1984

PARLIAMENT OF NEW SOUTH WALES

# TENTH REPORT

OF THE

# PUBLIC ACCOUNTS COMMI. TTEE

FOR THE

## FORTY-EIGHTH PARLIAMENT

Inquiry pursuant to reference by the Treasurer under the provisions of Section 57 ( I ) (f) of the Public Finance and Audit Act 1983 concerning the superannuation liabilities of New South Wales statutory authorities

(Transcripts of Evidence tabled together with this Report}

August, **1984.**

40813-3397

## COMMITTEE MEMBERS

The Members ofthe Public Accounts Committee as appointed by the Forty-
eighth Parliament on l0 May, 1984, were:

Mr Bob Carr, M.P., Chairman

Bob Carr was elected Member for Maroubra in a by-election in October, 1983.
A writer in Industrial Relations with*The Bulletin* for five years, Bob Carr was a former Education Officer with the N.S.W. Labor Council (1972-78) and reporter on ABC Current Affairs (1969-1972).

Mr John Aquilina, M.P., Vice Chairman

John Aquilina was elected Member for Blacktown in September, 1981. A high
school teacher by profession. John Aquilina was a Commissioner of the Ethnic Affairs Commission for two years and the Mayor of Blacktown for four years before entering Parliament

Mr Peter Collins, M.P.
Peter Co11ins was elected Member for 'Willoughby in September, 1981. A former
ABC TV journalist and practicing barrister, Peter Collins also served as Research and Public Relations Manager for the N.S.W. Liberal Party. Since entering Parliament, Mr Collins has held the shadow portfolio of Consumer Affairs, Planning and Environment and currently Industrial Relations, Employment and the Arts.

Mr Colin Fisher, M.P.

Colin Fisher was elected Member for Upper Hunter in February, 1970. Former
Minister for local Government (1975) and Minister for Lands and Forests (1976) in opposition Colin Fisher has served as National Party Spokesman on Local Government: on Planning and Environment and on Energy.

**Mr John Murray, M.P.**

John Murray, formerly a teacher, was elected Member for Drummoyne in April,
1982. An Alderman on Drummoyne Council for three terms, John Murray was Mayor of the Council for five years, the longest time ever served continuously by a Mayor of Drummoyne. Mr Murray is also a member of the Prostitution Committee and the House Committee.

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## 1: CHAIRMAN'S FOREWORD

The problem investigated in this report is one of undisclosed, inadequately costed expansion of public sector superannuation benefits.

The problem has arisen because public sector superannuation has been allowed to become at least two times as expensive as private sector superannuation. It has been aggravated by the inadequate disclosure and costing of increases in public sector superannuation benefits. As a rule, public bodies have not been accounting rigorously for their accrued superannuation liabilities and consequently the unfunded liability has been Growing unnoticed.

The Public Accounts Committee estimates the unfunded liability for past service for all statutory authority employees in the State Superannuation Scheme and the New South Wales Retirement Scheme (the two major schemes) to be of the order of $2.5 billion.

Similar concerns have been reflected within the last two years in a number of inquiries into superannuation throughout Australia. The Economic and Budget Review Committee of the Victorian Parliament recently completed its major review of public sector superannuation in Victoria. At the same time the Senate Standing Committee on Finance and Government Operations has held an Inquiry into the superannuation liabilities of Commonwealth statutory authorities. Further, Auditors General in the various jurisdictions have drawn their respective Parliaments' attention to the increasing problem of deferred superannuation costs.

In New South Wales, the Auditor General, Mr O'Donnell, drew the Parliament's attention to the problems in his 1981-82 and 1982-83 Reports. His primary concern was that statutory authorities were failing to adequately account for, and disclose, superannuation costs and liabilities.

During 1983 the Public Accounts Committee of the Forty-seventh Parliament under the Chairmanship of my predecessor Mr Michael Egan, reviewed the reporting and accounting practices of statutory authorities and made recommendations to the Treasurer covering aspects of financial reporting by statutory authorities. One recommendation was that accrual accounting be introduced for all authorities. In March of this year the Treasurer, the Honourable Ken Booth, M.P., gave effect to this and to many of the previous Committee's other recommendations through the Annual Reports Act and amendments to the Public Finance and Audit Act.

The thrust of the financial reforms introduced was to reflect more accurately, in the accounts of statutory authorities, the true costs of operations. The changes required authorities to treat financial provisions, including provisions for superannuation, as a charge to revenue and include such items in the Annual Statement of Revenue and Expenditure.

The reforms to date have not addressed the manner in which such provisions should be determined. Related to this issue is the problem of whether or not to deferred superannuation commitments.

It was with these concerns in mind that the Treasurer decided to refer the matter to the Public Accounts Committee in September 1983. The Treasurer highlighted a number of specific matters for investigation, namely:

(i) the ways in which statutory authorities in Australia provide for and report on liabilities for superannuation and other retirement benefits;

(ii) the accounting standards which have been adopted or are under consideration in relation to accounting for retirement benefits;

(iii) the various methods by which the liability might 'be calculated, highlighting the assumptions which are implicit in such calculations;

(iv) the extent to which these standards have been adopted by public sector statutory authorities in Australia and overseas (particularly the United Kingdom and North America).

The Committee set out to address the complex actuarial and accounting issues involved. To do this we engaged the services of Professor All Pollard, senior actuary and founder of the School of Actuarial Studies at Macquarie University, and Professor Bob Walker, Professor of Accounting at the University of New south Wales and advisor to the National Companies and Securities Commission,

In October 1983 the Committee sent out a questionnaire to 156 statutory authorities seeking information on their superannuation arrangments. Subsequently, the Committee held hearings at which 10 statutory authorities and 10 other organisations gave evidence. The Committee also received submissions from other interested parties.

In March the State election interrupted the Committee's work and it was not until June that the Committee, with three new members, was again fully functioning.

While deferred superannuation commitments continue to accumulate, as they will do under present arrangements, the people of New south Wales are not being charged the true cost for the goods and services they consume which are supplied by public authorities. Until these deferred commitments are properly disclosed and accounted for we are living in a fool's paradise. The Committee is of the view that full disclosure and the proper recognition of accounting expenses in relation to superannuation costs is a pressing necessity.

The question of whether or not to set aside additional funds to meet deferred superannuation commitments is amore difficult one. The Committee considered arguments both in support of the current pay-as-you-go funding arrangements as well as arguments in favour of full funding. Although not requested to express a view on this issue, the Committee believes that full funding should be introduced. The Committee notes, however, that the Government should avoid over-charging current consumers of public services by catching up the unfunded liabilities for past service in an unnecessarily hurried way.

A critical issue in relation to funding is that the investment performance and practices of the authorities and the public sector superannuation funds must come under much closer scrutiny than they have in the past. Hundreds of millions of dollars can be gained or lost depending on the investment earnings of monies set aside to fund deferred superannuation commitments. The better the investment earnings the more the State can afford to pay the superannuation benefits of public servants.

The issue that strikes me as the most important of all concerns the proper costing and public disclosure of proposed benefit changes. Because the costs of benefit increases do not have to be paid for until some time in the distant future there seems to be a predisposition to increase benefits to levels beyond which the.community can bear. It is clear there is a need for greater public accountability of the costs associated with proposed benefit changes. The Committee recommends that a mechanism be established whereby the full actuarially-assessed costs of proposed benefit changes is brought to the notice of Parliament before being implemented.

Finally, I thank my fellow Committee Members, the members of the Committee of the previous Parliament and especially my predecessor Mr Egan, for their work in this inquiry. The assistance of our advisors, Professors Pollard and Walker was valued and much appreciated. Last I thank the Director, Frank Sartor, for his valuable contribution to the Inquiry and the Committee Stenographer, Robin Long, who spent many long hours typing the Report.

Bob Carr, M.P., Chairman.

## 2: SUMMARY

### The Problem

2.1 The Auditor General has, of recent years drawn to the attention of Parliament two major problems :

(a) That statutory authorities were not adequately disclosing the full amount of superannuation expenses and liabilities in their financial statements;

(b) That the magnitude of these unreported liabilities was considerable and increasing (paragraph 3.6).

2.2 The unfunded liability for past service for all statutory authorities, in respect of members of the State Superannuation Scheme and the New South Wales Retirement Scheme (the two major schemes) is of the order of $2.5 billion (paragraph 3.14).

2.3 Under current funding arrangements for the State Superannuation Scheme as a whole, the annual cash payments by employers for superannuation are projected to increase by 136% in real terms from 1983 to 2012 and to continue to increase for some time thereafter (paragraph 3.18).

2.4 The cost of the State Superannuation Scheme, along with that of similar public sector schemes in other states, is high by community standards. This high cost is one of the factors contributing to the problem of financing superannuation liabilities (paragraph 3.30).

2.5 The large unfunded liability has come about because improvements have been made from time to time in scheme benefits without corresponding.. increases being made in contributions to ensure that the scheme's funding design was maintained. Further, the inadequate accounting procedures of statutory authorities have prevented the increasing liabilities resulting from the benefit improvements being drawn to the attention of the public (paragraph 3.33).

2.6 The Committee believes that over a long period of time there has been unsatisfactory public disclosure of the cost implications of benefit changes to the Parliament and the public prior to their implementation (paragraph 3.38).

2.7 The accounting and financial reporting practices of statutory authorities have not reflected the escalation of superannuation expenses, thus contributing to a climate wherein further benefit changes have been introduced with little regard to cost implications (paragraph 3.40).

2.8 54 separate superannuation schemes have been identified among the statutory authorities (paragraph 4.4). 29 of the authorities (including all the large authorities) have obtained actuarial assessments of their unfunded superannuation liabilities (paragraph 4.14).

2.9 In respect of the State Superannuation Scheme :

(i) Only 14% of the total liability for past service is covered by the contributions which employers have made to the Fund. The total employer's liability for benefits for 22 of the authorities is $1,494m, of which only $207m is covered by contributions made so.far by employers to the Fund (paragraph 4.17).

(ii) If authorities are to fully fund superannuation commitments that arise out of the future service of current employees, their annual contributions, as a percentage of salaries paid, would in respect of future service alone, be two and a half or more times their present concurrent employer contributions (paragraph 4.23).

(iii) If in addition to fully funding superannuation commitments arising out of future service, authorities were to extinguish their current unfunded liabilities in respect of past employee service over a 20 year period the required past-service employer contribution would be approximately three times the size of their current pay-as-you-go pension subsidies (paragraPh 4.23).

2.10 In respect of the N.S.W. Retirement Fund :

(i) The payment to fund the liability for past service over a 20 year period varies between authorities from nil to 6.3% of salaries. The latter figure applies to the State Rail Authority whose employees constitute over one half of the Fund's members (paragraph 4.24).

(ii) Full funding of superannuation commitments for future service would mean, for most authorities, an increase in annual contributions from the present figure of nil to about 6-7% of their salary bill (paragraph 4.25).

2.11 Under present arrangements with the State Superannuation Fund, no payments are made when an employee transfers to another authority, even though the new authority accepts responsibility for superannuation in respect of his previous employment. This is a major problem for Colleges of Advanced Education, and some smaller authorities (paragraph 4.35).

2.12 The present arrangements relating to staff transfers which allocate the whole of the employer liability to the final employer is inequitable. The Committee recommends

(i) That a system of 'transfer fees' be introduced so that the full burden of superannuation costs are not imposed only on the statutory authority which is the last employer of staff:

(ii) That such fees to be paid at the time of staff transfers:

(iii) That in order to minimise administrative costs such requirements for transfer fees be only applied in respect of staff who

(a) have ten years service, and
(b) are within ten years of normal retirement:

(iv) That the Bureau of Superannuation Research in consultation with the Government Actuary give high priority to the development of guidelines for the operation of these procedures (paragraph 4.41).

2.13 The Committee considers that the transfer of groups of employees between superannuation schemes (other than transfers arising from promotions) should not be undertaken without first securing estimates of the costs involved (paragraph 4.44).

Accounting and Reporting by N.S.W. Authorities

2.14 It is clear to the Committee that among statutory authorities there is no consistent policy for reporting superannuation costs. Indeed, some authorities vary their practices from year to year at the whim of management (paragraphs 5.16, 5.25).

2.15 The diversity of accounting practices adopted by New South Wales statutory authorities makes it difficult to compare the financial performance of authorities, or even to compare the financial performance of a given authority from year to year. It is only relatively recently that authorities have been encouraged to seek actuarial advice about the extent of their unfunded liabilities (paragraph 5.27).

2.16 The failure of authorities to recognise superannuation liabilities in .their financial statements has meant that the information made available to the managers of those organisations, to the Government, to the Parliament, and to the public at large has understated the costs being incurred in the provision of services (paragraph 5.28).

Funding practices elsewhere

2.17 A review of practices in other states and Overseas

indicates that it is general practice not to fund deferred superannuation commitments where the expenses of the department or authority are charged directly to consolidated revenue (paragraph 6.27).

2.18 There is good reason for not earmarking investments to meet the superannuation liability of departments dependent on budget allocations (paragraph 6.28).

2.19 It appears to be the general practice elsewhere with commercial or semi-commercial authorities to fully fund deferred superannuation liabilities (paragraph 6.29).

2.20 Although it cannot be said that it is a general practice, there are cases where fully funded statutory authorities, usually those which borrow from the public, choose not to pay their employer contributions to a separately constituted external superannuation fund (paragraph 6.30).

2.21 There are several examples (Commonwealth, South Australia, New South Wales, united Kingdom) where a statutory authority fully funds its liability by making payments to consolidated revenue, which accepts the payment into revenue and assumes the full liability but meets it on a pay-as-you-go basis (paragraph 6.31).

2.22 With the pay-as-you-go approach to the payment of benefits it is of considerable importance to know the projected increasing annual cash requirements of superannuation (paragraph 6.33).

The Recognition of Superannuation Costs

2.23 The Committee concluded that the obligations of a statutory authority to provide superannuation benefits should be regarded as liabilities for the purpose of financial reporting (paragraph 7.23).

2.24 Each statutory authority's Statement of Revenue and Expense should include the full superannuation expense for the period. Not to do so would amount to deceiving the Parliament and the public as to the true cost of running an authority and would be inconsistent with the objectives of accrual accounting which was recently introduced by the Government via the 1984 amendments to the Public Finance and Audit Act, 1983 (paragraph 7.26).

2.25 The Committee formed the view that the liability for superannuation commitments arising from past service of employees should be recognised in the balance sheets of statutory authorities. Standardisation of the method of calculating these commitments is necessary so that Government decisions concerning the allocation of resources to statutory authorities can be based on comparable data (paragraph 7.47).

2.26 It would be desirable to introduce regulations pursuant to Section 41B (1)(c) of the Public Finance and Audit Act to prescribe :

(a) That the amountof unfunded past service costs of a statutory authority should be disclosed in its balance sheet;

(b) That the calculation of superannuation expense accrued in an accounting period be calculated by reference to annual estimates of the amount of unfunded past service costs using an accrued benefit method based on projected salaries;

(c) That estimates of the amount of unfunded past service costs be obtained from the Government Actuary on an annual basis;

d) That revisions of estimates of the amount ofunfunded past service costs arising from periodical actuarial reviews need not be treated as an accounting expense (revenue) of the period in which that assessment was undertaken, but might at the discretion of the statutory authority concerned be allocated over a period not exceeding three years.

e) That to the extent that an amount of unfunded past service costs is attributable to services rendered before the start of the accounting period in which superannuation commitments are first fully recognised as a liability, those sums should be treated as an adjustment to the accumulated funds of the authority concerned.

(f) That statutory authorities should disclose the following information concerning superannuation liabilities and expenses:

(i) The date of the most recent actuarial report upon which calculations of superannuation liability and expense were based;

(ii) The following assumptions adopted by the Government Actuary:

- interest rates

- rate of increase in the consumer price index

- rate of salary increases;

(iii) The effect on the calculation of the amount of unfunded past service costs of the adoption of different values for the key economic assumptions and any other assumptions that the actuary considered to be of critical importance;

(iv) Any material changes in the terms and conditions of the superannuation scheme since the date of the last actuarial report;

The amount of any superannuation expenditure carried forward in a Given year as part of the cost of capital works.

## Actuarial Issues

2.27 The assessments made by the Actuary depend on a large number of economic and demographic assumptions about the future. The ,most critical assumptions are :

The interest rate earned on funds in the future;

The growth rate of salaries;

The pensioner indexation rate (CPI);

The pensioner commutation rate (paragraph 8.4).

2.28 An increase in the nominal rate of interest of 2% (other assumptions remaining the same) reduced Elcom's unfunded liability for past service (before provisions) from $256m to $154m, i.e. by 40%. The critical importance of the earning rate on funds invested is evident (paragraph 8.8).

2.29 A difference of opinion was noted in the evidence placed, before the Committee as to the interest rate which should be assumed in the assessment and in particular its relationship to, the assumed rates of salary growth and CPI growth (paragraph 8.15-8.21).

2.30 The Committee is concerned that poor investment performance by statutory authorities and public sector superannuation funds may cause the unfunded liabilities for past service of statutory authorities in respect Of superannuation commitments to be greater than those calculated by the Government Actuary (paragraph 8.22).

2.31 To assist authorities in assessing the adequacy of their superannuation funding arrangements, the Government Actuary should provide calculations using alternative values of the key variables so that the sensitivity of the estimates to the major assumptions can be known (paragraph 8.25).

2.32 The Committee believes that the triennial valuation reports of the major public sector funds should be much more timely, certainly no later than one year after balance date (paragraph 8.30).

2.33 Irrespective of the Government's final decisions on funding and accounting for superannuation, the Committee strongly recommends that an investigation be made by the Government Actuary at least every three years to assess each authority's superannuation commitments. Such assessments should also include reports concerning the projected cash requirements associated with meeting employer contributions as they fall due over the ensuing ten years (paragraph 8,32).

2.34 There is a need for greater disclosure off and more rigorous accounting for, superannuation commitments. To this end, it is desirable that the Government Actuary be
responsible for the calculation of the amount of unfunded past service costs for accounting purposes, in order to facilitate comparability in accounting calculations between
authorities (paragraph 8.34).

2.35 The Committee is concerned that the Government Actuary, whilst being very cooperative, may still be inadequately equipped to provide sufficient information to authorities, to Parliament and to Government on future superannuation obligations in a timely fashion (paragraph 8.31).

2.36 The Committee is reluctant to recommend the establishment of a new body to scrutinise proposed changes in superannuation benefits, although it believes public scrutiny is essential. Therefore the Committee, with the benefit of hindsight, considers it most important that proposed benefit changes should be required to be laid before the Legislative Assembly of the Parliament for at least 90 days and that they should be accompanied by a report from the Government Actuary into the financial implications of the changes. This report should include:

i) the new-entrant fully funded contribution rate as a percentage of salaries both before and after the proposed changes, and the percentage increase or decrease which this represents;

(ii) an estimate of the extent (if any) to which the proposed changes will affect the liability for past service in respect

(a) of all members of the particular scheme, and

(b) in respect separately of those members who are employees of the largest statutory authorities;

(iii) an indication of the extent to which the proposed benefits are commonly included within private sector schemes and public sector schemes elsewhere;

(iv) cash flow projections for 40 years both before and after the proposed changes;

(v) any other issues which the Actuary considers should be raised to enable the public to assess the financial implications of the proposed changes (paragraph8.36).

Investment Performance

2.37 The investment performance of statutory authorities and public sector superannuation funds is of crucial importance to the level of costs associated with employers' superannuation commitments .(paragraph 9.4)o

2.38 The Committee considers that authorities should be permitted to engage professional fund managers from both the public and the private sector thus requiring public sector fund managers to compete for their business on an equal footing (paragraph 9.11).

2.39 The Committee is concerned that if authorities were to fully fund their deferred superannuation commitments the consequent existence of surplus cash in an authority may encourage that authority to employ those funds towards unnecessary capital works i.e. works for which borrowing would not have been raised had internal cash not been available.

2.40 In' relation to 'internal investment' of superannuation monies by statutory authorities, the Committee recommends the following :

(a) Authorities which do not normally borrow funds not be allowed to invest superannuation funds in their own undertaking;

(b) All authorities be encouraged to invest superannuation monies external to their organisation in such a manner as to maximise investment earnings;

(c) Where authorities retain superannuation funds internally the balance of their 'internal investment' be increased annually at the assumed investment earning rate. This will be achieved if authorities do not operate at a deficit and adopt the expense recognition procedures outlined (paragraph 9.17).

2.41 The Committee noted evidence from interstate inquiries that the investment performance of public sector superannuation funds was far below that of their private sector counterparts. In part, this may have been due to restrictions on their investment powers (paragraph 9.20).

2.42 The Committee is of the view that, in order to secure better returns on superannuation fund investments, restrictions on the investment powers of public sector fund managers should be removed (paragraph 9.31).

2.43 The Committee believes that legislative provision should be made for the investment by statutory authorities of funds additional to their statutory contributions under the relevant superannuation acts (paragraph 9.32).

2.44 The Committee believes that the Government should pay greater attention to removing public service restrictions that limit the capacity of public sector fund managers to attract skilled staff by suitable remuneration packages (paragraph 9.35).

2.45 The Committee considers it important that the investment performance of all public sector fund managers be reviewed quarterly as in the private sector (paragraph 9.38).

The Funding of Superannuation Commitments

2.46 From a survey of statutory authorities both in Australia and overseas, the Committee concludes that the general practice appears to be one of full funding or of moving towards full funding of superannuation liabilities (paragraph 10.39).

2.47 The overwhelming majority of witnesses, at the Inquiry supported the principle of full funding of deferred superannuation commitments of statutory authorities. They were particularly definite about this in relation to the 'commercial' statutory authorities (paragraph 10.40).

2.48 Despite a view put forward that full funding by statutory authorities might have a serious impact on the capital markets the Committee is satisfied that :

(a) Funding the unfunded superannuation liabilities of all statutory authorities, presently established to be about $2.5 billion, over a period of not less than 20 years would not have a serious impact on the capital market;

(b) Fully funding obligations generated by future employee service would have even less impact on the capital market (paragraph 10.33).

2.49 The Committee considered the several arguments in favour of funding (paragraph 10.9) and at the same time recognised that significant arguments can be raised against full funding by statutory authorities (paragraph 10.25).

2.50 The Committee's views on the funding of superannuation commitments may be summarised as follows:

(i) statutory authorities should fully fund their deferred superannuation commitments;

(ii) authorities largely dependent on Treasury subsidies should pay their contribution to consolidated revenue which need not fund to meet the benefit payments. The great value of this course is in helping to show the full cost of taxpayer subsidy of the service provided (paragraph 10.44);

(iii) educational institutions should seek approval to pay their contributions in a similar way to the Commonwealth Department of Finance (paragraph 10.45);

(iv) commercial authorities should back their superannuation liabilities by earmarked assets or preferably by paying their contributions to .separately constituted funds, including the relevant public sector superannuation fund. It must be recognised that such earmarked assets are held to cover specific superannuation liabilities and if disposed of must be replaced by other earmarked assets of equal value (paragraph 10.53).

(v) the unfunded liability for past service in the case of New South Wales statutory authorities is so large that to amortise it over a limited period of years, as generally required in the private sector and overseas in the public sector, would impose too heavy a burden on consumers over the next decade or so (paragraph 10.55);

(vi) the liability for future service and the unfunded liability for past service should be dealt with together, by the payment in future of a level contribution (as a percentage of salaries). This level contribution would need to be determined by the Government Actuary separately for each authority (paragraph 10.56);

(vii) this should be regarded as the minimum level of funding. Under it the past service liability will continue to rise for some years. Authorities in a position to do so may therefore consider it desirable to contribute at a higher rate. Such additional payments should be at the discretion of individual authorities (paragraph 10.61);

(viii) the cost of any future benefit changes should be funded during the period of future service of the staff concerned (paragraph 10.59).

## 3: THE EXTENT OF THE PROBLEM

### The Auditor General expresses concern

3.1 The Auditor General has drawn attention to the magnitude and growth of employer liabilities for superannuation. The following are some quotations from his 1981-82 Report:

Although payment of portion of the employers' liability may be deferred, the liability accrues in relation to the employment of a contributor and accordingly should be regarded as part of the cost of employment and as such should be matched with revenue each year (page 197).

If it eventuates that statutory authorities have not set aside sufficient funds out of past earnings to meet those years' shares of the accruing deferred liabilities, the process of overtaking those arrears would force upwards the prices charged for services rendered by the authorities (page 37).

Actuarial studies suggest that employers' deferred liability for this cost [consumer price indexation of pensions] is considerable and is increasing (page 197).

Not all statutory authority employers have made full actuarially calculated provisions in their accounts out of earnings and I have sought advice to enable assessment of the extent of the liability which is accruing (page 197).

3.2 The 1982-83 Report of the Auditor General contained observations about unreported superannuation costs and commitments.

3.3 He pointed out that it could be professional misconduct for an auditor not to disclose all the costs incurred in providing the services sold in the accounting period. It would be contrary to accounting standards not to do so and it could then be professional misconduct for an auditor not to disclose the position.

In this context, any omission to disclose in the accounts the current and past service costs of employees' deferred benefits is of increasing concern. Although not payable until future dates, present day accounting thought is that the liability accrues during the employees' service as part of the cost of goods and services they are producing (page 10).

3.4 After expressing concern that, in respect of a number of tertiary education institutions, the provisions set aside for long service leave were only $19m against an accrued liability in excess of $75m he stated:

The situation regarding deferred superannuation contributions is worse (page 11).

3.5 After suggesting that the unrecorded liability for superannuation could be 'well in excess of $130m the Auditor General stated:

This is a measure of the costs incurred in the course of past years' operations, but not treated as a cost in those years, and therefore left to be paid by future taxpayers (page 11).

3.6 IN SUMMARY, THE AUDITOR GENERAL HAS, OF RECENT YEARS DRAWN TO THE ATTENTION OF PARLIAMENT TWO MAJOR PROBLEMS:

(a) THAT STATUTORY AUTHORITIES WERE NOT ADEQUATELY DISCLOSING THE FULL AMOUNT OF SUPERANNUATION EXPENSES AND LIABILITIES IN THEIR FINANCIAL STATEMENTS;

(b) THAT THE MAGNITUDE OF THESE UNREPORTED LIABILITIES WAS CONSIDERABLE AND INCREASING.

The Magnitude of Unfunded Past Service Liability

3.7 It is only in the last couple of years that statutory authorities, following the initiatives by the Auditor General, have been seized with the importance of having actuarial assessments made of their unfunded superannuation liabilities for past service. Some authorities still have to have assessments made in respect of some of their schemes. However assessments are available in respect of the largest authorities, and certainly in respect of enough authorities to enable a clear picture of the present overall position to be obtained.

3.8 The main liability is in respect of employees and former employees who are members of the State Superannuation Scheme (SSF). The position with that

Scheme will therefore be considered first. Assessments are available in respect of 22 authorities covering 62% of the statutory authority employees who are members of the Scheme and 82% of the pensioners. The total figures for these 22 authorities reveal the following:

| | $ million |
|---|---|
| Gross employer liability for superannuation | 1,494 |
| Less: Amount covered by employers' share in SSF | 207 |
| Amount of unfunded past service cost | 1,287 |
| Less: Provisions shown in employers' financial statements | 78 |
| Unrecognised liability for past[1] service | 1,210 |

3.9 Out of the 22 authorities, the ones responsible for the largest amounts of the $1,210m are:

| | |
|---|---|
| MWS & D Board | 249 |
| Electricity Commission | 224 |
| University of New South Wales | 167 |
| University of Sydney | 166 |
| State Bank | 106 |
| Maritime Services Board | 73 |
| Macquarie University | 48 |
| Sydney CAE | 40 |
| University of Newcastle | 38 |
| Hunter District Water Board | 33 |

3.10 When providing these assessments the Government Actuary also provided authorities with an estimate of the special payment which would need to be made each year for the next 20 years to eliminate this past service liability by the end of that 20 year period. He expressed this amount as a fixed percentage of the authority's salary bill in each of those 20 years. Figures for individual authorities depend very much on their age-sex distribution and on their proportion of pensioners. Figures for selected authorities are:

| Authority | % of salaries |
|---|---|
| MWS & D Board | 17.0 |
| Electricity Commission | 14.0 |
| University of New South Wales | 18.5 |
| University of Sydney | 16.5 |
| State Bank | 9.0 |
| Maritime Services Board | 20.0 |
| Macquarie University | 13.5 |
| Sydney CAE | 18.7 |
| university of Newcastle | 17.5 |
| Hunter District Water Board | 14.2 |

3.11 The payments mentioned in the preceding paragraph are merely those required to amortise the past service liability over 20 years. They are not sufficient in themselves to cure the problem for the future. This past service liability has arisen because the regular contributions being made each year to the State Superannuation Fund are not sufficient to cover the liability which accrues as a result of each year's activities.

3.12 Unless this situation is rectified by increasing the regular contribution in future to an amount which covers the accruing liability each year, an unfunded liability will remain. The Government Actuary has also provided figures which show his estimate of the regular employer contribution required in future, as a percentage of salaries, to meet the position. He shows the employer contribution actually made in 1982-83 for comparison. The comparison gives an indication of the inadequacy Of past funding. Some examples follow:

| Authority | Recommended regular future contribution (% of salaries) | Regular contribution in 1982-83 (% of salaries) |
|---|---|---|
| MWS & D Board | 15.5 | 7.2 |
| University of NSW | 19.0 | 6.3 |
| University of Sydney | 19.0 | 7.1 |
| State Bank | 10.0 | 3.8 |
| Maritime Services Board | 15.2 | 7.6 |
| Macquarie University | 19.5 | 5.6 |
| Sydney CAE | 18.5 | 6.6 |
| University of Newcastle | 18.5 | 6.2 |
| Hunter District Water Board | 14.8 | 6.1 |

This regular future contribution is for the future service of existing staff. They are older than new entrants and so eventually this regular contribution will fall back to the fully funded new-entrant contribution rate, estimated at 15.2% for the State Superannuation Schene as a whole.

3.13 The New South Wales Retirement Scheme has about 54,500 contributors from statutory authorities compared with about 34,500 in the State Superannuation Scheme. However, it provides a lower level of benefit and a high proportion receive a lump sum on retirement thus avoiding the high cost of CPI pension adjustments. For these reasons, even though employers only pay their liability when the benefit becomes payable, the unfunded liability for past service is less than under the State Superannuation Scheme. For 14 authorities with staff totalling 43,221 who are contributors to the Retirement Fund, assessments have been made by the Government Actuary. These show a total unfunded liability for past service of $655m, of which $573m is in respect of the State Rail Authority.

The Government Actuary estimates that this past service liability in respect of the State Rail Authority could be met by payments of 6.3% of salaries over 20 years. In addition, a regular payment for future service of 6.8% of salaries should be made. For other authorities the payment for future service is much the same (6.8%). For the State Superannuation Fund the typical corresponding figure is over 2 1/2 times this, showing how much more expensive is this latter scheme.

3.14 There are other schemes for which statutory authorities have an unfunded liability for past service. Only in respect of some of these have assessments been made, but it can be said that the bulk of the liability exists in respect of the State Superannuation Scheme and the New South Wales Retirement Scheme. IN RESPECT OF THESE TWO SCHEMES THE UNFUNDED LIABILITY FOR PAST SERVICE FOR ALL STATUTORY AUTHORITIES IS IN THE ORDER OF $2.5 BILLION.

3.15 The question naturally arises as to what burden will be placed on statutory authorities if no action is taken to fund these commitments. Projections by the Government Actuary give the figures in column 2 below (as a percentage of the salary bill) for employers' outlays over the next 28 years for the New South Wales Superannuation Scheme as a whole.

| Year ending June | Employers' outlay | | Employers' outlay ifno commutation of benefits |
|---|---|---|---|
| | (% of Salaries) | $m Nominal | (% of salaries |
| 1983 | 11.4 | 290 | 11.4 |
| 1987 | 12.2 | 444 | 12.5 |
| 1992 | 13.4 | 762 | 15.0 |
| 1997 | 14.8 | 1294 | 17.8 |
| 2002 | 16.4 | 2210 | 21.0 |
| 2007 | 18.4 | 3789 | 24.4 |
| 2012 | 20.2 | 6376 | 27.4 |

3.16 These figures suggest (and they are confirmed by figures produced by the Commonwealth Actuary for the Commonwealth Scheme using different assumptions) that the burden on employers (as a percentage of salaries) will double over 30 or so years and remain at that high level thereafter. These figures assume that staff grows at 0.5% per annum. If there is in the long term a higher rate of staff growth the ultimate figures will be a little lower because of the smaller ratio of pensioners to employees. If a slower rate of staff growthsoccurs, or a fall in staff, the ultimate figures will be higher. If the number of contributors were to remain unchanged the last figure of 20.2% would rise to about 23%. Thus the figures for individual authorities are likely to vary significantly from the above projections. Fot Statutory authorities as a whole the employer contribution required to fully fund a cohort of new entrants on the same basis is 15.2% of salaries.

3.17 The final column in the above table is included for information only, because of the movement away from lump sum payments in superannuation. If no lump sum payments were made the ultimate employer payout would rise to three times the present level (as a percentage of salaries) because of the high cost of pension indexation. The new-entrant fully funded contribution would rise from 15.2% of salaries to 21.5%.

3.18 UNDER CURRENT FUNDING ARRANGEMENTS FOR THE STATE SUPERANNUATION SCHEME AS A WHOLE THE ANNUAL CASH PAYMENTS BY EMPLOYERS FOR SUPERANNUATION ARE PROJECTED TO INCREASE BY 136% IN REAL TERMS FROM 1983 TO 2012 AND TO CONTINUE TO INCREASE FOR SOME TIME THEREAFTER.

The High Cost of Public Sector Superannuation

3.19 The reason for deciding not to provide funding for pension benefits at the time the liability is incurred, must be that there is a concern that at this stage to require cash contributions would have a serious impact on the prices charged for the authority's services. The hope, in adopting a pay-as-you-go approach, is that in future years the authority might be better able to meet those costs. This concern about the effect of superannuation costs on prices for services makes it necessary to refer to the real costs of superannuation packages in the public sector.

3.20 The Life Insurance Federation of Australia (LIFA) in a submission to the Inquiry dwelt at some length on the cost of public sector schemes and presented the results of a study done by the AMP society. The following are extracts from their submission:

(a) Public Sector New Entrant Cost

The employer contribution ranges generally from around 15 per cent to over 30 per cent [of salaries] (varying with entry age, actuarial basis, and age at retirement). A fairly typical case could be taken to be a 30 year old entrant to the Commonwealth Scheme who retires at age 65., where the contribution rate is 19.9 per cent on the first actuarial basis used.

(b) Private Sector New Entrant Cost

The employer contribution ranges generally from around 4 per cent to 11 per cent. A fairly typical case could be taken to be a 30 year old entrant to a scheme who retires at 65, with a lump sum of 15 per cent for each year of service, where the contribution rate is 6.3 per cent on the same actuarial basis.

From the figures reflected by this short summary of the AMP's analysis, it appears that a public sector scheme typically costs three times as much as a private scheme in terms of new entrant costs.

Commenting. on the total cost of the scheme across all contributors, including the cost of past service, is difficult because of lack of available information. However, from available data we believe that an approximate general indication of the total employer cost is of the order of 20 per cent or 22 per cent of salary roll in many larger public sector schemes. In the private sector, in those cases where schemes cover the majority of employed staff (rather than a selected group of senior employees) it is very rare for the total scheme cost to the employer to exceed 8 per cent to 12 1/2 per cent of salary roll. Thus again, comparative costs show the public sector level to be in the vicinity of 200 per cent of the private sector level. This may be a conservative estimate.

LIFA strongly believes that the overall level of benefits provided by many public sector schemes in Australia is too generous when compared with the benefits under private sector superannuation arrangements. Similarly, the long term costs exceed the amount which the community should equitably bear. LIFA suggests that the benefit structure of public sector schemes should not result in a liability exceeding 10-15 per cent of the relevent salaries, as an employer cost.

LIFA submits that the Commonwealth and State Governments should whenever possible take steps to place the same sort of restraints on the levels of benefits and contributions of public sector schemes as are placed on private sector schemes through the income tax legislation.

3.21 Mr Roach, consulting actuary, was asked by the Minister of Finance of the Commonwealth Government in November 1982 to make a comparison of the Commonwealth Superannuation Scheme with those in the private sector and those for State public servants. He concluded

On a comparable average basis, the New Entrant Contribution Rate payable by the employer, as a percentage of salaries, is:

(a) with respect to schemes in the private sector providing lump sum benefits, say 9% of salaries

(b) with respect to schemes in the private sector providing pension benefits, say 12.5% of salaries, and

(c) with respect to schemes in the public sector, in excess of 20% of salaries (for the Commonwealth Scheme it is 21.5% of salaries)

3.22 Mr Roach added a note which is of interest because of the recent trends against lump sum payments.

The rate is 21.5% of salaries while members continue to take cash benefits on resignation and would be of the order of 25.9% of salaries if all resigning members took deferred benefits on resignation.

All other things being equal, the Commonwealth Scheme members are members of a fund to which the employer's commitment to pay contributions has a much higher value than the comparable commitment in the private sector. The employer's commitment to pay in respect of other comparable public sector schemes is of the same order of magnitude as for the Commonwealth Scheme.

3.23 The Committee recognises that it is not possible for one state to ignore the approach to superannuation adopted by the public sector elsewhere in Australia; it understands too that the State Superannuation Scheme is not the most costly of public sector schemes in Australia. Nevertheless the high cost must be part of the concern to statutory authorities in New South Wales.

3.24 The high cost of public sector superannuation has already had an effect on some approved authorities in the Commonwealth sphere. The Senate Standing Committee on Finance and Government Operations in its Interim Report entitled Funding of Superannuation by Statutory Authorities dated December 1983 under the heading 'Problems uncovered by actuarial reviews' states

The Australian National Airlines Commission has emerging cost arrangements in respect of its employer contributions to the Commonwealth Scheme. The difficulties faced by the Commission in meeting its employer contributions received wide publicity in recent years. The end result has been for the Commission to terminate entry to the Scheme and develop an alternative private superannuation scheme, and for the Government to make up the shortfalls in employer contributions. The Commission established its own scheme for ground staff, and TAA employees are no longer able to join the Commonwealth Scheme.
In respect of those employees who decide to remain as members of the Commonwealth Scheme, TAA is to pay employer contributions to the Commonwealth at commercial levels (i.e. industry levels) with the Commonwealth making up the difference.

3.25 The same report points out that the Australian Shipping Commission (ANL) through making contributions of only 15% of salaries had built up by 1982 a liability of over $57m. It was advised that a contribution rate of 37%

would be required to bring the authority up to a point where it could meet its current and future Commonwealth Scheme commitments. This situation obviously contributed to the Commission's decision to establish a private scheme. It may also mean that ANL will seek Commonwealth assistance in meeting its unfunded liability.

3.26 Paragraph 3.22 of the same report mentions the high superannuation contribution being made by the Snowy Mountains Hydro-Electric Authority to pay off, over a period of some 70 years, its accumulated deficit.

The Committee notes that the Snowy Mountains Hydro-Electric Authority is an authority which has been wound down over a considerable period of time with the result that it has a decreasing, ageing workforce and a large superannuitant responsibility.

3.27 situations such as those just referred to have not occured with New South Wales authorities. However the Government Insurance Office in its submision did indicate a concern about costs and stated, with reference to the State Superannuation Scheme, that 'the level of cost is high by community standards'. The GIO submission argued that --

In order to operate efficiently and to full effect in the private sector, the Government Insurance Office should be able to establish a superannuation scheme which will reflect private sector characteristics

- lower employer cost
- uniform employer (and employee) cost throughout service
- full funding
- full vesting in appropriate circumstances

This is a major issue for the Government Insurance office.

The GIO stressed that there is no intention to reduce the entitlements of present staff.

3.28 A further comparison of the cost of public sector superannuation schemes, like the State Superannuation Scheme, with private sector schemes is given by the Economic and Budget Review Committee of the Victorian Parliament (hereafter EBRC) in its report A Review of Superannuation in the Victorian Public Sector, April, 1984.
The EBRC observed from a report by Mr Cook to the Victorian Treasurer:

The Committee notes ... that if it [the Victorian State Superannuation Scheme] were fully funded in the private sector manner, the costs to State employers of the State Scheme would be about twice the corresponding cost of the typical private sector scheme (page 263).

The EBRC went on to say:

If steps are not taken to reduce the predicted increases in the cost of superannuation, the State may be required to increase the level of financing of the State Scheme by measures that could include increased State taxation and/or reduced expenditure (page 267).

3.29 The Committee notes that the State Superannuation Scheme of New South Wales has a similar level of costs.

3.30 THE COMMITTEE ACCEPTS THAT THE COST OF THE STATE SUPERANNUATION SCHEME, ALONG WITH THAT OF SIMILAR PUBLIC SECTOR SCHEMES IN OTHER STATES, IS HIGH BY COMMUNITY STANDARDS. IT CONCLUDES THAT THIS HIGH COST MUST AT LEAST BE ONE OF THE FACTORS CONTRIBUTING TO THE PROBLEM OF FINANCING SUPERANNUATION LIABILITIES.

How the present position arose

3.31 The magnitude of the unfunded past service liabilities which were being revealed as a result of the Auditor General's inquiries, the rate at which these liabilities were growing, the impact which they might have on future costs of services provided by authorities, and especially the absence of proper accounting for, and disclosure of, superannuation costs were clearly factors which prompted the Auditor General to suggest that the matter be referred to the Public Accounts Committee. Therefore it is appropriate that reference should be made to the events which led to the present position.

3.32 As pointed out in paragraph 3.8 the largest unfunded liability for past service in relation to statutory authorities concerns those employees who are members of the State Superannuation Scheme of New South Wales. It is a unit type scheme, one of the characteristics of which is that contributions increase steeply with age. This means that contributions are relatively low in the early years of service and relatively high in the later years of service. If therefore the true cost of benefits were properly allocated to years of service it is likely that the true cost of superannuation in an employee's early years of service would be more than the amounts which have been paid in contributions. On a proper accounting basis therefore one would expect there to be some unfunded liability for past service for this reason alone. From a funding point of view this is not the real matter for concern; the Scheme was designed to be funded this way.

It is for reasons other than this that a large unfunded liability has built up.

3.33 THE LARGE UNFUNDED LIABILITY HAS COME ABOUT CHIEFLY BECAUSE IMPROVEMENTS HAVE BEEN MADE FROM TIME TO TIME IN SCHEME BENEFITS WITHOUT CORRESPONDING INCREASES BEING MADE IN CONTRIBUTIONS TO ENSURE THAT THE SCHEME'S FUNDING DESIGN WAS MAINTAINED. FURTHER, THE INADEQUATE ACCOUNTING PROCEDURES OF STATUTORY AUTHORITIES HAVE PREVENTED THE INCREASING LIABILITIES RESULTING FROM THE BENEFITS IMPROVEMENTS BEING DRAWN TO THE ATTENTION OF THE PUBLIC.

3.34 Appendix VI of the Thirteenth Valuation Report of the Fund takes 22 paragraphs to outline changes which have taken place over the years in the structure of the Fund up until 30 June 1978 and there have been more since then. Some of these changes involved increases in benefits without any requirement that the level of contributions be increased while the members concerned were employed. The benefit increases were granted with full recognition that no advance funding would be made, and that the employers would only meet the cost at the time the increased benefits were paid out. This is usually long after the employee has ceased work. The following are examples:-

(1) The Superannuation (Amendment) Act 1951 increased the unit of pension. Part of the pension increase was to be met by employers only as pensions were paid.

(2) The Superannuation (Amendment) Act 1955 further increased the unit of pension and also improved children's pensions. Employees' contributions remained unchanged and the full cost of the increase was to be met by employers as pensions were paid.

(3) The Superannuation (Amendment) Act 1960 raised the rate of widows' pension, both current and prospective; the full cost was to be met by employers as the pensions were paid.

(4) The Amendment Act of 1972 increased the pensions of some long serving employees, part of the cost being met by employers, and met only as pensions were paid.

(5) In 1973 the long standing practice of making periodic CPI adjustments to pensioners under the Commonwealth Government Employee's Superannuation Scheme was made automatic, and the States followed soon after. The legislation concerning the New South Wales SuperannuationScheme was passed in 1974. Whereas under the Commonwealth legislation approved authorities were required to meet the cost in advance by payments to Treasury, the New South Wales legislation provided for the pension increases to be paid for only as the pensions were paid. It is these CPI pension adjustments which, because of the high rates of inflation which now seem to be endemic, constitute the major component of the unfunded liability for past service.

3.35 Clearly none of the above changes required employers to undertake immediate cash payments. The Committee does not know to what extent the estimated ultimate cost, and the likely effect on charges for services by statutory authorities, were brought to the attention of and taken into consideration by, the decision-making authorities. The same benefits apply to employees of government departments and it is likely that the statutory authorities themselves were not major parties in the decisions. In any case the high' cost of the CPI pension adjustments would not have been anticipated in 1974 because at that stage the CPI increase over the previous 15-20 years had been of the order of 3% per annum. The quadrupling of oil prices in 1974 triggered off an inflationary era which has remained since.

3.36 FOR THE STATE SUPERANNUATION SCHEME A PRECEDENT WAS SET MANY YEARS AGO IN WHICH FAIRLY SMALL BENEFIT INCREASES WERE APPROVED WITHOUT ANY ADVANCE FUNDING. THE PRECEDENT WAS FOLLOWED ON A NUMBER OF SUBSEQUENT OCCASIONS LEADING FINALLY TO THE PRESENT SITUATION UNDER STUDY.

Lack of awareness of the cost of benefit increases

3.37 The Committee is not aware of what discussion or that cost estimates were available when previous benefit changes were approved. In this respect LIFA made the following Submission.

LIFA believes that in the larger public sector schemes there has been a tendency for benefit improvements to be without submission to Parliament of a proper actuarial assessment of the expected cost of the increases, and a verification by Parliament that the public are willing to finance this expected cost.

3.38 THE COMMITTEE BELIEVES THAT OVER A LONG PERIOD OF TIME THERE HAS BEEN UNSATISFACTORY DISCLOSURE OF THE COST IMPLICATIONS OF BENEFIT CHANGES TO THE PARLIAMENT AND THE PUBLIC PRIOR TO THEIR IMPLEMENTATION.

3.39 Moreover, after decisions were taken to improve benefits, the accounting procedures adopted by individual authorities have not reflected the full impact of those changes on superannuation expenses and liabilities. The non-disclosure of the full extent of the accruing expenses and liabilities may be explainable by the absence of any formal requirements for statutory authorities to employ accrual accounting, and by the absence of any Australian accounting standards on the subject of retirement benefits. Even so, it must be noted that the accounting and reporting practices adopted by statutory authorities in New South Wales have systematically understated superannuation expenses and liabilities.

3.40 SINCE THE ACCOUNTING AND FINANCIAL REPORTING PRACTICES OF STATUTORY AUTHORITIES HAVE NOT REFLECTED THE ESCALATION OF SUPERANNUATION EXPENSES, THESE PRACTICES HAVE CONTRIBUTED TO A CLIMATE WHEREIN BENEFIT CHANGES HAVE BEEN INTRODUCED WITH LITTLE REGARD TO COST IMPLICATIONS.

## 4: THE SUPERANNUATION COMMITMENTS AND FUNDING ARRANGEMENTS OF NEW SOUTH WALES STATUTORY AUTHORITIES

4.1 At the commencement of the Inquiry the Committee sent a questionnaire to all of the New South Wales Statutory Authorities except those that were known not to incur superannuation costs in their own right. The major purpose of the questionnaire was to obtain information about the superannuation schemes operating in the public sector, and on the accounting and funding policies being pursued by statutory authorities.

4.2 Of the 156 statutory authorities that are separate accounting entities identified by the Auditor General, 98 employ permanent staff. These authorities have about 131,000 permanent employees of whom about 110,200 were contributing to a superannuation shceme (refer Table 4.l). Some authorities (e.g. the State Rail Authority, Elcom, the Metropolitan Water Sewerage and Drainage Board, the Sydney County Council, are major employers, and their employees are a significant proportion of the members of the various schemes (refer Table 4.2) A further 31 authorities reported that their employees' superannuation entitlements were met by the Treasury and that the contributions of those employing authorities were paid direct to Treasury (refer Table 4.3).

4.3 It is apparent from the information provided to the Committee that the scale of superannuation payments by New South Wales statutory authorities has increased dramatically in recent years. Employer payments in 1978/79 were about $90m; in 1982/83 they were about $183m -- an increase of 102%.

4.4 The survey indicated that New South Wales statutory authorities and their employees contribute to 54 separate superannuation schemes. Of these, forty-five are schemes specific to a particular authority (for example, the Fish Marketing Authority Staff Superannuation Fund; the Government Insurance Office Life Representatives Superannuation Scheme). Some authorities are involved in several superannuation schemes covering different groups of their employees. Despite this diversity of schemes, one half of the staff of statutory authorities who contribute to superannuation schemes contribute to the New South Wales Retirement Fund and well over a quarter contribute to the State Superannuation Fund. The following paragraphs outline some features of the major schemes (and the manner in which they are funded).

TABLE 4.1

SUPERANNUATION SCHEMES OF NEW SOUTH WALES STATUTORY AUTHORITIES

| Scheme | Number of Authorities with Members | Approximate Number of Contributors | Approximate Number of Pensioners |
|---|---|---|---|
| State Superannuation Scheme | 76 | 34,500 | 5,500 |
| New South Wales Retirement Scheme | 34 | 54,500 | 2,100 |
| Local Government Pension Fund | 9 | 4,500 | - |
| Local Government Benefits Fund | 8 | 4,800 | - |
| Local Government Provident Fund | 4 | 200 | - |
| Local Government Insurance Account | 4 | 600 | - |
| Railway Service Superannuation Fund | 5 | 2,100 | 17,500 |
| Transport Retirement Fund | 3 | 1,200 | - |
| Transport Act Gratuities | 2 | 1,200 | - |
| Authority-specific Schemes | 45 | 6,600 | 300 |
| | | 110,200 | 25,400 |

A total of 54 separate Schemes have been identified.

TABLE 4.2

DISTRIBUTION OF MEMBERSHIP OF SUPERANNUATION SCHEMES AMONG AUTHORITIES

| | Permanent employees' | | Employees contributing to a superannuation scheme | |
|---|---|---|---|---|
| | Number | % of total | Number | % of total |
| The largest employing authority (State Rail Authority) | 39,476 | 30.1 | 34,701 | 31.5 |
| The six largest employing authorities | 87,132 | 65.5 | 74,034 | 67.2 |
| The thirty largest employing authorities | 125,452 | 95.8 | 102,249 | 92.8 |
| All 98 authorities | 130,982 | 100% | 110,199 | 100% |

TABLE 4.3

AUTHORITIES WHICH PAY SUPERANNUATION CONTRIBUTIONS TO TREASURY

Bathurst Orange Development Corporation

Builders Licensing Board

Long Service Leave Payments Corporation

Chipping Norton Lake Authority

Coal & Oil Shale Workers Superannuation Tribunal

Court of Auctioneers and Agents

Energy Authority of New South Wales

Fish River Water Supply

Forestry Commission

Government Insurance Office

Hawkesbury Agricultural College

Housing Commission of New South Wales

Hunter Valley Conservation Trust

Land Commission of New South Wales

Legal Services Commission

Local Government Superannuation Board

Macarthur Growth Area

Meat Industry Authority

Mine Subsidence Board

Motor Transport, Department of

Mulwala Water Supply

Plumbers, Gasfitters and Drainers Board

Rental Bond Board

State Brickworks

State Dockyard

South West Tablelands Water Supply

State Superannuation Board

Sydney Opera House Trust

Treasury Finance Corporation

Workers Compensation Commission

Zoological Parks Board

State Superannuation Fund

The Fund commenced in 1919 and provides a wide range of retirement and other benefits. It was originally designed as a defined contribution type scheme under which units of pension are bought, the number of permissible units depending on salary. These units are funded by level annual contributions from employer and employee payable over the employee's future service. The contributions depend on the employee's age when the contributions for the particular unit commence. Because the employer's contribution in respect of each employee expressed as a percentage of salary increases with age, the rate of funding of the scheme is quite low. This matter was referred to in paragraph 3.33 and is referred to again in paragraph 4.18. However, had the Scheme remained as originally planned the contributions would have met the benefits and the Scheme would have been fully funded.

4.6 As outlined in Section 3, for the past thirty years the Scheme has been subject to almost.continual amendment to keep it up to date with retirement benefit trends and with current economic conditions. It would have been consistent with the initial design of the Scheme if contribution rates had been increased every time benefits were improved so that the employer's obligation in respect of any employee would have ceased on termination of the employee's service. These funding changes however were usually not made.

4.7 A variety of approaches has been adopted in dealing with the cost of these benefit increases. In some cases it has been possible for the Fund to meet the full cost of the benefit increase out of its surplus. In others the higher benefit is being met by the Fund, subject to the employer giving a guarantee that if interest earnings over 5.5% are insufficient to meet the cost, the employer will meet the shortfall. In some cases the cost is met wholly by the employer; in others, the cost is shared between the Fund and the employer. Sometimes the contribution rates for new units were increased. It is not surprising therefore that the present financing arrangements are quite complex. The major part of the unfunded liability of employers is due to pension subsidies and particularly to the automatic 'cost-of-living' adjustments to pensions introduced in 1974. The employer faces cash outlays in respect of these adjustments long after the employee's service has ceased.

4.8 While the funding arrangement (or more correctly, part-funding arrangement) for many statutory authorities in relation to the State Superannuation Fund is as outlined in the last paragraph, it is not the position with all authorities. There are some authorities, such as the Government Insurance Office, which make, in addition to their normal employer contributions, an additional payment to Treasury to cover their liability for pension subsidies and cost-of-living adjustments to pensions. The consolidated fund then meets these pension payments as they emerge. The normal employer contribution for new units is 5/8 of the employee contribution. In the case of the Government Insurance Office a further 9/8 of the employee contribution is paid regularly to Treasury which in return takes over the deferred liability for pensions. A list of the authorities which pay contributions to Treasury appears as Table 4.3.

New South Wales Retirement Fund*

4.9 One half ofthe statutory authority employees who contribute to a superannuation scheme contribute to the New South Wales Retirement Fund. Employers do not contribute to the Fund, which represents solely the result of investing employee contributions. Employers pay the whole of their liability when the benefit emerges. That is, they normally pay a lump sum on retirement; but when the benefit is taken in pension form the employer pays at intervals while the pension is in course of payment. Thus the employer's liability for retirement benefits is only met after the employee retires. There is thus a large unfunded liability. Per employee it is a much smaller liability than under the New South Wales State Superannuation Fund because of the lower level of benefits, and because the lump sum nature of the scheme eliminates the heavy cost of cost-of-living pension adjustments.

Local Government Funds*

4.10 The Local Government Superannuation Board is responsible for three schemes (The Benefits Fund, The Provident Fund and The Insurance Account) which are all accumulation type schemes, which therefore have no unfunded liability and which are closed to new entrants. They are also responsible for the management of the Pension Fund. There are two catagories of employer associated with the Pension Fund namely --

(i) those funded by local government, and

(ii) those funded by the New South Wales Government.

4.11 An actuarial investigation is carried out every three years. The latest investigation indicated that the employer contribution paid by the former is adequate to meet the accruing benefits and that a 2% of salaries extra payment being made each year to fund past service benefits should eliminate any deficiency by 1994.

* These funds are now administered by the new Public Authorities Superannuation Board.

4.12 The second group of employers, namely those funded by the New South Wales Government (mainly public hospital employees), are in a different position. They contribute only 5 1/4% of salary, receive some refund in respect of resignations, and if the Fund is unable to pay benefits the shortfall is met from consolidated revenue. The 1981 investigation indicated that, if refunds to employers in respect of resignations were eliminated, the employer contribution rate should be 7.3% of salaries. The unfunded liability in respect of these employers was then estimated at $11.8 million.

Professorial Schemes

4.13 The Professorial Scheme of the University of Sydney provides another example of unfunded liability for superannuation. Many years ago the University of Sydney, as part of its terms of employment for professors, offered a non-contributory pension on retirement after age 60 with 15 years of service of 25% of professorial salary. The liability was met on a pay-as-you-go basis and for many years there has been an unfunded liability. Of recent years attempts have been made to build UP provisions, but a considerable proportion of this unfunded liability remains unfunded and unrecorded.

Actuarial Assessments

4.14 At June 1984 29 of the authorities. reported that they had obtained actuarial assessments of their unfunded liability for superannuation (refer Table 4.4). Most of the larger authorities had obtained separate actuarial assessments in respect of each of the schemes with which they are involved. The assessments in respect of the State Superannuation Fund and the New South Wales Retirement Fund had been carried out by the New South Wales Government Actuary, and outside consulting actuaries had been engage<] for most of the other assessments.

TABLE 4.4

STATUTORY AUTHORITIES SUBJECTED TO RECENT ACTUARIAL ASSESSMENT (as at June, 1984)

| Name of Authority | Scheme | Actuary |
|---|---|---|
| Coal & Oil Shale Mine Workers Superannuation Tribunal | C&OSMW Super Fund | Government |
| Dairy Industry Marketing Authority | S.S.F. | Government |
| Department of Motor Transport | N.R.F. | Government |
| Egg Corporation of New South Wales | Egg Board Plan | Legal & General |
| Electricity Commission of New South Wales | S.S.F. and N.R.F. | Government |
| Grain Handling Authority of New South Wales | S.S.F. and N.R.F. | Government |
| Hawkesbury Agricultural College | S.S.F. and N.R.F. | Government |
| Homebush Abattoir Corporation | S.S.F. and N.R.F. | Government |
| Hunter District Water Board | S.S.F. and N.R.F. | Government |
| Macquarie University | S.S.F. and | Government |
| | Professorial Scheme | E.S. Knight & Co. |
| Maritime Services Board | S.S.D. and N.R.F. | Government |
| Metropolitan Waste Disposal Authority | S.S.D. and N.R.F. | Government |
| Metropolitan Water Sewerage and Drainage Board | S.S.F. and N.R.F. | Government |
| Mitchell College of Advanced Education | S.S.F. | Government |
| New South Wales Retirement Fund | S.S.F. and N.R.F. | Government |
| Newcastle College of Advanced Education | S.S.F. | Government |
| Orange Agricultural College | S.S.F. and N.R.F. | Government |
| Public Service Association | S.S.F | Government |
| State Bank of New South Wales | S.S.F. and N.R.F. | Government |
| State Rail Authority | N.R.F. | Government |
| Sydney County Council | Employees'Accrued Entitlement Fund | Government |
| Sydney College of Advanced Education | S.S.F. | Government |
| Sydney Farm Produce Market Authority | S.S.F. | Government |
| Sydney Grammar School | S.S.F. | Government |
| Trotting Authority of New South Wales | S.S.F. | Government |
| University of Newcastle | S.S.F. and | Government |
| University of New England | Professorial Scheme | The Wyatt Company |
| University of New South Wales | Professorial Scheme | E.S. Knight & Co. |
| University of Sydney | S.S.F. and | Government |
| | Professorial Scheme | Government |

4.15 The Committee was informed that some authorities had encountered difficulties in obtaining actuarial assessments of their unfunded liability. The Newcastle College of Advanced Education, for example, advised that it had been seeking actuarial advice for several years before such advice was obtained from the Government Actuary. The Committee was advised that the Government Actuary is now in position to provide prompt attention to these requests. Requests for actuarial advice from an authority often necessitate special investigations. Mr Steel, Deputy Government Actuary, explained the process in the following terms:

The valuations for authorities [in respect of the State Superannuation Fund and the New South Wales Retirement Fund] can be done very quickly. The procedures are established, and we are able to provide that advice in a matter of weeks. But in other cases there is substantial delay in providing the advice.

First of all, the problem has to be analyzed. We then have to tell the authority the data we require, the authority has to extract it, and when it is eventually made available, the investigation can proceed. But the delays really only occur on the first occasion, because we can tell the authority our on-Going data requirements for subsequent investigations. They can then provide those rapidly, soon after the investigation date, and furthermore, our procedures, our computer programs, will not require amendment unless there has been some amendment to the scheme.

4.16 Table 4.5 presents information relating to the unfunded liability with respect to the State Superannuation Fund of the 22 authorities which have been reported on by the Government Actuary. The contributors from these 22 authorities total 21,635 out of a total 34,923 contributors to the State Superannuation Fund from all statutory authorities. Table 4.5 therefore provides a good indication of the overall financial position.

4.17 THE FIRST POINT TO NOTE FROM TABLE 4.5 IS THE VERY SMALL PROPORTION (14%) OF THE TOTAL LIABILITY FOR PAST SERVICE WHICH IS COVERED BY THE CONTRIBUTIONS WHICH EMPLOYERS HAVE MADE TO THE SCHEME. COLUMN 5, IS THE PRESENT VALUE OF THE EMPLOYERS' LIABILITY FOR BENEFITS -- $1,494 MILLION FOR THE 22 AUTHORITIES. COLUMN 6 IS THE VALUE OF THOSE BENEFITS WHICH WILL BE MET BY THE CONTRIBUTIONS MADE SO FAR TO THE FUND BY THESE EMPLOYERS -- A TOTAL OF ONLY $207 MILLION.

4.18 The small proportion of the liability which is covered by the Fund is partly due to improved benefits introduced without adequate funding, and partly due to the inherent slow rate of funding of unit schemes referred to in paragraph 4.5. Most authorities have made some provision for the liability in their accounts. These provisions are stated to total $78 million, so that the unfunded liability after allowing for their interest in the State Superannuation Fund and these provisions is $1,210 million.

Table 4.5

SUPERANNUATION LIABILITIES OF **STATUTORY AUTHORITIES: STATE** SUPERANNUATION FUND

| Name | Date of Investigation | Number Contributors | Number of Pensioners | Gross * Employer Liability $'000 | Employer Stake in Fund $'000 | Employers Internal Provision S'000 | Net * Liability S'000 |
|---|---|---|---|---|---|---|---|
| Grain Handling Authority | 31/10/83 | 232 | 51 | 16,550 | 2,495 | 7,284 | 6,771 |
| MWS & DB | 30/ 6/82 | 4,656 | 1,243 | 293,455 | 32,397 | 11,759 | 249,299 |
| Sydney Farm Produce Marketing Authority | 30/ 6/82 | 1 | 0 | 221 | 67 | 0 | ]54 |
| Electricity Commission of New South Wales | 30/ 6/82 | 4,131 | 686 | 290,654 | 34,754 | 31,640 | 224,260 |
| Newcastle CAE | 31/12/82 | 232 | 28 | 21,474 | 3,372 | 100 | 18,002 |
| Hawkesbury Agric College | 31/12/82 | 132 | 9 | 7,254 | 1,217 | 119 | 5,918 |
| Macquarie University | 31/12/82 | 835 | 64 | 55,458 | 7,586 | 0 | 47,872 |
| Dairy Industry Marketing Authority | 30/ 6/82 | 182 | 49 | 12,208 | 1,332 | 4,473 | 6,403 |
| University of Sydney | 31/12/83 | 2,185 | 468 | 197,253 | 31,400 | 0 | 165,853 |
| Orange Agricultural College | 31/12/83 | 48 | 1 | 1,851 | 295 | 5 | 1,551 |
| Maritime Services Board | 30/ 6/83 | 962 | 395 | 88,340 | 13,649 | 2,075 | 72,616 |
| State Bank | 30/ 6/83 | 4,255 | 543 | 144,044 | 19,447 | 18,630 | 105,967 |
| NSW Retirement Board | 30/ 6/83 | 2 | 1 | 753 | 240 | 0 | 513 |
| Hunter District Water Board | 30/ 6/83 | 605 | 150 | 38,506 | 4,463 | 650 | 33,393 |
| Metrop. Waste Disposal Auth. | 30/ 6/83 | 6 | 3 | 711 | 159 | 176 | 376 |
| Public Service Association | 31/12/83 | 59 | 5 | 3,838 | 482 | 170 | 3,186 |
| Mitchell CAE | 31/12/83 | 269 | 18 | 17,643 | 2,681 | 217 | 14,745 |
| Sydney CAE | 31/12/83 | 451 | 62 | 49,469 | 9,147 | Nil | 40,322 |
| University of NSW | 31/12/83 | 1,823 | 445 | 199,741 | 32,783 | Nil | 166,958 |
| Sydney Grammar School | 31/12/83 | 123 | 18 | 8,432 | 1,253 | 129 | 7,050 |
| Homebush Abattoir Corporation | 30/ 6/83 | 2 | 1 | 389 | 49 | 8 | 332 |
| University of Newcastle | 31/12/83 | 444 | 68 | 46,135 | 7,760 | 150 | 38,225 |
| | | 21,635 | 4,308 | 1,494,379 | 207,028 | 77,585 | 1,209,766 |

Note that the totals have been added for illustration but the investigation dates are not all the same

· The liability referred to here is the 'unfunded liability for past service'.

4.19 The Government Actuary has also estimated for each authority the contribution which should be paid as a percentage of salaries to fund this past service liability over a period of years. For a 20 year period these figures are given in the second column of Table 4.6 For comparison with the recommended contribution to amortize the past service liability, column 3 of Table 4.6 shows the pay-as-you-go 1982-83 deferred pension subsidies also as a percentage of salaries. It can be seen that they are small compared with the recommended contribution, indicating that they will grow considerably in later years if no attempt is made to set aside funds to meet the emerging cash commitments.

4.20 In addition each authority will need to pay a contribution to meet the benefits which will accrue from year to year in the future. This recommended contribution, for future service, is given in Table 4.6 in column 4. These contributions vary considerably from one authority to another depending particularly on the demographic characteristics of the staff. They are relatively low for the State Bank, for example, because of its younger membership and higher proportion of female contributors (52%), 80% of the latter being under age 25.

4.21 In column 5 of Table 4.6 is the regular employer contribution (paid concurrently with the employee contribution) for 1982-83 as a percentage of salaries. This should be compared with the figures in the previous column which are the contributions which should be paid each year to cover the benefits provided (i.e. to fully fund future commitments). In the case of Macquarie University, for example, the employer should pay 19.5% of salaries to cover the year's accrued expense, whereas only 5.6% was paid in 1982-83. The difference between the figures in these two columns indicates the rate at which unfunded liabilities are building up.

TABLE 4.6

STATE SUPERANNUATION FUND : CONTRIBUTION RATES REQUIRED TO FULLY FUND SUPERANNUATION COMMITMENTS OVER 20 YEARS

| Name of Authority | Past Service Contribution Payable for 20 years (% of Salaries) | Deferred Pension Subsidies in 1982-83 (% of Salaries) | Future Contribution Rate (% of Salaries) | Service Concurrent Employer Contribution in 1982-83 (% of Salaries | Total Contribution |
|---|---|---|---|---|---|
| Grain Handling Board | 8.25 | 4.3 | 19.5 | 20.4* | 27.75 |
| MWS & D Board | 17.0 | 6.9 | 15.5 | 7.2 | 32.5 |
| Electricity Commission of N.S.W. | 14.0 | 4.1 | 17.5 | 8.6* | 31.5 |
| Newcastle CAE | 19.0 | 3.9 | 18.0 | 6.8 | 37.0 |
| Hawkesbury CAE | 11.5 | 1.6 | 17.5 | 4.1 | 29.0 |
| Macquarie University | 13.5 | 1.8 | 19.5 | 5.6 | 33.0 |
| Dairy Industry Marketing Authority | 10.75 | 7.8 | 15.25 | 5.5 | 26.0 |
| University of Sydney | 16.5 | 4.5 | 19.0 | 7.1 | 35.5 |
| Orange CAE | 8.0 | - | 16.75 | 4.9 | 24.75 |
| Maritime Services Board | 20.0 | 9.5 | 15.25 | 7.6 | 35.25 |
| State Bank | 9.0 | 4.6 | 10.0 | 3.8 | 19.0 |
| Hunter District Water Board | 14.25 | 6.0 | 14.75 | 6.1 | 29.0 |
| Metrop Waste Disposal Authority | 13.5 | 9.3 | 16.0 | 3.6 | 29.5 |
| Public Service Association | 13.0 | 3.1 | 17.25 | 7.3 | 30.25 |
| Mitchell CAE | 12.25 | 1.6 | 18.5 | 5.5 | 30.75 |
| Sydney CAE | 18.75 | 4.4 | 18.5 | 6.6 | 37.25 |
| The University of New South Wales | 18.5 | 6.3 | 19.0 | 6.3 | 37.5 |
| Sydney Grammar School | 12.75 | 3.5 | 17.5 | 5.4 | 30.25 |
| Homebush Abattoir Corporation | 21.0 | 10.5 | 23.0 | 1.8 | 44.0 |
| University of Newcastle | 17,5 | 4.4 | 18.5 | 6.2 | 36.0 |

Special Payments were included in 1982-83 in these two cases

4.22 The total recommended contribution concerning both past and future service is given in column 6 of Table 4.6. In all cases the total contribution required if 20 year funding of the past service liability were adopted is a very high percentage of the salary bill.

4.23 WITH REGARD TO THE STATE SUPERANNUATION SCHEME IT IS CLEAR THAT:

(a) IF AUTHORITIES ARE TO FULLY FUND SUPERANNUATION COMMITMENTS THAT ARISE OUT OF THE FUTURE SERVICE OF CURRENT EMPLOYEES, THEIR ANNUAL CONTRIBUTIONS, AS A PERCENT OF SALARIES PAID, WOULD IN RESPECT OF FUTURE SERVICE ALONE, BE TWO AND A HALF OR MORE TIMES THEIR PRESENT CONCURRENT EMPLOYER CONTRIBUTIONS.

(b) IF IN ADDITION TO FULLY FUNDING SUPERANNUATION COMMITMENTS ARISING OUT OF FUTURE SERVICE, AUTHORITIES WERE TO EXTINGUISH THEIR CURRENT UNFUNDED LIABILITIES IN RESPECT OF PAST EMPLOYEE SERVICE OVER A 20 YEAR PERIOD THE REQUIRED 'PAST SERVICE EMPLOYER CONTRIBUTION WOULD' BE APPROXIMATELY THREE TIMES THE SIZE OF THEIR CURRENT PAY-AS-YOU-GO PENSION SUBSIDIES.

4.24 Similar figures for the Retirement Fund are given in Tables 4.7 and 4.8. The 14 authorities analysed cover 43,221 contributors and 1,699 pensioners out of a total of about 54,500 and 2,100 respectively. About one half of the contributors and pensioners are from the State Rail Authority. The employers' share of the Retirement Fund is very small because the lump sum benefit is not funded by the employer, as explained in paragraph 4.9; the employers' share relates only to payments made in respect of those who elected to take pensions. The recommended contributions are in Table 4.8.

TABLE 4.7

SUPERANNUATION LIABILITIES OF STATUTORY AUTHORITIES : NEW SOUTH WALES RETIREMENT FUND

| Name | Date of Investigation | Number of Contributors | Number of Pensioners | Gross Employer Liability $'000 | Employer Stake in NRF $'000 | Employers Internal Provision $'000 | Net Liability $'000 |
|---|---|---|---|---|---|---|---|
| Grain Handling Authority | 31/10/83 | 457 | 15 | 3,480 | 18 | 3,700 | (-238) |
| MWS & DB | 30/ 6/82 | 4,953 | 182 | 42,297 | 325 | 26,677 | 15,295 |
| Electricity Commission of New South Wales | 30/ 6/82 | 1,500 | 17 | 18,325 | 44 | | 18,281 |
| NSW Retirement Board | 30/ 6/83 | 35 | 0 | 326 | 0 | 245 | 81 |
| Dept of Motor Transport | 30/ 6/83 | 1,876 | 21 | 25,502 | 93 | 0 | 25,409 |
| Maritime Services Board | 30/ 6/83 | 1,672 | 96 | 22,345 | 197 | 6,857 | 15,291 |
| State Bank | 30/ 6/83 | 8 | 4 | 125 | 2 | 0 | 123 |
| State Rail Authority | 30/ 6/83 | 31,482 | 1,293 | 577,283 | 3,845 | 426 | 573,012 |
| Hunter District Water Board | 30/ 6/83 | 663 | 5 | 6,362 | 21 | 1,050 | 5,291 |
| Orange Agricultural College | 30/12/83 | 2 | 0 | 30 | 0 | 0 | 30 |
| Hawkesbury Agric College | 31/12/82 | 27 | 0 | 259 | 0 | 80 | 179 |
| Metrop Waste Disposal Auth | 30/ 6/83 | 32 | 0 | 292 | 0 | 164 | 128 |
| Homebush Abattoir Corp'n | 30/ 6/83 | 505 | 36 | 10,340 | 140 | 8,160 | 2,040 |
| Trotting Authority of NSW | 30/ 6/83 | 9 | 0 | 19 | 0 | 14 | 5 |
| | | 43,221 | 1,669 | 706,985 | 4,685 | 47,373 | 654,927 |

Note that the totals have been added for illustration but the investigation dates are not all the same

TABLE 4.8

NEW SOUTH WALES RETIREMENT FUND : CONTRIBUTION RATE REQUIRED TO FULLY FUNDED SUPERANNUATION COMMITMENTS OVER 20 YEARS

| Authority | Rate to Fund Past Service Liability over 20 years (% of Salaries) | Recommended Funding Rate for Future Service (% of Salaries) |
|---|---|---|
| Grain Handling Authority | Nil | 7.0 |
| MWS & D Board | 1.4 | 6.8 |
| Electricity Commission of NSW | 5.75 | 6.5 |
| Hawkesbury CAE | 3.25 | 6.75 |
| New South Wales Retirement Fund | To be funded in one year | 5.5 |
| Motor Transport, Dept of | 4.7 | 6.5 |
| Orange College of Advanced Education | As soon as possible (only 2 contributors) | 7.5 |
| Maritime Services Board | 3.3 | 7.2 |
| State Rail Authority | 6.3 | 6.8 |
| State Bank | Being funded over 5 years (8 contributors, 4 pensioners) | 8.0 |
| Hunter District Water Board | 3.2 | 6.4 |
| Mettop Waste Disposal Auth | To be fundedas soon as possible (only 32 contributors) | 6.3 |
| Homebush Abattoir Corporation | 1.6 | 6.8 |
| Trotting Authority of NSW | To be funded as soon as possible (only 9 contributors) | 4.2 |

4.25 WITH REGARD TO THE NEW SOUTH WALES RETIREMENT FUND,FULL FUNDING OF SUPERANNUATION COMMITMENTS FOR FUTURE EMPLOYEE SERVICE WOULD MEAN, FOR MOST AUTHORITIES, AN INCREASE IN ANNUAL CONTRIBUTIONS FROM THE PRESENT FIGURE OF NIL TO ABOUT 6-7% OF THEIR SALARY BILL.

4.26 Assessments have been made of the unfunded liabilities of authorities in respect of other schemes. The major ones are the Sydney County Council Employees' Accrued Entitlements Fund $87.8 million, University of Sydney Professorial Scheme $20.3 million, and the Macquarie University Professorial Scheme $5.85 million.

Attitude of Authorities to Funding

4.27 It should be noted that, of those authorities which offered comments on the matter during the course of the Inquiry, the majority supported the principle of funding their superannuation liabilities, and agreed that it would be desirable to fund the deferred liability over a period of years.

4.28 To some extent these responses must be interpreted with caution, since the term 'funding' was frequently used to denote the establishment of a 'provision for superannuation' as a liability on an authority's balance sheet -- without any corresponding investment of earmarked funds to meet emerging cash requirements. These authorities sometimes referred to the process of liability-recognition as amounting to an investment in an authority's 'own assets'. In this report, the step of recognising a liability for superannuation commitments through the establishment of a 'provision' account is distinguished from 'funding' in the sense of actually setting aside cash or other investments, either through the transfer of those assets to an entity separate from the employer's organisation, or by simply transferring and maintaining earmarked investments.

4.29 Representatives of various authorities pointed out that the extent to which they were allowed to build up investment funds could properly be regarded as a matter of government policy.

4.30 The requirements governing employers' contributions are set forth in the Superannuation Act, 1916, as amended. Division 7 of this Act establishes the level of contributions; in particular Section 10AJ(1)(b) states the amount of contribution to be paid by an employer shall be based upon the number of units of pension for which each such contributor contributes, upon the sex of the contributor, and, in the case of a woman contributor, upon whether she contributes for a pension payable at the age of 55 years or 60 years, and shall be in accordance with the tables of contributions fixed by or under this Act.

There is no provision for discretionary contributions over and above the requirements of these sections of the Act. Should it be decided as a matter of government policy to permit authorities to fund their superannuation commitments at higher levels using the vehicle of the State Superannuation Fund, it would be necessary to amend this statute. Corresponding amendments may be required in the case of other schemes.

significance of Superannuation Commitments to Statutory Authorities

4.31 The questionnaire addressed to statutory authorities invited comments as to whether existing arrangements for the payment of superannuation benefits were expected to cause 'financial problems', and if so, when such problems were expected to arise. Table 4.9 sets forth the responses: 23 authorities considered that they faced problems; of these, 17 were tertiary educational institutions.

4.32 Universities and Colleges of Advanced Education look ultimately to the Commonwealth for funding not the State of New South Wales. However they are state-based authorities, and the New South Wales Higher Education Board has certain responsibilities in relation to the administration of tertiary education.

4.33 The Committee was advised that the accumulated liabilities of these educational institutions can be seen as largely the product of past Commonwealth funding policies. Until 1979, the level of Commonwealth payments to universities and colleges was linked to 'expenditure'; transfers to a 'provision for superannuation' was apparently regarded by the Commonwealth authorities as only constituting book-entries, not 'expenditure'; only cash payments for benefits were treated as 'expenditure' in this context. In 1979 this policy was changed so that university and college funding recognised efforts to record emerging financial commitments.

STATUTORY AUTHORITIES EXPECTING SUPERANNUATION TO BECOME A FINANCIAL PROBLEM

| | Years Hence |
|---|---|
| Armidale College of Advanced Education | 3 |
| Cumberland College of Health Sciences | 4 |
| Dairy Industry Marketing Authority | 1 |
| Government Insurance Office | ? |
| Hawkesbury Agricultural College | ? |
| Homebush Abattoir Corporation | Immediately |
| Hunter District Water Board | ? |
| Kuring-gai College of Advanced Education | Immediately |
| Macquarie University | 10 |
| Mitchell College of Advanced Education | Immediately |
| Department of Motor Transport | ? |
| Nepean College of Advanced Education | 3-5 |
| Newcastle College of Advanced Education | 5 |
| New South Wales Institute of Technology | Immediately |
| New South Wales Trotting Authority | 3 |
| Northern Rivers College of Advanced Education | 10 |
| Riverina College of Advanced Education | 2 |
| Sydney College of Advanced Education | 5 |
| University of New England | 5 |
| University of New South Wales | Immediately |
| University of Sydney | Immediately |
| University of Newcastle | Immediately |
| University of Wollongong | Immediately |

4.34 While it is now possible for Commonwealth grants to these institutions to be applied to 'funding' superannuation commitments, the universities and colleges claim to have limited opportunities to undertake discretionary expenditure of this nature. The payroll of existing staff forms the major component of the budget of those institutions; some institutions commented that 80% or thereabouts was the norm. Moreover, many of these staff were 'tenured'. It was suggested that funds could only be set aside for the purpose of meeting emerging superannuation commitments if there were drastic cut-backs in library purchases or other activities.

Staff Transfers Between Authorities

4.35 Many Colleges of Advanced Eduction are encountering (or expect to encounter) financial difficulties because staff who have transferred from the Department of Education brought with them accumulated superannuation entitlements which otherwise would have been met by Treasury out of consolidated revenue. A number of other authorities are also experiencing difficulties arising from staff transfers particularly many of the smaller authorities, which typically recruit senior staff who are in the last years of their careers.

4.36 In its submission to the Committee, the Dairy Industry Marketing Authority drew attention to the impact of staff transfers:

A contributing factor towards the deficiency of $6.41m in the Authority's Provision for superannuation deferred liabilities at 30 June 1982 ... was the transfer in recent years to the Authority of a number of senior officers from other State Government Departments ...

The current practice may be appropriate where transfers take place wholly within departments funded through Consolidated Revenue. However, in the case of self-funding Statutory Authorities ... the present system imposes a heavy and unfair burden on financial resources.

4.37 Representatives of the Dairy Industry Marketing Authority appeared before the Committee in public hearings, and explained that of a total of 107 male and 76 female staff, 20 males and 1 female had transferred from government departments -- and most of the transferees had been 'very senior staff' Accordingly, while these transfers only involved around 11% of the Authority's workforce, it was estimated that they gave rise to around 25% of the Authority's unfunded liability for superannuation of approximately $6.41 million.

4.38 The representatives of the NSW Retirement Fund (which has subsequently been amalgamated with the Local Government Superannuation Fund) provided well-informed comments on the impact which staff transfers can have upon the financial affairs of employing authorities:

The most striking anomaly is the case of a former Executive Member of the New South Wales Retirement Board who was appointed to that position at age 58 following a career of more than 40 years service in various positions funded by the Consolidated Fund. This officer was a member of the Board for approximately 2 1/4 years and the Board is now required to pay all the deferred superannuation liability for his whole career. Similarly, the Retirement Board has to pay the whole of the deferred liability for its former Chairman who was paid by the Board for only the last 15 years of a 35 year career. The Board, on the advice of the Government Actuary, has set aside from its 1982/83 revenue (i.e. earnings on contributors' funds) $513,000 to meet the deferred superannuation liability for these two officers.

4.39 The Committee was advised that the Bureau of Government Superannuation Research has been considering ways of overcoming these anomalies by allocating the costs 'between employers. It is difficult to devise a solution which ensures that the costs are shared equitably and which minimises administrative costs. Major difficulties stem from the indexation of pensions, and from the operations of the unit-based State Superannuation Scheme which requires employers to make concurrent contributions when an employee elects to take up additional units.

4.40 One option would be to require an ex-employing authority to make a cash contribution towards the estimated pension costs of a transferee at the time that a member of staff was transferred; subject to appropriate legislative amendment the payments could be made directly to the fund concerned, or else to the new employer.

Another approach would require cash contributions from all but the last employer to be made at the time that an employee retires. Or cash contributions could be required both at the time of retirement and in subsequent years (to share the cost of pension indexation). The application of any of these procedures across the board would involve considerable administrative costs, and the Committee considered that efforts to eliminate the anomalies should only be directed at the cases involving relatively material amounts -- which (given the funding methods adopted in the major schemes) typically involve those employees transferring towards the end of their careers.

4 41 THE COMMITTEE CONSIDERS THAT THE PRESENT SYSTEM WHICH ALLOCATES THE WHOLE OF THE EMPLOYER LIABILITY UNDER THE STATE SUPERANNUATION SCHEME TO THE FINAL EMPLOYER IS INEQUITABLE. IT RECOMMENDS

(i) THAT A SYSTEM OF 'TRANSFER FEES' BE INTRODUCED SO THAT THE FULL BURDEN OF SUPERANNUTION COSTS ARE NOT IMPOSED ONLY ON THE STATUTORY AUTHORITY WHICH IS THE LAST EMPLOYER OF STAFF;

(ii) THAT SUCH FEES BE PAID AT THE TIME OF STAFF TRANSFERS:

(iii) THAT IN ORDER TO MINIMISE ADMINISTRATIVE COSTS SUCH REQUIREMENTS FOR TRANSFER FEES BE ONLY APPLIED IN RESPECT OF STAFF WHO

(A) HAVE TEN YEARS SERVICE, AND

(B) ARE WITHIN TEN YEARS OF NORMAL RETIREMENT;

(iv) THAT THE BUREAU OF SUPERANNUATION RESEARCH IN CONSULTATION WITH THE GOVERNMENT ACTUARY GIVE HIGH PRIORITY TO THE DEVELOPMENT OF GUIDELINES FOR THE OPERATION OF THESE PROCEDURES.

Staff Transfers Between Schemes within Authorities

4.42 During the Inquiry, a case-study of the effect of the accounting proposals outlined in Section 7 was undertaken using data obtained in relation to members of the State Superannuation Scheme who were employees of the Electricity Commission of New South Wales. It was ascertained that the number of Elcom employees who belonged to this Scheme had increased by around 500 during a period in which the total number of Elcom employees had declined. Further investigation revealed that only 211 of the 501 increase was attributable to transfers between schemes; many of these arose from normal promotions. But there were 101 'special transfers' whereby categories of power-station staff were considered eligible to obtain higher levels of benefits when transferred from the New South Wales

Retirement Fund to the State Superannuation Scheme. *Prima facie* the increase in membership of the State Superannuation Scheme carried with it an increase in Elcom's superannuation liabilities of around $7 million; while only 20% of the increase were 'special transfers' the fact that they were likely to be long-serving employees means that they may have involved a significant proportion of the increased liability.

4.43 Further inquiries revealed that a total of 1,200 Elcom staff transferred from The Local Government Superannuation Scheme to the New South Wales Retirement Fund in 1981/82. In response to questions concerning the availability of analyses of the cost of these transfers, Elcom advised:

No specific analysis of the cost of transferring staff from one scheme to another is made but the adequacy of the Commission's funding of superannuation schemes is subject to annual review and therefore the effect of the transfer is reflected in the review.

4.44 THE COMMITTEE CONSIDERS THAT THE TRANSFER OF GROUPS OF EMPLOYEES BETWEEN SUPERANNUATION SCHEMES (OTHER THAN TRANSFERS ARISING FROM PROMOTIONS) SHOULD NOT BE UNDERTAKEN WITHOUT FIRST SECURING ESTIMATES OF THE COSTS INVOLVED.

## 5: ACCOUNTING AND REPORTING OF SUPERANNUATION COSTS BY NEW SOUTH WALES STATUTORY AUTHORITIES

5.1 As pointed out in Sections 3.34 and 3.40 there has been inadequate disclosure of, and accounting for, superannuation costs by statutory authorities in the past. It is now proposed to summarise the accounting procedures followed by New South Wales statutory authorities in reporting superannuation costs.

5.2 The Committee surveyed the accounting practices used to record superannuation commitments and expenses by statutory authorities. Authorities were asked to outline the accounting methods used to reflect superannuation expenses and commitments, and to provide extracts from their last-published financial statements relating to superannuation commitments. Where responses were ambiguous, further enquiries were directed to the authorities concerned and some financial statements were reviewed in detail.

5.3 The Committee's survey came after the Auditor General drew attention to the failure of authorities to adequately account for and disclose superannuation costs in their accounts. Specifically in his 1981-82 report the Auditor General stated:

Not all statutory authority employers have made full, actuarially calculated provisions in their accounts out of earnings ....

He again expressed concern in his 1982-83 report about the failure of authorities to disclose in their accounts all of the current and past service costs of employees deferred benefits.

5.4 The 1982-83 financial statements of statutory authorities indicate that many had obtained or were seeking actuarial advice about the extent of employees' accrued entitlements. Many authorities had commenced providing footnote disclosures concerning those commitments; others had raised or increased 'provision' accounts to record some proportion of that liability. However of the authorities which had obtained actuarial advice by June 1983, very few had established provisions (liability) accounts to record the full extent of the amount of unfunded past service costs.

Funding Versus Expense Recognition

5.5 Just because an authority may show a superannuation expense in its Statement of Revenue and' Expense does not mean that future superannuation commitments have been 'funded' to the extent of the expense shown. Recognising a superannuation expense is merely a book entry along the following lines:

| | |
|---|---|
| Dr Expense | $XXX |
| Cr Provision for superannuation liability | $XXX |

The provision so created is not necessarily backed by any assets. This is 'expense recognition' and 'not funding'

5.6 An authority may fund all or part of its future superannuation commitments by making payments to an outside entity, to a trust fund or specifically earmarking investments. The contributions so paid as part of the funding arrangement during a given period are not necessarily the same as the 'accounting expense' incurred by the authority during that period. These cash contributions may have been set at levels recommended by actuaries having regard to management preferences about the level of funding. For example, if an actuary identified that an authority has an unfunded liability for past service he or she may recommend that payments be made by the authority over a period of say 20 years to make up the unfunded liability. However, this unfunded liability was generated by past service of employees and hence is an expense which. should have been recognised in the past and not the future. Funding contributions rarely equate to accounting expense.

Major Revenue Raising Authorities

5.7 It was considered that when reviewing the accounting practices of various authorities it would be useful to examine separately the methods used by revenue-raising authorities (able to fix their charges in the light of their recorded or budgeted expenses) from those of other authorities such as educational institutions.

5.8 Table 5.1. sets out a summary of the accounting policies adopted in the most recent financial statements of eight major authorities:

Electricity Commission of New South Wales
The Hunter District Water Board
Government Insurance Office
Maritime Services Board of New South Wales
Metropolitan Water Sewerage and Drainage Board
State Rail Authority of New South Wales
Sydney County Council
Urban Transit Authority of New South Wales

All of these have large numbers of employees, and raise revenue by charging for their services.

TABLE 5.1

ACCOUNTING AND REPORTING PRACTICES
OF EIGHT MAJOR REVENUE-RAISING AUTHORITIES

| | | | Number of authorities |
|---|---|---|---|
| A. | Amounts charged as superannuation expense represented: | | |
| | (I) | actual annual payments/contributions (cash basis) | 2 |
| | (ii) | actual payments/contributions plus transfer to provision for deferred liability | 6 |
| | | | 8 |
| B. | Basis of calculating the provision in 1982-83: | | |
| | (i) | actuarial calculation, based on set percentage of annual salaries to cover full liabilities | 1 |
| | (ii) | internal/no formal calculation; but an amount sufficient to cover estimated cash payouts over some period | 3 |
| | (iii) | deferred contributions for remaining estimated pensions to current retired employees; lump sum payments. | 1 |
| | (iv) | annual contributions based on previous experience; refunds | 1 |
| | | | 6 |
| C. | Footnote disclosures re superannuation | | 8 |
| D. | COntent of footnote disclosures varied and included: | | |
| | (i) | components of the balance of provisions; basis of calculation | 4 |
| | (ii) | amounts provided for in the current year | 3 |
| | (iii) | liability mentioned but not quantified | 2 |
| | (iv) | liability quantified | |
| | | (a) actuarial calculation | 1 |
| | | (b) non-actuarial calculation | 1 |
| | (v) | other | 2 |

5.9 It will be noted that in their most recent reports, six of these eight major authorities recorded superannuation 'expense' at an amount greater than what they had actually paid out by way of retirement benefits or contributions to a superannuation fund. This may reflect increasing attention to the issue following the Auditor General's expressions of concern about the limitations of prior practices whereby many authorities had equated the amounts paid in a given year with accounting 'expense' -- and so had understated the costs which were actually being incurred from year to year. Even so, these authorities may not have charged the full amount of superannuation expense accruing in that year.

5.10 The Committee was advised as to the period over which several authorities are planning to bring to account as 'expenses' the amount of unfunded past service costs which has been revealed by recent actuarial reviews conducted by the Government Actuary. The Government Actuary has advised authorities of the levels of contribution (expressed as a percentage of salaries) which would enable catch-up funding over a specified number of Years. While these recommendations formally constitute options for cash-budgeting decisions, the current practice of treating the amounts 'funded' in a given period as the same as the accounting 'expense' for that period (or the major component of reported expense) means that the arbitrary selection of a funding period affects the level of reported accounting 'expense'. The periods chosen varied between authorities.

5.11 Other authorities reported similar policies. The Electricity Commission made a 'special provision of $12 million' in 1982-83, over and above the amounts suggested by the Government Actuary. The Managing Director of the Government Insurance Office, Mr Jocelyn, advised that pending a further study of the problem, the Government insurance Office had decided to charge and fund an additional $5 million for superannuation expense in the current year, over and above what was formally required, in order to approximate the true expense accruing.

5.12 While efforts to remedy under-funding might be applauded, the accounting treatment adopted by some of these authorities meant that sums ranging from $5 million to $10 million were arbitrarily included in the annual 'expense' reported by those authorities.

5.13 IT IS DIFFICULT (IF NOT IMPOSSIBLE) FOR GOVERNMENT, THE PARLIAMENT, AND CONSUMERS TO EVALUATE THE FINANCIAL POSITION AND PERFORMANCE OF STATUTORY AUTHORITIES IF ACCOUNTING CALCULATIONS OF COSTS AND THE EXTENT OF LIABILITIES ARE THE PRODUCT OF SUCH MATTERS AS MANAGERS' PERCEPTIONS OF WHETHER TRADING RESULTS HAVE BEEN 'FAVOURABLE'.

5.14

recording of the full amount of liabilities and the full extent of expenses was properly a matter of government policy. For example, the submission from the State Rail Authority asserted:

... thus it would seem quite unrealistic that accounting purity should be accommodated at a time of acute lack of government resources and in a period of recession.

The Finance Director of the State Rail Authority, Mr Fuller, was questioned about this assertion:

> Q. Surely it makes no difference at all whether we are in the midst of a recession or an economic boom as to what accounting standards are required in the public sector of New South Wales?
>
> A. The realism of government is quite different.

5.15 It would seem that the State Rail Authority's submission and Mr Fuller's responses were based on the false assumption that there is a necessary nexus between the extent of funding of superannuation commitments, and the recording of superannuation expense. In the Committee's view, there is no reason for the Government and the Parliament (and the public) not to know the costs of the services provided by an authority during a year -- and such calculations should not be a function of the economic climate of the time.

5.16 IT IS CLEAR TO THE COMMITTEE THAT AMONG REVENUE RAISING AUTHORITIES THERE IS NO CONSISTENT POLICY FOR REPORTING SUPERANNUATION COSTS. INDEED, SOME AUTHORITIES VARY THEIR PRACTICES FROM YEAR TO YEAR AT THE WHIM OF MANAGEMENT.

Educational Institutions

5.17 Table 5.2 summarises the accounting policies adopted by universities and colleges. In recent years many of these bodies have been recording an increased liability for superannuation commitments through transfers to provision accounts. However, with a few exceptions (principally the university professorial schemes) the universities and colleges have not had the benefit of recent actuarial advice when considering the amounts they might transfer to those provisions.

TABLE 5.2

ACCOUNTING AND REPORTING PRACTICES OF EIGHTEEN EDUCATIONAL INSTITUTIONS

| | | | Number of institutions |
|---|---|---|---|
| A. | Amounts charged as superannuation expense represented: | | |
| | (i) | cash payments/contributions to fund | 8 |
| | (ii) | cash payments and transfer to provision for deferred liability | 10 |
| | | | 18 |
| B. | Basis of calculating the provision | | |
| | (i) | arbitrary, 'depending on availability of funds' | 6 |
| | (ii) | actuarial calculation, formula for deferred liability | 4 |
| | | | 10 |
| C. | Footnote disclosure: | | |
| | (i) | no disclosure | 5 |
| | (ii) | disclosure | 13 |
| | | | 18 |
| D. | Contents of footnote (those providing this disclosure) | | |
| | (i) | No provision made | |
| | | (a) because of Commonwealth funding policy prior to 1978 | 1 |
| | | (b) but aware of substantial accrued liabilities | 5 |
| | | (c) no further elaboration | 1 |
| | (ii) | Provision being made | |
| | | (a) but not based on actuarial assessment, and/or accrued liability estimated to be substantially greater than the provision | 5 |
| | | (b) based on actuarial assessment | 1 |
| | (iii) | Information not available from questionnaires | 2 |
| | | | 13 |

5.18 As was noted in connection with the discussion of the accounting practices of large revenue-raising authorities, university and college respondents tended to equate 'accounting' and 'funding' processes. Thus, for example, the University of Sydney's submission suggested that they supported bringing the full cost of superannuation to account, 'if funds were available'. This view may reflect current accounting practices for universities and colleges, whereby government grants are based on reported income and expenditure. In this setting, transfers to superannuation provisions are seen as necessarily reducing the level of expenditure on other items.

'5.19 To some extent the traditional reporting practices of universities may have encouraged this view: the preparation of a 'consolidated' balance sheet and income and expenditure account for inclusion in the Auditor General's report is a comparatively recent phenomenon. However the immediate consequences of traditional reporting practices and emerging superannuation commitments are that the financial statements of educational institutions have not reflected the actual 'liabilities' of those institutions. Consequently the tertiary education sector in New South Wales is not well placed to negotiate with the Commonwealth for increased funding to meet these costs: the relevant information is not available.

5.20 The Committee explored the reasons for non-disclosure of these commitments. It was suggested that there had been 'a degree of hope that the problem would go away'. But it was suggested that a key factor had been a lack of information about the extent of the liability, and (in the words of the University of New South Wales' representative):

a reluctance to put forward figures based on sets of assumptions which may not prove to be accurate (relative to an actuarial calculation).

5.21 The Committee received a submission from the New South Wales Higher Education Board which included the following statement:

The Board agrees that financial prudence would suggest that provision in respect of both long service leave and superannuation should be established by all institutions and added to each year in accordance with the annual increases in accrued liability. To date, having regard to the corporate autonomy of the institutions and the role of the governing bodies in the allocation of resources made available to them, the Board has not been able to see a way to have an element of compulsion introduced into the matter.

5.22 During public hearings, a member of the Board (Mr Correy) was asked about the extent of superannuation commitments:

Q. What sort of idea does the Board have about the unfunded superannuation liability of all or any of the colleges?

A. We are aware that some figures have been determined by the New South Wales Government Actuary on behalf of ... two of the colleges in the system at this stage -- the Hawkesbury Agricultural College and the Newcastle College of Advanced Education. I understand that ... the University of New South Wales has made some independent estimates of its liability .. So far as we can see, the view expressed by the Auditor General that the unfunded liability of universities and colleges currently could be well in excess of $130 million is a view that we would not have any grounds to contradict at the moment ....

5.23 Further questions concerned the accounting practices of tertiary institutions:

Q. What steps has the Board taken to counsel those institutions about how they should account for those superannuation liabilities?

A. In terms of accounting for them, we have been largely in the hands of the Auditor General as regards his requirements.

5.24 The Committee was advised that in 1981 the Commonwealth indicated that it would provide special funding in 1983-84 to assist institutions to solve their immediate problems with superannuation schemes with the aim of subsequently developing a national superannuation scheme; however as yet New South Wales universities have not participated, principally because the Commonwealth sought undertakings that institutions would not spend more than a specified percentage of their recurrent funds on superannuation and it was believed that the percentage specified was less than would be required to meet emerging commitments. The matter was still under investigation, and negotiations with the Commonwealth were proceeding.

TABLE 5.3

ACCOUNTING AND REPORTING PRACTICES
OF OTHER AUTHORITIES

| | | | Number of authorities | | |
|---|---|---|---|---|---|
| I. | Authorities which do not record superannuation expense: | | | | |
| A. | Staff from other Departments | | | 3 | |
| B. | No superannuation scheme as: | | | | |
| | (I) | small number of employees | 7 | | |
| | (ii) | no full-time employees | 3 | | |
| | (iii) | authority just being established | 1 | | |
| | (iv) | contribution met from Treasury | | | |
| | (v) | no information | 1 | 13 | 16 |
| II. | Authorities which charge superannuation expense: | | | | |
| | (I) | actual annual payments/contribution-cash basis | | 41 | |
| | (ii) | cash payments plus some transfer to provision for deferred liabilities | | 17 | 58 |
| A. | Basis of calculating the provision in IA(ii) for 1982/83 | | | | |
| | (i) | actuarial calculation | | | 4 |
| | (ii) | internal calculation, estimation, conversion table, formula | | | 11 |
| | (iii) | not clear | | | 2 |
| B. | Footnote disclosure: | | | | |
| | (i) | no disclosure | | | 40 |
| | (ii) | disclosure | | | 18 |
| | | | | | 58 |
| C. | Contents of footnote disclosures varied or included: | | | | |
| | (i) | components of provision, bases of calculatio | | | 11 |
| | (ii | amounts provided for in the current year | | | 4 |
| | (iii | reference to unquantified contingent liability | | | 3 |
| | (iv | contingent liability quantified | | | 4 |
| | | (a) actuarial calculation | | | 3 |
| | | (b) non-actuarial calculation | | | 3 |
| | (v | no provision made for the deferred liability | | | 3 |
| | (vi | other | | | 3 |

5.25 THE COMMITTEE FORMED THE VIEW THAT THE LACK OF CLEAR DIRECTION TO UNIVERSITIES AND COLLEGES TO AT LEAST DISCLOSE THE EXTENT OF THEIR LIABILITIES HAS CONTRIBUTED TO CONSIDERABLE DIVERSITY IN REPORTING PRACTICES. FURTHER, INDIVIDUAL INSTITUTIONS HAVE SHOWN LITTLE INITIATIVE' ON THEIR OWN PART.

Other Authorities

5.26 Table 5.3 sets forth the findings of the survey of 'other' New South Wales statutory authorities. Many of these do not have significant numbers of employees. It will be noted that of the 58 of these authorities which do record superannuation expense, 41 account for superannuation on a cash basis. Only seven attempted to record additional expenses and to reflect the extent of unfunded liabilities by transfers to provisions. While some had provided footnote disclosures of the extent of their unfunded liability, only a few had based these assessments on actuarial calculations.

5.27 THE DIVERSITY OF ACCOUNTING PRACTICES ADOPTED BY NEW SOUTH WALES STATUTORY AUTHORITIES MAKES IT DIFFICULT TO COMPARE THE FINANCIAL PERFORMANCE OF AUTHORITIES, OR EVEN TO COMPARE THE FINANCIAL PERFORMANCE OF A GIVEN AUTHORITY FROM YEAR TO YEAR. IT IS ONLY RELATIVELY RECENTLY THAT AUTHORITIES HAVE BEEN ENCOURAGED TO SEEK ACTUARIAL ADVICE ABOUT THE EXTENT OF THEIR UNFUNDED LIABILITIES.

5.28 THIS FAILURE OF AUTHORITIES TO RECOGNISE SUPERANNUATION LIABILITIES IN THEIR FINANCIAL STATEMENTS HAS MEANT THAT THE INFORMATION MADE AVAILABLE TO THE MANAGERS OF THOSE ORGANISATIONS, TO THE GOVERNMENT, TO THE PARLIAMENT, AND TO THE PUBLIC AT LARGE HAS UNDERSTATED THE COSTS BEING INCURRED IN THE PROVISION OF SERVICES.

## FUNDING BY STATUTORY AUTHORITIES IN OTHER STATES AND OVERSEAS

6.1 Statutory .authorities in New South Wales provide superannuation benefits of the same general character as those provided by similar public sector authorities in other states of Australia and overseas. The considerations which need to be taken into account in deciding the approach to funding and to the rate of funding for statutory authorities in New South Wales are much the same as the considerations which would apply in the case of statutory authorities elsewhere. Consistent with the Terms 'of Reference for the Inquiry this section therefore deals with the funding practices of statutory authorities in other states and overseas. Space limitations make it impossible to present here more than a broad overall picture in each case.

### The Commonwealth of Australia

6.2 Some twenty statutory authorities, mainly commercially oriented, have established their own private schemes covering an estimated 54,500 employees. These include the Reserve Bank and the Commonwealth Banking Corporation, whose schemes are very similar to the Commonwealth Superannuation Scheme, carry a similar employer cost, and are understood to be fully funded.

Most of the other private schemes, however, are lump sum schemes. The question of funding in the case of these private schemes is purely a matter for the particular authority.

6.3 The other authorities all use the Commonwealth Superannuation Scheme. Under this scheme the employee contributions are paid into, and the employee financed benefits paid out of, the Commonwealth Superannuation Fund. The employer financed benefits, which primarily are indexed pensions, are charged to the Commonwealth Revenue Fund on a pay-as-you-go basis, i.e. as the pensions are paid. Statutory authorities can be divided into three classes according to the manner in which they reimburse the .Commonwealth Revenue Fund for its undertaking. to pay the employer financed benefits.

6.4 A total of 143 statutory authorities, covering an estimated 37,500 employees are staffed by officers appointed under the Public Service Act, and are treated for this purpose as government departments. These include the Australian Bureau of Statistics, Commissioner of Taxation, Commonwealth Employment Service, the Public Service Board and similar authorities.

6.5 There are 50 other authorities, called approved authorities, who are required under the Superannuation Acts to reimburse the Commonwealth for the cost of the employer share of benefits. Four of these authorities reimburse the Commonwealth at the time the benefits are paid. They are --

Australian National Airlines Commission

Australian National University

Health Insurance Commission

Snowy Mountains Hydro-Electricity Authority

The authority is responsible for ensuring that sufficient employer contributions are paid to a specifically established reserve fund. However the Commonwealth, while incurring a binding liability, has no means of ensuring that the liability will be adequately covered by the funds set aside. The Commonwealth Actuary is engaged by three of the above authorities, but cannot formally advise the Department of Finance on possible problem areas that might come to his attention as professional etiquette requires him to only report these to the authority concerned.

6.6 The Snowy Mountains Hydro-Electricity Authority, which is being 'wound down', is making a 30% of salaries employer contribution to remove a reported $15m deficit over a period of 70 years. The difficulties faced by the Australian National Airlines Commission in meeting its employer contributions has received wide publicity in recent years. The end result has been for the Commission to terminate entry to the Commonwealth Scheme and develop a private scheme. TAA is to pay employer contributions at 'industry levels' for those employees remaining in the Commonwealth Scheme with the Commonwealth making up the difference.

6.7 Each of the remaining 76 approved authorities pays a contribution which envisages that its liability will be fully funded. A contribution rate of 25% of salaries was thought to be about the correct average level in 1975; particular authorities might need to pay more. In fact, most authorities have paid and are still paying 15%; some pay 20%. No actuarial reviews have yet taken place, but each authority will have to meet the cost in the end. The Department of Finance has requested the Commonwealth Actuary to conduct a review of the superannuation arrangements of 15 of the larger approved authorities. These include Telecom with 83,629 members in the Scheme, the Postal Commission with 29,400, CSIRO with 6,145 and the ABC with 4,680. For several reasons deficiencies are expected. The contribution rates are calculated on the assumption that contributions are paid to a notional fund which earns interest at the rate earned by the Commonwealth Superannuation Fund.

6.8 For some years the Australian Shipping Commission (ANL) has been aware that its employer contribution of 15% is insufficient to meet its superannuation liability. The Actuary advised ANL in February 1982 that a 37% contribution would be required to bring the authority up to the point where it could meet current and future commitments. As it had been contributing at the interim rate of 15% it had generated a liability of over $57m. This situation obviously contributed .to the Commission's decision in October 1982 to establish a new private lump sum scheme. It may also mean that ANL will seek Commonwealth assistance in meeting its unfunded liability under the Commonwealth Superannuation Scheme.

6.9 The Senate Standing Committee on Finance and Government Operations of the Commonwealth Government is currently carrying out an Inquiry into 'Funding of Superannuation by Statutory Authorities'. It has issued an Interim Report dated December 1983 from which much of the information in.paragraphs 6.2 to 6.8 is taken.

## South Australia

Funding arrangements for statutory authorities in South Australia can be divided into four categories:

### (i) Fully Funded

These authorities pay fully funded contributions to the State Superannuation Fund. They include authorities funded by Commonwealth Grants such as the Health Commission, semi-commercial type authorities', and the fire service which raises revenue from insurers.

### (ii) Fully Funded. through Treasury

These authorities pay a contribution sufficient to fully fund their future commitments to Treasury and Treasury takes over the obligation to pay pension and other benefits when due. Treasury, on actuarial advice, states what the contribution is to be.

This group includes authorities too small to have their own scheme, and deficit financed authorities such as the Transport Authority which runs at a loss. The pension funding payments just increase the loss which has to be subsidised, but the true position is revealed.

(iii) Borrowers of Funds from the Public

Rather than pay the employer contribution to an external trust fund and borrow further funds from the public, these authorities charge the cost to current income and set up a reserve in their balance sheet.

(iv) Colleges of Advanced Education

The Colleges do not fund; they pay pensions as they emerge. This situation has arisen because of the dependence on Commonwealth funding.

6.11 It might be argued that if secondary school teachers' pension benefits are not funded because they come under the heading of a government department, and hence the state budget, should not teachers in colleges of advanced"education be treated the same way.

This argument might apply in New South Wales but it is no longer relevant in South Australia since the South Australian Treasurer has now decided to fund all departmental pension commitments through payments to Treasury. No payment is to be made in respect of the past-service liability (because much of it might refer to other departments where the member had previously served); it will only cover the superannuation costs accruing during the year. Only if such steps are taken can the efficiency of sections of the public service be effectively measured. It is claimed also that the distinction between a government department and a statutory authority is not significant when the water supply authority in New South Wales is a statutory authority, whereas in South Australia it is a government department.

Victoria

6.12 There is no legislative requirement concerning funding of superannuation benefits in Victoria. The practices of the main commercial type authorities come under the following headings.

(i) Fully Funded Life Office Schemes

These are mainly small authorities.

TAB

Grain Elevators Board

Melbourne Underground Rail Loop Authority

Westgate Bridge Authority.

(ii) Fu11y Funded

Melbourne and Metropolitan Board of Works
state Bank Port of Geelong Authority

(iii) Partly Funded

These schemes are largely funded, only the pension adjustments being met on a pay-as-you-go basis.

State Electricity Commission Gas and Fuel Corporation

(iv) Lump Sum Benefit Funded -- Pension Unfunded

The Water and Sewerage Authorities
(Victoria, Geelong, Ballarat, Labrobe)
Portland Harbour Trust.

(v) pay-as-you-go

The Port of Melbourne Authority Superannuation 'Scheme keeps a notional fund recording the contributions paid by members and interest is added at the earning rate of the State Superannuation Fund. However no assets are kept to back the liabilities of the scheme. All funds are kept within the operating finances of the authority and benefit payments are made on a pay-as-you-go basis.

Several authorities are covered by the State Superannuation Fund which requires that employees make contributions but the employer's share of benefits is met on a pay-as-you-go basis. These authorities include --

Vicrail

State Rivers and Water

Supply Commission

Housing Commission

Victorian Forests Commission

State Insurance Office

As noted earlier in this report a wide ranging inquiry into the superannuation arrangements for statutory authorities in Victoria has just been carried out by the Economic and Budget Review Committee of the Victorian Parliament.

Western Australia

6.13 The State Superannuation Scheme is a unit scheme under which the. employer meets his share of pensions on a pay-as-you-go basis. Employees of a number of authorities are permitted to. join the State Superannuation Scheme. Despite a general recognition of the need to do so, the State Energy Commission and the Rural and Industries Bank are two of the few authorities where, following actuarial advice, the liability has been shown in the employer's accounts.

6.14 Other authorities have their own schemes, varying from endowment assurance plans, which are automatically fully funded, to managed funds. Many, including some largely financed from Consolidated Revenue, meet their commitment on a pay-as-you-go basis. The need in the case of commercial type authorities to recognise the liability has only. been addressed of recent years, and the current provisions in the accounts range from nil to a nominal amount. It is understood that attention is currently being given to the matter.

Queensland

6.15 Most of the Queensland statutory authorities have superannuation schemes which vary: from simple accumulation plans to benefit promise schemes based{ on final salary (usually lump sum) o Nearly all are life office schemes. Some, such as the Coal Mine Workers Pensions' Fund and the Queensland Electricity Supply Industry Employees Superannuation Scheme, do theirown investing. There is no legislative provision regarding funding levels. Sometimes, but only rarely, does the relevant act specify that an actuarial investigation shall be held. The funding! levels are set on thee advice of individual life office actuaries or of consulting actuaries. The extent of unfunded liability, if any, has not been disclosed.

New Zealand

6.16 Government departments whose employees are paid a salary out of Consolidated Revenue pay their pension commitments in connection with the New Zealand Government Superannuation Scheme on a pay-as-you-go basis. However, trading departments are required by legislation to contribute to the Government Scheme on a fully funded basis. Departments covered by this fully funded requirement include --

Post Office
Railways
Government Life
State Insurance
Public Trust
Energy and Works Department

Local authorities must contribute to the National Provident Fund in respect of their employees. It has an accumulation scheme and a 'Standard Scheme'. The latter is fully funded and guaranteed by the Government. It is bound by legislation covering private sector schemes and must meet usual funding standards.

South Africa

6.17 Private pension funds are subject to government supervision in South Africa. The main purpose Of the Pensions Funds Act is to ensure that funds' liabilities to members are funded at an acceptable pace of funding. The Registrar will normally consider a fund financially unsound if the value of the assets is not at least 95% of the value of the liabilities (allowing for future salary increases and pension increases). If special contributions designed to achieve this funding level within three years are planned, the financial position is normally acceptable.

Rule amendments involving retro-active benefit increases will only be approved if there is a scheme of special contributions calculated to achieve the required funding level within ten years. The aim is to permit retro-active benefit increases to be introduced only in stages that can be afforded.

6.18 Some South African statutory authorities such as municipalities, Electricity Supply Commission, water boards, Iron and Steel Corporation, SASOL, etc., have self administered pension funds which are subject to the full weight of the Pension Funds Act (just described) like any private sector fund.

6.19 Other public sector employers, like the Central Government, provincial governments, universities, S.A. Railways, Council for Scientific and Industrial Research, S.A. Bureau of Standards, etc., have funds classified as 'official funds' which are exempt from the Pensions Funds Act. However, they have their own individual acts and regulations. These subject them to much the same financial disciplines, including the need for funding, the need to have actuarial investigations from time to time and to have reports tabled in Parliament. It is interesting to note that the requirement for an actuarial investigation of these official funds was temporarily suspended in 1976 but reintroduced when actual and proposed benefit improvements raised the question of whether contributions would still be adequate.

United Kingdom

6.20 The Civil Service, the Armed Forces, Police and Firemen have pay-as-you-go schemes. There are also some small public sector pay-as-you-go schemes.

6.21 Nationalised industries like the electricity industry are publically-owned trading corporations. They operate commercially; they have funded pension schemes, and produce accounts like any private sector company. Whatever applies to the private sector applies to them. Nationalised industries 'contract out' of their obligations under the national superannuation scheme as do many private sector companies, and they have to meet the contracting out requirements. These include a certificate from the actuary to the fund, provided every three years, concerning the solvency of the fund.

6.22 Local government administrative staff are covered by a fully funded national scheme which is required to have regular actuarial investigations. Teachers are employed by local authorities but their scheme is a national one. Local authorities are required to pay a fully funded contribution to the central Exchequer which accepts responsibility for paying the benefits. A notional fund is set up for the teachers' scheme, i.e. a fund whose assets are hypothetical government stock. The scheme is investigated by an actuary every three years and the necessary employer contribution rate assessed. The Health Authorities have a similar notional fund.

Canada

6.23 Civil servants belong to a government pay- as-you-go scheme. Employees of some corporations, e.g. Manitoba Hydro and Manitoba Government Telephones, also come under the civil servants unfunded plan.

Both at provincial and federal level there are government bodies whose employees are not civil servants, e.g. Canadian National Railways, Air Canada, Atomic Energy of Canada, Canadian Broadcasting Corporation, Petroair and at the provincial level Hydro-Quebec, Ontario Hydro-Electric Corporation. They have their own pension plans and are required to conform to the provisions which apply to private corporations. This involves contributions determined by an actuary, periodical actuarial valuations and funding any deficits over a prescribed period.

United States of America

6.24 Following the loss of pension rights after employer company failure and malpractice, legislation was passed in 1974 (ERISA) to secure members' rights, to provide minimum funding standards, to insure benefits against the event of company failure, to provide for disclosure and reporting and many other matters. It is a most complex piece of legislation. Every plan must have an actuary who must carry out an investigation at least every three years. It is generally carried out every year. The minimum contribution to a plan in a year must equal the cost of benefits accruing during the year on any reasonable basis, plus the annual cost required to amortise over a period of years prescribed in the Act, unfunded prior service costs, unfunded benefit increases, deficiencies, etc. These requirements do not apply, however, to government owned entities.

6.25 The United States of America has a variety of public bodies owned by Federal, State and Local Governments. Some are financed by charges for services, some by government appropriations and some by both. Employees of such bodies who are not treated as civil servants belong to pension plans established by their employer. In some cases the plan documents specify the funding methods and the required amortisation of unfunded liabilities over a period of years. Generally the funding decision is made by the employer on the recommendation of the actuary. Only rarely is the funding requirement less than that prescribed above for private sector funds.

Germany

6.26 Retirement benefits for civil servants are provided on a pay-as-you-go basis. There is also no funding of benefits for employees of the Federal Railways and Postal Services. Electricity authorities, however, are Set up as companies with the state or municipal authorities holding most of the capital. For pension provision they are of the same status as private companies. There is no statutory requirement for companies to fund their pensions liabilities, but the most usual approach is the 'book reserve method'. This system developed soon after the Second world War to increase the supply of investment capital. Allocations to the reserve are tax deductible to the extent that they are actuarially justified. No allowance can, however, be made for future salary increases in these calculations. Also it is compulsory, except for government institutions and public corporations, to insure against employer insolvency with a national mutual insolvency fund. A note must appear in the accounts stating what proportion of the company's pension liability is covered by the reserve.

## OVERALL PATTERN

### Government Departments

6.27 IT IS CLEARLY GENERAL PRACTICE NOT TO FUND DEFERRED SUPERANNUATION COMMITMENTS WHERE THE EXPENSES OF THE DEPARTMENT OR AUTHORITY ARE CHARGED DIRECTLY TO CONSOLIDATED REVENUE. The arrangement in South Australia is that superannuation cost for the year is charged as an expense, and a corresponding amount paid to Treasury, and then recouped as part of the budget allocation. This enables correct costing by the departments and authorities concerned.

6.28 THERE IS GOOD REASON FOR NOT EARMARKING INVESTMENTS TO MEET THE SUPERANNUATION LIABILITY OF DEPARTMENTS DEPENDENT ON BUDGET ALLOCATIONS. If such earmarking were adopted the employer contributions would be met either by increased taxes or further government borrowings from the public. To the extent that the earmarked investments are in Government loans, in the former case this would just mean a change in the tax-borrowing mix in the government's financial operations, and in the latter case neither tax nor borrowings would be affected.

Commercial-type Authorities

6.29 IT APPEARS TO BE THE GENERAL PRACTICE WITH COMMERCIAL OR SEMI-COMMERCIAL AUTHORITIES TO FULLY FUND DEFERRED SUPERANNUATION LIABILITIES. This not merely ensures that the costs are met by the current generation of consumers; it also ensures that the cost and financial implications of benefit changes are fully considered and proved to be within the financial resources of the authority before they are implemented. The South African limitations ensure that such benefit improvements are implemented stage by stage as they are proved to be financially viable.

Public Borrowing Authorities

6.30 ALTHOUGH IT CANNOT BE SAID THAT IT IS A GENERAL PRACTICE, THERE ARE CASES WHERE FULLY FUNDED STATUTORY AUTHORITIES, USUALLY THOSE WHICH BORROW FROM THE PUBLIC, CHOOSE NOT TO PAY THEIR EMPLOYER CONTRIBUTIONS TO A SEPARATELY CONSTITUTED EXTERNAL SUPERANNUATION FUND. Rather, they charge the fully funded superannuation contribution as an expense and also set up a loan commitment in their balance sheet fully covered by tangible assets. The overall effect is the same as with an external fund which invests 100% in loans to the authority. Presumably the authority in such cases rates the supply of capital for its operations more highly than members' security and maximizing interest returns.

Funding through Treasury

6.31 THERE ARE SEVERAL EXAMPLES (COMMONWEALTH, SOUTH AUSTRALIA, NEW SOUTH WALES, UNITED KINGDOM) WHERE A STATUTORY AUTHORITY FULLY FUNDS ITS LIABILITY BY MAKING PAYMENTS TO CONSOLIDATED REVENUE, WHICH ACCEPTS THE PAYMENT INTO REVENUE AND ASSUMES THE FULL LIABILITY BUT MEETS IT ON A PAY-AS-YOU-GO BASIS.

Actuarial Investigations

6.32 Although there are instances where some rules are laid down (e.g. the term for amortising an unfunded 'liability) it is the accepted general practice for both ' the method and the assumptions used in the actuarial investigation to be left to the professional judgement of the actuary.

Cash Flow Projections

6.33 WITH THE PAY-AS-YOU-GO APPROACH TO THE PAYMENT OF BENEFITS IT IS OF CONSIDERABLE IMPORTANCE TO KNOW THE PROJECTED INCREASING ANNUAL CASH REQUIREMENTS OF SUPERANNUATION. For the Commonwealth Scheme this has recently been done by the Australian Government Actuary and it indicated that the cost would rise from the present 11% of salaries to about 22% over the next 40 years. He also indicated that, assuming that a real rate of interest of 3% per annum could be earned, the employer contribution for new entrants to the Scheme would be 21.5%.

## 7 : THE RECOGNITION OF SUPERANNUATION COSTS

### Accrual accounting -- and the recording of superannuation commitments and expenses

7.1 Until recently, New South Wales statutory authorities were granted considerable latitude in the choice of accounting methods. In 1983 the Public Accounts Committee of the Forty-seventh Parliament was asked by the Treasurer to examine and report on the appropriateness of an Annual Reports Act to govern the accounting and reporting requirements of statutory authorities. The Committee's report dated June 1983 recommended that:

An Annual Reports Act require statutory authorities to adopt accrual accounting, unless exempted by the Auditor General after receiving the views of the Public Accounts Committee.

Section 41B(1) of the Public Finance and Audit (Amendment) Act of 1984 adopted this recommendation in requiring that statutory bodies' financial statements except as provided in subsection 2 shall be prepared on an accrual accounting basis.

Subsection 2 provided that A statutory body may prepare the financial statements ... on a basis other than accrual accounting where that other basis has been approved by the Treasurer.

7.2 One way of explaining the effect of those new requirements is to describe the difference between 'accrual accounting' and the alternative of 'cash accounting'. In cash accounting, only sums actually received or paid out during a period are brought to account: the financial reports prepared in terms of 'cash accounting' only represent a summary of receipts and payments. These reports would not reflect such matters as the debts owing to an authority, or the extent to which an authority had incurred material financial obligations. Accrual accounting, on the other hand, reflects transactions which affect an entity's financial position regardless of whether they involved transfers of cash within an accounting period. Thus, for example, credit purchases would be recorded even though at balance date those creditors had not yet been paid. Financial reports prepared under accrual accounting should depict an authority's 'assets' and 'liabilities' and show its 'revenues' and 'expenses' for a period -- not just its cash transactions.

7.3 The enactment of the Public Finance and Audit (Amendment) Act of 1984 reflects the view that cash accounting does not provide information which is adequate to ensure that statutory authorities are accountable to Parliament and the public.

7.4 An essential feature of 'accrual' accounting which is of significance to the current inquiry is that the magnitude of an authority's 'expenses' is not necessarily the same as the amount actually paid out in a given accounting period. Accordingly, the calculation of the cost of employing staff would not be limited to the sums paid out in periodic wages, but should also take into account any 'liability' accruing in respect of holiday pay, long service leave, or superannuation entitlements.

7.5 It appears that many New South Wales statutory authorities which otherwise have observed the precepts of 'accrual accounting' have handled superannuation commitments as 'off balance' sheet items, and only recorded superannuation expenses on a cash basis. While 'accrual accounting' procedures may be legitimately disregarded in relation to certain immaterial items, it could not be said that superannuation commitments fall into that category: they are clearly significant.

7.6 Other New South Wales authorities have adopted a form of accounting which is neither cash accounting, nor accrual accounting. These authorities have recorded an 'expense' associated with superannuation commitments which was greater than the cash paid during a period, but less than the full amount of superannuation entitlements accrued. Some authorities only 'accrued' arbitrarily selected amounts; these sums were based on what managers considered they could 'afford' to record as an expense in a given year. Others based their calculations on actuarial recommendations as to what might be set aside in cash over a period in order to ensure that the amounts set aside plus reinvested interest would meet the emerging cash requirements for superannuation. These authorities have not actually been setting aside cash investments -- but even if they had, the amounts involved would not necessarily equal the expense accruing in that year.

7.7 Regardless of what accounting techniques have been used in the past by New South Wales statutory authorities, the current situation now requires the general use of 'accrual accounting'. This section examines how superannuation commitments might be accounted for in terms of the requirements of the Public Finance and Audit (Amendment) Act, 1984. While this legislation contemplates that some statutory bodies may be exempted from the application of accrual accounting, it is clear that this provision was intended to provide relief where, in the circumstances of particular authorities, these procedures would be expensive to apply without providing information which differed significantly from that supplied by other forms of accounting (see discussion in Public Accounts Committee Report on the Accounting and Reporting Requirements for Statutory Authorities, June 1983, pp 19 -22). Accordingly, the following discussion focusses on whether it is technically feasible for authorities with .superannuation commitments to apply accrual accounting without undue expense or delay.

Current status of accounting rules concerning accounting for superannuation commitments: Australia and overseas

7.8 The terms of reference of the present Inquiry include the examination of:
the accounting standards which have been adopted or are under consideration in relation to accounting for superannuation benefits

One way of examining the feasibility of applying accrual accounting to superannuation commitments would be to examine the procedures required by those standards.

7.9 Currently there are no accounting rules in force in Australia which explicitly deal with superannuation commitments. The accounting profession has yet to issue an accounting standard on the subject. The National Companies and Securities Commission has released proposals for the amendment of Schedule 7 of the Companies Act and Codes which would require listed companies and borrowing corporations to furnish details of their sponsorship of superannuation schemes, and require disclosure of 'unfunded liabilities'. These proposals have not yet been translated into revised regulations.

7.10 However, the matter has attracted considerable attention overseas. As long ago as 1948, the United States accounting profession issued rules governing aspects of accounting for superannuation commitments; in 1960 the · Institute of Chartered Accountants in England and Wales published recommendations on the treatment of retirement benefits; the Canadian profession has had accounting rules concerning superannuation commitments since 1966; and an International Accounting Standard was issued by the International Accounting Standards Committee in 1983.

7.11 Appendix 1 to this report summarises some major rule-making initiatives regarding accounting for superannuation commitments in the United States of America, Canada, the United Kingdom and Australia. The Appendix indicates the increasing tempo of rule-making activity from both the accounting profession and from government in the last decade or so, as high inflation and an escalation of salary levels have increased the exposure of organisations which have sponsored 'defined benefit' superannuation schemes. A review of these various accounting standards would be unduly complicated and lengthy.

Accordingly, it was considered appropriate to delineate the major accounting and financial reporting issues associated with superannuation commitments, and to refer to overseas accounting standards when they were considered relevant to the circumstances of New South Wales statutory authorities.

Are superannuation commitments "liabilities'?

7.12 Accrual accounting seeks to take into account the amount of any reductions in 'assets' or any increases in 'liabilities' within a period. Conversely, a 'balance sheet' or statement of financial position will set forth the assets and liabilities of a reporting entity. In order to consider whether accrual accounting should have regard to superannuation 'commitments', it is relevant to assess whether those commitments constitute 'liabilities' in an accounting sense.

7.13 At present the Australian profession has not adopted or endorsed a particular definition of the concept of 'liability'. In general, the strategy adopted by accounting standard-setting bodies has been that of developing specific rules to apply to specific situations, rather than producing definitions of key accounting concepts. However, recently both Australian and overseas bodies involved with the development of accounting standards have been refining the meaning of accounting concepts (such as 'liability') with the aim of establishing a 'conceptual framework' for the guidance of practitioners and standard-setting bodies.

7.14 A review of the accounting literature suggests that some attention has been paid to the question of whether the notion of 'liability' is limited to legal obligations, or whether it embraces a wider set of commitments. For example, some definitions of liability made explicit reference to 'legal' obligations; other definitions employ a more general test, and simply state that an accounting liability is 'an obligation' or that it involves a future payment or sacrifice.

7.15 The question of whether 'liabilities' are limited to legal obligations is particularly significant to 'private sector' superannuation arrangements. In this context, it has often been argued that since trust deeds establishing private sector superannuation funds commonly enable a sponsoring employer to terminate or limit its sponsorship of a scheme, no 'legal' obligation to meet those superannuation commitments is thereby imposed on the employer. Hence it is argued that there is no accounting 'liability', on the assumption that 'liabilities' can be equated with legal obligations (an assumption which is open to challenge since in practice accountants customarily treat a number of non-legal obligations or perceived commitments as liabilities or 'provisions').

7.16 Meantime, the pronouncements of the Financial Accounting Standards Board (FASB) in the United States of America constitute the most authoritative statement yet issued as to the meaning of 'liability' (or, perhaps more correctly, the most authoritative suggestion as to what meaning is considered consistent with the broad objective of furnishing information relevant to informed decision-making). The FASB has taken the position that the concept of "liability' is wider than mere legal obligations. The Board's Concepts Statement No. 3, Elements of Financial Statements of Business Enterprises (1980), offered the following definition of a 'liability':

probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

Note that on this basis, even the sponsorship of a defined-benefit superannuation plan by a private sector firm would constitute a 'liability' (presuming, of course, that one accepts that these benefits are a form of deferred compensation for services already rendered).

7.17 The FASB's proposals relate primarily to the private sector. It is of interest to note that a United States-Canadian body, the National Council on Government Accounting, has followed the FASB's lead in proposing that the superannuation commitments of government bodies be treated as 'liabilities' Any requirement for balance sheet disclosure may have a significant effect on the disclosed gearing of corporations, and of some government entities which are dependent upon public borrowings to finance their affairs. Because such a practice might place many large corporations in breach of their debt covenants, some consider it unlikely that the FASB's 'Preliminary Views' will be adopted immediately in the private sector. Nevertheless, it must be acknowledged that the FASB --regarded as one of the most authoritative sources of accounting rules in the world -- has explicitly concluded that corporate pension obligations are 'liabilities'.

7.18 The Committee received submissions on accounting matters from two sources: from the Australian Society of Accountants, and from the firm of Arthur Andersen & Company.

7.19 Arthur Andersen's submission expressed strong support for the contention that unfunded past service costs associated with superannuation commitments should be treated as 'liabilities' in both private sector and public sector settings (on the basis that the most generally accepted accounting concept of 'liability' did not regard legal status as determinant, and that these commitments arose from past transactions and represented compensation for past services).

7.20 The main thrust of the submission from the Australian Society of Accountants was to draw attention to International Accounting Standard 19 (IAS 19) which obliquely refers to superannuation commitments as a 'liability' (clause 50). While Australian accounting bodies have agreed to use their 'best endeavours' to ensure that International Accounting Standards are implemented locally as soon as is practicable, IAS 19 currently does not have more than persuasive force in Australia.

7.21 The Australian Society of Accountants' representative Mr Taylor was asked about the Society's views concerning the accounting treatment of superannuation commitments in the public sector. He agreed that the legal status of the superannuation commitments of statutory authorities was 'quite different to the private sector' and saw no reason to suppose that the Australian Society would object to the development of uniform requirements for the recognition of superannuation obligations by New South Wales statutory authorities. IAS 19 contained proposed minimum standards of reporting and disclosure; Mr Taylor considered that the development by Government of more precise requirements for statutory authorities could not be regarded as inappropriate or objectionable by the accounting profession. Indeed, the Australian Society's view was that the Government should seek to ensure uniformity of accounting treatment among statutory authorities 'wherever practicable and possible'.

7.22 During the public hearings held by the Committee, several witnesses with close knowledge of the superannuation industry offered their views about the desirability of sponsoring organisations disclosing particulars of their unfunded liabilities. The general thrust of their comments was that financial statements of those organisations should report superannuation liabilities. For example, Mr Trahair, representing the Institute of Actuaries, commented:

Over all, as an actuary, I think the major thing is disclosure of liabilities and reasonable costs. Full funding is not as important as either of these matters, in my view.

Mr Lewis, representing the Life Insurance Federation.of Australia, said:

The standard of reporting in public sector superannuation should try and place cost in the appropriate context rather than report simply what has been paid in the current year... It should seek to provide the taxpayer, the ratepayer or the electricity user, for instance, with a proper assessment of what all the ongoing costs are Mr Whittle, representing the Association of Superannuation Funds of Australia, commented.that in the private sector, 'a properly ordered set of company accounts would disclose an unfunded liability'; in his view, sponsoring organisations should disclose a liability, regardless of whether it was a legal obligation in terms of its trust deeds.

7.23 The Committee concluded that if it was acceptedthat the private-sector sponsorship of defined benefit superannuation plans may give rise to an accounting liability, the case for public-sector organisations to view those commitments as 'liabilities' is even stronger. From the viewpoint of a statutory authority, the employment of staff carries with it a firm obligation to meet retirement benefits. The obligations of such an authority are prescribed by law (rather than in conditional clauses in a trust deed). A statutory authority is unable to resile from those commitments. Whilst the government can in future amend the law to reduce superannuation benefits, the Committee assumed that this is neither a viable nor desirable option.

THE COMMITTEE CONCLUDED THAT THE OBLIGATIONS OF STATUTORY AUTHORITIES TO PROVIDE SUPERANNUATION BENEFITS SHOULD BE REGARDED AS LIABILITIES FOR THE PURPOSE OF FINANCIAL REPORTING.

## Recognition of Expenses for Superannuation as they 'Accrue'

7.24 If the superannuation commitments of statutory authorities.are 'liabilities', it follows that changes in the amount of those liabilities must necessarily be taken into account for the purpose of calculating 'superannuation expenses' in terms of accrual accounting. In principle, the amount of an authority's superannuation expense for a period would be the amounts actually paid in respect of superannuation (e.g. employer's concurrent contributions to a fund) plus or minus the amount of any change in the magnitude of the liability during that period. In practice the problems of cost estimation associated with superannuation may warrant modification of this approach to expense calculation.

7.25 Before examining these calculation procedures in detail, it may be useful to note the differences in the perspectives of actuaries and accountants towards superannuation 'liabilities' Whereas actuarial reviews may look towards both past and future employee service, the accounting concept of 'accrued expense' relates to employee entitlements which have arisen as a consequence of past service only. The actuarial calculation of contribution rates is designed to ensure that sums contributed and accumulated will be sufficient to meet emerging cash commitments, in future years. The accounting calculation of 'accrued expenses' is intended to provide information about the costs incurred in a given accounting period.

7.26 EACH STATUTORY AUTHORITY'S STATEMENT OF REVENUE AND EXPENSE SHOULD INCLUDE THE FULL SUPERANNUATION EXPENSE FOR THE PERIOD. NOT TO DO SO WOULD AMOUNT TO DECEIVING THE PARLIAMENT AND THE PUBLIC AS TO THE TRUE COST OF RUNNING AN AUTHORITY AND WOULD BE INCONSISTENT WITH THE OBJECTIVES OF ACCRUAL ACCOUNTING WHICH WAS RECENTLY INTRODUCED BY THE GOVERNMENT VIA AMENDMENTS TO THE PUBLIC FINANCE AND AUDIT ACT.

Calculation of Superannuation Liabilities and Expenses

7.27 Accounting practice in Australia (and other Commonwealth countries) generally involves the recording of 'liabilities' in financial statements at their face value. In the United States of America, on the other hand, it has long been accepted that long-term liabilities should be measured at 'present values' -- the figure obtained by discounting the face value with regard to current market rates of interest (see Opinion 21 of the Accounting Principles Board, 1971. An argument for the use of

'present values' is that they can be regarded as approximations of the 'current values' of commitments (and as such, they are consistent with the use of current exchange prices to value assets). Even so, all extant accounting standards (and a number of proposed rules) concerning the measurement of superannuation obligations appear implicitly to have assumed that the aim of the exercise is to calculate 'present values'. Accordingly, that assumption is also adopted in the following discussion.

7.28 The principles involved in calculating the amount of a liability are illustrated in the following highly-simplified example:

Suppose (i) that an individual's superannuation arrangements involve payment of a lump sum of $100,000 on reaching age 60 (the benefit being for 25 years of service);

(ii) the employee will reach retirement age in 10 years, and it is assumed that he or she will survive and receive that payment;

(iii) that a 10% p.a. interest rate is to be used for the calculation.

In this situation the gross commitment could be represented by the present value of $100,000 in 10 years time, at an interest rate of 10% p.a., which is $38,554. (One way of explaining the concept of present value is to point out that, in this example, $38,554 is the amount which would have to be invested at an interest rate of 10% p.a. compound if one wanted to accumulate the sum of $100,000 after 10 years).

7.29 However the figure of $38,554 could not be regarded as the measure of the 'liability' at the present time, since superannuation benefits are to be paid as compensation for both the employee's past service and for future service in the remaining 10 years of his working life. The accounting process involves assessing the extent to which liabilities have 'accrued' at a given point of time. In this example, the sum of $38,554 must be apportioned between

(a) the amount attributable to the employee's 15 years of past service, and

(b) the amount attributable to the expected 10 years of future service.

One method of allocating the present value of future benefits between past and future service is to base the allocation on the proportion of past service to overall working life:

| | |
|---|---|
| Period of past service: | 15 years |
| Total working life with organisation: | 25 years |
| Amount attributable to past service: | (15/25 x $38,554)<br>= $23,132 |

Hence the sum of $23,132 would represent the value to be placed on the 'liability' for superannuation commitments.

7.30 The illustration can now be extended. Suppose that the organisation concerned has decided to 'fund' its superannuation obligations by investing in an established trust fund which holds accumulated cash or cash-equivalents which it is hoped will satisfy the employee's entitlements when they become payable.

Suppose (iv) current value of 'funds' invested by trustees of superannuation fund: $20,000

The calculation of the 'liability' would be as follows:

| | |
|---|---|
| Present value of benefits payable which areattributable to past service: | $23,132 |
| Less | |
| Value of investments in superannuation fund | $20,000 |
| Amount of 'unfunded past service cost' | $ 3,132 |

The 'liability' of the employer which accountants may wish to report is sometimes described a the 'amount of unfunded past service costs' In this example, the value of the 'liability' of the employer would be $3,132. (It should be noted that if the superannuation funds were held by the organisation as earmarked investments the liability to be disclosed would be $23,132 while assets worth $20,000 would also be reported).

7.31 The Committee notes than an accepted description of the liability associated with superannuation benefits is the 'amount of unfunded past service costs', defined as follows:

'Amount of unfunded past service costs' means the present value of the expected obligations of the plan attributable to the service already rendered by past and present employees as determined by an accrued benefit valuation method based on projected salaries, to the extent such obligation has not been funded.

Calculations of the amount of the 'liability' arising from past service:

7.32 The allocation procedure illustrated in paragraph 7.29 is an example of an 'accrued benefit method', since it aims to calculate the amount of benefit that has been 'earned' to date in respect of an employee.

In practice, one does not have the benefit of certainty and such calculations might be applied to a workforce with differing prospects of mortality or of remaining in employment until retirement. Further, the terms and conditions for the payment of benefits would not be expressed in the manner suggested in this simple example: they may involve the payment of pensions (requiring an assessment of the post-retirement life expectancy of employees) and may involve the payment of benefits in the event of death or disablement. Moreover, the benefit payable may be related to final salary (and, in a unit scheme, the number of units taken up). In practice, therefore, the application of an 'accrued benefit method' requires assessment of the terms and conditions under which benefits are payable. Consequently the allocations might be made upon some basis other than the proportion of past years' service to estimated working life: it could be linked (for example) to the proportion of the current year's salary to estimated career-long salary receipts. That does not mean that the allocation process is entirely arbitrary. The objective is to estimate the amount attributable to past service, and the selection of one or other allocation method is a necessary element of that estimation procedure.

7.33 A review of various government or profession-sponsored accounting rules on superannuation (outlined in Appendix 1) indicates that the accounting procedures used to report on superannuation commitments differ from country to country. Since neither public nor private sectors have widely adopted the practice of recognising superannuation commitments as a liability, it is not surprising that little attention has been given to the problems of measuring such an accounting liability. The rules initially introduced in North America and the United Kingdom were aimed at minimising the extent to which accounting for pensions could distort reported earnings, and at requiring disclosure of the existence of those obligations. In the United States of America, the Securities and Exchange Commission required corporations to undertake more extensive disclosures, and in the 1960's introduced rules which compelled disclosure of any unrecognised liability arising from 'underfunding', relative to 'vested' employee entitlements. (An employee's entitlement is said to be 'vested' when that employee has satisfied the requirements -- usually a minimum period of service -- to be entitled to pension benefits). Subsequently the United States of America's Financial Accounting Standards Board has proposed that the amount of liabilities and periodic expenses should be calculated on the basis of 'accrued benefits'

7.34 If an organisation obtained annual estimates of 'the amount of unfunded past service costs' (the measure of its superannuation commitments) then, in principle, superannuation expense for the past accounting period could be calculated by reference to the difference between those magnitudes. Assuming that there were no changes in the terms of the scheme, the calculation of superannuation expense would (in principle) be as follows:

| | | | |
|---|---|---|---|
| | Amount paid by authority to superannuation fund by way of concurrent contributions, or to pensioners as supplementary benefits | | $XXX |
| Add | | | |
| | Amount of unfunded past service costs at end of year | $XXX | |
| Less | | | |
| | Amount of unfunded past service costs at beginning of year | $XXX | $XXX |
| | Superannuation expense of employer for year | | $XXX |

7.35 However in certain situations there may be a need to depart from this procedure:

(i) where there are major fluctuations in estimates of the amount of unfunded past service costs arising from periodic actuarial reviews or changes in the value of assets held in an external 'fund'

(ii) where a scheme is amended or a new scheme is introduced

(iii) where employees are transferred from one scheme to another during a period.

These matters are discussed in Appendix 2 of this report. However they do not affect the 'practicability' of basing calculations of superannuation expenses upon periodic calculations of the amount of unfunded past service cost.

7.36 In order to assess whether accrual accounting procedures can be applied in this fashion, it was first necessary to establish whether the Government Actuary was able to provide periodic assessments of the amount of unfunded past service costs. Such calculations are currently undertaken as part of periodic actuarial reviews. The Government Actuary, Mr Taylor, advised that it was now possible to provide up-dated estimates of the commitments of authorities with members in the major schemes.

Usually, we are able to report within four weeks of receiving a request. It is expected that this work could now be carried out, on a standard basis, without staff additional to the present complement... provided computer resources including capacity and time, of an order at least equal to those currently available, continue to be supplied to. this Office.

During the Inquiry, the Government Actuary was able to supply at short notice an up-dated estimate of the commitments of a major authority (the Electricity Commission) thus confirming the feasibility of the proposals. However it was recognised that these estimates were in no way a substitute for periodic actuarial reviews. The estimates would in fact be based on the most recent review and would therefore involve the same assumptions.

7.37 The Committee was advised (see paragraph 4.15) that it would be necessary to undertake fairly detailed actuarial reviews of authority-specific schemes, and that this could require some detailed study and extensive computer programming. Once these tasks had been completed, however, the cost of obtaining periodic estimates of the amount of unfunded past service costs would not be material.

7.38 THE CALCULATION OF SUPERANNUATION EXPENSE ACCRUED IN AN ACCOUNTING PERIOD MAY READILY BE CALCULATED BY REFERENCE TO ANNUAL ESTIMATESOF THE AMOUNT OF UNFUNDED PAST SERVICE COST USING AN ACCRUED BENEFIT METHOD BASED ON PROJECTED SALARIES. ESTIMATES OF THE AMOUNT OF UNFUNDED PAST SERVICE COSTS SHOULD BE PROVIDED BY THE GOVERNMENT ACTUARY ON AN ANNUAL BASIS.

Recognition of superannuation expenses and liabilities in financial statements

7.39 In terms of accrual accounting, items regarded as constituting 'expenses' are summarised in an income and expenditure statement for a given year. This statement may not necessarily set forth every revenue item and every expense item; otherwise readers of financial statements would face a difficult task interpreting a mass of detailed data. In the 'private sector', the minimum detail to be provided in reports provided by companies is set forth in Schedule 7 of the Companies Act and Codes. There is no equivalent code of 'standards' yet available for New South Wales statutory authorities. When considering whether superannuation expense should be separately disclosed by all authorities, it must be recognised that superannuation is part of the cost of employing labour -- and could sensibly be aggregated with wages and salaries. However, it seems reasonable to suppose that the materiality of the item would generally justify the separate disclosure of the amount of superannuation expense for a period.

7.40 Some authorities (such as the Metropolitan Water Sewerage and Drainage Board) treat certain wages and superannuation costs as part of the cost of constructing capital works. Hence the full amount of accrued superannuation costs might not be regarded as an expense of a given year. Again, given the likely interest of readers of financial statements in the full amount of 'accrued superannuation' for a year, it seems reasonable to expect those authorities to disclose the amount of superannuation expense 'capitalised' in a given year, by way of a footnote disclosure in their financial statements.

7.41 There seems to De little contention about the desirability of statutory authorities disclosing superannuation expenses. However the accounting literature reflects some disagreement about how superannuation' commitments should be disclosed. The question at issue is whether superannuation commitments should be shown as liabilities on the face of a balance sheet -- or only reported by way of notes to the accounts.

7.42 As a general principle, accountants report on the face of a balance sheet items regarded as liabilities. However no accounting standards currently on issue formally state that superannuation commitments should be treated in this fashion (though several standards do refer to the need for balance sheet 'provisions' in some circumstances). Moreover, given the magnitude of the 'amount of unfunded past service costs' it must be recognised that formal balance sheet recognition could have a significant effect on the balance sheets of many authorities. For these reasons, the matter is examined in some detail in the following paragraphs.

7.43 A submission from the accounting firm of Arthur Andersen and Company addressed the issue of disclosure of superannuation commitments. This submission noted that an exception to balance sheet recognition is sometimes made for so-called 'contingent liabilities' involving firm commitments the amount of which is unknown (e.g. where a court decision has established liability but has not yet quantified damages). However, limiting accounting recognition of superannuation commitments to footnote disclosure can not be supported on these grounds since they are readily quantifiable and the overall commitment for an organisation is not of a contingent nature.

7.44 Arthur Andersen also noted the possible objection to balance sheet recognition on the ground that estimates of superannuation obligations were 'not sufficiently certain and measurable', but as they pointed out, the same calculations were widely used for periodic expense recognition. Moreover, equally 'soft' numbers were widely accepted for balance sheet reporting purposes 'in the insurance industry. The Committee recognises that the use of estimates could later require adjustments but formed the view that to ignore superannuation commitments would constitute a far greater 'error'. The Committee considered that it is better for financial statements to be approximately 'right' than precisely 'wrong'.

7.45 The Committee noted that the FASB's 'Preliminary Views' paper 1982) advocates the inclusion of pension liabilities on the face of the balance sheet rather than as footnote disclosures. On the other hand, while International Accounting Standard 19 refers to superannuation commitments as a 'liability', it does so without actually stating that such items should be reported in the body of a balance sheet. However, the

Committee noted that IAS 19 was primarily intended to provide guidance on how financial statements should be prepared for private sector business entities. It is customary for private sector defined benefit superannuation schemes to be structured through separate 'funds' established in terms of trust deeds which permit sponsors to walk away from their commitments. In this context, payments for superannuation could perhaps be regarded as discretionary expenditures; certainly sponsorship of superannuation schemes would not constitute a 'legal' liability. Thus IAS 19 does not directly refer to the set of circumstances facing statutory authorities in New South Wales, whereby superannuation commitments constitute firm legal obligations.

7.46 At the present time, footnote-disclosures are the most widely adopted method of reporting on superannuation liabilities by New South Wales statutory authorities, though currently there is some diversity of treatment. The Auditor General has encouraged authorities to seek expert advice on the extent of their unfunded superannuation commitments, and to disclose this data in their financial reports. Many of the larger statutory authorities have adopted this policy of disclosure. Few would disagree that, as a consequence, the financial statements of statutory authorities are more informative. However current accounting practices cannot be regarded as satisfactory, for the following reasons:

* There are currently no guidelines concerning the form and content of those disclosures (and. concerning the use of expertactuarial assessments of superannuation commitments) so that the information being provided by various authorities is of varying relevance and reliability.

* Footnote disclosures have generally been accompanied by a method of expense recognition which equates the expense applicable to an accounting period with the dollars actually paid to a fund. Hence an authority's aggregate expenses for an accounting period may reflect that authority's funding policies, rather than the extent to which superannuation obligations have accrued during that period.

* The variability in expense-recognition practices of statutory authorities ensures that reported expenses (and hence reported surpluses or deficits of various authorities) are not comparable -- which limits the extent to which government budgetary practices are based on reliable information.
  Moreover, since some authorities link their pricing practices with projections of expenses, it follows that arbitrary modes of expense recognition for superannuation may have a material impact on the prices of services provided in New South Wales, in a manner which was unintended.

* Financial statements are not reflecting the full extent of the authority's financial commitments arising from past transactions and events.

7.47 THE COMMITTEE FORMED THE VIEW THAT THE LIABILITY FOR SUPERANNUATION COMMITMENTS ARISING FROM PAST SERVICE OF EMPLOYEES SHOULD BE RECOGNISED IN THE BALANCE SHEETS OF STATUTORY AUTHORITIES. STANDARDISATION OF THE METHOD OF CALCULATING THESE COMMITMENTS IS NECESSARY SO THAT GOVERNMENT DECISIONS CONCERNING THE ALLOCATION OF RESOURCES TO STATUTORY AUTHORITIES CAN BE BASED ON COMPARABLE DATA.

7.48 A corollary of balance sheet recognition of superannuation liabilities is that the financial statements of statutory authorities would in the ordinary course of events also disclose the expenses accruing for superannuation in the years in which those expenses are incurred. It must be noted that linking calculations of superannuation expenses with changes in the amount of unfunded past service costs does represent a modest departure from the procedures recommended in International Accounting Standard 19, whereby 'expense' recognition is linked with the level of funding recommended by an actuary. However (as noted in paragraph 7.45) IAS 19 was designed for business entities operating in an environment in which superannuation obligations are incurred by a 'fund' separate from the employer and in which an employer's sponsorship of defined benefit plans does not establish legal obligations; it contemplates situations in which an employer actually makes cash contributions to a fund in line with actuarial recommendations; and in any case it acknowledges that 'provisions' should be established where there remain significant 'unfunded liabilities' for past service.

7.49 As indicated above, Appendix 2 reviews some specific problems which may arise in applying 'accrual accounting' procedures to superannuation commitments.

7.50 The Committee was advised that the State Bank faces certain difficulties arising from existing arrangments. The State Bank must disclose provisions for superannuation on its balance sheet, whereas private banks with whom it competes have established their own superannuation schemes with separate trust funds --

so that they can treat superannuation liabilities and assets as off-balance sheet items. The State Bank considers that it is disadvantaged since its balance-sheet disclosure of provisions for superannuation commitments affect its gearing and other indicators of its position and performance which are examined by rating agencies and potential lenders in the capital market.

7.51 The Committee agrees that the State Bank may be disadvantaged vis-a-vis its private sector competitors. However, this problem arises from its association with the State Superannuation Scheme, and could be resolved by permitting the Bank to change its funding arrangements rather than by relieving it of the obligation of applying accrual accounting.

7.52 The Committee considers that in the interests of accountability, statutory authorities should adopt accounting procedures which permit valid comparisons of financial performance to be made between authorities, and of the performance of a given authority over time. In this connection it notes that the Public Finance and Audit Act, 1983 (as amended) provides that regulations may be introduced to make provision for the manner of preparation of a report on the operations of a statutory body (Section 17(2)(c)).

Accordingly, the Committee sees merit in the introduction of regulations establishing accounting standards for the treatment of superannuation commitments and expenses in the financial statements of statutory authorities.

7.53 THE COMMITTEE'S REVIEW OF ACCOUNTING MATTERS (OUTLINED ABOVE AND IN APPENDIX 1 AND 2) LEADS IT TO CONCLUDE THAT IT WOULD BE DESIRABLE TO INTRODUCE REGULATIONS WHICH PRESCRIBED:

(a) THAT THE AMOUNT OF UNFUNDED PAST SERVICE COSTS OF A STATUTORY AUTHORITY SHOULD BE DISCLOSED IN ITS BALANCE SHEET;

(b) THAT THE CALCULATION OF SUPERANNUATION EXPENSE ACCRUED IN AN ACCOUNTING PERIOD BE CALCULATED BY REFERENCE TO ANNUAL ESTIMATES OF THE AMOUNT OF UNFUNDED PAST SERVICE COSTS USING AN ACCRUED BENEFIT METHOD BASED ON PROJECTED SALARIES;

(c) THAT ESTIMATES OF THE AMOUNT OF UNFUNDED PAST SERVICE COSTS BE OBTAINED FROM THE GOVERNMENT ACTUARY ON AN ANNUAL BASIS;

(d) THAT REVISIONS OF ESTIMATES OF THE AMOUNT OF UNFUNDED PAST SERVICE COSTS ARISING FROM PERIODIC ACTUARIAL REVIEWS NEED NOT BE TREATED AS AN ACCOUNTING EXPENSE (REVENUE) OF THE PERIOD IN WHICH THAT ASSESSMENT WAS UNDERTAKEN, BUT MIGHT AT THE DISCRETION OF THE STATUTORY AUTHORITY CONCERNED BE ALLOCATED OVER A PERIOD NOT EXCEEDING THREE YEARS;

(e) THAT TO THE EXTENT THAT AN AMOUNT OF UNFUNDED PAST SERVICE COSTS IS ATTRIBUTABLE TO SERVICES RENDERED BEFORE THE START OF THE ACCOUNTING PERIOD IN WHICH SUPERANNUATION COMMITMENTS ARE FIRST FULLY RECOGNISED AS A LIABILITY, THOSE SUMS SHOULD BE TREATED AS AN ADJUSTMENT TO THE ACCUMULATED FUNDS OF THE AUTHORITY CONCERNED;

(f) THAT STATUTORY AUTHORITIES SHOULD DISCLOSE THE FOLLOWING INFORMATION CONCERNING SUPERANNUATION LIABILITIES AND EXPENSES:

(i) THE DATE OF THE MOST RECENT ACTUARIAL REPORT UPON WHICH CALCULATIONS OF SUPERANNUATION LIABILITY AND EXPENSE WERE BASED;

ii) THE FOLLOWING ASSUMPTIONS ADOPTED BY THE GOVERNMENT ACTUARY:

- INTEREST RATES
- RATE OF INCREASE IN THE CONSUMER PRICE INDEX
- RATE OF SALARY INCREASES;

(iii THE EFFECT ON THE CALCULATION OF THE AMOUNT OF UNFUNDED PAST SERVICE COSTS OF THE ADOPTION OF DIFFERENT VALUES FOR THE KEY ECONOMIC ASSUMPTIONS AND ANY OTHER ASSUMPTIONS THAT THE ACTUARY CONSIDERED TO BE OF CRITICAL IMPORTANCE;

(iv) ANY-MATERIAL CHANGES IN THE TERMS AND CONDITIONS OF THE SUPERANNUATION SCHEME SINCE THE DATE OF THE LAST ACTUARIAL REPORT;

(v) THE AMOUNT OF ANY SUPERANNUATION EXPENDITURE CARRIED FORWARD IN A GIVEN YEAR AS PART OF THE COST OF CAPITAL WORKS.

7.54 The Committee considers that these procedures should be adopted if information about the expenses actually being incurred by New South Wales statutory authorities is to be made available to managers of those authorities, to members of the Government, to the Parliament, and to the public.

8: ACTUARIAL ISSUES

8.1 The disclosure of superannuation expenses and liabilities in the annual financial statements of statutory authorities is a matter that needs to be addressed by accountants in the light of the issues raised in Section 7. However, the determination of such expenses and liabilities must, of necessity, involve actuaries and be associated with the regular actuarial reviews of each authority's superannuation commitments. The assumptions used in these actuarial reviews are part of the Committee's Terms of Reference :

(ii) the various methods by which the liability might be calculated, highlighting the assumptions which are implicit in such calculations.

These assumptions will now be considered.

8.2 The following extract from the Government Actuary's report (dated November, 1982) prepared for the Electricity Commission of New South Wales at 30 June 1982 illustrates the form of actuarial assessment:

| Assumptions: | Salary growth rate | 8.5% p.a. |
|---|---|---|
| | Pension Index'n Increases (CPI) | 8% poa. |
| | Interest Earnings | 10% p.a. |

| | State Superannuation Fund | NSW Retirement Fund |
|---|---|---|
| Employer's liability for past service ($m) | 256 | 18 |
| Provision in accounts ($m) | 32 | |
| Net unfunded liability for past service ($m) | 224 | 18 |
| Contribution (% of salaries) to fund this past service liability over : | | |
| 10 years | 26 | 10.75 |
| 15 years | 18 | 7.50 |
| 20 years | 14 | 5.75 |
| Recommended contribution (% of salaries) for future service | 17 | 6.50 |
| Total contribution (% of salaries) recommended if funding for past service liability is over : | | |
| 10 years | 43.50 | 17.25 |
| 15 years | 35.50 | 14 |
| 20 years | 31.50 | 12.25 |

8.3 It is noted that in calculating the Electricity Commission's 'Net unfunded liability for past service' the Government Actuary deducted an accounting provision of $32m from the employer's total liability for past service. The existence of such a provision does not necessarily mean that funds have been either generated or set aside to meet future employer superannuation commitments. An authority may be showing a deficit in its Statement of Revenue and Expense to the extent of the amount of superannuation expense charged for the period. This expense would be matched by a corresponding provision in the accounts. However, net additional revenue may not have been generated to match this provision. Thus, the existence of a provision alone does not mean that superannuation commitments have been funded.

Actuarial Assumptions

8.4 Any such assessments have to be based on demographic and economic assumptions about the future. Using the State Superannuation Scheme as an example, assumptions are made about the following variables:

Economic: Interest rate earned on. funds in future (or investment earning rate)
Growth rate of salaries
Pensioner indexation rate (inflation rate measured as CPI growth)

Demographic: Pensioner commutation rate

Mortality of breakdown pensioner

Rates of withdrawal

. Rates of normal retirement

· Rates of breakdown retirement

· Mortality of contributors

· Mortality of contributors after pension emergence

· Mortality of pensioners who have commuted pensions in excess of Fund's portion

· Life and service tables

· Marital status of male contributors and pensioners

· Age differences of spouses of male contributors and Densioners.

Economic Assumptions

8.5 The most critical assumptions are the economic assumptions. The following extract from a.letter received from the Government Actuary demonstrates the effect of varying these assumptions on the estimated accrued emDloyer .funded liability and the employer future service contribution rate:

With a view to assisting the Committee in placing the role of certain of the economic assumptions in perspective, I quote below the effects on results for one medium-sized old-established authority of varying those assumptions from the standard assumptions used in the recent reports to authorities (and quoted in your letter).

Assumptions (per cent per annum)

| | | | | |
|---|---|---|---|---|
| Pension indexation rate | 10 | 8 | 7 | 10.5 |
| Investment earning rate | 12 | 10 | 10 | 12 |
| Growth rate of salaries (other than by increment or promotion) | 10.5 | 8.5 | 9 | 11 |

Resulting Changes (per cent)

| | | | | |
|---|---|---|---|---|
| Relative change in accrued employer unfunded liability | nil | minus 0.6 | minus 7.9 | plus 11.1 |
| Relative change in recommended employer future service contribution rate | nil | plus 3.0 | minus 4.1 | plus 11.7 |

8.6 The critical factor in these calculations is the difference between the interest rate earned on the investments and the other two rates i.e. salary growth and CPI growth. In the long term, interest rates, salary growth rates,and cost increases tend to move to a degree in parallel, so that the difference between the rates moves by much less than the rates themselves.

Significance of Investment Earnings (Interest Rate)

8.7 In order to measure the sensitivity of the assessments to changes in the critical assumptions the calculations for the Electricity Commission of New South Wales were repeated on more optimistic assumptions about the future. These assumptions involve a change only in the nominal interest rate from 10% p.a. (see paragraph 8.2) to 12% p.a. The specific assumptions made were:

| | | |
|---|---|---|
| Salary growth | 8.5% | p.a. |
| Pension indexation increases (CPI) | 8% | p.a. |
| Interest earnings | 12% | p.a. |

The results, again for the State Superannuation Fund, under these assumptions were:

| | |
|---|---|
| Employers' liability for past service ($m) | 154 |
| Provision in accounts ($m) | 32 |
| Net Unfunded liability for past service ($m) | 122 |
| Contribution (% of salaries) to fund this past service liability Over : | |
| 10 years | 15.25 |
| 15 years | 11 |
| 20 years | 9 |
| Recommended contribution (% of salaries) for future service | 10.25 |
| Total contribution (% of salaries) recommended if funding for past service is over : | |
| 10 years | 25.50 |
| 15 years | 21.25 |
| 20 years | 19.25 |

8.8 It is noted from the calculations shown in paragraphs 8.2 and 8.7 that an increase in the nominal rate of interest of 2% reduced the Electricity Commission's unfunded liability for past service (before provisions) from $256m to $154m i.e. by 40%.

8.9 The result shown in paragraph 8.8 demonstrates that an inaccurate assumption in the level of interest earnings relative to the assumed salary growth rate and CPI growth rate could have a major effect on the estimated level of the unfunded liability of statutory authorities given in Tables 4.5 and 4.7. The significance of this assumption therefore led the Committee to seek justification from the Government Actuary of the rates assumed in the actuarial assessments made by his office.

Justification for the Assumed Rate of Interest

8.10 The Assistant Government Actuary has defined the interest earning rate to be :

The rate of interest assumed to be earned on assets to be built up to meet the employers' liabilities.

8.11 Further, the Government Actuary advised that the interest earning rate assumed was not the rate of return of superannuation bodies on funds invested. The Assistant Government Actuary explained this as follows:

Taking first the more straight forward case, the funding of liabilities under the New South Wales Retirement Benefits Act 1972, it will be noted that employers do not contribute to the New South Wales Retirement Fund ....

The rates of return on the State Superannuation Fund have direct relevance to the funding of employer liabilities arising under the Superannuation Act, 1916 but that relevance is limited because, as indicated above, the Fund covers only a small proportion, of the total employer's liability ....

8.12 In the case of the New South Wales Retirement Fund (NSWRF) the Fund does not receive contributions from employing authorities; it only holds and invests the contributions of employees. Hence the investment performance of the Retirement Fund only affects the benefits paid to employees in respect of their own contributions. It~ does not, as the Actuary indicated, affect the deferred commitments of the authorities.

8.13 By contrast the StateSuperannuation fund (SSF) receives and invests contributions from both employees and employing authorities. The employers' contributions, together with investment income earned on them, covers approximately 14% of the employers' share of benefits. The employee contributions to the Fund are of a slightly larger magnitude and these contributions (plus their investment earnings) meet part of the benefits to be paid. The employee and employer contributions combined are estimated to cover over 25% of the benefits to be paid, the balance to be met by employing authorities. Hence the interest rate adopted by the Actuary should, in respect of the State Superannuation Scheme, be a composite of both the investment performance of the employing authority and of the Fund. The investment performance of the SSF therefore affects the cost of superannuation to employers.

8.14 Assume that an authority has employees covered by both the SSF and the NSWRF. For the employees under the NSWRF the interest rate used in an actuarial assessment will be the authority's assumed investment earning rate. However, for the employees covered by the SSF the interest rate used in an actuarial assessment will be a composite of the authority's and the SSF's estimated investment earning rate. Clearly if the SSF's estimated future investment earning rate is different to that of the authority, different interest rates should be assumed for the two assessments.

8.15 The Government Actuary has explained that there is some difficulty in establishing the expected investment earnings of statutory authorities. He states :

May I respectfully suggest that, in initial actuarial investigations of the unfunded liabilities of authorities which have made little or no prior provision for these liabilities, expectations as to the precise future performance of these authorities in investing future provisions (either by way of separately invested assets or internally in their businesses) are difficult if not impossible to formulate by this Office or by the authorities. I understand that, in a number of cases, their investment powers are or have been under review and, in any case, the authorities are for the most part now subject to Ministerial direction. It was for this reason, amongst others, that discussion was initiated with the Treasury. The view of both the present Secretary and the late Deputy Secretary was that, in conditions of responsible economic management, the average real rate of interest would tend to lie, in the main and over the longer term, between 1.5 per cent p.a. and 2.5 per cent p.a.

8.16 A number of actuaries who appeared at the hearings were invited to express their views on the assumptions made by the Government Actuary in his assessmeats. Mr Trahair representing the Institute of Actuaries of Australia stated that:

Assuming a reasonable kind of investment strategy or policy one of the major factors in an actuary's mind is what we call the gap - the excess of the interest rate over salary increase rate. On those assumptions, that figure is 1.5%, which would be in the range of accepted practice within Australia. I think for long-term projections most actuaries would feel those assumptions to be probably a little high

8.17 Mr Whittle, representing the Association of Superannuation Funds of Australia, in referring to the assumptions used by the Government Actuary stated.

In a private sector scheme I would think those figures are in the right sort of order of magnitude. That is the sort of yardstick in a private sector scheme that might commonly be used. In a public sector scheme, the first part of the answer is that it would depend on how the monies are invested.

8.18 Mr Roach, advising the Government Insurance Office, was asked by the Chairman what assumptions he would make about a real rate of interest. He replied:

The simple and literal answer to your question is that I would use a one per cent real return at the moment. I have used that for well over ten years, through periods when the real return has been high and positive and has been low and negative. The range of assumptions currently used by actuaries, and used over the last ten years or so, would be from zero to two per cent. But currently most actuaries who work in this field would use one per cent in real terms.

The support for that is hard to generate. Looking to the future no one knows. What might happen in the future becomes speculative; it becomes, perhaps, even philosophical. Looking to the past, it depends which period you measure, but you would find studies over various periods of twenty years that might show real returns that are marginally negative, or perhaps as high as two or three per cent. You would find longer periods where the returns cover a narrower range. The consensus would be that it is near one per cent for the past.

8.19 The Committee also received evidence that real returns on investment can in the long term be considerably greater than 2% real per annum. The following studies were noted:

. Provision for Reserves to Meet Superannuation and Similar abilities:.Emphasis on the Choice of an Appropriate Discount Rate by Prof. R.R. Officer February 1984. This paper, based on estimated average returns received over the last 100 years, argued that returns of about 6% real p.a. were achievable in the long run for private sector superannuation funds with portfolios comprising Shares 40%, Property 25%, Government Securities 30% and other Securities 10%.

"The Effect of Inflation in Pension Schemes and their Funding", 1979 by D.G. Boden and T.D. Kingston (quoted by the Government Actuary). This paper, referring to U.K. conditions, stated that with a reasonably diversified portfolio it should be possible, in periods of stable inflation and with some economic growth, to achieve real returns of 4% to 5% or a gap between interest rate and wage inflation of the order of 2% per annum.

The Campbell and Cook Index for the 5 years to June 1983 based on a survey of 420 private sector superannuation funds gave an average annual return of 17.2% p.a., i.e. about 7% real. it is noted that this is considered to be a rather short period over which to'assess performance.

8.20 Professor Pollard, the Committee's actuarial adviser, pointed out that Professor officer's study was based on estimated average returns over the past 100 years, it did not take investment costs or charges into account, and that if Professor Officer's figures were used to estimate returns over the last 10, 20, 30 or 40 years (which are more relevant to the modern capital market) the margin of interest rate over wages growth rate never exceeded 1%. Professor Pollard, while not disputing Professor Officer's figures, therefore disagreed with his observations as they related to the assumptions to be used in actuarial assessments of scheme liabilities.

8.21 It is therefore noted that the difference of opinion as to the achievable rate of return for a balanced portfolio rests on a judgement as to the extent to which the future will reflect the past, and as to the period of years which should be used in any such study of the past. In any particular case the investment policy of the specific fund would need to be taken into account.

8.22 The Committee considers that a discount rate in excess of 2% real p.a. would not be appropriate for the assessment of the current unfunded liabilities of statutory authorities. The reasons for this include :

(a) The investment performance of most statutory authorities is likely to be somewhat inferior to that of an average private sector superannuation fund with a balanced portfolio because :

(i) authorities do not have equivalent investment expertise;

(ii) authorities that invest funds are likely to invest heavily in fixed interest securities. The earning rate on fixed interest securities is, in the long term, substantially less than earnings achievable on property and equities;

(iii) borrowing authorities may use these additional funds generated to meet deferred superannuation commitments to offset borrowings. The appropriate rate is then the opportunity cost of borrowings which is similar to the rate earned on semi-government securities.

(b) Some of the funds set aside to meet future superannuation commitments are held by the public sector superannuation funds where in some cases investment performance has been poor.

8.23 THE COMMITTEE IS CONCERNED THAT POOR INVESTMENT PERFORMANCE BY STATUTORY AUTHORITIES AND THE PUBLIC SECTOR SUPERANNUATION FUNDS MAY CAUSE THE UNFUNDED LIABILITIES FOR PAST SERVICE OF STATUTORY AUTHORITIES IN RESPECT OF SUPERANNUATION COMMITMENTS TO BE GREATER THAN THOSE CALCULATED BY THE GOVERNMENT ACTUARY.

8.24 Statutory authorities have' a responsibility to ensure that funds provided to meet future superannuation obligations are earning adequate returns. If the earning rate on funds held is less than the rate assumed by the Government Actuary then authorities should set aside more funds. If the earning rate is more than the assumed rate then less funds need to be set aside.

8.25 TO ASSIST AUTHORITIES IN ASSESSING THE ADEQUACY OF THEIR SUPERANNUATION FUNDING ARRANGEMENTS, THE GOVERNMENT ACTUARY SHOULD PROVIDE CALCULATIONS USING ALTERNATIVE VALUES OF THE KEY VARIABLES SO THAT THE SENSITIVITY OF THE ESTIMATES TO THE MAJOR ASSUMPTIONS CAN BE KNOWN.

Demographic Statistics

8.26 The Committee noted that the Government Actuary used demographic statistics taken from the records of the superannuation funds rather than from individual authorities undergoing actuarial assessments. Several questions were put to the Actuary on this matter and the following responses were received :

Q. was any effort made to vary demographic statistics to more accurately reflect individual authorities for which assessments were made?

A. The necessity and practicality of such investigation were carefully considered on generalgrounds, as described above. It was felt that the necessity was not pressing. As to practicality, it was considered that the collection, analysis and interpretation of statistics was not even remotely possible within the time-frame for reporting required by the Auditor General.

Q. How significant might this assumption be in calculating an authority's liability compared with the key economic assumptions such as the real rate of interest?

A. It is considered that the assumptions about membership experience are generally unimportant relative to the key economic assumptions, as regards both the accrued liability and the future service contribution. It is expected that new entrants will require contributions lower than the future service contribution rate. (Studies made confirm this.) The payment of the future service contribution rate for new entrants is expected to generate surplus. Ultimately, the contribution rate will fall to the new entrant rate, which depends partly on the individual authority's experience and partly on the aggregate experience of the State superannuation Fund. Detailed analysis would be complex and, it is considered, involve work out of all proportion to its worth. The triennial investigations of each authority's position can be expected to facilitate a satisfactory pace of funding.

Q. What steps are being taken to consider this variable in future actuarial assessments?

A. It is expected that pensioner experience for individual authorities will be extracted by this Office for 1983/84 and subsequent years.Contributor experience for individual authorities is expected to be extracted for 1984/85 and subsequent years. It is impractical to extract the experience for earlier years. At least three years' experience would need to be available to have a worthwhile volume of data for even the largest authorities. Hence, it is expected to be late 1987 at the earliest before any useful information is available. The results will be of more practical value for cash flow projections than for liability valuations.

8.27 The Committee also posed a number of questions concerning the sensitivity of actuarial assessments to some of the demographic statistics. The Committee is satisfied that these assumptions are somewhat less significant than the economic assumptions discussed above and must ultimately be left to advice of the Actuary.

Role of the Government Actuary

8.28 At the commencement of the Inquiry, the Government Actuary appeared to not be adequately geared to service the needs of statutory authorities and consequently delays were being experienced in obtaining actuarial assesments.

Most of these problems appear to have been resolved and consequently actuarial assessments for individual authorities are now being concluded in a matter of weeks.

8.29 The Committeesought from the Government Actuary illustrations of benefits to be paid each year for the next 40 years and the annual outlays on a pay-as-you-go basis for the same period for a representative sample of authorities. However, it was advised that this information was not available. It was considered that this information would assist the Committee in its deliberations on the advisability of fully funding superannuation commitments.

In the event the Committee had to rely on projected outlays of employer payments for the whole State Superannuation Scheme over 29 years.

8030 It is noted that the Valuation Report of the State Superannuation Fund as at 30 June 1978 only became available in 1981 whilst the Valuation Report of the Fund as at 30 June 1981 only became available in early 1984. The delay in the publication of these reports is of concern to the Committee. IT BELIEVES THAT THE TRIENNIAL VALUATION REPORTS SHOULD BE MUCH MORE TIMELY, CERTAINLY NO LATER THAN ONE YEAR AFTER BALANCE DATE.

8.31 THE COMMITTEE IS CONCERNED THAT THE GOVERNMENT ACTUARY, WHILST BEING VERY COOPERATIVE, MAY STILL BE INADEQUATELY EQUIPPED TO PROVIDE SUFFICIENT INFORMATION TO AUTHORITIES, TO PARLIAMENT AND TO GOVERNMENT ON FUTURE SUPERANNUATION OBLIGATIONS IN A TIMELY FASHION.

8.32 IRRRESPECTIVE OF THE GOVERNMENT'S FINAL DECISIONS ON FUNDING AND ACCOUNTING FOR SUPERANNUATION, THE COMMITTEE STRONGLY RECOMMENDS THAT AN INVESTIGATION BE MADE BY THE GOVERNMENT ACTUARY AT LEAST EVERY THREE YEARS TO ASSESS EACH AUTHORITY'S SUPERANNUATION COMMITMENTS. SUCH ASSESSMENTS SHOULD ALSO INCLUDE REPORTS CONCERNING THE PROJECTED cAsH REQUIREMENTS ASSOCIATED WITH MEETING EMPLOYER CONTRIBUTIONS AS THEY FALL DUE OVER THE ENSUING TEN YEARS.

8.33 It was evident in submissions to the Inquiry that officers of some authorities misunderstood aspects of funding, and it is believed a close association between authorities and the Government Actuary should be encouraged.

8.34 AS DISCUSSEDIN SECTION 7, THERE IS A NEED FOR GREATER DISCLOSURE OF, AND MORE RIGOROUS ACCOUNTING FOR, SUPERANNUATION COMMITMENTS. TO THIS END, IT IS DESIRABLE THAT THE GOVERNMENT ACTUARY BE RESPONSIBLE FOR THE CALCULATION OF THE AMOUNT OF UNFUNDED PAST SERVICE COSTS FOR ACCOUNTING PURPOSES, IN ORDER TO FACILITATE COMPARABILITY IN ACCOUNTING CALCULATIONS BETWEEN AUTHORITIES.

Costing and Public Disclosure

8.35 As outlined in paragraphs 3.8 and 3.9, one of the causes of the build-up of unfunded superannuation liabilities to the present levels was that there has been inadequate public disclosure and costing of benefit changes prior to their implementation. The Committee is of the view that some mechanism is necessary to prevent benefit increases from being granted before adequate public disclosure and debate has taken place.

8.36 THE COMMITTEE IS RELUCTANT TO RECOMMEND THE ESTABLISHMENT OF A NEW BODY TO SCRUTINISE PROPOSED CHANGES IN SUPERANNUATION BENEFITS, ALTHOUGH IT BELIEVES PUBLIC SCRUTINY IS ESSENTIAL. THEREFORE, THE COMMITTEE, WITH THE BENEFIT OF HINDSIGHT, CONSIDERS IT MOST IMPORTANT THAT PROPOSED BENEFIT CHANGES SHOULD BE REQUIRED TO BE LAID BEFORE THE LEGISLATIVE ASSEMBLY OF THE PARLIAMENT FOR AT LEAST 90 DAYS AND THAT THEY SHOULD BE ACCOMPANIED BY A REPORT FROM THE GOVERNMENT ACTUARY INTO THE FINANCIAL IMPLICATIONS OF THE CHANGES. THIS REPORT SHOULD INCLUDE:

(i) THE NEW ENTRANT FULLY FUNDED CONTRIBUTION RATE AS A PERCENTAGE OF SALARIES BOTH BEFORE AND AFTER THE PROPOSED CHANGES, AND THE PERCENTAGE INCREASE OR DECREASE WHICH THIS REPRESENTS;

(ii) AN ESTIMATE OF THE EXTENT (IF ANY) TO WHICH THE PROPOSED CHANGES WILL AFFECT THE LIABILITY FOR PAST SERVICE IN RESPECT

(a) OF ALL MEMBERS OF THE PARTICULAR SCHEME, AND

(b) IN RESPECT SEPARATELY OF THOSE MEMBERS WHO ARE EMPLOYEES OF THE LARGEST STATUTORY AUTHORITIES;

(iii) AN INDICATION OF THE EXTENT TO WHICH THE PROPOSED BENEFITS ARE COMMONLY INCLUDED WITHIN PRIVATE SECTOR SCHEMES AND PUBLIC SECTOR SCHEMES ELSEWHERE;

(iv) CASH FLOW PROJECTIONS FOR 40 YEARS BOTH BEFORE AND AFTER THE PROPOSED CHANGES;

(v) ANY OTHER ISSUES WHICH THE ACTUARY CONSIDERS SHOULD BE RAISED TO ENABLE THE PUBLIC TO ASSESS THE FINANCIAL IMPLICATIONS OF THE PROPOSED CHANGES.

## 9: INVESTMENT PERFORMANCE

9.1 Under defined benefit schemes such as the State Superannuation Scheme and the New South Wales Retirement Benefit Scheme employee contributions are fixed and hence the only variable is the amount of employer contributions. The better the investment performance of statutory authorities (on funds set aside to meet future superannuation commitments) and of public sector superannuation funds the less employers have to contribute and hence the 'less the cost passed on to ratepayers and/or taxpayers.

9.2 Although investment performance is especially significant if statutory authorities are accumulating funds under a 'full' funding scheme it is also important under existing 'partial' funding arrangements. Its importance in respect of the public sector superannuation funds is independent of the pace of funding adopted by employing authorities.

9.3 The effect of improving investment earnings on the magnitude of employer contributions was illustrated by the example in respect of the Electricity Commission which was Given in Section 8.7. An increase in the interest earnings assumption from 10% p.a. to 12% p.a. reduced Elcom's unfunded liability for past service by 40% (i.e. from S256m to $154m).

9.4 THE INVESTMENT PERFORMANCE OF STATUTORY AUTHORITIES AND PUBLIC SECTOR SUPERANNUATION FUNDS IS OF CRUCIAL IMPORTANCE TO THE LEVEL OF EMPLOYERS' COSTS FOR SUPERANNUATION COMMITMENTS.

Statutory Authorities (Excluding Superannuation Funds)

9.5 As pointed out by the Government Actuary (refer paragraph 8.1) it is difficult, if not impossible, to assess the likely future investment performance of statutory authorities in respect of funds under their management. There is very little information available on their past investment performance and even that information may not be relevant to the investment by them of superannuation funds. The Committee notes that New South Wales .statutory authorities as at 30 June, 1983 held investments totalling approximately $9,200m. If the superannuation funds are excluded this number reduces to $5,620m. An initial review of the investment strategies and resultant performance of statutory authorities (excluding the superannuation funds, the State Bank and the Government Insurance Office) suggests that they have been less than optimal notwithstanding the legislative restrictions under which many authorities operate. This is a matter that the Committee will be pursuing further by way of a separate inquiry.

9.6 The average rate (allowing for capital profits or losses) earned over the last five years on various sector assets by the superannaution funds with investements totalling $4,118 million who subscribe to the survey of investment performance carried out by I.M.S. Pty Ltd and published in their Report of December, 1983, has been as follows:

| Government Securities | Ordinary Shares | Property | Other |
|---|---|---|---|
| 10.7% | 25.4% | 20.2% | 14.6% |

While these returns do vary, particularly in the case of ordinary shares, the general pattern is consistent in the long term. Investment in property and ordinary shares in the long term produces higher returns than government securities and fixed interest investments. The average holdings of the funds (by market value) in the above survey where the fund managers have discretion as to the type of investment was roughly 30% in government securities (to satisfy the 30/20 requirement), 48% in shares and 17% in property.

9.7 If the funds set aside by statutory authorities for superannuation are invested in government securities or invested internally, the cost to them of superannuation is likely to be much greater than if the funds were invested in a good portfolio of shares and property.

9.8 Experience has shown that investments in property and ordinary shares, and even in fixed interest securities, is a job for highly skilled and experienced experts. A wide range of skills is required, and it is unlikely that any but the largest authorities would be able to justify the overhead costs of setting up an investment department of the required standard. However, in the private sector there are in the fund management area many competent companies who would undertake the responsibility for a reasonable fee. Some authorities such as the Government Insurance Office and the State Bank, because of their special areas of activity, may have appropriate expertise available to them.

9.9 Within the public sector, fund managers include the State Superannuation Board, the Public Authorities Superannuation Board, the Government Insurance Office and the State Bank. These bodies may be able to provide the necessary investment service by setting up a new separate fund. The Committee has therefore considered the advisability of allowing authorities to use the services of public sector fund managers in the investment of their superannuation funds.

9.10 A number of factors arise which suggest that this is not the best course of action. There is presently no legislative provision whereby the State Superannuation Board can accept additional monies from employers for investment on deposit or otherwise. As will be discussed in Section 9.25 the investment earnings of public sector superannuation funds may themselves be somewhat less than optimal. For example, until the year commencing 1 July 1982, the rate of interest paid by the New South Wales Retirement Fund on employers' advance payments was so low (6.50% p.a.) as to be a positive disincentive to invest in it. Hence if statutory authorities were requested to invest superannuation funds with public sector fund managers, the best return on their investments may not be achieved.

9.11 THE COMMITTEE CONSIDERS THAT AUTHORITIES SHOULD BE PERMITTED TO ENGAGE PROFESSIONAL FUND MANAGERS FROM BOTH THE PUBLIC AND THE PRIVATE SECTOR THUS REQUIRING PUBLIC SECTOR FUND MANAGERS TO COMPETE FOR THEIR BUSINESS ON AN EQUAL FOOTING.

9.12 Currently, authorities may choose to 'invest' funds accumulated to meet superannuation commitments in their own undertakings. There are, howevers, a number of problems associated with this arrangement.

9.13 For authorities that borrow funds such internal investments may merely reduce outside borrowings and hence the implicit return achieved is the opportunity cost of borrowing funds from external sources. This rate will be considerably less than the earning rate achievable from a balanced portfolio. Clearly authorities are better off investing funds with external fund managers and borrowing funds to meet their capital works program.

9.14 AN ADDITIONAL PROBLEM ENVISAGED IS THAT THE EXISTENCE OF SURPLUS CASH IN AN AUTHORITY MAY ENCOURAGE THAT AUTHORITY TO EMPLOYTHOSE FUNDS TOWARDS UNNECESSARY CAPITAL WORKS I.E. WORKS FOR WHICH BORROWING WOULD NOT HAVE BEEN RAISED HAD INTERNALCASH NOT BEEN AVAILABLE.

9.15 Finally, if funds are invested internally, cash flow problems could arise when deferred superannuation commitments have to be paid. It could be argued that the actual payment of deferred commitments is really a cash budgeting problem similar to cash budgeting for asset replacement. The Committee accepts that cash budgeting is ultimately up to management. Nevertheless, it notes that for authorities that are labour intensive the cash payments required to meet deferred superannuation commitments in future years could be substantial and could cause cash flow problems especially if all superannuation monies are invested in fixed assets.

9.16 Irrespective of the pace of funding of superannuation commitments adopted by an authority, the Committee believes that guidelines are necessary for authorities wishing to invest superannuation monies in their own activities.

9.17 IN RELATION TO 'INTERNAL INVESTMENT' OF SUPERANNUATION MONIES BY STATUTORY AUTHORITIES THE COMMITTEE RECOMMENDS THE FOLLOWING:

(a) AUTHORITIES WHICH DO NOT NORMALLY BORROW FUNDS NOT BE ALLOWED TO INVEST SUPERANNUATION FUNDS IN THEIR OWN UNDERTAKING.

(b) ALL AUTHORITIES BE ENCOURAGED TO INVEST SUPERANNUATION MONIES EXTERNAL TO THEIR ORGANISATION IN SUCH A MANNER AS TO MAXIMIZE INVESTMENT EARNINGS.

(c) WHERE AUTHORITIES RETAIN SUPERANNUATION FUNDS INTERNALLY THE BALANCE OF THEIR 'INTERNAL INVESTMENT' BE INCREASED ANNUALLY AT THE ASSUMED INVESTMENT EARNING RATE. THIS WILL BE ACHIEVED IF AUTHORITIES DO NOT OPERATE AT A DEFICIT AND ADOPT THE EXPENSE RECOGNITION PROCEDURES OUTLINED IN SECTION 7.

Investment Earnings of Public Sector Superannuation Funds

9.18 As indicated in paragraph 8.2 the investment earning rate of the State Superannuation Fund has a direct bearing on the level of contributions to be paid by employers to meet deferred obligations. The same is also true in the case of the Local Government Superannuation Scheme. In the case of the New South Wales Retirement Benefit Scheme the investment performance of the Fund has a direct bearing on the level of benefits received by Scheme members.

9.19 The significance of the investment performance of the public sector funds is demonstrated by the magnitude of investments held by these funds as at 30 June, 1983:

| | $ '000 |
|---|---|
| State Superannuation Fund | 2,346,181 |
| New South Wales Retirement Fund | 363,897 |
| Local Government Superannuation Board (31 March 1983) | 824,963 |
| | 3,535,041 |

9.20 The Committee noted evidence from interstate inquiries that the investment performance of public sector superannuation funds was far below that of their private sector counterparts.

9.21 A number of observations of the Economic and Budget Review Committee of the Victorian Parliament (EBRC, A Review of Superannuation in the Victorian Public Sector, April, 1984) are noted:

The Committee notes that the return achieved by the Public Sector Schemes over the five year period ending 30 June 1983 was 28% less than the results of the 250 private sector schemes summarized in the Campbell and Cook Index, i.e. 12.4% compared with 17.2% (page 318).

If, instead of relying on its own investment management during the review period, each Public Sector Fund had placed the value of its 1978 assets (and subsequent cash flows) under the control of professional commercial managers, the consultants estimate the market value of assets at June 1983 would have been some $575 million greater than the outcome actually achieved by the twelve surveyed schemes (page 325).

9.22 Recent press reports have questioned the investment performance of the Superannuation Fund Investment Trust (SFIT) for Commonwealth public servants. A report in *The Bulletin* of 7 February 1984 stated:

The record of the SFIT indicates selectivity in its investment approach. But it cannot be said to have been a particular successful approach, Results compare quite poorly with those of other funds,

Sad to record, the contributors would have been better off had the fund invested all their cash each year in long term Commonwealth bonds.

9.23 The poor performance of interstate public sector superannuation funds does not necessarily imply that New South Wales funds also perform poorly. However there is some evidence that local schemes have also been poor investment' performers.

9.24 The overall earning rates of the New South Wales public sector schemes in recent years are summarized in the following table.

| | Rate per cent per annum | | |
|---|---|---|---|
| Year ended 30 June | State Superannuation Fund | NSW Retirement Fund | Local * Government Superannuation Fund |
| 1978 | 8.67 | 10.77 | 10.8 |
| 1979 | 9.12 | 10.66 | 10.6 |
| 1980 | 9.92 | 9.83 | 11.8 |
| 1981 | 10.43 | 11.77 | 11.2 |
| 1982 | 10.98 | 12.51 | 14.1 |
| 1993 | 12.07 | 13.48 | 12.7 |

Each period ends on 31 March.

9.25 By comparison as indicated in paragraph 9.20 the Campbell and Cook Index for 250 private sector schemes shows an average performance over the five years to 30 June 1983 of 17.2% p.a. Further the EBRC in its report (page 319) gave the average return of Victorian Public Sector Schemes over the same period as 12.4%. Even by this comparison the New South Wales funds fare badly.

9.26 The Committee stresses that the above comparisons are not completely reliable given that different measuring bases are used to calculate each of the rates quoted. Nevertheless, they may constitute evidence of poor investment performance.

9.27 As discussed in paragraphs 8.14 and 9.6 to achieve a rate of return comparable to their private sector counterparts the New South Wales public sector schemes need to have a balanced portfolio of investments. The following investment portfolios as at 30 June 1983 were noted.

| Investment Category | Average Portfolio for Private Sector | State Superannuation Fund | Retirement Fund | Local Government Superannuation Fund (March 1983) |
|---|---|---|---|---|
| Government Securities | 30 | 35 | 42 | 31 |
| Ordinary Shares | 40 | 10 | 0 | 10 |
| Property | 20 | 18 | 19 | 27 |
| Other | 10 | 37 | 39 | 32 |
| Total | 100% | 100% | 100% | 100% |

Note: The bases of valuation of assets of the different funds may not be comparable.

9.28 The Committee gave consideration to the carrying out of an investigation into the investment performance over the last five years of these three major New South Wales public sector funds on the same basis as is used for the published investment performance of private sector funds. The Committee was informed that such a study was not possible because the records kept did not permit the necessary detailed reconstruction of the assets held in the past to be made. However from the small holdings of the higher-earning share investments by all three funds, as shown in the Table in paragraph 9.27, it can be assumed that their investment performance has been less than optimal.

9.29 All three of the major New South Wales Superannuation funds cited legislative restrictions as a major factor which has determined their current investment portfolio and performance. The State Superannuation Board, for example, suggested that its powers in relation to property investments are so unclear that it is often forced to forego good investment opportunities because of doubt and delay over the interpretation of its investment powers. In the property area the purchase price is limited to the Valuer General's valuation. Its investments in the corporate sector are limited to 25% of the fund and share investments have to satisfy a certain earnings and dividend-paying history.

9.30 The object of investment policy should be to obtain the highest investment return consistent with adequate security of capital. Current legislative restrictions are clearly making the performance of the funds sub-optimal if not uncompetitive.

9.31 THE COMMITTEE IS OF THE VIEW THAT, IN ORDER TO sECURE BETTER RETURNS ON SUPERANNUATION FUND INVESTMENTS, RESTRICTIONS ON THE INVESTMENT POWERS OF PUBLIC SECTOR FUND MANAGERS SHOULD BE REMOVED.

9.32 FURTHER, THE COMMITTEE BELIEVES THAT LEGISLATIVE PROVISION SHOULD BE MADE FOR THE INVESTMENT BY STATUTORY AUTHORITIES OF FUNDS ADDITIONAL TO THEIR STATUTORY CONTRIBUTIONS UNDER THE RELEVANT SUPERANNUATION ACTSo

9.33 Some public sector fund managers, whether as a matter of policy or to keep costs to a minimum, limit their range of investment activity. The New South Wales Retirement Fund, for example, concentrates mainly on fixed interest investments, It has but small holdings in ordinary shares and invests in only one area of property. Such fund managers might find it difficult to compete with private sector fund managers.

9.3.4 Experts in the investment field soon earn a reputation within the industry, and their services are highly competed for with offers of excellent remuneration packages. Another disability which public sector fund managers may suffer is their lesser ability to compete for such specialist staff, and lesser ability to hold their own experts with proven ability.

9.35 THE COMMITTEE BELIEVES THAT THE GOVERNMENT SHOULD PAY GREATER ATTENTION TO REMOVING PUBLIC SERVICE RESTRICTIONS THAT LIMIT THE CAPACITY OF PUBLIC SECTOR FUND MANAGERS TO ATTRACT SKILLED STAFF BY SUITABLE REMUNERATION PACKAGES.

9.36 There are no regular publicly available measures of the investment performance of New South Wales public sector superannuation funds.

9.37 In its submision to the Committee the State Bank commented on the need for regular investment performance assessment:

Investment performance is the only factor that Trustees of superannuation funds can influence to minimise the long term cost of superannuation benefits.

For this reason, the investment performance of the Statutory Authorities' superannuation assets as well as that of the State Superannuation Fund and other public sector funds should be assessed and compared on a regular basis with their private sector counterparts. Trustees of private sector superannuation funds are continually reviewing their investment performance through independent investment performance measurement services. These reviews are usually carried out on a quarterly basis. Such a review could initially be carried out for the Authorities' funds on an annual. basis.

9.38 THE COMMITTEE CONSIDERS IT IMPORTANT THAT THE INVESTMENT PERFORMANCE OF ALL PUBLIC SECTOR FUND MANAGERS BE REVIEWED QUARTERLY AS IN THE PRIVATE SECTOR.

## 10: THE FUNDING OF SUPERANNUATION COMMITMENTS.

10.1 In Section 7 it was argued that the full expense relating to the superannuation commitments arising out of each year's operations should be recognised in the Statement of Revenue and Expense of each statutory authority. This would guarantee that the current consumers of services, the Parliament and the public, would at least be aware of the cost of public sector superannuation to the community.

10.2 The recognition of an amount for superannuation 'Expense' in an authority's Statement of Revenue and Expense automatically means the creation of a 'Provision' in that authority's Balance Sheet. In any given year such accounting treatment which recognises superannuation costs does not necessarily mean that the authority concerned has generated additional revenue and created additional assets to back that provision. For example the authority may have operated at a loss equal to its superannuation expense.

The creation of a provision may simply be a book entry and may not in any way mean that the superannuation commitments (liabilities) have been 'funded'.

10.3 If it is assumed that in the long term an authority will not continue to operate at a deficit, that is such that the authority's capital will not be eroded, then it follows that the recognition of superannuation expense in the Statement of Revenue and Expense (and the creation of a provision in the Balance Sheet) will, in the long run mean that additional revenues must be raised by the authority to match the superannuation expense. Thus expense recognition may in the long term imply full funding of superannuation commitments.

10.4 For the purpose of this Section 'funding' will be defined as the raising of additional revenues to cover superannuation commitments.

10.5 It follows from the definition of funding in paragraph 10.4 that funds generated to meet future superannuation commitments could be managed in any of the following ways:

(a) they could be paid to Treasury with the effect that the Consolidated Fund assumes the liability for subsequent benefit payments;

(b) they could be set aside as a provision in the authority's accounts and covered by earmarked assets (i.e. invested in the authority's operations);

(c) they could be paid into a separately constituted and appropriately managed trust fund;

(d) they could be managed by public sector superannuation funds or by some other public investment agency which would set up a separate new fund for the purpose.

10.6 The steps.involved in the expense recognition/ funding process for an authority could be as follows:

(i) Calculate full superannuation expense relating to a year's activities

(ii) Charge the full expense to the Statement of Revenue and Expense for that year and create a provision in the balance sheet.

(iii) Choose (a) to raise additional funds to match the superannuation expense for the year;

or

(b) not to raise additional funds.

(iv) If the decision in step (iii) is made to fund then the authority may :

· (a) use the funds generated for normal operations;

or

(b) invest funds in external assets specifically to meet future superannuation commitments;

or

(c) pay funds to Treasury and have the Consolidated Fund meet the future commitments when they emerge (this would mean that the provision in the accounts of the authority would be removed as the obligation has been discharged by the payment of funds); or

(d) any combination of (a), (b), or (c) above,

10.7 The steps to be dealt with in this Section are steps (iii) and (iv) above. It should be noted that for simplicity paragraph 10.6 envisages that the accounting expense for superannuation calculated for a given year equates to the funding payments that might be recommended by an actuary under a new entrant funding schedule, which are usually expressed as a constant percentage of salaries. In. practice it is unlikely that the two amounts will be the same, but this would make no difference to the principles discussed in this Section.

10.8 In the course of the Inquiry the Committee considered four basic arguments in support of the full funding of deferred superannuation commitments. Each argument will now be outlined in turn.

## Arguments in Favour of Funding

10.9 One of the strongest arguments in support of full funding concerns the principle of inter-generational equity. Put simply, it is claimed to be equitable that the cost of benefits currently incurred (in this case the cost of retirement benefits for current employees) should be met by the current generation of consumers and should not be left to be paid for by future generations of consumers.

10.10 If deferred superannuation commitments were to be funded now, as the obligations arise, authorities would have to raise revenue now and current consumers would meet the relevant costs. These consumers would meet this cost in either of two ways:

(a) through higher prices for goods and services charged by commercial authorities;
or

(b) by higher taxes where authorities derive their revenue from the Consolidated Fund via the annual budget appropriation.

10.11 The cross subsidy which occurs between current and future generations if full funding is not adopted is illustrated by the following statistics provided by the Government Actuary in relation to the State Superannuation Fund:

Current pace of funding

Employer payments in 1983 = 11.4% of salaries Employer payments in 2012 = 20.2% of salaries

Full funding rate (i.e. assuming full funding had always been adopted)

Employer payments every year = 15.2% of salaries

As indicated in paragraph 3.15 the annual cost is estimated to rise in real terms from $290 million in i983 to $684 million in 2012 i.e. an increase of 136%.

10.12 Apart from questions of equity, the payment by current consumers/taxpayers of the superannuation costs resulting from current employees' service has other obvious consequences. Firstly, proposals for benefit improvements would come under closer scrutiny as such improvements would have an immediate impact on prices and/or taxes. Clearly, under the current funding arrangements where the impact is deferred, employers are more likely to be over generous with the promised superannuation package. Secondly, the public servants themselves, in their role as consumers/taxpayers, would contribute more towards their future benefits. The first effect could be described as promoting public disclosure and accountability, and the second as a part- application of the user-pays principle.

10.13 A second argument is that the benefits provided by the current generation of superannuitants to themselves may be inconsistent with the capacity of future generations to pay. If this were to occur Governments may in the future be forced to cut benefits of pensioners by amending current legislation.

10.14 There is evidence that under current arrangements, future superannuation payouts by employers will be substantially higher than at present. Projections made by the Government Actuary indicate that the superannuation contributions in respect of the whole of the New South Wales Superannuation Fund as a percentage of salaries, may be expected to rise from 11.4% to over 20.2% within 29 years (an increase of 77%) and will continue to rise for another decade or so. For individual authorities the rise in costs may be greater.

10.15 The Actuary also made some calculations on the assumption that certain desired changes to the scheme were implemented. He found that employer costs were projected to rise to 23.9% of salaries in 29 years' time compared to 20.2% under the current benefit structure.

10.16 The cost of meeting superannuation benefits is greater when the benefits are paid as a pension instead of as a lump sum at the end of an employee's period of employment. At the present time the Actuary's calculation of the cost of future superannuation commitments is based on an assumption that a high percentage of employees will commute their retirement pension to a lump sum. The introduction of higher taxation on lump sum payments brought down in the 1983 Commonwealth Budget could substantially reduce this percentage. The Actuary has calculated that if no commutations were to occur the employer cost would rise to 27.4% of salaries in 29 years' time and would continue to rise. This is an increase of 140% over current costs.

10.17 At the time when consumers and taxpayers will have to meet the bill for deferred superannuation commitments for current employees, taxpayers will also increasingly have to subsidise benefits to the aged because of an ageing population. Clearly, the overall demographic pattern of the population lends support to this argument. This argument was supported by evidence from Mr Lewis, the General Manager Superannuation, of the Australian Mutual Provident Society:

A. (Mr Lewis) I think as part of the post-war baby boom those people would have to regard their present superannuation, whether it is promised by the parliamentary scheme or an occupational scheme or the public service scheme, or an old age scheme, as insecure in real terms.

Q. Would have to regard them as insecure?

A. Yes. I believe that from the turn of the century the rate at which the retiring population is added to goes up rather more quickly than it will in the next twenty years, and that is when the costs will start to bite ... But the major problem is not so much that which we know, but the fact that in macro-economic terms, as you have indicated, we will have around about the same proportion of population of working age 40 years hence, but we will have perhaps 80 per cent greater proportion of retired age ... We will be moving from about 11 per cent over age 65 to about 18 per cent over age 65, 40 years hence.

10.18 Individual authorities whose level of activity diminishes may also find themselves in a position where they cannot continue without substantial Government subsidy. Such individual cases would exacebate the general trend.

10.19 Whether such outcomes are unlikely or not, the Inquiry noted with interest a submission from union representatives concerning the Pension Fund contributed to by 'Special Employers' under the Local Government Scheme. They expressed concern that their superannuation benefits might not be met at some time in the future because the employers' commitment was not fully funded. The Pension Scheme to which they refer, although not fully funded, is very largely funded, and there is also a legislative requirement for Consolidated Revenue to meet any shortfall should that situation arise. While the Committee is of the firm opinion that guaranteed superannuation benefits of this and all other statutory authorities will be met from some source, it noted that there is concern in some areas because of the absence of adequate funding.

10.20 In relation to the argument about future capacity to pay, it was put to the Committee that when the current workforce retires and has to be paid benefits, the level of wealth in the community as a whole will be independent of whether or not the superannuation commitments were funded or not. Total production and consumption in say 2020 will be the same irrespective of the funding policies pursued and hence the community's capacity to pay will be the same.

10.21 Even assuming the argument in paragraph 10.20 is valid, the problem arises that the relative claims of different sections of the community are very dependent on whether funding does or does not take place. With two sections of the community in competition the pensioners' claims on wealth would be much stronger if their pensions had been fully funded.

10.22 It is difficult to be certain whether or not the cost of superannuation benefits in the future is of such a magnitude as to cause a future Government to cut benefits. However, it is clear that the magnitude of future superannuation commitments is such that this is a possibility. Clearly full funding of superannuation commitments would avoid such a possibility.

10.23 A third argument in favour of fully funding deferred superannuation commitments is that the costs of superannuation can be considerably reduced by investment in appropriate assets. The high returns which have been obtained over long periods by superannuation funds with large investments in ordinary shares and property indicate that the cost of superannuation can be considerably reduced in this way (refer Section 9).

10.24 Finally, a system of financing superannuation on a pay-as-you-go basis, with Consolidated Revenue meeting part of the bill for deferred commitments which the individual authorities cannot afford implies cross subsidies between Government functions not necessarily intended by Government policy. Full funding ensures that the cost and financial implications of benefit changes are fully considered in relation to the financial resources of each authority. Further, Government can also clearly appreciate the full cost of the particular activities carried out by each authority consistent with its program-budgeting strategy.

## Arguments Against Fundinq

10.25 A number of arguments were put to the Committee against the full funding of deferred commitments. One of the major contrary arguments put to the Committee was that the pace of funding was essentially a matter for decision by Government in the context of each year's budget deliberations. The Government should be able to maintain flexibility in deciding to what extent charges for goods and services provided by statutory authorities (and taxation) are to be increased each year. Full funding would take away the Government's prerogative in this area and so interfere with Government policy.

10.26 Another anti-funding argument is that there is no risk to members of public sector superannuation funds as the Government will never be bankrupt, whereas the benefits of employees in the private sector are not risk free. According to this argument there is no compelling reason to accumulate large sums of money to meet future obligations which will always be able to be paid.

10.27 If superannuation commitments are fully funded it would mean that large amounts of capital would be generated either within statutory authorities or placed in investments. This, it is argued, could seriously affect the capital markets. This view was put by Mr Trahair, representing the Institute of Actuaries of Australia.

Q. My first question concerns your view whether statutory authorities should fully fund their superannuation liabilities?

A It could have a material effect on government charges and may effect inflation. It will have a big effect on the capital market and the investment of the securities involved.

Over all, as an actuary, I think the major thing is disclosure of liabilities and reasonable costs. Full funding is not as important ...

10.28 Mr Whittle, representing the Association of Superannuation Funds, put this view regarding the effect of funding on the capital markets.

... the funding of superannuation liabilities would have what might be called, an enormous impact on the capital market .o.

10.29 Questioned about the effect on the capital markets of fully funding superannaution commitments, Mr Renton, Executive Director of the Life Insurance Federation of Australia, stated:

The fact that you have a fund set up in that way does not really create assets in the community. Certainly, you are creating assets but, in order, correspondingly to set up those assets the taxpayer or the electricity. consumers or whatever have been deprived of the corresponding amount of money which in the absence of that fund, would have been invested elsewhere in the system. It is only a bookkeeping exercise and not a real economic wealth exercise.

10.30 The State Bank argued that full funding of superannuation liabilities would have little effect on the capital markets. To illustrate this the Bank considered the effect of suddenly investing $2.5 billion, being a rough estimate of the unfunded past service superannuation liabilities of all New South Wales statutory authorities:

The Bank understands that concern has been expressed 'about the effect on the capital markets of the funding of the past sevice superannuation liabilities of New South Wales statutory authorities. These are estimated to amount to some $2.5 billion, but are only likely to be fully funded over a period of some 20 years.

To gauge the likely impact on capital markets of this we can consider the following figures extracted from the latest available Financial Flows Supplement of the

Reserve Bank of Australia's Bulletin (March 1983). Figs]res are for financial year ended 30 June 1982.

| | $ billion<br>30/6/82 |
|---|---|
| Total Assets of: | |
| Life offices and Pension Funds | 34.4 |
| All Financial Institutions | 203.2 |
| Assets of Life Offices and Pension Funds: | |
| Commonwealth Government Securities | 5.4 |
| Local and Semi-Government Securities | 4.9 |
| Fixed Assets (properties) | 6.4 |
| Ordinary and Preference Shares | 6.9 |
| | 1981/82 |
| Net borrowings: | |
| Commonwealth Government | 0.1 |
| State and Local Governments | 3.7 |
| Corporate Trading Enterprises | 6.4 |

Even if the liabilities were fully funded as at 30 June 1982, and the amount was estimated as S2.5 billion at that date, this would have only represented 7.3% of the assets of Life Offices and Pension Funds and 1.2% of the assets of all financial institutions at that time. Total assets of all financial institutions have grown by 15.2% p.a. on average over the 10 years to 30/6/82 (a low of 11.0% in a year and a high of 22.3% in a year) which would have amounted to $30.9 billion on the 30 June, 1982 level of total assets of financial institutions. The amount of $2.5 billion needs to De seen in this context.

10.31 It is noted that in the illustration provided by the State Bank it is assumed that the $2.5 billion in unfunded superannuation commitments would, if fully funded, become available for investment in one year. In actual fact this will not be so. Current proposals by the Government Actuary contemplate funding over a period of 20 years or more.

10.32 The Committee also took independent advice on this question. This mentioned, in addition, the availability to Australian investors of large overseas capital markets.

10.33 THE COMMITTEE IS SATISFIED THAT:

(A) FUNDING THE UNFUNDED SUPERANNUATION LIABILITIES OF ALL STATUTORY AUTHORITIES, PRESENTLY ESTABLISHED TO BE ABOUT $2.5 BILLION, OVER A PERIOD OF NOT LESS THAN 20 YEARS WOULD NOT HAVE A SERIOUS IMPACT ON THE CAPITAL MARKET;

(B) FULLY FUNDING OBLIGATIONS GENERATED BY FUTURE EMPLOYEE SERVICE WOULD HAVE EVEN LESS IMPACT ON THE CAPITAL MARKET.

10.34 It has also been claimed that fully funding superannuation liabilities may be inflationary (paragraph 10.27). The Committee sought evidence of the effect of amortising the unfunded liability for past service of three authorities over a 20 year period. The impact on prices of the products and services involved were given as 6%, 1%, 0.7%. These increases would be one-off price increases. The effect on prices of fully funding commitments that arise from future service as opposed to the current partial funding arrangement would be less than these. Full funding would therefore not appear to have a major effect on inflation nor would the amortisation of unfunded past service liabilities. It should be noted that if deferred commitments are not being funded in the present they will still have to be met in the future. Hence the inflationary impact of paying benefits is inescapable.

10.35 It has also been put to the Committee that full funding of superannuation commitments is not desirable for those authorities that rely on consolidated revenue for. funding. Mr Renton, Executive Director of the Life Insurance Federation of Australia put the argument this way:

I think it is much less important in the case of the public service proper or instrumentalities which are virtually departments ...... In fact, a case can be made against funding for those just on the basis that it is an empty bookkeeping gesture; you are creating assets in one pocket but they are balanced by liabilities somewhere else in the public sector system as a whole. It may be better that rather than go through that empty gesture and provide a pool of funds with the administrative hassle of how to invest them, one does not do the actual funding. That is not to say that one should not do the calculation as to what the actual cost would be, because I think it is a very important piece of management information, but the ascertaining of the annual commitment and the accrued liability is not in itself dependent on whether the scheme is funded or not.

10.36 Finally, it has been argued that productivity in the economy will increase and that this will offset at least in part, the escalation in the real value of claims by future superannuation beneficiaries. Accordingly, it is suggested that the need to fully fund deferred superannuation commitments is not so pressing. This argument clearly has some merit although it might be argued that benefits that might arise as a result of productivity improvements should be shared by all of the community and not diverted to meet the benefits bestowed upon one sector of the community, namely public service employeeso

Further, that extra productivity is likely to lead to claims for increased employee benefits including certainly claims for higher wages. These claims would in themselves lead to higher costs including higher superannuation costs.

## Practices Elsewhere

10.37 Section 6 described the practices of statutory authorities in other states and overseas. Full funding of superannuation liabilities appears to be the general practice of statutory authorities in South Africa, New Zealand, the United Kingdom, Canada and the United States of America. For private sector schemes in South Africa, the United States of America and Canada there are specified periods within which any deficits must be funded and this practice is generally followed by statutory authorities.

10.38 In South Australia the position could be described as a fully funded one. In the Commonwealth sphere the intention was for approved authorities to be fully funded through Treasury, although over the last few years it appears that employer contributions have inadvertently fallen short of the required level. Statutory authorities in Victoria, New South Wales and Western Australia have considerable unfunded liabilities. It seems significant that there are currently government inquiries into the matter in Canberra, Victoria and New South Wales and it is understood that the problem is under consideration in Western Australia.

10.39 THE GENERAL PRACTICE OF STATUTORY AUTHORITIES BOTH IN AUSTRALIA AND OVERSEAS APPEARS TO BE ONE OF FULL FUNDING OR OF MOVING TOWARDS FULL FUNDING OF SUPERANNUATION LIABILITIES.

Views of Interested Parties

10.40 The Committee also canvassed the view of bodies that made submissions to the Inquiry. The views obtained are summarised in Table 10.1. IT WILL BE SEEN THAT AN OVERWHELMING MAJORITY OF WITNESSES SUPPORTED THE PRINCIPLE OF FULL FUNDING OF DEFERRED SUPERANNAUTION COMMITMENTS.
IT IS APPARENT FROM THEIR COMMENTS THAT THEY WERE MUCH MORE DEFINITE ABOUT THIS IN RELATION TO THE 'COMMERCIAL' STATUTORY AUTHORITIES.

| Table 10.1 | Summary of Views put to the Committee |
|---|---|
| Institute of Actuaries | Funding not essential; disclosure, of liabilities and costs more important. |
| Life Insurance Federation of Australia | Funding for 'commercial' authorities essential; not essential for authorities funded by consolidated revenueo |
| The Association of Superannuation Funds of Australia | Uncommitted - funding bas advantages and disadvantages; disclosure should occur. |
| The Australian Society of Accountants | Funding necessary. |

Table 10.1 (Continued)

| | |
|---|---|
| Assistant Government Actuary | Funding should occur, especially for self-financing (commercial) authorities. |
| State Superannuation Board | Uncommitted - a matter of government policy. |
| NSW Retirement Board | Supports full funding. |
| Local Government Superannuation Board | Supports full funding. |
| University of NSW | Supports funding, if funds available. |
| University of Sydney | Supports funding for commercial authorities; for other authorities if funds available. |
| Higher Education Board | Supports funding if funds available. |
| Maritime Services Board | Supports funding; have already increased annual funding. |

Table 10.1 (Continued)

| | |
|---|---|
| Government Insurance Office | Supports funding for commercial authorities; recognition of costs important for all authorities. |
| State Rail Authority | Funding not necessary. |
| Metropolitan Water Sewerage and Drainage Board | Supports funding; have increased funding. |
| Sydney County Council it is currently fully funding its commitment. | Supports funding; |
| Electricity Commission | Supports funding. |
| Dairy Industry Marketing Authority | Uncommitted. |
| State Bank of NSW | Supports funding. |

THE COMMITTEE IS OF THE VIEW THAT THERE IS A STRONG CASE FOR FULL FUNDING OF DEFERRED SUPERANNUATION OBLIGATIONS ESPECIALLY FOR THE 'COMMERCIAL' AUTHORITIES WHICH CHARGE FOR THEIR GOODS AND SERVICES.

Method of Funding

10.42 The method of funding must depend on the manner in which the authority is financed. The State Rail Authority is the major example of an authority which depends to a large extent on government subsidies for its revenue. Presumably its charges have reached the maximum level that the traffic will bear, and any further cost increases will require an increase in the government subsidy. It is considered that as far as this Authority is concerned the liability should be funded; but funded by payments to Treasury as is done in South Australia.

10.43 If Treasury chooses to use these funding payments to meet the subsidy increase, the exercise, from the Treasury point of view, has the appearance of a book entry. However, from the point of view of the SRA, extra revenue is received, and used formally to pass the commitment for superannuation to Treasury and as a result the true cost of that Authority's operations is recognised. This Would deal with a large part of the unfunded liability connected with the Retirement Fund.

10.44 IT IS THE VIEW OF THE COMMITTEE THAT AUTHORITIES WHICH ARE SUBSTANTIALLY SUBSIDISED FROM CONSOLIDATED REVENUE SHOULD BE PERMITTED TO FUND THEIR LIABILITY IN THIS WAY BY PAYMENTS TO TREASURY. THE GREAT VALUE OF THIS COURSE IS IN HELPING TO SHOW THE FULL COST OF TAXPAYER SUBSIDY OF THE SERVICE PROVIDED.

10.45 The universities and colleges of advanced education are in a similar situation to the State Rail Authority in that they are dependent on government grants to meet their expenditure. In their case however it is the Australian Government. This does not in the Committee's view alter the situation. The universities and colleges should fund their superannuation liabilities. Whether this is done through a separate fund, or through payments to the Ministry of Finance in Canberra is a matter for the Australian Government. The latter method, which is similar to that proposed above for the State Rail Authority, is the method adopted by the Australian government for the Canberra College of Advanced Education and is presumably a method acceptable to them.

10.46 It would not result in any immediate' cash outlays by them, but would formally pass the commitment for future superannuation payments to the Ministry of Finance of the Australian Government, and would permit the true costs of the universities and colleges to be recognised. This would deal with some hundreds of millions of dollars of the unfunded liability in connection with the State Superannuation Scheme and other schemes.

10.47 THE COMMITTEE THEREFORE CONSIDERS THAT AUTHORITIES WHICH ARE SUBSTANTIALLY FINANCED FROM COMMONWEALTH GRANTS SHOULD SEEK APPROVAL TO FUND THEIR LIABILITY BY PAYMENTS TO THE COMMONWEALTH DEPARTMENT OF FINANCE. '

10.48 The remaining authorities are commercial type authorities whose income is obtained largely from charges made for services rendered or goods produced. Steps to fully fund the superannuation liability over a period of years will mean higher charges than normal for superannuation over that period. However the Committee regard this as a preferable alternative to ignoring the situation, since this would result in much higher superannuation costs in due course.

10.49 Some of these commercial-type authorities, such as the Government Insurance Office, already meet their superannuation liability by payments to Treasury. From a statutory authority's funding point of view this is satisfactory in that it has met its liability; from the Government's point of view the payments reduce its immediate borrowing requirement. This is the system adopted with approved authorities under the Commonwealth Superannuation Scheme.

10.50 Clearly if all the authorities were to adopt this approach, some large amounts would be involved resulting in increasing commitments for future budget expenditure. One might well ask why, if the employer's unfunded liability (i.e. the major part of their liability) is dealt with in this way, should not their normal contributions to the State Superannuation Fund, and for that matter the employee's contributions, also be paid to Treasury? Such a method of financing charges current customers of the authority with the cost and, if State borrowings are not. reduced, lowers the current taxation burden by transferring at to a later generation. If taxation is unaffected, State

borrowings are reduced by the amount of the contributions and the cost of the borrowings to Treasury is the rate of interest used in calculating the contribution. It would be unfair to an authority's customers if the employer's contribution paid to Treasury were based on a lower rate of interest than that which would be earned if the contributions were placed in the hands of professional fund managers. Yet if the latter rate were used, as it should be, it would be expensive borrowing for Treasury.

10.51 A similar situation arises if authorities who traditionally borrow from the public choose to invest in their own business the funds which are set aside for superannuation, thus reducing their external borrowingso Ignoring the question of members' security, there are economic arguments against this procedure. As discussed' in Section 9, it is recognised that if the funds were invested in a portfolio of assets (property, shares, etc) the effective return obtained, including capital gains, would exceed the rate of interest paid by the authority on its loans. The higher earnings thus obtained would reduce significantly the cost of superannuation. It is therefore in the interests of both the authority and of its customers to have superannuation provisions backed by an earmarked portfolio of appropriate superannuation assets.

10.52 The magnitude of the cost involved in investing in an authority's loans rather than in an appropriate portfolio of superannuation fund assets is indicated by figures produced to the Economic and Budget Review Committee of the Victorian Parliament and quoted in paragraph 9.21 of this report. A policy of investing largely in government and semi-government authorities was estimated to have cost twelve authorities $575 million in the last few years alone.

10.53 THE COMMITTEE THEREFORE CONSIDERS THAT AUTHORITIES WHICH ARE LARGELY FINANCED BY CHARGES FOR SUPPLYING GOODS AND SERVICES SHOULD FUND THEIR LIABILITY EITHER THROUGH PAYMENTS TO A FUND (INCLUDING THE RELEVANT PUBLIC SECTOR SUPERANNUATION FUND) OR THROUGH THE ESTABLISHMENT OF EARMARKED INVESTMENTS HELD BY THE AUTHORITY FOR THAT PURPOSE. IT MUST BE RECOGNISED THAT SUCH EARMARKED ASSETS ARE HELD TO COVER SPECIFIC SUPERANNUATION LIABILITIES AND IF DISPOSED OF MUST BE REPLACED BY OTHER EARMARKED ASSETS OF EQUAL VALUE.

Funding Unfunded Liabilities for Past Service

10.54 In South Africa deficits must be amortized over a period of up to ten years. In the United States of America maximum periods are, for initial unfunded liabilities 40 years, for subsequent changes 30 years, add for actuarial gains or losses between investigation dates 15 years. There is some relief if substantial business hardship would occur, or if the requirements were adverse to plan participants in the aggregate. The aim is to amortise over a period not exceeding the expected remaining working lives of the participating members.

10.55 THIS APPROACH IS NECESSARY IN THE PRIVATE SECTOR. IT IS APPROPRIATE TOO IN THE PUBLIC SECTOR WHERE THE AMOUNT OF THE UNFUNDED LIABILITY IS SMALL. THE COMMITTEE CONSIDERS THAT THE MAGNITUDE OF THE UNFUNDED LIABILITY FOR PAST SERVICE IN THE CASE OF N.S.W. STATUTORY AUTHORITIES IS SO LARGE THAT THIS APPROACH WOULD IMPOSE TOO HEAVY A BURDEN ON CONSUMERS OVER THE NEXT DECADE OR TWO.

The Minimum Level of Funding

10.56 The new entrant fully funded contribution under the State Superannuation Scheme is calculated to be 15.2% of salaries. It therefore seems inequitable that current consumers should only be providing (as they are) 11.4% of salaries and thus forcing the next generation of consumers, and all generations thereafter, to pay something in the order of 22% of salaries. It seems just as inequitable however, to require consumers now to provide 30% or more of salaries (as recommended by the Government Actuary -see the final column of Table 4.6) in order to make up for the shortfall which has arisen over past years. The aim of these recommended contributions is to bring the contributions of later generations eventually back to the 15.2% which should have been the contribution rate throughout.

10.57 The Committee is of the view that no generation should be required at any time to pay as much as the projected 22% to which costs would eventually rise if present arrangements were to continue. Equity would seem to demand the payment from now on of a level percentage of salaries thus spreading the liability for past service equally over all future consumers, not merely those during the next 20 years. This would mean a payment greater than the present 11o4%. The payment should of course not be less than the year's normal outgo and should not be less than the rate required to cover future service see paragraph 4.20 and column 4 of Table 4.6).

10.58 Equally however it should not exceed the projected eventual rate of about 22%. The appropriate rate would have to be worked out by the Government Actuary for each authority taking into account its estimated staff growth, and would be reviewed at each future investigation. The required rate would not be much above the recommended future contribution rate shown in Table 4.6. It would only be a modest amount greater than the fully funded new-entrant contribution rate and would be much less than the total of the past service contribution and the future service contribution recommended by the Government Actuary.

10.59 The Committee therefore considers that the liability for future service and the unfunded liability for past service should be dealt with together by the payment in the future of a level contribution (as a percentage of salaries). This level contribution would be determined separately for each authority. Under this arrangement there would be no special additional payment to amortise the past service liability over a limited period such as 20 years. The past service cost would in this way be spread over all future generations. THE COST OF ANY FUTURE BENEFIT CHANGES HOWEVER SHOULD BE FUNDED DURING THE PERIOD OF FUTURE SERVICE OF THE STAFF CONCERNEDo

10060 For a numerical illustration of this approach to funding consider the figures for the Electricity Commission of NSW. The net unfunded past service liability is shown in Table 4.5 as $224 million. The recommended future service contribution is given in Table 4.6 as 17.5% of salaries and an extra contribution for the next 20 years of 14% of salaries is recommended in Table 4.6 to amortise the past service liability of $224 million. Under this approach contributions would immediately jump to a high 31.5% of salaries and remain at about this high level for 20 years when they would fall suddenly to about 15-16% of salaries. Under the funding proposal in paragraph 10.59 both future service and past service liability would be met by a level contribution higher than 17.5% but probably not greater than 20%. in dollars and based on the salaries of contributors to the State Superannuation Fund at the time (June 1982) of $93.5 million, the Government Actuary's funding proposal would result in a jump in total employer payments from about $10 million to nearly $30 million. Under this funding proposal they would rise to under $19 million. These figures are for the State Superannuation Scheme only but for comparison of magnitudes it should be noted that Elcom's long service leave provision at June 1982 was $66 million.

10.61 If the Government Actuary's recommendations were adopted the unfunded liability for past service would still rise for a time, as the early payments are not large enough to cover interest on that liability. Under the proposal just outlined, the unfunded liability for past service will continue to rise for many years before it begins to fall. Authorities in a position to do so may therefore consider it desirable to contribute at a higher rate than that proposed in the above paragraphs in order to hold back this rise in their past service liability. There is an argument for doing this, namely that current consumers are largely those who have benefited somewhat from the unduly low superannuation contributions of recent years. However, the Committee is of the opinion that the question of any such supplementation payments should be left to the discretion of individual authorities. The formula of paragraphs 10.56 to 10.60 is put forward as a minimum funding requirement.

10.62 THE COMMITTEE'S VIEWS ON THE FUNDING OF SUPERANNUATION COMMITMENTS MAY BE SUMMARISED AS FOLLOWS:

(i) STATUTORY AUTHORITIES SHOULD FULLY FUND THEIR SUPERANNUATION COMMITMENTS;

(ii) AUTHORITIES LARGELY DEPENDENT ON TREASURY SUBSIDIES SHOULD PAY THEIR CONTRIBUTIONS TO

CONSOLIDATED REVENUE WHICH NEED NOT FUND TO MEET THE BENEFIT PAYMENTS;

(iii) EDUCATIONAL AUTHORITIES SHOULD SEEK APPROVAL TO PAY THEIR CONTRIBUTIONS IN A SIMILAR MANNER TO THE COMMONWEALTH DEPARTMENT OF FINANCE;

(iv) COMMERCIAL AUTHORITIES SHOULD BACK THEIR SUPERANNUATION LIABILITIES BY EARMARKED ASSETS OR PREFERABLY BY PAYING THEIR CONTRIBUTIONS TO A SEPARATELY CONSTITUTED FUND, INCLUDING THE RELEVANT PUBLIC SECTOR SUPERANNUATION FUND;

(v) THE UNFUNDED LIABILITY FOR PAST SERVICE IN THE CASE OF THE NSW STATUTORY AUTHORITIES IS SO LARGE THAT TO AMORTISE IT OVER A LIMITED PERIOD OF YEARS, AS GENERALLY REQUIRED IN THE PRIVATE SECTOR AND OVERSEAS IN THE PUBLIC SECTOR, WOULD IMPOSE TOO HEAVY A BURDEN ON CONSUMERS OVER THE NEXT DECADE OR SO;

(vi) THE LIABILITY FOR FUTURE SERVICE AND THE UNFUNDED LIABILITY FOR PAST SERVICE SHOULD BE DEALT WITH TOGETHER, BY THE PAYMENT IN FUTURE OF A LEVEL CONTRIBUTION (AS A PERCENTAGE OF SALARIES). THIS LEVEL CONTRIBUTION WOULD NEED TO BE DETERMINED BY THE GOVERNMENT ACTUARY SEPARATELY FOR EACH AUTHORITY;

(vii) THIS SHOULD BE REGARDED AS THE MINIMUM LEVEL OF FUNDING. UNDER IT THE PAST SERVICE LIABILITY WILL CONTINUE TO RISE FOR SOME YEARS. AUTHORITIES IN A POSITION TO DO SO MAY THEREFORE CONSIDER IT DESIRABLE TO CONTRIBUTE AT A HIGHER RATEo SUCH ADDITIONAL

PAYMENTS SHOULD BE AT THE DISCRETION OF INDIVIDUAL AUTHORITIES:

(viii) THE COST OF ANY FUTURE BENEFIT CHANGES SHOULD BE FUNDED DURING THE PERIOD OF FUTURE SERVICE OF THE STAFF CONCERNED.

APPENDIX 1

MAJOR RULE-MAKING INITIATIVES: ACCOUNTING FOR SUPERANNUATION COMMITMENTS

'Private Sector'

1948 American Institute of Accountants, Accounting Research Bulletin No. 36.

* The amount of 'past service obligations' arising on the adoption of a plan could not be charged against retained earnings or against current income in the year that plan was adopted, but should be amortised as an expense of current and future years.

1960 Institute of Chartered Accountants in England and Wales, Statement N21, 'Retirement Benefits'.

* There should be disclosure by way of note of any guarantees associated with retirement benefit schemes 'if the amount is or may become material'
* Provision should be made for material obligations to provide retirement benefits.

1965 Canadian Institute of Chartered Accountants, CICA Bulletin No. 21.

1966 United States of America: Accounting Principles Board Opinion No. 8

* Pension expense should be recognised as it accrues (even though an employer may be entitled to cancel or modify a plan).
* Calculation of the expense should not be limited to amounts for which there is a vested entitlement.
* Calculation of obligations and of expense should be based on actuarial calculations - any actuarial cost method that spreads expense systematically over employees' working lives.
* The expense associated with past service obligations arising at inception or improvement of plan should be allocated over future years (not charged against retained earnings)o

1980 United States of America: Statement of Financial Accounting Standards No. 36, "Disclosure of Pension Information" (amending APB 8)

- extended the list of footnote disclosure items for defined benefit plans by requiring disclosure of
  * the actuarial present value of vested accumulated plan benefits
  * the actuarial present value of nonvested accumulated plan benefits
  * the plans' net assets available for benefits
  * the assumed rates of return used in determining the actual present values of vested and nonvested accumulated plan benefits
  * the date as of which the benefit information was determined

1981 United Kingdom Companies Act included rules for the disclosure of pension commitments - Schedule 1(50)(4) - which

* required disclosure of particulars of pension commitments

(a) included under any provision shown in the company's balance sheet

(b) for which no provision has been made.

(NB These requirements may have been designed to encourage the accounting profession to address the problem of calculating superannuation expenses, and the amount of liabilities).

required separate disclosure of pension commitments relating wholly or partly to past directors of a company.

1982 United States of America: Financial Accounting Standards Board published its 'preliminary views' on accounting for pensions (and revision of the 1980 Statement of Financial Accounting Standards No. 36):

* Calculation of pension benefit obligations for defined benefit plans should have regard for estimated future salary increases.

* There should be disclosure on the face of a plan-sponsor's balance sheet (rather than in footnotes) of the net pension liability (pension benefit obligation, less plan assets measured at 'fair value', plus or minus a 'measurement valuation allowance')~

* Balance sheets should carry an intangible 'asset' representing the unamortised cost of past plan amendments (or the 'cost' of initiating a plan) where credit was granted for employees' past service.

(NB Proposals to establish a 'measurement valuation allowance' and to amortise the cost of plan improvements were designed to 'smooth' the pattern of charges for superannuation expenses).

1983 Institute of Chartered Accountants in England and Wales issued an 'Exposure draft' (ED 32, May 1983) which was of very limited scope, relative to North American requirements. It was only concerned with 'disclosure' and avoided prescribing methods of calculating expense. It

* proposed disclosure of any deficiency on a 'discontinuance actuarial valuation (i.e. a measure of present solvency of a scheme, calculated by reference to present salary levels, and restricted to vested benefits only).

* avoided prescribing disclosure of actuarial assumptions since these "may not be helpful without disclosure of sensitivity of the valuation to variations in (the assumptions)" and "any meaningful disclosure could be disproportionately long".

* claimed that "regular reporting of changes and prospective changes (in annual contribution rates) provides useful information on the trend of pension costs

1983 International Accounting Standards Committee, IAS 19 (serves as a guideline to member countries, including Australia)

* Proposing that expense should be calculated using either an "accrued benefit valuation method" or a "projected benefit valuation method" - a proposal which leaves a wide range of options open, and only excludes the recording of superannuation expenses on the basis of 'pay-as-you-go' or 'terminal funding' methods.

* permitted the allocation of expenses for past service, 'experience adjustments' or the effects of changes in actuarial assumptions on superannuation costs either to the year in which they arise, or over the expected remaining working lives of participating employees.

1983 Australia: National Companies and Securities Commission 'Green Paper', Financial Reporting Requirements of the Companies Act and Codes:

proposed that listed commpanies and borrowing corporations should disclose (by way of note) particulars of superannuation plans, the extent of 'unfunded past service costs', and particulars of the last actuarial valuation.

'Public Sector'

Recently the Australian accounting profession established a "Public Sector Accounting Standards Board"; this body has yet to produce any statements.

This initiative follows the establishment overseas of bodies with similar objectives - notably a joint United States/Canadian body, the National Council on Governmental Accounting (NCGA), and more recently in the United States of America, a Government Accounting Standards Board.

The NCGA has issued several statements on the subject of pension accounting.

1979 Statement 1 'Governmental Accounting and Financial Reporting Principles'

Stated that pension trust funds are to be accounted for "in essentially the same manner as proprietary funds" (which suggested that accounting treatment should follow rules developed by the accounting profession's Accounting Principles Board or the later-established Financial Accounting Standards Board).

1981 Interpretation No. 4:

Offered a preliminary interpretation of references in Statement 1 to accounting requirements for Public Employee Retirement Systems (in the light of specific private-sector rules): e.g. discussed methods of valuation of marketable securities and other assets held by the funds; required disclosure of market values of those marketable securities; required disclosure of accounting policies; indicated methods to be used to calculate and disclose the actuarial present value of accumulated plan benefits; required separate disclosure of anticipated increases in vested and non-vested accumulated benefits based on projected salary increases.

APPENDIX 2

## SUBSIDIARY ACCOUNTING ISSUES

This appendix outlines the background to the specific accounting recommendations summarised in paragraph 7.53 above. Matters considered here are:

(a) methods of calculating superannuation expense for a given period methods of reporting superannuation commitments in financial statements

### (a) Calculating the amount of unfunded past service costs and periodic superannuation expense

1. As outlined in paragraph 7.34, the calculation of superannuation expense can 'in principle' be undertaken as follows:

| | | |
|---|---|---|
| Amount paid by authority to superannuation fund by way of concurrent contributions, or to pensioners as supplementary benefits | | $XXX |
| Add | | |
| Amount of accounting 'liability' for superannuation at end of year | $XXX | |
| Less | | |
| Amount of accounting 'liability' for superannuation at beginning of year | $XXX | $XXX |
| Superannuation expense of employer for year | | $XXX |

In practice departures from this procedure may be supportable:

(i) where there are major fluctuations in estimates of the amount of unfunded past service costs arising from periodic actuarial reviews or changes in the value of assets held in an external 'fund'

(ii) where a scheme is amended or a new scheme introduced.

(iii) Where employees are transferred from one scheme to another during a period.

2. Moreover there may be transitional arrangements associated with the change from a 'cash' or 'partial accrual' basis to an 'accrual' basis of accounting.

Expense smoothing

3. Periodic actuarial reviews may lead to major revisions in estimates of the amount of unfunded past service costs. An actuarial review may disclose that actual employment experience (staff turnover, mortality, promotion etc.) is not consistent with the assumptions made in a prior actuarial review. Or the actuary may adopt revised assumptions concerning long-term investment returns, salary levels, or inflation. The treatment of the dollar-amount of these revisions as an expense (revenue) of the period in which that estimate became available could lead to some volatility in periodic expenses. It must be recognised that many statutory authorities (in New South Wales and elsewhere) operate in terms of statutory rules or policy guidelines which link their level of 'funding' (in the form of government budget allocations) to budgeted surpluses or deficits for a given year. Other authorities engaged in the sale of services may aim to fix their prices so as to 'break even' or to earn some target rate of return.

Increasing the level of reorded accounting expenses may thus be readily translated into a reduction in the services or an increase in prices. In this context, volatility in expenses could lead to some disloction of the programmes adopted by authorities - and create difficulties for consumers .

4. Accounting practices have been developed to 'smooth' the effect of estimation errors ('experience adjustments') by allocated them over a number of accounting periods (rather than to a single period). One such 'smoothing' technique was recently proposed in the United States of America by the Financial Accounting Standards Board, and involves the creation of a 'Measurement Valuation Allowance' to be amortised over the average remaining service period of active plan participants. The FASB has acknowledged that such 'smoothing' procedures are inconsistent with other well-established accounting procedures whereby changes in the estimated values of assets or liabilities are treated as charges to income in the year in which they are recognised.

5. While, in principle, the calculation of superannuation 'expense' should not be subject to arbitrary calculations, an exception could be made in relation to the treatment of these periodic revisions of the estimated amount of superannuation liabilities. However it would be inappropriate to apply 'smoothing' procedures over an extended period - since this could unduly defer cost-recognition and encourage efforts to manipulate recorded cost data. Such a possibility has been canvassed in the FASB's 'Preliminary Views' document, and in the introduction to International Accounting Standard 3.

One possibility would be to prescribe that revisions of estimates of the amount of unfunded past service costs arising from periodic actuarial reviews need not be treated as an accounting expense (revenue) of the period in which that assessment was undertaken, but might at the discretion of the statutory authority concerned be allocated over a period not exceeding three years.

6. Another source of material changes in the 'amount of unfunded past service costs' could be significant variations in the value of investments held by a fund, or changes in the accounting techniques used to value those investments. This arises since the calculation of the amount of unfunded past service costs necessarily requires an assessment of the extent of existing funding. The Government Actuary currently calculates the extent to which a given authority has funded its contributions to the State Superannuation Scheme on the basis Of the net assets of that Scheme, and for this purpose relies upon reported balance sheet figures of that fund. Some of these figures are based on historical cost data, others on 'current values' For example, real estate is revalued (upwards) periodically while fixed interest securities are retained at book values (which, after a period of rising interest rates, are often less than current market values).

7. The use of current market values by funds could produce fairly volatile balance sheet aggregates, while changing market conditions could lead to variations in the amounts calculated for unfunded past service costs' for individual employer-authorities. On the other hand, selective (rather than comprehensive) revaluations could also distort the calculation of unfunded past service costs.

If the amount of an authority's 'liabilitY' arising from unfunded superannuation commitments was to be reported on a current basis, then in the interests of consistency it would seem appropriate that estimates of the extent of current funding should be based on current market values. Indeed, Section 9 of this report contains recommendations for frequent evaluation of the investment performance of various superannuation funds - which would provide data concerning the current values of assets held by various funds. It must be recognised that use of these values could cause considerable short-term fluctuations in estimates of the net amount of superannuation liabilities - which are in the main long-term commitments. It might be noted that presently estimates made of the amount of an authority's stake in the State Superannuation Fund are based on the values at which those assets are recorded in the SSF's books. Some of these values are obtained from periodic (though not annual) revaluations of Fund assets: properties held by the State Superannuation Scheme are not all revalued each year, but all are revalued on a three-yearly cycle. This practice has the effect of 'smoothing' the effect of short-terms fluctuations in the market prices of property assets, and (if adopted for other assets) might be seen as a reasonable compromise.

Treatment o{ the cost of introducing or amending a scheme

9. The terms and conditions of anew. superannuation scheme may recognise the past service of existing employees - and so give rise to an immediate 'liability' which has not been previously recorded or treated as an expense. When a scheme is 'improved' (e.g. by providing an indexed pension) then that also can give rise to a significant increase in the magnitude of the liability.

10. Some might argue that (for private sector organisations at least) the cost of introducing or improving a scheme reflects a decision made within a particular accounting period, and so should be recorded as an expense of that period. However North American accounting rules permit these amounts to be brought to account over a period of years - and so spread the impact of the increased liability. Recently the FASB has canvassed the possibility of recognising the amount of increased liability immediately, but handling periodic charges through the establishment of an intangible asset-item, to be amortised over the average remaining working life of active employees who are members of that scheme.

11. There has been relatively little examination of these technical accounting issues in the context of public sector organisations. However in the private sector, there have been long standing rules on this matter, principally directed towards prohibiting the charging of any part of the superannuation costs against prior-period surpluses. (See Appendix 1) Recently International Accounting Standard 3 prescribed that the cost of plan improvements should be charged to income at the time the promise of such plan improvements was made (paragraph 48).

12. On the other hand, it could be argued that such a treatment of the costs of improving a plan could have a massive effect on reported costs in a given year. Elsewhere in this report the Committee expressed the view that future proposals for improvements in benefits should be closely examined, and the cost of such proposals assessed. No recommendation was advanced about the manner in which the cost of improvements in benefits should be handled, though in the absence of any recommendation International Accounting Standards 3 would provide guidance.

Transfer of Employees between Schemes

13. There are a variety of circumstances under which an authority's employees may transfer between schemes. The most common circumstances would arise with promotions -where an employee who had contributed to (say) the New South Wales Retirement Fund may move to a staff position carrying with it entitlements to membership of the State Superannuation Scheme. Upon such a transfer the employer would assume a different 'liability" for superannuation: in terms of the accounting procedures outlined in Section 7, these costs would be treated as expenses of the period in which that transfer took place.

14. Other transfers may arise from abnormal circumstances: from the reclassifiction of a large group of staff, perhaps as a consequence of the amalgamation of several authorities. The costs involved with the transfer of staff from one scheme to another may be material. It does not appear that authorities contemplating such changes have been obtaining formal actuariat assessments of the costs involved - despite the fact that the offer of eligibility in a different scheme may involve many millions of dollars. Moreover, given the failure of authorities to record the costs of superannuation accruing in a given year, the costs of these transfers has not been recorded in the period in which they have occurred. The procedures outlined in Section 7 would overcome this anomaly.

Transitional Arrangements

15. Few authorities have reported the full amount of their superannuation commitments as liabilities in their financial statements. The transition to the systematic adoption of accrual accounting for superannuation raises the question of how the accumulated liability should be treated when those obligations are first recognised. The choice is between (a) regarding those previously unsecured expenses as an expense of the year when they are first recognised, or (b) treating those amounts as charges against accumulated funds.

16. The comments made earlier concerning the desirability of minimising the volatility of recorded expenses of statutory authorities by 'smoothing' the effect of revised actuarial estimates would apply with even greater force to the transition to full accrual accounting. The propriety of treating part of a statutory authority's accululated liability for superannuation commitments as a charge against prior periods rather than against current or future periods is of considerable significance, particularly for those organisations which are involved in trading activities and which endeavour to price their services at a level which meets their operating costs. The choice of accounting treatment will not affect the level of cash payments which will have to be made by those authorities. But (all other things being equal) the choice of accounting technique would have a considerable effect on their reported expenses.

17. Guidance on this issue can be obtained from both Australian Statements of Accounting Standards, and International Accounting Standards.

(as amended June 1981) establishes a requirement that gains or losses (whether of revenue nature) should be taken into account Profit and Loss Statement,

(a) irrespective of whether they are attributable to the ordinary operations of the business entity during the period, or to events or' transactions outside those operations; and

(b) even though they may relate to prior periods

However clause 19 of this Statement recognises that in certain circumstances the treatment of some items as charges against prior periods is justified:

Where a business entity changes an accounting method in order to comply with a statutory requirement or with an accounting standard either of which specifically requires the making of an initial accounting entry to give retroactive effect to the changed method of accounting, the resulting gain or loss should be adjusted directly against retained profits or accumulated losses as at the beginning of the period in which the change is made, and adequate disclosure should be made in the financial statements or notes on them.

19. Similar provisions are set forth in International Accounting Standard 8. IAS 8 distinguishes changes in accounting policies and changes in accounting estimates; the latter are to be treated as charges to income in the period of change (or in the period of change and future periods if the change affects both). As for changes in accounting policies, IAS 8 asserts that these should only be made:

if the adoption of a different accounting policy is required by statute or by an accounting standard setting body or if it is considered that the change would result in a more.appropriate presentation of the financial statements of an enterprise.

The adjustments associated with changes in accounting policies should be either

(a reported by adjusting opening retained earnings in the financial statements for the current period and amending the comparative information in respect of prior years which is included in the financial statements, or

(b separately disclosed in the current income statement as part of net income.

20. Since the transition to full accrual accounting is required by recent statutory amendments, both AAS 1 and IAS 8 indicate that the initial recording of unfunded past service costs (or charges to top-up existing provisions for superannuation) as to to fully record the liability existing at the beginning of the accounting period in which that change is made, should be treated as a 'prior period adjustment'. This treatment would also ensure that future charges for superannuation costs would only record the expense accruing in those future periods. Future payments to an external fund would be treated as a reduction of the disclosed liability (since such cash payments reduce the extent to which these commitments are 'unfunded').

21. While full balance sheet recognition may lead some authorities to record an accumulated 'deficit', this only arises from prior systematic understatement of superannuation expenses.

## Reporting superannuation commitments in financial statements

22. A study of the requirements (or proposed requirements) of government agencies and accounting standard-setting bodies indicates that there is some general agreement about the desirability of disclosing:

* information about an organisation's association with a superannuation scheme
* the date of the last actuarial review of the superannuation scheme

Somewhat more contentious are requirements for the disclosure of

* particulars of actuarial methods used to calculate the amount of expense or 'unfunded past service' (and any changes in those assumptions)
* particulars of actuarial assumptions adopted in the calculation of the amount of expense or the amount of unfunded past service
* some indication of the sensitivity of the calculation of the amount of unfunded past service to changes in those assumptions
* particulars of 'vested' and 'unvested' benefits

These issues will be reviewed briefly.

23. The proposition that organistions reporting superannuation commitments should disclose particulars of the actuarial methods used to calculate the amount of those commitments has been incorported in some United States rules (see, e.g. Interpretation 4 and Statement 6 of the National Council on Government Accounting). Other rules or proposals have only involved disclosure if there has been a change in actuarial methods which have materially affected the calculated commitments (see, e.g. the United States of America's Securities and Exchange Commission's requirements for Form 10-K filings). It has been argued that such disclosures would only be meaningful to a few expert readers of financial reports (an objection which could of course be equally applied to many other complex accounting or reporting techniques). However if the current proposals of the FASB were followed, so that all firms calculated their superannuation 'liability' and expense using an accrued benefit method based on projected salaries, the significance of disclosing actuarial methods would be lessened.

24. The suggestion that reporting entities should disclose the key assumptions used in actuarial calculations has been more widely supported., particularly in North America (see, e.g., the requirements of the Securities and Exchange Commission, and the NCGA's Interpretation 4 and Statement 6). Recently the FASB invited comments on whether information about actuarial assumptions should be disclosed, and reported that respondents 'generally favoured disclosure of the assumed interest rate (or rates)' However 'respondents were divided on whether actuarial assumptions other than the interest rate should be disclosed' ('Preliminary Views', page 24).

25. After considering these responses, the FASB concluded that interest rate and salary increase assumptions should be disclosed:

[The Board] noted that those two disclosures have the most significant impact on the amounts in the financial statements, that they are related to each other, that they differ among employees, and that their effect on the financial reports is generally relatively easy to understand.

The FASB did not require disclosure of projected changes in general price levels (inflation)- which when read in conjunction with proposed investment nominal returns would indicate expected 'real' returns.

26. On the other hand, the National Council on Government Accounting recently proposed footnote disclosures of the following information:

> Significant assumptions used in the actuarial valuations, including the rate of return on the investment of present and future assets, projected salary increases (due to merit, seniority and promotion), pre- and post-retirement mortality, rates of withdrawal from active service before retirement for reasons other than death, rates of disability and expected retirement ages.

Significant changes affecting financial reporting comparability with prior years, including changes in benefits, actuarial cost assumptions or actuarial methods; also the effect of such changes on the funding requirement determination for the period covered by the financial statement. (Statement 6, 1983)

27. While there seems fairly strong support for disclosure Of at least some key assumptions, a different view has been expressed in the 1983 United Kingdom exposure draft. The authors of this document suggested that this information would not be meaningful unless there was also disclosure of the sensitivity of the calculations to the choice of' assumptions (an option it dismissed as likely to require disproportionately long explanations). Significantly, .there has been considerable support for the very form of disclosure that this United Kingdom document rejected: disclosure of the sensitivity of the calculations to variations in assumptions - particularly variations in the assumed interest rate.

28. The Financial Accounting Standards Board reported that information provided to it indicated that individual actuaries could develop estimates of the present value of projected benefits of identical pension plans with variances of 20 to 25 percent ('Preliminary Views', paragraph 120). However it seems likely that this estimate is conservative. The calculations may be very sensitive to a variation in the interest rate assumption alone. While the effect of a change in interest rates will depend upon such matters as the age distribution of employees, it has been suggested that a variation in the real interest rate of plus or minus 1% could affect the present value of projected benefits by 20% to 25% (and have an even greater effect on the amount of unfunded past service cost).

29. Some indication of the impact of variations in interest rates was provided in actuarial reports provided by the Government Actuary at the request of the Electricity Commission of New South Wales. The Government Actuary had undertaken his review of the Commission's liability under the New South Wales Retirement Fund on the assumptions of interest earnings of 12% and inflation of 10% and salary growth of 10.5%. At the request of the Commission, thes~ calculations were re-run with a nominal interest rate 2% higher and other rates unchanged. This had the effect of reducing the net liability from $256 million to $154 million - a reduction of approximately 40%.

30. It was noted that the cost.of obtaining information which incorporated in footnote disclosures would provide some indication of the sensitivity of the liability calculation to the key assumptions would be minimal: it would only require some additional computer time.

31. Another disclosure issue concerns the status of benefit entitlements. Several United States requirements (the Securities and Exchange Commission's rules, Statement of Financial Accounting Standards No. 35, and Interpretation 4 of the National Council on Government Accounting) have required disaggregation of the actuarial present value of accumulated plan benefits between 'vested' and 'nonvested' entitlements. (An employee's right to receive benefits from a retirement benefit scheme is said to be 'vested' when it is no longer contingent upon his reamining in the service of the employer). The emphasis on 'vested' entitlements can be linked with the debate about liability recognition: it has been argued that the extent of the accounting 'liability' is limited to 'vested benefits'. However, given that the accounting concept of 'liability' is to be interpreted as relating to probable future sacrifices then the distinction between vested and non-vested entitlements is of little significance except in situations where an organisation is not regarded as a 'going concern'

PHOTOGRAPH OF MEMBERS

*From left:* John Murray, Bob Carr (Chairman), Peter Collins, Colin Fisher, John Aquilina (Vice Chairman).

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