss** | | | | |
| Units in fixed income trusts | - | 56,972 (i) | - | 56,972 |
| Units in unlisted equity trusts | - | 76,813 (i) | - | 76,813 |
| Total | - | 133,785 | - | 133,785 |

## Note 16 – Financial instruments (cont'd)

| 2014 | Level 1 $'000 | Level 2 $'000 | Level 3 $'000 | Total $'000 |
|---|---|---|---|---|
| **Financial assets at fair value through profit or loss** | | | | |
| Units in fixed income trusts | - | 54,815 (i) | - | 54,815 |
| Units in unlisted equity trusts | - | 70,904 (i) | - | 70,904 |
| Total | - | 125,719 | - | 125,719 |

(i) Valuation determined by the unit redemption prices of unlisted managed funds.

## Note 17 – Auditors remuneration

| | 2015 $ | 2014 $ |
|---|---|---|
| Remuneration for audit of the financial reports and regulatory reporting | 66,025 | 62,250 |
| | **66,025** | **62,250** |

Auditor is Deloitte Touche Tohmatsu

## Note 18 – Commitments for expenditure

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Non-cancellable operating lease commitments** | | |
| Within one year | 904 | 845 |
| Later than one year but not later than five years | 3,401 | 2,960 |
| Longer than five years | - | 468 |
| | **4,305** | **4,273** |

a) These commitments relate entirely to motor vehicle and property leases.
b) The company has granted the lessor of the property a bank guarantee to support the lease obligations.
c) Property lease has a remaining term of seven years at report date.
d) Motor vehicle leases have a remaining term of up to five years at report date.

| **Liabilities recognised in respect of non-cancellable operating leases** | | |
|---|---|---|
| Lease incentives | 486 | 529 |
| Make good of lease premises | 225 | 225 |
| | **711** | **754** |

## Note 19 – Related party transactions

Details of transactions between the Group and other parties are disclosed below.

a) HAMB Systems Limited is a company limited by guarantee providing computer software services to a number of health funds. The Company is a member of that company. Normal commercial transactions involving payments to HAMB Systems Limited totalling $1,102,579 (2014: 963,829) took place during the year. Mr M.J. Bassingthwaighte AM, a Director of Defence Health, is Chairman of HAMB Systems Limited and Major General G P Fogarty AO (Ret'd), Chief Executive Officer of Defence Health is a Director of HAMB Systems Limited.
b) Australian Health Service Alliance Limited is a company limited by guarantee which negotiates the terms by which hospital services and hospital related medical and paramedical services are provided to its members. The Company is a member of that company. Normal commercial transactions involving payments to Australian Health Service Alliance Limited totalling $571,962 (2014: $554,513) took place during the year. Mr M.J. Bassingthwaighte AM, a Director of Defence Health, is a Director of Australian Health Service Alliance Limited.
c) Members Own Health Funds is a company limited by guarantee, funded by means of fees payable by its members in return for the provision of services by the company and provides marketing, advertising and promotion services in relation to the Trade Marks. The Company is a member of that company. Normal commercial transactions including payments to set up Members Own Health Funds totalling $644,930 took place during the year. Mr M.J. Bassingthwaighte AM, a Director of Defence Health, is a Director of Members Own Health Funds.
d) During the year the Company received health insurance contributions from and paid health insurance benefits to some Directors of the Company and their relatives on normal commercial terms and conditions.
e) Defence Health Ltd pledged $220,000 in donations to Defence Health Foundation. The trustee of Defence Health Foundation is a subsidiary of Defence Health Limited.

## Note 20 – Remuneration of key management personnel

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Short-term employee benefits | 1,292 | 1,477 |
| Post-employment benefits | 181 | 176 |
| Termination benefits | - | 195 |
| | **1,473** | **1,848** |

Remunerations are reviewed and determined with due regard to current market rates and are benchmarked against comparable industry remunerations.

The specified Directors for 2015:
Mr M J Bassingthwaighte AM
Mr A I Beckett
Ms J A Blackburn
Air Commodore P D Byrne
Major General G H Garde AO RFD (Ret'd)
COL Anthony Hambleton AM
Mr G Richardson
Ms A M Williams

The specified executives for 2015:
Major General G P Fogarty AO (Ret'd) – Chief Executive Officer
Ms C Mulcare – Chief Financial Officer
Mr A N Guerin – Company Secretary and Chief Operating Officer (resigned as Chief Operating Officer 31 October 2014)

## Note 21 – Contingent liabilities and contingent assets

There are no material contingent liabilities and contingent assets at reporting date.

## Note 22 – Subsequent events

There have not been any matters or circumstances occurring subsequent to the end of financial year that have significantly affected, or may significantly affect, the operations of the company.

## Directors' Declaration

The Directors of Defence Health Limited declare that:

(a) in the Directors' opinion, there are reasonable grounds to believe that the Group is able to pay its debts as and when they become due and payable;

(b) the attached financial statements are in compliance with international Financial Reporting Standards, as stated in Note 1 to the financial statements; and

(c) in the Directors' opinion, the attached financial statements and notes thereto are in accordance with the *Corporations Act 2001*, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the consolidated entity.

Signed in accordance with a resolution of the Director's made pursuant to *S.295(5)* of the *Corporations Act 2001.*

On behalf of the Board of Directors.

| | |
|---|---|
| ............................................................ | ............................................................ |
| Mr Alan I Beckett<br>Director | Major General Gregory H Garde AO RFD (Ret'd)<br>Director |
| 16 September 2015 | 16 September 2015 |

Deloitte Touche Tohmatsu
ABN 74 490 121 060

550 Bourke Street
Melbourne VIC 3000
GPO Box 78
Melbourne VIC 3001 Australia

DX: 111
Tel: +61 (0) 3 9671 7000
Fax: +61 (03) 9671 7001
www.deloitte.com.au

# Independent Auditor's Report
# to the members of Defence Health Limited

We have audited the accompanying financial report of Defence Health Limited, which comprises the statement of financial position as at 30 June 2015, the statement of profit or loss and other comprehensive income, the statement of cash flows and the statement of changes in equity for the year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year as set out on pages 13 to 42.

*Directors' Responsibility for the Financial Report*

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

*Auditor's Responsibility*

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

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

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

*Auditor's Independence Declaration*

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of Defence Health Limited, would be in the same terms if given to the directors as at the time of this auditor's report.

*Opinion*

In our opinion:

(a) the financial report of Defence Health Limited is in accordance with the *Corporations Act 2001*, including:

  (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2015 and of its performance for the year ended on that date; and

  (ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and

(b) the financial statements also comply with International Financial Reporting Standards as disclosed in Note 1.

DELOITTE TOUCHE TOHMATSU

Peter A Caldwell
Partner
Chartered Accountants
Melbourne, 17 September 2015