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Dear Julindi

**PRESENTATION OF FINANCIAL STATEMENTS**

We refer to deliberations during the SAICA Medical Schemes Project Group (MSPG) meeting held on 22 June 2021 on the presentation of the financial statements of a medical scheme.

We would like to bring to your attention two matters:

1. Order of liquidity presentation in the statement of financial position
2. Direct method used in the statement of cash flows.

**1. Order of liquidity in the statement of financial position**

Currently medical schemes (“schemes”) present assets and liabilities as current and non-current on the face of the statement of financial position. There are schemes that would prefer to rather present assets and liabilities in order of liquidity as allowed by IAS 1 *Presentation of Financial Statements* (“IAS 1”).

As part of the implementation programmes for IFRS 17 *Insurance Contracts* (“IFRS 17”), the trustees of many schemes are reviewing and challenging current presentation and disclosures in the financial



statements. Consequently, schemes have questioned whether an order of liquidity presentation is not more appropriate than a current/ non-current presentation for specifically assets, but also for liabilities.

### ***Business of a medical scheme***

Schemes have to ensure they have adequate financial resources available to fund member claims as they arise. The occurrence and timing of the claims are uncertain and could occur during the current financial year or in multiple future financial years. The fluctuations in the claim trends and therefore the solvency requirement of a scheme over time results in uncertainty around the asset utilisation cycle.

Member contributions, invested in assets, which were not utilised to fund claims and other medical scheme expenditure in a financial year are carried forward for the benefit of members in future financial periods. The frequency and severity of claims directly impacts the timing and usage of the contributions.

The size of a scheme's asset base and its solvency level introduces further uncertainty around the timing of the liquidation or disposal of assets. Investment strategies adopted by schemes and the implementation and management of the strategies also creates uncertainty around the timing of realisation of assets.

These varied aspects introduce levels of subjectivity requiring judgement for current and non-current classification of assets.

We will consider the requirements of IAS 1 to explain the reasons why we believe the order of liquidity presentation is more appropriate for the statement of financial position of a scheme.

### ***IAS 1 requirement***

IAS 1 states the following:

*“An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 66–76 except when a presentation based on liquidity provides information that is **reliable and more relevant**. When that exception applies, an entity shall present all assets and liabilities in order of liquidity (IAS 1 paragraph 60)”.*



It further states the following in paragraph 63:

*“For some entities, such as financial institutions, a presentation of assets and liabilities in increasing or decreasing order of liquidity provides information that is **reliable and more relevant** than a current/non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.”*

In order to support the presentation approach favoured by many medical schemes, we have considered “reliable” and “more relevant” in more detail.

### **Reliable**

The term 'faithful representation' is used in the Conceptual Framework for Financial Reporting (“Framework”) instead of 'reliability' (Framework paragraph BC 2.22). The International Accounting Standards Board decided against replacing the term 'reliability' with the term 'faithful representation' in the Standards (IAS 1 paragraph BC 105J). Therefore, the term 'reliability' still appears in IAS 1. We have therefore considered below what 'faithful representation' means.

“To be a perfectly faithful representation, a depiction would have three characteristics. It would be (Framework paragraph 2.13):

— *Complete*

“A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations” (Framework paragraph 2.14).

— *Neutral*

“A neutral depiction is without bias in the selection or presentation of financial information” (Framework paragraph 2.15)

— *Free from error*

“Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process” (Framework paragraph 2.18).

We believe an order of liquidity presentation will result in more reliable, i.e. faithful representation. Presentation in the statement of financial position will be more complete, neutral and free from error.

There is subjectivity around the realisation of assets thus making the current and non-current classification less reliable.



The order of liquidity provides more information about the liquidity of the assets in the statement of financial position, with more detail in the notes. IAS 1 paragraph 61 requires disclosure about the following in the notes:

*“Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:*

- (a) no more than twelve months after the reporting period, and*
- (b) more than twelve months after the reporting period.”*

### **More relevant**

“Relevant financial information is capable of making a difference in the **decisions made by users**. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources” (Framework paragraph 2.6).

The order of liquidity presentation without segregation into current and non-current, is judged to be more relevant for users of a scheme’s financial statements. It enables the users to understand the uncertainty around the asset usage and therefore help to inform the users’ decisions.

### **Recommendation to CMS**

Presenting the statement of financial positions in order of liquidity will be reliable and more relevant, specifically around the manner in which a scheme’s assets are realised and managed.

We recommend that the order of liquidity is adopted as the preferred method for presenting the statement of financial position of a scheme, however also allowing schemes to continue using the current/ non-current basis of presentation, disclosing in their accounting policy how it best reflects more relevant and reliable information for users. This approach, in our view, will lead to improved overall quality of financial statements and lead to financial statements providing information which will enable users to assess the financial performance of a specific medical scheme.



## **2. Direct method used in the statement of cash flows**

IAS 7 *Statement of Cash Flows* (“IAS 7”) requires an entity to report cash flows from operating activities using either the direct method or indirect method.

*“An entity shall report cash flows from operating activities using either:*

- (a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or*
- (b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows” (IAS 7 paragraph 18).*

IAS 7 encourages entities to report cash flows from operating activities using the direct method, as this method provides information which may be useful in estimating future cash flows and which is not available under the indirect method (IAS 7 paragraph 19). However, both methods are available to report cash flows from operating activities.

Obtaining an understanding of a scheme’s future cash flows is essential to form a view of the ability of a scheme to generate sufficient financial resources to fund member claims. Schemes should be encouraged to present cash flows from operating activities using the direct method.

### ***Conclusion and recommendation to CMS***

As IAS 7 encourages entities to report cash flows from operating activities using the direct method, schemes should be encouraged to use the direct method through guidance in the SAICA Medical Schemes Accounting Guide and Circulars issued by the Council for Medical Schemes.

We thank you for the opportunity to make this submission. We are looking forward to your response.

Yours Sincerely

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