# INTEGRATED ANNUAL REPORT 2013

FEM

THE FEDERATED
EMPLOYERS' MUTUAL
ASSURANCE COMPANY
PROPRIETARY LIMITED (RF)

FEM

The Federated Employers' Mutual Assurance Company Proprietary Limited (RF) was established as a mutual insurer in 1936 and on the introduction of the Workmen's Compensation Act 1941 was granted a licence to continue to transact workmen's compensation insurance for the building industry.

This insurance compensates employees or their dependants following an injury arising from occupational accidents and illness occasioned by industrial diseases. Its business operations are essentially confined to the insurance of employers against their liabilities under the Compensation for Occupational Injuries and Diseases Act 1993.

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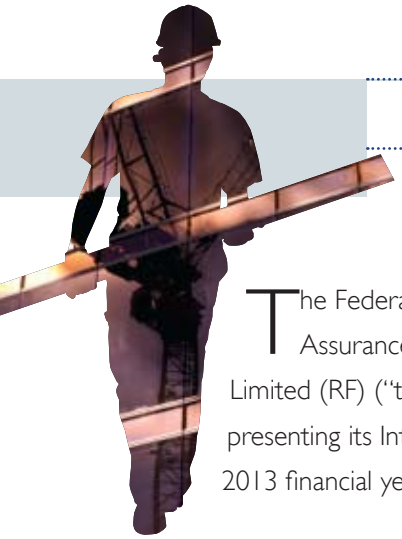


# Introduction

***The report covers the integrated sustainability performance for the year ended 31 December 2013***

The Federated Employers' Mutual Assurance Company Proprietary Limited (RF) ("the Company") has pleasure in presenting its Integrated Annual Report for the 2013 financial year.

The report covers the integrated sustainability performance of the Company for the period 1 January 2013 to 31 December 2013. The Company operates in the Republic of South Africa. Underwriting profits are generated in South Africa; net profits include investment income, of which a portion is earned from foreign investments.

Management's interpretation of materiality has been applied in determining the content and disclosure in this report.

The audited annual financial statements have been prepared according to International Financial Reporting Standards (IFRS), and the Companies Act 71 of 2008, as amended. The Company's external auditors, PricewaterhouseCoopers Inc. and SizweNtsalubaGobodo Inc., expressed an unqualified opinion on the annual financial statements.

## Company profile

The Company was established as a mutual short term insurer in 1936 and, on the introduction of the Workmen's Compensation Act, 1941, was granted a licence to transact workmen's compensation insurance for the building industry. Its business operations are confined to the insurance of employers against their liabilities under the Compensation for Occupational Injuries and Diseases Act, 1993 and extend to any employer falling within Class V of the Commissioner's industrial classifications for the construction industry. In terms of the Memorandum of Incorporation ("MOI") of the Company, the Company operates as a mutual short term insurer and shareholding is effectively restricted to policyholders. Shareholders are not entitled to any dividends or distribution of the assets of the Company, except for the nominal amount of share capital upon dissolution. The mutual structure of the Company is entrenched in non-alterable provisions in the MOI of the Company, hence the "(RF)" designation at the end of the Company's name.

## Targets

The primary objective of the Company is to assure policyholders and claimants of the on-going sustainability of the Company. This includes appropriate funding of the Company's long term pension obligations in respect of disability and death benefits.

The Company prepares a rolling three year strategy on an annual basis in order to ensure the long term financial sustainability of the Company. Two key targets of the Company are to remain conservatively capitalised in excess of statutory capital requirements and to achieve at least a break-even underwriting result each year (after making provision for premium rebates to be paid to policyholders and before any investment income expected to be earned by the Company). Premium rebates are targeted at 30% (2012: 20%) of annual net premium earned and the distribution thereof among policyholders is based on their relative claims experience in order to incentivise improved health and safety practices in the workplace. These objectives were achieved for the past financial year.

# THE FEM STORY

***Builders look to better themselves***

The Annual Congress of the National Federation of Building Trades Employers in 1936 was told by its president, Joseph Garnett, that "Never before in the history of the country has there been such amazing activity in the building industry as exists today and I see no reason why that activity should not continue for some considerable time".

# Chairman's report

***for the year ended 31 December 2013***

I am pleased to report on the activities and results of the Company for the year ended 31 December 2013.

The Company again recorded excellent results and continues to grow in key areas of its business. The Company continues to recognise Policyholder's with favourable loss ratios and has paid R453.4 million in merit rebates over a five year period. Included in the financial statements are a further R358.6 million to be paid to qualifying Policyholder's over a two year period, R111.2 million in medical claims paid and R69.4 million paid to Pensioners.

**Economic environment**

The construction industry slowed down considerably after the 2010 FIFA World Cup with both the amount of work available and the profitability declining. An important contributing factor to the limited construction activity is municipalities that continue to underspend on their budgets. Major infrastructure projects announced by the government in 2013 have yet to materialise and the anticipated activity to stimulate the construction economy has not yet begun.

Demand for new construction work remains fragile and growth in construction activity remains subdued. Nevertheless, there is an expectation that construction activity could rebound later in the year. A key factor that will affect the pace of construction-activity growth is the rate at which the SA government rolls out its planned infrastructure expenditure, with the turnover of the construction industry being highly sensitive to government spending as government is the largest client in the industry. To date, tenders relating to the government's infrastructure plans have been slow in coming to market.

As Africa expands and has already begun a somewhat slow infrastructure cycle, South Africa is implementing encouraging initiatives for future growth in the construction industry. The Infrastructure Development plan and Presidential Infrastructure Coordinating Commission (PICC) are just some of the initiatives in this regard. The construction industry could be well poised for some sort of recovery.

Whilst this recovery could be slowed by inter alia, poor economic growth and reduced government revenue, there is a certain amount of cautious optimism around. Companies are continuing to expand into Africa and although there are a reasonable number of medium-sized projects, there will have to be a significant increase in government spending and an improvement in local and global economies to stimulate any meaningful growth.

The recovery in the construction sector started gaining momentum in the third quarter of 2013 with confidence levels rising to its highest level in three years. First National Bank reported that conditions in the construction sector had improved significantly over the past few quarters and this was likely to continue in the foreseeable future.

**Governance**

The Company recognises that sound governance will benefit and sustain its long-term performance. With the current South African environment of increased

regulatory, legislative and reporting requirements in the financial services industry, the Board strives and is committed to achieve compliance.

Our governance processes continue to be enhanced. During the year, the Company has focused on the new solvency requirements to be introduced by the Financial Services Board with regards to solvency assessment and management. The Company is well positioned to achieving the solvency requirements as required by the regulator. The Directors confirm that the Company has substantially complied with the recommendations of King III. The newly formed Social & Ethics committee and Risk & Compliance committee have achieved their objectives for the year. The Company now has the following committees each of which has written terms of reference set out in board approved charters:

- *Audit Committee*
- *Remuneration and Nominations Committee*
- *Investment Committee*
- *Risk and Compliance Committee*
- *Social and Ethics Committee*

**Board of Directors**

The Company has a stable Board, which is considered to be well balanced in terms of skills and experience. Nine of the twelve directors (75%) are non-executive directors of which four (44%) are black. In terms of the Company's MOI, one third of the directors retire by rotation each year and are eligible for re-election at the Company's annual general meeting. The independence of the directors is reviewed annually and all nine non-executive directors, including the chairman, are classified as independent in terms of King III requirements.

During the year the Company appointed a trade union representative to the Board. We are awaiting a nomination from the State Commissioner's office for a representative to be appointed on our Board. This is required in terms of the applicable licensing conditions.

**Acknowledgements**

My sincere thanks to our CEO, Thelma Pugh and her executive team for their leadership and achieving yet another year of excellent results. Also thank you to my fellow directors for their valuable guidance and contribution. On behalf of the Board, I wish to convey my thanks to the employees of the Company for their commitment and loyalty and to our policyholders for their continued support.

NF Maas
*Chairman*

# Chief executive officer's report

***for the year ended 31 December 2013***

I am pleased to report on the activities and results of the Company for the year ended 31 December 2013.

## Overall performance

Net insurance premium revenue totalled R592.8m for the year, which is an increase of R45.1m or 8% over the previous year, which is mainly driven by a growth in Client payrolls. New business amounted to R26.8m compared to R13.9m in the previous year.

Investment income totalled R923.0m and represents an 18.8% return on average financial assets held during the year (2012: 18.7%). This return was driven by high returns achieved on African investment funds, local listed equities and was underpinned by solid performance on international listed equities coupled with the currency benefits from a weakening Rand.

The gross claims expense (before reinsurance effects) decreased by R86.9m to R71.6m for the year and is mainly due to a reduction in the volume of claims and a lower than expected increase in the average cost per claim.

Total pension costs decreased by R7.2m (4.8%) to R143.5m for the year. The decrease is due mainly to a lower than expected net charge to the pension liability for the year. New pensions awarded during the year increased by R21.7m to R87.5m. The annual pensions increase approved by the Compensation Commissioner, effective 1 April 2014, is 6.4% *(1 April 2012: 6.0%)*.

Administration expenses, including BBBEE spend, totalled R66.0m for the year, which is an increase of R6.6m over the corresponding figure of R59.4m for 2012.

It is pleasing to report that the Company maintained an underwriting surplus for the sixth consecutive year, recording an underwriting profit of R37.3 million for the year (2012: R56.6 million). After including investment income, the total income transferred to retained profit amounted to R952.5 million (2012: R757.1 million).

## General

### *Information & technology*

The Company's operating computer system continues to be enhanced to meet new requirements and changes in the business environment. The system is considered to be of a high standard and enables the provision of efficient services to policyholders and their employees. Many elements of the system are currently being redeveloped to keep pace with current trends in software development.

### *Employment equity*

The Company is committed to creating a diverse workforce through an advancement of previously disadvantaged people, women and employees with disabilities. The Company continues to make progress on its employment equity plan.

### *Broad based black economic empowerment ("BBBEE")*

The Company continues to make progress on its long term BBBEE strategy. The Company has a current BBBEE rating of "AA" (level three BBBEE contributor) which is a 110% procurement recognition level and aims to maintain this rating. The Company is currently being rated under the Scorecard for Specialised Enterprise

due to its mutual structure and consequent lack of beneficial ownership.

*Corporate governance*

It is pleasing to report that the Company is substantially compliant with the recommendations of King III, as detailed in the Corporate Governance Report contained elsewhere in this Integrated Annual Report.

**Solvency margin – international basis**

The international solvency margin is calculated as net assets, per the financial statements, over the net insurance premium revenue. The solvency margin has increased from 429.6% to 558.3% as a result of a 39.9% increase in the net asset value in 2013.

**Occupational health, safety and rehabilitation**

Financial assistance amounting to R8,6m *(2012: R8,2m)* was provided to the health and safety programmes of the various construction industry associations. Statistics reflect a steady decrease in the number of workers injured proportionate to the number insured, with the accident frequency rate steadily decreasing each year. A run-off table of accident frequencies for the past 5 years is presented below. The Company's claims registered cycle is normally 2½ years, and therefore 2012 and 2013 are subject to change, but compared to prior years there is a clear indication of the decrease over time.

| | *Underwriting year* | | | | |
|---|---|---|---|---|---|
| *Accident frequency rate (per 100 employees): number of accidents over total insured* | 2009 | 2010 | 2011 | 2012 | 2013 |
| Financial year end | | | | | |
| 2009 | 3.10 | - | - | - | - |
| 2010 | 3.55 | 3.08 | - | - | - |
| 2011 | 3.58 | 3.27 | 2.60 | - | - |
| 2012 | 3.59 | 3.30 | 2.80 | 2.42 | - |
| 2013 | 3.60 | 3.30 | 2.83 | 2.64 | 2.74 |

It is also pleasing to note that the Company made a large number of health and safety awards to employers in recognition of their efforts to promote health and safety among their workers. During 2013, R130,6m *(2012: R96,0m)* was paid to policyholders in merit rebates.

**Health & safety awards**

The Company continues to recognise policyholders that achieve excellence in health and safety. To receive these awards, policyholders had to meet or exceed very stringent criteria as set out by the Company. In addition to their normal merit rebate payment, policyholder's also receive an additional rebate. The 2013 awardees for these prestigious awards were:

- *Platinum award: Group Five Oil & Gas (Pty) Ltd*
- *Gold award: DIP Civils (Pty) Ltd*
- *Silver award: Tri-Star Construction (Pty) Ltd*
- *Bronze award: Boupen Housing (Pty) Ltd*

**Prospects**

The Company is well positioned to face the future challenges and remains committed to the provision of an effective and efficient compensation service to all our stakeholders. To all of them, we extend our very best wishes for the time that lies ahead.

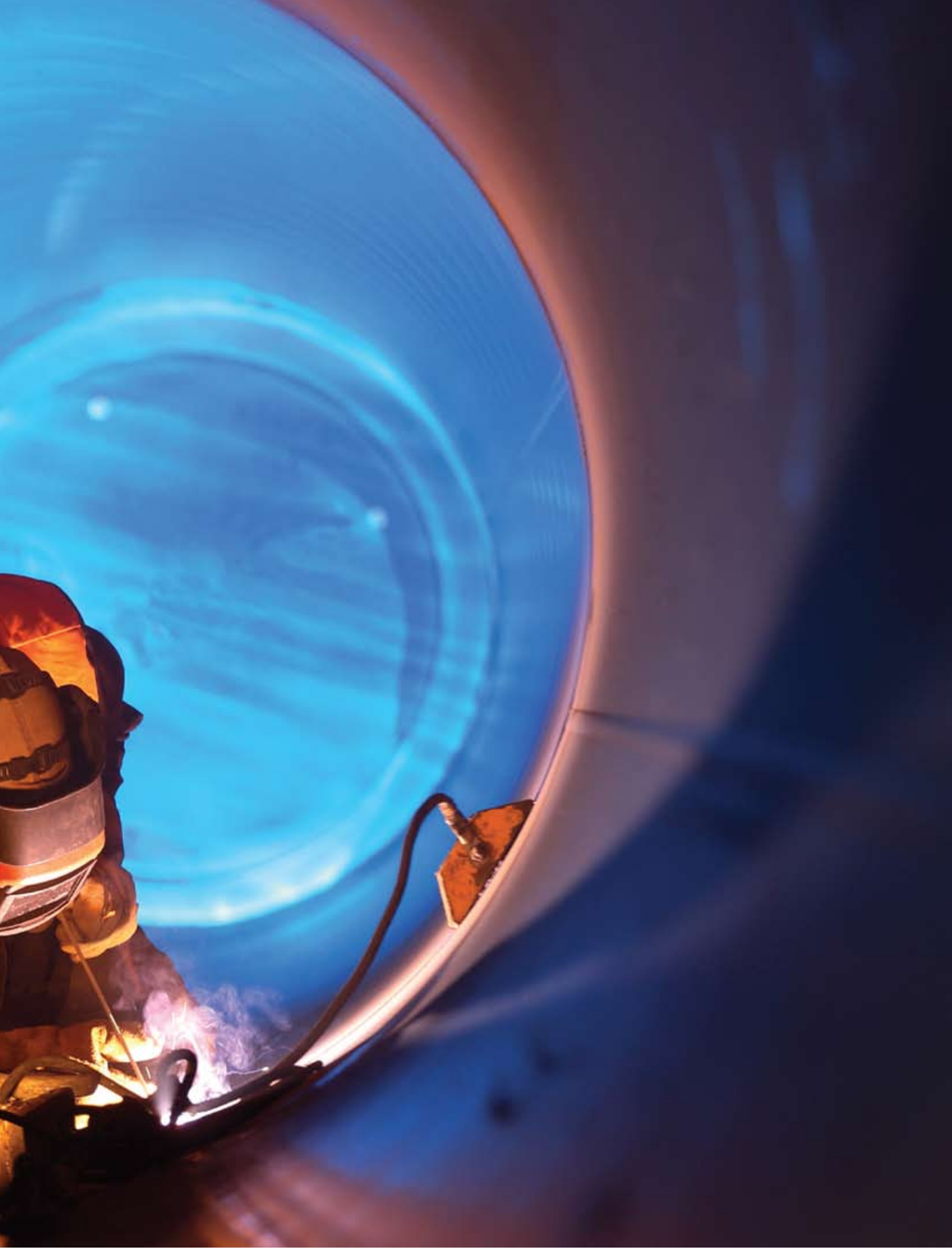
**Thanks**

Ready co-operation and assistance continues to be received from the office of the Compensation Fund at all levels and we are particularly grateful to the Commissioner for this support.

My sincere thanks to my fellow directors for their continued advice and wise counsel throughout the year.

Finally, I thank my executive committee and staff of the Company for their devoted and excellent service during the year.

TT PUGH
*Chief Executive Officer*



# Chief financial officer's report

***for the year ended 31 December 2013***

The review of the Company's financial performance for the year ended 31 December 2013 is focused on the underwriting result and key line items of the statements of comprehensive income, statement of financial position and statement of cash flows. The Company remained strongly cash generative, with R221.6m *(2012: R217,6m)* in cash generated from operating activities during the year.

| **Underwriting result** | ***Movement*** | ***2013*** | ***2012*** |
|---|---|---|---|
| | ***%*** | ***R'000*** | ***R'000*** |
| Earned premium | 9 | 603,614 | 554,006 |
| Premiums ceded to reinsurers | 72 | (10,791) | (6,268) |
| | **8.2** | **592,823** | **547,738** |
| Net claims | (43) | (141,606) | (249,014) |
| New pensions awarded | 18 | (53,017) | (44,818) |
| Net movement in pensions liability | 20 | (16,423) | (13,644) |
| **Underwriting result for the year** | **60** | **381,777** | **240,262** |
| Administration expenses | 11 | (66,042) | (59,443) |
| Accident prevention expenses and grants | 11 | (16,336) | (14,760) |
| **Underwriting profit before premium rebates** | **80** | **299,399** | **166,059** |
| Premium rebates to policyholders | 139 | (262,083) | (109,492) |
| **Underwriting profit for the year** | **(34)** | **37,316** | **56,566** |

The 80% increase in the underwriting profit before premium rebates is mainly attributable to the 43% decrease in net claims which has been partly offset by the 18% increase new pensions awarded and the 20% increase the net movement in pensions liability. The increase in administration expenses is mainly attributable to an increase in consulting fees as a result of the implementation costs on solvency assessment and management ("SAM").

The increase in grants and accident prevention expenses is as a result the Company's continued commitment to health & safety in the industry.

The provision for premium rebates has been increased to 30% *(2012: 21%)* of premium revenue, resulting in an underwriting profit for the year of R37.3m. This is the sixth consecutive year that an underwriting surplus has been maintained.

| **Overall financial result** | ***Movement*** | ***2013*** | ***2012*** |
|---|---|---|---|
| | ***%*** | ***R'000*** | ***R'000*** |
| Underwriting profit for the year | (34) | 37,316 | 56,566 |
| Investment income | 31 | 922,976 | 707,508 |
| Investment expenses | 11 | (7,810) | (7,012) |
| **Total comprehensive income for the year** | **31** | **952,482** | **757,062** |

## Financial position

Total financial assets at fair value of R4,924 billion increased by R1,147 billion or 30% which includes the investment of net cash generated from operations of R221,6m and the realisation of investments. Total insurance liabilities increased by R171,2m or 12%. The pensions liability increased from R864,6m in 2012 to R938,6m in the current period, representing an 8.6% increase.

The Company's net asset value totalled R3,339 billion at 31 December 2013, representing a 40% growth in net assets for the year.

Full details of the Company's financial position and cash flows are set out in the accompanying annual financial statements.

## Financial outlook for 2014

The Company is expected to remain cash generative and management do not expect any material deterioration in the underwriting account in the year ahead. The Company is conservatively capitalised to withstand potential adverse investment market movements and to provide policyholders and claimants certainty on future benefit payments.

A Daya
*Chief Financial Officer*

# Corporate governance report

***for the year ended 31 December 2013***

**Front row:** *Dr APH Jammine, H walker, TT Pugh (Chief Executive Officer), NF Maas (Chairperson), L Willis (Secretary).*
**Back Row:** *JR Barrow, A Letshele, GM McIntosh (Executive director), Dr H Ngakane, PL Siphayi, CS Jiyane, A Daya (Executive Director), M Ilsley.*

The directors are committed to applying good corporate governance. This includes applying discipline, independence, fairness, social responsibility and transparency. In this regard the directors endorse the codes of corporate practice and conduct recommended in the King III report.

By supporting these codes, the Company demonstrates its commitment to the highest standards of integrity and ethical conduct in dealings with all its stakeholders.

**The Board of directors**

At the end of the period under review, there were twelve directors *(2012: eleven)* on the Board, nine *(2012: eight)* of whom are non-executive. The non-executive directors bring diversity and experience, insight and independent judgement on issues of strategy, performance, resources and standards of conduct. New appointments to the Board are submitted to the Board by the Remuneration and Nominations committee for approval, prior to appointment. All such appointments are subject to shareholder approval at the next annual general meeting. The roles of the Chairman and the Managing Director do not vest in the same person, and the Chairman of the various Board committees are independent non-executive directors.

The Chairman and Chief Executive Officer provide leadership and guidance to the Board, encourage proper deliberation on all matters requiring the Board's attention and obtain optimum input from the other directors.

All directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are followed.

All directors are entitled to seek independent professional advice about the affairs of the Company at the Company's expense should this prove to be necessary.

Executive directors have service contracts with the Company containing standard terms and normal notice periods. Service contracts for non-executive directors are in the process of being finalised. In terms of the Company's Memorandum of Incorporation, one third of these directors retire by rotation each year and are eligible for re-election at the Company's annual general meeting, and this year they are Messrs CS Jiyane, NF Maas and H Ngakane.

During the year Mr MA Letshele was appointed as a Non-executive director.

Executive and non-executive directors' emoluments are disclosed in the accompanying annual financial statements.

The board of directors meet at least three times per year and has ultimate responsibility for the Company's strategy, governance and oversight of key performance and risk areas. Specific functions are delegated to board committees which act under written terms of reference – separate reports are provided by the various committees elsewhere in this Integrated Annual Report.

*Attendance at meetings during the year*

| Board | Feb | April | May | June | Sept | Nov |
|---|---|---|---|---|---|---|
| **Non-executive directors** | | | | | | |
| NF Maas (Chairman) | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| H Walker (Lead independent director) | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| JR Barrow | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| MG Ilsley | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| APH Jammine | ✓ | ✓ | ✓ | × | ✓ | ✓ |
| CS Jiyane | ✓ | ✓ | × | ✓ | ✓ | ✓ |
| MA Letshele | - | - | - | - | ✓ | ✓ |
| H Ngakane | ✓ | ✓ | ✓ | ✓ | ✓ | × |
| PL Siphayi | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| **Executive directors** | | | | | | |
| TT Pugh | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| A Daya | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| G Mc Intosh | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |

MA Letshele was appointed in September 2013

✓ *Attended* × *Absent with apology*

## Audit committee

The audit committee meets at least twice a year with management, the external auditors and internal auditors. The external auditors and internal auditors have unrestricted access to the committee and the committee has unrestricted access to the Company's management, employees, external and internal auditors and outside consultants.

The audit committee operates under a Board approved charter, which conforms to all of the King III principles applicable to audit committees.

*Attendance at meetings during the year*

| | April | Sept |
|---|---|---|
| MG Ilsley (Chairman) | ✓ | ✓ |
| JR Barrow | ✓ | ✓ |
| H Walker | ✓ | ✓ |
| PL Siphayi | ✓ | ✓ |

✓ *Attended*

## Remuneration and Nominations committee

The remuneration and nominations committee advises the Board on remuneration policies, packages and other terms of employment for all directors and senior executives. Its specific terms of reference also include recommendations to the Board in matters relating, inter-alia, to staff remuneration policies, incentive schemes, executive incentives, nomination of new directors, recommendation on the composition of the various sub committees and directors' fees. The committee may seek advice from independent professional advisors. The committee meets at least once a year unless otherwise required.

*Attendance at meetings during the year*

| | April | Oct | Nov |
|---|---|---|---|
| H Walker (Chairman) | ✓ | ✓ | ✓ |
| NF Maas | ✓ | ✓ | ✓ |
| APH Jammine | ✓ | ✓ | ✓ |
| CS Jiyane | ✓ | ✓ | ✓ |

✓ *Attended*

## Investment committee

The committee meets at least four times a year and acts under a delegated authority within the parameters of a board approved investment policy. The committee in turn appoints specialist investment consultants to assist in the exercise of its investment mandate from the board.

*Attendance at meetings during the year*

| | Jan | Jan | Mar | May | Jul | Jul | Sept | Nov |
|---|---|---|---|---|---|---|---|---|
| APH Jammine (Chairman) | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| MG Ilsley | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| NF Maas | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| H Ngakane | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| H Walker | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |

✓ *Attended*

## Risk and Compliance committee

The committee includes executive members and is responsible for ensuring that the Company has implemented an effective policy and plan for the management of risk and for monitoring of actions taken in response to risks identified. The committee may seek advice from independent professional advisors. The committee meets at least twice a year unless otherwise required.

*Attendance at meetings during the year*

| | April | Sept | Sept |
|---|---|---|---|
| CS Jiyane (Chairman) | ✓ | ✓ | ✓ |
| MG Ilsley | ✓ | ✓ | ✓ |
| H Walker | ✓ | ✓ | ✓ |
| TT Pugh | ✓ | ✓ | ✓ |
| A Daya | ✓ | ✓ | ✓ |

✓ *Attended*

## Social and Ethics committee

The committee has an independent role and is governed by a formal charter. The committee assists the Board in monitoring the Company's activities in terms of legislation, regulation and codes of best practice with regards to compliance with transformation codes and interaction with policyholders and employees. The committee may seek advice from independent professional advisors. The committee meets at least twice a year unless otherwise required.

*Attendance at meetings during the year*

| | April | Sept | Sept |
|---|---|---|---|
| H Ngakane (Chairman) | ✓ | ✓ | ✓ |
| JR Barrow (Co Chairman) | ✓ | ✓ | × |
| PL Siphayi | ✓ | ✓ | ✓ |
| TT Pugh | ✓ | ✓ | ✓ |
| A Ismail | ✓ | ✓ | ✓ |
| A Daya | ✓ | ✓ | ✓ |

✓ *Attended* × *Absent with apology*

## Executive committee

The executive committee is appointed by the Managing Director and as such is not a sub-committee of the board.

The Managing Director, Mrs TT Pugh, chairs her executive committee, which comprises executive directors and senior executives. The committee is responsible for implementing the strategies and policies determined by the Board, managing the business affairs of the Company, prioritising the allocation of capital and technical human resources and establishing best management practices.

The committee is also responsible for management appointments and monitoring their performance.

The present committee comprises:

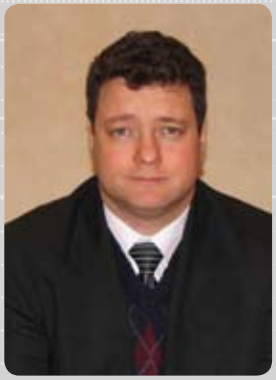
- *TT Pugh (Chief Executive Officer)*
- *A Daya (Chief Financial Officer)*
- *A Ismail (Chief Human Resources Officer)*
- *GM McIntosh (Chief Information Officer)*
- *R van Deventer (Chief Operations Officer)*
- *RG Spreadbury (Chief Underwriting Officer)*

# Executive Team

**Thelma Pugh**
*Chief Executive Officer*

**Ashwin Daya**
*Chief Financial Officer*

**Rudolph van Deventer**
*Chief Operations Officer*



**Gys McIntosh**
*Chief Information Officer*

**Rob Spreadbury**
*Chief Underwriting Officer*

**Ayesha Ismail**
*Chief Human Resources Officer*

# Remuneration and nominations committee report

***for the year ended 31 December 2013***

## Composition and functioning

The Remuneration and Nominations committee has oversight of the Company's remuneration practices and is constituted as a committee of the board. The Committee is also responsible for appropriate succession planning for board membership, board committee membership and senior management of the Company. The committee comprises independent non-executive directors, as recommended by King III. During the period under review, H Walker, NF Maas, APH Jammine and CS Jiyane served on the committee. The chief executive officer is a permanent invitee of the committee and is recused from discussions that relate to her performance appraisal and remuneration. Details of the committee and meeting attendance are included in the Corporate Governance Report.

*The primary responsibilities of the committee include:*

- Ensuring that the remuneration policy is aligned to and promotes the achievement of the Company's strategic goals within the risk appetite of the Company, while ensuring individual performance.
- Benchmarking of remuneration to ensure that the Company is competitive in the employment market.
- Ensuring that all benefits are correctly valued.
- Conducting the performance evaluation and setting targets for the Chief Executive Officer.
- Reviewing incentive schemes.
- Reviewing the remuneration of non-executive directors and making recommendations to the board in this regard.
- Reviewing the composition of the board to ensure that it remains appropriate in terms of balance of skills and diversity. Recommending any new appointments to the board for approval.
- Reviewing the composition of board committees to ensure an appropriate balance of skills and diversity and recommending any proposed changes to the board for approval.
- Ensuring that succession plans for senior management are in place.

## Remuneration policy

The Company's remuneration policy encompasses fixed and variable pay components. This policy is aimed at driving a culture of high performance of the employees and the Company without encouraging the taking on of undue risk. The remuneration policy supports the development and retention of employees who contribute to the on-going sustainability of the Company. Remuneration packages are structured through a mix of annual guaranteed salary and a variable portion which includes both short and medium term incentives. Packages are reviewed annually to ensure that the Company remains competitive in the employment market. Annual salary increases are merit based, with cognisance taken of changes in the consumer price index, and adjustments made for performance based on the employee's annual performance rating.

## Benchmarking

The Remuneration and Nominations committee reviews the Company's overall pay framework on an annual basis. These reviews are based on market benchmarking surveys. Pay bands are established for each job grade and are either positively or negatively adjusted for job and Company complexity. The Company's benchmarking is based on an independent survey conducted by PwC.

**Executive directors' and executive management remuneration**

The remuneration of executive directors and executive management consists of three components of which a significant portion is performance related:

- Annual guaranteed pay
- Short term incentive bonus
- Medium term retention scheme

Short term incentive bonuses are based on a balanced scorecard which incorporates all significant areas of the business. Short term incentive bonus calculations are subject to a maximum value which is based on a percentage of the guaranteed pay. The maximum payable is 66% for the chief executive officer and 35% for executive directors and executive management.

Medium term retention scheme payments are based on a rolling three-year profit cycle and individual performance, with payment deferred for three years. The achievements of targets are reviewed by the Remuneration and Nominations committee before any incentive payments are accrued for. All bonus payments are subject to an external audit review. In determining the three-year profit pool, only items of income and expense that are considered to be directly "controllable" by management are included in the calculation. Each participant's share of the pool is based on their individual performance rating.

The performance of the chief executive officer is assessed by the chairman of the Remuneration and Nominations committee and the chairman of the board. The performance of executive directors and executive management is assessed by the managing director and reviewed by the remuneration and nominations committee.

**Management and staff**

The remuneration of management and staff consists of two components of which a significant portion is performance related:

- Annual guaranteed pay
- Short term incentive bonus

Management and staff receive an annual guaranteed salary and participate in the short term incentive scheme. The performance of management and staff are assessed by the respective line manager and reviewed by the chief human resource officer.

**Annual salary increase**

Annual salary increases are performance based, using the change in the September consumer price index as a guideline for salary increases. All salary increases are recommended by the remuneration and nominations committee for approval by the board.

**Employee benefits – retirement funds**

Membership of a retirement fund is compulsory for all full time employees. The Company offers a provident fund to all full time employees. The Company employees are participants in the Sanlam Umbrella Fund. The fund is administered by Sanlam Employee Benefits. Integrated Portfolio Management are the fund brokers. The fund is a defined contribution scheme and the Company carries no liability in relation to the performance and valuation of the fund.

**Medical aid**

Membership of the Discovery Medical Aid is not compulsory but encouraged for all employees.

## Non-executive directors' remuneration

Non-executive directors receive a retainer fee for appointment to the board or any committee plus an attendance fee per meeting. The chairman of the board or any committee receives a higher fee. The fee structure for 2014 was approved by shareholders at the 2013 annual general meeting of the Company.

In line with best practice, non-executive directors do not participate in any incentive schemes. Consulting fees of R165k *(2012: R165k)* were paid to MG Ilsley and R108k *(2012: R0k)* were paid to H Walker. Non-executive directors remuneration was increased in 2014 in line with the approval granted at the annual general meeting held in 2012 and are disclosed below.

## Board effectiveness

An independent Board effectiveness assessment is done every alternate year. The Chairman of the Board conducts an internal Board effectiveness assessment every alternate year.

| | 2014 Meeting Fee | 2014 Retainer | 2013 Meeting Fee | 2013 Retainer |
|---|---|---|---|---|
| **Board** | | | | |
| Chairman | 26 535 | 159 211 | 159 211 | 159 211 |
| Member | 13 267 | 79 606 | 79 606 | 79 606 |
| **Audit** | | | | |
| Chairman | 23 004 | 125 165 | 125 165 | 125 165 |
| Member | 11 502 | 62 582 | 62 582 | 62 582 |
| **Remuneration and nominations** | | | | |
| Chairman | 18 781 | 87 615 | 87 615 | 87 615 |
| Member | 9 391 | 43 808 | 43 808 | 43 808 |
| **Investment** | | | | |
| Chairman | 20 890 | 106 396 | 106 396 | 106 396 |
| Member | 10 445 | 53 198 | 53 198 | 53 198 |
| **Risk and compliance** | | | | |
| Chairman | 12 939 | 93 874 | 93 874 | 93 874 |
| Member | 8 626 | 46 937 | 46 937 | 46 937 |
| **Social and ethics** | | | | |
| Joint Chair | 10 564 | 49 284 | 49 284 | 49 284 |
| Member | 7 043 | 32 856 | 32 856 | 32 856 |

H Walker

*Chairman: Remuneration & Nominations Committee*

# Social and ethics committee report

***for the year ended 31 December 2013***

The committee has an independent role and is governed by a formal charter. The committee assists the board in monitoring the Company's activities in terms of legislation, regulation and codes of best practice relating to:

- Ethics
- Stakeholder engagement, including policyholders, employees, customers and communities
- Compliance with transformation codes
- Environment

**Ethical standards**

The Company has a Code of Ethics ("Code"), which has been fully endorsed by the Board and applies to all directors and employees. The Code is regularly reviewed and updated as necessary to ensure it reflects the highest standards of behaviour and professionalism.

In summary, the Code requires that at all times, the Company's personnel act with the utmost integrity and objectivity and in compliance with the letter and spirit of both the law and Company policies. Failure by employees to act in terms of the Code, results in disciplinary action.

The Code is discussed with new employees as part of their induction training and forms part of their employment contract.

A "whistle-blowing" and an "anonymous tip off" facility exist for reporting of non-adherence to the Code of Ethics or ethics-related matters.

**Social and ethics governance**

Details of the committee and meeting attendance are included in the Corporate Governance Report contained elsewhere in this Integrated Annual Report.

The committee's responsibilities include monitoring of the Company's activities relating to:

- Social and economic development
- Good corporate citizenship
- The Company's promotion of equality
- Prevention of unfair discrimination
- Zero tolerance to corruption
- Contribution to development of the communities in which the Company's activities are predominantly conducted
- Donations and charitable giving
- Consumer relationships, including the Company's advertising, public relations and compliance with consumer protection laws
- Labour and employment, including the protection of any stakeholder making reports to the whistle blowing facility

The members of the committee believe that the Company is substantially addressing the issues required to be monitored by the committee in terms of the Companies Act.

**Transformation**

The Company is committed to the spirit of and intent behind the Broad-Based Black Economic Empowerment (BBBEE) Act. The Company's long term BBBEE plan is aligned to the Department of Trade and Industry (DTI) codes of good practice. The Social and Ethics committee is accountable for transformation. The Chief Financial Officer and Chief Human Resource Officer are responsible for the implementation of the long term BBBEE plan.

The Company's current rating score is as follows:

| | Allocated points | 2013 | Allocated points | 2012 |
|---|---|---|---|---|
| Ownership | - | - | 20 | 0.52 |
| Management control | 15 | 9.08 | 10 | 6.25 |
| Employment equity | 15 | 15.69 | 15 | 15.00 |
| Skills development | 20 | 16.72 | 15 | 12.73 |
| Preferential procurement | 20 | 16.43 | 20 | 18.17 |
| Enterprise development | 15 | 13.97 | 15 | 11.79 |
| Socio-economic development | 15 | 9.82 | 5 | 5.00 |
| | **100** | **81.71** | **100** | **69.46** |
| **Recognition level** | | **110%** | | **100%** |
| **BBBEE contribution level** | | **Level 3** | | **Level 4** |

It is pleasing to report that the Company has made progress on its BBBEE rating from a recognition level of 100% in the prior period to 110% in the current period. The current period is defined as the validity period of the BBBEE rating certificate. The Company's rating is done during the March month following the financial year end. The BBBEE rating for the financial year end 2013 will be done during March 2014. The BBBEE spend on socio-economic development for the financial year ended 31 December 2013 was R4.3m *(2012: R4.4m)*.

Owing to the Company's mutual structure and consequent lack of beneficial ownership, the Company qualifies to be rated under the adjusted scorecard as provided for in Statement 004: Scorecards for Specialised Enterprises. The current scorecard has been rated in accordance with the Adjusted Scorecard for Specialised Enterprises.

- **Management control:** The management control element of the Company's scorecard includes the board of directors and executive management. The Company scored 9.08 points out of the allocated 15 points.
- **Employment equity:** The Company is committed to creating a diverse workforce through an advancement

of previously disadvantaged people, women and employees with disabilities. The Company's target is to maintain a score of 15 points. The current points of 15.69 are due to bonus points being scored for exceeding the economic active population in the senior management category.

- **Skills development:** The Company is committed to developing the skills and knowledge of its employees. The Company has also through the skills development program provided bursaries for university students. The Company also pays a monthly stipend allowance to these students. The Company maintains its focus on developing scarce and critical skills in its claims processing department.
- **Preferential procurement:** The Company's procurement policy is to source products and services from empowered suppliers. The Company has scored 12 out of the allocated 12 points *(2012: 12 points)* on procurement from suppliers based on their BBBEE recognition level and 3 out of the allocated 3 points (2012: 3 points) on procurement from small enterprises.
- **Enterprise development:** The Company has maintained its Enterprise Development fund with Cadiz Asset Management, resulting in a score of 13.97 points out of 15 *(2012: 11.79 points)*.
- **Socio-economic development:** The Company continues to fund:
  - Habitat for Humanity
  - Childline
  - CHOC (Childhood Cancer Fountation)
  - The Sunflower Fund
  - Reach for a Dream
  - Northcliff Rotary wheel chair project
  - Thandulwazi Trust
  - Cotlands

**BBBEE rating – future developments**

The Company has appointed its rating agency to make an application on its behalf to the Department of Trade and Industry. The Company is seeking exemption from certain principles of the revised generic codes due to its mutual structure and consequent lack of beneficial ownership. The current scorecard for the revised codes is:

| | Allocated points |
|---|---|
| Ownership | 25 |
| Management control | 15 |
| Skills development | 20 |
| Enterprise & Supplier development | 40 |
| Socio-Economic development | 5 |

**Employment equity**

An employment equity plan has been in operation for some time and is overseen by the Chief Executive Officer and Chief Human Resource officer. We have ensured that our employment policies, practices and working environment are non-discriminatory.

For the year under review 100% *(2012: 80%)* of our vacancies have been filled with candidates from designated groups against our target of 90%. Due to low staff turnover, the focus of accelerated development programmes has been protracted, but we have identified succession planning as crucial and staff from designated groups have been identified to be fast-tracked and developed in an endeavour to be placed in key positions in the organisation.

**Employment equity occupation levels - 2013**

| | African | Indian | Coloured | White | Total |
|---|---|---|---|---|---|
| Executive management | - | 2 | - | 4 | **6** |
| Senior management | 2 | 3 | - | - | **5** |
| Middle management | 4 | 2 | 4 | 4 | **14** |
| Junior management | 17 | 7 | 8 | 8 | **40** |
| Tactical level | 9 | 1 | 3 | 1 | **14** |
| **Total** | **32** | **15** | **15** | **17** | **79** |

59.7% of the total staff complement is black female.

**Employment equity occupation levels - 2012**

| | African | Indian | Coloured | White | Total |
|---|---|---|---|---|---|
| Executive management | - | 2 | - | 4 | **6** |
| Senior management | 2 | 3 | - | - | **5** |
| Middle management | 2 | 2 | 3 | 4 | **11** |
| Junior management | 16 | 8 | 9 | 9 | **42** |
| Tactical level | 9 | 1 | 4 | 1 | **15** |
| **Total** | **29** | **16** | **16** | **18** | **79** |

59.5% of the total staff complement is black female.

| | 2013 | 2012 |
|---|---|---|
| Executive management | 33.3% | 33.3% |
| Senior management | 100.0% | 100.0% |
| Middle management | 71.4% | 63.6% |
| Junior management | 80.0% | 78.6% |
| Tactical level | 92.9% | 93.3% |
| **Total** | **78.5%** | **77.2%** |

The Company has shown an improvement from an overall 77.2% black representation in the prior period to 78.5% black representation in the current period. Black female representation has marginally increased from 59.5% in the prior period to 59.7% in the current period. Attracting and retaining senior black talent remains a challenge for the Company.

H Ngakane

*Co Chairman: Social & Ethics Committee*

JR Barrow

*Co Chairman: Social & Ethics Committee*

Habitat for Humanities Project in Cape Town.

Forest Town School

Zolile is a 17 year old boy who has Spinal Muscular Atrophy, a degenerative condition that causes his muscles to become progressively weaker. He was in desperate need of a motorized wheelchair adapted to his needs. He needed a seat that can tilt in place with a full back support to prevent his scoliosis from developing further. The wheel chair has become an integral component of his personality and confidence as it enables him to socialise with his friends and family as he is now independently mobile with the motorised wheelchair provided to him by FEM.

# Risk and compliance committee report

***for the year ended 31 December 2013***

The risk and compliance committee has an independent role and is governed by a formal charter. The Board is responsible for the oversight of the risk management and compliance process and has delegated this responsibility to the risk and compliance committee.

The committee is responsible for ensuring that the Company has implemented an effective policy and plan for the management of risk and compliance.

The primary responsibilities of management include:

- a risk management policy, including risk tolerance levels and risk appetite limits, for consideration by and ultimate approval of the board (to be distributed widely throughout the Company following approval);
- conducting a systematic, documented, formal risk assessment at least once a year:
  - applying a top down approach to identify and assess the risks affecting the various income streams of the Company, the critical dependencies of the business, the sustainability and the legitimate interests and expectations of stakeholders;
  - prioritising and ranking risks to focus responses and interventions;
  - quantifying the key risks where practicable;
  - deciding the appropriate risk responses and interventions;
- maintaining a risk register recording the above items and reporting thereon to the Committee at each meeting;
- preparing summary risk reports for presentation to the Audit Committee and the Board; and
- integrating risk in the day-to-day activities of the Company (including performance of risk assessments and monitoring of risk responses and interventions on a continuous basis).

**Risk governance**

The Company follows a disciplined approach in evaluating risks and developing appropriate strategies to mitigate and manage the risk. In compliance with King III, the Board obtained assurance from internal audit regarding the effectiveness of the risk management process and the adequacy of the risk methodology process. The risk and compliance committee is responsible for ensuring that the Company has implemented an effective plan for risk and that the disclosure on the risk register is comprehensive and relevant.

Internal audit facilitates the annual risk management workshop and reports its findings and risk ratings to the audit committee on an annual basis.

The Chief Executive Officer is responsible for designing, implementing and maintaining the risk register and the monitoring thereof on an on-going basis. The Chief Executive Officer and executive management reviews the risks on a regular basis to ensure the validity of the risk and the implementation of mitigating actions.

**Risk management process**

Risk management is included in the Company's annual planning cycle. In determining the strategic and operational plans for the year ahead, each department is required to review its register. This includes the review of the risks

of the previous financial year and the validity thereof and considering any new risks:

- The Company understands the importance of risk management and implementation of an appropriate governance structure for the reporting of risk and control.
- The Company has undertaken a robust and comprehensive risk identification process. This is an ongoing process as new risks in the Company are identified and the changes in existing risks are identified.
- Each risk is evaluated in terms of the likelihood of the risk occurring and the impact that the risk would have, should it occur. The effectiveness of the internal control structure is assessed.
- Management has a robust process for evaluating, monitoring and reporting on key internal controls over identified risks. Clear reporting lines are established to ensure that control failures and the occurrence of risk events are appropriately reported and assessed.
- The Company has the ability to identify and adapt to changes that might occur in the risk profile and adapt to any occurrence of risk events.

**Risk ratings**

Each risk on the register is assigned an impact and likelihood rating. The impact assigned to a risk is assessed on a five-point scale, and considers the human resource, compliance, financial and reputational impact on the Company. The likelihood of a risk occurring is measured on a five-point scale.

The impact and likelihood ratings are then multiplied to determine inherent or gross risk to the Company. Detailed risk mitigating plans and processes are identified or developed for each risk which then determines the residual risk or net risk level. Residual ratings are then assigned to each risk.

**Key risks**

- Loss of trading license – management constantly review the progress and application of all license conditions and ensure that the necessary action is taken where applicable.
- BBBEE requirements – a long term plan is in place and to date the Company has achieved its target.
- Loss of key staff – retaining skilled employees in the medical claims assessing area remains a key focus area.
- Internal and external fraud – all operating processes are constantly reviewed and enhanced.
- Negative impact of financial markets – the Company has a diverse investment portfolio and applies asset-liability modelling to manage its investment risk.

The Company's overall risk rating results reflect a marginal improvement from the previous year.

**Compliance review**

Deloitte completed a detailed compliance review of the Company during 2012. Their recommendations required a few minor amendments to internal policies and further detailed consideration of compliance issues relating to the Consumer Protection Act. After subsequent meetings, Deloitte are in the process of obtaining an opinion as to whether the business of underwriting COIDA (Compensation for Injuries and Diseases Act) is subject to the Consumer Protection Act.

**CS Jiyane**
*Chairman*

# Investment committee report

***for the year ended 31 December 2013***

The Board is responsible for the oversight of the Company's investment management and has delegated this responsibility to the investment committee. The investment committee is governed by a formal charter.

The committee is essentially responsible for ensuring that the Company has implemented an effective policy and plan for the management of investments. Investments are classified and accounted for as "financial assets at fair value through income".

**Investment governance**

Details of the committee and meeting attendance are included in the Corporate Governance Report contained elsewhere in this Integrated Annual Report.

The investment committee's primary responsibilities are:

- to carry out the responsibilities delegated to the committee by the Board as outlined in the charter;
- to appoint, monitor the performance of and, where necessary, replace the mandated investment consultants;
- to formulate the Company's investment policy with the assistance of the mandated investment consultants (including the specified strategic asset allocation and allocation range limits) and recommend approval thereof by the board;
- to implement tactical asset allocation, asset class and manager re-balancing, and transition management based on input from the mandated investment consultants;
- to appoint, monitor the performance of and, where necessary, replace the mandated investment managers, based on the recommendations of the investment consultants; and
- reporting on activities to the Board at each board meeting.

**Investment consultants**

The Company has appointed RisCura as their asset consultants. Their primary responsibilities are:

- Assistance in the formulation of the Investment Policy;
- Annual asset/liability modelling exercise based on the Company's most recent financial position and advice regarding any required changes to the strategic asset allocation;
- Recommendations regarding tactical asset allocation;
- Monitoring of asset managers and recommendations on any changes required to the appointed managers;
- Recommendations on written mandates to be implemented with asset managers and assistance with the negotiation of related fee arrangements;
- Input on investment benchmarks for sign off by the investment committee;
- Reporting at each committee meeting on investment performance relative to benchmarks, as well as appropriate reporting on exposures to credit risk; and
- Annual reporting on liquidity and counter party risk.

**Asset managers**

On an on-going basis, the Company's asset consultants advise the committee on the optimum allocation of asset managers to each asset class. The Company currently has a total of eleven asset managers *(2012: twelve)* and sixteen portfolios *(2012: eighteen)*.

**Asset match**

The Company's asset consultants prepare an asset liability model ("ALM") each year to ensure the appropriate asset allocation to match the liabilities of the Company. The necessary assets are rebalanced to ensure the appropriate liability coverage. The Company adopts the following asset mix:

- Pensioner's liability – low risk investments
- Insurance liabilities – low to moderate risk investments
- Surplus – medium risk investments

The Company is currently diversified across the following asset classes and geographic regions:

- Equities – South Africa
- Listed and unlisted bonds – South Africa
- Inflation linked bonds – South Africa
- Cash – South Africa
- Property – South Africa
- Unlisted equities and property – Africa
- Equities – International

**Investment return**

The Company has achieved an average return of 18.77% *(2012: 18.76%)* for the period.

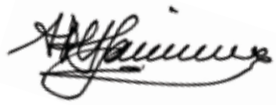
**CRISA**

The Company has not as yet enforced or adopted the code for responsible investing in South Africa *("CRISA")*. The Company will take into account the constraints around the code before making a final decision.

**Performance benchmark**

The Company uses the following benchmark to monitor asset manager performance.

- Balanced funds – CPI plus 5%
- Local equity – SWIX index
- Local bonds – ALBI index
- Local inflation link bonds – R197 and R202 ILB
- Local property – FTSE / JSE SA listed property index
- Local cash – SteFI index
- Local credit opportunities – SWIX index
- Africa equity and property – FTSE/JSE Africa 30 excluding SA index
- Global equity – MSCI World index
- Global credit opportunities – MSCI All Country index



**APH Jammine**
*Chairman*

# Report by directors

***for the year ended 31 December 2013***

## Statement of directors' responsibilities

The Company's board of directors are responsible for preparing this report and for the preparation and fair presentation of the accompanying annual financial statements for the year ended 31 December 2013 in accordance with International Financial Reporting Standards ("IFRS") and the South African Companies Act ("the Act"). In accordance with section 29(2) of the Act, the board is responsible for ensuring that the annual financial statements are not false, misleading or incomplete in any material respect.

The joint independent auditors are responsible for reporting on whether the accompanying annual financial statements are fairly presented in accordance with IFRS.

## Internal financial controls

The board has considered and satisfied itself as to the adequacy of the Company's system of internal financial controls. This assessment is supported by the report by the audit committee.

## Going concern

The annual financial statements have been prepared on the basis that the Company will continue as a going concern for a period of at least 12 months from the reporting period end. The board has reviewed the capital adequacy of the Company and the operating budget for the forthcoming year and has satisfied itself as to the appropriateness of the going concern assumption. This assessment is supported by the report of the audit committee.

## General information

General information about the Company is provided in note 1 to the accompanying financial statements.

## Financial review

Details of the Company's financial position at 31 December 2013 and its results and cash flows for the year then ended are provided in the accompanying annual financial statements. A brief commentary thereon is set out below.

Financial assets totalled R4,924 billion at year end increasing by R1,147 billion or 30% which includes the investment of net cash generated from operations of R361,2m. Total insurance liabilities increased by R171,2m or 12%. The pensions liability increased from R864,6m in 2012 to R938,6m in the current period, representing a 8.6% increase. The Company's net asset value totalled R3,339 billion at 31 December 2013, representing a 40% growth in net assets for the year.

The Company maintained an underwriting surplus for the year, recording an underwriting profit of R37.3 million for the year *(2012: R56.6 million)*. After including investment income, the total income transferred to retained profit amounted to R952.5 million *(2012: R757.1 million)*.

The Company remained strongly net cash generative with R361,2m *(2012: R322,6m)* generated from operations.

## Investments strategy and returns

The Company's investment strategy is managed by the Investment sub-committee of the board, acting on the advice of specialist investment consultants.

An asset-liability modelling exercise is performed annually to determine the optimum percentage allocation of investments to different asset classes after taking into account the liability profile of the Company. Ranges are then specified around these strategic asset allocations to facilitate tactical asset allocation decisions during the year. The objective is to enhance the Company's investment returns for the benefit of stakeholders, while ensuring that the Company remains adequately capitalized and has adequate liquid cash resources to meet all of its short and long term obligations.

The success of this strategy is borne out by the excellent investment returns achieved for the period. Investment income totalled R923.0 million *(2012: R707.5 million)*, representing an 18.77% *(2012: 18.76%)* return on average investments held during the period.

**Protection of policyholders' interests**

Shareholders approved a new Memorandum of Incorporation ("MOI") for the Company at a special general meeting held on 10 April 2013. In addition to complying with new Companies Act requirements, the MOI introduced unalterable provisions designed to protect the long-term interests of policyholders by entrenching the mutual status of the Company.

**Change in Company name and Company registration number**

Following the adoption of the new MOI, the Company's name has changed from The Federated Employers' Mutual Assurance Company Limited (registration number 1936/008971/06) to The Federated Employers' Mutual Assurance Company Proprietary Limited (RF) (registration number 1936/008971/06).

**Board changes**

The new MOI also made provision for an increase in the size of the board in order to accommodate additional appointments required to comply with the Company's licensing conditions under the Compensation for Occupational Injuries and Diseases Act No. 130 of 1993. Following due process, Mr MA Letshele has been appointed as a union representative on the board and the Company has formally invited the State Compensation Commissioner to appoint a representative to the board.

**Dividends**

In accordance with clause 3.1.6 of the MOI, the Company may not make any form of distribution to its shareholders in their capacity as shareholders. Accordingly, all profits or assets of the Company are to be retained or applied to and paid as policyholder payments as determined by the board in accordance with the relevant provisions of the MOI.

**Prospects**

Notwithstanding the challenging conditions in the construction industry, the Company has again achieved excellent results and returns for policyholders while fulfilling its mandate to fund claims and benefits for injured workers and their dependents. No material changes are anticipated to be made to the Company's current strategy and operations in the forthcoming year.

**Events after the reporting period**

There have been no material changes in the affairs or financial position of the Company from 31 December 2013 up to the date of this report.

**Approval of annual financial statements**

The accompanying annual financial statements for the year ended 31 December 2013 were approved by the board on 16 April 2014 and are signed on behalf of the Company by:

Mr N Maas
*Chairman*

Mrs TT Pugh
*Chief Executive Officer*

# Certificate by company secretary

***for the year ended 31 December 2013***

I hereby confirm, in terms of the South African Companies Act ("the Act"), that for the year ended 31 December 2013, the Company has lodged with the Registrar of Companies all such returns as are required of the Company in terms of the Act and that all such returns are true, correct and up to date.

**EJ Willis**
*Secretary*
16 April 2014

# Report by audit committee

***for the year ended 31 December 2013***

This report to shareholders is issued in compliance with section 94(7)(f) of the South African Companies Act and has been approved by all members of the Audit Committee.

The audit committee has adopted formal terms of reference that has been approved by the board. The committee has conducted its affairs in compliance with its terms of reference and has discharged its responsibilities contained therein. A copy of these terms of reference is available upon request from the company secretary.

The audit committee comprised the following independent directors who all held office throughout the reporting period under review and were in attendance at all meetings:

- MG Ilsley (Chairman)
- JR Barrow
- H Walker
- PL Siphayi

The chairman of the board, chief executive officer, chief financial officer, chief information officer and representatives of internal and external audit were in attendance at all meetings by invitation only. An actuarial report was presented by the outsourced actuarial service provider at the year-end audit committee meeting.

The audit committee held two meetings during the year and has held one meeting after the financial year end. At these meetings, the audit committee received and considered reports from the internal and external auditors and from management. The committee inter alia:

- reviewed and approved the external audit plan for the year ended 31 December 2013 , approved the engagement terms and proposed external audit fees, satisfied itself regarding the independence of the joint independent auditors and considered the findings reported by the joint independent auditors following the conclusion of their audit;
- reviewed and approved the internal audit work plan, approved the proposed internal audit fees and considered the findings of internal audit reports, including internal audit's overall assessment of the Company's control systems;
- received summary risk management reports and considered the financial reporting consequences for the interim and annual financial statements issued by the Company;
- assessed the appropriateness of the going concern assumption underlying the preparation of the annual financial statements;
- assessed the adequacy of the Company's finance function;
- reviewed the interim report, annual financial statements and annual integrated report issued by the Company; and
- reported thereon to the board.

After consideration of all of the findings reported by internal audit covering those areas included in their annual work plan, explanations given by management and discussions with the joint external auditors on the results of their audit, the committee concluded that:

- nothing has come to its attention, which would indicate that there was a material breakdown in the

Company's systems of internal control during the year; and
- the Company's internal financial controls form a reasonable basis for the preparation of reliable financial statements.

After consideration of a written assessment prepared by management to support the going concern assumption underlying the preparation of the annual financial statements, the committee concluded that the Company is adequately capitalised and should remain a going concern for the foreseeable future.

The audit committee has satisfied itself that the chief financial officer has appropriate expertise and experience and has satisfied itself of the appropriateness of the expertise, resources and experience of the Company's finance function.

The board has concurred with the audit committee's assessments regarding the Company's internal controls, going concern status and finance function.

The committee has nominated, for election at the forthcoming annual general meeting, PricewaterhouseCoopers Inc. and SizweNtsalubaGobodo Inc. as the joint independent auditors and Messrs A Taylor and N Sigasa as the designated joint auditors responsible for performing the functions of auditor, for the 2014 year.

The audit committee has considered and opted not to obtain independent assurance on the annual integrated report issued by the Company for the year ended 31 December 2013. However, the committee has reviewed the information contained in the annual integrated report based on their knowledge and understanding of the Company's operations and checked the financial information for consistency to the figures in the annual financial statements.

The audit committee recommends approval by the board of the annual financial statements for the year ended 31 December 2013.

On behalf of the audit committee:

**Mr MG Ilsley**
*Chairman of audit committee*

# Report of the independent auditors

***for the year ended 31 December 2013***

We have audited the financial statements of The Federated Employers' Mutual Assurance Company Proprietary Limited (RF) set out on pages 38 to 76, which comprise the statement of financial position as at 31 December 2013, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

**Directors' responsibility for the financial statements**

The company's directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

**Auditor's responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 management, as well as evaluating the overall presentation of the financial statements.

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

**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of The Federated Employers' Mutual Assurance Company Proprietary Limited (RF) as at 31 December 2013, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa.

Other reports required by the Companies Act and or included in the Integrated Annual Report (collectively referred to as "reports").

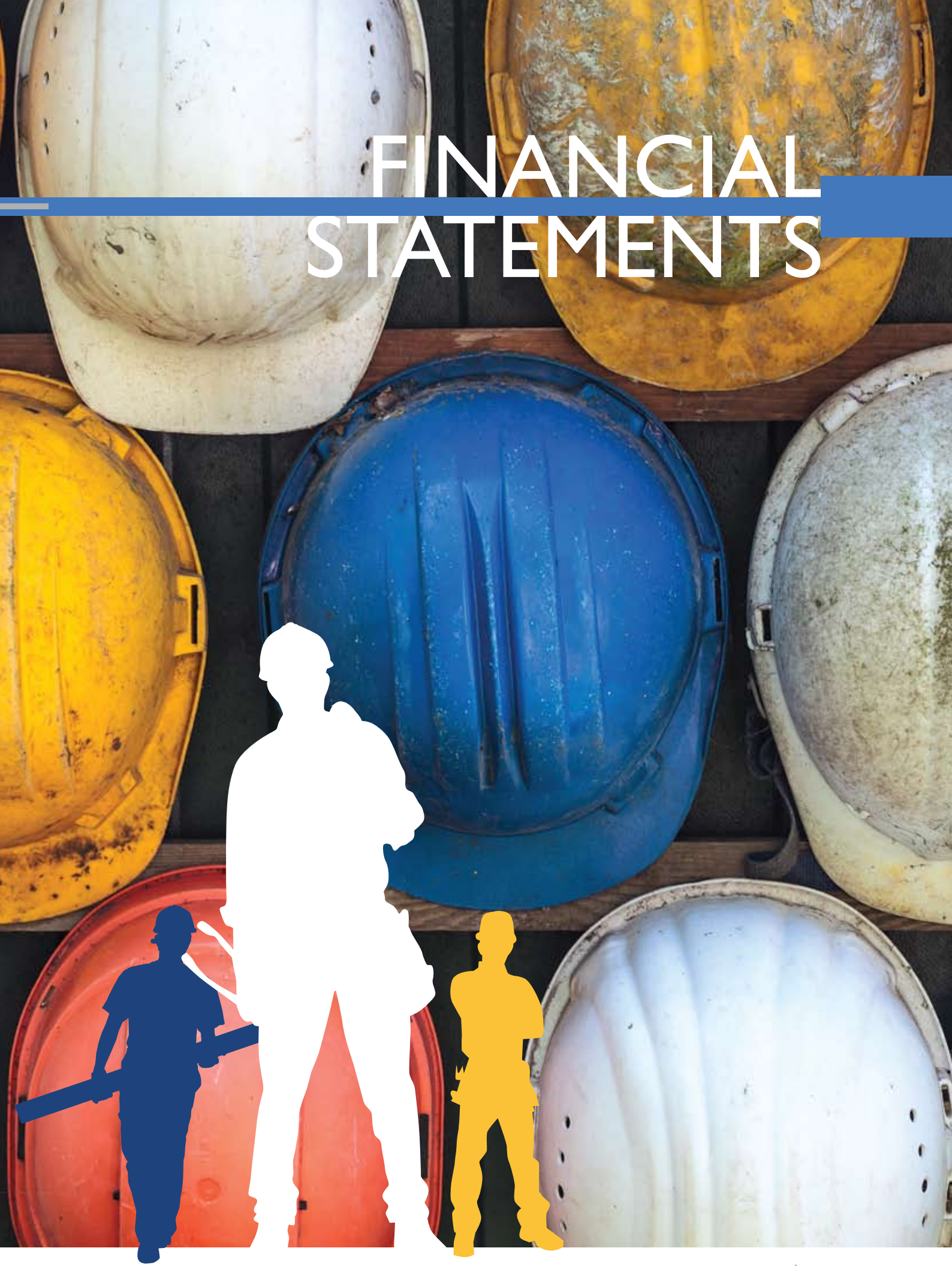
As part of our audit of the financial statements for the year ended 31 December 2013, we have read the Introduction, the Chairman's Report, the Chief Executive Officer's Report, the Chief Financial Officer's Report, the Corporate Governance Report, the Remuneration and Nominations Committee Report, the Social and

Ethics Committee Report, the Risk and Compliance Committee Report, the Investment Committee Report, the Statement of Directors' Responsibilities, the Certificate by the Company Secretary and the report of the Audit Committee (collectively referred to as "reports") for the purpose of identifying whether there are material inconsistencies between these reports and the audited financial statements. These reports are the responsibility of the respective preparers. Based on reading these reports we have not identified material inconsistencies between these reports and the audited financial statements. However, we have not audited these reports and accordingly do not express an opinion on these reports.

**PricewaterhouseCoopers Inc.**
**Director: A Taylor**
*Registered Auditor*
Johannesburg
16 April 2014

**SizweNtsalubaGobodo Inc.**
**Director: N Sigasa**
*Registered Auditor*
Johannesburg
16 April 2014

# FINANCIAL STATEMENTS



# Statement of Financial Position

***for the year ended 31 December 2013***

| | Note | 2013 R'000 | 2012 R'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Furniture, equipment and motor vehicles | 6.1 | 4 752 | 3 448 |
| Reinsurance assets | 6.2 | 2 712 | 9 379 |
| Financial assets at fair value through income | 6.3 | 4 924 285 | 3 776 813 |
| Other financial assets measured at amortized cost | | | |
| Insurance receivables | 6.4 | 3 949 | 28 527 |
| Other receivables | 6.5 | 13 323 | 7 317 |
| Cash and cash equivalents | | 15 143 | 20 022 |
| **Total assets** | | **4 964 164** | **3 845 506** |
| **EQUITY AND LIABILITIES** | | | |
| Ordinary share capital | 6.6 | 10 | 10 |
| Retained income | SOCE | 3 339 158 | 2 386 675 |
| **Total equity** | | **3 339 168** | **2 386 685** |
| **Liabilities** | | | |
| Insurance liabilities | | 1 597 076 | 1 425 860 |
| Pension liabilities | 6.7 | 938 633 | 864 550 |
| Unpaid claim liabilities | 6.8 | 205 313 | 244 962 |
| Unearned premium liability | 6.9 | 94 498 | 89 196 |
| Premium rebate liability | 6.1 | 358 632 | 227 152 |
| Financial liabilities measured at amortized cost | | | |
| Trade and other payables | 6.11 | 27 920 | 32 961 |
| **Total liabilities** | | **1 624 996** | **1 458 821** |
| **Total equity and liabilities** | | **4 964 164** | **3 845 506** |

# Statement of comprehensive income

***for the year ended 31 December 2013***

| | Note | 2013 R'000 | 2012 R'000 |
|---|---|---|---|
| **Gross premium income** | 7.1 | **608 915** | **561 795** |
| Premium rebates to policyholders | | (262 083) | (109 492) |
| Unearned premium | | (5 301) | (7 790) |
| **Gross earned premium** | 7.2 | **341 531** | **444 513** |
| Insurance premium ceded to reinsurers | | (10 791) | (6 268) |
| **Net earned premium** | 7.3 | **330 740** | **438 245** |
| | | | |
| **Gross claims and benefits** | | **(215 120)** | **(309 202)** |
| Claims expense | | (71 597) | (158 504) |
| Pensions expense | | | |
| New pensions awarded | 6.7 | (87 474) | (65 813) |
| Net charge to pension liabilities | 6.7 | (56 049) | (84 885) |
| | | | |
| Claims recovered from reinsurers | | 4 074 | 1 726 |
| **Net claims and benefits** | | **(211 046)** | **(307 476)** |
| | | | |
| **Underwriting profit before operating expenses** | | **119 694** | **130 769** |
| Administration expenses | 7.4 | (66 042) | (59 443) |
| Accident prevention expenses and grants | | (16 336) | (14 760) |
| **Net profit before investment income** | | **37 316** | **56 566** |
| Net investment income | 7.5 | **915 166** | 700 496 |
| Investment income | | 922 976 | 707 508 |
| Investment expenses | | (7 810) | (7 012) |
| | | | |
| **Net profit for the year** | | **952 482** | **757 062** |
| Other comprehensive income | | - | - |
| **TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | | **952 482** | **757 062** |

# Statement of changes in equity

***for the year ended 31 December 2013***

| | Share capital | Statutory contingency reserve | Retained income | TOTAL |
|---|---|---|---|---|
| | R'000 | R'000 | R'000 | R'000 |
| **Opening balance at 1 January 2012** | **10** | **38 719** | **1 590 895** | **1 629 624** |
| Transfer from contingency reserve | - | (38 719) | 38 719 | - |
| Total comprehensive income for the 2012 year | - | - | 757 062 | 757 062 |
| **Closing balance at 31 December 2012** | **10** | **-** | **2 386 676** | **2 386 686** |
| Total comprehensive income for the 2013 year | - | - | 952 482 | 952 482 |
| **Closing balance at 31 December 2013** | **10** | **-** | **3 339 158** | **3 339 168** |

# Statement of cash flows

***for the year ended 31 December 2013***

| | Note | **2013 R'000** | 2012 R'000 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Net profit for the year | SOCI | 952 482 | 757 062 |
| Adjustments for depreciation and other operating activities: | | (781 581) | (600 627) |
| Depreciation | 7.4 | 1 664 | 1 679 |
| Impairment of insurance receivables | | 273 | 202 |
| Net foreign currency gain on financial assets | 7.5 | (187 353) | (19 489) |
| Net valuation gain on financial assets measured at fair value | 7.5 | (596 093) | (582 965) |
| Net profit on disposal of furniture, leasehold improvements, equipment and motor vehicles | 7.4 | (72) | (54) |
| Net movements in operating assets and liabilities | 8.1 | 190 252 | 159 875 |
| Income tax refund | | - | 6 300 |
| Interest and dividend income on financial assets measured at fair value | | (139 530) | (105 054) |
| **Cash generated from operating activities** | | **221 623** | **217 556** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Net cash invested in financial assets measured at fair value | 8.2 | (363 135) | (321 012) |
| Interest and dividend income on financial assets measured at fair value | | 139 530 | 105 054 |
| Purchases of furniture, equipment and motor vehicles | | (2 989) | (1 744) |
| Proceeds on disposals of furniture, equipment and motor vehicles | | 92 | 85 |
| **Cash applied to investing activities** | | **(226 502)** | **(217 617)** |
| Net decrease in cash for the year | | (4 879) | (61) |
| Cash and cash equivalents at beginning of year | | 20 022 | 20 083 |
| **Cash and cash equivalents at year end** | | **15 143** | **20 022** |

# Notes to the financial statements

***for the year ended 31 December 2013***

## 1. General information about the Company

The Company is a short term insurer registered in terms of the South African Short Term Insurance Act No. 53 of 1998. More specifically, the Company operates as a mutual association licensed under the South African Compensation for Occupational Injuries and Diseases Act No. 130 of 1993 to carry on the business of insurance of certain classes of employers within the construction industry against their liabilities to employees in terms of this Act.

Owing to the mutual shareholding structure of the Company, it is classified as a private company under the South African Companies Act. However, the provisions of the Company's Memorandum of Incorporation make it subject to the same extended accountability provisions as are applicable to a public company.

## 2. Application of new and revised IFRSs

In the current year, the Company has applied a number of new and revised International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB") that are mandatorily effective for accounting periods beginning on or after 1 January 2013. In addition, the Company has early adopted IFRS 9 Financial Instruments that is mandatorily effective for accounting periods beginning on or after 1 January 2015.

### 2.1 Amendments to IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities

The amendments to IFRS 7 became effective for financial periods commencing on 1 January 2013 and require entities to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement. As the Company does not have any offsetting arrangements in place, the application of the amendments has had no material impact on the disclosures or on the amounts recognised in the financial statements.

### 2.2 New and revised standards on consolidation, joint arrangements, associates and disclosures

A package of five standards on consolidation, joint arrangements, associates and disclosures was issued in May 2011. As the Company does not have any subsidiaries, joint arrangements or associates, the application of the new and revised standards has had no impact on the disclosures or on the amounts recognised in the financial statements.

### 2.3 IFRS 13 Fair Value Measurement

The Company has applied IFRS 13 for the first time in the current year. IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The scope of IFRS 13 is broad; the fair value measurement requirements of IFRS 13 apply to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except for leasing transactions that are within the scope of IAS 17 Leases, and measurements that have some similarities to fair value but are not fair value, such as the value in use in IAS 36 Impairment of Assets

# Notes to the financial statements

***for the year ended 31 December 2013***

and the estimation of insurance liabilities and related reinsurance assets under IFRS 4 Insurance Contracts.

The application of IFRS 13 has not had any material impact on the amounts recognised in the consolidated financial statements.

### 2.4 Amendments to IAS 1 Presentation of Items of Other Comprehensive Income

The amendments to IAS 1 Presentation of Items of Other Comprehensive Income became effective for financial periods commencing 1 January 2013. The amendments introduce new terminology, whose use is not mandatory; retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements; and require items of other comprehensive income to be grouped into two categories in the other comprehensive income section (based on whether the items may be reclassified subsequently to profit or loss). The Company has no items of other comprehensive income and has opted to continue to present a single statement titled, "Statement of comprehensive income ("SOCI")". Consequently, these amendments to IAS 1 have not had any impact on the presentation of the financial statements.

### 2.5 Amendments to IAS 1 Presentation of Financial Statements

The Annual Improvements to IFRSs 2009 - 2011 have made a number of amendments to IFRSs. The amendments that are relevant to the Company are the amendments to IAS 1 regarding when a statement of financial position as at the beginning of the preceding period (third statement of financial position) and the related notes are required to be presented. The amendments specify that a third statement of financial position is required when: (a) an entity applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items in its financial statements; and (b) the retrospective application, restatement or reclassification has a material effect on the information in the third statement of financial position. The amendments specify that related notes are not required to accompany the third statement of financial position.

These amendments do not necessitate the presentation of a third statement of financial position in the current year's financial statements, but may become relevant in future reporting periods.

### 2.6 IAS 19 Employee Benefits (as revised in 2011)

IAS 19 Employee Benefits (as revised in 2011) became effective for financial periods commencing 1 January 2013 and introduced changes to the accounting for defined benefit plans and termination benefits. The Company's employees are members of a defined contribution retirement plan and are not provided any termination benefits. Consequently, the revised standard has had no impact on the presentation of the financial statements.

### 2.7 IFRS 9 Financial Instruments

IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was amended in October 2010 to include requirements for the classification, measurement and de-recognition of financial liabilities.

# Notes to the financial statements

***for the year ended 31 December 2013***

Key requirements of IFRS 9:

- All recognised financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement are required to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognised in profit or loss.

  The Company has applied the option provided under IFRS 9 to irrevocably designate, at initial recognition, all debt investments which would otherwise be required to be subsequently measured at amortised cost to be financial assets classified as subsequently measured at fair value. Thus all debt and equity investments continue to be measured at fair value and the implementation of IFRS 9 has had no material impact on the financial position and results of the Company as previously reported.

- IFRS 9 also introduces a requirement for the amount of change in the fair value of a financial liability that is attributable to changes in the credit risk of that liability to be presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss.

  The Company is prohibited from issuing debt instruments under its Memorandum of Incorporation and, consequently, this new requirement is not relevant to the Company.

## 3. New and revised IFRSs not yet effective

The Company has early adopted IFRS 9 (as explained in note 2), but has not applied the following other new and revised IFRSs that have been issued but are not yet effective:

- Amendments to IFRSs 10 & 12 and IAS 27 regarding investment entities (effective for annual periods beginning on or after 1 January 2014, with earlier application permitted);

  The amendments to IFRS 10 define an investment entity and require a reporting entity that meets the definition of an investment entity not to consolidate its subsidiaries but instead to classify its subsidiaries as subsequently measured at fair value. These amendments will not impact on the Company as it does not have any subsidiaries.

- Amendments to IAS 32 regarding offsetting of financial assets and financial liabilities (effective for annual periods beginning on or after 1 January 2014, with earlier application permitted).

  The amendments to IAS 32 clarify the requirements relating to the offset of financial

# Notes to the financial statements

***for the year ended 31 December 2013***

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". The directors of the Company do not anticipate that the application of these amendments to IAS 32 will have any significant impact on the Company; however a detailed review has not yet been completed to identify any financial assets and liabilities that may qualify for offset.

## 4. Significant accounting policies

### 4.1 Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

### 4.2 Basis of preparation

The Company's financial statements have been prepared on the historical cost basis except for financial instruments that are subsequently measured at fair value or amortized cost as explained in the accounting policy note below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is defined in note 14, which also provides information on the application of the fair value measurement hierarchy to the Company.

The Company has made the following reclassifications and re-ordering of items to improve the presentation of the financial statements:

- Accrued investment income of R5.75 million (2012: R4.86m) previously included in other receivables is now included in financial assets measured at fair value in the SOFP.
- Amounts due to reinsurers of R0m *(2012: R413k)* previously shown separately is now included in trade and other payables in the SOFP.
- Accrued leave liability of R1 326k *(2012: R902k)* previously shown separately is now included in trade and other payables in the SOFP.

# Notes to the financial statements

***for the year ended 31 December 2013***

- The order of items in the SOCI has been changed and increased disclosures of items have been made on the face of the SOCI to improve the relevance and presentation thereof.

- Increased disclosures have been made on the face of the SOCF to improve the presentation thereof. In addition, investment income reinvested by asset managers in financial assets are now disclosed separately as interest and dividend income on financial assets measured at fair value of R139,1m *(2012: R105,1m)*.

- Changes have been made to the line items presented in the note to financial assets measured at fair value to improve the relevance and presentation thereof. Note that these changes have had no impact on the classification and measurement of any financial assets under IFRS.

The reclassifications and re-ordering of items explained above are readily apparent and had no material impact on the Company's financial position and results as previously reported. Consequently, the changes do not require any further detailed disclosures or the presentation of a third balance sheet for the 2012 financial year.

The principal accounting policies set out below are the same as those applied in the previous financial year, except for the changes introduced by the early adoption of IFRS 9 Financial Instruments as explained in note 2. These changes had no impact on the measurement of the Company's financial assets and financial liabilities and, consequently, did not require any retrospective adjustments to the financial position or results as previously reported.

### 4.3 Financial instruments

Insurance assets and liabilities, other than insurance receivables and payables, are not accounted for as financial instruments and are subject to separate, specific accounting policy notes.

Financial assets and financial liabilities are recognised when the Company becomes a party to the contractual provisions of the instruments. Receivables and payables are recognized when due.

*Classification*

All financial assets, other than cash and receivables, are classified as subsequently measured at fair value. This includes debt instruments irrevocably designated as measured at fair value at initial recognition.

Cash and receivables are classified as subsequently measured at amortized cost. Short-term receivables are measured without discounting.

The Company is prohibited under its Memorandum of Incorporation from issuing any debt instruments. Consequently, financial liabilities are limited to payables and derivative financial liabilities.

Payables are classified as subsequently measured at amortized cost. Short-term payables are measured without discounting.

The Company enters into a variety of derivative financial instruments to manage the exposure of its investments to equity, interest rate and foreign exchange rate risks, including foreign exchange forward contracts, interest rate swaps and cross

# Notes to the financial statements

***for the year ended 31 December 2013***

currency swaps. Derivative assets and liabilities are classified as subsequently measured at fair value.

*Initial measurement*

At initial recognition, financial assets and financial liabilities are measured at fair value plus or minus, in the case of a financial asset or financial liability classified as subsequently measured at amortized cost, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. The transaction price is assumed to reasonably approximate this initial measurement value unless there is clear evidence to the contrary.

*Subsequent measurement*

Gains or losses arising on the subsequent re-measurement of financial assets and financial liabilities measured at fair value are recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any dividend or interest earned on financial assets and is included in the "Net valuation gain/(loss) on financial assets measured at fair value" item within investment income in the statement of comprehensive income.

Interest income arising on the subsequent re-measurement of financial assets and financial liabilities measured at amortized cost is recognized through profit or loss over time by applying the effective interest method, except for short-term receivables and payables when the effect of discounting is immaterial.

Financial assets measured at amortized cost are assessed for indicators of impairment at the end of each reporting period and are considered to be impaired when 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 to be derived from the asset have been affected.

*Offsetting*

Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously.

### 4.4 Equity instruments

Equity instruments issued by the Company are recognized at the proceeds received, net of direct issue costs, and are subject to specific restrictive conditions stipulated in the Company's Memorandum of Incorporation. These restrictive conditions are designed to entrench the mutual shareholding structure of the Company and protect the long-term interests of policy holders. Inter alia, the Company may not change the terms of the existing ordinary shares in issue (other than to convert the par value shares to shares of no par value) and may only issue new shares if such shares are of the same class and have the same preferences, rights, limitations and other terms as the existing ordinary shares in issue.

### 4.5 Insurance contracts issued

Insurance assets and insurance liabilities are recognised when the Company becomes party to the contractual provisions of insurance contracts issued to policyholders.

# Notes to the financial statements

***for the year ended 31 December 2013***

*Classification*

The Company issues statutory insurance contracts under the South African Compensation for Occupational Injury and Diseases Act to certain classes of employers within the construction industry against their liabilities to employees in terms of the Act. These contracts, which transfer significant insurance risk, provide various forms of compensation to the employees of policyholders in the event of injury on duty or occupational disease. Details of the various forms of compensation are provided in note 12.

The benefits and obligations arising from insurance contracts issued by the Company consist of premiums due and receivable from policyholders, compensation due and payable to claimants and longer-term expected payables in respect of: unpaid or incurred but not reported claims; pension claims; and premium rebates.

Premium receivables are classified as financial assets subsequently measured at amortized cost. Short-term receivables are measured without discounting.

Longer-term expected payables are classified as insurance liabilities and are measured in accordance with IFRS 4 Insurance Contracts as explained below.

*Discretionary participation features*

The insurance contracts issued by the Company when read in conjunction with the Company's Memorandum of Incorporation ("MOI") provide for a discretionary participation feature, which entitles the policyholder to receive merit rebates of premiums (referred to as "premium rebates"):

- that are likely to be a significant portion of the total contractual benefits;
- whose amount and timing is to be determined at the sole and absolute discretion of the board of directors of the Company in accordance with the provisions of the MOI.

Relevant details of this discretionary participation feature and critical judgments to be made by the directors to determine the related liability for premium rebates to policyholders at each financial period end are provided in note 5.1.

*Recognition and measurement*

Premiums are recognized as revenue (earned premiums) proportionally over the annual period of coverage ending in February each year. The portion of premium received that relates to unexpired risks at the balance sheet date is calculated on the 1/365$^{ths}$ basis and reported as the unearned premium liability. Premiums are not subject to any commissions, taxes or duties.

Premiums are raised based on the rates applicable to the projected wage returns submitted by employers at the commencement of each underwriting year (declared wage returns) and are adjusted when actual wages are reported by the employer at the conclusion of the underwriting year (actual wage returns). The aggregate expected adjustment resulting from differences between declared and actual wage returns is accrued for as "pipeline premium". The pipeline premium adjustment is determined as a percentage of the initial premium raised based on trends in recent historical experience of variations between premiums based on initial declared versus final actual wage

# Notes to the financial statements

***for the year ended 31 December 2013***

returns, as well as consideration of economic factors impacting on the construction industry at the time. Relevant details of the pipeline premium adjustment applied in the current year are provided in note 5.2.

Claims and directly related expenses are charged to income as incurred based on the estimated liability for compensation owed to injured workers, surviving spouses and minor children. These include all direct claims settlement costs that arise from events that have occurred up to the end of the reporting period even if they have not yet been reported to the Company. The Company does not make provision for indirect claims costs as these are considered to be immaterial in relation to the overall financial positions and results of the Company.

The Company does not discount its liabilities for unpaid claims other than for pension liabilities as explained below. Liabilities for unpaid claims are estimated using the input of assessments for individual cases reported to the Company (based on: medical assessments, current medical treatment costs, recent experience on settlements of similar cases and the applicable statutory compensation amounts) and statistical analyses of historical experience for incurred but not reported claims (including analysis of average claims costs and the amount of claims).
Pension liabilities are determined as the sum of the discounted present value of the expected future pension payments and directly related future administration expenses. This determination is based on assumptions as to future pension increases, mortality, morbidity, pension administration expenses and investment returns. The discount rate is determined by reference to investment yields, specifically yields on South African government bonds which approximate the weighted average duration of the pensioner portfolio. A margin for adverse deviations is included in the assumptions.

*Liability adequacy test*

At the end of each reporting period, the Company considers the need for liability adequacy tests to be performed to assess the adequacy of insurance liabilities in respect of the current portfolio of unexpired risks. There was no need to perform liability adequacy tests at the end of the current or previous financial year owing to the favorable claims ratios recorded by the Company in the preceding two financial years.

# Notes to the financial statements

***for the year ended 31 December 2013***

### 4.6 Reinsurance contracts held

The Company enters into reinsurance contracts with reinsurers under which the company is compensated for large individual or cumulative losses on insurance contracts issued by the Company. These contracts transfer significant insurance risk to the reinsurer and, accordingly, are classified as reinsurance contracts held.

The benefits to which the Company is entitled under its reinsurance contracts consist of current receivables due from reinsurers (in respect of the reinsurers' share of settled claims and any profit commissions receivable by the Company) and longer term expected receivables from reinsurers not yet due for payment to the Company (in respect of the reinsurers' expected share of unpaid and incurred but not reported claims). Receivables are classified as subsequently measured at amortized cost, whereas expected receivables are classified as reinsurance assets and measured consistently with the related insurance liabilities in accordance with the terms of each reinsurance contract.

Premiums payable for reinsurance contracts are recognized when due and are subsequently classified as financial liabilities measured at amortized cost. Short-term payables are measured without discounting.

The aggregate amounts receivable and expected to be receivable from individual reinsurers are assessed for recoverability on an annual basis. If there is objective evidence that the aggregate amount recoverable is impaired, the Company reduces the carrying amount thereof to its recoverable amount and recognizes that impairment loss through profit or loss. The Company gathers the objective evidence that a balance is impaired using the same process adopted for financial assets held at amortized cost.

### 4.7 Furniture, leasehold improvements, equipment and motor vehicles

Furniture, leasehold improvements, equipment and motor vehicles are stated at cost less accumulated depreciation and accumulated impairment losses. Depreciation is recognized so as to write off the cost of assets less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

Assets are derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized through profit or loss.

Depreciation is calculated using the straight-line method to reduce the cost of assets to their residual values over their estimated useful lives as follows:

| | |
|---|---|
| • Furniture & fittings | 5 - 10 years |
| • Leasehold improvements | 3 years |
| • Motor vehicles | 4 - 5 years |
| • Computer equipment | 3 years |

# Notes to the financial statements

***for the year ended 31 December 2013***

### 4.8 Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event; it is probable that the Company will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

### 4.9 Operating lease expenses

Operating lease payments are recognized as an expense on a straight-line basis over the lease term. In the event that lease incentives are received to enter into operating leases, the aggregate benefit of such incentives is recognized as a liability and is applied as a reduction of rental expense on a straight-line basis over the lease term.

### 4.10 Retirement benefit expenses

The retirement benefit fund, Sanlam Umbrella Provident Fund is a defined contribution fund administered by Sanlam Employee Benefits Administration Services and is governed by the South African Pension Fund Act of 1956. The fund covers all qualifying employees.

Payments to the fund are recognized as an expense when employees have rendered service entitling them to the contributions.

### 4.11 Income tax

The Company is exempt from income tax in accordance with section 10(1)(t)(xvi)(cc) of the South African Income Tax Act.

### 4.12 Foreign currencies

Transactions in currencies other than Rands (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Exchange differences on monetary items are recognized in profit or loss in the period in which they arise.

### 4.13 Segment reporting

The Company offers a single statutory insurance product and is managed within a single geographical segment, namely South Africa. Consequently, there are no distinguishable operating segments and no segment reporting is provided in the financial statements.

## 5. Critical accounting judgments and key sources of estimation uncertainty

In the application of the company's accounting policies, which are described in note 4, the directors of the Company are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in

# Notes to the financial statements

***for the year ended 31 December 2013***

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.

## 5.1 Critical judgments in applying accounting policies

The following is the critical judgment, apart from judgments involving estimations (see note 5.2 below), that the directors have made in the process of applying the Company's accounting policies and that has the most significant effect on the amounts recognized in the financial statements:

*Ultimate liability for premium rebates to policyholders*

The insurance contracts issued by the Company when read in conjunction with the Company's Memorandum of Incorporation ("MOI") provide for a discretionary participation feature, which entitles the policyholder to receive premium rebates:

- that are likely to be a significant portion of the total contractual benefits;
- whose amount and timing is to be determined at the sole and absolute discretion of the board of directors of the Company in accordance with the provisions of the MOI.

The Company's MOI provides that the board shall in its sole and absolute discretion determine the specific measurement criteria and period of measurement to be applied to determine the requirements for policyholders to participate in premium rebates (including, without limitation, the quantum and timing thereof) and the basis of allocation of the aggregate quantum of premium rebates among and between the participating policyholders. Such determination shall be made by the board on each occasion that premium rebates are to be paid and may vary from time to time.

The MOI further provides that, in exercising its discretion, the board shall consider the relative contributions of policyholders to the underwriting profits of the company, as determined by the premium income and claims expenses recorded in the Company's accounts during the period of measurement determined by the board, and the need to incentivize improved health and safety practices.

The decisions of the board regarding premium rebate payments are final and binding on each shareholder/policyholder.

The board currently targets to pay approximately 30% *(2012: approximately 30%)* of premium income as premiums rebates to qualifying policyholders. This amount totals R166,0 million to be paid in 2014 and R192,6 million to be paid in 2015 and is recognized as a premium rebate expense through profit or loss.

Premium rebates are generally paid 18 months after the completion of the relevant underwriting year ending in February each year. The aggregate carrying amount of the premium rebate liability at 31 December 2013 in respect of the current and previous underwriting years is R358.6 million *(2012: R227.2 million)*. Dependent upon the Company's future operating results and external developments impacting on the Company during the intervening periods, the ultimate amounts paid in respect of the current and previous underwriting years may differ

# Notes to the financial statements

***for the year ended 31 December 2013***

from the carrying amount of the premium rebate liability at 31 December 2013.

### 5.2 Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

*Ultimate liability for claims made under insurance contracts*

The estimation of the ultimate liabilities arising from claims made under insurance contracts is the Company's most critical source of estimation uncertainty. There are several sources of uncertainty that need to be considered in the estimate of the liability that the Company will ultimately pay for such claims (net of any reinsurance recoveries):

- Liabilities for unpaid claims are based on best estimates for individual cases reported to the Company (based on: medical assessments, current medical treatment costs, recent experience on settlements of similar cases and the applicable statutory compensation amounts) and statistical analysis of historical experience for incurred but not reported claims (including analysis of average claims costs and the amount of claims). The ultimate cost of unpaid claims may differ from the aggregate liability recorded at 31 December 2013 of R205.3 million *(2012: R245.0 million)*.

- Pension liabilities are determined as the sum of the discounted present value of the expected future pension payments and directly related future administration expenses. This determination is based on assumptions as to: future pension increases; morbidity (in respect of the period of temporary disability payments); longevity (in respect of the period of monthly pension payments); pension administration expenses; and the discount rate applied. A margin for adverse deviations is included in the assumptions. The ultimate cost of settling current pension obligations may differ from the aggregate liability recorded at 31 December 2013 of R938.6 million *(2012: R864.6 million)*.

# Notes to the financial statements

***for the year ended 31 December 2013***

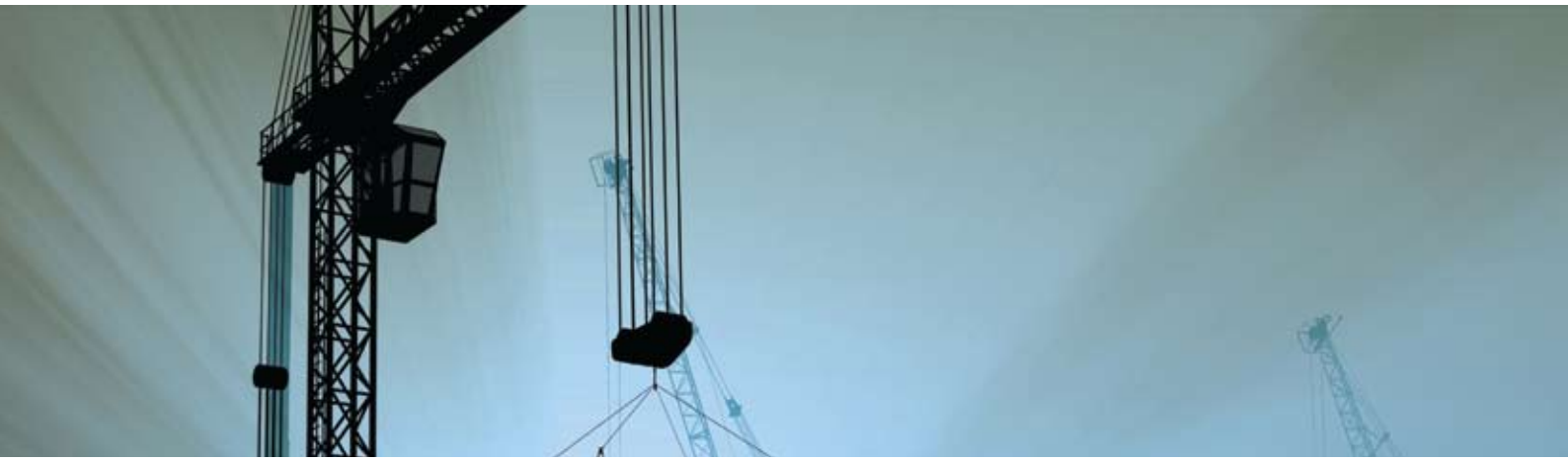
*Ultimate pipeline premium adjustment for current underwriting year*

Under the current insurance policies written by the Company, policyholders are required to estimate their premium based on their expected payroll. If the actual payroll is less than or in excess of the estimate, an adjustment is made in the next underwriting year. This net adjustment is referred to as pipeline premium.

The Company is aware of the existence of pipeline premium and that it relates to the current underwriting year and has in the past attempted to estimate the pipeline premium based on past experience. In the current year the Company has adopted a more prudent approach regarding pipeline premiums and consider it appropriate to estimate this contingent asset at 0%.

*Fair value of financial instruments*

The fair value of financial instruments where no active market exists or where quoted prices are not otherwise available are determined by using valuation techniques. This is particularly relevant to valuations of unquoted corporate bonds and illiquid quoted corporate bonds where reliance is of necessity placed on the application of internal valuation models by the Company's mandated bond managers or by their outsourced party valuators. While investment mandates generally provide for some form of independent assurance on the application of these internal valuations, this does not provide direct assurance as to the reliability of internal valuations of these financial assets. Changes in credit risk, liquidity discount and volatility factors, or the incorrect application of internal models, could affect the reported fair value of unquoted corporate bonds and illiquid quoted corporate bonds held by the Company and valued at R724,9 million at 31 December 2013 *(2012: R638,8 million)*.



# Notes to the financial statements

*for the year ended 31 December 2013*

The following notes provide additional disclosures relating to items shown in the statement of financial position.

## 6.1 Furniture, leasehold improvements, equipment and motor vehicles

| | Furniture & fittings R'000 | Leasehold improvements R'000 | Office equipment R'000 | Computer equipment R'000 | Motor vehicles R'000 | Total R'000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| Balance at 1 January 2012 | 1 737 | - | 810 | 3 000 | 4 723 | 10 270 |
| Additions | 24 | - | 57 | 713 | 950 | 1 744 |
| Disposals | - | - | - | (173) | (1 171) | (1 344) |
| Balance at 31 December 2012 | 1 761 | - | 867 | 3 540 | 4 502 | 10 670 |
| Additions | 31 | 400 | 175 | 974 | 1 409 | 2 989 |
| Disposals | - | - | (21) | (277) | (603) | (901) |
| Balance at 31 December 2013 | 1 792 | 400 | 1 021 | 4 237 | 5 308 | 12 758 |
| **Accumulated depreciation** | | | | | | |
| Balance at 1 January 2012 | (1 466) | - | (662) | (2 266) | (2 462) | (6 856) |
| Depreciation charge | (88) | - | (48) | (660) | (883) | (1 679) |
| Disposals | - | - | - | 165 | 1 148 | 1 313 |
| Balance at 31 December 2012 | (1 554) | - | (710) | (2 761) | (2 197) | (7 222) |
| Depreciation charge | (76) | (26) | (52) | (548) | (962) | (1 664) |
| Disposals | - | - | - | 277 | 603 | 880 |
| Balance at 31 December 2013 | (1 630) | (26) | (762) | (3 032) | (2 556) | (8 006) |
| **Net carrying amount** | | | | | | |
| 2012 | 207 | - | 157 | 779 | 2 305 | 3 448 |
| 2013 | 162 | 374 | 259 | 1 205 | 2 752 | 4 752 |

## 6.2 Reinsurance assets

| | 2013 R'000 | 2012 R'000 |
|---|---|---|
| Reinsurance share of insurance liabilities | 2 712 | 9 379 |

Reinsurance assets consist of the reinsurers' share of unpaid and incurred but not reported claims (the reinsurance underwriting year coincides with the financial year and, consequently, there are no unearned portions of premiums ceded to reinsurers). The reinsurers' share of settled claims is included in other receivables.

The Company reviewed the amounts expected to be receivable from reinsurers at year end and determined that no impairment is necessary.

A maturity analysis of reinsurance assets is contained in note 13.

# Notes to the financial statements

*for the year ended 31 December 2013*

| | 2013 R'000 | 2012 R'000 |
|---|---|---|
| **6.3 Financial assets measured at fair value** | | |
| Local: | | |
| - Listed equity securities | **856 126** | 611 566 |
| - Balanced fund portfolios | **392 817** | 431 978 |
| - Listed debt securities: fixed interest rate | **180 211** | 175 790 |
| - Listed debt securities: inflation linked | **1 031 412** | 765 861 |
| - Unlisted corporate debt securities with derivative overlay (note 1) | **408 335** | 386 799 |
| - Derivative equity forward contract | **(13 967)** | - |
| - Money market investments | **281 907** | 238 655 |
| | **3 136 841** | 2 610 649 |
| Foreign: | | |
| - Listed equity securities | **751 327** | 489 786 |
| - Unlisted corporate debt securities with derivative overlay (note 2) | **316 534** | 251 926 |
| - Derivative equity forward contract | **16 384** | - |
| - Derivative foreign exchange forward contract liability (note 2) | **(6 053)** | - |
| - USD cash plus MSCI all country equity forward contract | **567 682** | 333 943 |
| - Listed corporate debt securities | **82 050** | 50 449 |
| - Unitised equity securities | **53 767** | 35 196 |
| | **1 781 691** | 1 161 300 |
| Accrued income | **5 753** | 4 864 |
| | **4 924 285** | 3 776 813 |

***Note 1***

The Company has invested through investment-linked insurance policies into unlisted, and listed, but illiquid, local corporate bonds with maturity dates of up to 5 years. As part of the so-called "credit opportunities/alpha transport" product structure:

- interest rate duration risk on the bonds is immunized through interest rate swaps into short term rates; and
- the Company purchases equity forward contracts for the same nominal value as the aggregate value of the corporate bonds.

Thus the Company effectively receives a local equity market return (based on an approximation of the JSE SWIX Total Return Index) plus the credit and liquidity spread on the bonds. Note that the corresponding capital amount invested is exposed to both equity pricing risk on the relevant market indices and credit default risk on the separate corporate bonds.

# Notes to the financial statements

*for the year ended 31 December 2013*

| | **2013 R'000** | 2012 R'000 |
|---|---|---|

## 6.3 Financial assets measured at fair value

***Note 2***

The Company has invested through a protected cell structure into listed foreign corporate bonds and money market investments. As part of the so-called "credit opportunities/alpha transport" product structure:

- interest rate duration risk and non-USD currency risk on the bonds is immunized through interest rate swaps into short term rates and foreign currency swaps into USD respectively; and
- the Company purchases equity forward contracts for the same nominal value as the aggregate value of the corporate bonds and money market investments.

Thus, the Company effectively receives an equity market return (based on the MSCI Country Index) plus the credit spread on the bonds. Note that the corresponding capital amount invested is exposed to both equity pricing risk on the forward equity contract and credit default risk on the separate corporate bonds and money market securities.

A maturity analysis of the Company's financial assets is contained in note 13.

The Company's financial assets are exposed to various financial risks. Details of these risks and results of sensitivity testing of the key risks are provided in note 13.

The Company's application of the fair value hierarchy to the measurement of its financial assets, as required by IFRS 13 Fair Value Measurement, is shown in note 14.

## 6.4 Insurance receivables

| | | |
|---|---|---|
| Premiums receivable | | |
| Due from policyholders | **12 542** | 11 083 |
| Allowance for impairments | **(8 593)** | (8 320) |
| | **3 949** | 2 763 |
| Pipeline premium accrual | **-** | 25 764 |
| | **3 949** | 28 527 |

A maturity analysis of the insurance receivables is contained in note 13.

The carrying amount of insurance receivables is considered to be a reasonable approximation of fair value.

Impairment charges for unrecoverable premium receivables amounting to R7.1 million (2012: R0.4 million) have been written off against premium income.

# Notes to the financial statements

*for the year ended 31 December 2013*

| | 2013 R'000 | 2012 R'000 |
|---|---|---|
| **6.5 Other receivables** | | |
| Amounts due from reinsurers | **11 978** | 6 172 |
| Prepayments | **175** | 168 |
| Related party receivables | **46** | 131 |
| Other amounts receivable (individual balances of less than R1 million) | **1 124** | 846 |
| | **13 323** | 7 317 |

A maturity analysis of other insurance receivables is contained in note 13.
The carrying amount of other receivables is considered to be a reasonable approximation of fair value.
The Company reviewed the recoverable amounts of other receivables at year end and determined that no impairment is necessary.

| | | |
|---|---|---|
| **6.6 Ordinary share capital** | | |
| Ordinary share capital | **10** | 10 |

The Company's authorized and issued ordinary share capital remained unchanged during the current and previous financial years and consists of 500,000 ordinary shares of 2 cents each.

| | | |
|---|---|---|
| **6.7 Pension liabilities** | | |
| Opening balance | **864 550** | 772 314 |
| Net charge to profit or loss | **56 049** | 84 885 |
| Change in expectation for pension increases | **48 256** | 79 777 |
| Other experience adjustments | **(21 039)** | - |
| Unwind of discount rate and expected benefit payments and expenses | **(27 212)** | 15 190 |
| Change in risk margins: | | |
| Release of prior year risk margins | **(88 292)** | (71 303) |
| Reinstatement of risk margins for current year | **93 111** | 88 292 |
| Other changes in actuarial assumptions | **51 225** | (27 071) |
| Pensions paid during year | **(69 440)** | (58 462) |
| New pension awards (transferred from unpaid claim liabilities) | **87 474** | 65 813 |
| Closing balance | **938 633** | 864 550 |

# Notes to the financial statements

*for the year ended 31 December 2013*

| | 2013 R'000 | 2012 R'000 |
|---|---|---|
| **6.8 Unpaid claims liabilities** | | |
| Unpaid reported claims | **183 641** | 226 280 |
| Incurred but not reported claims | **21 672** | 18 682 |
| | **205 313** | 244 962 |
| A maturity analysis of unpaid claims is contained in note 13. | | |
| The movement in unpaid claim liabilities is analysed as follows: | | |
| Opening balance | **244 962** | 195 864 |
| Claims paid included in the existing estimate | **(109 999)** | (56 241) |
| Estimate raised for current year claims | **177 174** | 208 072 |
| Claims paid that were registered in the current year | **(55 371)** | (54 327) |
| Adjustments to estimate for prior period claims | **36 280** | 21 046 |
| Pensions awarded | **(87 474)** | (65 813) |
| - from current year estimates | **(20 201)** | (22 457) |
| - from prior year estimates | **(67 273)** | (43 356) |
| Movement in unreleased & un-awarded pension liability | **(3 249)** | (6 783) |
| Movement in ibnr claims | **2 990** | 3 144 |
| | **205 313** | 244 962 |

Results of sensitivity testing of unpaid claims and claims development over the past 5 years are shown in note 12.

**6.9 Unearned premium liability**

A maturity analysis of unearned premium liability is contained in note 13.

The movement in the unearned premium liability is analyzed as follows:

| | | |
|---|---|---|
| Opening balance | **89 196** | 81 406 |
| Net charge/(release) to gross premiums (refer note 7.2) | **5 302** | 7 790 |
| Release of opening balance | **(89 196)** | (81 406) |
| Unearned portion of current year premiums | **94 498** | 89 196 |
| | **94 498** | 89 196 |

The reinsurance underwriting year coincides with the financial year and, consequently, there are no unearned portions of premiums ceded to reinsurers.

**6.10 Premium rebate liability**

| | | |
|---|---|---|
| Premium rebate liability relating to: | | |
| Underwriting year ended February 2013 (2012: February 2012) | **166 004** | 105 539 |
| Underwriting year ending February 2014 (2012: February 2013) | **192 628** | 121 613 |
| Total premium rebate liability | **358 632** | 227 152 |

A maturity analysis of premium rebate liability is contained in note 13.

# Notes to the financial statements

*for the year ended 31 December 2013*

| | 2013 R'000 | 2012 R'000 |
|---|---|---|
| **6.10 Premium rebate liability continued** | | |
| The movement in premium rebate liability is analyzed as follows: | | |
| Opening balance | **227 152** | 213 664 |
| Premium rebate charge for the year | **262 082** | 109 493 |
| Current year – Allowance for premium rebates | **187 218** | 118 102 |
| Prior years - Actual versus provided premium rebate payments | **74 864** | (8 609) |
| Premium rebates paid | **(130 602)** | (96 005) |
| Closing balance | **358 632** | 227 152 |
| **6.11 Trade and other payables** | | |
| Staff incentives payable | **14 082** | 12 267 |
| Uninsured employers contribution to State Compensation Fund | **6 256** | 10 343 |
| Straight-lining of operating lease expenses | **1 110** | 972 |
| Accrued leave liability | **1 326** | 902 |
| Amounts due to reinsurers | **-** | 413 |
| Other current payables (individual balances of less than R1 million) | **5 146** | 8 064 |
| Total trade and other payables | **27 920** | 32 961 |

A maturity analysis of trade and other payables is provided in note 13.

## 7. Notes to the statement of comprehensive income

The following notes provide additional disclosures relating to items shown in the statement of comprehensive income.

### 7.1 Gross premium income

| | | |
|---|---|---|
| Initial premiums raised on declared wage returns | **571 914** | 514 322 |
| Pipeline premium accrual for current year | **-** | 25 764 |
| Actual versus expected pipeline premiums for previous year | **37 001** | 21 710 |
| | **608 915** | 561 796 |

# Notes to the financial statements

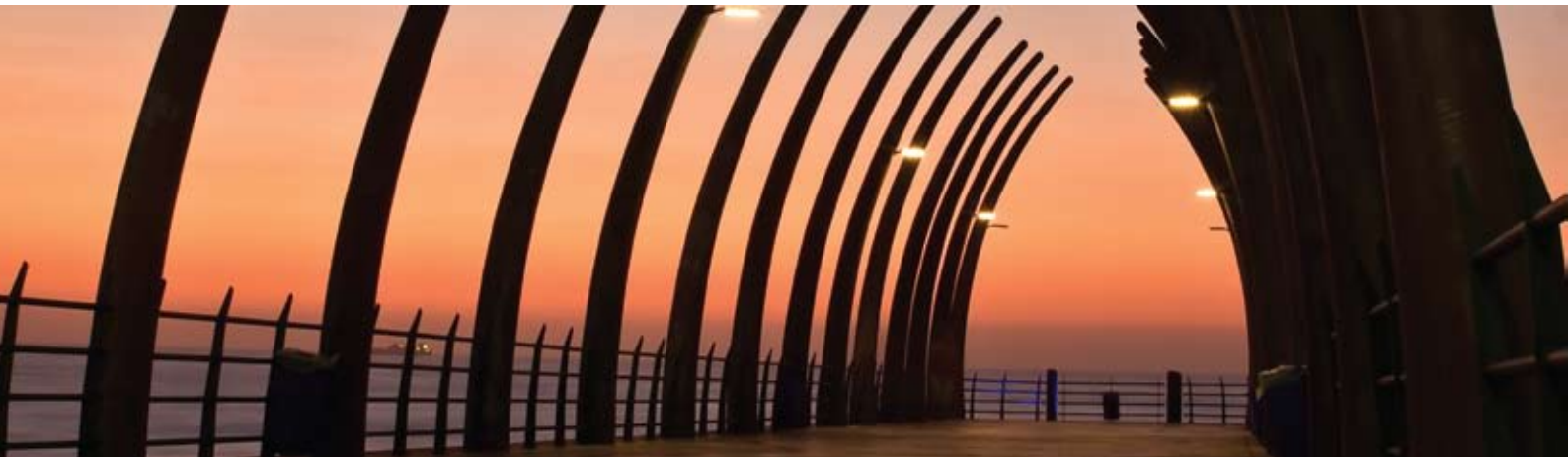
*for the year ended 31 December 2013*

| | 2013 R'000 | 2012 R'000 |
|---|---|---|
| **7.2 Gross earned premium** | | |
| Gross premium income | **608 915** | 561 796 |
| Premium rebates to policyholders | **(262 082)** | (109 493) |
| Current year - Allowance for premium rebates | **(187 218)** | (118 102) |
| Prior years – Actual versus expected premium rebate payments | **(74 864)** | 8 609 |
| Net unearned premium (charge) / release to gross premiums | **(5 302)** | (7 790) |
| Release of opening balance | **89 196** | 81 406 |
| Earned portion of initial premiums raised in previous year | **85 033** | 78 703 |
| Earned portion of pipeline premium accrued in previous year | **4 163** | 2 703 |
| Unearned portion of current year premiums | **(94 498)** | (89 196) |
| Unearned portion of initial premiums raised in current year | **(94 498)** | (85 033) |
| Unearned portion of pipeline premium accrued in current | **-** | (4 163) |
| Gross earned premium | **341 531** | 444 513 |
| **7.3 Net earned premium** | | |
| Gross earned premium | **341 531** | 444 513 |
| Premiums ceded to reinsurers | **(10 791)** | (6 268) |
| Ceded portion of initial premiums raised on declared wage | **(11 203)** | (6 179) |
| Ceded portion of pipeline premium accrual for current year | **-** | (412) |
| Ceded portion of actual versus expected pipeline premiums for previous year | **412** | 323 |
| Net earned premium | **330 740** | 438 245 |

# Notes to the financial statements

*for the year ended 31 December 2013*

| | 2013 R'000 | 2012 R'000 |
|---|---|---|
| **7.4 Administration expenses** | | |
| BBBEE expenditure- socio economic and skills development | **4 291** | 4 406 |
| Depreciation | **1 664** | 1 679 |
| Directors' remuneration | **12 068** | 10 657 |
| Employee costs (average no of 76 employees (2012: 75 employees)) | **30 573** | 27 052 |
| Basic salaries | **23 164** | 20 077 |
| Retirement fund contributions | **2 691** | 2 432 |
| Medical aid contributions | **1 401** | 1 269 |
| Training and recruitment costs | **547** | 998 |
| Travelling allowances | **1 352** | 995 |
| Temporary staff | **23** | 58 |
| Incentive costs | **1 395** | 1 223 |
| External audit fees | **1 361** | 1 353 |
| Current year | **1 361** | 1 351 |
| Prior years | **-** | 2 |
| Legal fees | **44** | 140 |
| Professional and other fees | **5 234** | 3 826 |
| Premises rentals | **4 353** | 3 996 |
| Profit on disposal of furniture, equipment and motor vehicles | **(72)** | (54) |
| Other expenses | **6 526** | 6 388 |
| Total administration expenses | **66 042** | 59 443 |



# Notes to the financial statements

*for the year ended 31 December 2013*

| | 2013 R'000 | 2012 R'000 |
|---|---|---|
| **7.5 Net investment income** | | |
| Investment income | **922 976** | 707 508 |
| Interest income on cash and cash equivalents | **102 344** | 71 688 |
| Dividend Income | **37 186** | 33 366 |
| Net foreign currency gain on financial assets | **187 353** | 19 489 |
| Net valuation gain on financial assets measured at fair value | **596 093** | 582 965 |
| Investment expenses | **(7 810)** | (7 012) |
| Total net investment income | **915 166** | 700 496 |

The net gain on financial assets at fair value through profit or loss incorporates any interest and dividends earned on the financial assets.

Certain of the Company's mandated asset managers offset their investment fees and transactional costs in unit pricing and, consequently, these expenses are incorporated in the net gain on financial assets at fair value through profit or loss. Where investment expenses are explicitly disclosed by asset managers, these are included in the investment expense line item.

## 8. Notes to the statement of cash flows

The following notes provide additional disclosures relating to items shown in the statement of cash flows.

### 8.1 Net movements in operating assets and liabilities

| | | |
|---|---|---|
| Insurance receivables (including accrued income (note 6.3)) | **24 305** | (12 137) |
| Other receivables | **(6 895)** | (140) |
| Reinsurance assets | **6 667** | 1 702 |
| Insurance liabilities | **170 803** | 162 701 |
| Trade and other payables | **(4 628)** | 7 749 |
| Total net movements in operating assets and liabilities | **190 252** | 159 875 |

### 8.2 Net cash invested in financial assets measured at fair value

| | | |
|---|---|---|
| Purchases of financial assets measured at fair value | **(3 725 446)** | (3 624 695) |
| Proceeds on disposals of financial assets at fair value through income | **3 174 958** | 3 284 194 |
| Net foreign currency gain on financial assets | **187 353** | 19 489 |
| Net cash invested in financial assets measured at fair value | **(363 135)** | (321 012) |

# Notes to the financial statements

*for the year ended 31 December 2013*

| **9. Operating lease commitments for the year ended 31 December 2013** | **2013 R'000** | 2012 R'000 |
|---|---|---|

The Company leases all four regional offices under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

The aggregate operating lease expense (premises rentals), which is charged to profit or loss on a straight-line basis, is disclosed in note 7.4.

The aggregate future minimum lease payments under non-cancellable operating leases are as follows:

| | | |
|---|---|---|
| Due within 1 year | **4 598** | 4 353 |
| Due > 2 years | **6 923** | 11 464 |
| Total | **11 521** | 15 817 |

## 10. Related party disclosures

### 10.1 Related parties

The following entities are related parties:

The Federated Employers' Trust Proprietary Limited ("FET") owns 41.9% (2012: 45.9%) of the issued shares of the Company. FET was created to facilitate the transfer of shares to new policyholders and the repurchase of shares from exiting policyholders.

Federated Employers' Trust ("the Trust"), an inter-vivos trust, owns 100% (2012: 100%) of the issued shares of FET. The sole purpose of the Trust is to hold the share capital of FET and the sole beneficiaries of the Trust are the policyholders of the Company. In terms of the Trust Deed, all reasonable expenditure incurred by the Trust must be paid by the Company. In 2013, the amount paid by the Company on behalf of the Trust amounted to R23k (2012: R22k).

### 10.2 Related party transactions

Transactions with related parties and amounts due from/(to) related parties are as follows:

The Company paid FET an administration fee of R224k (2012: R58k). The net amount due from FET at 31 December 2013 is R46k (2012: R131k).

The Company leases its Houghton offices from a related party, Barrow Properties Proprietary Limited. Operating lease costs paid for the year amounted to R3.48 million (2012: R3.20 million). There were no amounts due to the related party at 31 December 2013 (2012: R Nil).

*Premium income*

Certain non-executive directors are employed by construction companies which hold policies issued by the Company. The following premiums invoiced to these companies were calculated at the same rates as would be applicable to other policyholders and no amounts were outstanding at the current and previous financial year end.

| **Non-executive director** | **Related policyholder** | | |
|---|---|---|---|
| Mr JR Barrow | Barrow Construction (Pty) Ltd | **1 123** | 472 |
| Mr NF Maas | Gauteng & Free State Piling (Pty) | **-** | 191 |
| | | **1 123** | 663 |

# Notes to the financial statements

*for the year ended 31 December 2013*

| **10. Related party disclosures for the year ended 31 December 2013** | **2013 R'000** | 2012 R'000 |
|---|---|---|

## 10.2 Related party transactions continued

*Rebates paid*

Certain non-executive directors are employed by construction companies which hold policies issued by the Company. The following premium rebates paid to these companies were calculated on the same scale as would be applicable to other policyholders and no amounts were outstanding at the current and previous financial year ends:

| **Non-executive director** | **Related policyholder** | | |
|---|---|---|---|
| Mr JR Barrow | Barrow Construction (Pty) Ltd | **10** | 139 |
| Mr NF Maas | Gauteng & Free State Piling | **-** | 69 |
| | | **10** | 208 |

## 10.3 Directors' remuneration

| | | |
|---|---|---|
| Non-executive directors' fees: | | |
| Mr NF Maas (Chairman) | **497** | 405 |
| Mr H Walker (Lead independent director) | **556** | 457 |
| Mr JR Barrow | **288** | 263 |
| Mr MG Ilsley | **501** | 409 |
| Mr GD Irons | **-** | 150 |
| Dr APH Jammine | **464** | 332 |
| Mr CS Jiyane | **320** | 231 |
| Mr MA Letshele | **50** | - |
| Dr H Ngakane | **333** | 281 |
| Mrs PL Siphayi | **275** | 243 |
| Total non-executive directors' fees: | **3 284** | 2 771 |

During the year Mr MA Letshele was appointed as a non-executive director. Mr GD Irons resigned as a non-executive director in the previous year.

Executive directors' remuneration:

| | | |
|---|---|---|
| Mrs TT Pugh | | |
| Total cost of employment, excluding motor vehicles | **1 684** | 1 583 |
| Motor vehicle expenses | **229** | 170 |
| Leave encashment | **-** | 80 |
| Short term incentive | **552** | 469 |
| Medium term incentive | **1 953** | 1 457 |
| | **4 418** | 3 759 |
| Mr A Daya | | |
| Total cost of employment, excluding motor vehicles | **1 171** | 1 099 |
| Motor vehicle expenses | **185** | 149 |
| Leave encashment | **-** | 171 |
| Short term incentive | **269** | 199 |
| Medium term incentive | **629** | 499 |
| | **2 254** | 2 117 |

# Notes to the financial statements

*for the year ended 31 December 2013*

| **10. Related party disclosures for the year ended 31 December 2013** | **2013 R'000** | 2012 R'000 |
|---|---|---|
| **10.3 Directors' remuneration continued** | | |
| Executive directors' remuneration: | | |
| Mr GM McIntosh | | |
| Total cost of employment, excluding motor vehicles | **1 167** | 1 096 |
| Motor vehicle expenses | **167** | 153 |
| Leave encashment | **-** | 123 |
| Short term incentive | **149** | 139 |
| Medium term incentive | **629** | 499 |
| | **2 112** | 2 010 |
| Total executive directors' remuneration | **8 784** | 7 886 |
| Total directors' remuneration (included in expenses in note 7.4) | **12 068** | 10 657 |
| **10.4 Executive committee remuneration (excluding executive directors)** | | |
| Total cost of employment, excluding motor vehicles | **2 774** | 2 572 |
| Motor vehicle expenses | **449** | 398 |
| Short term incentive | **500** | 400 |
| Medium term incentive | **1 407** | 862 |
| | **5 130** | 4 232 |

## 11. Capital management

The principal capital management objective is to enhance the Company's investment returns for the benefit of stakeholders, while ensuring that the Company remains adequately capitalized and has adequate liquid cash resources to meet all of its short and long term obligations. An asset-liability modelling exercise is performed annually to determine the optimum percentage allocation of investments to different asset classes after taking into account the liability profile of the Company. Ranges are then specified around these strategic asset allocations to facilitate tactical asset allocation decisions within these ranges. The implementation of the Company's investment strategy is managed by the investment committee of the board acting on the advice of specialist investment consultants.

The Company is prohibited from making any borrowings and, therefore, no leverage is incorporated in the capital structure.

# Notes to the financial statements

*for the year ended 31 December 2013*

## 12. Insurance risk
## for the year ended 31 December 2013

The Company is exposed to various insurance risks as explained below. There have been no significant changes from the previous year in the exposure to insurance risk or policies, procedures and methods used to measure the risk.

The Company accepts insurance risk through statutory insurance contracts issued to certain classes of employers within the construction industry under the Compensation for Occupational Injuries and Diseases Act No. 130 of 1993 ("the COID Act"). These classes of employers must procure the insurance covers provided under the COID Act either from the Company or the State Compensation Fund. The Company issues no other types of insurance contracts.

The following compensation is payable in respect of employees injured on duty in terms of the COID Act:

### Temporary disablement

Periodic payments at 75% of the employee's monthly earnings at the time of the accident, subject to a maximum payment of R20 780 per month for up to 24 months.

### Permanent disablement

If the degree of disablement is 30% or less, compensation takes the form of a lump sum based on 15 times the employee's monthly earnings at the time of the accident, subject to minimum and maximum payments of R58 174 and R232 761 respectively. Where disablement is less than 30%, the lump sum is calculated proportionately.

If the degree of permanent disablement is 31% or more, compensation takes the form of a monthly pension. The monthly pension for 100% permanent disablement is calculated at 75% of the employee's monthly earnings, subject to minimum and maximum monthly pensions of R2 909 and R20 780 respectively. Where the degree of permanent disablement is less than 100%, the pension is calculated proportionately.

### Compensation on death

Compensation to the surviving spouse consists of both a lump sum equal to twice the monthly pension applicable for 100% permanent disablement and a monthly pension equal to 40% of the pension applicable for 100% permanent disablement. This pension continues on remarriage and only ceases upon death of the surviving spouse.

Compensation to each child under 18 years of age takes the form of a monthly pension equal to 20% of the pension applicable for 100% permanent disablement, provided that the total pension payable to the surviving spouse and children does not exceed the amount of the pension applicable for 100% permanent disablement. This pension ceases upon death, marriage or the attainment of 18 years of age, but continues after the child reaches 18 years of age if the child is physically or mentally handicapped (for such a period as can reasonably be expected that the deceased employee would have maintained the child). The pension also continues after 18 years of age if the child is busy with secondary or tertiary education (for such period as can reasonably be expected that the deceased employee would have contributed to the child's maintenance).

Compensation to the family for funeral costs to a maximum of R15 470.00 or the actual amount, whichever is the lesser.

### Medical and transportation expenses

All reasonable medical expenses incurred by or on behalf of the employee and the reasonable expenses incurred for the conveyance of the injured employee to a hospital, doctor or to their residence.

# Notes to the financial statements

*for the year ended 31 December 2013*

| **12. Insurance risk (Continued)**<br>**for the year ended 31 December 2013** | **2013**<br>**R'000** | 2012<br>R'000 |
|---|---|---|

The Company is exposed to a pricing risk to the extent that premiums are insufficient to meet the related future compensation costs. Premium rates are set by the State Compensation Commissioner, but may be loaded by the Company in the event of adverse claims experience in respect of individual policyholders. The Company applies loadings to policyholders' rates each year based on a sliding scale above a threshold claims to premiums ratio, currently 65%. There was no premium deficiency in the current or previous financial years.

Underwriting risk is further mitigated by the Company's reinsurance programme under which the Company is compensated above deductible amounts up to specified limits for large individual or cumulative losses on insurance contracts issued by the Company. The Company has reduced the quantum of reinsurance protection over time owing to the increased capacity to take risk onto the Company's own balance sheet. Accordingly, the impact of reinsurance is immaterial in the ordinary course of events and is excluded from the sensitivity and claims development analyses shown in this section.

The risks associated with the statutory insurance contracts issued by the Company are complex and subject to a number of variables which complicate quantitative sensitivity analysis. This is addressed separately for claims made under insurance contracts and subsequent pension liabilities under appropriate headings below.

*Claims made under insurance contracts*
The Company applies various techniques based on past claims development experience to quantify these sensitivities. This includes indicators such as average claim cost, amount of claims occurrence, expected loss ratios and claims development over past financial periods.

Results of sensitivity testing based on expected loss ratios are as follows, shown gross of reinsurance as impact on underwriting profit:

| | | |
|---|---|---|
| Sensitivity: | | |
| 5% variation in loss ratio | **30 446** | 28 090 |

The following table shows the development of claims over the past 5 years on a gross of reinsurance basis. The top half of the table shows how the estimates of total claims for each underwriting year develop over time. The lower half of the table reconciles the cumulative claims to the amount appearing in the statement of financial

| | Prior to 2010 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| - at end of underwriting year | 147 692 | 144 584 | 111 978 | 176 986 | 165 099 |
| - one year later | 120 473 | 136 604 | 120 138 | 149 710 | |
| - two years later | 132 744 | 144 141 | 122 282 | | |
| - three years later | 128 083 | 127 662 | | | |
| - four years later | 121 543 | | | | |
| Current estimate of cumulative claims | 121 543 | 127 662 | 122 282 | 149 710 | 165 099 |
| Cumulative payments & pension awards to date | (109 596) | (111 224) | (100 041) | (109 475) | (50 646) |
| Unpaid claims at 31 December 2013 | 11 947 | 16 438 | 22 241 | 40 235 | 114 453 |
| **Total unpaid claims at 31 December 2013** | | | | | **205 313** |

# Notes to the financial statements

***for the year ended 31 December 2013***

| **12. Insurance risk (Continued)**<br>**for the year ended 31 December 2013** | **2013**<br>**R'000** | 2012<br>R'000 |
|---|---|---|

The development of accidents registered for the last five years is shown below:

| *Accident / underwriting year* | *2009* | *2010* | *2011* | *2012* | *2013* |
|---|---|---|---|---|---|
| - at end of underwriting year | 9 313 | 8 537 | 7 324 | 7 565 | 7 402 |
| - one year later | 10 249 | 9 072 | 7 912 | 8 246 | - |
| - two years later | 10 337 | 9 147 | 7 978 | - | - |
| - three years later | 10 366 | 9 165 | - | - | - |
| - four years later | 10 379 | - | - | - | - |

The development of the average cost of claims for the last five years is shown below:

| *Accident / underwriting year* | *2009* | *2010* | *2011* | *2012* | *2013* |
|---|---|---|---|---|---|
| | *R* | *R* | *R* | *R* | *R* |
| - at end of underwriting year | 13 169 | 15 311 | 13 813 | 17 153 | 19 639 |
| - one year later | 13 490 | 14 775 | 14 971 | 17 900 | - |
| - two years later | 11 707 | 14 847 | 14 479 | - | - |
| - three years later | 11 594 | 13 261 | - | - | - |
| - four years later | 11 048 | - | - | - | - |

*Pension liabilities*

Pension liabilities are determined as the sum of the discounted present value of the expected future monthly payments arising from previous pension awards and directly related future administration expenses. This determination is based on assumptions as to: morbidity (in respect of the period of temporary disability payments); longevity (in respect of the period of monthly pension payments); future pension increases; pension administration expenses; and the discount rate applied. The discount rate is determined by reference to investment yields, specifically yields on South African government bonds which approximate the weighted average duration of the pensioner portfolio. A margin for adverse deviations is included in the assumptions.

The principal assumptions used to determine the Company's pension liabilities are as follows:

| Expected future costs | | |
|---|---|---|
| Mortality/morbity (impacting period of disability pay) | SAT | SAT |
| Longevity (impacting period of pension payments) | SAT | SAT |
| Annual inflationary pension increases | 6,42% | 7,47% |
| Pension administration costs per pensioner per month | R 1 840 | R 1 750 |
| Annual increases in pensioner administration costs | 7,06% | 7,47% |
| Discount rate (applied to determine present value) | 8,28% | 8,98% |

*SAT:- refers to standard actuarial tables as provided by the South African Actuarial Society and adapted for the Company's pensioner base as determined appropriate by the Company's independent actuaries. Allowance is made for HIV infection and Aids mortality, including improvements resulting from the government's roll out of antiretroviral drugs.*

# Notes to the financial statements

*for the year ended 31 December 2013*

| **12. Insurance risk (Continued)**<br>**for the year ended 31 December 2013** | **2013**<br>**R'000** | 2012<br>R'000 |
|---|---|---|

*Pension liabilities continued*

Results of sensitivity testing of the principal assumptions used to determine the Company's pension liabilities are as follows, shown as an impact on profit:

| **Principal assumptions** | **Impact** | | |
|---|---|---|---|
| Sensitivity: | | | |
| 10% increase in mortality | Shorter period of current disability pay | **(24 908)** | (23 841) |
| 10% decrease in mortality<br>i.e. a 10% increase in longevity | Longer period of future pension payments | **27 694** | 26 572 |
| 10% increase in direct pension administration expenses | Increased expected future costs | **6 489** | 5 372 |
| 1% once-off upliftment to monthly pensions | Increased future pension costs | **8 455** | 7 811 |
| 0.5% absolute decrease in net discount rate (discount rate less annual pension increase rate) | Increased present value of liability | **54 494** | 51 885 |

## 13. Financial risk

The Company's financial instruments are exposed to various financial risks as explained below. There have been no significant changes from the previous year in the exposure to financial risk or policies, procedures and methods used to measure the risk.

*Credit risk*

Credit risk is the risk of financial loss to the Company if a debtor (including a counter party to a financial instrument) fails to make payments of interest and the principal value when due. The Company is exposed to this risk through its bond and money market investments. Reinsurance assets do not present a material credit risk to the Company owing to the limited reinsurance covers in place. Furthermore, there is no material exposure to credit risk from premium debtors owing to the statutory nature of the insurance covers and the very limited concentration risk.

The Company's investment policy puts limits on local and foreign bond and money market investments, including portfolio composition and issuer type limits. The performance of the bond and money market investment portfolios are monitored by the investment committee of the Board.

# Notes to the financial statements

*for the year ended 31 December 2013*

## 12. Insurance risk (Continued)
## for the year ended 31 December 2013

The following table provides an analysis of the credit quality of reinsurance assets, financial assets at fair value through income, insurance receivables, other receivables & cash and cash equivalents.

| **At 31 December 2013** | A rated or better | Below A or unrated | **Total** |
|---|---|---|---|
| Reinsurance assets | - | 2 712 | 2 712 |
| Financial assets measured at fair value | 2 731 942 | 2 192 343 | 4 924 285 |
| Liquid investments | 2 167 135 | 1 581 693 | 3 748 828 |
| Equity investments | 832 470 | 1 498 894 | 2 331 364 |
| Quoted equities | 836 106 | 1 494 910 | 2 331 016 |
| Derivative equity forward contracts | (3 636) | 3 984 | 348 |
| Bond investments | | | |
| Quoted SA Government bonds | 1 031 412 | - | 1 031 412 |
| Quoted non-SA government | - | 82 050 | 82 050 |
| Money market investments | 298 249 | - | 298 249 |
| Accrued investment income | 5 004 | 749 | 5 753 |
| Unquoted or illiquid quoted investments | 564 807 | 610 650 | 1 175 457 |
| Corporate bonds | 121 656 | 58 555 | 180 211 |
| Corporate bonds (held under insurance contracts) | 441 978 | 282 891 | 724 869 |
| Africa (ex-SA) equities and property investments | 1 173 | 269 204 | 270 377 |
| Other financial assets measured at amortized cost | | | |
| Insurance receivables | - | 3 949 | 3 949 |
| Other receivables | - | 13 323 | 13 323 |
| Cash and cash equivalents | - | 15 143 | 15 143 |
| **Total reinsurance, financial and other assets** | **2 731 942** | **2 227 470** | **4 959 412** |

# Notes to the financial statements

*for the year ended 31 December 2013*

## 13. Financial risk
## for the year ended 31 December 2013

The following table provides an analysis of the credit quality of reinsurance assets, financial assets at fair value through income, insurance receivables, other receivables & cash and cash equivalents.

| **At 31 December 2012** | A rated or better | Below A or unrated | **Total** |
|---|---|---|---|
| Reinsurance assets | | 9 379 | 9 379 |
| Financial assets measured at fair value | 1 601 944 | 2 174 869 | 3 776 813 |
| Liquid investments | 1 475 447 | 1 304 515 | 2 779 962 |
| Equity investments | 416 247 | 1 288 156 | 1 704 403 |
| Quoted equities | 416 247 | 1 283 962 | 1 700 209 |
| Derivative equity forward contracts | - | 4 194 | 4 194 |
| Bond investments | | | |
| Quoted SA Government bonds | 765 860 | - | 765 860 |
| Quoted non-SA government | 50 449 | - | 50 449 |
| Money market investments | 238 655 | 15 731 | 254 386 |
| Accrued investment income | 4 236 | 628 | 4 864 |
| Unquoted or illiquid quoted investments | 126 497 | 870 354 | 996 851 |
| Corporate bonds | 126 497 | 49 293 | 175 790 |
| Corporate bonds (held under insurance contracts) | - | 638 725 | 638 725 |
| Africa (ex-SA) equities and property investments | - | 182 336 | 182 336 |
| Other financial assets measured at amortized cost | | | |
| Insurance receivables | - | 28 527 | 28 527 |
| Other receivables | - | 7 317 | 7 317 |
| Cash and cash equivalents | - | 20 022 | 20 022 |
| **Total reinsurance, financial and other assets** | **1 601 944** | **2 240 114** | **3 842 058** |

# Notes to the financial statements

*for the year ended 31 December 2013*

## 13. Financial risk (Continued)
## for the year ended 31 December 2013

### *Market risk*

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of market factors. Market factors include three types of risk: currency risk, interest rate risk and equity risk. These are addressed under separate headings below.

### *Currency risk*

Currency risk relates to investments issued by foreign entities when adverse changes in foreign currency exchange rates occur. The Company holds equities, bonds and related derivative financial instruments issued by foreign entities domiciled in developed and emerging markets. Exposure to bonds issued in non-US Dollar currencies is eliminated by derivative currency swaps, but there is a risk that these swaps may not be completely effective. The Company's foreign investments are limited by South African foreign exchange control regulations to 25% of total investments, but, at the discretion of the South African Reserve Bank, may increase beyond this percentage as a result of foreign investment gains relative to local investment gains. Foreign currency investments are monitored by the investment committee of the board and holdings are adjusted when outside of % strategic asset allocation limits. The Company's current investment strategy is to maximise foreign investments. Zero cost collar derivative instruments have been used to lock in gains resulting from depreciation in the Rand/US Dollar exchange rate during the past year.

The following table includes an analysis of foreign currency denominated investments included in financial assets measured at fair value:

| | **2013** **R'000** | 2012 R'000 |
|---|---|---|
| Liquid investments | | |
| Equity investments | **1 335 393** | 823 729 |
| Quoted equities | **1 319 009** | 823 729 |
| Derivative equity forward contracts | **16 384** | - |
| Bond investments | | |
| Quoted non-SA government and corporate Bonds | **82 050** | 50 449 |
| Unquoted or illiquid quoted investments | **316 534** | 251 926 |
| Africa (ex-SA) equities and property investments | **53 767** | 35 196 |
| Currency derivative forward contracts | **(6 053)** | - |
| Total foreign currency denominated investments | **1 781 691** | 1 161 300 |

Results of sensitivity testing of the financial asset value based on 20% depreciation in the Rand:

| | | |
|---|---|---|
| Sensitivity: | | |
| 20% depreciation in the Rand versus the US Dollar: | | |
| increase in financial assets | **6%** | 5% |
| increase in financial asset value | **300 185** | 195 794 |

### Interest rate risk

Interest rate risk is the potential for financial loss caused by fluctuations in fair value or future cash flows of financial instruments because of changes in market interest rates.

The Company is exposed to this risk through its interest bearing investments, which include government and corporate bonds and money market investments.

# Notes to the financial statements

*for the year ended 31 December 2013*

| **13. Financial risk (Continued)**<br>**for the year ended 31 December 2013** | **2013**<br>**R'000** | 2012<br>R'000 |
|---|---|---|
| **Interest rate risk** | | |
| Capital exposure to interest rate movements in yields on foreign fixed interest bonds and money market investments is eliminated through derivative interest rate swaps, but there is a risk that these swaps may not be completely effective. | | |
| Results of sensitivity testing of the financial asset value based on interest rate movements are as follows: | | |
| Sensitivity: | | |
| 2% increase in SA interest rates: | | |
| decrease in financial assets | **(5%)** | (5%) |
| decrease in financial asset value | **(239 506)** | (195 786) |
| **Equity risk** | | |
| Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The Company is exposed to this risk through its equity investments, which include derivative equity forward contracts. | | |
| The Company is subject to prudential investment limits applicable to different asset classes under the South African Short Term Insurance Act No. 53 of 1998 and is subject also to prescribed investment requirements under the Compensation for Occupational Disease and Injuries Act No. 130 of 1993. The percentage allocation of investments to equities is determined by an annual asset-liability modelling exercise after taking into account the liability profile of the Company. Equities are monitored by the investment committee of the Board and holdings are adjusted when the investments are outside of the % strategic allocation limits. | | |
| Results of sensitivity testing based on changes in equity market valuations are as follows, shown as impact on profit and the financial asset value: | | |
| Sensitivity: | | |
| 10% reduction in the ALSI: | | |
| decrease in financial assets | **(2%)** | (2%) |
| decrease in financial asset value | **(114 984)** | (58 743) |
| **Liquidity risk** | | |
| Liquidity risk is the risk that the Company will not be able to meet all cash outflow obligations as they become due. The Company mitigates this risk by monitoring cash activities and expected outflows. The Company does not have material liabilities that can be called unexpectedly on demand. The Company has no material commitments for capital expenditures and there is no need for such expenditures in the normal course of business. Claim payments, premium rebates and operational expenditure are currently funded by annual premium receipts. Consequently, the principal risk is that investment returns are inadequate to fund long term pension obligations. This risk is considered to be low at the present time based on the Company's investment strategy and high level of capital surplus retained by the Company. | | |

# Notes to the financial statements

*for the year ended 31 December 2013*

## 13. Financial risk (Continued)
## for the year ended 31 December 2013

The expected maturity profile of the Company's insurance and financial assets and its insurance and financial liabilities, is as follows:

| At 31 December 2013 | Less than 1 year | 1- 5 years | More than 5 years | Total |
|---|---|---|---|---|
| Reinsurance assets | 1 443 | 1 155 | 114 | 2 712 |
| Financial assets measured at fair value | 2 557 104 | 1 240 564 | 1 126 617 | 4 924 285 |
| Liquid investments | 2 279 518 | 468 840 | 1 000 470 | 3 748 828 |
| Equity investments | 1 954 888 | 376 476 | - | 2 331 364 |
| Quoted equities | 1 954 540 | 376 476 | | 2 331 016 |
| Derivative equity forward contracts | 348 | - | - | 348 |
| Bond investments | | | | |
| Quoted SA Government bonds | 20 628 | 10 314 | 1 000 470 | 1 031 412 |
| Quoted non-SA government | - | 82 050 | - | 82 050 |
| Money market investments | 298 249 | - | - | 298 249 |
| Accrued investment income | 5 753 | - | - | 5 753 |
| Unquoted or illiquid quoted investments | 277 585 | 771 724 | 126 148 | 1 175 457 |
| Corporate bonds | 7 208 | 46 855 | 126 148 | 180 211 |
| Corporate bonds (held under insurance contracts) | - | 724 869 | - | 724 869 |
| Africa (ex-SA) equities and property investments | 270 377 | - | - | 270 377 |
| Other financial assets measured at amortized cost | | | | |
| Insurance receivables | 3 949 | - | - | 3 949 |
| Other receivables | 897 | 1 780 | 10 646 | 13 323 |
| Cash and cash equivalents | 15 143 | - | - | 15 143 |
| **Total reinsurance and financial assets** | **2 578 536** | **1 243 499** | **1 137 377** | **4 959 412** |
| Insurance liabilities | 540 295 | 529 697 | 527 084 | 1 597 076 |
| Pension liabilities | 74 480 | 337 069 | 527 084 | 938 633 |
| Unpaid and incurred but not reported claims | 205 313 | - | - | 205 313 |
| Unearned premium liability | 94 498 | - | - | 94 498 |
| Premium rebate liability | 166 004 | 192 628 | - | 358 632 |
| Financial liabilities measured at amortized cost | | | | |
| Trade and other payables | 27 920 | - | - | 27 920 |
| **Total insurance and financial liabilities** | **568 215** | **529 697** | **527 084** | **1 624 996** |
| **Excess/(Shortfall) of assets over liabilities** | **2 010 321** | **713 802** | **610 293** | **3 334 416** |

There are no financial assets past due but not impaired at 31 December 2013.

# Notes to the financial statements

*for the year ended 31 December 2013*

## 13. Financial risk (Continued)
## for the year ended 31 December 2013

The expected maturity profile of the Company's insurance and financial assets and its insurance and financial liabilities, is as follows:

| At 31 December 2012 | Less than 1 year | 1- 5 years | More than 5 years | Total |
|---|---|---|---|---|
| Reinsurance assets | 1 477 | 3 806 | 4 096 | 9 379 |
| Financial assets measured at fair value | 1 812 961 | 1 097 915 | 865 937 | 3 776 813 |
| Liquid investments | 1 623 593 | 413 485 | 742 884 | 2 779 962 |
| Equity investments | 1 349 026 | 355 377 | - | 1 704 403 |
| Quoted equities | 1 344 832 | 355 377 | - | 1 700 209 |
| Derivative equity forward contracts | 4 194 | - | - | 4 194 |
| Bond investments | | | | |
| Quoted SA Government bonds | 15 317 | 7 659 | 742 884 | 765 860 |
| Quoted non-SA government | - | 50 449 | - | 50 449 |
| Money market investments | 254 386 | - | - | 254 386 |
| Accrued investment income | 4 864 | - | - | 4 864 |
| Unquoted or illiquid quoted investments | 189 368 | 684 430 | 123 053 | 996 851 |
| Corporate bonds | 7 032 | 45 705 | 123 053 | 175 790 |
| Corporate bonds (held under insurance contracts) | - | 638 725 | - | 638 725 |
| Africa (ex-SA) equities and property investments | 182 336 | - | - | 182 336 |
| Other financial assets measured at amortized cost | | | | |
| Insurance receivables | 28 527 | - | - | 28 527 |
| Other receivables | 488 | 2 812 | 4 017 | 7 317 |
| Cash and cash equivalents | 20 022 | - | - | 20 022 |
| **Total reinsurance and financial assets** | **1 863 475** | **1 104 533** | **874 050** | **3 842 058** |
| Insurance liabilities | 509 137 | 435 873 | 480 850 | 1 425 860 |
| Pension liabilities | 69 440 | 314 260 | 480 850 | 864 550 |
| Unpaid and incurred but not reported claims | 244 962 | - | - | 244 962 |
| Unearned premium liability | 89 196 | - | - | 89 196 |
| Premium rebate liability | 105 539 | 121 613 | - | 227 152 |
| Financial liabilities measured at amortized cost | | | | |
| Trade and other payables | 32 961 | - | - | 32 961 |
| **Total insurance and financial liabilities** | **542 098** | **435 873** | **480 850** | **1 458 821** |
| **Excess/(Shortfall) of assets over liabilities** | **1 321 377** | **668 660** | **393 200** | **2 383 237** |

There are no financial assets past due but not impaired at 31 December 2012.

# Notes to the financial statements

*for the year ended 31 December 2013*

## 14. Fair value measurement

**for the year ended 31 December 2013**

Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same - to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). Fair value excludes transaction costs which would be incurred to sell the asset or transfer the liability e.g. sales commission.

When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfill a liability is not relevant when measuring fair value.

Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on the basis explained above, except for leasing transactions that are within the scope of IAS 17 Leases, and measurements that have some similarities to fair value but are not fair value, such as the value in use in IAS 36 Impairment of Assets and the estimation of insurance liabilities and related reinsurance assets under IFRS 4 Insurance Contracts. Key areas of estimation uncertainty affecting insurance liabilities are explained in note 5.2 and information concerning insurance risks, including results of sensitivity testing of key insurance risks is provided in note 12.

For financial reporting purposes, fair value measurements of financial assets and financial liabilities are categorized into Level 1. 2 or 3 based on the degree to which the inputs to the measurements are observable and the significance of the inputs to the 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, 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.

# Notes to the financial statements

*for the year ended 31 December 2013*

## 14. Fair value measurement (Continued)

**for the year ended 31 December 2013**

Application of the fair value hierarchy to the Company's financial assets and financial liabilities is as follows:

| At 31 December 2013 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets measured at fair value | 4 058 311 | 865 974 | - | 4 924 285 |
| Liquid investments | 3 099 464 | 865 974 | - | 3 965 438 |
| Equity investments | 1 976 265 | - | - | 1 976 265 |
| Quoted equities | 1 996 285 | - | - | 1 996 285 |
| Derivative equity forward contracts | (20 020) | - | - | (20 020) |
| Bond investments | | | | |
| Quoted SA Government bonds | 1 035 396 | - | - | 1 035 396 |
| Quoted non-SA government | 82 050 | - | - | 82 050 |
| Money market investments | - | 865 974 | - | 865 974 |
| Accrued investment income | 5 753 | - | - | 5 753 |
| Unquoted or illiquid quoted investments | 958 847 | - | - | 958 847 |
| Corporate bonds | 180 211 | - | - | 180 211 |
| Corporate bonds (held under insurance contracts) | 724 869 | - | - | 724 869 |
| Africa (ex-SA) equities and property investments | 53 767 | - | - | 53 767 |
| Other financial assets measured at amortized cost | | | | |
| Insurance receivables | - | 3 949 | - | 3 949 |
| Other receivables | - | 13 323 | - | 13 323 |
| Cash and cash equivalents | - | 15 143 | - | 15 143 |
| **Total financial assets** | **4 058 311** | **898 389** | **-** | **4 956 700** |
| Financial liabilities measured at amortized cost | | | | |
| Trade and other payables | - | 27 920 | - | 27 920 |
| **Total financial liabilities** | **-** | **27 920** | **-** | **27 920** |
| **Net financial assets / (liabilities)** | **4 058 311** | **870 469** | **-** | **4 928 780** |

There have been no transfers between Level 1 and 2, and no financial assets or financial liabilities have been categorized into level 3, in the current financial year.

# Notes to the financial statements

*for the year ended 31 December 2013*

## 14. Fair value measurement (Continued)

**for the year ended 31 December 2013**

Application of the fair value hierarchy to the Company's financial assets and financial liabilities is as follows:

| At 31 December 2012 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets measured at fair value | 3 204 215 | 572 598 | - | 3 776 813 |
| Liquid investments | 2 354 504 | 572 598 | - | 2 927 102 |
| Equity investments | 1 529 137 | - | - | 1 529 137 |
| Quoted equities | 1 529 137 | - | - | 1 529 137 |
| Derivative equity forward contracts | - | - | - | - |
| Bond investments | | | | |
| Quoted SA Government bonds | 770 054 | - | - | 770 054 |
| Quoted non-SA government | 50 449 | - | - | 50 449 |
| Money market investments | - | 572 598 | - | 572 598 |
| Accrued investment income | 4 864 | - | - | 4 864 |
| Unquoted or illiquid quoted investments | 849 711 | - | - | 849 711 |
| Corporate bonds | 175 790 | - | - | 175 790 |
| Corporate bonds (held under insurance contracts) | 638 725 | - | - | 638 725 |
| Africa (ex-SA) equities and property investments | 35 196 | - | - | 35 196 |
| Other financial assets measured at amortized cost | | | | |
| Insurance receivables | - | 28 527 | - | 28 527 |
| Other receivables | - | 7 317 | - | 7 317 |
| Cash and cash equivalents | - | 20 022 | - | 20 022 |
| **Total financial assets** | **3 204 215** | **628 464** | **-** | **3 832 679** |
| Financial liabilities measured at amortized cost | | | | |
| Trade and other payables | - | 32 961 | - | 32 961 |
| **Total financial liabilities** | **-** | **32 961** | **-** | **32 961** |
| **Net financial assets / (liabilities)** | **3 204 215** | **595 503** | **-** | **3 799 718** |

There were no transfers between Level 1 and 2, and no financial assets or financial liabilities were categorized into level 3, in the 2012 financial year.

## HEAD OFFICE

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