

- 3 million people covered and still growing
- More value to members through product and service innovation
- Continued profit growth for future sustainability
- Jane

Enhancing Leadership through Growth

Medibank Private Annual Report 2006

About Medibank Private

Medibank Private is Australia's largest provider of private health insurance. We are the only truly national health insurer, covering nearly three million people: 2.8 million Australian residents plus approximately 160,000 of Australia's sizeable international student and visitor population.

Medibank Private offers health insurance to all Australians through retail and corporate products, as well as catering for overseas students and visitors.

In November 2005, we began marketing travel insurance for both domestic and international travel, further expanding our product offering.

Medibank Private is a wholly-owned Commonwealth Company as defined in the *Commonwealth Authorities and Companies Act 1997*. We are a Government Business Enterprise and a company subject to the *Corporations Act 2001*.

We offer an extensive retail network that provides our members with easy and fast access to a range of services. This includes 108 retail outlets, approved agents, a national member contact centre and online access at www.medibank.com.au.

Contents

- 1 Our vision, mission and values
- 2 Performance Highlights
- 4 Chairman's Report
- 6 Managing Director's Report
- 8 Board of Directors
- 10 Our Management Team
- 12 Our Results
- 16 Our Business Performance
- 20 Our Members
- 26 Our People
- 30 Our Sustainability Report
- 35 Our Future
- 37 Financial Report
Including the Corporate Governance Statement,
Directors' Report and Financial Statements

our results



page 12

our business performance



page 16

our members



page 20

Our vision is to be recognised as the leader in private health insurance in Australia.

Our mission

- Be a profitable and sustainable business, with the capacity to invest and innovate
- Build a high-performance organisation that unites, engages, empowers and recognises our people
- Deliver great member products and benefits at affordable prices through a consistent and excellent service experience
- Be a growing and efficient business with improving shareholder value
- Give life to the statement 'I feel better now'

Our values

- Act with integrity
- Respect all people
- Care about the needs of our fund members
- Encourage innovation

our people



page 26

our sustainability report



page 30

our future



page 35

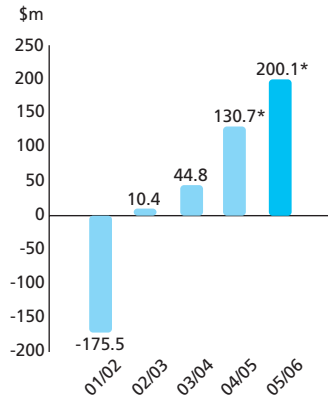
Performance Highlights

Operating profit
Up 53.1%

Operating profit/loss

Up 53.1%

A fourth consecutive year of strong profit growth is clear evidence of our financial turnaround.

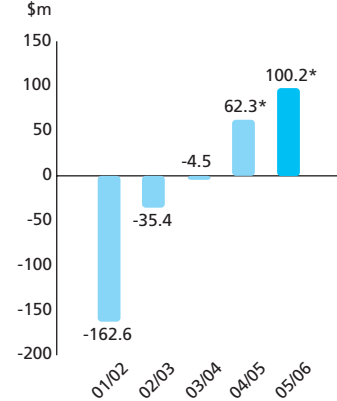


*Australian International Financial Reporting Standards (AIFRS) compliant

Underwriting profit after expenses

Up 60.9%

For the second consecutive year, a strong underwriting profit has been recorded.



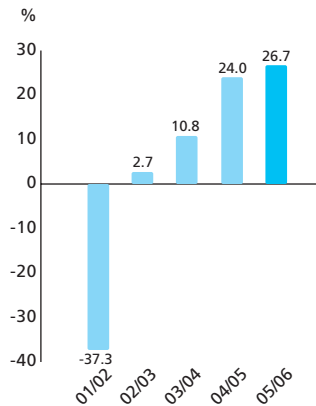
*Australian International Financial Reporting Standards (AIFRS) compliant

Return on equity
Up to 26.7%

Return on equity

Up to 26.7%

Strong profit growth enables us to work our equity harder, producing superior returns.

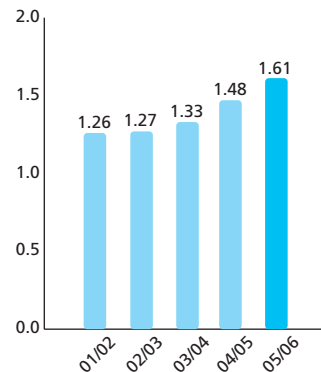


Solvency multiple

Up 8.8%

Medibank Private continues to build prudential strength.

Solvency multiple

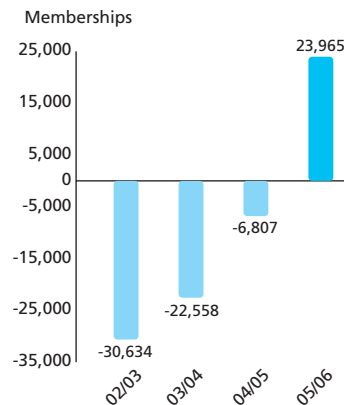


Membership growth
Up 23,965

Membership growth

Up 23,965

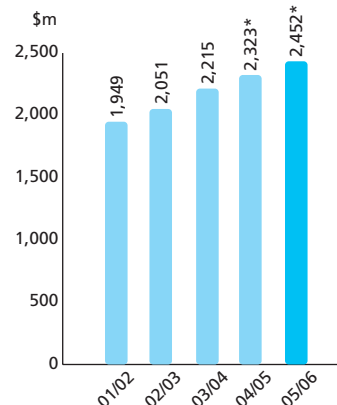
2005/06 saw us achieve our highest net resident membership growth in four years.



Claims expense (excluding reinsurance)

Up 5.5%

A record amount was paid for member benefits this year.

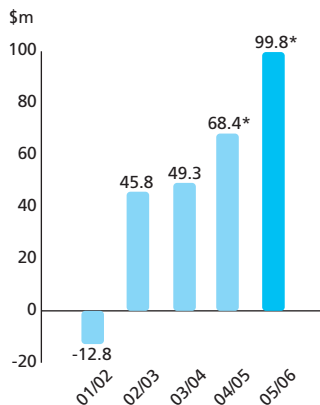


*Australian International Financial Reporting Standards (AIFRS) compliant

Investment and other income

Up 45.9%

Strong returns on investment have been achieved through a balanced investment strategy.

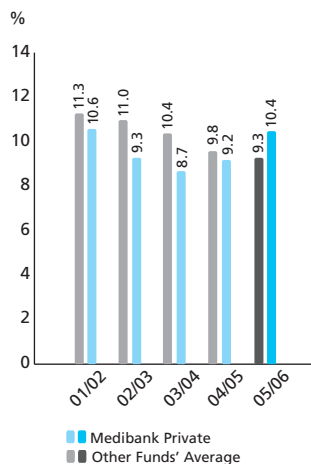


*Australian International Financial Reporting Standards (AIFRS) compliant

Management Expense Ratio (MER)

Up 1.2%

Our MER recorded an increase over last year due to investment in information technology.

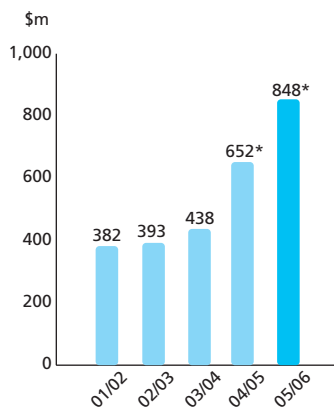


■ Medibank Private
■ Other Funds' Average

Net assets

Up 30.1%

We maintained strong growth in net assets.

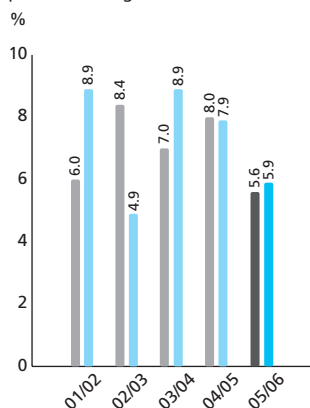


*Australian International Financial Reporting Standards (AIFRS) compliant

Average premium rate increases

Contained to 5.9%

Medibank Private continues to drive premium rate growth downward.

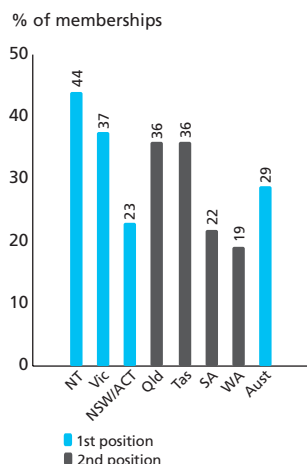


■ Medibank Private
■ Other Funds' Average

Market share

Market leader

Medibank Private's market share remains strong.



■ 1st position
■ 2nd position

Facts at a Glance Financial

Premium revenue:
\$2,835 million

Benefits paid:
\$2,452 million

Operating profit:
\$200.1 million

Underwriting profit after expenses:
\$100.2 million

Investment and other income:
\$99.8 million

Return on equity:
26.7%

People and Services

People covered:
3 million

Market share:
29%

Contracted private hospitals:
435

Contracted ancillary providers:
4,038

Hospital procedures paid:
721,222

Ancillary services paid:
14,788,665

Chairman's Report

Strong foundation for sustainability

More than ever before in our 30-year history, the core tenets of member value and sound management and governance provide the solid foundation on which to build the next phase of Medibank Private. Industry-wide challenges of containing health care costs and major private health insurance reform, along with a proposed change in ownership represent new opportunities for us. Our strong performance this financial year has reinforced the foundation on which to build our future business.



Focusing on members

Medibank Private's 2005/06 result of \$200.1 million was achieved by keeping members at the centre of all our strategies. Among our most successful initiatives over the past 12 months have been the hospital contracting process, which has significantly reduced the pressure on premium growth and this is expected to continue in coming years; introduction of well-being programs to help members stay healthy and, in doing so, reduce claims; and the member recruitment programs for our new insurance products – *MyOptions*, which attracted thousands of new, younger members to Medibank Private, and *Priority* our corporate product range.

Our financial result demonstrates Medibank Private's ability to continuously deliver both sustainable profit performance and member value. From a broader perspective, this year's profit result represents less than a twelfth of the value delivered back to members through benefit claim payments. In 2005/06, we continued to carefully manage our business to stem the growth in premium rates, while still investing in the business to ensure we are equipped to serve the future needs of our members.

Corporate governance

Acknowledging the increasing public expectation of good corporate governance, the Board and management of Medibank Private established a compliance benchmark equivalent where applicable to an ASX 100 company.

Beyond this base level, we have established a Member Service Charter to benchmark our service standards. Performance against this Charter is tracked, independently audited and regularly monitored.

The Board has worked with management to focus on ensuring sound capital adequacy coverage combined with a balanced risk profile for our investments, which has resulted in healthy investment returns with reasonable protection from volatility.

Meeting the ASX benchmark standards of corporate governance, transparency and management accountability, as well as the health insurance industry's prudential requirements, is critical to our overall strategy to ensure the long-term sustainability of the business.

Balancing member value and long-term sustainability

Medibank Private has balanced the need to make a responsible profit with providing better value to members. Our profit margin for 2005/06 was 7.1%, slightly under the weighted average profit margin recorded for our four major competitors in the previous year. This is against a backdrop of increased profitability across the sector this year. Medibank Private has not only met our obligation to provide for a sustainable future, we have also improved product value and service to members.

The changing industry

Having delivered a consistent four-year trend of healthy profit improvement, Medibank Private is now well positioned to take on the changing landscape of the health insurance industry in Australia.

Private health insurance plays a crucial role in underpinning the economics of the overall health care system in Australia.

With publicly-financed health systems throughout the world under challenge, the need for a viable and adaptable private health industry has never been greater. The private and public health sectors should be seen as complementary with each other. We need to remember that policy holders of private health insurance, apart from paying their Medicare levy, also pay two out of every three dollars of premium, or \$7 billion per annum into the health system. Therefore, the Federal Government's investment in their private health insurance rebate represents very good value, as well as reducing pressure on the public health system, with more than half of all elective surgery now being performed in private hospitals.

The cost of health care is a constant source of debate. Health costs in Australia and all comparable countries continue to increase. As our population ages and as new, sophisticated treatments and procedures come onto the market, costs will escalate. Managing the rate of increase is a central issue for all health funders – public and private.

Medibank Private has been more successful than most funds in responding to the issue of escalating health costs, having introduced initiatives such as increasing the effectiveness of contracting with private hospitals and ancillary service providers. Medibank Private has every intention of maintaining that success and will continue to find new ways to generate greater efficiencies in the health care sector for the benefit of the fund's members.

Medibank Private has welcomed the Federal Government's recently announced reforms to private health insurance regulation as a positive opportunity to provide more comprehensive care in the most appropriate setting for our members. As industry leader, Medibank Private will continue to advocate for reforms that afford health funds more flexibility in responding to member health needs.

Medibank Private's future ownership

The focus on the private health insurance industry intensified in 2005/06, particularly when the Federal Government announced in April 2006 its intention to sell Medibank Private.

The Board and management will endeavour to assist the process with the view to ensuring that a smooth and successful transition is achieved, while fulfilling our obligations to members under the *National Health Act*, as well as our broader legal responsibilities.

We will also ensure that we remain focused on running an excellent business for the benefit of our close to three million members.

Outlook

The outlook for Medibank Private is positive. Medibank Private's unique attributes, of market leader and the only national health fund, along with its strong financial and operating performance, and strong membership growth, place us in an excellent position to continue to drive value for all stakeholders in the future.

With the decision to sell Medibank Private, the health insurance industry has the potential for more vigorous competition that will stimulate it to provide better products and services than currently offered.

In concluding, I wish to extend my thanks to my fellow Directors who have again contributed to the smooth and effective governance of this excellent organisation. Their complementary skills and experience have made an important contribution to the strong performance in 2005/06. I have been very impressed with the quality and commitment of our staff, led by the Managing Director George Savvides and his senior leadership team. They have again performed exceptionally well and, on behalf of the Board, I thank them all for their valuable contribution throughout the year.



Peter M. Kirby
Chairman

Managing Director's Report

Turning leadership into value

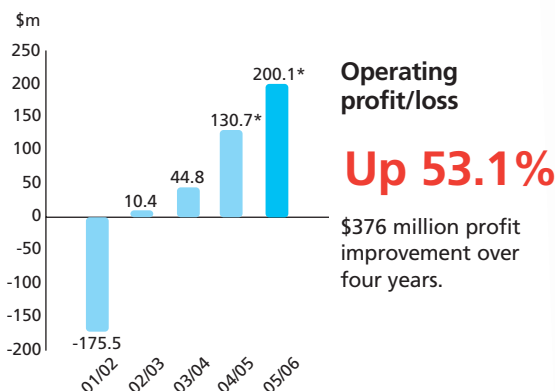
What better way to recognise Medibank Private's 30th year than by celebrating it with a record business performance which incorporated strong membership growth. In 2005/06, we strengthened our position as industry leader by generating improved value and service for our nearly three million fund members across Australia.

Record operational performance

For the fourth consecutive year, Medibank Private has produced improved financial performance in a highly competitive market, lifting profit to \$200.1 million, a 53.1% increase on last year's \$130.7 million. This result is partially attributable to the fund's efforts in benefit cost management, achieved in a sector experiencing constant escalation in health care costs.

The lift reflected in the 2005/06 profit result was partially driven by a healthy underwriting profit after expenses of \$100.2 million, a growth of 60.9% on the previous year, representing an underwriting margin of 3.5% and the second consecutive year of a positive underwriting return.

Strong cash flow and operating surplus resulted in a significantly enlarged investment pool of \$1.5 billion. Combined with a buoyant investment market and increased allocation to growth assets, an investment return of \$97.9 million was generated – a return of 7.5%, and an increase of 43.8% on last year's investment return of \$68.1 million. While growth assets have contributed to this excellent result, Medibank Private's investment portfolio remains conservative in comparison to our industry peers.



Operating profit/loss

Up 53.1%

\$376 million profit improvement over four years.

*Australian International Financial Reporting Standards (AIFRS) compliant

Medibank Private seeks to balance a responsible financial performance to ensure the fund's sustainability, with the need to ensure members have access to improved benefits and lower premium growth.

The main drivers of our healthy result include:

- a strong growth in memberships with a net increase of 76,718 resident policy units this year – the strongest growth in four years;
- continued containment of the fund's Management Expense Ratio (MER), which was 10.4%. Whilst being an increase on last year, this reflects a heavy investment in our IT developments. Excluding this impact, the MER remains a healthy 9.0%; and
- contained benefit outlay growth by negotiating the purchase of more competitive hospital services for our members, a strategy that has contributed to a significant reduction in the annual growth rate in hospital benefits paid per policy unit from 11% to 8% over the past two years.

In 2005/06, we continued to strengthen our prudential position. On top of considerable improvement last year, our capital adequacy and prudential reserves were at record levels by year end. Our Standard & Poor's rating of 'A-' is the highest rating achieved for the private health insurance sector.

These results were achieved while we continued to invest significantly in building a stronger business, releasing new products, improving our retail network and investing in IT infrastructure. These investments have helped us create a business that is now stronger and more confident than at any time in our 30-year history.

We have continued our comprehensive investment in new core systems to replace our 20-year-old IT infrastructure, through our Business Systems Renewal (BSR) program. During 2005/06, we completed a high-level design and detailed plan, which resulted in the adoption of a progressive implementation of new systems rather than the previously chosen single-step implementation process. While this will result in a longer implementation period, this more prudent approach will better manage delivery risk, including organisational impact, while realising progressive business benefits.

A year of growth

Medibank Private's first net increase in membership in four years was the result of:

- improved customer service, complemented by a refurbishment program within our network of 108 retail sites and expanded web capability at medibank.com.au to enable our members to access secure online claiming and other services;
- the outstanding performance of two new health insurance products introduced last year – *MyOptions*, designed to meet the needs of younger members; and *Priority*, a health cover combined with a well-being program for employers and corporate members;
- expanding our product offering to include the marketing of travel insurance. The Medibank Private branded travel product continued to exceed sales targets with approximately 20,000 policies sold since its launch in November 2005; and
- improved benefits offered to our members, such as waiving excesses and co-payments for children, and revamping our member rewards program.

Driving value for our members

For our fund members, we've been determined to ensure they receive the best possible value from their private health insurance. This is illustrated in the significant reduction in the growth in average premium rate increases to 5.9% in 2005/06, down by a third compared to two years ago.

Encouraging our members to adopt healthy lifestyles and take a proactive approach to their health continues to be a cornerstone of Medibank Private's organisational values. This year we launched a case management service for chronically ill members to improve their health and quality of life. We currently have 1,000 members enrolled in the program and plan to extend the offer to 40,000 members over the next three years, making it the largest initiative of its kind in private health in Australia.

A hospital stay can be a complex and worrisome experience for some. This year, Medibank Private introduced a member satisfaction survey to better understand members' hospital experiences. This will be shared with hospitals to improve the quality and safety of patient service delivery, and it will help us better assist members navigate and prepare for the hospital experience.

Medibank Private community and people

As part of our ongoing commitment to the community, we've joined forces with the AFL, Netball Australia and Cricket Australia to introduce Medibank Private 1Seven – a program to promote healthy eating and active lifestyles for Australian primary school-aged children, with the aim of making a positive impact on reducing the alarming increase in childhood obesity.

Medibank Community, our program encouraging employee community involvement, includes a half-day of paid volunteering leave each year. Our staff assisted our community partners by contributing around 1,000 hours of their time volunteering in their communities.

Our employees have embraced the challenge of continuous improvement and remained passionate about their desire to serve our members. They performed with dedication and loyalty, even with the uncertainty of the organisation's future ownership. I thank them for their outstanding commitment in 2005/06, and their contribution to an excellent financial result.

Our future

As the Federal Government has decided to sell Medibank Private, we have endeavoured to ensure the business is in the best condition to transfer to a new owner.

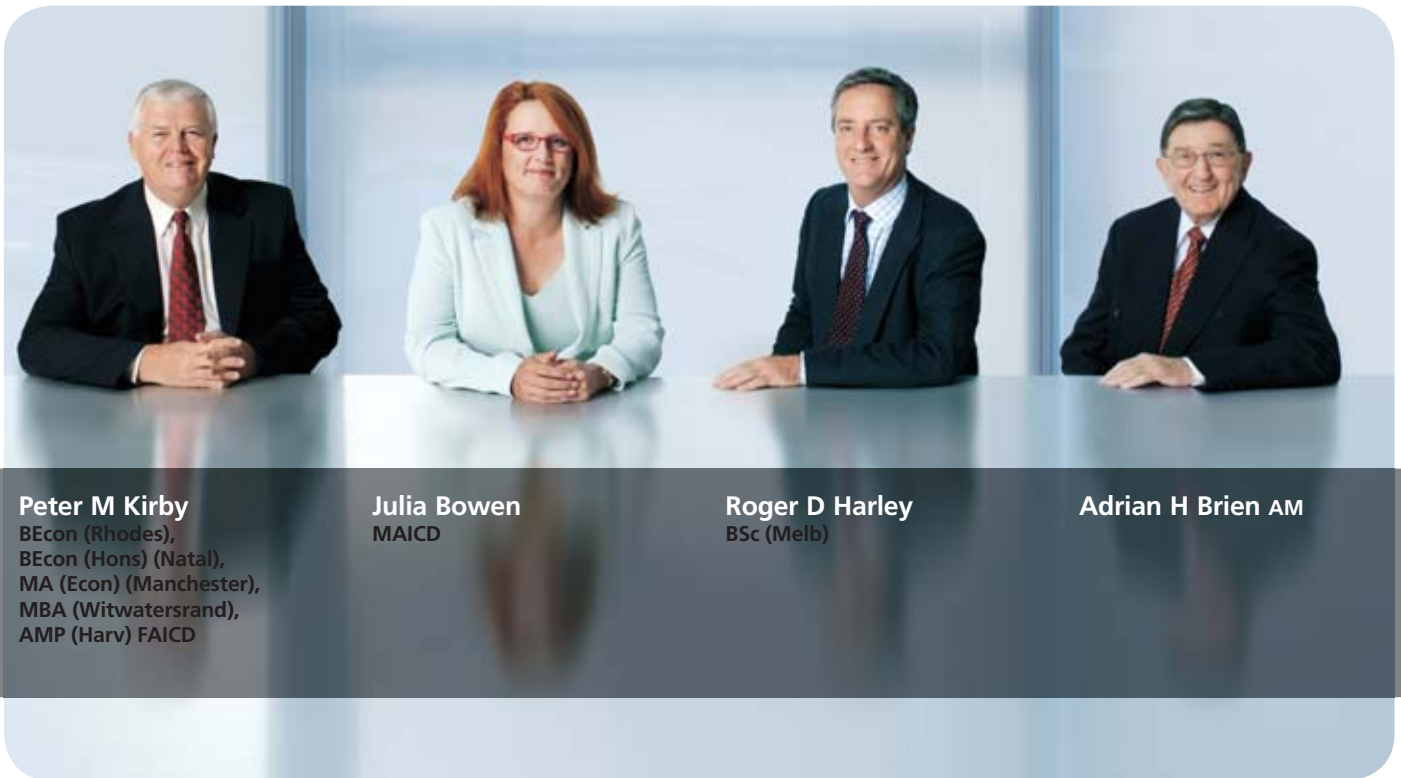
As we celebrate our 30th year, Medibank Private is performing strongly as Australia's leading health fund and the future for the company is bright. The changes we have made to improve business performance and customer service have been significant. We continue to focus on these areas through initiatives such as the BSR program.

We have a clear vision for our future and a robust, challenging corporate plan that will provide the discipline we need to further unlock the potential of this Australian business. Medibank Private will continue its commitment to be Australia's number one private health insurer, provide excellent products for our members and continue growing the fund for the benefit of our policy holders and stakeholders alike.



George Sawides
Managing Director

Board of Directors



Peter M Kirby
BEcon (Rhodes),
BEcon (Hons) (Natal),
MA (Econ) (Manchester),
MBA (Witwatersrand),
AMP (Harv) FAICD

Julia Bowen
MAICD

Roger D Harley
BSc (Melb)

Adrian H Brien AM

Non-executive Chairman

Appointed Director and Chairman from 8 February 2004. Current term expires 7 February 2007. Chairman of the Nomination, Remuneration & Human Resources Committee.

Mr Kirby has extensive corporate leadership experience internationally and in Australia and is currently a Director of Orica Limited; Macquarie Bank Ltd and Beacon Foundation (Tripartite Trading Pty Ltd). He is a Member of the Advisory Council of MIR Investment Management Ltd. Mr Kirby received the Centenary Medal in 2003.

Mr Kirby was formerly Managing Director and Chief Executive Officer of CSR Ltd and a member of the Board of the Business Council of Australia. Prior to joining CSR, Mr Kirby was Chairman/CEO of ICI Paints and a business director of the Imperial Chemical Industries PLC group ('ICI') based in the UK.

Non-executive Director

Appointed Director from 3 November 2003. Current term expires 2 November 2006. Chairman of the Business Enablement Committee.

Ms Bowen has executive and consulting experience in information technology and is currently an independent consultant.

Ms Bowen was formerly Director, Consulting Services, Asia Pacific, Cerner Corporation; and Systems and Programmes, Cable & Wireless Optus; Manager of business consulting group, Aspect Computing; and Support Program Manager for the Royal Navy Nuclear Submarine Weapons Systems.

Ms Bowen is a Foundation member of the Ernst & Young Worldwide Masters Program.

Non-executive Director

Appointed Director from 30 August 2004. Current term expires 29 August 2007.

Mr Harley has extensive investment banking experience with a track record as an adviser to a number of private and ASX-listed companies.

He is currently a Director of Fawkner Capital Management Pty Ltd; Member of Pooled Development Fund Registration Board (Venture Capital); Member, Funds Management Committee of the Industry Research & Development Board and Director of related investment holding companies. He is also Chairman, Yarra Bend Park Trust and Trustee, Alfred Deakin Lecture Trust.

Mr Harley was formerly Director Equity Capital Markets, Deutsche Bank Australia; and Director Corporate Finance, Deutsche Bank Australia.

Non-executive Director

Appointed Director from 26 June 2002. Current term expires 28 June 2008. Chairman of the Investment Committee.

Mr Brien brings to Medibank Private extensive corporate experience acquired over many years in private enterprise. He is currently Chairman, Equitrade Ltd; a Member of Pooled Development Fund Registration Board (Venture Capital); Trustee, Les Favell Cricket Foundation; and Life Governor, Flinders Medical Centre Research Foundation. Mr Brien received the Centenary Medal in 2003.

Former positions include CEO of Adrian Brien Automotive Group; Member, Board of Governors, Flinders University; and Member, Board of Management, Flinders Medical Centre, South Australia.



George Savvides
BE (Hons) (UNSW),
MBA (UTS), FAICD

Brian F Keane
FAICD, FAMI

**Johannes U (Just)
Stoelwinder**
MD (Monash), MBBS (WA),
FRACMA, FACHSE, FAFPHM

Peter B Wade
BComm (Hons), MA,
FCPA, FAICD

Managing Director

Appointed Director from 6 September 2001. Appointed Managing Director 1 April 2002. Current term expires 11 December 2008.

Mr Savvides has over 18 years' corporate leadership experience in the health care industry. He is currently a Board Member of AHIA (Australian Health Insurance Association) and International Federation of Health Plans. He is also a Director of World Vision Australia and World Vision International; Director of Australian Centre for Health Research Limited (ACHR); and Member Advisory Committee, Genepharma Ltd.

Mr Savvides was formerly Managing Director of Healthpoint Technologies Limited, Managing Director and CEO, Sigma Co Ltd and Managing Director, Smith+Nephew Pty Ltd, Australasia.

Non-executive Director

Appointed Director from 30 August 2004. Current term expires 29 August 2007.

Mr Keane has executive experience in corporate leadership and marketing in the insurance industry.

He is currently a Director of CSIRO; Lawcover Pty Ltd; Lawcover Plus Pty Ltd; Aurora Energy Pty Ltd; The Hollard Insurance Company Pty Ltd; and Chairman of MTA Insurance Agency Pty Ltd. He is a Member of the Australian Competition Tribunal.

Mr Keane was formerly CEO of AAMI Ltd; and Director of Royal & Sun Alliance Australia Ltd; TAB Ltd; AAI Ltd (Australian Pensioners Insurance); IEC Ltd; Motor Accidents Authority of NSW; and RAC Insurance Ltd.

He is a former Director and President of the Insurance Council of Australia.

Non-executive Director

Appointed Director from 26 June 2002. Current term expires 28 June 2008. Chairman of the Product, Benefits & Innovation Committee.

Professor Stoelwinder has extensive experience in medical and health care roles and is currently Chair of Health Services Management, Department of Epidemiology and Preventive Medicine, Monash University. He is also Acting Director, Centre for Health Economics, Faculty of Business & Economics, Monash University.

His former positions include CEO and Director of the Southern Health Care Network; CEO, Monash Medical Centre; Queen Victoria Medical Centre (Melbourne); Director, Private Health Insurance Administration Council (PHIAC); and Professor and Head, Health Services Management Development Unit, Flinders University, School of Medicine.

Non-executive Director

Appointed Director from 26 June 2002. Current term expires 28 June 2008. Chairman of the Audit & Risk Management Committee.

Mr Wade has extensive experience acquired over many years in both corporate and public sectors.

He is currently Chairman, Open Universities Australia Pty Ltd; Director, CASS Foundation Limited; The Knox School Ltd; and PhillipsKPA Consulting Pty Ltd.

Mr Wade was formerly General Manager, Monash University; Deputy Chairman, VicGrain Ltd; Director, Graincorp Ltd; and Director, Banksia Wines Ltd.

Directors' complete details and experience are located in the Directors' Report on page 42.

Our Management Team

George Savvides

Managing Director – Commenced role April 2002

George has over 18 years of experience in the health care industry, including former positions as Managing Director of Sigma; Regional Managing Director for Smith+Nephew; and General Manager CIG Healthcare. George was a Director on the Board of Medibank Private prior to being appointed in his current executive role. George is currently a Board Member of AHIA (Australian Health Insurance Association); Director of ACHR (Australian Centre for Health Research Limited); Councillor, International Federation of Health Plans; and non-executive Director World Vision International and World Vision Australia.

Simon Blair

Chief Operating Officer – Commenced role July 2002

Simon previously worked as Lead Health Specialist for the World Bank. Prior to that he was the CEO of Australia's largest public hospital group, the Inner & Eastern Health Care Network. As Chief Operating Officer, Simon is responsible for marketing, product, customer services, distribution, channel sales and the Strategic Business Units.

Tony Jones

Group Manager – Corporate Strategy & Communications Commenced role March 2005

Tony has over 15 years of experience in investment banking, including over ten years with Deutsche Bank AG, where he was co-head of their consumer, health care and leisure investment banking team in Australia and New Zealand. In this position, Tony worked with BRL Hardy, Simeon McGuigan, Sigma, Mayne, Aristocrat, Tattersall's, Sky City, AWB, ANZ and Utilicorp. At Medibank Private, Tony's division manages corporate planning, strategy development, regulatory policy and communications.

Bruce Levy

Group Manager – Health Services Commenced role June 2004

Prior to joining Medibank Private, Bruce had extensive experience in the health industry culminating as General Manager of the Alfred Hospital, for which he drove a financial turnaround, redeveloped models of care delivery and managed community interest groups. Bruce's Health Services Division encompasses claims processing, managing hospital and provider relations, driving member well-being programs, implementing quality and safety initiatives, and overseeing the \$2.5 billion health services expenditure by Medibank Private members. Bruce is also the Executive Business Sponsor of our Business Systems Renewal (BSR) program.

Heather Parkinson

Group Manager – Human Resources Commenced role August 2005

Heather has over 20 years of experience in people management and organisational development gained from senior roles with Ford, Coles Myer and, most recently, Pacifica Group Limited. Her division manages the company's human capital: development, training, continuous improvement, knowledge management and culture.



- 1 George Savvides
- 2 Simon Blair
- 3 Tony Jones
- 4 Bruce Levy
- 5 Heather Parkinson
- 6 Michael Sammells

Michael Sammells

Chief Financial Officer – Commenced role November 2005

Michael brings over nine years of health industry experience and 14 years of other industry experience, in both financial and operational roles, to his current position. He has worked in both the public and private sector. Previous roles include Mayne Group in Health and Logistics, Director of Finance and Corporate Services at Southern Health and, more recently, National Hospital Manager, Medibank Private. As Chief Financial Officer, Michael is responsible for the financial standing of the company and the actuarial services vital to our ongoing success.

1976

Medibank Private begins operations as part of the Federal Government's Health Insurance Commission.

1976

Medibank Private's entire retail centre network moves to online computerisation to become the world's largest computerised health insurance system at that time.

1981

Medibank Private claims the top spot as the largest health insurance organisation in Australia.

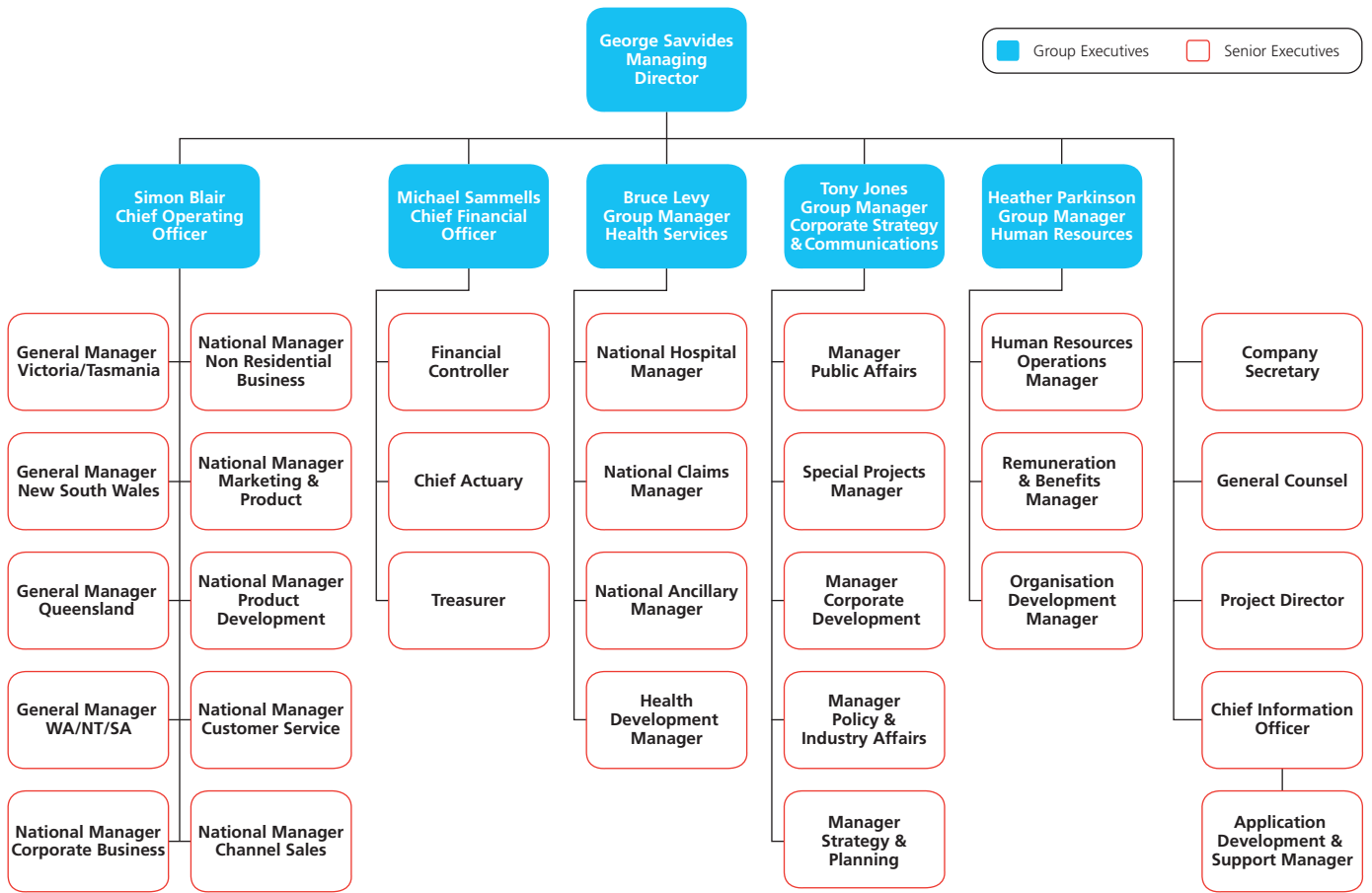
1986

Medibank Private begins its advocacy role, promoting preventative health measures as a major sponsor of the 'Life. Be in it.' campaign.

1990

The Medibank Private 'I feel better now' advertising slogan is first used.

Leadership structure



1998

Medibank Private is incorporated as a Government Business Enterprise.

2002

Medibank Private hits a financial low, posting a loss of \$175 million.

2005

Medibank Private completes the financial turnaround by posting a record \$131 million profit.

2006

Medibank Private achieves record business performance.



Our Results



We recorded a net profit of \$200.1 million for 2005/06.



2005/06 saw us achieve our highest membership growth in four years.

We delivered the second consecutive reduction in premium rate growth.

Our Results

Strong membership growth, an excellent uptake of new products and efficient fund management all helped to contribute to Medibank Private's solid financial results this year.

Over 200,000 new resident policy units sold this year.

Our underlying Management Expense Ratio of 9.0% is one of the lowest in the industry.

We entered the travel insurance market, marking a first successful stride into product diversification.

Profit results

Medibank Private recorded a net profit of \$200.1 million for 2005/06. This represents a 53.1% increase over last year's result and the fourth successive year of significant improvement in our financial performance (refer to page 2).

Importantly, this strong profit result was driven by an underwriting profit after expenses of \$100.2 million, which represents a margin of 3.5%. This is the second consecutive year that Medibank Private has posted a positive underwriting return off the back of three consecutive years of losses, and is further evidence of the completion of Medibank Private's financial turnaround. Underwriting margins now place us in a competitive position in relation to other health funds.

Medibank Private's investment portfolio earned \$97.9 million, a return of 7.5%. This result is due to the strong returns our balanced portfolio received from Australian and global equity markets. As the financial strength of Medibank Private increased, we were able to place more funds into growth assets.

Medibank Private's premium revenue of \$2.84 billion was an increase of 9.1% over last year. In terms of benefit outlays, Medibank Private continued to contain costs by negotiating cost-effective purchasing of hospital and ancillary services on behalf of our members. This resulted in a significant reduction in the annual growth rate in hospital benefits paid per policy unit from 11% to 8% over the past two years.

Fund management

The efficient and prudent management of member contributions is one of Medibank Private's highest priorities. Our Management Expense Ratio (MER) for 2005/06 was 10.4%. This was impacted by both the operating costs being expensed and the writedown in asset value of the Business Systems Renewal (BSR) program, our IT infrastructure replacement initiative. When the cost impact of BSR is excluded, the underlying MER for the business is 9.0%, which continues to be one of the lowest in the industry. This has been achieved while we have continued to invest in our retail network, customer service function, the Medibank Private brand and our sales capability.

As a result of strong fund management, Medibank Private was able to deliver to members the second consecutive reduction in premium growth, with average premium rate increases of 5.9%.

The excellent result for 2005/06 sees Medibank Private with a strong balance sheet and a sound capital adequacy position. This provides surety that the fund is comfortably positioned to meet all our future benefit obligations and that we can continue to return further value to our stakeholders.

Membership growth

A significant contribution to Medibank Private's profit result was the strong performance in membership growth.

We achieved our highest membership growth in four years with over 200,000 new resident policy units sold, a 34% lift on 2004/05 figures. In addition to attracting new members, we achieved a 3% reduction in member lapses for the year, another record result that reflects three consecutive years of retention performance improvement. By year end, the fund had a net increase of 76,718 resident policy units.

While all states grew strongly, ahead of both plan and stretch targets, exceptional growth was recorded in Queensland and Western Australia. Strategies that contributed to the solid performances of these states included: better alignment of retail centres with population and traffic volumes; a stronger focus on sales; and targeted retention programs to reduce member lapse rates.

Medibank Private's strategies for membership growth have focused on two core themes: attracting new members through targeted marketing and communications campaigns, and retaining existing members by delivering excellent service and value. These strategies have been delivered through a combination of well-executed and integrated campaigns covering marketing, service delivery improvement, improved member communications and better product value.

In November 2005, following a successful six-month pilot in Western Australia, we started marketing travel insurance nationally – effectively expanding our product range. This first stride into



Keeping premium rate growth down in an environment where health care costs have risen faster than the Consumer Price Index (CPI) in recent years is the challenge. We are succeeding.

diversification has been very successful, with sales of 19,540 policies since the product launch. Medibank Private now markets 1.5% of sales in the travel insurance market with a continued growth outlook. Significantly, 90% of people who took out Medibank Private branded travel insurance already had their health insurance with us. This highlights not only the strength of the Medibank Private brand and the loyalty it inspires, but also the enormous potential for Medibank Private to pursue product diversification with our member base in the future.

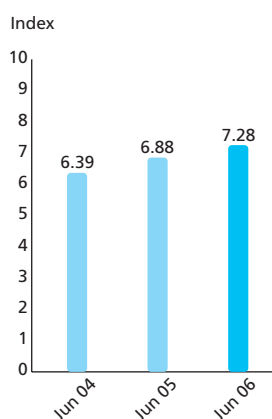
Our brand

Medibank Private, a well-known Australian brand, continues to be the most recognised brand in the Australian private health insurance sector.

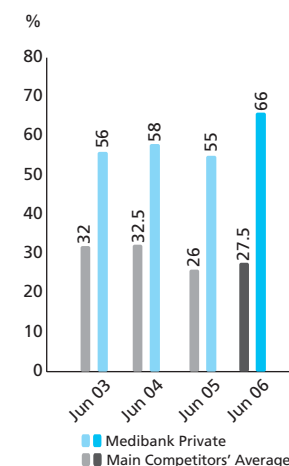
The Medibank Private brand has continued to go from strength to strength during the year. Research on brand awareness found 66% of consumers aware of the Medibank Private brand. Our research shows Medibank Private's awareness levels are higher than our two nearest competitors combined. For the majority of people, Medibank Private is the first health fund they think of – a testament to the strength and value of the Medibank Private brand.

In addition, the Medibank Private brand scored 7.28 out of a possible 10 on our brand value index, which indicates positive member perceptions of the fund. Member satisfaction with Medibank Private remains strong and continues to grow, with an overall satisfaction rating of 83.2% at the end of June 2006.

Medibank Private brand value index on the rise



High brand awareness





Our Business Performance

Initiatives to expand our member base and retain existing members in a highly competitive industry remained key this year, as evidenced by the introduction of online extras claiming in February 2006.

Our Business Performance

At Medibank Private, our members are the focus of everything that we do. To create better value for them, and to drive their health dollar further, we strive to continually improve our products and services, keep the cost of premium growth down and deliver excellent value-for-money health protection.

Our website continued to be the most popular in the private health insurance category, with 2 million visits in 2005/06.

During 2005/06, we significantly reduced the rate of increase in the cost of hospital benefit outlays.

Our BSR core system replacement program will deliver long-term benefits.

Containing premium growth

The cost of health care continues to rise in Australia and throughout the developed world. New technologies, ageing populations and the massive costs of research are just some of the reasons. One example that illustrates all three is the pacemaker. A traditional pacemaker, used to assist people suffering from heart disease, costs around \$4,500. The latest pacemaker, which incorporates a built-in defibrillator that can automatically 'kick-start' the heart should it stop beating, costs around \$60,000 – more than thirteen times the cost of the old model! The new features are suitable for only a percentage of patients, however early indications show it may be selected for many patients outside this core group.

The challenge for Medibank Private is to keep down the cost of premium growth in an environment where health care costs have risen faster than the Consumer Price Index (CPI) in recent years. Medibank Private has responded to this challenge and delivered on our commitment to reduce premium rate growth for the second consecutive year.

Smarter purchasing

The sustainability of Medibank Private and our ability to contain premium growth depends on our effectiveness in purchasing health services on behalf of members. In early 2005, Medibank Private introduced a new 'hospital purchasing strategy' to address the rapid growth in costs associated with hospital care. Put simply, the objective of this purchasing strategy was to achieve the best possible value on behalf of our members.

During 2005/06, the benefits of our purchasing strategies have begun to be realised. We have significantly reduced the rate of increase in our hospital benefit outlays which account for 60% of total outlays. At the same time, new quality and safety guidelines have been incorporated, adding further member value.

This reduction in the growth of benefit outlays has translated into the growth of premium rate increases continuing to be reduced.

Harnessing new technology

In a highly complex national business such as our own, it is vital that we adopt appropriate innovative technologies that can provide sophisticated solutions to facilitate our growth and meet the needs of our members.

Business Systems Renewal (BSR) program

Medibank Private has continued our comprehensive investment in replacing our 20-year-old core business IT infrastructure through a project known as the Business Systems Renewal (BSR) program.

Commenced in 2005, the project will be implemented over a number of stages to provide a new generation of information technology. BSR will streamline claims processing and the overall management of a large and diversified portfolio of business activities, and enable us to bring new products to market with greater speed and certainty. It will provide Medibank Private with the capacity to not only be more innovative, but to also respond rapidly to an ever-changing business environment.

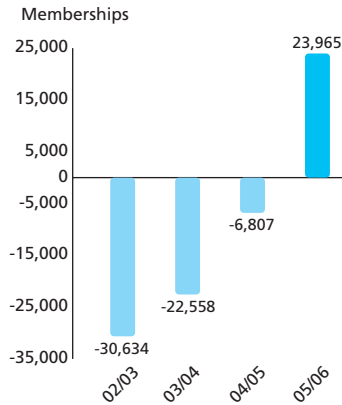
After comprehensive analysis, high-level design and detailed planning throughout 2005/06, a phased, progressive implementation of the new systems was adopted, rather than the previously identified single-step implementation process. While this will result in a longer implementation period, this more prudent approach will better manage delivery risk, including organisational and member impact.

This new implementation strategy has resulted in a rework of some of the analysis and design that had occurred earlier in 2005/06 and adjustments to the carrying value of our BSR assets have been made.

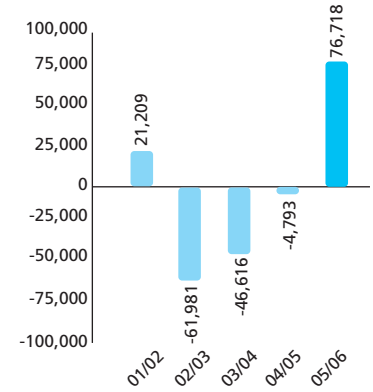
Under the new direction, the BSR program will start to impact positively on our day-to-day business in 2007/08. Benefits will in some cases be quite tangible, such as the anticipated reduction in our management expenses. However, it is the long-term strategic benefit that will flow from this generational business systems change that will deliver enduring gain for Medibank Private's way of doing business.

Our Business Performance continued

Net membership growth



Net increase in resident policy units



Online claim services

Medibank Private's website continues to be the most popular in the private health insurance category. In 2005/06, we had more than two million visits to the website, a 30% increase over the previous year.

More than \$15 million in premiums and more than 32,000 renewals were processed online in 2005/06. In addition, sales of health cover policies online grew by more than 35% over the previous year. The capability of our website was expanded during the year to enable members to buy travel insurance and receive tax statements and other important communications.

In February 2006, Medibank Private made further advances to our online member services with the introduction of online extras claiming. This new service gives our members the ability to submit a claim online for many of their extras services without having to submit a receipt. To date, over 18,000 items and \$1.5 million have been claimed through this service, with an average processing and reimbursement clearance time of three hours from receipt. In July 2006, the service was further enhanced to enable members to request that any PackageBonus entitlements they may have are used to reduce their gap. The facility will be further refined later this year to enable Electronic Funds Transfer payments for paid claims. The growth of our online member services is set to continue with the commencement of promotion of the new service in July 2006.

The Medibank Private website continues to increase in importance as a convenient information exchange for both our members and the business.

Scanning technology

In September 2005, while progressing the BSR program, we introduced new scanning technology that facilitated claims being processed without the need for manually keying in data. Known as the imaging and workflow project, this initiative helped reduce costs and increased the speed and accuracy of claims payments. The benefits associated with this technology will flow into our broader BSR program.

Faster claiming for hospitals and providers

Allied to our internal technological developments, Medibank Private has also participated in an industry-wide initiative that provides a secure electronic link for organisations involved in the health care billing process, including medical practitioners, billing agents and hospitals, Medicare Australia and health funds.

Known as 'eclipse', Medibank Private is already using this information processing system for online patient eligibility verification. Eclipse's role is set to grow as it is integrated with our BSR program to speed Medibank Private's settlement of medical and hospital claims.

Managing risk

While the vast majority of the 90,000 health service providers to whom we make payments do the right thing, Medibank Private has appropriate benefit risk management practices in place to monitor and protect against potentially fraudulent, as well as inappropriate, claims submissions.

Working with specialist investigators to identify inappropriate claiming activity, such as fraudulent multiple claims or over-charging for services, we have been able to influence improved compliance and reduce inappropriate behaviour, as well as recovering monies that were falsely claimed. This exercise and ongoing monitoring yielded approximately \$27 million in savings for 2005/06.

Another important initiative in managing the Medibank Private risk profile has been the focus of the business to ensure a balanced age profile exists within the Medibank Private membership base. Through the community rating system, all members on the same rating product are charged the same premium equally regardless of age, lifestyle or pre-existing medical conditions. Essential to the future viability of any health fund is the need to maintain a balanced member risk pool capable of delivering effective cross-subsidisation of the elderly and sick with the young and healthy. This mix helps maintain the affordability of private health insurance for all members within a community rating system.

Product innovation

The introduction of new products and improvement of existing ones has been critical in attracting new members and retaining existing members through increased member satisfaction.

Medibank Private understands how important it is for families to have access to high-quality, flexible, health insurance and we continue to make the health needs of families a priority. In March 2006, Medibank Private added the 'no excess for children' feature to all stand-alone hospital products – a benefit that was previously available only to members on 'PackagePlus' hospital covers. In addition, Medibank Private introduced 'no daily co-payments' for children treated in Members' Choice hospitals. These important initiatives have enabled Medibank Private to ease the burden of health care costs for Australian families. More than one-third of Medibank Private's members benefited from these enhancements which can save hundreds of dollars per hospital admission.

In May 2006, Medibank Private introduced a 'private room guarantee' for members who have PremierPlus and *Priority* products. This means members on these covers will enjoy the benefits of a private room for their hospital stay at a Members' Choice hospital. In the unlikely event this does not occur, the member will receive a one-off payment. It's Medibank Private's way of recognising the value to members of a private room when they require hospital treatment. Also in May, Medibank Private expanded our range of overseas visitors cover products with the launch of Executive Visitors Cover and Basic Visitors Cover. These products have proven popular with those on working visas and international visitors seeking a low-cost health cover option.

Two products launched during 2004/05, *MyOptions* and *Priority*, have been tremendously successful. Together, they accounted for almost 20% of our new sales in 2005/06.

MyOptions is a product targeted at singles and couples under 35. *MyOptions* has exceeded expectations with 90% of sales to the target demographic and overall sales 70% ahead of forecasts.

The *Priority* range, introduced in May 2005, has also been a star performer during the year and has quickly earned the reputation as leader in the corporate health cover market. Developed with the needs of the corporate sector in mind, *Priority* offers health cover and a well-being program for employees, along with measurement and intervention tools for employers to track and improve their employees' health. An excellent product, combined with an integrated corporate communications and marketing campaign targeting employers, human resource professionals and employees, has given Medibank Private access to over 135,000 employees nationwide and helped achieve the ambitious sales targets set for the 2005/06 financial year.

Attracting members

A key focus for Medibank Private this financial year has been to continue to grow our membership base, and ambitious sales targets were set to that effect. We undertook a number of strategic marketing and sponsorship activities aimed at driving membership growth, including:

- *MyOptions* campaign – this integrated national marketing campaign targeted young singles with the tag line 'you don't have to be sick to benefit'. This campaign directly contributed to sales of this product exceeding forecasts.
- Medibank Private International Tennis Tournament – as the major sponsor of this nationally-televised Sydney-based event, we reach

millions of Australians and receive extensive brand exposure.

This year the sponsorship was fully integrated with a national advertising campaign, further extending its effectiveness in attracting new members.

- Family campaign – in May 2006, Medibank Private initiated a new, nationally-based family campaign to drive sales by attracting new, young families to the fund. The campaign positions Medibank Private as the 'family-friendly' fund through print, radio, television and editorial coverage.
- Competitive market offers – a number of state-based campaigns were executed throughout the year, often combining tailored promotional offers relevant to the local market and providing a competitive edge for our sales teams.
- Maintaining brand awareness through sponsorships – Medibank Private continued successful sponsorships with the Melbourne Storm rugby league club, the Melbourne Tigers basketball team, the Adelaide Thunderbirds netball team and the West Coast Eagles football club, achieving the objective of both generating brand awareness and encouraging physical exercise.

Member retention

In addition to attracting new members, Medibank Private has worked hard to improve member retention in a highly competitive industry.

feelbetter Rewards program

In February 2006, Medibank Private relaunched our member loyalty rewards program, known as 'feelbetter Rewards', where members can purchase discounted products and services in the areas of health and well-being, leisure and lifestyle, and travel and entertainment.

The relaunched program has a much broader range of products and services and a greater emphasis on health and well-being products, such as special discounts on fitness equipment, fitness memberships and weight loss programs. This program is cost-neutral – which means it does not add to the cost of members' contributions, providing extra value to members for being with Medibank Private.

Welcoming our new members

In January 2006, we introduced a Medibank Private 'welcome-pack' to formally welcome our new members to the fund. The welcome-pack contains information designed to help new members understand Medibank Private and the health care process and provides information such as our Member Service Charter, how to get started, how to make a claim, managing out-of-pocket expenses and how to get the most out of the Medibank Private PackageBonus feature.

Learning from our members

As part of many strategies underway to improve member retention, Medibank Private has established a team to deal exclusively with members who have indicated an intention to leave the fund.

Specially trained staff in the 'save team' find out why the member is dissatisfied and wishes to leave and then delivers the most appropriate intervention to retain the member. This may involve explaining how the member can make better use of their health plan or find a more suitable plan that better meets the member's needs.

This initiative has contributed to \$9.6 million in retained premium value over the year. Ultimately, Medibank Private will use the information gained from this program to develop long-term proactive strategies to improve retention and continually improve our member services.

Our Members



Member satisfaction with our overall service delivery reached a record high of 83.2%.



Our member contact centre receives almost 6,000 calls and 4,500 service transactions each day.



Our Members

Our business is about serving our members – providing them with friendly, efficient service and helping them to protect or restore their good health. This year, we took great strides in improving the way we serve our members and introducing initiatives that will better support members to live healthy lifestyles.

Our Members' Choice network is the largest of its kind in Australia.

Our first contact resolution rate across both retail sites and member contact centre was 87.3%.

Medibank Private remains committed to delivering strongly on all the promises contained in our Member Service Charter.

Excellent delivery of member services

During the year, Medibank Private continued to refine and improve the service and value we deliver to our members. Providing our members with excellent service and ensuring they receive value from their private health insurance is critical to inspiring member loyalty and maintaining our membership base.

Customer service – setting new benchmarks

Improving existing services for our members has been a priority for Medibank Private this year and has had a positive impact on member retention. Also contributing to our overall net membership growth was a 3% reduction in the number of lapsed members for the year, taking the number of lapses to the lowest in Medibank Private's recent history.

The importance of our member contact centre continues to grow. It receives almost 6,000 calls and processes 4,500 service transactions each day. First contact resolution through our contact centre reached an all-time high of 83.2%, up 15% on last year. At the same time, Customer Service Officer productivity measured by calls per hour increased by 10%.

Overall, member satisfaction with service delivery through both the contact centre and retail sites reached a record high of 83.2% in 2005/06, while our first contact resolution rate across both these channels was 87.3%.

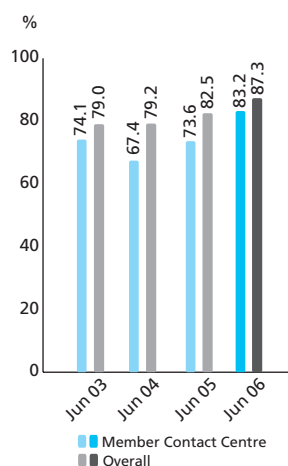
Member satisfaction is one of the highest priorities for Medibank Private. In those instances where our members disagree or are dissatisfied with an outcome, they have the option of having their concern reviewed by Medibank Private, or externally through the Private Health Insurance Ombudsman. In 2005/06, Medibank Private received 19% fewer complaints; in addition, the Ombudsman recorded an 18.8% reduction in complaints in relation to Medibank Private.

Over the coming year, Medibank Private plans to introduce improvements to our telephony systems that will give us greater technological sophistication and more capability. This will result in further increases in member satisfaction through improved interaction and better segmentation, as well as greater efficiency.

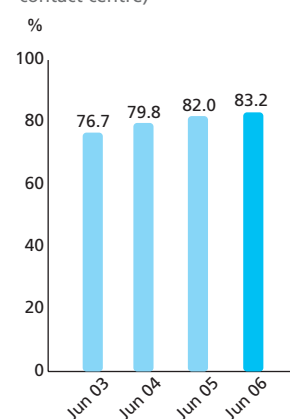
In the past year, Medibank Private expanded our retail network – already the largest network in the private health sector in Australia – by opening a further seven retail sites. In addition, a further 24 stores were upgraded or extensively refurbished during the year. Our national retail network team across 108 sites is now better equipped than ever before to drive sales, create a positive member experience and improve member retention.

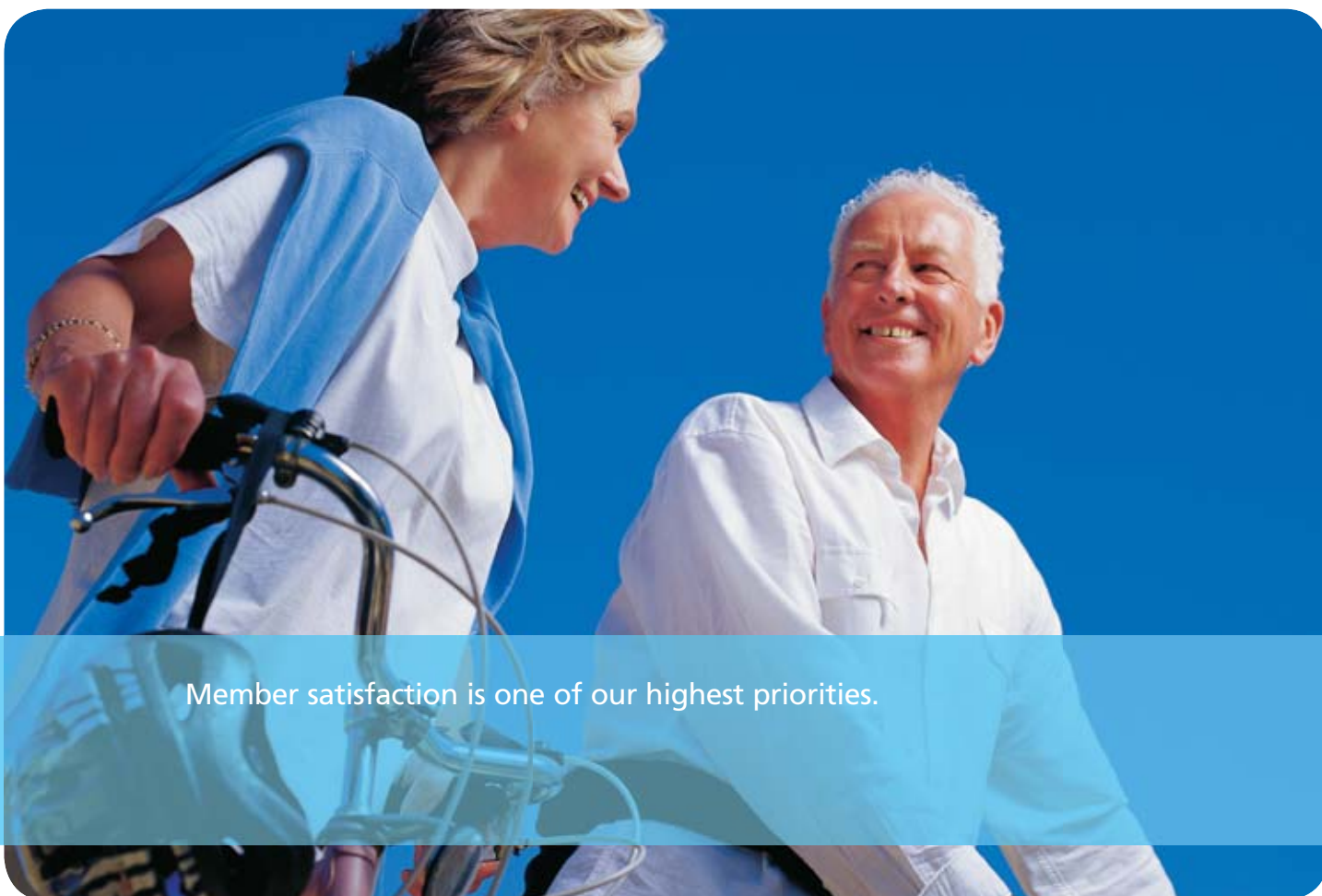
Medibank Private remains committed to the Member Service Charter we adopted in January 2005, which outlines our commitment to delivering service excellence to our members. Our performance against the Charter was audited for 2005/06 and the results are contained in Our Sustainability Report on page 34.

First contact resolution



Overall member satisfaction (Retail sites and member contact centre)





Member satisfaction is one of our highest priorities.

Better choice for members

Our Members' Choice network has more than 4,000 Members' Choice health care provider locations throughout Australia. In January 2006, we more than doubled the number of contracted optical retail outlets to over 600 stores nationally. New customer service standards have been incorporated into contracts to ensure our members are informed of discounts, so that they can get the very best value out of their health cover. As a result of the expanded optical network, our members now have significantly improved access to Members' Choice optical deals, which includes the availability of a selection of frames and lenses with no out-of-pocket costs for most members.

Ensuring positive health outcomes for our members

Medibank Private is committed to supporting and encouraging our members to achieve good health. Following three successful pilots this year, we launched the Medibank Private *betterhealth* program suite, which features the 'on call', 'on track' and 'online' programs to support members to better manage their health and achieve their health goals. Over the coming year, additional programs will be added to the *betterhealth* program suite.

***betterhealth* 'on call' program for members with chronic diseases and health risks**

This telephone-based disease and case management service is part of the *betterhealth* program suite and was launched in December 2005 for members with chronic conditions such as congestive heart failure, chronic obstructive pulmonary disease and coronary artery disease.

Working with a registered nurse, program participants complete a telephone assessment and then receive regular phone calls to provide information and advice in relation to their particular health conditions and assistance with self-management. An action plan may be developed if they do not already have one provided by their doctor. Participants also have access to a 24-hour, seven-day-a-week health-support line, provided by registered nurses. The program helps members to better manage their health conditions, improve knowledge of their disease and improve their quality of life.

More than 1,000 members are currently enrolled in this program and we plan to extend the offer to 40,000 members over the next three years. The 'on call' program will improve the health of some of our most vulnerable members, as well as mitigating the rate of increase of our current hospital claims costs.

Our Members continued

betterhealth 'on track' diabetes management program

Diabetes is one of the fastest-growing chronic diseases in Australia. With small lifestyle changes and regular health checks, many people with diabetes can avoid hospital visits relating to the management of their diabetes, relieving pressure on the health system and the cost of managing the disease.

In July 2004, in conjunction with the International Diabetes Institute, Medibank Private commenced a 12-month pilot program to support members to better manage their diabetes. The results of this program, which were finalised this year, showed statistically significant improvements in diabetes control and in risk factors such as cholesterol and weight.

The program also resulted in a 16% decrease in hospital admissions during the intervention period for the 295 participants.

Members reported having a better understanding and awareness of their diabetes as a result of taking part in the program. Members also reported discussing this feedback with their doctor and feeling more confident about talking to their doctor about their diabetes management.

This program will be made available as a core part of Medibank Private's *betterhealth* program suite from late 2006.

betterhealth 'online'

This online program, part of the *betterhealth* suite of initiatives, was launched in August 2006 following the completion of planning work in 2005/06. The program is closely linked to the *feelbetter* rewards program.

A focus on hospital quality and safety

Medibank Private is committed to ensuring our members receive the best possible health outcomes. We expect our hospital partners to provide services in a professional way that is both ethical and complies with best practice quality and safety in the health care sector. To this end, we have a number of initiatives underway that will encourage continual improvement in the way health services are provided.

Contracting quality and safety with hospitals

As part of negotiations with hospitals, in addition to securing a competitive, fair price for services to members, Medibank Private incorporated into the agreements a Quality and Safety Framework. As well as minimum requirements, the framework requires hospitals to put into practice the recommendations of the Australian Council for Safety and Quality in Health Care and evaluate their performance against other providers.

Medibank Private Safety and Clinical Improvement Incentive Pool

Medibank Private this year committed more than \$900,000 to an Incentive Pool that will fund hospitals to support innovation and excellence in patient care and encourage the sharing of best practice. In April 2006, the Medibank Private Safety and Clinical Improvement Incentive Pool awarded grants to 34 hospital projects, following a total of 84 submissions. Examples of initiatives funded include:

- the implementation of medication management guidelines in a small rural private hospital;
- the establishment of an expert nurse version of the medical emergency team; and
- the implementation of a transfusion nurse specialist to provide expert training and monitoring.

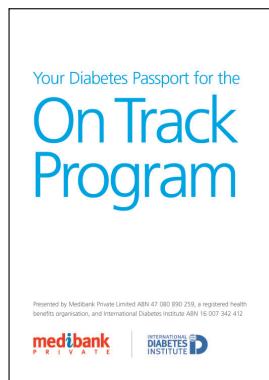
A full list of hospitals and projects is outlined in Our Sustainability Report, on page 33 of this report.

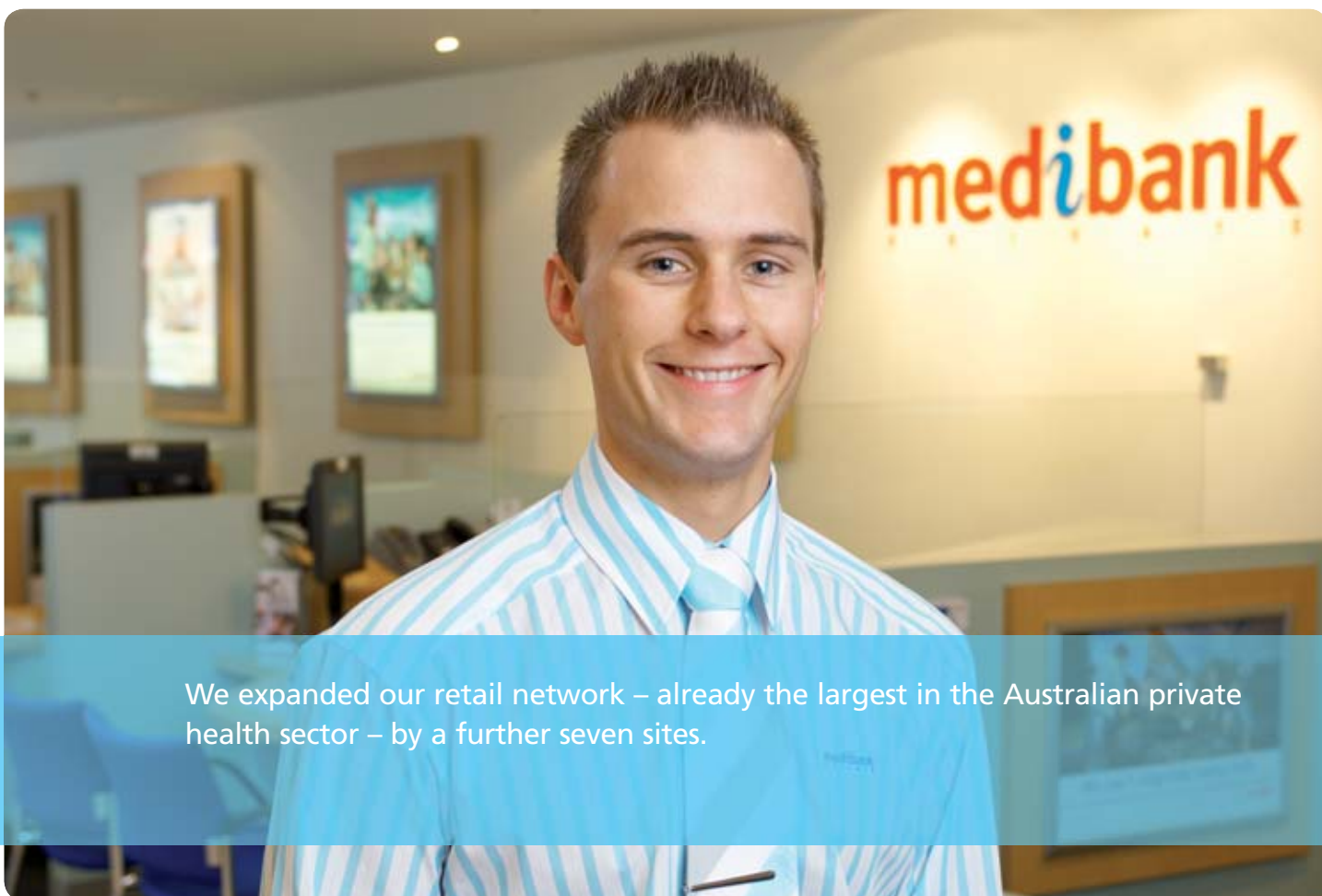
The Incentive Pool is a natural extension of the quality and safety requirements that have been embedded in contracts Medibank Private has in place with our Members' Choice hospital providers.

The findings will be shared with both the industry and the public to promote awareness of effective interventions across the private hospital sector and the broader Australian health care sector. A further pool of \$1 million will be available in 2007 to continue this initiative.

Member 'hospital experience' surveys

Listening to our members is a critical part of ensuring that our members' health care experience meets their expectations. To assess how we and the hospitals are performing, Medibank Private commenced regular surveying of our members to find out more about their hospital experience. The aim of the surveys is to improve the quality of care our members receive in hospitals and the quality of customer service Medibank Private provides during their hospital experience. This insight into our members' experience will help us to continually improve the health care and service that our members receive.





We expanded our retail network – already the largest in the Australian private health sector – by a further seven sites.

Retail sites

ACT

Belconnen
Civic
Woden

NSW

Albury
Armidale
Bankstown
Blacktown
Bondi Junction
Broken Hill
Brookvale
Burwood
Campbelltown
Castle Hill
Charlestown
Chatswood
Coffs Harbour
Dubbo
Erina
Haymarket
Hornsby
Hurstville
Lismore
Liverpool
Martin Place
Miranda

North Ryde
North Sydney
Orange
Pagewood (Eastgardens)
Parramatta
Penrith
Tamworth
Tuggerah
Wagga Wagga
Wollongong

NT

Casuarina

QLD

Brisbane
Broadbeach
Browns Plains
Bundaberg West
Cairns
Capalaba
Carindale
Chermside
Elanora
Gladstone
Helensvale
Indooroopilly
Ipswich

Kippa-Ring
Loganholme
Mackay
Maroochydore
Mitchelton
Rockhampton
Southport
Toowoomba
Townsville
Upper Mt Gravatt

SA

Adelaide
Elizabeth
Marion
Modbury
Unley
West Lakes

TAS

Glenorchy
Hobart
Kingston
Launceston
Rosny

VIC


Airport West
Ballarat
Bendigo
Broadmeadows
Camberwell
Chadstone
Cheltenham
Dandenong
Doncaster
Elsternwick
Epping
Forest Hill
Fountain Gate
Frankston
Galleria Melbourne
Geelong
Glen Waverley
Greensborough
Maribyrnong
Pahran
Preston
QV Melbourne
Ringwood
Shepparton
Traralgon
Wantirna South
Warrnambool

Watergardens
Werribee

WA

Booragoon
Cannington
Fremantle
Joondalup
Karrinyup
Midland
Morley
Perth
Whitford

Our People



Medibank Private is committed to developing the leadership skills of today's and tomorrow's leaders.



We believe that to be the best, we need every employee working towards our common goal of being the leader in private health insurance in Australia.

In the past year, 55 staff completed customised leadership development programs.

Our People

At Medibank Private, we're proud to serve the health and well-being needs of the three million people we cover across Australia. This is the heart and soul of what we do. Key to performing well in a service-based industry is ensuring that we recruit and retain the best people. After all, it's our own employees who provide our members with exceptional service. It's our employees who enable us to be the industry leader. And it's our employees who give us the edge in a highly competitive industry.

At Medibank Private, we believe you never stop learning.

We have developed exceptional customer service through a comprehensive 'service edge' training program.

This year we began planning an executive development program for our most senior leaders.

Alignment – the way of the future

To be the best in the field, we understand that we need every employee – frontline staff, support staff, managers and executives – sharing and working towards our common goal of being the leader in private health insurance.

To this end, we've embarked on a very exciting journey that will enable us to improve the way we work. In January 2006, we began to work towards a vision of achieving a unified, harmonious organisation where our people, business structures and goals are fully aligned. The alignment project is expected to take place over a period of two years. At the end of this period, we will have tapped deeper into Medibank Private's potential to become a collaborative, member-focused and high-performance organisation.

An organisation of great leaders

Great leaders inspire a culture of innovation, customer focus and exceptional performance. For this reason, Medibank Private is committed to developing the leadership skills of today's and tomorrow's leaders.

In 2005/06, 55 staff completed our customised leadership development programs designed to enhance professional development, refine leadership skills and manage the transition to, or performance in, the role of a leader. A further 35 staff have commenced these leadership programs this year.

At Medibank Private, we believe you never stop learning. This year we began planning an executive development program for our most senior leaders. The program will support the executive-level Medibank Private managers to further develop their individual leadership skills and to better utilise the capacity and ability of their management teams.

Capitalising on our talent

In an increasingly tight labour market, organisations must find new and innovative ways to manage their talent if they are to continue to succeed and lead in their industry.

In February 2006, Medibank Private introduced a new system to better equip us to respond to the challenges of today's labour market conditions. Medibank Private's talent-succession strategy is centred on four key platforms:

1. Organisation-wide succession planning – planning today for tomorrow's leadership and skill needs.
2. Fully understanding the capability we have within the organisation.
3. Identifying our high-potential employees so we can invest in their career development.
4. Identifying roles where risk of staff changes could damage the business, and so develop strategic initiatives to mitigate these risks.

In addition to developing a fully integrated approach to managing labour force issues, Medibank Private introduced appropriate human resource technology systems that will enable us to implement and deliver against our talent succession planning objectives.

Supporting our people to adapt to new technology

Medibank Private's Business Systems Renewal (BSR) program is a comprehensive business transformation initiative, combining multiple technology implementations and significant process redesign.

To ensure the successful implementation of this program, we will engage our staff as the business embraces this change.

Giving our people the sales edge

Medibank Private has invested over several years in building our customer service expertise through a comprehensive 'service edge' training program. Our 'service edge' program saw us as a finalist in the Australian Human Resources Institute (AHRI) Awards for people management.

Over the past year, Medibank Private has expanded the 'service edge' training program that customer service staff regularly undertake. Introduced in July 2005, the revamped program has a much stronger sales focus that will support our people to develop and refine the skills required to maximise sales, as well as continue to deliver exceptional customer support. The program is one of the first in Australia to utilise the latest sales research, drawn from best practice sales organisations globally, to further develop and refine our sales capability.

As well as providing the skills to generate a sales-focused culture, Medibank Private has restructured our remuneration and benefits to better recognise and reward sales effectiveness by teams and individuals.

Our people – our sustainability

A core strategy to delivering quality service is to provide a workplace in which our people can engage. Details of workforce diversity and staff community engagement programs are contained in Our Sustainability Report from page 30.

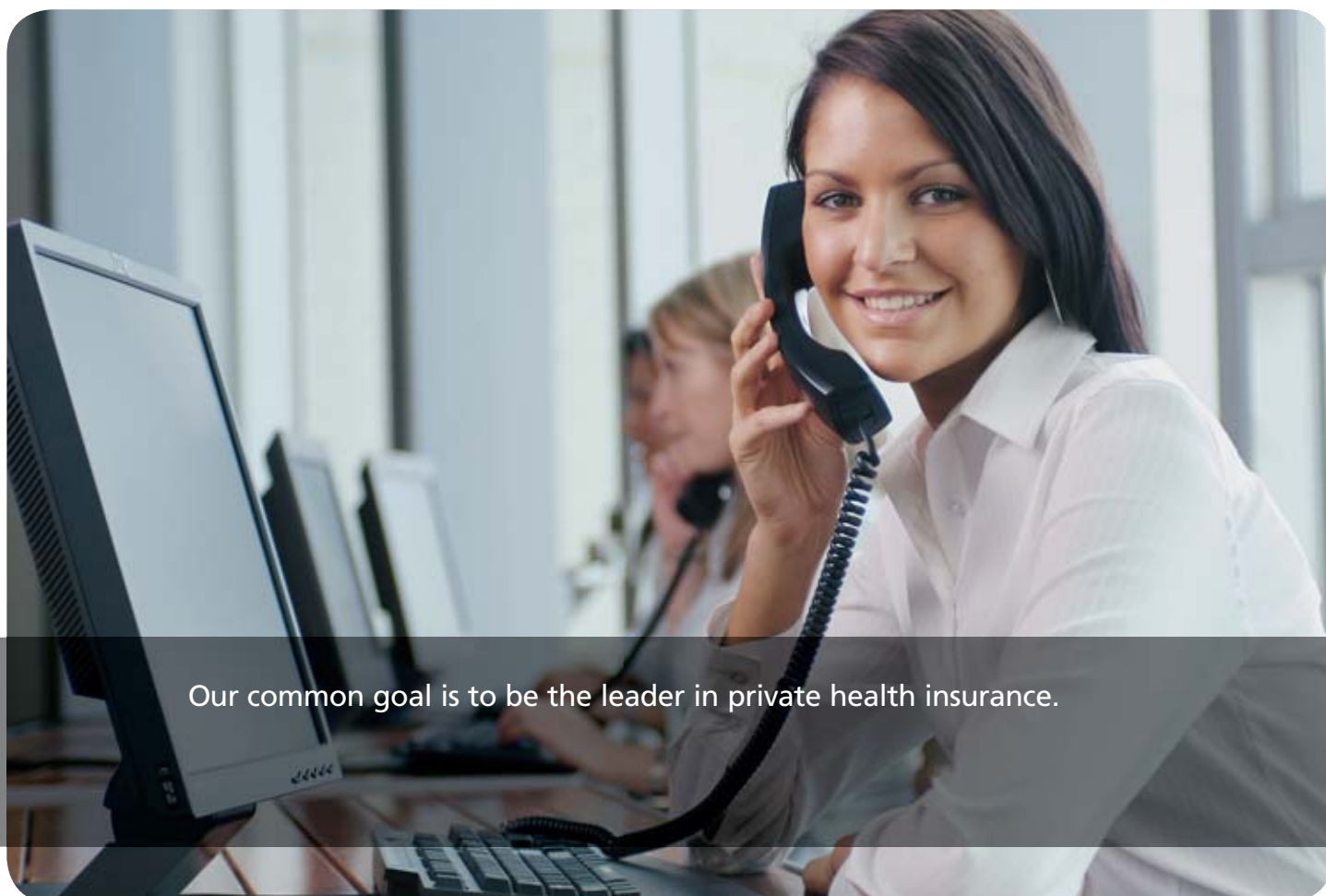
Continuous improvement ingrained

Following the creation of the Quality Action Teams in 2002, which empowered staff to solve business problems or identify business improvement opportunities, Medibank Private has developed this approach further to streamline the way we work and ensure the best possible service delivery for our members.

The new approach is based on Lean and Six Sigma business process frameworks – while originally associated with manufacturing, the potential for this approach to improve the quality and consistency of the member experience has made this a successful approach in service industries like ours.

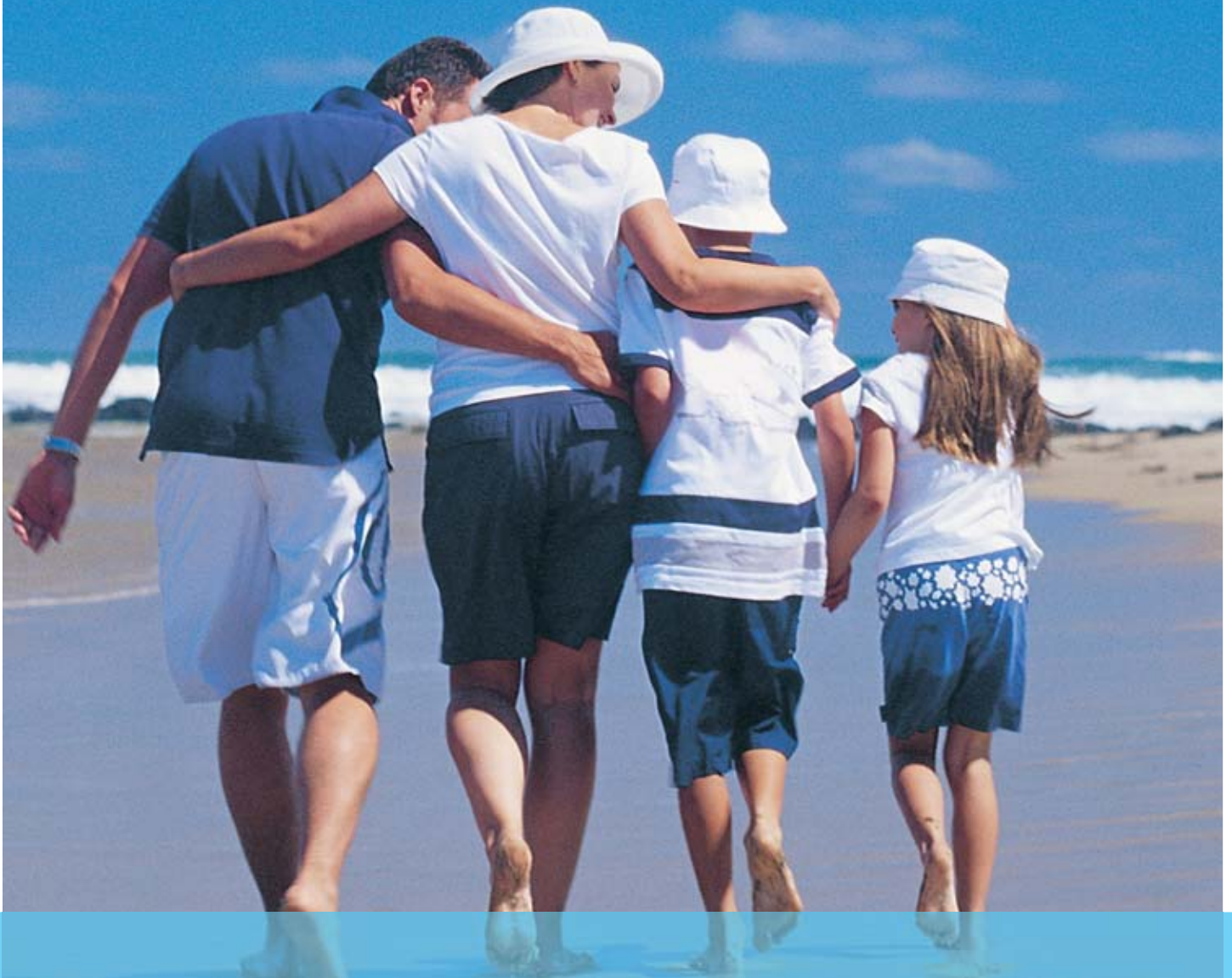
Through it we are focusing on enhancing member experiences, encouraging innovation on the job, helping work teams to identify problems and equipping them for effective problem solving.

Already, our staff have used this methodology to identify productivity improvements in some of our core business activities.



Our common goal is to be the leader in private health insurance.

Our Sustainability Report



We seek better health outcomes at every level of the Australian community.

Our Sustainability Report

Medibank Private takes pride in our record of fostering a sustainable business that returns value to the community. The core platforms on which our sustainability is built include: fostering a diverse and engaged workforce; supporting our members and the community to achieve positive health outcomes; improving the delivery of health care services; ensuring sustainable cost management; and delivering on our service promises.

Our people

At Medibank Private, a diverse and engaged workforce is a critical element in our ability to lead the industry and add value for our members. Our staff are encouraged and supported to make positive contributions to the communities in which they work and live, with the aim of fostering a strong sense of community spirit and community responsibility.

Supporting a diverse workforce

Medibank Private is committed to offering a safe and enjoyable working environment that offers equal opportunities for all. To support our people, we provide access to financial assistance for staff in need, leadership and development programs, online career management and a focus on work/life balance.

Medibank Private supports opportunities for staff to achieve their potential and encourages them to contribute meaningfully to their communities.

Significantly, the number of employees returning from parental leave during the financial year was 80% – an increase on the 54% return rate recorded in the previous reporting period.

Medibank Private staff benefit from a 'good health' day: one paid day of leave per calendar year for leisure and well-being purposes. Staff who are members of recognised emergency service organisations can access two weeks of paid leave per calendar year as part of an emergency or disaster response.

Medibank Private has been recognised for our innovative approach to drawing on the cultural and linguistic diversity of staff – an in-house interpreter list, representing over 10 languages, is maintained to enhance our customer service delivery.

Personal and professional development is valued by Medibank Private. We offer a study support program for staff pursuing academic study, which can include study leave, payment of course fees or access to Medibank Private resources to support research.

We also protect the health and security of our staff by providing them with free income protection insurance and subsidising the cost of staff personal health insurance.

Table 1
Medibank Private staff diversity and benefits

	2005/06	2004/05
Part-time employees	334	208
OH&S claims	12	12
Women in senior management	13.8%	8.7%
Staff aged over 50 years	269	268
Staff who used a good health day	1,215	1,157

Volunteering – staff engaging with the community

Every Medibank Private employee is entitled to one half-day of paid community leave per calendar year, where they are able to bring their unique skills and experience to make a positive difference in their communities. In 2005/06, 243 staff (a total of 16%) utilised their community leave, a 5% increase over the previous year. This equates to almost 1,000 hours. Our target for 2006/07 is that 20% of staff use their community leave.

Activities undertaken by Medibank Private staff during the year included:

- conducting a capability study to determine IT requirements for a community house project;
- planting 7,500 trees to restore degraded land as part of a community environment recovery project;
- taking part in the promotion of Heart Week 2006; and
- refurbishing the recreation facilities at a men's crisis and temporary accommodation centre in Victoria.

Our Sustainability Report continued

Giving campaigns

Medibank Private staff are supported to undertake fund-raising drives to encourage employee donations to community charities. More than 16 organisations have benefited from this support, including: the Oaktree Foundation, Wesley Mission Melbourne, the Salvation Army, South Australia Guide Dogs Association, Whitelion, Cancer Council, Leukaemia Foundation, Red Cross, Fitted for Work and Urban Seed. It is estimated that more than \$20,400 has been raised for community organisations through the efforts of Medibank Private staff.

Community partnerships

During 2005/06, Medibank Private worked with a number of community organisations to offer support and guidance, as well as working in collaboration to effect positive change. Organisations that Medibank Private worked in partnership with include Whitelion, Melbourne Cares, Urban Seed, the Rotary Club and Wesley Mission Melbourne, helping to make a difference to the lives of individuals and community groups.

Some of these initiatives included:

- working with Whitelion to offer employment at Medibank Private for a young person returning to society from the juvenile justice system;
- conducting a workshop with a range of not-for-profit organisations to share Medibank Private's insights into brand, sponsorships and reputation management. This initiative was developed with Melbourne Cares to provide a learning forum for not-for-profit organisations; and
- supporting the Oaktree Foundation Study Tour in South Africa, where entrants raised funds to benefit communities in need.

Achieving positive health outcomes

Medibank Private members

Following on from the success of three health and well-being pilot programs, this year we introduced Medibank Private *betterhealth* to help members take better care of their health. *betterhealth* is a suite of programs that has benefits for the community and Medibank Private, reducing the burden of preventable disease on our health care system by supporting our members to have a better quality of life.

Evidence of the success of our *betterhealth* programs is shown in the results achieved, verified and reported on this year for our 'on track' program for members with diabetes. This program was piloted in 2004/05 and results compiled and verified in 2005/06. Participants in the 'on track' program were sent a diabetes 'passport' to record the appropriate routine checks from their doctor, as well as record their self-reported diabetes care and lifestyle information. Result highlights are shown in Table 3. The 'on track' program will again be available for eligible members in late 2006.

Medibank Private is encouraging innovation and excellence in clinical care by awarding more than \$900,000 to 34 hospital projects.



The *betterhealth* pilot program achieved a 16% reduction in the number of hospital admissions during the 'on track' intervention period.

Medibank Private staff after a successful day of tree-planting at the Medibank Private forest project at Bacchus Marsh, Victoria.



Fronted by Andrew Gaze, Medibank Private 'Gaze Days' encourages children to get active.

Improving delivery of health care

Medibank Private partners in health care

Medibank Private is committed to improving the quality of health care services delivered in Australia. We are working with contracted hospitals to identify, implement and evaluate measures to improve clinical outcomes for our members and achieve better value for our hospital purchasing expenditure.

This year, Medibank Private committed more than \$900,000 to an Incentive Pool that will fund hospitals to undertake projects to improve clinical outcomes and encourage innovation and best practice in clinical care. In April 2006, the Medibank Private Safety and Clinical Improvement Incentive Pool awarded grants for 34 hospital projects following a total of 84 submissions. See Table 2 for a full list of projects underway. We will review progress in the next report.

Table 2
Medibank Private Safety and Clinical Improvement Incentive Pool

Medibank Private has awarded more than \$900,000 in grants to 34 hospital projects to support innovation and excellence in patient care.

Hospital	State	Project type				
		Falls prevention	Medication management	Discharge planning and readmission	Clinical innovation	Improving use of patient-related information
Baringa Private Hospital	NSW					
St George Private Hospital	NSW					
Sydney Adventist Hospital	NSW					
Sydney Adventist Hospital	NSW					
Westmead Private Hospital	NSW					
Wolper Jewish Hospital	NSW					
Allamanda Private Hospital	Qld					
Mater Misericordiae Hospital, Townsville	Qld					
Peninsula Private Hospital	Qld					
Calvary Health Care, Adelaide	SA					
Keith & District Hospital Inc	SA					
St Andrew's Hospital	SA					
Hobart Private Hospital	Tas					
St Helen's Private Hospital	Tas					
Cabrini Hospital	Vic					
Epworth Eastern Hospital	Vic					
Epworth Freemasons Hospital	Vic					
Frances Perry House	Vic					
Knox Private Hospital	Vic					
Melbourne Private Hospital	Vic					
St John of God, Geelong	Vic					
St Vincents & Mercy Private Hospital	Vic					
The Avenue Private Hospital	Vic					
The Bays	Vic					
The Geelong Clinic	Vic					
The Valley Private Hospital	Vic					
The Victoria Clinic	Vic					
Mercy Hospital, Mount Lawley	WA					
Hollywood Private Hospital	WA					
Mount Hospital	WA					
Peel Private Hospital	WA					
South Perth Hospital	WA					
St John of God, Subiaco	WA					
St John of God, Bunbury	WA					
Total for project type		\$178,266	\$233,600	\$75,222	\$333,289	\$102,111

Our Sustainability Report continued

Delivering on our promises

Member Service Charter

Medibank Private remains committed to the Member Service Charter we adopted in January 2005, as we seek to deliver service excellence across all areas of our business. The Charter standards form the benchmark against which we continue to review our performance.

Our performance against each of our Charter promises has been independently reviewed by customer service professionals, Pitcher Partners, for 2005/06. The review found Medibank Private delivered on 22 of the 24 Charter promises – an improvement on the previous year.

We again met our exacting standards in relation to accessibility, privacy, honesty and transparency, and prompt resolution of complaints and problems. We improved our ancillary claims processing times and we will be working to ensure we respond to public enquiries by email and letter within one and five days respectively.

Visit www.medibank.com.au for the full review.

Encouraging healthy lifestyles

As the leader in private health insurance, Medibank Private believes we have an obligation to educate and inform the broader public about health issues, to encourage active, healthy lifestyles and to promote positive reform in the health sector.

Safe Sports Report 2006

Each year, Medibank Private conducts research into sporting activities and sports injuries in Australia. Medibank Private's research found that one in five children suffers a sporting injury and about 5.2 million Australians are injured each year through sports participation.

Our aim is to promote community awareness of the need to exercise regularly and safely. The importance of appropriate preparation before engaging in sporting activities, as well as seeking advice on how to adequately prepare for a sport to avoid or minimise injury, were central to the report's message.

Through promoting community awareness and providing some practical preventative advice, Medibank Private aims to decrease the number of sports injuries in the community, highlight the value of private health insurance and reduce the \$2 billion that sports injuries cost the community each year.

Workplace health

Medibank Private is also a strong supporter for the promotion of workplaces that foster a healthy environment for employees.

Research commissioned by Medibank Private, the first of its kind into the health of Australia's workforce, found that the majority of Australian employees don't exercise enough, have poor diets, are overweight and suffer from stress. Medibank Private's research found strong links between an employee's health profile and their productivity and performance at work.

During the past year, Medibank Private has been working with employers, peak bodies and industry groups to increase awareness of the benefits to employers and employees of fostering a healthy workplace, and the risks of not doing so.

Through this initiative, Medibank Private is supporting systemic change in the way workplaces plan and support the health needs of their employees to improve lifestyles and improve the performance of the Australian workplace.

Community health promotion

Medibank Private participates in a comprehensive range of programs and events in our communities aimed at increasing awareness and engagement in positive and healthy lifestyles.

During 2005/06, Medibank Private was involved in the following community health promotion initiatives:

- 'Gaze Days' – Drawing on the popularity of Andrew Gaze, Medibank Private set up a fun day for kids at the Melbourne Sports and Aquatic Centre, where children could try out different sports activities with the help of professional players, including some of the Melbourne Storm rugby league team and the Melbourne Tigers basketball team.
- As part of our commitment to encouraging local communities proactively manage their health and well-being, we supported activities including Bendigo Men's Health Week, Rural Health Week in Victoria, the 'Beyond the Classroom' citizenship initiative for high school students in Western Australia and the Medibank Private Active Towns awards in Tasmania.
- Juvenile Diabetes Research Foundation (JDRF) – for the third year, Medibank Private has supported the annual Jelly Baby Appeal by selling jelly babies at retail outlets to raise funds in support of JDRF. Medibank Private also supports JDRF's other major fundraising initiative, the annual 'Walk to Cure' held in October each year.
- Medibank Private 1Seven – launched in August 2006, Medibank Private is the sponsor and originating partner of this national program, with the Australian Football League, Netball Australia and Cricket Australia, to promote healthy eating and physical activity among primary school-aged children.

Advocating for a better health care system

As the leader in the private health sector, Medibank Private takes an active role in advocating for reforms that will improve the health system and educate the community about health issues.

Medibank Private continues to act as a leading industry advocate across a range of policy areas. Throughout the year, Medibank Private participated in a number of industry forums, including the Australian Health Insurance Association's National Conference and the Australian Financial Review's 8th Annual Health Congress.

Medibank Private's Managing Director, George Savvides, is one of two Australian representatives on the Council of the International Federation of Health Plans. This membership provides access to explore the health trends and innovation pursued by private health insurers around the world. Medibank Private also contributed with other industry participants on the Australian Government's policy and legislative reform initiatives, such as prostheses reform, to ensure the future growth and sustainability of the private health industry.

Table 3
Highlights of results from the 295 participants who completed the 'on track' diabetes program

16%	reduction in the number of hospital admissions during the intervention period
56%	of those who were overweight or obese lost weight
70%	of those with blood glucose levels (HbA1c) above the recommended level at the beginning of the program showed improvement
39%	reduced their systolic blood pressure level
26%	achieved a reduction in systolic blood pressure of 10mmHg or greater
35%	reached target for total cholesterol – a 14% improvement from the base line
82%	reported discussing their written feedback with their GP
23%	reported a change in diabetes treatment by their doctor
50%	recorded an increase in physical activity per week
80%	of those who completed the evaluation reported an increase in their knowledge of diabetes



Our Future

Strong ongoing momentum places us in an excellent position for the future.

Our Future

Medibank Private's unique attributes, excellent financial and operating performance and strong ongoing momentum place us in an excellent position to continue to drive value for all stakeholders in the future.

We will build on the success of our hospital purchasing strategy to further improve the value we offer our members.

We will develop and launch a range of diversified products.

We will support our members through a holistic, proactive approach to health care.

Using these strategies, we will expand our member base.

Continue to grow

In the coming year, we intend to continue to expand our member base as the strong sales momentum of our current products continues.

We will continue to enhance the customer value proposition of our brand through the further refinement of our product range; the release of new products that our members want; continuing to provide our members with excellent service; and the development of new ways to improve the health of our members.

These strategies will contribute to Medibank Private's further growth by enabling us to attract members who are new to private health insurance, and those from other health funds.

Broaden our product range

Medibank Private's branded travel insurance product, launched in November 2005, has scope for further growth and is the precursor for the introduction of a wider range of new product offerings that form part of our planned diversification program.

Any new product offerings will draw on our existing knowledge and experience and will be required to meet strict performance criteria. Medibank Private will only introduce products that represent good value to our members and that will make a substantial contribution to earnings.

Our access to a ready customer market of a large proportion of Australians gives us a significant base from which we can develop and launch a range of diversified products in the future.

Member health

The Medibank Private *betterhealth* program suite, which has programs that have demonstrated the ability to improve member health, reduce hospital visits and moderate claims, will be further expanded over the coming years. The programs not only help members better manage their health, but contribute to reducing claims costs through proactive health care.

Mitigate health costs inflation

Outlays on member benefits represent around 90% of our total costs. Over the coming year, Medibank Private plans to build on the success of our 2005/06 hospital purchasing strategy to further improve the value and quality outcomes for our members. This purchasing strategy is a critical element in securing the best possible care at the most appropriate cost for our members, as well as enabling Medibank Private to effectively control the growth in claims costs, which will keep pressure on the rate of premium growth.

Manage efficiently

Medibank Private is committed to our long-term approach to improve the efficiency of the fund's management expenses. Already underway, the update of our information technology infrastructure, including the Business Systems Renewal (BSR) program, is a key element in ensuring the long-term flexibility and efficiency of Medibank Private.

Advocate for a better health system

Medibank Private will proactively embrace the recently announced Federal Government private health reforms to ensure they result in a better product offering for members.

Of these reforms, the most significant is the potential for health funds to offer members benefits associated with a broader range of health services, including preventative health care and services that substitute for acute hospital care. As the leader in the private health sector, Medibank Private takes an active role in advocating for reforms that will improve the health system and educate the community about health issues.

Sale of Medibank Private

With the Government's decision to sell Medibank Private, the organisation looks forward confidently to the new opportunities that could open up to the company in the future.

Medibank Private is excited about the strong potential of the organisation to benefit all our stakeholders.

Financial Report

Corporate Governance Statement

Medibank Private is a wholly-owned Commonwealth company as defined in the *Commonwealth Authorities and Companies Act 1997 (Cth)*, a Government Business Enterprise (GBE), and a company subject to the *Corporations Act 2001 (Cth)*.

Governance at Medibank Private

Medibank Private is committed to implementing the highest standards of corporate governance. The governance practices derive principally from the provisions of the *Commonwealth Authorities and Companies Act 1997 (Cth)* and requirements of the Governance arrangements for Commonwealth Government Business Enterprises (1997).

The Company is also committed to reporting in accordance with the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations (ASX Guidelines)* in so far as they are applicable to an unlisted GBE such as Medibank Private.

During the year, the Company continued to comply with the ASX Guidelines except for Principle 5 'make timely and balanced ASX Listing Rules disclosures', which is not applicable to an unlisted GBE, such as Medibank Private.

A dedicated corporate governance section on the Medibank Private website (www.medibank.com.au) provides a detailed description of the Company's governance framework and associated practices with links to key documents. This section of the website includes a corporate governance checklist and specific disclosures for recommendations:

- 1.1 – Summary of matters reserved for the Board,
- 2.5 and 9.5 – Nomination, Remuneration & Human Resources Committee Charter,
- 3.3 and 10.1 – Medibank Private's Code of Conduct, and
- 4.5 – Audit & Risk Management Committee Charter.

Our Shareholder

Ownership and Shareholder Minister

The Commonwealth of Australia holds all shares in Medibank Private Limited. The responsible Shareholder Minister is the Minister for Finance and Administration, Senator the Hon. Nick Minchin.

Shareholder communication

The Shareholder Minister is briefed on a regular basis on the performance of Medibank Private and any significant financial, operational or strategic issues as they arise.

Under the Commonwealth GBE governance arrangements, a rolling three-year Corporate Plan is submitted annually to the Shareholder Minister. A high-level summary of the Corporate Plan (the Statement of Corporate Intent) is tabled annually in Parliament. Quarterly reports on progress against the Corporate Plan are made to the Shareholder Minister.

Medibank Private's Annual Report is submitted to the Commonwealth Parliament in accordance with Section 9 of the *Commonwealth Authorities and Companies Act 1997 (Cth)*.

Board of Directors

Role and responsibilities

The Board of Directors is responsible for the overall corporate governance of Medibank Private and the Company's performance, and is accountable to the Shareholder Minister.

In carrying out its governance role, a key task of the Board is to drive the performance of the Company. The Board must also ensure that the Company complies with all of its contractual, statutory and other legal obligations, including the requirements of all applicable regulatory bodies. The Board has the overall responsibility for the successful operations of the Company.

The powers and duties of the Board are specified in the Constitution of Medibank Private, the *Corporations Act 2001 (Cth)*, the *National Health Act 1953 (Cth)*, and other relevant legislation and law.

Key accountabilities and matters reserved to the Board include:

- setting and reviewing objectives, goals and strategic direction, and assessing performance against these benchmarks;
- ensuring the Company is financially sound, meets prudential requirements and has appropriate financial reporting practices;
- ensuring a process is in place for the maintenance of the integrity of internal controls, risk management, delegation of authority and financial and management information systems;
- appointing, supporting, evaluating and rewarding the Managing Director;
- monitoring the executive succession plan and ensuring a process of evaluating and rewarding key executives;
- ensuring high business standards, ethical conduct and fostering a culture of compliance and accountability; and
- reporting to the Shareholder Minister on the Board's stewardship of the Company and monitoring the achievement of the Corporate Plan.

The Chairman, Mr P Kirby, leads the Board. He has responsibility for ensuring the Board receives accurate, timely and clear information to enable the Directors to analyse and constructively critique the performance of management and the Company as a whole. The Chairman is responsible for representing the Board to the shareholder.

The Company Secretary is appointed by the Board and reports directly to the Chairman. The Company Secretary is responsible for developing and maintaining information systems that are appropriate for the Board to fulfil its role. The Company Secretary is also responsible for ensuring compliance with Board procedures and provides advice to the Board, via the Chairman, on governance matters.

Board composition

The Board of Medibank Private comprises seven non-executive Directors including a non-executive Chairman, and an executive Managing Director. All current non-executive Directors are independent in accordance with the ASX Guidelines' criteria for independence.

Details of the Directors and Company Secretaries, including names and qualifications, are included in the Directors' Report, together with Directors' remuneration.

Directors are appointed by the responsible Shareholder Minister in accordance with the Company's Constitution. Current practice is for terms of appointment to be of three years duration and reappointment is permissible.

During the year no new Directors were appointed and, except for Mr Savvides, no Director's term of appointment expired. Mr Savvides' term expired on 31 March 2006 and he was reappointed for a further term to 11 December 2008.

Director induction and education

Medibank Private has an induction program for new Directors, which is reviewed periodically by the Board Nomination, Remuneration & Human Resources Committee.

Directors are provided with detailed briefings by management on corporate strategy and current issues affecting Medibank Private and the private health insurance industry generally. All Directors are encouraged to visit retail centres, call centres and operational and support divisions, and to meet with employees across the business.

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

Conflicts of interest

Directors must keep the Board advised on an ongoing basis of any interest that could potentially conflict with those of the Company. Each Director is obliged to notify the other Directors of any material personal interest that he or she may have in a matter that relates to the affairs of the Company (subject to certain exceptions specified in the *Corporations Act 2001 (Cth)*).

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

Independent professional advice and access to company information

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

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

Director remuneration

The Commonwealth Remuneration Tribunal sets remuneration and travel allowances for non-executive Directors, including the Chairman. The Managing Director's remuneration is set in consultation with the Remuneration Tribunal under its advisory jurisdiction. No retirement benefits, other than statutory superannuation, are payable to Directors upon expiry of office.

Details of Directors' remuneration are included in the Directors' Report and Note 20 to the Financial Statements.

Director dealings in company shares

As the Commonwealth of Australia holds all shares in Medibank Private, no trading in the shares is allowed.

Board meetings

The Board scheduled ten Board meetings during the year, with additional meetings for strategic planning. The Board met 12 times during the year.

The agendas for Board meetings are prepared in conjunction with the Chairman, the Managing Director and the Company Secretary. Board reports are circulated in advance of Board meetings. Management executives are regularly involved in Board discussions.

Board performance

The Board has adopted contemporary performance measures in assessing the effectiveness of the Board.

A review of Board performance is conducted annually by way of alternate formal and informal assessment. The aim is to undertake an objective assessment of the performance of the Board as a whole. An informal review was conducted during the year ended 30 June 2005.

A formal independently facilitated review of Board performance was conducted during the year ended 30 June 2006. This comprised confidential interviews with the Chairman, each Director and senior executives. Feedback from this review was provided to the full Board as part of its continuous improvement program. A separate Board Committee performance review was conducted during the year with feedback provided to the full Board.

At the close of each Board meeting, an independent non-executive Director, selected on a rotation basis, provides performance feedback to the Board and suggestions for improvement.

Board Committees

To assist in the performance of its responsibilities, the Board has established a number of Board Committees, being:

- Audit & Risk Management Committee;
- Business Enablement Committee;
- Investment Committee;
- Nomination, Remuneration & Human Resources Committee; and
- Product, Benefits & Innovation Committee.

Each Committee operates under a charter approved by the Board, which is reviewed periodically. Copies of the charters can be found in the Corporate Governance section of the Company's website. Board Committees monitor and facilitate detailed discussion on particular issues and other matters as delegated by the Board. They have no delegated authority, but make recommendations and report to the Board of Directors on appropriate and relevant issues.

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

Audit & Risk Management Committee

All non-executive Directors are currently members of the Audit & Risk Management Committee. The Managing Director attends Audit & Risk Management Committee meetings by invitation. The Chairman of this Committee, Mr P Wade, is an independent non-executive Director who is not the Chair of the Board.

The role of the Audit & Risk Management Committee is to assist the Board in relation to the reporting of financial information, risk management and compliance. Key responsibilities include:

- reviewing the annual financial report;
- approving and monitoring the annual risk assessment plan;
- monitoring the activities of the internal audit and compliance functions;
- reviewing the performance of the External Auditor;

Corporate Governance Statement continued

- monitoring the effectiveness of the internal control framework;
- monitoring the effectiveness of the Company's fraud control policies and procedures; and
- monitoring the procedures in place to ensure compliance with the legislation, regulations and codes.

The Committee Charter recommends that the Committee meets approximately four times per year. The Committee met four times during the year.

The External Auditor met with the Audit & Risk Management Committee three times during the year and, on each occasion, also met without management being present.

Business Enablement Committee

Four non-executive Directors and the Managing Director are currently members of the Business Enablement Committee. The Chairman of the Committee, Ms J Bowen, is an independent non-executive Director.

The primary role of the Committee is to:

- provide advice to the Board on productivity and business improvement initiatives and related business cases;
- enable Board overview of IT strategy, project management and implementation; and
- monitor the management of business systems project risk and post implementation reviews.

The Committee Charter recommends that the Committee meet approximately four times during the year. The Committee met four times during the year.

Investment Committee

The Investment Committee comprises four non-executive Directors and the Managing Director. The Chairman of the Committee, Mr A Brien AM, is an independent non-executive Director.

The primary role of the Committee is to set the investment strategy and to monitor the effectiveness of that strategy to achieve optimum return relative to risk whilst meeting the Company's prudential capital requirements.

The Committee Charter recommends that the Committee meets approximately three times a year. The Committee met twice during the year.

Nomination, Remuneration & Human Resources Committee

The Nomination, Remuneration & Human Resources Committee comprises three non-executive Directors. The Managing Director attends Committee meetings by invitation. The Chairman of the Committee, Mr P Kirby, is an independent non-executive Director.

The primary role of the Committee is to review and make recommendations on Board composition and nomination, Board and senior executive remuneration, Board and senior executive succession planning, and insurance requirements as they relate to Directors and officers of the Company.

The Committee sets the policy and guidelines for the performance evaluation of the Managing Director and key executives, and reviews these guidelines regularly to ensure alignment with industry best practice.

The Committee also sets the policy and guidelines for the remuneration and performance evaluation of all other employees within the framework of individual Australian Workplace Agreements or Certified Agreements.

The Committee Charter recommends that the Committee meet approximately twice a year. The Committee met four times during the year.

Product, Benefits & Innovation Committee

The Product, Benefits & Innovation Committee comprises four non-executive Directors and the Managing Director. The Chairman of the Committee, Professor J Stoelwinder, is an independent non-executive Director.

The primary role of the Committee is to review, on behalf of the Board, the strategic direction of product design, purchasing strategies and other initiatives in health services delivery aimed at improving value to members.

The Committee Charter recommends that the Committee meets approximately four times a year. The Committee met four times during the year.

Accountability and audit

External audit

In accordance with the *Commonwealth Authorities and Companies Act 1997 (Cth)*, the Commonwealth Auditor-General audits the records and Financial Statements of the Company. The Australian National Audit Office (ANAO) has appointed Ernst & Young to conduct the audit on behalf of the Auditor-General.

The Board has a policy of auditor independence. The external audit partner is rotated in accordance with the provisions of CLERP 9.

The Audit & Risk Management Committee meets with the External Auditors during the year to:

- discuss the external audit and internal audit plans, identifying any significant changes in structure, operations, internal controls or accounting policies likely to impact the Financial Statements;
- review the results and findings of the auditor, the adequacy of accounting and financial controls, and monitor the implementation of any recommendations made; and
- finalise annual reporting, review the preliminary financial report prior to sign-off and any significant adjustments required as a result of the auditor's findings.

Internal control framework

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

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

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

Certification by Managing Director and Chief Financial Officer

In accordance with Board policy, the Managing Director, Chief Financial Officer and other senior executives provide a self-assessment sign-off regarding the controls and activities of the Company, including assurance as to the Company's financial condition.

This process supports the Managing Director and Chief Financial Officer's written certification to the Board under ASX Guideline Recommendation 7.2 that the certifications they give to the Board under ASX Guideline Recommendation 4.1 (as to the integrity of the Company's financial statements) are founded on a sound system of risk management and internal compliance and control that implements the policies adopted by the Board, and that the Company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.

Based on the evaluation performed as at 30 June 2006, the Managing Director and Chief Financial Officer concluded that as of the evaluation date, such risk management and internal compliance and control systems were reasonably designed to ensure that the Financial Statements and notes of the Company are in accordance with the *Corporations Act 2001* and there are reasonable grounds to believe the Company will be able to pay its debts as and when they become due and payable.

While the core financial information systems of the Company are considered to be controlled effectively, there remains scope for a range of improvements.

Internal audit and risk management

The Audit & Risk Management unit conducts internal audits in accordance with a risk-based Internal Audit Plan. This plan is reviewed and approved annually by the Audit & Risk Management Committee and the Board. All significant audit reports and a summary of other audit reports are reviewed by the Audit & Risk Management Committee and approved by the Board.

The Audit & Risk Management Manager reports directly to the Chair of the Audit & Risk Management Committee.

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

Business risk management

The Board has in place a system of business risk management that forms part of the business planning and monitoring process across all key business units. Each business unit is responsible for assessing and updating its risk profiles, including related mitigation programs.

The Audit & Risk Management Committee reports on the status of business risks. Each year a full risk assessment and mitigation plan is prepared and endorsed by the Board. The risk assessment process includes input from the Board, executive and management across the business.

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

Compliance

The Compliance Unit, which reports to the General Counsel, is responsible for designing, implementing and maintaining a comprehensive compliance reporting process to mitigate regulatory risk. This includes the development of an Operational Compliance Plan, which is reviewed and approved by the Board on an annual basis.

As part of its commitment to Trade Practices compliance, the Company has in place an active Trade Practices compliance training program, which is completed annually by all staff members.

The Compliance Unit is dedicated to a privacy compliance program. There are five staff members available, including a dedicated Privacy Officer, to answer all privacy related queries. Dedicated policies, procedures and annual training are in place to increase staff awareness, safeguard members' personal information and foster a privacy culture.

Ethical Standards

The Company has documented key governance policies and procedures. These include the Company's vision, mission and core values, as well as policy statements on conduct and ethical behaviour, the role of the Board and key executives, and compliance with statutory and stakeholder reporting obligations. These policies are reviewed on a regular basis.

The Board approved Code of Conduct sets out clearly the ethical standards that are expected of all Directors, managers and employees in their dealings with members, suppliers and each other. Any action or omission that contravenes the Code of Conduct constitutes misconduct and is subject to counselling or disciplinary action appropriate to the circumstances.

All Directors, managers and employees must avoid conflicts as well as the appearance of conflicts between personal interests and the interests of the Company.

The reporting of fraud and other inappropriate activity is encouraged by the Board and management via a formal, confidential reporting system and other internal processes. These processes ensure that people making a report are protected from any discrimination or intimidation.

Directors' Report

The Board of Directors of Medibank Private Limited (Medibank Private) has pleasure in submitting its report.

Board of Directors

The names and details of the Directors in office during the financial year and until the date of this report are as follows.

Current Directors:

Peter M Kirby BEcon (Rhodes), BEcon (Hons) (Natal), MA (Econ) (Manchester), MBA (Witwatersrand), AMP (Harv) FAICD
(Non-executive Chairman)

Appointed Director and Chairman from 8 February 2004. Current term expires 7 February 2007. Chairman of the Nomination, Remuneration & Human Resources Committee.

Mr Kirby has extensive corporate leadership experience internationally and in Australia and is currently a Director of Orica Limited, Macquarie Bank Limited, Beacon Foundation (Tripartite Trading Pty Ltd) and a Member of the Advisory Council of MIR Investment Management Ltd. Mr Kirby received the Centenary Medal in 2003.

Mr Kirby was formerly Managing Director and Chief Executive Officer of CSR Limited (1998 to 2003) and a member of the Board of the Business Council of Australia (2001 to 2003). Prior to joining CSR, Mr Kirby was Chairman/CEO of ICI Paints and a business director of the Imperial Chemical Industries PLC group ('ICI') based in the UK.

Julia Bowen MAICD
(Non-executive Director)

Appointed Director from 3 November 2003. Current term expires 2 November 2006. Chairman of the Business Enablement Committee.

Ms Bowen has executive and consulting experience in information technology and is currently an independent consultant.

Ms Bowen was formerly Director, Consulting Services, Asia Pacific, Cerner Corporation; and Systems and Programmes, Cable & Wireless Optus. Foundation member of the Ernst & Young Worldwide Masters Program; Manager of business consulting group, Aspect Computing; and Support Program Manager for the Royal Navy Nuclear Submarine Weapons Systems.

Adrian H Brien AM
(Non-executive Director)

Appointed Director from 26 June 2002. Current term expires 28 June 2008. Chairman of the Investment Committee.

Mr Brien has extensive corporate experience acquired over many years in private enterprise. He is currently Chairman, Equitrade Ltd; a Member of Pooled Development Fund Registration Board (Venture Capital); Trustee, Les Favell Cricket Foundation; and Life Governor, Flinders Medical Centre Research Foundation. Mr Brien received the Centenary Medal in 2003.

Mr Brien was formerly CEO of Adrian Brien Automotive Group; Member, President's Advisory Board, Mitsubishi Motors Australia; National Chairman, Australian Ford National Dealer Council; Member, Board of Governors, Flinders University South Australia; Member, Board of Management, Flinders Medical Centre South Australia; Member, Vehicle Licensing Board of South Australia; Chairman, Australian Ford Dealer Credit Dealer Council; and Governor, Fordstar Board of Governors.

Roger D Harley BSc (Melb)
(Non-executive Director)

Appointed Director from 30 August 2004. Current term expires 29 August 2007.

Mr Harley has extensive investment banking experience with a track record as an adviser to a number of private as well as ASX listed companies. He is currently a Director of Fawkner Capital Management Pty Ltd; Member of Pooled Development Fund Registration Board (Venture Capital); Member, Funds Management Committee of the Industry Research & Development Board and Director of related investment holding companies. He is also Chairman, Yarra Bend Park Trust and Trustee, Alfred Deakin Lecture Trust.

Mr Harley was formerly Director Equity Capital Markets, Deutsche Bank Australia; and Director Corporate Finance, Deutsche Bank Australia.

Brian F Keane FAICD, FAMI
(Non-executive Director)

Appointed Director from 30 August 2004. Current term expires 29 August 2007.

Mr Keane has executive experience in corporate leadership and marketing in the insurance industry and is currently a Director of CSIRO, Lawcover Pty Ltd, Lawcover Plus Pty Ltd, Aurora Energy Pty Ltd, The Hollard Insurance Company Pty Ltd and Chairman of MTA Insurance Agency Pty Ltd. Member of the Australian Competition Tribunal.

Mr Keane was formerly CEO AAMI Ltd; Director of Royal & Sun Alliance Australia Ltd, AAI Ltd (Australian Pensioners Insurance), IEC Ltd, Motor Accidents Authority of NSW, TAB Ltd, RAC Insurance Ltd. Director and President of Insurance Council of Australia.

George Savvides BE (Hons) (UNSW), MBA (UTS), FAICD
(Managing Director)

Appointed Director from 6 September 2001. Appointed Managing Director 1 April 2002. Current term expires 11 December 2008.

Mr Savvides has over 18 years' corporate leadership experience in the health care industry and is currently a Board member of AHIA (Australian Health Insurance Association) and International Federation of Health Plans. He is also Director, World Vision Australia and World Vision International; Director of Australian Centre for Health Research Limited (ACHR); and Member Advisory Committee, Genepharm Ltd.

Mr Savvides was formerly Managing Director of Healthpoint Technologies Limited, Managing Director and CEO, Sigma Co Ltd; Managing Director, Smith+Nephew Pty Ltd, Australasia; General Manager, CIG Healthcare Australia; Chairman, Medicines Partnerships of Australia; and Member, CSIRO Health Sector Advisory Council.

Johannes U Stoelwinder MD (Monash), MBBS (WA), FRACMA, FACHSE, FAFPHM
(Non-executive Director)

Appointed Director from 26 June 2002. Current term expires 28 June 2008. Chairman of the Product, Benefits & Innovation Committee.

Professor Stoelwinder has had extensive experience in medical and health care roles and is currently Chair of Health Services Management, Department of Epidemiology and Preventive Medicine, Monash University and Acting Director, Centre for Health Economics, Faculty of Business & Economics, Monash University.

Professor Stoelwinder was formerly CEO and Director, Southern Health Care Network; Director, Kitaya Holdings Pty Ltd; CEO, Monash Medical Centre; Queen Victoria Medical Centre (Melbourne); Director, Private Health Insurance Administration Council (PHIAC); Professor and Head, Health Services Management Development Unit, Flinders University, School of Medicine; and Professorial Fellow, Institute of Public Health and Health Services Research, Monash University, Faculty of Medicine.

Peter B Wade BComm (Hons), MA, FCPA, FAICD
(Non-executive Director)

Appointed Director from 26 June 2002. Current term expires 28 June 2008. Chairman of the Audit & Risk Management Committee from 8 February 2004.

Mr Wade has extensive experience acquired over many years in both corporate and public sectors. He is currently Chairman, Open Universities Australia Pty Ltd; Director, CASS Foundation Limited; The Knox School Limited; and PhillipsKPA Consulting Pty Ltd.

Mr Wade was formerly General Manager, Monash University; Deputy Chairman, VicGrain Ltd; Director, Graincorp Ltd and Banksia Wines Ltd.

Directors' meetings

The number of meetings of the Board of Directors and Board Committees during the year, and attendance by Directors at those meetings, are shown below.

Director	Board Meeting		Audit & Risk Management Committee ^(a)		Business Enablement Committee ^(b)		Product, Benefits & Innovation Committee ^(c)		Investment Committee ^(d)		Nomination, Remuneration & Human Resources Committee ^(e)	
	A	H	A	H	A	H	A	H	A	H	A	H
P M Kirby	12	12	4	4	4	4	4	4	1	2	4	4
G Savides ^(f)	12	12	4	4	4	4	4	4	2	2	4	4
J Bowen	11	12	4	4	4	4	4	4	— ^(g)	2	— ^(g)	4
A H Brien	11	12	4	4	2 ^(g)	4	2 ^(g)	4	2	2	4	4
R Harley	11	12	3	4	1 ^(g)	4	3 ^(g)	4	2	2	3	4
B Keane	11	12	4	4	3	4	3	4	1 ^(g)	2	— ^(g)	4
J U Stoelwinder	12	12	4	4	3 ^(g)	4	4	4	1 ^(g)	2	4	4
P B Wade	11	12	4	4	3	4	— ^(g)	4	1	2	— ^(g)	4

A – Number of meetings attended

H – Number of meetings held during the time the Director held office during the year

^(a) Mr Wade is Chairman of the Audit & Risk Management Committee.

^(b) Ms Bowen is Chairman of the Business Enablement Committee.

^(c) Professor Stoelwinder is Chairman of the Product, Benefits & Innovation Committee.

^(d) Mr Brien is Chairman of the Investment Committee.

^(e) Mr Kirby is Chairman of the Nomination, Remuneration & Human Resources Committee.

^(f) Mr Savides attends the Audit & Risk Management Committee, Business Enablement Committee and Nomination, Remuneration & Human Resources Committee meetings by invitation.

^(g) Director not a member of this Committee.

Company Secretaries:

Neil K Greenaway FCIS, FCA, FCPA, FAICD
(Company Secretary)

Appointed Company Secretary on 2 April 2004. Mr Greenaway has been a Chartered Accountant for over 25 years and a Chartered Secretary for nine years. Formerly held executive financial and secretarial positions with St Vincent's Health, Tupperware International and KPMG.

Alex D Mathey Solicitor, BA, LLB, Accredited Compliance Specialist
(General Counsel and Company Secretary)

Appointed Company Secretary on 3 March 2006. Mr Mathey has a wealth of experience having worked across the Asia Pacific in highly regulated, politically sensitive and competitive environments for a number of major and internationally listed companies, including The Coca-Cola Company, Crown Limited and Aviva (formerly Norwich Union Financial Services Group).

Sarah L Bussey Solicitor, MA (Cantab), MAICD
(General Counsel)

Appointed Company Secretary on 19 October 2001, resigned 3 March 2006. Ms Bussey, a practising lawyer for over 15 years has been practising in Australia for ten years. She is an active member of the Australian Corporate Lawyers Association and the Law Institute of Victoria. Formerly a partner with Phillips Fox Lawyers.

Directors' interests

The Commonwealth of Australia is the sole shareholder in the Company. No Director holds shares or options in Medibank Private.

At the date of this report, Medibank Private has the following committees:

- Audit & Risk Management Committee;
- Business Enablement Committee;
- Product, Benefits & Innovation Committee;
- Investment Committee; and
- Nomination, Remuneration & Human Resources Committee.

The role of these Committees is outlined in the Corporate Governance Statement section of the Annual Report. All non-executive Directors are members of the Audit & Risk Management Committee. Not all Directors are members of each of the other Committees, however, all Directors are welcome to attend any meetings of these Committees.

Directors' Report continued

Principal activities

The principal activity of Medibank Private during the financial year was to operate a registered health benefits organisation in accordance with the National Health Act 1953 (Cth). The Company directly or indirectly provides a range of services, such as:

- hospital insurance for private patients;
- ancillary or extras cover;
- cover for overseas students and visitors to Australia; and
- marketing of travel insurance.

Results

Medibank Private's 2005/06 operating profit was \$200,062,000 (2004/05 \$130,715,000). The Company is exempt from paying income tax.

Dividends

The Company's Constitution prohibits the payment of dividends and accordingly no dividends were paid during the year.

Review of operations

A review of Medibank Private's operations is contained in the Chairman's and Managing Director's Reports, and other sections of the Annual Report.

Significant changes in the state of affairs

Total equity increased by \$200,062,000 during the 2005/06 financial year. Contributing factors included:

- additional revenue due to membership growth and premium rate increase;
- improved investment income through increased exposure to growth assets and favourable investment markets;
- better purchasing arrangements reducing the rate of growth in benefit outlays; and
- containment of management expenses, which included a write-down in value of the Business System Renewal (BSR) program.

Significant events after the balance date

During the 2005/06 financial year, the Federal Government announced its intention to sell Medibank Private. Subsequent to reporting date, legal and business advisors have been appointed by the Federal Government to assist them on the sale process.

Likely developments and future results

Directors anticipate that stable underwriting returns will continue into the 2006/07 financial year, which will be delivered by:

- continued focus on membership growth, delivered by continued product development and focusing on key market segments;
- continuing to implement strategies to ensure the effectiveness and efficiency in both hospital and ancillary purchasing; and
- increasing efforts in members based programs, helping them proactively manage their health, fitness and well-being.

Sound returns are expected from the strong and balanced investment portfolio, dependent upon market performance in respective investment sectors.

Remuneration Report

This report outlines the remuneration arrangements in place for Directors and executives of Medibank Private.

1 Remuneration report summary

1.1 Remuneration strategy and structure

Medibank Private operates a strong performance based approach to remuneration. Our philosophy is to ensure the mix and quantum of remuneration properly reflects the responsibilities and duties of our executives and Directors. The remuneration approach adopted by Medibank Private provides a competitive reward proposition targeted at attracting, motivating and retaining the most appropriately qualified and experienced individuals.

These objectives are achieved through the following mix of reward elements:

	Elements of remuneration	Directors		
		Non-executive	Executive	Senior executives
Fixed remuneration	Cash salary	X	✓	✓
	Cash fees	✓	X	X
	Superannuation	✓	✓	✓
	Other benefits	✓	✓	✓
Short-term incentives	Cash	X	✓	✓
	Deferred cash	X	✓	✓
Long-term incentives ⁽¹⁾	Cash	X	✓	✓
Post-employment	Service agreements	X	✓	✓
	Termination payments	X	✓	✓

⁽¹⁾ Plan ceased on 30 June 2006.

1.2 Fixed remuneration

Fixed remuneration comprises cash salary, superannuation contributions and car parking. Nominated benefits may also be packaged, which include novated car leases, salary sacrificed superannuation contributions and additional FBT exempt items such as laptop computers.

To ensure market competitiveness of fixed remuneration, data is sourced from various surveys and, where appropriate, specialist remuneration consultants. Surveys from Mercer, CSI and Hay were referred to during the year, with Mercer and Ernst & Young engaged for specialist executive remuneration advice.

Fixed remuneration is reviewed annually and is determined by the scope of the individual's role, their level of knowledge, skills and experience, their performance and market benchmarking.

Non-executive Directors' fees, including committee fees, are set by the Commonwealth Remuneration Tribunal. The level of their fees is not set with reference to measures of Company performance.

As determined by the Commonwealth Remuneration Tribunal, annual fees were increased by 3.9 per cent with effect from 1 July 2005. Non-executive Directors now receive a fee of \$48,620 in relation to their service as a Director of the Board. The Chairman, taking into account the greater commitment required, now receives a fee of \$97,210. In addition, Directors who sit on the Audit & Risk Management Committee receive an additional fee of \$5,680 and the Chairman of that Committee receives an additional fee of \$11,360 per annum. Directors are entitled to life insurance cover and may purchase private health insurance cover on the same terms as employees. Compulsory statutory superannuation contributions are also made.

1.3 Short-Term Incentive (STI) plan

A new STI plan was introduced this financial year, aimed at driving performance and rewarding executives for achievement against targeted and stretch objectives. For senior executives, objectives consist of corporate financial and non-financial targets and a mix of operational and individual objectives.

Potential earnings vary, based on the impact of a role and are capped at a maximum of 60 per cent of fixed remuneration. Generally 50 per cent of the STI earned is payable after the final financial result is declared and 50 per cent deferred for three years. Both elements are payable in cash, but executives may elect to sacrifice any award to superannuation.

1.4 Long-Term Incentive (LTI) plan

To encourage a longer-term perspective on the part of executives, a LTI plan was introduced, for a limited number of key executives. The LTI plan aligns this element of remuneration to the sustained achievement of corporate plan objectives. The LTI plan was ceased on 30 June 2006, with the remaining executive fulfilling the conditions of his plan and paid accordingly. The LTI plan has been replaced by the deferred short-term incentive contained within the STI plan described above.

1.5 Post-employment

Key executives have been engaged under the terms of service agreements that act as a form of retention mechanism. Payable upon cessation of employment, they provide compensation for constraints regarding working for a competitor for up to six months.

Termination arrangements were not common outside of the Managing Director, but have been introduced this year to protect Medibank against the possible flight risk of key executives under a sale environment. These range from six months (as a standard clause, or if terminated as a result of a trade sale) through to 12 months (if terminated due to change in control of an executive's role outside of a trade sale).

2 Non-executive Directors' remuneration

Details of non-executive Directors' remuneration for the financial year are set out in the following table:

30 June 2006	Directors' fees ⁽¹⁾ \$	Audit & Risk Management Committee \$	Non-Monetary benefits \$	Superannuation benefits ⁽²⁾ \$	Other \$	Total remuneration \$
Non-executive Directors						
P M Kirby (Chairman)	97,194	5,680	7,438	9,259	1,705	121,276
J Bowen	48,612	5,680	1,012	4,886	1,108	61,298
A H Brien	48,612	5,680	5,801	4,867	1,092	66,052
R D Harley	48,612	5,680	5,126	4,886	901	65,205
B F Keane	48,612	5,680	248	4,886	832	60,258
J U Stoelwinder	48,612	5,680	6,685	4,886	637	66,500
P B Wade	48,612	11,360	6,030	5,397	1,222	72,621
Total Non-executive Directors	388,866	45,440	32,340	39,067	7,497	513,210

⁽¹⁾ Represents actual Directors' Fees paid during the financial year reflecting an increase in fees, which became effective 1 July 2005.

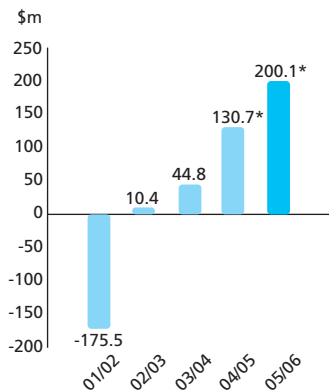
⁽²⁾ Compulsory superannuation contributions made on behalf of non-executive Directors to satisfy the Company's obligations under applicable Superannuation Guarantee Charge legislation.

Directors' Report continued

3 Company performance – the link to reward

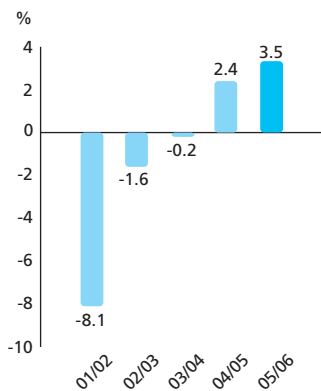
3.1 Five-year performance

Operating profit/loss



*Australian International Financial Reporting Standards (AIFRS) compliant

Underwriting margin after expenses



3.2 Link to performance

Performance reviews are conducted annually and the entire at-risk component of executive remuneration is tied to performance.

The Short-Term Incentive Plan includes measures tied to a number of key performance objectives. Measures (both target and stretch) are set annually, covering corporate financial and more direct operational and individual performance targets.

The mix and weighting of measures may vary annually, depending on the financial year focus of the organisation.

These in turn cascade to individual executives participating in the plan. For this year, measures included: corporate financial results, market share, reduced premium increase, benefit outlay, customer satisfaction, employee turnover, and on plan performance for our major core system change project. An annual performance contract is struck with each executive, incorporating measures set and agreed to by the Board.

4 Executive remuneration

4.1 Executive team

Executives with the highest remuneration during the financial year and to whom this report applies are:

Name	Role	Commencement date ⁽¹⁾
Current		
George Savvides	Managing Director	1 April 2002
Simon Blair	Chief Operating Officer	1 July 2002
Tony Jones	Group Manager – Corporate Strategy & Communications	30 March 2005
Bruce Levy	Group Manager – Health Services	1 June 2004
Michael Sammells	Chief Financial Officer	4 November 2005
Heather Parkinson	Group Manager – Human Resources	15 August 2005
Kerry Crompton	Chief Information Officer	3 April 2006
Former		
Cecil Piccinino	Chief Financial Officer	31 October 2005
Surinder Singh	Chief Information Officer	31 March 2006

⁽¹⁾ Commenced in the role.

4.2 Board policy on remuneration

The Nomination, Remuneration and Human Resources Committee has recommended, and the Board has adopted a policy that remuneration will:

- reward executives for corporate, operational and individual performance against targets set by reference to appropriate benchmarks;
- align the interests of the executives to reward growth in shareholder value;
- link reward with the strategic goals and performance of Medibank Private; and
- ensure total remuneration is competitive by market standards.

Details of the composition and responsibilities of the Nomination, Remuneration and Human Resources Committee are set out in

the Corporate Governance Statement. The Committee and senior management receive advice on matters relating to remuneration from both internal and where appropriate, external sources.

The Board has a policy that remuneration packages of executives include both a fixed component and an at-risk or performance-related component (STI). The Board views STI as an essential driver of Medibank Private's strong performance based approach to remuneration. The mix between fixed remuneration and at-risk remuneration is designed to incentivise executives, and reflects competitive market conditions for this level of role. For the Managing Director and his Group Executive team, a maximum of 60 per cent of fixed remuneration can be earned in addition to guaranteed components of salary. This mix between fixed and variable remuneration reflects the Board's commitment to performance-based reward.

4.3 At-risk remuneration – Short-Term Incentive (STI) plan

Summary of STI

What is the STI?	An annual cash incentive plan linked to specific annual targets (which are predominantly financial). Up to 50 per cent of incentive awarded under this Plan is deferred for a period of three (3) years.
Who participates in the STI?	Managing Director and nominated senior executives.
Why does the Board consider the STI an appropriate incentive?	The STI is designed to put a reasonable proportion of executive remuneration at-risk against meeting targets linked to Medibank Private's annual business objectives.
Are incentives awarded where performance falls below a minimum threshold performance level?	Incentives are discounted if the overall company performance fails to meet the required threshold. In recent years this threshold has been linked to a minimum level of Company profit performance (before significant items) that must be achieved before any payments are awarded.
Who assesses the performance of senior executives?	The Managing Director assesses the performance of senior executives at the end of each financial year and confers with the Board regarding his assessment.
Who assesses the performance targets for the Managing Director?	The Board agrees the Managing Director's targets at the beginning of each year and assesses performance against those targets at the end of the financial year.
What are the qualifying hurdles?	Each executive must achieve a certain rating on their performance review to be eligible to participate in the overall plan and be considered for an incentive payment.
What are the performance conditions?	Performance targets under the plan are specified by the Board for the Managing Director and agreed between the Managing Director and executives following the approval of each annual revision of the Corporate Plan and annual budget. Targets are established under different categories (generally a mix of corporate, operational and individual) with differential weightings assigned.
Why were these conditions chosen?	Targets are set in line with the annual budgets and Medibank Private's Corporate Plan. They are intended to improve company performance.
Are both target and stretch performance conditions imposed?	Yes. The STI and the performance conditions set under the STI have been designed to motivate and reward high performance.

4.4 At-risk remuneration – Long-Term Incentive (LTI) plan

The LTI plan ceased on 30 June 2006 when the remaining executive fulfilled the conditions of his plan and was subsequently paid. The accumulated amount of LTI accrued and paid out to 30 June 2006 for executives is detailed in the following table:

Name and position	Balance of accrued LTI at 30 June 2005	Amount credited to LTI for the financial year	Amount paid during the financial year	Balance of accrued LTI at 30 June 2006
S Blair, Chief Operating Officer	133,463	48,836	(182,299)	–
B Levy, Group Manager – Health Services	79,060	95,850	–	174,910
C Piccinino, Formerly Chief Financial Officer	82,304	28,854	(111,158)	–

Directors' Report continued

5 Directors' and senior executives' remuneration

Details of each element of remuneration for Directors and senior executives are included in the table below:

	Short-term			Post-employment			Long-term			Other	Total remuneration \$
	Salary and fees \$(^a)	STI \$	Non-monetary benefits \$	Other ^(b) \$	Super-annuation \$	Retirement benefits \$	LTI ^(c) \$	Deferred STI ^(d) \$	Other ^(e) \$	Termination benefits \$	
30 June 2006											
Directors											
P M Kirby (Chairman)	102,874	–	7,438	1,705	9,259	–	–	–	–	–	121,276
G Sawides (Managing Director)	475,353	94,013 ^(f)	22,553	2,953	41,606	–	–	94,013 ^(f)	8,455	–	738,946
J Bowen	54,292	–	1,012	1,108	4,886	–	–	–	–	–	61,298
A H Brien	54,292	–	5,801	1,092	4,867	–	–	–	–	–	66,052
R D Harley	54,292	–	5,126	901	4,886	–	–	–	–	–	65,205
B F Keane	54,292	–	248	832	4,886	–	–	–	–	–	60,258
J U Stoelwinder	54,292	–	6,685	637	4,886	–	–	–	–	–	66,500
P B Wade	59,972	–	6,030	1,222	5,397	–	–	–	–	–	72,621
Total Director remuneration	909,659	94,013	54,893	10,450	80,673	–	–	94,013	8,455	–	1,252,156
Current executives											
S Blair	367,831	74,497	8,979	1,547	31,989	–	48,836	74,497	6,295	–	614,471
T Jones	370,419	74,813	5,892	584	12,373	–	–	74,813	3,332	–	542,226
B Levy	357,448	80,514	6,901	584	33,890	–	95,850	80,514	7,307	–	663,008
M Sammells ⁽¹⁾	294,315	63,130	7,145	1,486	24,643	–	–	63,130	5,276	–	459,125
H Parkinson ⁽²⁾	240,037	46,909	5,537	1,412	20,856	–	–	31,272	1,604	–	347,627
K Crompton ⁽³⁾	65,176	14,207	–	320	5,520	–	–	14,207	435	–	99,865
Total current executive remuneration	1,695,226	354,070	34,454	5,933	129,271	–	144,686	338,433	24,249	–	2,726,322
Former executives											
C Piccinino ⁽⁴⁾	213,555	–	6,109	1,196	9,897	–	28,854	–	–	265,770	525,381
S Singh ⁽⁵⁾	217,499	–	5,181	438	19,574	–	–	–	–	230,087	472,779
Total former executive remuneration	431,054	–	11,290	1,634	29,471	–	28,854	–	–	495,857	998,160

^(a) Salary and fees includes accruals for annual leave.

^(b) Other benefits include salary and continuance insurance and subsidised health insurance.

^(c) LTI plan amounts have been accrued.

^(d) STI amounts have been accrued and payment is deferred for three years.

^(e) Comprises accrual for long service leave.

^(f) \$62,675 of G Sawides' STI is subject to performance objectives that are still in progress, and will be paid at the completion of those objectives being achieved.

⁽¹⁾ Appointed Chief Financial Officer 4 November 2005.

⁽²⁾ Commenced 15 August 2005.

⁽³⁾ Commenced 3 April 2006.

⁽⁴⁾ Left employment 31 October 2005.

⁽⁵⁾ Left employment 31 March 2006.

6 Executive service agreements

Terms of employment (including all components of remuneration) for the Managing Director and senior executives are formalised in individual employment contracts. Specific information relating to the terms of the service agreements contained within these contracts is set out in section 6.1.

6.1 Summary of specific terms

Name	Notice period by Medibank Private	Notice period by executive	Maximum termination payment	Maximum discretionary bonus payment ^(a)
G Savvides	6 months ^(b)	3 months	15 months ^(c)	n/a
S Blair	6 months	3 months	12 months	9 months
T Jones	6 months	3 months	12 months	9 months
B Levy	6 months	3 months	12 months	9 months
M Sammells	6 months	3 months	12 months	9 months
H Parkinson	6 months	3 months	12 months	9 months
K Crompton	6 months	3 months	12 months	n/a

^(a) Relates to positive contribution to a sale other than an IPO, and is at the full discretion of the Board. Maximum combined termination payment and performance bonus is capped at 15 months.

^(b) Minimum notice period for G Savvides is six months, with a maximum of 12 months.

^(c) The maximum payment includes the Board's discretion to award an additional nine months payment to G Savvides in the event of termination resulting from a sale.

6.2 Restraint of trade

Medibank Private negotiates appropriate restraint of trade conditions with senior executives, which are included in each executive's individual employment contract. Restraint clauses are intended to protect the legitimate business interests of Medibank Private upon cessation of employment of senior executives.

Indemnification of Directors and officers

An indemnity agreement has been entered into between Medibank Private and each of the Directors of the Company. Under the agreement, to the fullest extent allowed by law, the Company has agreed to indemnify those officers against any claim or for any expenses or costs which may arise as a result of work performance in their respective capacities. There is no monetary limit to the extent of this indemnity. There have been no claims made pursuant to the above indemnity arrangements.

Medibank Private paid a premium of \$187,842 in respect of insurance covering each of the Directors and Executive Officers of Medibank Private against liabilities and expenses arising from any claim(s) made against them as a result of work performed in their respective capacities to the extent permitted by law.

Rounding

Medibank Private is a Company of the kind specified in Australian Securities and Investment Commission class order 98/0100. In accordance with that class order, amounts in the financial statements and the Directors' Report have been rounded to the nearest thousand dollars unless specifically stated to be otherwise.

Auditor independence and non-audit services

The Directors received a declaration from the Auditor General. This declaration is located on the following page.

Resolution of Directors

This report is made in accordance with a resolution of the Directors.



P M Kirby
Chairman



G Savvides
Managing Director

Melbourne, 8 September 2006

Auditor's Independence Declaration to the Directors of Medibank Private Limited



Mr Neil Greenaway
Company Secretary
Medibank Private Limited
GPO Box 9999
MELBOURNE VIC 3001

Dear Mr Greenaway

Auditor's Independence Declaration to the Directors of Medibank Private Limited

In relation to my audit of the financial report of Medibank Private Limited for the year ended 30 June 2006, to the best of my knowledge and belief, there have been:

- (i) no contraventions of the auditor independence requirements of the *Corporations Act 2001*; and
- (ii) no contravention of any applicable code of professional conduct.

Australian National Audit Office

Michael J. Watson
Group Executive Director

Delegate of the Auditor-General

Canberra
8 September 2006

Income Statement

For the financial year ended 30 June 2006

	Note	2006 \$'000	2005 \$'000
Revenue			
Premium revenue		2,835,337	2,598,658
Claims expense			
Claims incurred	13(b)	(2,428,475)	(2,297,975)
State levies		(23,353)	(25,255)
Health Benefits Reinsurance Trust Fund recoveries		649,817	628,158
Health Benefits Reinsurance Trust Fund levies		(637,254)	(602,506)
Net claims incurred		(2,439,265)	(2,297,578)
Underwriting result		396,072	301,080
Expenses			
Employee benefits expense		(110,439)	(99,440)
Information and technology expense		(33,864)	(35,751)
Marketing expense		(36,052)	(28,579)
Lease expense	4(d)	(13,837)	(11,546)
Office and administration expense		(49,655)	(40,369)
Depreciation and amortisation expense	4(c)	(12,171)	(10,799)
Business systems renewal program expense	4(f)	(13,577)	(5,049)
Impairment of intangible assets	4(g)	(26,135)	(7,041)
Other expenses		(95)	(187)
Total expenses		(295,825)	(238,761)
Underwriting result after expenses		100,247	62,319
Investment and other income			
Investment income	4(a)	113,704	73,364
Investment expense	4(e)	(15,775)	(5,294)
Other income	4(b)	1,886	326
Total investment and other income		99,815	68,396
Profit for the year		200,062	130,715

The above statement should be read in conjunction with the accompanying notes.

Balance Sheet

As at 30 June 2006

	Note	2006 \$'000	2005 \$'000
Current assets			
Cash and cash equivalents	19(a)	908,169	905,867
Trade and other receivables	5	104,989	90,873
Inventories	6	491	164
Financial assets at fair value through profit and loss	7	517,857	288,892
Prepayments	8	4,019	3,136
Total current assets		1,535,525	1,288,932
Non-current assets			
Financial assets at fair value through profit and loss	7	246	246
Plant and equipment	9	27,514	27,863
Intangible assets	10	27,062	31,442
Total non-current assets		54,822	59,551
Total assets		1,590,347	1,348,483
Current liabilities			
Trade and other payables	11	372,448	362,339
Financial liabilities at fair value through profit and loss	12	948	–
Claim liabilities	13	342,332	306,762
Provisions	14	22,452	24,404
Total current liabilities		738,180	693,505
Non-current liabilities			
Other payables	11	408	20
Provisions	14	3,559	2,778
Total non-current liabilities		3,967	2,798
Total liabilities		742,147	696,303
Net assets		848,200	652,180
Equity			
Contributed equity	15	85,000	85,000
Retained earnings	16	763,200	567,180
Total equity		848,200	652,180

The above statement should be read in conjunction with the accompanying notes.

Cash Flow Statement

For the financial year ended 30 June 2006

	Note	2006 \$'000	2005 \$'000
Cash flows from operating activities			
Premium receipts		2,844,582	2,626,820
Receipts from other		1,718	192
Interest received		485	774
Payments for benefits and levies		(2,414,674)	(2,253,754)
Payments to suppliers and employees		(260,903)	(213,634)
Net cash flow from operating activities	19(b)	171,208	160,398
Cash flows from investing activities			
Trust distributions received		16,793	4,854
Interest received		63,972	57,913
Interest received on special purpose fund		165	87
Proceeds from sale of financial assets		307,240	93,589
Investment charges		(828)	(301)
Purchase of financial assets		(517,738)	(257,042)
Purchase of software intangibles		(30,182)	(20,232)
Purchase of plant and equipment		(8,328)	(13,540)
Net cash flow used in investing activities		(168,906)	(134,672)
Cash flows from financing activities			
Proceeds from issue of shares		–	85,000
Net cash flow from financing activities		–	85,000
Net increase in cash and cash equivalents		2,302	110,726
Cash and cash equivalents at beginning of period		905,867	795,141
Cash and cash equivalents at end of period	19(a)	908,169	905,867

The above statement should be read in conjunction with the accompanying notes.

Statement of Changes in Equity

For the financial year ended 30 June 2006

	Issued capital \$'000	Retained earnings \$'000	Total equity \$'000
At 1 July 2004	–	436,465	436,465
Issued during the financial year			
– equity injection by Commonwealth of Australia	85,000	–	85,000
Profit for the year	–	130,715	130,715
At 30 June 2005	85,000	567,180	652,180
At 30 June 2005	85,000	567,180	652,180
<i>AIFRS adjustments due to adoption of AASB 1023, 132 and 139:</i>			
Fair value movement in financial assets	–	12	12
Premium revenue	–	569	569
Risk margin on outstanding claims	–	(5,963)	(5,963)
Discount on outstanding claims	–	1,340	1,340
At 1 July 2005	85,000	563,138	648,138
Profit for the year	–	200,062	200,062
At 30 June 2006	85,000	763,200	848,200

The above statement should be read in conjunction with the accompanying notes.

Notes to the Financial Statements

For the financial year ended 30 June 2006

Note 1: Summary of significant accounting policies

(a) Basis of preparation

The financial report is a general-purpose financial report, which has been prepared in accordance with the requirements of the Corporations Act 2001 and Australian Accounting Standards. The financial report has also been prepared on a historical cost basis, except for cash which has been measured at nominal value and financial assets and financial derivatives which have been measured at fair value.

The financial report is presented in Australian dollars and all values are rounded to the nearest \$'000 unless otherwise stated under the option available to the Company under ASIC Class Order 98/100. The Company is an entity to which the class order applies.

(b) Statement of compliance

The financial report complies with Australian Accounting Standards which includes Australian equivalents to International Financial Reporting Standards ('AIFRS'). Compliance with AIFRS ensures that the financial report, comprising the financial statements and notes thereto, complies with International Financial Reporting Standards ('IFRS').

This is the first financial report prepared based on AIFRS and comparatives for the year ended 30 June 2005 have been restated accordingly except for the adoption of AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 139 *Financial Instruments: Recognition and Measurement* and AASB 1023 *General Insurance Contracts*. The Company has adopted the exemption under AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* from having to apply AASB 132, AASB 139 and AASB 1023 to the comparative period. Reconciliations of AIFRS equity and profit for 30 June 2005 to the balances reported in the 30 June 2005 financial report and at transition to AIFRS are detailed in Note 28.

Australian Accounting Standards that have recently been issued or amended but are not yet effective have not been adopted for the annual reporting period ending 30 June 2006.

AASB amendment	Affected standard(s)	Nature of change to accounting policy	Application date of standard *	Application date for Medibank Private
2005-1	AASB139: <i>Financial Instruments: Recognition and Measurement</i>	No change in accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2005-4	AASB139: <i>Financial Instruments: Recognition and Measurement</i> AASB132: <i>Financial Instruments: Disclosure and Presentation</i> AASB1: <i>First time adoption of AIFRS</i> AASB1023: <i>General Insurance Contracts</i> AASB1038: <i>Life Insurance Contracts</i>	No change in accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2005-5	AASB1: <i>First-time Adoption of AIFRS</i> AASB139: <i>Financial Instruments: Recognition and Measurement</i>	No change in accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2005-9	AASB4: <i>Insurance Contracts</i> AASB1023: <i>General Insurance Contracts</i> AASB139: <i>Financial Instruments: Recognition and Measurement</i> AASB132: <i>Financial Instruments: Disclosure and Presentation</i>	No change in accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2005-10	AASB132: <i>Financial Instruments: Disclosure and Presentation</i> AASB101: <i>Presentation of Financial Statements</i> AASB114: <i>Segment Reporting</i> AASB117: <i>Leases</i> AASB133: <i>Earnings per Share</i> AASB139: <i>Financial Instruments: Recognition and Measurement</i> AASB1: <i>First-time Adoption of AIFRS</i> AASB4: <i>Insurance contracts</i> AASB1023: <i>General Insurance Contracts</i> AASB1038: <i>Life Insurance contracts</i>	No change in accounting policy required. Therefore no impact.	1 January 2007	1 July 2007
New Standard	AASB 7 <i>Financial Instruments: Disclosures</i>	No change in accounting policy required. Impact on certain disclosures of financial assets and liabilities.	1 January 2007	1 July 2007

* Application date is for the annual reporting periods beginning on or after the date shown in the above table.

The following amendments are not applicable to Medibank Private and therefore have no impact.

AASB amendment	Affected standard(s)
2005-6	AASB3: <i>Business Combinations</i>
2006-1	AASB121: <i>Effects of Changes in Foreign Exchange Rates</i>
2006-2	AASB1: <i>First-time Adoption of AIFRS</i>

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 1: Summary of significant accounting policies continued

(c) Revenue and other income recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to Medibank Private and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

(i) Premium revenue

Premium revenue comprises contributions received, inclusive of any Government Rebate.

Medibank Private has elected to apply the option available under AASB 1 of adopting AASB 1023 from 1 July 2005. Outlined below are the relevant accounting policies for premium revenue for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

Premium revenue is recognised in the income statement from the commencement date of the current period of insurance cover in accordance with the pattern of the incidence of risk expected to match the seasonality of claims over the term of the insurance cover. Premium revenue relating to future financial periods is classified as unearned premium liability and is measured in accordance with the pattern of the incidence of risk expected to match the seasonality of claims over the term of the insurance cover.

Accounting policies applicable for the year ending 30 June 2005

Premium revenue is recognised when earned over the period of the membership. Premium revenue relating to future financial periods is classified as unearned premium liability and is measured on a daily pro rata time basis between the reporting date and the premium due date.

(ii) Sale of non-current assets

The gain or loss on disposal of non-current assets is calculated as the difference between the carrying amount of the asset at the time of disposal and the net proceeds on disposal (including incidental costs).

(iii) Investment income

Unit trust distribution income is recognised when received. Interest income accrues using the effective interest method. Refer to Note 1(i) for details on the measurement of gains and losses on financial assets measured at fair value through profit and loss and derivative financial assets.

(iv) Other income

Travel insurance commission income is recognised as income in the periods in which it is earned. Rental income is recognised as it accrues. Other income is recognised as income in the periods in which it is earned.

(v) Net reinsurance revenue

The amount receivable from the Health Benefits Reinsurance Trust Fund is determined by the Private Health Insurance Administration Council after the end of each quarter. Estimated provisions for amounts receivable are provided for periods for which determinations have not yet been made, including an estimate of reinsurance on claims liabilities.

(d) Claims

Claims expense represents payment for claims and the movement in claims liabilities.

(e) Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term. Lease incentives are recognised in the income statement as an integral part of the total lease expense.

Lease incentives

In the event that lease incentives are received to enter into non-cancellable operating leases, such incentives are recognised as a liability. Lease payments are allocated between the rental expense and the reduction of the liability over the term of the lease.

(f) Cash and cash equivalents

Cash assets include cash on hand, short-term bank bills, commercial notes and restricted funds held in a special purpose fund account and in escrow (generally maturing within 90 days) and are stated at nominal value.

For the purposes of the Cash Flow Statement, cash includes all cash assets as described above, net of outstanding bank overdrafts. Further, cash includes restricted funds held in a special purpose fund for future settlement of claims under the Australian Competition and Consumer Commission 'Principles of Settlement' agreement, as well as funds held in escrow as part of the contractual arrangements with Eternity Private Health.

(g) Trade and other receivables

Medibank Private has elected to apply the option available under AASB 1 of adopting AASB 132, AASB 139 and AASB 1023 from 1 July 2005. Outlined below are the relevant accounting policies for trade and other receivables for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

Trade and other receivables are recognised and carried at the original invoice amount less an allowance for any uncollectable amounts.

The recognition criteria for the impairment of trade and other receivables is detailed in Note 1(l).

Accounting policies applicable for the year ending 30 June 2005

Trade and other receivables were recognised and carried at the original invoice amount less a provision for any uncollectible debts. An estimate for doubtful debts was made when collection of the full amount was no longer probable. Bad debts were written off as incurred.

(h) Inventories

The loyalty scheme tickets are valued at the lower of cost and net realisable value.

(i) Financial assets at fair value through profit and loss

Medibank Private has elected to apply the option available under AASB 1 of adopting AASB 132, AASB 139 and AASB 1023 from 1 July 2005. Outlined below are the relevant accounting policies for financial assets for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

Assets Backing General Insurance Liabilities

Financial assets that back general insurance liabilities that are within the scope of AASB 139 *Financial Instruments: Recognition and Measurement* and are permitted to be designated as 'at fair value through profit or loss', have been designated as 'at fair value through profit or loss' under AASB 139 *Financial Instruments: Recognition and Measurement* on first application of AASB 1023 *General Insurance Contracts* or on initial recognition of the asset.

Medibank Private has determined that its cash and cash equivalents and financial assets, that have a quoted market price in an active market and whose fair value can be reliably measured, are financial assets permitted to be designated as assets backing general insurance liabilities.

Measurement

Financial assets that are designated at fair value through profit and loss, consist of externally managed equity trusts, both domestic and international, an internally managed floating rate note portfolio (that reset monthly, quarterly and biannually, however, have an average duration of 1,230 days) and an internally managed cash portfolio (that consists of 11am, bank bills and commercial paper with an average duration of 50 days). Gains or losses are recognised in the income statement.

The gain or loss on disposal of assets backing general insurance liabilities is calculated as the difference between the carrying amount of the financial asset at the time of disposal and the proceeds on disposal.

Purchases and sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place are recognised on the trade date, i.e. the date that Medibank Private commits to purchase the asset.

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date, with the exception of foreign currency positions which are valued at the official closing price sourced from the Bloomberg financial information service on the balance sheet date. For investments with no active market, fair value is determined using valuation techniques such as option pricing models.

Accounting policies applicable for the year ending 30 June 2005

Investments were carried at net market value being the quoted market close price at the close of business on the balance sheet date. Changes in net market value were recognised as a revenue or expense in the income statement for the period.

Non-current investments are recorded at cost.

Note 1: Summary of significant accounting policies continued**(j) Financial liabilities at fair value through profit and loss**

Medibank Private has entered into derivatives contracts this financial year including over-the-counter equity options (puts and calls), cash-equity swaps, and foreign exchange forward, swap and option contracts. These transactions were entered into primarily to protect the Australian equity, Australian property and Global equity asset classes against downside movements in excess of an established level.

Medibank Private has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for derivative financial instruments for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

Medibank Private uses derivative financial instruments such as put and call arrangements to economically hedge its risk associated with equity market fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Changes in fair value are recognised in the income statement for the period. The fair value of these arrangements is determined using valuation techniques. Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Accounting policies applicable for the year ending 30 June 2005

Derivative financial instruments are recorded at market value. Changes in net market value are recognised as revenue or expense in the income statement for the period. Derivative financial instruments were recorded in the balance sheet as financial assets at fair value through profit and loss in the 2005 year.

(k) Derecognition of financial assets and liabilities

Medibank Private has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for derecognition of financial assets and liabilities for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006*Financial assets*

Medibank Private derecognises a financial asset when, and only when, the contractual rights to the cash flows from the financial asset expire.

Financial liabilities

Derecognition of a financial liability takes place when the obligation specified in the contract is discharged or cancelled or expires.

Accounting policies applicable for the year ending 30 June 2005*Financial assets*

A financial asset was derecognised when the contractual right to receive or exchange cash no longer existed.

Financial liabilities

A financial liability was derecognised when the contractual obligation to deliver or exchange cash no longer existed.

(l) Impairment of financial assets

Medibank Private has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for impairment of financial assets for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

Medibank Private assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

Financial assets at amortised cost

If there is objective evidence that an impairment loss on receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognised in the income statement.

Financial assets at fair value

Medibank Private first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Accounting policies applicable for the year ending 30 June 2005*Financial assets at fair value*

Medibank Private first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

(m) Advances to hospitals

Advances to hospitals are measured at cost. Funds advanced are forwarded to hospitals which are subsequently reduced by claims expenses incurred.

(n) Foreign currencies

Both the functional and presentation currency of Medibank Private is Australian dollars (\$AUD).

The fund managers appointed to manage the international sector of the Medibank Private investment portfolio invest in selected foreign securities.

Foreign currency transactions are translated to Australian currency at the rates of exchange ruling at the date of the transactions. Amounts receivable and payable in foreign currencies at balance date are translated at the rates of the exchange on that date.

Exchange differences relating to amounts receivable and payable in foreign currencies are brought to account as exchange gains or losses in the income statement in the financial period in which the exchange rates change.

(o) Taxes

Medibank Private pays all relevant taxes including goods and services tax, fringe benefits tax, and payroll tax. Medibank Private is exempt from income tax.

Goods and services tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST except:

- (i) where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- (ii) receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

Cash flows are included in the cash flow statement on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority, are classified as operating cash flows.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

(p) Plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses.

Purchases of plant and equipment are recognised initially at cost, except for purchases costing less than \$1,000 which are expensed in the year of acquisition (other than where they form part of a group of similar items which are significant in total).

Assets under construction are not depreciated until in use.

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 1: Summary of significant accounting policies continued

Depreciation is provided on a straight-line basis on all plant and equipment. The expected useful lives are as follows:

	2006	2005
Leasehold improvements:		
– retail centres	5 years	5 years
– all other improvements	the lease term	the lease term
Plant and equipment	6 – 6.5 years	6 – 6.5 years

The assets' residual values, useful lives and amortisation methods are reviewed, and are adjusted if appropriate at each financial year end.

Impairment

The recognition criteria for the impairment of plant and equipment is detailed in Note 1(r).

Derecognition and disposal

An item of plant and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use or disposal.

Any gain or loss arising from derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the year the asset is derecognised.

(q) Intangibles

Intangible assets acquired separately are initially measured at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is charged against profits in the year in which the expenditure is incurred.

Amortisation is provided on a straight-line basis on all intangibles. The expected useful lives are as follows:

	2006	2005
Software intangibles	3 – 5 years	3 – 5 years

The useful lives of intangible assets are assessed as finite. Intangible assets with finite lives are amortised over the useful life and assessed for impairment whenever there is an indication that the intangible asset is impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, which is a change in accounting estimate. The amortisation expense of intangible assets with finite lives is recognised in profit or loss in the expense category consistent with the function of the intangible asset.

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when Medibank Private can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure so capitalised is amortised over the period of expected benefits from the related project.

The carrying value of intangible asset arising from development expenditure is tested for impairment annually when the asset is not yet available for use, or more frequently when an indicator of impairment arises during the reporting period.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

(r) Impairment of assets

At each reporting date, Medibank Private assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, or when annual impairment testing for an asset is required, an estimate of recoverable amount is made. An asset's recoverable amount is the higher of its fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and the asset's value in use cannot be estimated to be close to its fair value. In such cases, the asset is tested for impairment as part of the cash generating unit to which the asset belongs. When the carrying amount of an asset or cash generating unit exceeds its recoverable amount, the asset or cash generating unit is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An assessment is also made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior periods. Such reversals are recognised in the income statement unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic value over its remaining useful life.

(s) Health Benefits Reinsurance Trust Fund

Under the provisions of the *National Health Act 1953*, some hospital benefits may be charged to the reinsurance account. All health insurers must participate in the Health Benefits Reinsurance Trust Fund, which shares, between all health insurers, a proportion of the hospital claims of all persons aged 65 years and over and those memberships with more than 35 days of hospitalisation in any one year.

The amount payable to or receivable from the Health Benefits Reinsurance Trust Fund is determined by the Private Health Insurance Administration Council after the end of each quarter. Estimated provisions for amounts payable or receivable are provided for periods for which determinations have not yet been made, including an estimate of reinsurance on unrepresented and outstanding claims.

The net reinsurance revenue for 2005/06 was \$12,563,000 (\$25,652,000 was received during 2004/05) and is included as part of claims expense. The net amount receivable from the Reinsurance Trust Fund at 30 June 2006 was \$4,977,000 (2005: \$7,879,000), and is included in sundry debtors (Note 5).

(t) Provisions

Provisions are recognised when Medibank Private has a present legal or constructive obligation as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

If the effect of the time value of money is material, provisions are discounted using a current discount rate that reflects the risks specific to the liability.

(u) Make good provision

Make good provisions are recognised when Medibank Private has a present legal or constructive obligation as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

Make good provisions are discounted to take into effect the time value of money using a current discount rate that reflects the risks specific to the liability.

Where discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

Note 1: Summary of significant accounting policies continued**(v) Claims liabilities and unexpired risk liability**

Medibank Private has elected to apply the option available under AASB 1 of adopting AASB 1023 from 1 July 2005. Outlined below are the relevant accounting policies for claims liabilities and unexpired risk liability for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006**(i) Claims liabilities**

The liability for outstanding claims provides for claims received but not assessed and claims incurred but not received. The liability is based on an actuarial assessment taking into account historical patterns of claim incidence and processing. It is measured as the central estimate of the present value of expected future payments arising from claims incurred at the reporting date under insurance cover issued by Medibank Private. The expected future payments are discounted to present value using a risk-free rate. The outstanding claims liability includes a risk margin reflecting the inherent uncertainty in the central estimate of the present value of the expected future payments.

The liability also allows for an estimate of claims handling costs, which include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any part of the general administrative costs directly attributable to the claims function. The allowance for claims handling costs at 30 June 2006 is 2.34 per cent of the claims liability.

In 2000, Medibank Private launched a new PackagePlus product range which included a benefit category, PackageBonus, covering additional health related services. A feature of this benefit category is that any unused PackageBonus in a calendar year is carried forward to future calendar years subject to a maximum limit. Accordingly, 85 per cent of the PackageBonus amount, less the amount paid, has been included in claims liabilities to reflect the expected future utilisation of this benefit in respect of membership up to 30 June 2006.

(ii) Unexpired risk liability

The liability adequacy test is required to be performed to determine whether the unearned premium liability (contributions in advance) is adequate to cover the present value of expected cash flows relating to future claims arising from rights and obligations under current insurance coverage, plus an additional risk margin to reflect the inherent uncertainty in the central estimate.

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

Liability adequacy testing did not result in any deficiency.

Accounting policies applicable for the year ending 30 June 2005

The provision for unpresented and outstanding claims provides for claims received but not assessed and claims incurred but not received. The provision is based on an actuarial assessment taking into account historical patterns of claim incidence and processing. No discounting was applied to the provision due to the generally short time period between claim incidence and settlement.

The provision also allows for an estimate of operating expenses to cover the cost of processing outstanding claims. Medibank Private's policy is to reflect only the proportion of management expenses associated with the processing of benefits. The ratio at 30 June 2005 is 2.16 per cent.

In 2000, Medibank Private launched a new PackagePlus product range which included a benefit category, PackageBonus, covering additional health related services. A feature of this benefit category is that any unused PackageBonus in a calendar year is carried forward to future calendar years subject to a maximum limit. Accordingly, 85 per cent of the PackageBonus amount, less the amount paid, has been included in provisions to reflect the expected future utilisation of this benefit in respect of membership up to 30 June 2005.

(w) Trade and other payables

Medibank Private has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for trade and other payables for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

Trade and other payables are carried at amortised cost and represent consideration to be paid in the future for goods and services received, whether or not billed to Medibank Private.

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

Accounting policies applicable for the year ending 30 June 2005

Trade and other payables are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to Medibank Private.

(x) Employee benefits

Provision is made for employee entitlement benefits accumulated as a result of employees rendering services up to the reporting date. These benefits include wages and salaries, annual leave and long service leave.

Liabilities arising in respect of wages and salaries and annual leave which have vested at reporting date and for which Medibank Private has an unconditional obligation to pay, are measured at their nominal amounts based on remuneration rates which are expected to be paid when the liability is settled. The liability for long service leave is recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to expected future wage and salary levels, experience of employee departures, and periods of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currencies that match, as closely as possible, the estimated future cash outflows.

The short-term incentive (STI) plan is available to staff and has been developed to link the achievement of overall company performance with individual performance outcomes that are over and above the targeted objectives of the role. The total potential STI available is set at a level so as to provide sufficient incentive for staff to achieve the targets and such that the costs of the STI are fully funded by business performance. There is a qualifying hurdle which must be met in order to trigger payments under the short-term incentive plan of budgeted financial result plus the cost of the plan. The provision is recognised upon approval by the relevant authority.

A new short-term incentive (STI) for senior executives was introduced this financial year, and is aimed at driving performance and rewarding executives for achievement against targeted and stretch objectives. For senior executives, objectives consist of corporate financial and non-financial targets and a mix of operational and individual objectives. Potential STI earnings are capped at 60 per cent of fixed remuneration. Generally 50 per cent of STI earned is payable after the final financial result is declared and 50 per cent deferred for three years. The deferral component is discounted to net present value using a risk-free rate of return.

A long-term incentive plan (LTI) was available, for a limited number of key executives. This plan ceased at 30 June 2006. The LTI plan aligned this element of remuneration to the sustained achievement of corporate plan objectives. The LTI accrues annually over three years, the cumulative total of which is to be payable at the conclusion of the three year period. The LTI is linked to the achievement of predetermined performance hurdles, namely, capital adequacy targets and financial result.

(y) Contributed equity

Fully paid ordinary shares are classified as contributed equity.

(z) Product classification

Insurance contracts are defined as those containing significant insurance risk at the inception of the contract, or those where at the inception of the contract there is a scenario with commercial substance where the level of insurance risk may be significant over time. The significance of insurance risk is dependent on both the probability of an insurance event and the magnitude of its potential effect.

The revenue recognition criteria are detailed in Note 1(c).

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

Medibank Private has determined that all insurance cover provided to with members are insurance contracts.

The insurance risk assumptions are detailed in Note 2(i).

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 2: Critical accounting estimates and assumptions

The carrying amount of certain key asset and liability amounts are often determined based on estimates and assumptions of future events. The key areas in which estimates and judgements are applied are described below.

Except for the introduction of AASB 1023 *General Insurance Contracts* at 1 July 2005, the critical accounting estimates and assumptions have not changed significantly between the 2005 and 2006 years.

Ultimate liability arising from claims made under insurance coverage
Provision is made for the estimated cost of claims incurred but not settled at balance date.

(i) Insurance risk assumptions

The estimation of outstanding claims liabilities is based largely on the assumption that past claims settlement patterns are an appropriate predictor of the expected future claims settlements and involves a variety of actuarial techniques that analyse experience, trends and other relevant factors. The process for establishing the outstanding claims provision involves extensive consultation with internal actuaries, claims managers and other senior management. The process includes monthly internal claims review meetings attended by senior divisional management and the Chief Actuary.

The critical assumptions in the determination of the amounts that Medibank Private will ultimately pay for claims arising under insurance cover provided are the expected level of claims incidence, reporting and payment.

(ii) Central estimates

The outstanding claims provision comprises the central estimate and a risk margin which is added to the central estimate to achieve a desired probability of adequacy. The outstanding claims provision is discounted at risk-free rates of return to reflect the time value of money.

A central estimate is an estimate of the level of claims provision that is intended to contain no intentional under or over estimation. In simple terms, the central estimate is equally likely to be too high (more than adequate) or too low (less than adequate) and is commonly described as providing a 50 per cent probability of adequacy. Medibank Private requires a higher probability that estimates will be adequate over time, and a risk margin is added to the central estimate of outstanding claims.

Central estimates for each class of business are determined based on analysis of historical experience which assumes an underlying pattern of claims development and payment. The final selected central estimates are based on a judgmental consideration of the results and qualitative information.

Central estimates are calculated excluding the impact of the Health Benefits Reinsurance Trust Fund. A separate estimate is made of levies payable to and recoveries from the Health Benefits Reinsurance Trust Fund.

(iii) Risk margin

The overall risk margin is determined after consideration of the uncertainty of the outstanding claims estimate, with the objective of achieving at least a 75 per cent probability of sufficiency. The risk margin applied at 30 June 2006 is 2.5 per cent which equates to \$6,741,000 as reflected in Note 13(a).

(iv) Financial assumptions used to determine outstanding claims provision

The outstanding claims provision is discounted to net present value using a risk-free rate of return. The risk free rate applied at 30 June 2006 is 5.97 per cent which equates to \$1,973,000 as reflected in Note 13(b).

(v) Impact of changes in key variables on the outstanding claims provision (excluding PackageBonus)

The impact of changes in key outstanding claims variables are summarised below. Each change has been calculated in isolation of the other changes and each change shows the impact on profit and equity assuming that there is no change to another variable. Please refer to table below.

Note 3: Financial risk management objectives and policies

Medibank Private's principal financial instruments, other than derivatives, comprise cash and short-term deposits, debentures (including bank bills, promissory notes, commercial paper and floating rate notes), fixed interest investments, domestic and global property trusts, domestic equity trusts and global equity trusts.

The main purpose of these financial instruments is to maintain solvency and capital adequacy positions as determined by board policy and to achieve appropriate levels of return for risk from the reserves available. Medibank Private enters into derivative transactions, principally equity market index hedges and forward currency contracts with the sole purpose of managing its risks to equity market downturns and currency risks arising from its investment operations. It is Medibank Private's policy that at no time over the period trading of these derivative instruments will be undertaken.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 1 to the financial statements.

Cash flow interest rate risk

Medibank Private's exposure to the risk of changes in market interest rates consists of its exposure to fixed interest investments. This risk is mitigated by keeping investments of this description to less than 1 per cent of the portfolio.

Foreign currency risk

Medibank Private's investments in global equity trusts and global property trust asset classes are exposed to fluctuations in currency exchange rates. Forward rate contracts are entered into between the Australian dollar and the following currencies, US dollar, Japanese Yen, the Euro and Pound Sterling. Medibank Private's investment policy states that 100 per cent of this foreign currency risk is to be economically hedged.

Credit risk

Medibank Private trades only with recognised, creditworthy third parties.

In addition, receivable balances are monitored on an ongoing basis with the result that Medibank Private's exposure to bad debts is not significant.

Financial assets are recorded in the balance sheet at the amount that best represents the maximum credit risk exposure.

There are no significant concentrations of credit risk within Medibank Private.

The credit risk associated with investment in debt assets arises from default of counterparties. Counterparty limits are calculated daily and compared to authorised credit limits before further transactions are undertaken. All debt securities are rated investment grade.

Impact of changes in key variables on the outstanding claims provision (excluding PackageBonus)

		Financial Impact	
	Movement in Variable	Profit/(loss) \$'000	Equity \$'000
Central estimate	+1%	(2,696)	(2,696)
Central estimate	-1%	2,696	2,696
Discount rate	+1%	325	325
Discount rate	-1%	(329)	(329)
Weighted average term to settlement	+1 month	1,285	1,285
Weighted average term to settlement	-1 month	(1,291)	(1,291)

Note 4: Revenue and expenses

	Note	2006 \$'000	2005 \$'000
(a) Investment income			
Interest		63,972	57,913
Interest from ordinary activities		485	774
Trust distributions		16,793	4,854
Realised gain on financial assets		6,107	–
Unrealised gain on financial assets		26,347	9,823
		113,704	73,364
(b) Other income			
Rental income		148	48
Travel insurance commission		1,384	39
Interest on special purpose fund		165	87
Other		189	152
		1,886	326
(c) Depreciation and amortisation			
Depreciation – plant and equipment		1,555	1,384
Depreciation – leasehold improvements		5,246	3,529
Amortisation – software		5,370	5,886
		12,171	10,799
(d) Lease expense			
Operating lease rental expense		13,837	11,546
(e) Investment expense			
Investment management fees		828	301
Realised loss on financial assets		13,513	35
Unrealised loss on financial assets		1,434	4,958
		15,775	5,294

(f) Business systems renewal program expense

13,577

5,049

Medibank Private has continued its comprehensive investment into the replacement and upgrading of core business IT infrastructure, known as the Business Systems Renewal (BSR) program.

Commenced in 2005, the multi-year project was aimed to provide, over a number of stages, a new generation of information technology that would streamline claims processing and the overall management of a large and diversified portfolio of business activities, as well as allow us to support the introduction of new products. Following a review, the program is in the course of a replanning phase, designed to deliver a staged implementation.

(g) Impairment

Impairment of intangible assets

(i), (ii)

26,135

7,041

(i) Business systems renewal program

At 30 June 2006, in line with a recommendation from management, the Board of Directors reviewed the current status of the BSR program and determined that the program was not likely to meet its original stated objectives or timetable as a single-step implementation. A replanning phase is currently being undertaken to determine the future direction of the program on a staged implementation basis. This has resulted in an impairment of the asset for the year of \$26,135,000.

(ii) Significant software expenses relating to 30 June 2005

As a result of Medibank Private updating its financial and core computer systems, costs associated with existing legacy systems have been expensed as incurred during the financial year. These costs have been recorded in the income statement for the year ending 30 June 2005 and amount to \$8,091,000. These costs have been treated as accelerated software depreciation expenses of \$895,000, plant and equipment assets written off of \$7,041,000 and information and technology expenses of \$155,000.

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 5: Trade and other receivables

	Note	2006 \$'000	2005 \$'000
Contributions in arrears	(i)	9,273	9,514
Allowance for doubtful debts		(387)	(387)
		8,886	9,127
Sundry debtors	(ii)	15,625	18,034
Allowance for doubtful debts		–	(485)
		15,625	17,549
Goods and services tax		1,559	3,491
Government rebate scheme	(iii)	78,919	60,706
		104,989	90,873

Terms and conditions relating to the above financial instruments:

- (i) Contributions in arrears are non-interest bearing.
- (ii) Sundry debtors are non-interest bearing and generally on 30-day terms and includes net reinsurance receivable.
- (iii) Government rebate scheme is non-interest bearing and generally on 15-day terms.

Note 6: Inventories

	2006 \$'000	2005 \$'000
Current		
Loyalty scheme – tickets		
At cost	516	192
Provision for diminution in value	(25)	(28)
	491	164

Note 7: Financial assets at fair value through profit and loss

	Note	2006 \$'000	2005 \$'000
Current			
Unit trusts	(i)	260,316	168,367
Debentures, notes and bills	(ii)	252,889	120,192
Derivatives	17(c)	4,652	333
		517,857	288,892

Terms and conditions relating to the above financial instruments:

- (i) Unit trusts are readily saleable with no fixed terms.
- (ii) Debentures, notes and bills are interest bearing and are reset either monthly, quarterly or biannually with an average maturity of 1,230 days.

Non-current

Other		246	246
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Note 8: Prepayments

	2006 \$'000	2005 \$'000
Advance payments to hospitals	225	–
Prepayments	3,794	3,136
	4,019	3,136

Note 9: Plant and equipment

	Plant and equipment \$'000	Leasehold improvements \$'000	Assets under construction \$'000	Total \$'000
Gross carrying amount				
Carrying amount at beginning of the financial year	9,726	30,301	558	40,585
Transfers in/(out)	42	347	(389)	-
Additions	623	5,570	354	6,547
Disposals	(195)	(1,955)	-	(2,150)
Balance at 30 June 2006	10,196	34,263	523	44,982
Accumulated depreciation				
Carrying amount at beginning of the financial year	(3,088)	(9,634)	-	(12,722)
Depreciation expense	(1,555)	(5,246)	-	(6,801)
Disposals	192	1,863	-	2,055
Balance at 30 June 2006	(4,451)	(13,017)	-	(17,468)
Net carrying amount				
As at 30 June 2006	5,745	21,246	523	27,514
As at 30 June 2005	6,638	20,667	558	27,863

Note 10: Intangible assets

	Note	Software \$'000	Assets under construction \$'000	Total \$'000
Gross carrying amount				
Carrying amount at beginning of the financial year		22,614	17,928	40,542
Transfers in/(out)		1,614	(1,614)	-
Additions		3,531	23,594	27,125
Disposals		-	-	-
Impairment	4(g)(i)	-	(26,135)	(26,135)
Balance at 30 June 2006		27,759	13,773	41,532
Accumulated amortisation				
Carrying amount at beginning of the financial year		(9,100)	-	(9,100)
Amortisation expense		(5,370)	-	(5,370)
Disposals		-	-	-
Impairment		-	-	-
Balance at 30 June 2006		(14,470)	-	(14,470)
Net carrying amount				
As at 30 June 2006		13,289	13,773	27,062
As at 30 June 2005		13,514	17,928	31,442

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 11: Trade and other payables

	Note	2006 \$'000	2005 \$'000
Current			
Trade creditors	(i)	18,776	22,664
Other creditors and accrued expenses	(ii)	29,574	31,310
Unearned premium liability	(a), (iii)	323,997	308,346
Lease incentives	(iv)	101	19
		372,448	362,339

Terms and conditions relating to the above financial instruments:

- (i) Trade creditors are non-interest bearing and are normally settled up to 30 days.
- (ii) Other creditors are non-interest bearing.
- (iii) Unearned premium liability is non-interest bearing.
- (iv) Lease incentives are non-interest bearing and are settled over the term of the lease.
The current liability represents 12 months or less of the term of the lease.

Non-current

Lease incentives	(v)	408	20
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Terms and conditions relating to the above financial instruments:

- (v) Lease incentives are non-interest bearing and are settled over the term of the lease.
The current liability represents 12 months or more of the term of the lease.

(a) Unearned premium liability

	2006 \$'000	2005 \$'000
Beginning balance	308,346	287,338
Deferral of premium on contracts written during the year	322,138	306,454
Earnings of premiums deferred in prior years	(306,487)	(285,446)
Balance at 30 June	323,997	308,346

Note 12: Financial liabilities at fair value through profit and loss

	Note	2006 \$'000	2005 \$'000
Current			
Derivatives	17(c)	948	–

Note 13: Claims liabilities**(a) Gross claims liability**

	Note	2006 \$'000	2005 \$'000
Claims liability – central estimate of the expected present value of future payments for claims liabilities ⁽ⁱ⁾	2(iv)	327,775	300,281
Claims handling costs		7,816	6,481
Risk margin ⁽ⁱⁱ⁾	2(iii)	6,741	–
Gross claims liability		342,332	306,762

⁽ⁱ⁾ The expected future payments of claims liabilities excluding PackageBonus are discounted to present value using a risk-free rate of 5.97 per cent.

⁽ⁱⁱ⁾ The risk margin of 2.5 per cent of the underlying liability of claims liabilities excluding PackageBonus has been estimated to equate to a probability of adequacy of at least 75 per cent.

(b) Claims incurred

Current year claims relate to risks borne in the current financial year. Prior year claims relate to a reassessment of the risks borne in all previous financial years.

		2006 \$'000	2006 Total \$'000
Claims incurred			
Undiscounted	(6,256)	2,436,704	2,430,448
Discount	–	(1,973)	(1,973)
	(6,256)	2,434,731	2,428,475

(c) Reconciliation of movement in claims liabilities

	2006 \$'000	2005 \$'000
Beginning balance	306,762	270,582
Additional provision	323,267	296,147
Amounts utilised during the year	(287,544)	(239,118)
Movement in claims handling costs	1,335	(449)
Movement in risk margin	6,741	–
Movement in discounting	(1,973)	–
Reversal of unused provision	(6,256)	(20,400)
Balance at 30 June	342,332	306,762

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 14: Provisions

	Note	2006 \$'000	2005 \$'000
Current			
Employee benefits	(i)	19,753	17,715
Make good	(ii)	1,176	1,120
Restructuring	(iii)	634	353
Other	(iv)	889	5,216
		22,452	24,404
Non-current			
Employee benefits	(i)	3,559	2,778

Movement in provisions

	2006 \$'000
(i) Employee benefits	
Carrying amount at beginning of the financial year	20,493
Additional provision	14,966
Amounts utilised during the year	(11,185)
Reversal of unused provision	(962)
Balance at 30 June 2006	23,312
(ii) Make good	
Carrying amount at beginning of the financial year	1,120
Additional provision	226
Amounts utilised during the year	(170)
Reversal of unused provision	–
Balance at 30 June 2006	1,176
(iii) Restructuring	
Carrying amount at beginning of the financial year	353
Additional provision	634
Amounts utilised during the year	(158)
Reversal of unused provision	(195)
Balance at 30 June 2006	634
(iv) Other ^(a)	
Carrying amount at beginning of the financial year	5,216
Additional provision	1,547
Amounts utilised during the year	(5,586)
Reversal of unused provision	(288)
Balance at 30 June 2006	889

^(a) Other provisions comprise provision for redundancies.

Note 15: Contributed equity

	2006 \$'000	2005 \$'000
(a) Fully paid ordinary shares		
Ordinary shares fully paid	85,000	85,000

(b) Movements in shares on issue

	2006		2005	
	Number of shares	\$'000	Number of shares	\$'000
Beginning of the financial year	85,000,100	85,000	100	–
Issued during the financial year				
– equity injection by Commonwealth of Australia	–	–	85,000,000	85,000
Balance at end of the financial year	85,000,100	85,000	85,000,100	85,000

(c) Terms and conditions of contributed equity**Ordinary shares**

Ordinary shares entitle their holder to one vote, either in person or by proxy, at a meeting of the company, and in a winding up or reduction of capital, the right to repayment of the capital paid up on the share.

Ordinary shares do not have the right to receive dividends and, in the event of winding up the company or reduction of capital, do not have the right to participate in the distribution of the surplus assets of the company.

Note 16: Retained earnings

	2006 \$'000	2005 \$'000
Beginning balance	567,180	436,465
AIFRS adjustments due to adoption of AASB 1023, 132 and 139	(4,042)	–
Profit for the year	200,062	130,715
Balance at 30 June	763,200	567,180

Note 17: Financial instruments**(a) Interest rate risk**

The following table sets out the carrying amount, by maturity, of the financial instruments exposed to interest rate risk:

	Floating interest rate ⁽ⁱ⁾		Fixed interest maturing in:						Non-interest bearing		Total	
			1 year or less		Over 1 to 5 years		Over 5 years					
	2006 \$'000	2005 \$'000	2006 \$'000	2005 \$'000	2006 \$'000	2005 \$'000	2006 \$'000	2005 \$'000	2006 \$'000	2005 \$'000	2006 \$'000	2005 \$'000
Financial assets												
Cash assets ⁽ⁱⁱ⁾ (Note 19)	864,682	903,342	41,470	–	–	–	–	–	2,017	2,525	908,169	905,867
Receivables (Note 5)	–	–	–	–	–	–	–	–	104,989	90,873	104,989	90,873
Financial assets at fair value through profit and loss (Note 7)	–	–	2,010	21,096	250,879	96,582	–	2,514	265,214	168,946	518,103	289,138
Total financial assets	864,682	903,342	43,480	21,096	250,879	96,582	–	2,514	372,220	262,344	1,531,261	1,285,878
Weighted average interest rate:	5.86%	5.77%	6.75%	6.15%	6.29%	6.30%	–	9.00%				
Financial liabilities												
Trade and other payables (Note 11)	–	–	–	–	–	–	–	–	372,856	362,359	372,856	362,359
Financial liabilities at fair value through profit and loss (Note 12)	–	–	–	–	–	–	–	–	948	–	948	–

⁽ⁱ⁾ The cash figure includes monies at call and short-dated discounted securities.

⁽ⁱⁱ⁾ Floating interest rates represent the most recently determined rate applicable to the instrument at balance date.

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 17: Financial instruments continued**(b) Fair values**

Set out below are the fair values of all of Medibank Private's financial instruments recognised in the financial statements.

The fair value of cash and cash equivalents and non-interest bearing monetary financial assets and financial liabilities of Medibank Private is equal to their carrying amounts.

The fair value of other monetary financial assets and financial liabilities is based upon market prices prevailing at balance date.

	Note	2006 Fair value \$'000	2005 Fair value \$'000
Financial assets			
Cash	19(a)	908,169	905,867
Trade and other receivables	5	104,989	90,873
Financial assets at fair value through profit and loss (current)	7	517,857	288,892
Financial assets at fair value through profit and loss (non-current)	7	246	246
		1,531,261	1,285,878
Financial liabilities			
Trade and other payables (current)	11	372,448	362,339
Trade and other payables (non-current)	11	408	20
Financial liabilities at fair value through profit and loss	12	948	–
		373,804	362,359

The unit trusts and debentures, notes and bills are readily traded on organised markets in standardised form.

(c) Economic hedging activities**General economic hedge**

Medibank Private has entered into derivative transactions on its Australian and international equity and property holdings that protect Medibank Private against excessive negative movements in these asset classes.

All currency exposure existing as a result of Medibank Private's international investments has been economically hedged.

Note 18: Commitments

	2006 \$'000	2005 \$'000
(a) Capital expenditure commitments		
Estimated capital expenditure contracted for at balance date, but not provided for, payable:		
Within one year	15,861	2,635
After one year but not more than five years	2,602	60
Longer than five years	–	–
	18,463	2,695
(b) Operating lease commitments		
Future operating lease rentals not provided for, payable:		
Within one year	19,352	14,983
After one year but not more than five years	46,240	38,014
Longer than five years	15,266	18,148
	80,858	71,145
Operating leases are entered into as a means of acquiring access to corporate and retail property, office equipment, and motor vehicles. Rental payments are generally fixed, with differing clauses to adjust the rental to reflect increases in market rates. These clauses include fixed incremental increases, market reviews and inflation escalation clauses during a lease on which contingent rentals are determined. For the majority of operating leases for retail property there are renewal options. Purchase options exist in relation to operating leases for motor vehicles at the end of their term. No renewal or purchase options exist in relation to operating leases for office equipment. No operating leases contain restrictions on financing or other leasing activities.		
(c) Other expenditure commitments		
Other commitments not provided for, payable:		
Within one year	20,103	18,612
After one year but not more than five years	19,734	22,659
Longer than five years	5,668	781
	45,505	42,052
Other commitments consist of IT outsourcing, security and cleaning commitments.		
Total commitments payable	144,826	115,892

Note 19: Cash and cash equivalents

	2006 \$'000	2005 \$'000
(a) Reconciliation of cash		
For the purposes of the Cash Flow Statement, cash includes cash on hand and in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash at the end of the financial year as shown in the Cash Flow Statement is reconciled to the related items in the Balance Sheet as follows:		
Cash (i) and (ii)	908,169	905,867
Total cash and cash equivalents	908,169	905,867
(b) Reconciliation of the net profit to net cash flows from operations		
Profit	200,062	130,715
<i>Adjustments for:</i>		
Depreciation	6,801	4,913
Amortisation	5,370	5,886
Net loss on disposal of plant and equipment	95	100
Realised gain on financial assets	(6,107)	–
Unrealised gain on financial assets	(26,347)	(9,823)
Realised loss on financial assets	13,513	35
Unrealised loss on financial assets	1,434	4,958
<i>Non-operating cash flows:</i>		
Interest income	(63,972)	(57,913)
Interest income on special purpose fund	(165)	(87)
Trust distribution	(16,793)	(4,854)
Investment charges	828	301
<i>Impairment of assets:</i>		
Software	26,135	7,041
<i>Transfers to/(from) provisions:</i>		
Diminution in inventory value	(3)	28
Groups in arrears	–	(140)
Doubtful debts	(485)	(621)
<i>Changes in assets and liabilities</i>		
<i>(Increase)/decrease in assets</i>		
Trade and other receivables	(13,631)	(3,477)
Inventories	(324)	(192)
Prepayments	(883)	12,986
<i>Increase/(decrease) in liabilities</i>		
Trade and other payables	15,904	22,475
Claims liabilities	30,948	36,179
Provisions	(1,172)	11,888
Net cash flow from operating activities	171,208	160,398
(c) Financing facilities		
Unsecured overdraft credit facility, reviewed annually:		
Amount used	–	–
Amount unused	16,000	16,000
	16,000	16,000

(i) On 20 February 2004, Medibank Private reached agreement on a 'Principles of Settlement' with the Australian Competition and Consumer Commission regarding an Action in October 2000. The settlement requires payment of \$5 million to a special purpose fund account to be paid out over three years. These funds are classified as restricted funds by Medibank Private. The fund will continue to operate until the monies are fully expended through the payment of member settlement claims made against the fund.

(ii) This includes restricted funds of \$4.3 million held in escrow under the contractual agreement between Eternity Private Health and Medibank Private.

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 20: Directors and executive disclosures

(a) Details of key management personnel

(i) Directors

P M Kirby	Chairman (non-executive)
G Sawides	Managing Director
J Bowen	Director (non-executive)
A H Brien	Director (non-executive)
R D Harley	Director (non-executive)
B F Keane	Director (non-executive)
J U Stoelwinder	Director (non-executive)
P B Wade	Director (non-executive)

(ii) Executives

Current

S Blair	Chief Operating Officer
T Jones	Group Manager – Corporate Strategy & Communications
B Levy	Group Manager – Health Services
M Sammells	Chief Financial Officer – appointed 4 November 2005
H Parkinson	Group Manager – Human Resources – appointed 15 August 2005
K Crompton	Chief Information Officer – appointed 3 April 2006

Former

C Piccinino	Chief Financial Officer – ceased employment 31 October 2005
S Singh	Chief Information Officer – ceased employment 31 March 2006

b) Compensation of key management personnel

(i) Compensation policy

Medibank Private operates a strong performance-based approach to remuneration. Our philosophy is to ensure that the mix and quantum of remuneration properly reflects the responsibilities and duties of our executives and directors. The remuneration approach adopted by Medibank Private provides a competitive reward proposition, targeted at attracting, motivating and retaining the most appropriately qualified and experienced individuals.

(A) Nomination, Remuneration & Human Resources Committee

The Nomination, Remuneration & Human Resources Committee has recommended, and the Board has adopted a policy that remuneration will:

- reward executives for corporate, operational and individual performance against targets set by reference to appropriate benchmarks;
- align the interests of the executives to reward growth in shareholder value;
- link reward with the strategic goals and performance of Medibank Private; and
- ensure total remuneration is competitive by market standards.

(B) Compensation Structure

In accordance with best practice corporate governance, the structure of non-executive Director and executive compensation is separate and distinct.

(C) Non-executive Director compensation

Non-executive Directors' fees, including committee fees, are set by the Commonwealth Remuneration Tribunal. The level of their fees is not set with reference to measures of Company performance.

As determined by the Commonwealth Remuneration Tribunal, annual fees were increased by 3.9 per cent with effect from 1 July 2005. Non-executive directors now receive a fee of \$48,620 in relation to their service as a director of the Board. The Chairman, taking into account the greater commitment required, now receives a fee of \$97,210. In addition, directors who sit on the Audit & Risk Management Committee receive an additional fee of \$5,680 and the Chair of that committee receives an additional fee of \$11,360 per annum. Directors are entitled to life insurance cover and may purchase private health insurance cover on the same terms as employees. Compulsory statutory superannuation contributions are also made.

The compensation of non-executive directors for the period ended 30 June 2006 is detailed on page 71 of this report.

(D) Executive compensation

Objective

Medibank Private aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities within Medibank Private.

Structure

Executive remuneration comprises both a fixed component and an at-risk component. Fixed remuneration provides a guaranteed level of reward based on the executive's role, skills, knowledge, experience, individual performance and the employment market. At-risk remuneration rewards executives for achieving financial and business targets – no reward is earned unless pre-determined performance targets are achieved. The mix between fixed remuneration and at-risk remuneration depends on the level of seniority of the executive or the area of responsibility.

The compensation of executives for the period ended 30 June 2006 is detailed on page 71 of this report.

Note 20: Directors and executive disclosures continued**(E) Fixed compensation****Objective**

The level of fixed remuneration is set so as to provide a base level of remuneration that is appropriate to the position, consistent with the incumbent's skills and experience and is competitive in the market.

Fixed remuneration is reviewed annually and is determined by the scope of the individual's role, their level of knowledge, skills and experience, their performance, and market benchmarking.

Structure

Fixed remuneration comprises cash salary, superannuation contributions and car parking. Nominated benefits may also be packaged, which include novated car leases, salary sacrificed superannuation contributions and additional FBT exempt items such as laptop computers.

(F) Variable compensation – Short-Term Incentive (STI) plan**Objective**

A new STI plan was introduced this financial year, aimed at driving performance and rewarding executives for achievement against targeted and stretch objectives. For senior executives, objectives consist of corporate financial and non-financial targets and generally a mix of operational and individual objectives.

Structure

Potential earnings vary, based on the impact of a role and are capped at a maximum of 60 per cent of fixed remuneration. Generally 50 per cent of the STI earned, is payable after the financial result is declared and 50 per cent deferred for three years. Both elements are payable in cash, but executives may elect to sacrifice any award to superannuation.

(G) Variable compensation – Long-Term Incentive (LTI) plan**Objective**

To encourage a longer-term perspective on the part of executives, an LTI plan had been introduced, for a limited number of key executives. The LTI plan aligned this element of remuneration to the sustained achievement of corporate plan objectives.

The LTI plan ceased on 30 June 2006, with the remaining executive fulfilling the conditions of his plan and was subsequently paid.

(ii) Compensation of key management personnel for the year ended 30 June 2006

	Short-term		Post-employment			Long-term			Other	Total remuneration
	Salary & fees \$(^(b))	STI \$	Non-monetary benefits \$	Other (^(c)) \$	Super-annuation \$	Retirement benefits \$	Deferred LTI (^(d)) \$	STI (^(e)) \$	Other (^(f)) \$	
30 June 2006										
Directors (^(a))										
P M Kirby (Chairman)	102,874	–	7,438	1,705	9,259	–	–	–	–	121,276
G Sawides (Managing Director)	475,353	94,013 (^(g))	22,553	2,953	41,606	–	–	94,013 (^(g))	8,455	738,946
J Bowen	54,292	–	1,012	1,108	4,886	–	–	–	–	61,298
A H Brien	54,292	–	5,801	1,092	4,867	–	–	–	–	66,052
R D Harley	54,292	–	5,126	901	4,886	–	–	–	–	65,205
B F Keane	54,292	–	248	832	4,886	–	–	–	–	60,258
J U Stoelwinder	54,292	–	6,685	637	4,886	–	–	–	–	66,500
P B Wade	59,972	–	6,030	1,222	5,397	–	–	–	–	72,621
Total director remuneration	909,659	94,013	54,893	10,450	80,673	–	–	94,013	8,455	– 1,252,156
Current senior executives										
S Blair	367,831	74,497	8,979	1,547	31,989	–	48,836	74,497	6,295	614,471
T Jones	370,419	74,813	5,892	584	12,373	–	–	74,813	3,332	542,226
B Levy	357,448	80,514	6,901	584	33,890	–	95,850	80,514	7,307	663,008
M Sammells (⁽¹⁾)	294,315	63,130	7,145	1,486	24,643	–	–	63,130	5,276	459,125
H Parkinson (⁽²⁾)	240,037	46,909	5,537	1,412	20,856	–	–	31,272	1,604	347,627
K Crompton (⁽³⁾)	65,176	14,207	–	320	5,520	–	–	14,207	435	99,865
Total current senior executive remuneration	1,695,226	354,070	34,454	5,933	129,271	–	144,686	338,433	24,249	– 2,726,322
Former senior executives										
C Piccinino (⁽⁴⁾)	213,555	–	6,109	1,196	9,897	–	28,854	–	–	265,770
S Singh (⁽⁵⁾)	217,499	–	5,181	438	19,574	–	–	–	–	230,087
Total former senior executive remuneration	431,054	–	11,290	1,634	29,471	–	28,854	–	–	495,857

(^(a)) Directors comprise all those who acted at any time during the reporting period.

(^(b)) Salary & Fees includes accruals for annual leave.

(^(c)) Other benefits include salary and continuance insurance and subsidised health insurance.

(^(d)) LTI plan amounts have been accrued.

(^(e)) STI amounts have been accrued and payment is deferred for three years.

(^(f)) Comprises accrual for long service leave.

(^(g)) \$62,675 of G Sawides' STI is subject to performance objectives that are still in progress, and will be paid at the completion of those objectives being achieved.

(⁽¹⁾) Appointed Chief Financial Officer 4 November 2005.

(⁽²⁾) Commenced 15 August 2005.

(⁽³⁾) Commenced 3 April 2006.

(⁽⁴⁾) Left employment 31 October 2005.

(⁽⁵⁾) Left employment 31 March 2006.

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 20: Directors and executive disclosures continued*(iii) Compensation by category: key management personnel for the year ended 30 June 2005*

	Short-term			Post employment		Long-term	Other		Total remuneration
	Salary & fees \$(^(b))	STI \$	Non-monetary benefits \$	Other ^(c) \$	Super-annuation \$	Retirement Benefits \$	LTI ^(d) \$	Termination benefits \$	
30 June 2005									
Directors ^(a)									
P M Kirby (Chairman)	102,447	–	9,142	1,004	9,220	–	–	–	121,813
G Sawides (Managing Director)	458,759	168,000	14,071	1,890	39,768	–	–	–	682,488
M D Bollen ⁽¹⁾	10,331	–	–	775	930	–	–	–	12,036
J Bowen	54,060	–	2,126	1,103	4,865	–	–	–	62,154
A H Brien	–	–	2,126	1,158	58,925	–	–	–	62,209
R D Harley ⁽²⁾	43,730	–	6,904	806	3,936	–	–	–	55,376
B F Keane ⁽²⁾	43,730	–	2,126	144	3,936	–	–	–	49,936
J U Stoelwinder	54,060	–	4,902	653	4,865	–	–	–	64,480
P B Wade	59,716	–	5,654	894	5,374	–	–	–	71,638
Total director remuneration	826,833	168,000	47,051	8,427	131,819	–	–	–	1,182,130
Current senior executives									
S Blair	359,077	128,625	6,583	1,272	31,434	–	73,349	–	600,340
S Boomert ⁽³⁾	235,457	78,586	6,583	1,272	21,191	–	–	202,717	545,806
T Jones ⁽⁴⁾	94,616	61,250	–	530	2,896	–	–	–	159,292
B Levy	312,128	140,640	6,971	530	28,007	–	49,560	–	537,836
C Piccinino	329,043	117,026	6,793	1,272	28,909	–	50,154	–	533,197
S Singh	288,273	93,184	5,266	530	24,916	–	–	–	412,169
Total current senior executive remuneration	1,618,594	619,311	32,196	5,406	137,353	–	173,063	202,717	2,788,640

^(a) Directors comprise all those who acted at any time during the reporting period.^(b) Salary and Fees includes accruals for annual leave.^(c) Other benefits include salary and continuance insurance and subsidised health insurance.^(d) LTI plan amounts have been accrued and are not payable until the third anniversary of the plan.⁽¹⁾ Retired 27 August 2004.⁽²⁾ Appointed 30 August 2004.⁽³⁾ Left employment 30 June 2005.⁽⁴⁾ Appointed 30 March 2005.*(iv) Compensation by category: key management personnel*

	2006 \$	2005 \$
Short-term	3,602,676	3,325,818
Post-employment	239,415	269,172
Long-term	638,690	173,063
Termination benefits	495,857	202,717
	4,976,638	3,970,770

Note 21: Related party disclosure

There were no related party transactions that required disclosure during the financial year ended 30 June 2006.

Note 22: Events after the balance sheet date

During the financial year the Federal Government announced its intention to sell Medibank Private. Subsequent to reporting date, legal and business advisers have been appointed by the Federal Government to assist them on the sale process.

Note 23: Contingent liabilities

There are no material contingent liabilities at reporting date.

Note 24: Auditor's remuneration

Amounts received or due and receivable by the auditor, Australian National Audit Office and its contractor, for:

	2006 \$	2005 \$
Auditing the financial report	245,525	160,000
Other services – regulatory reporting	97,750	66,357
Other services – advisory	105,000	–
Other services – miscellaneous	40,589	–
	488,864	226,357

Note 25: Solvency requirement

Medibank Private's Solvency Requirement, as per the Health Benefits Organisations – Solvency Standard 2005, is \$986,496,000. Total Fund Assets are \$1,590,347,000 representing an excess of \$603,851,000 over the solvency requirement.

Note 26: Segment reporting

Medibank Private operates in the business of providing private health insurance in Australia.

Note 27: Additional company information

Medibank Private is a registered health benefits organisation, incorporated and operating in Australia.

Registered Office and Principal Place of Business

Level 17
700 Collins Street
Docklands VIC 3008
Australia
Tel: (03) 8622 5222

Note 28: Transition to AIFRS

For all periods up to and including the year ended 30 June 2005, Medibank Private prepared its financial statements in accordance with Australian Generally Accepted Accounting Practice (AGAAP). These financial statements for the year ended 30 June 2006 are the first Medibank Private is required to prepare in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS).

Accordingly, Medibank Private has prepared financial statements that comply with AIFRS applicable for periods beginning on or after 1 January 2005 and the significant accounting policies meeting those requirements are described in Note 1. In preparing these financial statements, Medibank Private has started from an opening balance sheet as at 1 July 2004, the date of transition to AIFRS, and made those changes in accounting policies and other restatements required by AASB 1 *First-time adoption of AIFRS*.

This note explains the principal adjustments made in restating its AGAAP balance sheet as at 1 July 2004 and its previously published AGAAP financial statements for the year ended 30 June 2005.

Exemptions applied

AASB 1 allows first-time adopters certain exemptions from the general requirement to apply AIFRS retrospectively.

Medibank Private has taken the following exemption:

- Comparative information for financial instruments is prepared in accordance with AGAAP and Medibank Private has adopted AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 139 *Financial Instruments: Recognition and Measurement* from 1 July 2005.
- Comparative information for general insurance contracts is prepared in accordance with AGAAP and Medibank Private has adopted AASB 1023 *General Insurance Contracts* from 1 July 2005.

Explanation of material adjustments to the cash flow statement

There are no material differences between the cash flow statement presented under AIFRS and the cash flow statement presented under previous AGAAP.

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 28: Transition to AIFRS continued**Balance Sheet reflecting reconciliation of adjustments to AIFRS as at 1 July 2004**

	Note	AGAAP \$'000	AIFRS Impact \$'000	AIFRS \$'000
Current assets				
Cash assets		795,141	–	795,141
Receivables		86,213	–	86,213
Other financial assets		117,546	–	117,546
Other		16,122	–	16,122
Total current assets		1,015,022	–	1,015,022
Non-current assets				
Other financial assets		190	–	190
Plant and equipment	a	37,254	(19,902)	17,352
Intangibles	a	–	19,902	19,902
Total non-current assets		37,444	–	37,444
Total assets		1,052,466	–	1,052,466
Current liabilities				
Payables		36,293	–	36,293
Provisions	b	289,244	1,034	290,278
Other		287,375	–	287,375
Total current liabilities		612,912	1,034	613,946
Non-current liabilities				
Provisions		2,025	–	2,025
Other		30	–	30
Total non-current liabilities		2,055	–	2,055
Total liabilities		614,967	1,034	616,001
Net assets		437,499	(1,034)	436,465
Equity				
Contributed equity		–	–	–
Retained earnings		437,499	(1,034)	436,465
<i>Breakdown of impact on retained earnings:</i>				
Make good provision	b	–	(1,034)	–
Total equity		437,499	(1,034)	436,465

Note 28: Transition to AIFRS continued**Balance Sheet reflecting reconciliation of adjustments to AIFRS as at 30 June 2005**

	Note	AGAAP \$'000	AIFRS Impact \$'000	AIFRS \$'000
Current assets				
Cash assets		905,867	–	905,867
Receivables		90,873	–	90,873
Inventories		164	–	164
Other financial assets		288,892	–	288,892
Other		3,136	–	3,136
Total current assets		1,288,932	–	1,288,932
Non-current assets				
Other financial assets		246	–	246
Plant and equipment		27,863	–	27,863
Intangibles		31,442	–	31,442
Total non-current assets		59,551	–	59,551
Total assets		1,348,483	–	1,348,483
Current liabilities				
Payables		53,973	–	53,973
Provisions	b	331,080	87	331,167
Other		308,365	–	308,365
Total current liabilities		693,418	87	693,505
Non-current liabilities				
Provisions		2,778	–	2,778
Other		20	–	20
Total non-current liabilities		2,798	–	2,798
Total liabilities		696,216	87	696,303
Net assets		652,267	(87)	652,180
Equity				
Contributed equity		85,000	–	85,000
Retained earnings		567,267	(87)	567,180
<i>Breakdown of impact on retained earnings:</i>				
Make good provision	b	–	(87)	–
Total equity		652,267	(87)	652,180

Income Statement for the year ended 30 June 2005

	Note	AGAAP \$'000	AIFRS Impact \$'000	AIFRS \$'000
Revenues from ordinary activities				
Member contributions		2,598,658	–	2,598,658
Proceeds from disposal of other financial assets		93,589	–	93,589
Other revenue		73,691	–	73,691
		2,765,938	–	2,765,938
Expenses from ordinary activities				
Member benefits		(2,298,027)	–	(2,298,027)
Employee benefits expense		(103,417)	–	(103,417)
Information and technology expense		(36,386)	–	(36,386)
Marketing expense		(28,603)	–	(28,603)
Office and administration expense		(41,425)	–	(41,425)
Depreciation expense		(10,799)	–	(10,799)
Investment expense		(5,259)	–	(5,259)
Other expenses from ordinary activities	b	(17,596)	(87)	(17,683)
Book value of other financial assets sold		(93,624)	–	(93,624)
Profit from ordinary activities		130,802	(87)	130,715

Notes to the Financial Statements continued

For the financial year ended 30 June 2006

Note 28: Transition to AIFRS continued

Impact of adopting AIFRS

Reference	Item	AGAAP	AIFRS	Impact
a	Intangible assets	Computer software was classified as plant and equipment.	Under AASB 138 <i>Intangible Assets</i> , computer software is classified as an intangible asset. Therefore, computer software has been reclassified from plant and equipment to intangible assets.	Equity at transition: No effect
b	Make good provisions	Such costs were not required to be recognised.	Under AASB 137 <i>Provisions, Contingent Liabilities and Contingent Assets</i> , where the construction of an asset results in the obligation to dismantle or remove the asset and restore the site, an estimate of such costs is required to be expensed through the income statement.	Equity at transition: \$1,034,000 Equity at 30 June 2005: \$1,121,000 Profit for 30 June 2005: \$87,000

Restated Balance Sheet on adoption of AASB 132, AASB 139 and AASB 1023 as at 1 July 2005

	AIFRS 30 June 2005 \$'000	Note	Adjustment \$'000	AIFRS 1 July 2005 \$'000
Current assets				
Cash and cash equivalents	905,867		–	905,867
Trade and other receivables	90,873		–	90,873
Inventories	164		–	164
Financial assets at fair value through profit and loss	288,892	a	12	288,904
Prepayments	3,136		–	3,136
Total current assets	1,288,932		12	1,288,944
Non-current assets				
Financial assets at fair value through profit and loss	246		–	246
Plant and equipment	27,863		–	27,863
Intangible assets	31,442		–	31,442
Total non-current assets	59,551		–	59,551
Total assets	1,348,483		12	1,348,495
Current liabilities				
Trade and other payables	362,339	b	(569)	361,770
Claims liabilities	306,762	c, d	4,623	311,385
Provisions	24,404		–	24,404
Total current liabilities	693,505		4,054	697,559
Non-current liabilities				
Other payables	20		–	20
Provisions	2,778		–	2,778
Total non-current liabilities	2,798		–	2,798
Total liabilities	696,303		4,054	700,357
Net assets	652,180		(4,042)	648,138
Equity				
Contributed equity	85,000		–	85,000
Retained earnings	567,180		(4,042)	563,138
Total equity	652,180		(4,042)	648,138

Note 28: Transition to AIFRS continued**Impact of adopting AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 139 *Financial Instruments: Recognition and Measurement* and AASB 1023 *General Insurance Contracts***

Reference	Item	AGAAP	AIFRS	Impact
a	Assets backing general insurance liabilities	Financial assets were measured at market value.	Financial assets that back general insurance liabilities that are within the scope of AASB 139 <i>Financial Instruments: Recognition and Measurement</i> and are designated as 'at fair value through profit or loss', have been designated as 'at fair value through profit or loss' under AASB 139 <i>Financial Instruments: Recognition and Measurement</i> on first application of AASB 1023 <i>General Insurance Contracts</i> or on initial recognition of the asset.	Increase to assets and an increase to equity of \$12,000, due to fair value accounting.
b	Premium revenue	Premium revenue was recognised when earned over the period of the membership.	Under AASB 1023 <i>General Insurance Contracts</i> , premium revenue is recognised from the attachment date in accordance with the pattern of the incidence of risk expected over the term of the contract.	Decrease to liabilities and an increase to equity of \$569,000, due to difference in measurement of premium revenue.
c	Claims liabilities – risk margin	The outstanding claims provision did not require a risk margin.	Under AASB 1023 <i>General Insurance Contracts</i> , the outstanding claims liability includes, in addition to the central estimate of the present value of the expected future payments, a risk margin that relates to the inherent uncertainty in the central estimate of the present value of the expected future payments.	Increase in liabilities and a decrease to equity of \$5,963,000, due to adoption of a risk margin.
d	Claims liabilities – discounting	The outstanding claims provision did not require discounting.	Under AASB 1023 <i>General Insurance Contracts</i> , the outstanding claims liability has been discounted for the time value of money using risk-free discount rate.	Decrease in liabilities and an increase to equity of \$1,340,000, due to discounting.

Directors' Declaration

In accordance with a resolution of the Directors of Medibank Private Limited, we state that:

In the opinion of the Directors:

- (1) (a) the financial statements and notes of the Company are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the Company's financial position as at 30 June 2006 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards and Corporations Regulations 2001; and
 - (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- (2) This declaration has been made after receiving the declarations required to be made to the Directors by the Managing Director and Chief Financial Officer in accordance with section 295A of the Corporations Act 2001 for the financial period ending 30 June 2006.

On behalf of the Board



P M Kirby

Melbourne, 8 September 2006



G Savvides

Independent audit report to members of Medibank Private Limited



Independent audit report to members of Medibank Private Limited

Scope

The financial report, remuneration disclosures and directors responsibility

The financial report comprises the balance sheet, income statement, statement of changes in equity, cash flow statement, accompanying notes to the financial statements, and the directors' declaration for Medibank Private Limited (the company), for the year ended 30 June 2006.

The directors of the company are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the company, and that complies with Accounting Standards in Australia, in accordance with the *Corporations Act 2001*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach

I conducted an independent audit of the financial report in order to express an opinion to the members of the company. My audit was conducted in accordance with the Australian National Audit Office Auditing Standards which incorporate the Australian Auditing and Assurance Standards, in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

I performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001*, including compliance with Accounting Standards in Australia, and other mandatory financial reporting requirements in Australia, a view which is consistent with my understanding of the company's financial position, and of its performance as represented by the results of its operations and cash flows.

I formed my audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

Independent audit report to members of Medibank Private Limited continued

While I considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of my procedures, my audit was not designed to provide assurance on internal controls.

Independence

I am independent of the company, and have met the independence requirements of Australian professional ethical pronouncements and the *Corporations Act 2001*. I have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the directors' report. In addition to my audit of the financial report, I was engaged to undertake the services disclosed in the notes to the financial statements. The provision of these services has not impaired my independence.

Audit opinion

In my opinion:

1. the financial report of Medibank Private Limited is in accordance with:
 - (a) the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the financial position of Medibank Private Limited at 30 June 2006 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the *Corporations Regulations 2001*; and
 - (b) other mandatory financial reporting requirements in Australia.

Australian National Audit Office



Michael J. Watson
Group Executive Director

Delegate of the Auditor-General
Canberra

8 September 2006

Corporate Directory

Company name

Medibank Private Limited

Directors

Peter Kirby (Chairman)
George Sawides (Managing Director)
Julia Bowen
Adrian Brien AM
Roger Harley
Brian Keane
Johannes (Just) Stoelwinder
Peter Wade

Company Secretaries

Neil Greenaway
Alex Mathey

Registered Office

Level 17
700 Collins Street
Docklands Victoria 3008

ACN

080 890 259

ABN

47 080 890 259
Medibank Private Limited is a registered health
benefits organisation

General Counsel

Alex Mathey

Auditor

Auditor-General

Bankers

Westpac Banking Corporation

Contact details

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Acknowledgements and thanks to the following Medibank Private staff:

Ben Abrew, Kris Bardin, Rachel Berry, Sing Chongkijthavorn, Ranier Dela Cruz, Alicia Giachin, Jeremy Hose, Shaul Jontof-Hutter, David Lawrence, Phil Lamont, Melanie Mackintosh, Rebecca Mein, Rachel Olliffe, Casey Payne, Melissa Porto, Simon Rumbold, Nihal Samararatna, Kurt Schnelle, Trinh Tran, Lori Turner, Anton Zytnik

