

REPORT OF PROCEEDINGS BEFORE

GENERAL PURPOSE STANDING COMMITTEE No. 1

**INQUIRY INTO THE REVIEW AND MONITORING OF
THE NEW SOUTH WALES WORKERS COMPENSATION
SCHEME**

At Sydney on Thursday 14 February 2002

The Committee met at 10.00 a.m.

PRESENT

Reverend the Hon Fred Nile (Chair)

The Hon Michael Gallacher
The Hon Tony Kelly
The Hon Greg Pearce
The Hon Henry Tsang
The Hon Dr Peter Wong

This is a privileged document published by the Authority of the Committee under the provisions of Section 4 (2) of the Parliamentary Papers (Supplementary Provisions) Act 1975.

[The committee had earlier taken evidence in camera]

CHAIR: I welcome the media and members of the public to the hearing of General Purpose Standing Committee No. 1 inquiring into the review and monitoring of the New South Wales workers compensation scheme. I advise that under Standing Order 252 of the Legislative Council any evidence given before the Committee and any documents presented to the Committee that has not yet be tabled in Parliament may not, except with the permission of the Committee, be disclosed or published by any member of such committee or by any other person. A copy of the guidelines governing broadcast of the proceedings are available on the table near the door.

JOHN JOSEPH DELLA BOSCA, Special Minister of State, Minister for Industrial Relations, Assistant Treasurer, Minister Assisting the Premier on Public Sector Management, and Minister Assisting the Premier for the Central Coast appeared before the Committee:

CHAIR: Are you conversant with the terms of reference of this inquiry?

The Hon JOHN DELLA BOSCA: Yes, I am.

CHAIR: If at any stage during your evidence you should consider that in the public interest certain evidence or documents you may wish to present should be heard or seen only by the Committee, the Committee would be willing to accede to your request. You can actually ask us to go into camera and the Committee would have to consider your request then.

The Hon JOHN DELLA BOSCA: Thank you.

CHAIR: One of the matters concerning the Committee is the conflicting information we were getting from actuaries, so some questions relate to those technical questions. Regarding acceptance of Tillinghast's advice, during 2001 and up until late November 2001 did you accept Tillinghast's advice regarding the financial impact of the reforms?

The Hon JOHN DELLA BOSCA: Yes. Tillinghast is the scheme actuary. For obvious reasons the acceptance of their advice is based on the fact that they are the appointed scheme actuaries. The second issue is that in relation to your introductory remarks and the issue of actuaries, the actuarial profession, as I understand it, is a profession whose science is based on provision of estimates and it is always important for someone in a position of public responsibility like this Committee and like myself to be empirical about these matters, but given that I am the Minister and that they are the scheme actuaries and I am the Minister for the scheme, I had to give quite high weight to advice that the formal scheme actuaries were giving the Government or the WorkCover board.

CHAIR: During 2001 and up until late November 2001 before the reform bill was presented in Parliament, did WorkCover, either verbally or in writing, inform you that they agreed or disagreed with Tillinghast' actuarial advice?

The Hon JOHN DELLA BOSCA: I cannot recall any specific advice that I received from WorkCover but I have had a large number of discussions over the last 18 months with senior officers of WorkCover, including Ms McKenzie's predecessor as well as Ms McKenzie as well as other senior officers of WorkCover to the effect that the actuarial estimates that the Government has given and that the scheme has given are normally on the conservative side of the argument, that is, in regard to estimations the scheme actuaries will tend to err on the side of caution in making any estimations.

The Hon GREG PEARCE: Does that mean the deficit is worse or better?

The Hon JOHN DELLA BOSCA: I think from the sense of the question I mean that if actuaries are warning about a potential problem they will underline that problem. That is the general tone of advice I have had from WorkCover but also from other actuaries and from people in the insurance industry.

CHAIR: Just to make it clear, WorkCover itself never expressed any doubts or reservations about Tillinghast's advice to you during that time?

The Hon JOHN DELLA BOSCA: Only in the general terms that I have already said, that we have taken the view that the scheme actuary has an obligation—I think anybody in the context of recent world, if not

Australian, events with HIH, which relates to auditors rather than actuaries, but anybody in the financial estimation or review professions has to be very cautious. We have had the Enron issue and the HIH issue, so therefore one makes the assumption that responsible auditors, responsible actuaries and responsible professionals are being cautious in their advice.

CHAIR: During 2001 were you aware of the five scenarios that Tillinghast used to cost the reforms and that some of the scenarios indicated that the reforms would increase the cost of the scheme and not reduce the cost?

The Hon JOHN DELLA BOSCA: Yes I was. It is important to understand that in relation to those five scenarios, during the public debate over the scheme reforms some of those scenarios became irrelevant as the debate itself changed its nature, but I was aware of those scenarios.

CHAIR: At whose suggestion was it to include only one or two of the five scenarios?

The Hon MICHAEL GALLACHER: The best one.

The Hon JOHN DELLA BOSCA: A range of WorkCover senior officers and the actuaries had a number of discussions about these matters. I think it is important to understand that ultimately the decision to include two in the report was Tillinghast. There were discussions between senior officers of WorkCover and Tillinghast, which were mutual discussions, based on which scenarios were most likely to give a clear picture, both from a public perspective, a scheme perspective and a government perspective. A short summary of the two scenarios, which is a very crude way of putting it so I will be careful in the way I put it, is the way in which WorkCover and the Government anticipated that if the scheme reforms were to work—and the expression used in the report is—

The Hon GREG PEARCE: We all wonder whether they will work.

The Hon JOHN DELLA BOSCA: I accept the member's interjection, but it is one of us and them. "Targets most likely to be achieved" is the terminology that the actuaries used. One scenario estimates the targets from the scheme's point of view by saying, "If these reforms work this is what will happen." The other scenario is more pessimistic about those targets. One is the conservative view that I suggested actuaries may tend to take when providing advice to a scheme and one is the view of the scheme.

The Hon MICHAEL GALLACHER: Is that an accepted practice of actuaries that has been going on for some time or is this a new process?

The Hon JOHN DELLA BOSCA: Mr Gallacher will have to ask actuaries about that. I am not a member of that profession and have no capacity to answer that.

The Hon MICHAEL GALLACHER: Minister, would you not be concerned that there is some consistency in the advice that is being given to your Government since you came to power in 1995, what is likely to happen and what is not likely to happen? Since 1995 we have seen a continual rapid deterioration in the scheme and now we are told, many years later, that we have had to make these changes and the Government has had access to this information. What has the Government been doing with this information since 1995 if that is the information that you have been given in terms of a likely scenario?

The Hon JOHN DELLA BOSCA: Just to make it clear in terms of the publicly available information in regard to actuarial assessment of the scheme, the scheme is transparent to the effect that there is an official scheme actuary, which is the conventional approach with schemes like this or with insurance underwriting books. The scheme actuary has changed on at least one occasion in the last few years. Tillinghast became the scheme actuaries 2½ years ago. Prior to that it was Towers Perrin. I think Mr Gallacher would be aware of that.

The Hon MICHAEL GALLACHER: Trowbridge. I was aware of it.

The Hon JOHN DELLA BOSCA: I got tongue-tied and said the wrong one. The scheme reports on a six monthly basis as to its financial fundamentals and on a quarterly basis to the board. It is important to understand that that has been a transparent process. Those reports are available to the Parliament, as Mr Gallacher knows. They are available in the public arena. There is no level of secret information passed on to the Minister or to anybody else by the scheme actuaries so any information that Parliament has is also information the Minister has. In addition, the advisory council has engaged actuarial advice, which again makes quarterly reports about scheme

trends. Indeed, it has made some reports more often than that. Previously, the actuary that performed those tasks for the advisory council was Mr David Zaman, a private actuary, and it is currently Mr John Walsh of Pricewaterhousecoopers. That is the sum total of formal actuarial advice that WorkCover or the Government would get in that sense. From time to time the board or the Minister, with the agreement of the board, could ask the scheme actuary or another actuary to make a report and, as members of the Committee are aware, Pricewaterhousecoopers also made an evaluation of the report looking at certain specific scheme issues.

All of that advice has been in the public arena from the time or very shortly after the Government received it. I think it is a fair observation, without any disrespect to the actuarial profession, to say that because of the nature of the actuarial profession and the issues that are dealt with, three actuaries given similar assumptions and similar numbers will come up with perhaps broadly similar trends but may come up with widely different opinions as to the way a given scheme is performing or the numbers in relation to issues like deficits, surpluses, average projected premium levels and so on. It is important to consider that because from the line of questioning I think there is concern that some information has been concealed from the Parliament. That is not the case.

CHAIR: With the five scenarios, was that a new approach by the actuaries. Mr Gallacher mentioned 1995. They had not been producing that type of approach previously?

The Hon JOHN DELLA BOSCA: It is important to understand those five scenarios were produced in the context of the reform debate so the only job that the scheme actuaries have from year to year or six months to six months is to produce their valuation report on the scheme.

CHAIR: It was a new approach to get the five scenarios?

The Hon JOHN DELLA BOSCA: That is right. The five scenarios emanate from a request to review what were the likely impacts of the scheme reforms and the decision to then finally report on two scenarios and the reason why the Committee is aware of the five and the two is because all that material has been made available to the Parliament and because, as I said, the two scenarios were the most likely scenarios to give insight as to the impact of the reforms.

The Hon MICHAEL GALLACHER: What about the 1998 reforms, the commutation reforms, for example? What were you given then? I am sure you would have looked at that advice because that was a significant part of your recent reforms. What advice were you given from the actuaries?

The Hon JOHN DELLA BOSCA: I was not the Minister in 1998.

The Hon MICHAEL GALLACHER: But your Government was most certainly in government and if you did look at turning back the significant reform you would need to go back and look at the advice you were given, surely?

The Hon JOHN DELLA BOSCA: If Mr Gallacher will bear with me, I have no objection to making that information available to the Committee. I was not the Minister at the time.

CHAIR: You will take that question on notice. Regarding the retrospective financial impact on the deficit, during 2001 when was it decided to make the reforms retrospective for each of the common law commutations and disputes, including legal costs?

The Hon JOHN DELLA BOSCA: It is important to reinforce the Government's position in respect to the reform package. In respect to retrospectivity overall in the scheme, the only retrospective effects are as to process, that is, there are no general effects as to benefits, with the exception of the additional 27 November issues which you just enumerated, the common law change, commutations—

CHAIR: Disputes regarding legal costs.

The Hon JOHN DELLA BOSCA: Yes, and they were retrospective as to process but have some potential implications for benefits in a small number of cases. Those were the result of the independent inquiry that the Government received. It is quite clear from the inquiry that they are the recommendations that were made, and the Government adopted those recommendations.

The Hon GREG PEARCE: A small number of cases, you reckon. You came out quoting this 14 January report by Tillinghast saying that there was \$800 million to \$1.3 billion retrospective savings.

The Hon JOHN DELLA BOSCA: They are savings due to process. As I said, the Government has—

The Hon GREG PEARCE: Due to process?

The Hon JOHN DELLA BOSCA: I think it is a very important issue to distinguish between a retrospective decision that impacts on someone's benefit entitlement and a retrospective decision that affects the process by which the disputes will be resolved or the benefits will be arrived at. They are the changes that have that very substantial impact. I thought what the member was going to ask me then was why the date varied, which is the other matter, I should say for clarity, because that is the one difference between what the Government did and what was in the Sheahan report, and that was because of where I thought he was going with his next question which was that there was then a flood of applications for common law. The Government took the view that substantial notice of the changes had been given in the public arena. Shortly after the Sheahan inquiry was published I indicated that the Government intended to proceed with those reforms. Therefore, on that basis the Government took the view that given the very large number of additional claims, well against normal trend lines, we should adopt a slightly earlier date than was recommended by Justice Sheehan.

The Hon GREG PEARCE: Just to be clear on that, you retrospectively took away the rights of those people who had made claims to receive compensation and that is where up to \$1.2 billion of savings will come from.

The Hon JOHN DELLA BOSCA: No, we did not. It is important for the Committee to focus on the fact that the figures the Hon Greg Pearce is quoting relate to the changes that were made to the dispute resolution process. Those impacts are not retrospective as to benefit availability. They are retrospective only as to the way in which the disputes will be resolved. The only changes that could impact on people's benefits, if you like, that were at all retrospective were the ones in relation to common law, commutations and disputes involving legal costs. They will result in an independent inquiry.

The Hon MICHAEL GALLACHER: Are you confident that the advice you have given now in terms of the reforms will be successful for your Government in terms of reforming the scheme?

The Hon JOHN DELLA BOSCA: I have to say that a long experience in politics has made me reluctant to be too confident about anything. What I am confident of is that we have achieved many of our objectives of scheme reform. Since I have been the Minister we have been underlining that a critical series of initiatives for us was to get a better scheme in terms of dispute resolution so that people did not have to wait substantial lengths of time to resolve issues; to get a scheme which concentrated on injury management and concentrated on the victims of industrial accidents and so on being able to return to work as soon as they were able; to focus on claims management, injury management and other issues rather than disputation; and to focus on a dispute settlement procedure which was much less formalistic and able to deliver its results much more quickly than had been the case in the old scheme.

The presupposition was that in pursuing those scheme reform objectives many of the financial difficulties of the scheme would begin to correct themselves. All I can say in response to the Hon Michael Gallagher's question is that the proof of the pudding will be in the eating. In terms of the financial issues, over the next 12 to 18 months to two years we will see what happens with the six monthly and yearly evaluations of the scheme. The preliminary work of the scheme actuaries is already in the public arena. I do not think I need to comment on it any further.

The Hon MICHAEL GALLACHER: You have spoken a lot this morning about buffets, wide selections and proof of the pudding. At the end of the day this is about getting control of the scheme. Can you tell the Committee, now that you have been given this advice in January by Tillinghast, when we will see reductions in premiums for businesses in New South Wales? Can you give us a date?

The Hon JOHN DELLA BOSCA: That is clearly not something that I can do at this Committee or am likely to be able to do in the short term. What I can say with confidence is that we now have a better workers compensation scheme. The early evidence from the report that the Hon Michael Gallacher refers to a few weeks ago is that the scheme reforms are successful in respect to financial issues such as the deficit. Obviously—and I do not think anyone would need to be reminded—there is a relationship between the deficit and premium levels. There is also a relationship between the deficit and the potential of the scheme to improve occupational health and

safety. I think they are the two things that will correct themselves over the three to five years that the scheme will take to recover.

The Hon MICHAEL GALLACHER: What do you define as short term?

The Hon JOHN DELLA BOSCA: In respect to?

The Hon MICHAEL GALLACHER: You said over the "short term", in the short term. You are talking about reductions in premiums and the benefits in the short term. What do you define as short term—six months, 12 months, two years?

The Hon JOHN DELLA BOSCA: I have not set the scheme any specific targets in relation to premiums. I think it is generally accepted that in a number of industries premiums are unacceptably high. What the Government has committed to do is to reform the scheme, make sure that it has served the purpose for which it was originally designed, that that would have a fairly immediate and in the short term—I think the answer is that there has been an early indication from the scheme actuaries that there is likely to be a significant reduction in the deficit. As I said at the beginning of this inquiry, beyond that the Government is looking at scheme design issues. Specific issues such as premium levels are matters which the scheme will deal with as it returns to financial health.

The Hon MICHAEL GALLACHER: In other words you have no timeframe when you expect to see some significant reforms that will lead to a reduction in premiums. I am asking you for a time. People out there want to know how long they will have to wait to get a reduction.

The Hon JOHN DELLA BOSCA: I think people also want honesty from people in public office.

The Hon MICHAEL GALLACHER: That is true.

The Hon JOHN DELLA BOSCA: The fact of the matter is that if you start giving answers to things that are simply unknowable for the sake of political expediency, say, I could give the Hon Michael Gallacher any answer I liked provided it was after next March and it may have no political implication. I think what the public and the stakeholders in this scheme and the Parliament are interested in is an honest answer. The honest answer is that no-one can know the answer to that question, no matter how skilled they are as an actuary or otherwise.

The Hon MICHAEL GALLACHER: In the correspondence the Committee was given earlier this year we were told that we would move towards any of these concepts regarding private underwriting when the scheme was stabilised. Now we are told that we are now moving towards options for scheme design reform that could in fact include some sort of concept of private underwriting. At the same time we have just been told by the Minister that he has no expectation in terms of time when we will see some reductions in premiums. There are some significant areas of uncertainty in regard to the forward planning of the Minister. We need to know, and the Committee needs to know, when we will see certain benchmarks over the next six months to 12 months if we are going to move towards scheme design. The Minister has not been clear on that at all.

The Hon JOHN DELLA BOSCA: I am not sure that I understand what the Hon Michael Gallacher is actually saying.

The Hon MICHAEL GALLACHER: You do understand.

The Hon JOHN DELLA BOSCA: I will simply restate the obvious: for me to give an answer to his first question, which was when will premiums go down, it is not like the sun rising tomorrow. I am afraid there is no scientific answer to that question. You can ask any actuary, any professional insurer, anybody who has any understanding of the way in which insurance premiums and risk management operate and they will not be able to give you a definitive answer to that question. What I can give you a qualified answer to, because you already have the information, is that the scheme actuary says that there has been a very significant reduction in the deficit of the scheme which then allows you to consider the ways in which you would operate scheme design. We will put together an options paper which the Committee can utilise at the forum it is planning to participate in the debate about scheme design.

The matter of when premiums will go down, when occupational health and safety will improve, all those sorts of issues are things that can be mapped out only in a very indicative way and anybody, whether it is the Hon

Michael Gallacher, myself or the scheme actuary, who presented themselves here and said that premiums will go down on 5 March 2003 would be a liar.

CHAIR: Just to clarify this issue about the funds and the savings, is the \$1.3 billion—so the public does not think it will happen next year—is over a period of time. Can you refer to the length of time that those savings of \$1.3 billion will take effect? It was estimated over a period of years.

The Hon GREG PEARCE: Is that your expectation of what will be saved?

CHAIR: Can you just clarify the period of time?

The Hon JOHN DELLA BOSCA: Just so it is clear, the best advice I have in relation to that report and that number is that that is a one-off effect on the deficit of the scheme changes.

CHAIR: Will it take effect immediately or within 12 months?

The Hon JOHN DELLA BOSCA: I am not saying that. That is what the scheme's actuaries have reported.

The Hon GREG PEARCE: What do you say? What is your expectation of the change to the premiums?

The Hon JOHN DELLA BOSCA: As I said, I am not an actuary. My job as a Minister is to take the best advice I can from the appropriately appointed professionals. At this stage I am taking the view that as the scheme's actuaries Tillinghast are likely to have a conservative view of these matters I am inclined to think that the advice they have given me is correct.

The Hon MICHAEL GALLACHER: Is that the same advice they gave the Committee last year when they were quite clear about not seeing any significant reforms to the scheme in the short term? They gave that evidence under oath. The reference you have just made to the \$1.3 billion, this Committee has not been given the opportunity to test it.

The Hon JOHN DELLA BOSCA: The Hon Michael Gallacher has asked a good question but of the wrong person. The person he has to ask that question of is Tillinghast.

The Hon MICHAEL GALLACHER: But you are accountable to the people of New South Wales. The buck stops with you at the end of the day. You know that.

The Hon JOHN DELLA BOSCA: But I am not accountable for Tillinghast's professional advice. That is the question the Hon Michael Gallacher has asked. I suggest that you seek an answer from them.

The Hon GREG PEARCE: You rammed through all of these changes. Do you or do you not expect to make the savings?

The Hon JOHN DELLA BOSCA: I have repeatedly said to this Committee that my expectation is that the scheme reforms are having two substantial effects. The first is that they have overall improved the prospect of good dispute resolution, rapid settlement of claims, better injury management. The impact that they have had on the financial fundamentals of the scheme will become evident over the next 18 months, three years, five years. It will take some time before anyone can say with certainty exactly how the scheme has performed. The preliminary advice from the actuaries is both in terms of a one-off benefit and the two scenarios that have been referred to previously by the Committee that there has been a very substantial improvement in the prospect of the deficit going forward. Therefore, a responsible Minister, a responsible parliamentary committee and a responsible Parliament would take the view that they had to be empirical about the advice. The advice from the scheme's actuaries is that the situation is improving. Therefore, I will say that the scheme has improved substantially in a financial way but no actuary will start dealing with issues where there is no trend line established. Until a trend line is established they will not give us an answer. Nor should they.

CHAIR: Just to clarify that, Tillinghast supported the lowest savings scenario as the best estimate. Therefore, is it normal practice to adopt the actuary's preferred estimate? If the answer is yes, why did the Government then adopt the highest estimate?

The Hon JOHN DELLA BOSCA: I do not think there is enormity of practice in regard to this. It is simply a matter that all this material was to be publicly disclosed, as I gave an undertaking to the Parliament.

The Hon GREG PEARCE: You have said repeatedly that you followed their advice. Their advice is the lower one, not the higher one.

The Hon JOHN DELLA BOSCA: As the Hon Greg Pearce well knows, their advice is a range. That is why they presented two scenarios.

The Hon MICHAEL GALLACHER: But you did not include the range in your press release after 7 January, did you?

The Hon JOHN DELLA BOSCA: As the Hon Michael Gallacher has referred to previously, he cannot have it both ways. The point about this advice, as I have said, is that you take the advice that the actuaries have given you. You cannot expect it to be anything other than what it is. It is an estimate based on the best possible calculations by professionals as to the scheme's performance.

The Hon MICHAEL GALLACHER: Are you saying therefore that with this one-off saving we are down to about \$1.6 billion to \$1.7 billion in the unfunded liability as of now?

The Hon JOHN DELLA BOSCA: The Hon Michael Gallacher, this Committee, Parliament, the public and the Minister will have to wait until the next Tillinghast evaluation before we know the answer to that question.

The Hon MICHAEL GALLACHER: You just told us that there was a \$1.3 billion one-off.

The Hon JOHN DELLA BOSCA: That is what the 7 January report—to which I referred previously—said.

The Hon MICHAEL GALLACHER: So you are still unclear about that.

The Hon JOHN DELLA BOSCA: I am not unclear about anything: I know exactly what the actuary's report said—and I think the Hon Michael Gallacher probably does too. I have already explained the way in which a responsible government and a responsible Parliament would deal with advice from an actuary.

The Hon GREG PEARCE: Minister, in the last two years the Auditor-General has qualified the State's accounts because the assets and liabilities of the scheme's statutory funds have not been consolidated into those accounts. You mentioned Enron. Is it not the case that you, the Premier and the Treasurer are behaving exactly like the board of Enron in disguising that true deficit in the accounts?

The Hon JOHN DELLA BOSCA: The Hon Greg Pearce knows that is absolute rubbish.

The Hon GREG PEARCE: What is the difference between the way that Enron performed and what you are doing?

CHAIR: Let the Minister answer the question.

The Hon JOHN DELLA BOSCA: The very substantial difference is that the accounts of WorkCover and any qualification or otherwise of the Auditor-General are in the full public arena. In any respect, he knows that I was speaking about Enron and HIH in terms of the way that responsible governments—and responsible Oppositions for that matter—should deal with reports from bodies such as auditors and actuaries. We can only be empirical about them. We can look at the basis upon which they have drawn their conclusions and then take our policy and ministry decisions based on them. Actuaries—if you will pardon my saying so, Mr Chairman—are not in a position to be all knowing, all seeing or all powerful. They cannot predict the future; all they can do is base their advice on the best estimates and the trends that they observe. They can outline those to us and then as public office bearers—who, as Opposition Committee members have reminded me, are responsible to the public—we must make responsible decisions on that basis. I think the Government, WorkCover and the board have been doing that.

The Hon GREG PEARCE: You just said that the difference between the deficit of WorkCover and your treatment of it and the Enron board is that the Auditor-General makes it public.

The Hon JOHN DELLA BOSCA: I have given my answer to that fairly fatuous question. I am happy to take other questions on notice, but I have already answered that question.

CHAIR: Do any Committee members have questions on notice for the Minister?

The Hon MICHAEL GALLACHER: Yes. We will send some questions to the Minister.

CHAIR: Thank you for appearing before the Committee, Minister. We appreciate your co-operation.

The Hon MICHAEL GALLACHER: While the Minister is here I must make this point. Although the Minister has correctly come to the Committee today and given some of his ideas and visions, we have had very little time to explore them. We might have to have expanded time with the Minister in any future public hearings in order to explore some of those ideas. The Minister has raised many issues today and I would love to be in a position to ask more questions.

CHAIR: There will be an opportunity to have a general discussion of these matters at the forum.

The Hon JOHN DELLA BOSCA: As I have said to the Committee before, I am happy to appear as the Chair and the Committee advise is appropriate. A more appropriate time might be towards the time when WorkCover and my office develop the issues paper for the Committee. I would be happy to appear before the Committee again, but I think the forum is probably the next convenient occasion.

The Hon MICHAEL GALLACHER: Will evidence to the forum be given under oath or will it be simply a round-table discussion?

CHAIR: It will be a discussion around a table.

The Hon HENRY TSANG: It is a forum.

(The witness withdrew)

(Short adjournment)

ROBERT JOHN SENDT, Auditor-General of New South Wales, 234 Sussex Street, Sydney, sworn and examined:

LEE INGLIS WHITE, Assistant Auditor-General of New South Wales, 234 Sussex Street, Sydney, affirmed and examined:

CHAIR: Thank you for your appearance before the Committee today. Are you each conversant with the terms of reference of the inquiry?

Mr SENDT: Yes.

Mr WHITE: Yes.

CHAIR: If you wish to give evidence in camera, the Committee has the right to consider that request.

Mr SENDT: I have no desire to do so, Mr Chairman.

Mr WHITE: Thank you.

CHAIR: Do you wish to make an opening statement?

Mr SENDT: I have a brief statement, Mr Chairman. As you will be aware, for a number of years now the Audit Office has been concerned about the WorkCover scheme statutory funds. Our concerns have mainly been the lack of recognition of the scheme's finances in the State's over all financial statements. Because of the size of the scheme funds and their net financial position—and hence the impact of the non-recognition—I have qualified the audit opinion on the Treasurer's total State sector accounts for not consolidating the scheme. We have reported this to Parliament as well as a summary of our views on why the lack of recognition is a breach of accounting standards. The basis of my qualification and supporting views can be explained to the Committee today if that will be helpful to its inquiries.

From my review of the two interim reports of this Committee issued to date, I note that a conclusion has been drawn that there is an urgent need to establish clear ownership responsibility for the scheme. I think it is important to distinguish, as your reports do, between the issue of accounting recognition and the issue of stakeholder ownership of the scheme. The former may excite accountants and auditors but clearly the latter is more important. Without that accountability for the scheme being clear, parties and sectors may operate in ways inconsistent with bringing financial stability to the scheme.

Also the deterioration of the financial position of the scheme has been prominent in my reports. We have reported in the last seven years underwriting losses and accumulated deficits. Some commentary has been made on potential causes of the losses and on scheme reforms undertaken over that time. However, the reports do not include prospective assessments on the effectiveness of reforms or other options to those reforms. These would be matters outside my mandate. They would also be largely outside our area of expertise. As financial auditors, we are required to have an understanding of our clients' businesses—be they workers compensation, electricity generation or policing—but that level of understanding can never be as detailed as that of those who are charged with running those businesses. I make those remarks not to be unhelpful but simply to avoid creating unrealistic expectations as to our role in analysing in detail the many changes to workers compensation that have been made or proposed.

In conclusion, I indicate that Mr White had audit responsibility within my office for insurance, including workers compensation, from 1996 until very recently. While I can address the more general questions Committee members may ask, with your permission I will defer to Mr White if more detail is required.

CHAIR: What work does the Audit Office do a regular basis with regard to WorkCover?

Mr SENDT: We carry out the annual audit of the financial report of the WorkCover Authority. The financial report is more than just the financial statements; it includes all the notes to those financial statements. One of the notes to the WorkCover Authority's financial statements—albeit a very large note—is the financial statements relating to the scheme itself. Therefore, as part of that report we are required to check the veracity of any material in the notes as much as the financial statements. The scheme itself has not been regarded as an entity in its own right that we audit; we simply audit it as a note to the authority's accounts.

CHAIR: Is it an audit or not?

Mr SENDT: It is an audit. As he would be aware, there are licensed insurers who undertake the management of claims, collection of premiums and the payment of benefits. Those licensed insurance have their own auditors and as part of their responsibility they audit the trust funds—if I may use that expression—held by the insurers in relation to workers compensation. Our role extends to a review of the information supplied to us by those auditors in confirming the details relating to the individual insurer's components of the overall statutory funds.

CHAIR: Must you take those audit reports at face value because you cannot do the detailed work within the insurance companies?

Mr SENDT: We do not do original, first-hand work on those reports, but if issues arise in the material that the auditors provide to us, we do—and would—go further and inquire into that.

CHAIR: Has that happened where you have questioned some of the audit reports?

Mr WHITE: From what I can recall, there have been certain issues that were raised in the audit reports coming through from the auditors of the licensed insurers. Then we have gone back to sitting down with WorkCover management and the auditors of the licensed insurers to understand what is the issue and the impact on the overall aggregation of these scheme's statutory funds.

CHAIR: Have you always had complete co-operation?

Mr WHITE: Yes, we have, Chairman. To conclude on what the Auditor-General advised, the work we would do around the scheme's statutory funds is based on the auditing standards, which is the framework that we as auditors use. The findings from our work, like all other entities that we audit, are reported through to Parliament at least on an annual basis.

CHAIR: Moving on to the issue of the actuaries who give advice to WorkCover, do you believe that the advice given by WorkCover's consultant actuaries, Tillinghast-Towers Perrin is totally independent?

Mr WHITE: We have had interaction with Tillinghast in a number of ways, Chairman. For the last couple of years they have been the consulting actuaries to WorkCover. Before that time we were using Tillinghast to assist us in gaining our audit assurance. Prior to the time that Tillinghast were the consulting actuaries to WorkCover another firm was being used, which was Trowbridge. In order for us to do our work, we need to use an actuary. Our involvement with Tillinghast at that time and since that time when they have been consulting actuaries to WorkCover did not indicate to us that there were any difficulties with their independence. I would say though that perhaps independence of service providers receives a lot of attention, particularly at the moment. When there is an economic relationship between an entity and a service provider, you may not ever have an independence issue or total independence, as you are suggesting, but people may always hold a perception. At times perceptions can be as strong as any actual issues, I suppose.

CHAIR: As you would be aware, there has been earlier reference to the collapse of the HIH group of companies and some matters overseas. These collapses show that the reliability of actuarial advice needs to be questioned. Is it the normal practice in the audits of Australian general insurance companies for the auditors to engage the services of an experienced general insurance actuary to review the advice of the actuary providing advice to the insurer on outstanding claims reserves? We understand that in New Zealand the Auditor-General obtains the advice of an experienced firm of general insurance consulting actuaries to review the advice provided to the Accident Compensation Commission by consulting actuaries. From what you just said, it sounds as though you do.

Mr WHITE: Yes. To complete my response on this question, I would indicate, Chairman, that as we do our audit we are required to follow the auditing standards. The auditing standards say that in situations where an expertise is being used by an organisation the auditor is required to use their judgment as to what the work and the nature of that work would be. An organisation using an actuary to assist in the determination of certain figures does not automatically mean that the auditor has to go and use someone of a similar expertise. Given the nature of insurance and the amount of influence that the determination of an outstanding claims provision would have, certainly we in the office for the last five years at least have used actuaries to assist us in arriving at our auditing assurance.

CHAIR: Would you outline the process and the advice the New South Wales Auditor-General's Office obtains to satisfy itself that the outstanding claims reserves of the New South Wales WorkCover scheme are adequate?

Mr WHITE: To capture again what I indicated, we will use the auditing standards and our own office methodology to determine our plan. Our plan generally will involve reviewing the contents of information being reported through from the auditors of the licensed insurers, then obtaining a copy of the consulting actuary's report. Our people will then review that and take note of any issues that are currently being raised by the consulting actuary.

CHAIR: Who do you mean by "our people"?

Mr WHITE: The Audit Office people.

CHAIR: In your office?

Mr WHITE: Yes. At times we will see issues that we will talk on directly with the consulting actuary. We would challenge things such as reconciliation of data, which is an important step to ensure that whatever the consulting actuary is using reconciles back to the information flowing into the financial statements. We will discuss things with the consulting actuary in terms of materiality and their understanding of materiality. As I have indicated, we will then take the steps of using an expert to assist us in analysing the work. Generally what we will ask an actuary assisting us is not necessarily to go and completely reperform the work of the actuary but at least to consider the methodology, the underlying assumptions, the form of the report and the findings of the report.

CHAIR: Who is the actuary you are using?

Mr WHITE: In 2001 we used the New South Wales Government actuary. In 2000 we used the New South Wales Government actuary in terms of the scheme's statutory funds. I believe for about four years before that we were using Tillinghast.

CHAIR: You have not used any other actuaries?

Mr WHITE: Not on WorkCover. We do for certain insurance ones, but not on WorkCover.

CHAIR: What is the relationship of the New South Wales Government actuaries to you?

Mr WHITE: Nothing more than that they are a service provider.

CHAIR: Are they a company hired by you?

Mr SENDT: They are a unit, as I understand it, in the Premier's Department under the Premier's portfolio that has been around for many years.

CHAIR: They are full-time public servants working within the Premier's office?

Mr SENDT: Yes.

The Hon MICHAEL GALLACHER: My question is directed more towards Mr White. Are you aware of the interim report that this Committee brought down on 17 January, I believe, in relation to the work of and the information and evidence given to the Committee thus far?

Mr WHITE: We certainly got a copy of the report and I have reviewed it. I could not say I am fully conversant with it.

The Hon MICHAEL GALLACHER: Are you aware that the Committee for the first time, in a groundbreaking way, elected to utilise the expertise of a reference group because of, as you rightly pointed out and as Mr Sendt earlier, the sheer detail that is involved in looking at actuarial calculations and methodology? The Committee has a reference group that consists of an accountant and an actuary. Are you aware of that?

Mr WHITE: Yes, I think I am.

The Hon MICHAEL GALLACHER: In the Standing Committee's report is a report from the reference group actuary, Ernst & Young, that raises in my mind, and I suspect in the minds of a number of members of this Committee, some serious discrepancies or at least questions about discrepancies in relation to the methodology used by the WorkCover actuary in coming to the final conclusion that we were given in January about certain savings that were made. Have you had a chance to look at the findings of the reference group?

Mr WHITE: Not in detail, no.

The Hon MICHAEL GALLACHER: If you were to look at them—and I am not suggesting you do that now because they are quite detailed—and you agreed with me that they raised some serious questions, what would you do once you have identified those questions in this parliamentary report?

Mr WHITE: Take into consideration perhaps what we understand the issues to be raised if they concern scenarios or methodologies and take those into account perhaps when we look at the ongoing relationship between the consulting actuaries and WorkCover.

The Hon MICHAEL GALLACHER: If you became aware of discrepancies in a parliamentary report such as this and evidence that was given to the Committee last year, a distinction between the two, would you initiate an inquiry?

Mr SENDT: We would not initiate an inquiry into the fact that the discrepancy has been brought to attention. We would take it into account, as we would any other information that indicates in a particular area or particular audit we may be needed to go a bit further. We may need to go to our consulting actuary or a consulting expert, whatever the area might be, and ask him or her to give us some guidance on whether the allegation, if I could call it that, was sound. We may go to the client agency and seek its response and try to come to some judgment as to whether the figures that were being put to us for audit were still sound.

The Hon MICHAEL GALLACHER: Would you go to the Committee's reference group and get it to clarify its position?

Mr SENDT: It depends what the life of that reference group is, Mr Gallagher.

The Hon MICHAEL GALLACHER: Now that I have raised it with you for the first time, once you have had an opportunity to look at that part of the interim report, which is the submission from Ernst and Young dated 17 January, could you report back to the Committee your conclusions? Is that possible?

The Hon TONY KELLY: They can take any of these questions on notice.

Mr SENDT: Yes, we will take that on notice.

The Hon MICHAEL GALLACHER: It is marked Appendix 1.

Mr WHITE: This is their report, as I understand it, regarding the estimates of reforms, not in respect to prior years' financial statements.

The Hon MICHAEL GALLACHER: In relation to the financial impact of reforms.

Mr SENDT: We are not here to particularly defend the actuarial profession or the expertise of any particular actuaries. But I would have to say that one of the things that actuaries rely on in making forecasts or projections is the analysis of recent trends. That work is made much more difficult in a situation such as workers compensation where there have been a number of changes over a number of years which (a) disturb the existing trends and (b) may be establishing a trend of its own. In that case, the work of actuaries is particularly difficult.

The Hon MICHAEL GALLACHER: What was insightful was the evidence given on—correct me if I am wrong—26 November last year to the Committee from the WorkCover actuary stating under oath, if I could paraphrase, that there would be little impact in the short term as a result of the reforms. On 7 January the Committee was given an amended report which basically throws the evidence that was given in November out the window. We are told the savings will be quite significant but we have not had a chance to test it. We have been told, and we have heard today, that everything is based on the actuarial advice that is given to government. Where it is insightful is the fact that the reference group, who have that area of expertise that we lack, say there are real

question marks over the calculations. If the reference group is correct in its advice to the Committee, after you have an opportunity to look at the report, there may be significant questions for the Auditor-General's Office further down the line in terms of the methodology that is being used to arrive at these calculations.

The Hon TONY KELLY: The first report was a draft which they then withdrew, and the only one that they put any credibility on is the final one.

Mr WHITE: If they did that report at the back end of November, did they have clarity on exactly what the nature of the reforms were by then?

The Hon MICHAEL GALLACHER: Yes. They were involved in the calculations of the impact of the reforms during the very early stages, in fact right through their entirety to their passage through Parliament. It is also interesting to note, and I refer to the added contribution from the Hon Tony Kelly, that not only did they withdraw their earlier report, their draft report—

The Hon TONY KELLY: It was a draft report.

The Hon MICHAEL GALLACHER: —but they did not wish, nor did the Government, for the draft report that the legislation was based to be printed and be allowed to be made public in this report or any other report. That is why there are still question marks over two lots of information that have been given to this Committee.

CHAIR: I wish to clarify another matter that was raised earlier about the role of the New South Wales Government actuary, which you seem to be dependent upon.

Mr WHITE: In the last two years they have assisted us.

Mr SENDT: Only by our own choice. We are not obligated in any way to use the Government actuary or anybody else for any advice we seek.

The Hon TONY KELLY: Up till then you were using Tillinghast. WorkCover uses them and you no longer use them.

Mr SENDT: Correct, so we cannot use them.

CHAIR: The question I was going to ask is: Do you have confidence that the New South Wales Government Actuary has the experience and knowledge to conduct these reviews? I gather you must, or you would not be using the Government Actuary.

Mr WHITE: That is right. The position will change over time, but the Government Actuary that we are currently using, Peter Gerard, had given us an indication of the nature of his experience, which was in general insurance and workers compensation particularly. I believe that experience cut across doing peer reviews in other States and Territories and determination of other workers compensation liabilities in other States as well. So he seemed to have the experience, and he was quite ready to do the work.

CHAIR: You are not concerned that his relationship with the Premier's Department might compromise his independence, or that it would be better to have an independent actuary from outside the government?

Mr SENDT: I think the Government Actuary is known for taking quite an independent stance on a range of matters.

The Hon TONY KELLY: A bit like the Auditor-General and the Crown Solicitor. It is the same sort of relationship, is it not?

Mr SENDT: Yes. Administratively, he is part of the Premier's Department, but physically and operationally—

CHAIR: He does not have to consult with them?

Mr SENDT: Not operationally.

CHAIR: He works independently?

Mr SENDT: Very much so.

The Hon MICHAEL GALLACHER: Does he do the actuarial work for the Treasury-managed fund?

Mr SENDT: I do not believe he does.

CHAIR: I move to another matter raised in evidence received by the Committee on 21 November 2001. Mr Doug Pierce from the NRMA suggested that the workers compensation unfunded liability should be included in the balance sheet of every employer in New South Wales. Do you agree? If so, why? Or where do you think it should be? I know this is a question that you have been looking at earlier. Do you have a recommendation as to where it should be?

Mr SENDT: Clearly, Mr Chairman, we have qualified the total State sector accounts because of our belief, based on accounting standards, that it should be recognised in the State's finances. I think the quote from Mr Pierce probably stemmed from a contrary view expressed by someone in government, and perhaps by ourselves, that if you did not accept the view that it belongs in the State's accounts then it must belong somewhere, it cannot just exist in the ether; and if it does not belong in the State's accounts, it must belong in the accounts of the employers. If you take the view, contrary to ours, that the scheme is owned by the employers, then in theory some component of the deficit should be recognised in each of their balance sheets.

CHAIR: But your position is that it should be part of the Treasurer's budget papers?

Mr SENDT: The budget papers tend to deal with the general government sector, or the departments if you like. The total State sector accounts is a wider concept. They represent the overall State finances, and we believe they should be included in that.

CHAIR: Earlier we heard evidence from the Minister that they are obviously opposed to that view because it would then put the Government into deficit.

Mr SENDT: It would certainly take a few billion dollars off the Government's net asset position. It certainly would not put the overall balance sheet into deficit. If the results for the year were incorporated—and the results for individual years jump around quite substantially—it may well be that in a particular bad year it would have the effect of putting the State's results into deficit. But, equally, in other years it has broken even or even made a small profit.

CHAIR: So you are looking at just the annual income and expenditure. Where would the unfunded liability lie?

Mr SENDT: We are basically looking at the unfunded liabilities, Mr Chairman.

Mr WHITE: The consolidation of the WorkCover scheme statutory funds into the total State accounts.

The Hon TONY KELLY: Of the overall deficit?

Mr WHITE: It is consolidation of the entity. The WorkCover statutory funds have assets and liabilities, the difference being the deficit. So all of it would go in: you would take in the assets and you would take in the greater liabilities, and it would have a deficit effect.

The Hon GREG PEARCE: So it would affect the annual accounts income and expenditure and it would also will affect the assets and liabilities?

Mr SENDT: Correct. You are doing a consolidation or a type of aggregation.

The Hon TONY KELLY: On the assumption that these reforms may bring in an annual surplus from here on in, would there be a bit of a problem with governments, of whatever colour, using that to cloud the rest of their operations, saying, "We have got a half billion dollar surplus out of WorkCover," but because it is consolidated

you could have a \$300 million loss in the rest of the government's operations, and the government could come out and say, "We have made a \$200 million surplus."

Mr SENDT: That is a possibility, Mr Kelly, but the focus on government financial results tends to be the budget result, which is the general government sector, rather than bringing in the trading entities. So we have never said it should be part of that budget result. What we have said is that it should be part of the wider total State sector finances. So, theoretically that is a possibility, but not a probability.

CHAIR: So you would separate it from the budget papers as such? It is like a trading entity, you are saying?

The Hon TONY KELLY: In a budget.

Mr SENDT: In effect, yes.

CHAIR: Would that protect the way in which the ratings are calculated concerning the government maintaining its AAA rating?

Mr SENDT: The ratings agencies are well aware of the workers compensation situation. They are well aware that the finances of the scheme are not brought into account. I know, from my days working in Treasury, that the rating agencies would query Treasury, when they are doing their annual review, as to what was happening with workers compensation, what reforms might be being planned, and what the outlook was. So the fact that it is not consolidated, or if it were to be suddenly consolidated, I do not think would in itself would affect the ratings. What would affect the ratings would be if the deficit continued to grow and there was no immediate prospect of it being addressed.

CHAIR: Therefore, on the question of ownership, are you saying that the government has ownership?

Mr SENDT: We believe, yes, the government does have ownership.

The Hon Dr PETER WONG: Did you ever express concern about the rapid escalation of the unfunded deficit over the years? Were you aware of the level of the rapid escalation of the unfunded deficit at all?

Mr SENDT: Certainly, over a period of years, we have reported to Parliament on the growth. Our last report—which was in December 2001—included a seven-year table showing how the deficit had grown, it showed what the underwriting losses were in each of the years, and it indicated some observations on why that deficit had grown, but it also foreshadowed the reforms that the government at the time was considering.

Mr WHITE: If I might add to that, Mr Chairman. Back in around 1996 and 1997 the previous Auditor-General qualified the audit opinion on the accounts of WorkCover about the financial viability of the scheme's statutory funds as well. So it was certainly reported on quite extensively over a number of years.

The Hon Dr PETER WONG: If that was the case, did you ever express concern on the management of WorkCover? In particular, you mentioned earlier a breach of accounting standards, and furthermore that they did nothing to alert the government of the unfunded liability. Did you ever expressed concern on the management of WorkCover?

Mr SENDT: We would certainly expressed our concern to management if there were management aspects associated with the financial report. You said in your question that they never alerted government. I cannot respond to that. I do not know whether that is true or untrue. In terms of a breach of accounting standards, we have not taken the view that the scheme should be consolidated into the WorkCover Authority's result. Various opinions have been sought over the past five or six years on where the scheme's deficit should be recorded. There have been Crown Solicitor's opinions, and there have been opinions that we have sought from the big five accounting firms.

The Hon GREG PEARCE: Which unanimously agreed with you.

Mr SENDT: The big five do.

Mr WHITE: That is correct.

Mr SENDT: The advices we have had from Crown Solicitors and Solicitors General have tended to suggest that it belongs somewhere, it does not belong with the WorkCover Authority, that maybe it belongs with the Parliament, but that it does belong with government in the wider sense.

The Hon Dr PETER WONG: Is that not part of a management problem? The management should at least tell the government what it thinks is the next step that should be taken.

Mr SENDT: In terms of the inclusion of the result, that is an issue for the Treasurer and Treasury. In terms of what reforms are needed to the scheme, certainly the WorkCover Authority has a role in that. I cannot comment on the extent to which they have or have not advised government, or on how well they have done that.

The Hon GREG PEARCE: Given that the accounts have been qualified for so many years, would you describe the failure to deal with this issue of the deficit and ownership of it as responsible?

Mr SENDT: It has been two years that we have qualified the accounts.

The Hon GREG PEARCE: You mentioned that the 1997 accounts were qualified.

Mr WHITE: That was in respect of the financial viability. The Auditor-General is referring to the aggregation and consolidation issue at the moment.

Mr SENDT: Certainly, in a number of reports we have raised the increasing deficits of the scheme. We have expressed our concerns. We expressed concern in the last report that while we had not qualified on the basis of the scheme not being a going concern, it certainly was an issue we addressed. We did not qualify it as not being a going concern—which, removing it from accounting and audit speak, basically means if you take the view that the scheme or the entity is not capable of remaining solvent in the short term, an auditor would qualify the opinion. We did not take that view because there were a number of reforms being discussed and being proposed. Also, there was no immediate financial difficulty, in the sense that there were substantial investments of some \$6 billion had by the scheme. So it was not as though the scheme was in imminent danger of collapse.

Our concern was more about the need for government to address the growing liability. There have been a raft of reforms over recent years, including the more substantial ones in 2001. So we will continue to monitor the position. If it appears over a period of time that those reforms are not working, or other problems arise, clearly the investments of the authority will be run down, and at some stage in the future we might have to revisit our opinion and say that it is no longer a going concern. But at this stage that is not something that we have had to address.

CHAIR: Of course, one of the problems with the reforms is that we cannot see the impact of those reforms for probably five years.

Mr WHITE: That has always been a challenge. It has been a challenge as well because I am led to believe by actuaries that at different times you may very well get what is described as a honeymoon period: where things may look initially as though they are improving, and then over time cultures or whatever start to make the reforms less effective. If I could come back to the question that you raised earlier, Mr Chairman, about Mr Pierce and his assertion about recording them in each employer's books. There seems to me to be some confusion about what is consolidation and control of an entity and perhaps cash flow and funding.

Clearly, the employers of New South Wales will have to make contributions, as they do each year in renewing their workers compensation. So they are the people who end up paying. But who is controlling it? I am not sure that Mr Pierce would actually be saying that the employers in New South Wales are controlling it. With accounting standards, it is the concept of control that leads us to bring it back to the government's total State sector accounts. So there is a distinction there for accounting purposes between who is controlling an organisation and who may necessarily be funding it. So, in the private sector, if you see a scenario with a group of companies, you will see that the holding company will consolidate subsidiary entities into their financial statements, but they may not necessarily be held responsible for making the cash payments for the liabilities of those subsidiaries. So cash flow and control are two different concepts.

CHAIR: Thank you for that clarification. On another, different area: Under the new prudential regulation of general insurance companies being introduced by the Federal Government from 1 July 2002, all insurers are required to set outstanding claims reserves at a 75 per cent level of accuracy. WorkCover uses a 50 per cent level. Should WorkCover follow the 75 per cent approach? If not, why not? What is your recommendation?

Mr WHITE: This question is really around the practice of the use of prudential margins or risk margins. The use of these margins is not particularly new. The practice has existed for some time in both the private and public sectors of using margins, albeit more so in the private sector. It seems to me, as an observer of what has occurred with prudential margins, that there was never particular clarity as to the degree of what type of margin was being used within sets of financial statements. Clearly the WorkCover scheme's statutory funds accounts have always stated that it is a central estimate with 50 per cent sufficiency and there is no margin being used, but that is more in recent times. What has been a difficulty is that unless there is disclosure of what is occurring, the use of the financial statements will not permit understanding whether that level of margin gets moved between year on year, and that is something we observed at one time.

If we go back a number of years to around about 1995, the previous Auditor-General qualified the audit opinion on the financial statements of WorkCover around the use of the prudential margin. It was not to do with the existence of the margins; it was that, over a sequence of years, WorkCover did not have prudential margins and then adopted a prudential margin the following year, and then reversed that the following year after that. So if you are actually asking someone to understand what has occurred over a three-year period—these margins can amount to hundreds of millions of dollars and the figure was not there, then it was there, and then it was not there again—you are getting a distortion of results at least, so those accounts were qualified. To come back to the question: if the latest thinking is that 75 per cent sufficiency is appropriate, and I understand that that is a prudential regulation that will be used, and we see it being adopted and there is clear disclosure in the financial statements, then by all means that may be useful.

CHAIR: So you would recommend that WorkCover should be 75 per cent then?

Mr WHITE: I would say that WorkCover would need a good reason not to be consistent with other insurance organisations on that matter.

The Hon MICHAEL GALLACHER: I have a question in regard to another issue we were discussing a few minutes ago, so afterwards we can continue with this topic. Have you looked at or had any examination of the Treasury Managed Fund?

Mr WHITE: We are the auditors of the Treasury Managed Fund.

The Hon MICHAEL GALLACHER: What is the situation with the Treasury Managed Fund as opposed to the private sector that we are constantly hearing about, namely, the \$3 billion deficit caused by unfunded liability? What is happening in terms of the Government's own administration of claims from the public sector?

Mr WHITE: I do not have a detailed knowledge on it but what I can say is that the Treasury Managed Fund is a different situation again to the WorkCover scheme's statutory funds. The Treasury Managed Fund is a self-insurance activity of the Government. Therefore it is just another employer that is managing its own claims experience, and that would be relatively different to the type of experience that you might find with other schemes' statutory funds.

The Hon MICHAEL GALLACHER: Is there an unfunded liability with the Treasury Managed Fund?

Mr SENDT: We could provide that information to the Committee. We do report on the Treasury Managed Fund in our volumes to Parliament each year but I cannot recall the situation as at 30 June last year.

The Hon MICHAEL GALLACHER: If what you are saying is right—that the Government has ownership of it—therefore is it not the case that there will be an amalgamation of the two unfunded liabilities if the Government has control to give a clear indication of the financial impact of what is happened in relation to workers compensation, both in the private sector and in the public sector in New South Wales?

Mr WHITE: The Treasury Managed Fund is currently incorporated into the financial statements of both the public accounts and the total State accounts. That is already there and it is reported widely. I suppose if you trying to look for something at greater length you could suggest aggregating them but I see them a little bit differently. The WorkCover scheme is something that was set up for a particular purpose whereas the Treasury Managed Fund did not necessarily need to exist. It was a decision taken at some point in time to go the self-insurance route.

The Hon MICHAEL GALLACHER: But you agree with me, however, that the rules by which both operate are now the same? Basically how it impacts upon an employee who is injured is exactly the same, whether the employees in the public sector or the private sector.

Mr WHITE: They would certainly be under similar legislation, that is right.

The Hon MICHAEL GALLACHER: Yes, just as it is the same if a private employer operates as a self-insurer.

Mr WHITE: Yes.

The Hon MICHAEL GALLACHER: Have you conducted any auditing work in recent times in relation to the investment strategy for WorkCover?

Mr WHITE: Not in respect of investment strategy, no.

The Hon MICHAEL GALLACHER: Are you entitled to do that?

Mr WHITE: I am not sure if we would go to the extent of appraising a strategy. Certainly we would be focused on situations where there was non-compliance, if the investments were outside perhaps of what WorkCover was allowed to do or the licence of the insurers to put the investments in. We would certainly be concerned with that, but not necessarily the strategy itself.

The Hon MICHAEL GALLACHER: So are you given a report every year from WorkCover with regard to exactly where the investments are made, or is that only done on request?

Mr WHITE: No. When the licensed insurers report to WorkCover, they would give a clear indication of where the investments are sitting, usually in the defined categories such as equities, bonds or whatever. Then the auditors of the licence insurers would certainly be ensuring that those investments are clearly and completely being recorded into those categories.

The Hon MICHAEL GALLACHER: Mr Sendt, in your opinion as the Auditor-General, would allowing a full use of commutations enable insurers to close off ongoing liabilities to reduce the potential financial liability on these statutory funds?

Mr SENDT: I think that is a question that really needs knowledge or expertise that is far beyond what we have. It is a question you really need to ask someone with either actuarial experience or particular experience in workers compensation. As we have seen over recent years there was an expectation that commutations were going to reduce or have the effect of reducing the deficit of the scheme. The subsequent experience seems to have discounted that view. It is a very difficult area partly because people's behaviours and cultures change and people react to changes in ways that may not have been envisaged.

The Hon MICHAEL GALLACHER: I take it therefore that you have not conducted any audit commutations on the scheme?

Mr SENDT: No, only to the extent, the indirect extent, that the level of commutations impacts on the deficit.

The Hon GREG PEARCE: Have you done a performance audit on the WorkCover scheme?

Mr SENDT: No, we have not.

The Hon GREG PEARCE: When are you going to?

Mr SENDT: We ask for suggestions every year from Parliament as to what topics we should do and that has not been suggested to us.

The Hon GREG PEARCE: Perhaps I will suggest it to you.

Mr SENDT: You may do.

The Hon GREG PEARCE: How bad do you think the WorkCover deficit really has to get before it is taken really seriously, given that it is currently at the same sort of level as the HIH disaster? How bad would it have to get to really take it seriously?

Mr SENDT: That is a difficult question to answer. As I said, I know the ratings agencies, in determining how sound they regard the Government finances, take WorkCover into account. They would have been aware of the growth in the deficit. They are still taking the view that it is not serious enough to impact on the overall State finances. I guess where it would have an impact or would have real economic effects, if I can distinguish from what auditors and accountants might view it as, is if the deficit became such that there was either no real possibility of expecting employers to fund it, hence general taxpayers would have to fund it, or, alternatively, if the premiums or a special levy on the top of premiums had to be imposed and that was so high that it had an impact on investment decisions in the State by employers—for example, if the employers decided not to expand in New South Wales because workers compensation premiums were so high.

What that level is, I do not know. I do not doubt that employers or businesses, when deciding where to invest, look at a whole range of issues from land tax to stamp duty to pay roll tax and to workers compensation as well as where the markets are. How much each of those is weighted in their minds, I cannot say. Certainly we consider it is serious enough at this stage to have reported on it to Parliament and to have contemplated at least qualification on the basis of going concern.

The Hon GREG PEARCE: Are you not having the wool pulled over your eyes by the Government? In your predecessor's 1998 report, he drew attention in 1996 and 1997 to future viability of the scheme's statutory funds. I will read from his report to Parliament:

Because the Government has now taken steps to replace the scheme with a privatised system, it was not considered necessary to highlight this matter in this year's audit report.

That was the excuse then. What is the excuse now? The reforms came in last year. Are you doing your job? Are you really testing that?

Mr SENDT: I do not think it is our role to test the will of Parliament in passing reforms or not passing reforms.

The Hon Dr PETER WONG: Can I ask the Hon Greg Pearce's question another way?

Mr SENDT: Okay.

The Hon Dr PETER WONG: If you take WorkCover as a separate entity, as you mentioned earlier in connection with HIH, how bad is it? To what extent is it comparable to HIH?

Mr WHITE: We do not have an understanding of HIH, except what has been reported in the media. Obviously the royal commission is ongoing so to draw a comparison with HIH would be improbable for us to do. What we can say is that you can see through the reports that there is a very significant deficit within the scheme's statutory funds at the moment and that is also having an implication for the total State sector accounts.

The Hon Dr PETER WONG: In more layman's terms, because I am not an accountant, would you say it is good, bad, very bad or extremely bad? Which term would you use?

Mr SENDT: It depends on whether you are talking about the result—

The Hon Dr PETER WONG: The unfunded liability as a whole.

Mr SENDT: —or the practices behind the result.

The Hon Dr PETER WONG: The WorkCover scheme overall.

Mr SENDT: The result last year was a deficit of \$2.75 billion. As I said, I cannot judge the accuracy of the actuarial projections about the latest reforms. We would have to see what transpires with those. If those reforms turn out to have no real impact—I am not suggesting that is the case—apparently the deficit would continue to

grow, and certainly in terms of dollars, the WorkCover scheme deficit would grow to something of a similar order to what the HIH liabilities are now being touted as.

CHAIR: I think the point being made by the Hon Dr Peter Wong is how critical you would then be of that. I get the general gist that you would start to make some pretty strong statements. At what point do you get concerned about the size of the deficit?

Mr SENDT: We have been concerned for a number of years. That is why it we draw it to Parliament's attention.

CHAIR: But verbally or expressing that in strong language.

Mr WHITE: There is a qualification on the total State accounts and that is a pretty strong indication that there is a disagreement at least over the accounting practice of the deficit.

CHAIR: That is your way of doing that. I suppose it is a matter of whether that registers with the community—that that is criticism.

Mr WHITE: Well, it is a combination. It would be the qualification on the total State accounts and it is also what is actually in the public document from the Auditor-General concerning the scheme's statutory funds as well.

Mr SENDT: I should add that our reports to Parliament do attract a degree of media attention. Certainly our coverage of the WorkCover scheme deficit within those reports has been one of the matters that has achieved media attention.

Mr WHITE: Certainly the Auditor-General and I in early 2000 appeared before the Public Accounts Committee as well in respect of WorkCover. In particular that issue was discussed with us at some length on the non-recognition as well. I think we also had discussions with Richard Grellman at the time he was doing his report.

CHAIR: I would just follow up that point about your qualifying WorkCover. If, for example, WorkCover does not increase the prudential margin to 75 per cent, would that be another reason why you would qualify WorkCover when you do you audit in June?

Mr WHITE: No. We would need to consider where the thinking is at the time of looking at it, if when looking at the regulation there is great support for that type of adjustment. What I would say on that also is that the other side of that entry is actually going to affect the unfunded deficit. If you moved the sufficiency or if WorkCover decides to move the sufficiency of its outstanding claims provision from a central estimate of 50 per cent up to 75 per cent, that is not automatically a 25 per cent change but it would be a significant increase onto the outstanding claims provision and then automatically onto the unfunded deficit. So that change in accounting policy may very well have a hundreds of millions of dollars change to the unfunded deficit, all other things that we have spoken about being equal.

The Hon Dr PETER WONG: Would you be very concerned if the sufficiency increased to 75 per cent, with the unfunded liability closer to \$3 billion as it is now? Knowing that you will not see any reform results within five years, would you not be very concerned about that?

Mr SENDT: I think you have to understand that changing the provision is simply an accounting entry; it does not change the way the scheme is operating. It certainly would increase the numbers, but that in itself would not be cause for concern. What is a cause for concern is if the scheme itself is continuing to run at a deficit and if the premiums continue to be less than what is required to meet the existing level of benefits, or, looking at it the other way, where the benefits are higher than the existing level of premiums will allow.

CHAIR: If it were increased to 75 per cent, it would not mean that the scheme is inefficient?

Mr WHITE: No.

CHAIR: You would regard it as simply an accounting change?

Mr WHITE: It is a change in an accounting policy to move from 50 per cent to 75 per cent.

The Hon MICHAEL GALLACHER: To make it consistent with other accounting methodology used by all other insurers?

Mr WHITE: Certainly, to bring it in line with that prudential regulation, if you like.

CHAIR: If they did it, and it increased the unfunded liability, you would probably need to have a qualification somewhere in that unfunded liability to explain why it jumped another \$0.5 billion or whatever?

Mr WHITE: WorkCover would be required to identify and explain that change in accounting policy.

Mr SENDT: It is certainly something we would comment on in presenting figures, so that any readers of our reports understood that there was a change in policies between the years that impacted the movement in the figures.

CHAIR: What would your estimate be? Would it be \$0.5 billion?

Mr WHITE: I could not say. You would need someone to sit down and do that estimate.

The Hon MICHAEL GALLACHER: For how long has it remained at 50 per cent?

Mr WHITE: Certainly for about the last five years it has been at a central estimate.

The Hon MICHAEL GALLACHER: Are you aware whether it was higher or lower prior to that?

Mr WHITE: Previous to that, they implemented for one year introducing a prudential margin. I could not tell you what the level of sufficiency was, but obviously it was greater than 50 per cent.

The Hon GREG PEARCE: That scared them?

Mr WHITE: They did not have it, then they brought it in for one year, and then they took it out again.

The Hon MICHAEL GALLACHER: So they have brought it down to 50 per cent?

Mr WHITE: Which is described as the central estimate or the best estimate, and that is how it is described in the financial statements.

The Hon HENRY TSANG: With the implementation of the 2001 reform, can you see any indication of the trend changing? Would it be likely to change to a more positive—?

Mr SENDT: We have not conducted audit work since the June 2001 audit. With regard to the changes that have occurred since then, firstly I doubt whether they have flowed through to any figures as yet, in terms of the claim lodgments and benefit payments. We would have to rely initially on the actuary's assessment at the time of the 2002 audit, assisted by our own actuarial advice.

CHAIR: You could ask the New South Wales Government Actuary to look at the reforms and advise you as to what the estimate of savings would be and how it would affect the unfunded liability?

Mr SENDT: We would look at the estimate of the liability in the June 2002 financial report and the actuarial advice on which that was based, and we would get the Government Actuary, or whoever happens to be our adviser at the time, to indicate whether that seemed appropriate. We would not conduct an audit or a review of the reform package itself.

The Hon GREG PEARCE: In both last year's and this year's reports to Parliament in relation to the WorkCover Authority you noted that the WorkCover Authority had a practice of revaluing non-current assets, which you say should, instead, have been credited to asset revaluation reserves, and that that has artificially inflated the surpluses of WorkCover. Has WorkCover corrected that yet, or is it still giving us incorrect results?

Mr WHITE: As you have rightly pointed out, there is that qualification about the accounting treatment of the revaluation of their investments each year. WorkCover, including the management, the board of directors and

the different boards, has always maintained that they are closer in an analogy to an insurance operation than another type of organisation such as a manufacturer. That assertion means that if they were an insurance operation, under the current standards they are allowed to take that revaluation through in the way they have currently been doing it.

Our view is that, whilst I have some empathy for that understanding, it does not match exactly what the accounting standards are saying, which is why we qualify. But in reaching a qualification, we do know that the accounting standard bodies have started to move to address a number of those types of issues, so that they may find that qualification removed if the standard bodies move that way.

The Hon Dr PETER WONG: Given that we will not see much result from the reform of the WorkCover legislation, and given that there is an unfunded deficit, is it almost unavoidable that WorkCover will need to increase its premiums?

Mr SENDT: I think it would be premature for us to say that, because, as some of the earlier questions have indicated, there is actuarial advice that indicates the reforms may have savings of up to \$1.3 million, which would have a substantial impact on the deficit. It will still leave a substantial deficit, and the Government obviously needs to keep it in mind whether it is \$1.5 billion or \$2 billion or \$2.5 billion after the reforms. At some stage, that still has to be addressed.

(The witnesses withdrew)

(Luncheon adjournment)

KATHERINE MARY McKENZIE, General Manager, WorkCover New South Wales, 400 Kent Street, Sydney, and

RODNEY STEWART McINNES, Assistant General Manager, Insurance Division, WorkCover, 400 Kent Street, Sydney, sworn and examined:

CHAIR: Are you conversant with the terms of reference of this inquiry?

Ms McKENZIE: Yes.

Mr McINNES: Yes.

CHAIR: If you wish to give any evidence in camera the Committee would be willing to accede to your request.

Ms McKENZIE: Thank you.

Mr McINNES: Thank you.

CHAIR: Do you wish to make an opening statement?

Ms McKENZIE: No, thank you.

CHAIR: The Committee has had previous briefings from you.

Ms McKENZIE: Yes. I think most of the things we would want to say in an opening statement we have covered one way or another in previous evidence or the Minister has covered in his remarks this morning.

CHAIR: One of the matters concerning the Committee has been the different versions of Tillinghast's advice to the Committee and some statements made by them at the last hearing. I would like that to be now clarified for the record. Some of their comments may contradict the views and statements made by WorkCover at the last hearing. If you do not have an opening statement, would you clarify any part of the advice provided to WorkCover by Tillinghast, the comments made by them at the last hearing, the second interim report of our Committee or statements made by Tillinghast at the last hearing?

Ms McKENZIE: I am not 100 per cent sure exactly what comments you are talking about but if this is going to the figures in the draft report compared to figures in the final report that was given to the Committee, then I would say that the draft report was very much a draft report. We tried to make that clear to the Committee at the time it was given. It was the best we could do in the time available. It was based on the best that Tillinghast could produce. There was a lot of pressure at that time for us to produce something. We put strong qualifications on it when it was given and when the January report came we did express the view that the January report was to be preferred because it had been able to take into account the passing of the legislation, the development of the rules and regulations to support it and also Tillinghast had had more time to look at the data and consider what the implications of the reforms might be. Really, that is the beginning and the end of the explanation for the differences between the numbers in the two reports.

CHAIR: So you or WorkCover did not have any real concern that there seemed to be a change in the figures between November and January?

Ms McKENZIE: It was an evolutionary thing. We always take the view, as the Minister said this morning, that these reports tend to be fairly conservative. As the Committee notes in its own report said, it is very difficult to cost these sorts of reforms. There is a lot of uncertainty attached to them. There is a lot of uncertainty before a bill is passed by Parliament as to whether it will come out the other end the same way it went in or will have substantial amendments made to it. All of those things potentially have big implications for costings.

There was a lot of cultural change that we were aiming for in the reforms. Actuaries really cannot cost that. As the Committee itself said, very tight time frames were associated with this. The reforms were evolving through a series of consultations with stakeholders and it was very difficult in that environment to be confident about the

accuracy of something that was produced with speed, but we did the best we could and in the interest of trying to give the Committee the most up-to-date information that we had, we gave the draft report.

CHAIR: Did you make a statement or any statements to the Minister or his office that you had some concerns about those November figures, even though they were draft figures, that you felt that they may have been inaccurate or could have been misleading?

Ms McKENZIE: No. We would have presented that information to the Minister on the same basis as we received it, that it was the best we could do in that time frame, that there were aspects of it that had not been properly investigated but it was the best we could do at the time.

CHAIR: Did you put that reservation in writing to him to say, "It is the best that we could do. It may need updating."

Ms McKENZIE: No. I am pretty sure we would not have put that in writing because at the pace that these things were happening most of this was being done through a series of discussions over time. At some stages things were changing daily in terms of what was going into the bill and what was not going into the bill, although some things were known earlier in the year. Subsequent to that we had the Sheahan inquiry, subsequent to that there was further work and more consultation and discussion with stakeholders that changed the final form of the bill. I think really the actuarial advice was just one aspect of what was going on and it was viewed in that context.

Mr McINNES: It is also fair to say that the reliances and limitations in the draft report itself made it reasonably clear what those limitations were and that the analysis had been done on a settlement year basis and that there may be further savings when it was looked at on an accident year basis.

CHAIR: Did you have any concerns yourself about that report in November or the information you were getting up until November?

Mr McINNES: Again, we took the report on face value as what it was represented to be, that is, a draft report on settlement year analysis—nothing more nothing less, and on that basis I think the report was fine and clearly the report in its own reliances and limitations sets out those limitations.

CHAIR: They qualified it themselves.

Ms McKENZIE: That is right. At the beginning of the draft report Tillinghast actually says, "This analysis is intended solely to provide a guide to the potential financial effects of proposed changes and does not purport to deliver a firm estimate of the likely saving" and we viewed it that way.

The Hon MICHAEL GALLACHER: They did not give in evidence, unfortunately, that sort of vagary that we interpret there in the letter.

Ms McKENZIE: It was written in the draft report. It was clearly there in the executive summary.

The Hon MICHAEL GALLACHER: You would think under oath you would be far more circumspect in what you were saying.

Mr McINNES: What we are saying?

The Hon MICHAEL GALLACHER: No, Tillinghast, when they were giving evidence. They were very clear in relation to their view.

Ms McKENZIE: They are issues you will have to take up with Tillinghast rather than us. You always try to be as clear as you can. I suspect that actuaries are not good at presenting in public forums like this and some allowance has to be made for that possibly as well. It can be fairly intimidating.

CHAIR: And the views they were presenting were again based on that interim report?

Ms McKENZIE: That is right. The real truth was in that time frame some of the work had not been done yet and December gave the opportunity for more of that work, remembering that the bill was not passed by the Parliament until 4 December. It was not until after that that WorkCover did a lot of work on the rules, regulations

and guidelines to support the bill with the aim of 1 January implementation and seeing the details of all of that obviously gave a much clearer picture than a draft bill that had not been passed by the Parliament possibly could.

CHAIR: So in a sense it may have been misleading to have called it a report; maybe it was more of a guide?

Ms McKENZIE: With hindsight perhaps we should have been a bit more reluctant to give something that was so clearly a draft—

CHAIR: To perhaps downgrade it in some way to show that it was a guide?

Ms McKENZIE: Yes. That will always be the case with any report given on reforms before you have actually seen the reality of what happens when they are implemented. It is quite often the case that reforms, particularly in workers compensation schemes, do not deliver exactly what you have anticipated they will deliver so any actuarial report is going to have to be read in that context but may not turn out exactly the way you thought it would.

CHAIR: Are you happy with Tillinghast's work? As an employee—you are paying them—are you happy with their approach in November and subsequently?

Ms McKENZIE: They are not really employees. They are independent contractors. We, of necessity, rely on their professional advice and expertise. They are a well-respected, renowned actuarial firm. We have got no reason to think that they are giving us anything other than their best professional advice.

CHAIR: So you have not been critical of them?

Ms McKENZIE: No.

CHAIR: There have been no critical communications from WorkCover?

Ms McKENZIE: In the nature of any contractual relationship of that kind we often put pressure on them to say, "We need a report now. Can you do it a bit faster?"

CHAIR: No, I meant the quality of their work. Are you happy with the quality of their work?

Ms McKENZIE: Yes.

The Hon MICHAEL GALLACHER: We saw some announcement about 1½ weeks to two weeks ago by Justice Sheahan as commissioner about difficulties you are experiencing with the arbitrators. Where are you up to with that?

Ms McKENZIE: I should just clarify that is not us, it is the Workers Compensation Commission that is managing that process so that is a question that may be better addressed to Justice Sheahan or somebody from the Workers Compensation Commission. Certainly, I read the press articles, possibly like you did, which said they recruited 33 arbitrators. In context that is probably not a problem because it will take quite some time for disputes to arise and the likelihood of us needing more arbitrators in the foreseeable future is fairly slim and, as I understand it, Justice Sheahan made those comments in the context of a speech about what was happening at the commission and really I think the emphasis was that he was not going to take just anybody. He was only going to take good quality applicants, which we would very much endorse, because whether the reforms deliver what they need to deliver will be dependent on making sure that they are good quality applicants, those people who will be arbitrating these very serious disputes.

The Hon MICHAEL GALLACHER: What has WorkCover done to assist to ensure that you do get that up and running and fully operational because obviously you have a vested interest in the success of that commission. It is not just a matter of sitting back and watching it in the newspapers.

Ms McKENZIE: Certainly in the lead-up to the establishment of the commission there was a lot of support provided in helping to get the information technology systems up, helping to get the building in order, making sure that staff were recruited and that it was able to be up and running on day one, but in terms of recruiting arbitrators, that is not my decision; that is a decision for Justice Sheahan. Those processes have been worked out by

the commission. Obviously we have an interest and we are happy to be helpful where we can be but it is not my responsibility. It is the Workers Compensation Commission's responsibility.

The Hon MICHAEL GALLACHER: With the operation of the commission so far, what have you been able to see? In terms of the kind of matters that are coming before it, have you been able to form any opinions or assumptions?

Ms McKENZIE: I think the real truth is that it is far too early to say. It is only the middle of February; not much happened in January, unsurprisingly. I think the last figures we got suggested that there had only been three or four matters go to the commission. The early signs are encouraging in terms of the IT system being up and the aims that we set of trying to have a paperless system that could be run as efficiently as possible. That seems to be going okay, but I think it is too early to say. We need to wait at least another six or seven months before we have a clear picture of how that is travelling.

The Hon MICHAEL GALLACHER: As part of the next stage, the scheme design, have you conducted a review of the role or operation of the WorkCover Authority in regard to what options are available for the future of the WorkCover Authority in its role within the scheme design?

Ms McKENZIE: Certainly we are putting a lot of effort into our internal management, our planning and budget cycle, developing our corporate priorities, looking at our organisation to make improvements wherever we can. There is a lot of effort going into that and a full program is under way looking at those things. However, in terms of the future role of the authority, I think that is linked into further work on scheme design because obviously the way the authority is structured and the functions it undertakes or does not undertake will be dictated by the decisions of the Government and the Parliament about the future structure of the scheme. We cannot anticipate that; all we can do is be as prepared and well run as we can be and able to adapt to any changes that come upon us as a result of those sorts of public policy outcomes.

The Hon MICHAEL GALLACHER: I take it that no recommendations or options have been put by you to the Government to look at perhaps streamlining the way WorkCover operates? Downsizing?

Ms McKENZIE: I do not think there is much room for downsizing. I have been there for 18 months now. When I first got there that was my prejudice. Now, having had a pretty good look at the place, I think if anything there are some areas where we could improve our level of expertise. Like any organisation, it is not perfectly run. There are probably areas where people are not utilised as well as they could be. That is why we have begun a process of organisational improvement that is going through at a very micro level, looking at each branch in the organisation, what it does, whether it has the right staffing complement, whether it has the right skills set, looking at all of those issues. I guess we are seeing Gosford as an opportunity in that context because we expect we will have a higher rate of turnover than would be normal to ensure that we are not filling jobs that we do not need to fill, that if we are having a look at those jobs to make sure that they are still relevant, that we are recruiting people with the right skills set. That will be an ongoing process for at least the next 12 months.

The Hon MICHAEL GALLACHER: You have raised the issue of Gosford. With the creation of the new Workers Compensation Commission in the city what are you preparing for with regard to the distance between Gosford and the commission here?

Ms McKENZIE: Once again we have a large IT strategic plan. All of it is being proceeded with with Gosford in mind. We are expecting to have a much heavier reliance on electronic communications of various kinds. We are modernising our systems, rebuilding all our infrastructure, looking at things like our telephony services to try to find options that mean we do not have to pay STD rates on phone calls, all those sorts of things. There is a full and comprehensive plan that we could readily make available to the Committee should you be interested about what we are doing on the IT front both to support the reform program and also with a view to ensuring that we can still operate efficiently and have good lines of communication when we move to Gosford.

The Hon MICHAEL GALLACHER: What will the annual saving be on making that relocation to Gosford, for example, with regard to rents and those sorts of costs?

Ms McKENZIE: I will have to take that on notice. I do not have those figures in my head. We can tell you what the current rent is. I just do not happen to recall it right now.

The Hon MICHAEL GALLACHER: That is fine. As we were going down that path I just thought I would ask you that question.

Ms McKENZIE: If I can take that on notice we can get back to you with the numbers on what the annual rent is.

The Hon MICHAEL GALLACHER: What staff will be staying? Will executive staff be staying in Sydney?

Ms McKENZIE: No.

The Hon MICHAEL GALLACHER: The whole lot. So you will be up there as well?

Ms McKENZIE: Yes.

Ms McKENZIE: How do you go between that and IR?

Ms McKENZIE: I will still have an office in the city. I expect what will be happening is that I will be having a fairly mobile existence. I will be commuting between Gosford and the city and just making sure I plan my work around that.

The Hon MICHAEL GALLACHER: It is a great life.

Ms McKENZIE: Just getting down to the practical realities of this, I go to Gosford reasonably frequently now because the building has been built. I do my emails and I talk on the phone and I do files etc. It just takes a bit more organisation but it is perfectly possible to do with modern technology. It is pretty reliable. I can do my IR role and my WorkCover role on the same computer. It links into their systems. It takes a bit of organisation.

The Hon MICHAEL GALLACHER: Can you take on notice the savings between Gosford and the city?

Ms McKENZIE: Yes.

CHAIR: Are there any problems with the transfer of staff to Gosford where you may lose some of your more experienced people who are not prepared to move to Gosford?

Ms McKENZIE: We are certainly doing our best to plan for that. Some people have said that they will not be coming to Gosford. We have done a number of staff surveys to try to map who those people are. It does get very difficult because people change their minds. A lot of people who originally said they would not go to Gosford are changing their minds and saying that they will go. So we are just trying to ensure that to the extent that we can manage it actively we have the crucial people we need in place to ensure that we have business continuity and that this is managed over a period of time. People come and go. I guess in the end it is just about managing a slightly higher rate of turnover than we have traditionally had in WorkCover. In some cases that is probably not such a bad thing. We have had some very good people join the organisation in recent times because they live on the Central Coast and they are sick of commuting. They have brought a lot of new enthusiasm and keenness to the organisation and are very keen to get to Gosford.

The Hon TONY KELLY: There will be a high turnover to begin with but then it stops altogether.

Ms McKENZIE: We have done a lot of looking at other agencies that have been moved. I guess we are anticipating a similar experience. To begin with there is a fair degree of resistance and staff are fairly negative about it but over time as they get used to the idea and consider their options some of that negativity disappears. If you take the Department of Agriculture as an example, it ended up retaining a lot more of its staff than it had anticipated.

The Hon TONY KELLY: Forty per cent, I think.

Ms McKENZIE: I think you just have to manage that over time. That is all you can really do. As I said, we have gone through a process to map all our crucial skills and positions and we have a range of strategies for ensuring that we try to retain the skills that we need over the transition phase.

The Hon TONY KELLY: The firearms registry has had a 1 per cent turnover in two years.

Ms McKENZIE: We have tried to see it as an opportunity but in the context of the move to Gosford we can have a look at some of our organisational structures and make sure they are still what we need, what we want right now.

The Hon GREG PEARCE: What is the attitude of the board to the deficit?

Ms McKENZIE: I am not sure what you mean by that question. As a member of the board I can tell you what my attitude is.

The Hon GREG PEARCE: What I am getting at is that when I have gone through the board papers there is very little sense of urgency about doing anything to address the deficit and I wonder what the board's attitude is to the deficit. Is it one that simply says, "Tough luck, the State will pick it up or the employers will pick it up." What is the attitude?

Ms McKENZIE: I guess I find it a little difficult because you are asking me to make comments about the state of mind of other people. I think that is probably something—

The Hon GREG PEARCE: I have said to you that in looking at the records of the board, the minutes, there is no sense of urgency.

Ms McKENZIE: I guess all I can say in response to that is that certainly it has been discussed at the board. It is discussed at the board on a regular basis, particularly when the quarterly reports and the evaluation reports come to the board. They view it with seriousness. It is one thing to view it with seriousness; it is a much more difficult matter to work out what you can do to fix it.

The Hon GREG PEARCE: What initiatives has the board taken to try to fix it?

Ms McKENZIE: In the context of the way the authority is structured at the moment, the board only has responsibility for the administrative policies of the authority. There is a split there. The board does not have responsibility for developing the policy aspects of this, if you like. That is the Government's responsibility.

The Hon GREG PEARCE: Has the deficit arisen because of the costs? The issues we found were increased use of common law, inappropriate commutation payments, inadequate premium collections and reduced return on investments. They sound to me like administrative management issues, not policy development issues. They are things that a board would be actively trying to address.

Ms McKENZIE: I think I would disagree with that. Certainly the board has looked at it.

The Hon GREG PEARCE: Investment returns—what is the policy there? Inadequate premium collections—what is the policy there? Am I missing something?

Ms McKENZIE: No. I guess I am just trying to make the distinction between—I guess we always have to remember in this scheme that basically how it operates is determined by the Parliament and by the legislative framework. While ever that legislative framework is in place I as general manager and the board must act within the structure of that legislative framework. All the things you have talked about are dictated by what the legislative framework says about what the rules are.

The Hon Dr PETER WONG: Are you trying to say that everything is the Government's fault?

Ms McKENZIE: Well, everything is the Parliament's fault.

The Hon GREG PEARCE: I do not have much of a role in collecting premiums.

Ms McKENZIE: But the Parliament sets the rules for how that is done. In terms of collecting premiums, maybe there is a bit of a different argument. As you know, we have been doing a lot of work on how we can look at that but at the end of the day a lot of those issues come back to the scheme design issues that we have talked about. It is the insurers who collect the premiums.

The Hon GREG PEARCE: The Minister is the insurer.

CHAIR: You have made a distinction about the WorkCover board handling administrative matters. Who handles the other matters just read out by the Hon Greg Pearce?

Ms McKENZIE: In terms of changes—

CHAIR: Obviously you are responsible but do you have another committee or executive group?

Ms McKENZIE: Certainly we have an executive group. In terms of the sorts of changes like the reforms that were put through last year we obviously had a big hand in formulating those but in conjunction with the advisory council, the Labor Council, employer groups and everybody else who had an input into it. Ultimately what was put forward to the Parliament was a decision of the Cabinet and ultimately what got passed was a decision of the Parliament.

CHAIR: Was it the board or your and your executive officers doing all that work you just referred to?

Ms McKENZIE: It was mostly the executive.

CHAIR: It almost sounds as though the board is an advisory group.

Ms McKENZIE: No. It is very difficult. You would have seen from the board papers that a great range of matters go to the board. Investment performance is certainly closely monitored by the board—which approves any changes to it—as are licensing issues to do with insurers. Decisions made in the context of the legislative framework go to the board for its endorsement or otherwise. There is a lot of robust discussion and debate about those things. Because of the way the statute is set up the board is responsible for administrative policies, such as the regulation of self-insurers, investment performance and whether the investment strategy is correct or should be changed—as we did last year.

The Hon GREG PEARCE: Is the board responsible for managing the insurers or is that a matter for government and Parliament?

Ms McKENZIE: It is not responsible for managing the insurers: the insurers are responsible for managing themselves. The legislative framework dictates the beginning and end of our responsibility. We have a regulatory role in relation to insurers but we do not manage them.

The Hon Dr PETER WONG: So you have no management role whatsoever?

Ms McKENZIE: With insurers.

The Hon Dr PETER WONG: Or anybody for that matter.

Ms McKENZIE: We regulate them. We introduce restrictions in terms of what they can and cannot do within the boundaries of the legislative framework.

The Hon GREG PEARCE: I have a simple question: Did the board or WorkCover recently renegotiate the insurers' remuneration packages?

Ms McKENZIE: Yes, we are in the process of doing that.

The Hon GREG PEARCE: You are doing that, not the Government? As part of those packages are you building in incentives for the way that insurers perform?

Ms McKENZIE: Yes.

The Hon GREG PEARCE: So you have a role regarding the way that insurers perform?

Ms McKENZIE: A regulatory role.

The Hon GREG PEARCE: Are you not building in the dollars that they are paid?

Ms McKENZIE: I do not manage an insurance company. We are trying to build in the best set of incentives we can that line up insurers' behaviour with the outcomes that we are seeking from the scheme. Basically, we are setting rules at a high level and saying, "You work out for yourself how you are going to get there. If you get there, you'll get paid; if you don't get there, you won't get paid."

The Hon GREG PEARCE: You do not call that management?

The Hon TONY KELLY: It is a contractual arrangement; management is day-to-day operations.

The Hon GREG PEARCE: That is what management is.

The Hon TONY KELLY: No, it is not; they are two different things.

Mr McINNES: It is not even a contractual arrangement; it is a licensing arrangement. They are licensees.

The Hon GREG PEARCE: Does it or does it not have an impact on the way they operate?

Ms McKENZIE: Perhaps this is a semantic discussion, but I do not call that management.

The Hon GREG PEARCE: Does it have an impact on the way that you expect insurance companies to perform their role?

Ms McKENZIE: Yes, but there are limits on the extent to which we can influence that.

The Hon GREG PEARCE: It appears from the way in which the deficit blew out that you have no influence over that.

Ms McKENZIE: I am not sure that you can blame the insurers for the deficit either. One of the difficulties of is that there are many aspects to this. A whole range of factors has contributed to the deficit over the years. I do not think you can say it was the fault of the insurers or WorkCover.

The Hon GREG PEARCE: I am not suggesting that it is the fault of the insurers; I am asking what role WorkCover has played in doing something about it.

Ms McKENZIE: I will give the same answer: WorkCover has done the best it can within the confines of the statutory arrangements and the legislative structure.

The Hon Dr PETER WONG: Who manages the whole scheme? Is there no manager?

Ms McKENZIE: I am becoming a bit troubled about the possibility of quite different interpretations of what "managing" means.

The Hon Dr PETER WONG: You tell us what it means. Is there a manager in place to manage the WorkCover scheme? If there is a manager, what role do you play in that management? You say you are not the manager, so who the hell is?

Ms McKENZIE: If you look at the scheme you will see that it has many participants—including medical providers, rehab providers, physios, occupational physicians, insurers, lawyers, WorkCover, the Government and Parliament—all of whom contribute in one way or another to its success or failure. It all ties together or does not tie together. You cannot say it is the fault of one person and not anybody else.

The Hon Dr PETER WONG: I am not saying that it is anyone's fault; I am seeking a definition. Are you a manager of some kind?

Ms McKENZIE: I am manager of the WorkCover Authority.

The Hon Dr PETER WONG: But you do not manage the WorkCover scheme.

Ms McKENZIE: I manage only aspects of the WorkCover scheme. We are a regulator of the scheme. I do not manage the claims or the insurance companies. We set the rules within the constraints of the legislative framework in the best way we can to encourage good scheme outcomes.

The Hon Dr PETER WONG: Assuming there is 100 per cent management—whatever you like to call it—what percentage is your management of the scheme: 10 per cent, 15 per cent or zero?

Ms McKENZIE: I am not sure that I can give a sensible answer to that question.

The Hon Dr PETER WONG: Your answers do not make sense to me. You are trying to tell us that you are managing something but we do not know what exactly. To what proportion do you manage—however you like to define it?

Ms McKENZIE: I do not think I can give a sensible answer. I manage the WorkCover Authority. Part of my responsibilities in managing the WorkCover Authority is to regulate, within the constraints of the statutory scheme that is set down, various aspects of the scheme, including insurers, lawyers and so on. I do not manage; I regulate.

The Hon TONY KELLY: The Hon Dr Peter Wong is referring to where we should go in the future.

CHAIR: We are discussing the current situation, which seems to be confusing. One of the roles of this Committee is to help WorkCover and the Minister to make recommendations that may affect the future structure and operations and where responsibility will lie. The structure has developed over the years and has not been clarified properly. That is part of the problem. It is not your personal problem, Ms McKenzie, because you have not been there all that time. We must admit that there are some problems with the structure of the organisation and we must examine them and return with some positive recommendations.

Ms McKENZIE: I agree with that.

CHAIR: We will discuss that issue at the forum.

The Hon Dr PETER WONG: I note that Ms McKenzie's title is "General Manager".

The Hon TONY KELLY: Of the authority, not the whole scheme. She does not manage the lawyers—no one manages them.

The Hon Dr PETER WONG: She should have advised the Government, or Parliament for that matter, a long time ago that nobody is managing the damn thing.

Ms McKENZIE: That is not quite what I said.

CHAIR: No one person is managing everything. Is a basic problem the fact that the arrangements, such as licensing, restrict the actions that WorkCover can take to improve insurers' performance in the scheme?

Ms McKENZIE: Yes.

CHAIR: That is another area we must look at.

Ms McKENZIE: What you say is quite right: many of these things come back to the way that the scheme was designed, which is why the Minister has said that we must look at this area next to see what clearer arrangements we can develop.

CHAIR: Do you have any thoughts about what improvements you would recommend in response to the problems that the Hon Dr Peter Wong mentioned?

Ms McKENZIE: Once again it is difficult to know the correct answer. There are many potential options. Looking around Australia, every jurisdiction has a slightly different way of organising it. In Queensland it is a public monopoly and part of what the bureaucracy does is manage the scheme: it manages the claims and is basically a centralised insurer. Western Australia has very much a privately underwritten model and the regulation is fairly hands off. Victoria is a little similar to NSW. It has a series of contractual-based arrangements with providers in the

scheme and it uses that as a mechanism for trying to control their behaviour. I guess it is a matter of judgment as to which of those works better.

CHAIR: Does WorkCover have any recommendations about direction?

Ms McKENZIE: I certainly think there are limitations associated with the current legislative framework and the powers that WorkCover has. In most cases we are one step removed: it is all care but no real control over what the players in the scheme do. In my view, we need to move in one direction or the other. We either say "Over to you" and set up a regime whereby people look after themselves in the scheme—

The Hon TONY KELLY: The West Australian scheme, in other words.

Ms McKENZIE: Yes, or we move to the Queensland scheme or to some hybrid model in between involving some contractually based set of arrangements whereby you might contract—the Minister mentioned this possibility this morning—with a whole series of different people, including insurers, to carry out different functions in the scheme. At least by doing that you are dividing it up on a functional basis and you are clear about what the arrangements are for each function. That is one of the difficulties we have with the current arrangements. In many cases it is not that easy, partly because the structure has evolved over time, as you said. Perhaps it is time to sit back and look at whether the fundamentals are right.

CHAIR: Perhaps someone should produce a blueprint for the future. Maybe we can all do that together—or perhaps we would finish up with another hybrid monster.

Ms McKENZIE: We have engaged in some significant reforms over the past 12 months and certainly our focus at the moment is very much concentrated on trying to ensure that those reforms are implemented as effectively as we can possibly manage. A lot of effort and energy inside the organisation—the reform process and the monitoring process—is going in to trying to ensure that those targets that have been set are met, to the extent that that is within our control. We need to spend some time and energy concentrating on that. The other point is that that has caused a lot of upheaval for participants in the scheme and we need a little time for it to settle down before we launch into more major change.

CHAIR: The recent changes to the scheme are the biggest for years.

Ms McKENZIE: That is right. I think we need to be a little careful about this next phase of reform. We must ensure that we take our time and hear evidence from everybody with expertise to offer—we need to talk to a range of people. There are many possible options. The think I told the Committee before that I took a quick trip to the United States [US] last year to examine these sorts of issues. I asked Richard Victor, head of the research institute in the United States who monitors all the US schemes, what he thought was the best model. He replied that he thought it was an impossible question to answer because you cannot say, "Here's the question; here's the answer". You must look at a whole array of cultural issues. In some cases, when what works in one jurisdiction is duplicated in another jurisdiction, it is a dismal failure. It is often very difficult to tell why it has worked in one place but not in another. It sometimes comes down to cultural issues, the nature of the industries in that area or how the economy is travelling. We will have to be very careful and ensure that we go through a proper process and hear all the potential views before we leap off and do more harm than good.

CHAIR: You must ensure that all the current reforms, which are quite dramatic, are working successfully.

Ms McKENZIE: Yes.

CHAIR: Do you have some sort of timetable in mind after which you can say that everything—for example, the new arbitrator system and so on—is working? Do you think that will take six months or 12 months?

Ms McKENZIE: I think six months will definitely be too short because of the current rate at which matters are coming in—we will have had hardly any matters by then. The early indications are encouraging. In 12 months we will have a slightly better indication, but in some cases it will be three to five years before we really know. It is worth reiterating some of the evidence given previously to the Committee: these are long-tail schemes; claims can last for 40 or 50 years. Looking at short time periods and trying to make judgments about the future can be a very dangerous pastime. Mistakes were made in the past: things looked as though they were travelling well and changes were made to the scheme that ended up sending it back into deficit. I think we should be careful not to draw too many conclusions too soon about how these things are travelling.

CHAIR: I was referring not so much to the savings but to the period before the new systems will be functioning. Will that take six months or a year?

Ms McKENZIE: We met our 1 January target: everything was proclaimed and commenced on 1 January. The infrastructure is there.

CHAIR: I was referring to the activity.

Ms McKENZIE: That will take some time to flow through.

The Hon TONY KELLY: It has to settle down to a level playing field.

Ms McKENZIE: It is the same principle. I was not talking so much about the financial impact. It will take quite a while to see whether behaviours are changing in the way that we anticipated or whether something different is happening. We will have to keep an eye on that for quite a long time. The experience of previous reforms to the scheme have been that you might have fixed the problem over here but suddenly another problem pops out over there that you have not anticipated when you were doing the reforms. We will keep a close eye on how that is all travelling for at least a couple of years.

CHAIR: Are the new arbitrators in operation?

Ms McKENZIE: Yes. The 33 arbitrators are already recruited and on board.

CHAIR: They are working?

Ms McKENZIE: There are no disputes for them to deal with. They would be capable of dealing with disputes, as I understand it, but there are not any disputes yet because they have not got through the system.

The Hon MICHAEL GALLACHER: How long will it take for them to get through the system?

Ms McKENZIE: It is a little bit hard to say. Once again, the early signs are encouraging, with provisional liability, the claims assistance service and some of the other measures that we have put in place. As you know, one of the original aims was to try to reduce the number of disputes. The early signs are that they have been quite effective. In a way, from our point of view, this would be a good thing because it was an aim to reduce the number of disputes. It may mean that it takes longer for disputes to get to us.

The Hon MICHAEL GALLACHER: Is the arbitrator getting paid on a job-by-job basis?

Ms McKENZIE: Yes.

Mr McINNES: It is important to realise that there is this notion of a honeymoon period, which has come up previously with any changes. Once the change is put in place, until everyone involved in the system—and there are lot of players involved in this system—get used to how the system works, you get this apparent better than might be real outcomes starting to come through. The fact that we have had only three or four matters arrive at the commission to date is certainly not indicative of what you would expect longer term. I would expect you would probably need to get twelve months experience before things stabilise at some kind of equilibrium in terms of the commission. In terms of other areas, like commutations and common law, you might have to wait five years before you get to a point of equilibrium.

The Hon MICHAEL GALLACHER: I direct my question to Ms McKenzie. What changes, if any, are likely to occur to the prudential management of the scheme on or before 1 July? I believe there have been some changes in relation to prudential holdings at a Federal level.

Ms McKENZIE: Do you mean the new Australian Prudential Regulation Authority [APRA] requirements?

The Hon MICHAEL GALLACHER: To bring it up to 75 per cent?

Ms McKENZIE: Yes.

The Hon MICHAEL GALLACHER: What effect will that have on the unfunded liability?

Ms McKENZIE: The scheme is not bound by APRA regulation and has not been bound by APRA regulation, so it does not necessarily flow on at all.

The Hon MICHAEL GALLACHER: So it will not have an effect at all?

Ms McKENZIE: No.

The Hon MICHAEL GALLACHER: You will not go up to the 75 per cent.

Ms McKENZIE: At the moment we could not.

Mr McINNES: We are not meeting the 50 per cent, as you know.

The Hon MICHAEL GALLACHER: We were told earlier that other prudential organisations maintain that 75 per cent, whereas in New south Wales we have 50 per cent.

Ms McKENZIE: That is probably a desirable aim to have, but it is not very realistic at the moment given the financial state of the scheme.

The Hon MICHAEL GALLACHER: When will you be finalising your submission? I believe you told us earlier that the Parliament sets the premium rates. All the time I have been a member I have never been asked to be involved in setting premium rates.

Ms McKENZIE: It is not the Parliament that sets the premium rates, it is the Governor.

The Hon MICHAEL GALLACHER: When you say the Governor sets the premium rates, he signs the decree.

Ms McKENZIE: Yes.

The Hon MICHAEL GALLACHER: On whose recommendation does he do that?

Ms McKENZIE: The board's.

The Hon MICHAEL GALLACHER: Not the Minister's recommendation.

Ms McKENZIE: No.

The Hon MICHAEL GALLACHER: So really the board is setting the rates and the Governor signs the bit of paper. When will you finish your submission—and I suspect you would put a submission with your involvement in the board—with regards to premium rates for the next twelve months?

Mr McINNES: That is normally finalised for the April board meeting, which would be the last Monday in April, I think.

The Hon MICHAEL GALLACHER: What actuarial report on the scheme will be the one that they will use—the next one?

Mr McINNES: It will be based on the December valuation, which the actuaries have now started work on and would be due at the end of March. That forms the basis for the premium rate setting process.

The Hon MICHAEL GALLACHER: Will the actuary, to the best of your knowledge, include the \$1.3 billion one-off saving on the scheme in those calculations?

Mr McINNES: I suspect the actuary will use the lower figure for the December calculations.

The Hon MICHAEL GALLACHER: The lower figure was?

Mr McINNES: \$800 million or so.

The Hon MICHAEL GALLACHER: You believe the actuary will factor that in?

Mr McINNES: That is what I believe, yes.

The Hon MICHAEL GALLACHER: Do you have any information to show whether the scheme has blown out any further?

Mr McINNES: The purpose of that valuation is to assess that question. We will not know until we see that.

The Hon MICHAEL GALLACHER: When does the board sign off on setting the premium rates?

Ms McKENZIE: It normally goes to the April board meeting.

The Hon MICHAEL GALLACHER: And the board will make its determination then?

Mr McINNES: That is correct.

CHAIR: One of the problems in trying to work out the deficit is the impact of the legislative reforms. We have heard a great deal about the retrospective impact. How do you understand the retrospective impact of the reforms?

Ms McKENZIE: There are some retrospective impacts, partly retrospective as to process and some retrospective impact as to benefits in relation to common law and commutations. You can make out an argument in relation to commutations that it was only ever a wrapping up of weekly benefits into a lump sum. So all you have done is said there are more limited circumstances in which you can do that now. The retrospective impact comes about because effectively after the cut-off date in the legislation people will be governed by the new rules rather than by the old rules. I think that was reasonably clearly understood at the time.

CHAIR: Did Tillinghast, as the actuary doing those reports, understand the retrospective aspect? That seems to be one of the reasons why they were confused with their calculations.

Ms McKENZIE: I think what actually happened there was the work had not been done on costing the retrospective aspects in the earlier draft report, but it was done in time for the January report. Once again it is difficult because we are obviously talking regularly to Tillinghast about developments in the policy development process and what the final package was likely to look like, but they were playing catch-up, if you like, trying to cost some of this stuff along the way. They tried to focus on giving us the best that they could at the time. They just did not have time, as I understand it, to cost the retrospective impact until the January report.

CHAIR: Was that because of their lack of knowledge of it or because of lack of time?

Ms McKENZIE: Lack of time, I think.

CHAIR: Were they aware of the retrospective aspect?

Ms McKENZIE: At what point they were aware of what—

CHAIR: Did you brief them on the retrospective aspect or draw it to their attention?

Ms McKENZIE: We were giving them documents and we were having discussions with various people who work at Tillinghast.

The Hon MICHAEL GALLACHER: Was that after 26 November you had those meetings and gave them those documents?

Ms McKENZIE: It was continuous all through the year.

Mr McINNES: It was continuous. There are elements that are retrospective, if you like, in relation to the original bill that was passed in June. There are elements that are retrospective, obviously, in the second bill. All of the elements that form those bills were subject to negotiation and consideration of different options and various degrees of retrospectivity, et cetera. That was subject to the consultation process and elements of that were finalised at different stages. Some elements were finalised, then revisited at later stages. Again it was very much a moving piece. We attempted to keep Tillinghast abreast of that as reasonably possible.

Ms McKENZIE: For example, the Minister mentioned in his evidence this morning that Sheehan had recommended the 1 January cut-off date for common law. Once the exposure draft bill went out we had a great flood of claims. So the decision was taken to move that date to the date of introduction of the bill because the view was that people had sufficient forewarning. That is obviously going to have an impact because it was a lesser period of time during which claims could flood into the system, which they could not have known until that happened.

CHAIR: In your structure who tells Tillinghast to make sure it takes account of the retrospective nature?

Mr McINNES: I am the one primarily responsible for liaising with the actuaries. I am not the only person obviously who talks to them from time to time. It was certainly my primary responsibility.

The Hon MICHAEL GALLACHER: What meetings did you have with them after 26 November to 7 January? You obviously had a Christmas break.

Mr McINNES: I did.

The Hon MICHAEL GALLACHER: How many meetings did you have with them prior to the Christmas break after 26 November?

Mr McINNES: I could not give you a specific number. A lot of contact occurs over the phone and we have contact via e-mail and face-to-face. We have contact regularly through all three mediums.

Ms McKENZIE: A lot of what would have been going to the actuary at that time, remembering that the bill did not pass the Parliament until 4 December, was "Here is the final version of the bill." Then progressively over a period of time "Here are our draft rules and guidelines." As you would know, there was a lot of subordinate legislation that supported this, including finalising impairment guidelines and a whole raft of regulations that were not developed and certainly not finalised until after that point in time. As they were developed they were passed on to Tillinghast. Like any actuary, the more information they got the clearer a picture they were able to develop, hopefully, and that fed into their January report.

CHAIR: Did you ask them to do the five scenarios for the January report? Did you initiate that or did Tillinghast?

Mr McINNES: The five scenarios were done in the first half of the year, from memory. That was not new work. That was earlier work that was built on with their subsequent work.

CHAIR: Did you or did they propose that?

Mr McINNES: I think those scenarios came out of discussions with Tillinghast. Certainly I do not think I personally proposed those. They looked at a range of hypothetical outcomes from the reforms that we were intending to put in place and set up a number of models for modelling possible implications. Out of that process came their five scenarios.

Ms McKENZIE: Ultimately those decisions are up to Tillinghast. We hire them to give us professional advice. We have a lot of dialogue with them making sure that we give them as much information as we can. But we hire them as our professional advisers. How they choose to present information and that kind of thing is their decision.

CHAIR: They initiated the five scenarios concept?

Ms McKENZIE: As I have just described, there were a series of discussions about the sensible way of presenting this, how can we indicate that there is a bigger range of things here, and that we are not going to have a

big degree of accuracy. It is probably lost in the midst of time as to who first suggested it. In the end, it is up to them to decide how they are going to present it.

Mr McINNES: That is right. Ultimately it was their decision to decide to present the information that way.

CHAIR: Who decided to reduce the five scenarios to the two scenarios we are now dealing with?

Mr McINNES: Again, I would say ultimately that was a matter for Tillinghast to make that decision. Again, it is fair to say we had discussions with them as they developed their modelling and analysis over time. As I understand it, a decision was made to focus on the two scenarios that were selected in the main body of the report as being the more likely and more relevant outcomes to the Government and to WorkCover.

The Hon MICHAEL GALLACHER: Have all the guidelines and absolutely everything required for the operation of that legislation been completed?

Ms McKENZIE: Yes.

The Hon MICHAEL GALLACHER: When was it completed by?

Ms McKENZIE: In time to be gazetted on 21 December.

The Hon MICHAEL GALLACHER: Do you remember the date last year that we finished debate on the workers compensation reforms?

Ms McKENZIE: It was 4 December.

The Hon MICHAEL GALLACHER: They gave evidence on 26 November.

Mr McINNES: I think it was 21 November.

The Hon MICHAEL GALLACHER: We then have the next lot of debate going through the Legislative Council. Going on what you have said, they had to wait for the legislation to pass before that was drawn up?

Ms McKENZIE: We did not start with a blank piece of paper.

The Hon MICHAEL GALLACHER: The impression you gave was that they had to wait for everything to be finalised.

Ms McKENZIE: Going back to what I said to begin with, the more finalised they were the more accurate a picture they could form about what was going to happen. There were bits and pieces of drafts of various things that we have been using to consult with all the stakeholders in the scheme. But they could not know what the final version was going to look like until we had been through all of those processes and they were gazetted on 21 December. I can tell you that there were negotiations over aspects of those things right up to the last moment.

The Hon MICHAEL GALLACHER: At the end of the day, the legislation went through virtually unamended.

Ms McKENZIE: Yes.

The Hon MICHAEL GALLACHER: They would have been working their calculations out on the legislation that you had presented to them plus the earlier guidelines. They would have known exactly what the Government's reform program was.

Ms McKENZIE: They might have been more sceptical than we were about whether we would achieve those timeframes or not and factor that in.

The Hon MICHAEL GALLACHER: You are only guessing.

Ms McKENZIE: I am only guessing. You have to ask them those questions. I do not know what their state of mind was.

CHAIR: Were those two scenarios chosen by Tillinghast or by you?

Mr McINNES: Obviously, the lower scenario is what they are calling their actuarial central estimate, which is their midpoint. The highest scenario is, if you like, their advice on what result we would get if we, as we have described it, mainly achieved the targets that we originally set. This comes back to some of the issues that have been talked about—the conservatism of the actuarial process. They are not confident that the targets that we have set ourselves will be met. Obviously, we are aiming to achieve those targets, and ideally better those targets.

The Hon GREG PEARCE: What are those targets?

Ms McKENZIE: Commencing on time.

Mr McINNES: For example, to reduce the number of disputes. We were looking to make some dramatic reductions. As has been talked about previously, the level of disputes in New South Wales is the highest in Australia, and we were looking to make some quite dramatic reductions there.

The Hon GREG PEARCE: To what, though? Are those targets on a piece of paper? What are those targets?

Mr McINNES: The targets were done in the modelling for those five scenarios. Part of the modelling of those scenarios—and I cannot remember the numbers off hand—is to achieve different levels, assuming different numbers of disputes, for example, in the system. Broadly, we were aiming to halve the number of disputes within the system. In practice, the midpoint scenario that they have assumed assumes that we do not meet the targets. Whether we do or do not, obviously time will tell. What we achieved over the next 12 months may not be what is achieved in three to five years time. I guess the issue in terms of that process was that we wanted to know what we would save if we achieved the goals we have set ourselves.

Ms McKENZIE: Might I make the important point that there are limitations. As we said at the beginning, you cannot put too much focus on the bottom line number that an actuary's report comes up with, because the only thing that we can be sure about is that it will be wrong. The only question will be by how much.

The Hon GREG PEARCE: I am not asking you that. I am asking you what were the targets that you set. Are they on a piece of paper? If so, I would like to see that piece of paper.

Mr McINNES: If you are asking do I have a single piece of paper at this point in time—

The Hon GREG PEARCE: I know you do not have it at this point in time. Is there a piece of paper, or can you compile a piece of paper, that sets out those targets?

Mr McINNES: We are in the process of finalising all those targets. When we did all the modelling there were targets set, and we can go back and dig out those targets from those models.

The Hon GREG PEARCE: I would like to see those targets.

Mr McINNES: That is possible.

The Hon GREG PEARCE: Are those the targets that Tillinghast refers to in the reports and in their scenarios?

Mr McINNES: Yes.

The Hon GREG PEARCE: They are the same targets?

Mr McINNES: But can I also say that those targets were set—

The Hon GREG PEARCE: Tillinghast talks a lot about the targets. I want to know what the targets were.

Ms McKENZIE: Fine. We will give them to you.

Yes. What Rod probably is trying to clarify is that since those targets were done things have moved on. We have had various pieces of legislation put in place, and what we expect to achieve now may not be entirely what we started out in the process hoping to achieve.

The Hon GREG PEARCE: When Tillinghast on 14 January 2002 writes and puts figures "if targets achieved", what are they talking about? Are they talking about the original targets or are they talking about new targets, or what are they talking about?

Ms McKENZIE: They are talking about the targets that they had at the time.

Mr McINNES: Which were the original targets.

The Hon GREG PEARCE: If we could see the original targets, that would be very helpful.

Ms McKENZIE: I guess the point that Rod is trying to make is that they are probably out of date already.

The Hon GREG PEARCE: We have been given a report dated 14 January 2002 with figures in it, and we are all working on those figures. You are now telling me that they do not relate to reality.

Mr McINNES: No, we are not suggesting that they do not relate to reality.

The Hon GREG PEARCE: Well, that they do not relate to what you are suggesting will happen.

Ms McKENZIE: They have limitations.

Mr McINNES: What we are suggesting is that they have limitations. Time moves on.

The Hon GREG PEARCE: What are those limitations?

Mr McINNES: The limitation is that all of that is based on an analysis of data to June 2001, for example.

The Hon GREG PEARCE: The target is set by you. It is not data that is analysed; it is a target. You set the target.

Mr McINNES: What I am saying is that things have happened since June 2001, which was the starting point for all of that work.

The Hon GREG PEARCE: Indeed.

Mr McINNES: In fact, the original starting point was December 2000.

The Hon GREG PEARCE: It sounds like Mr Scully's solution to trains not running on time: you simply change the timetables.

Mr McINNES: I do not think that is fair.

The Hon TONY KELLY: On either Mr Scully or Mr McInnes.

Mr McINNES: As we have seen over the past six months, the experience in the scheme has changed significantly.

CHAIR: So there is a time lag.

Mr McINNES: There is always this retrospectivity to any analysis and any advice you get from actuaries. The reality is that by the time they give the advice some things have moved on.

CHAIR: You are saying that hopefully the targets will be bettered and that there will be higher savings?

Ms McKENZIE: That is what we are hoping.

Mr McINNES: Yes.

The Hon GREG PEARCE: I am concerned that we have a report which at a certain date refers to targets. All I want to know is what those targets were so that I can relate them to the report and understand it.

Ms McKENZIE: We will give them to you.

The Hon Dr PETER WONG: If the target is no longer applicable, how far off target or better than target is your new target? On what basis did you determine the new target?

Mr McINNES: What we are planning to do is set up systems to monitor how the reforms are going.

The Hon Dr PETER WONG: I do not think that answers my question at all.

Mr McINNES: I am trying to answer the question.

The Hon Dr PETER WONG: Fine.

Mr McINNES: What we are planning to do is set up systems to monitor how those reforms are going in terms of implementation versus the expected outcomes. In that process we will have a set of expected outcomes against which we will be measuring, and those expected outcomes, if you like, will be the new targets.

Ms McKENZIE: And you will be able to compare those with the targets that were originally set.

The Hon Dr PETER WONG: I am still not getting an answer to my question. If there is a new target, as you have just said, what is that new target? How does it differ from the old target? What criteria were there for setting the new target? On what basis did you set this as a new target?

The Hon GREG PEARCE: They set them to match the experience.

Mr McINNES: No. We intend to set a bar to achieve certain outcomes.

The Hon Dr PETER WONG: Is it 10 per cent better, 20 per cent better, or what is it?

Ms McKENZIE: Halving the number of disputes.

Mr McINNES: For example.

The Hon Dr PETER WONG: The original target was to halve the number of disputes. What is the new target?

The Hon TONY KELLY: Halve them again!

The Hon Dr PETER WONG: Halve them again?

Mr McINNES: That assumes that the number of disputes does not change, for example, and it does change over time.

The Hon Dr PETER WONG: I still don't get it. How is the new target different from the old target—10 per cent, 20 per cent or 30 per cent? What is it? We are talking about statistics, so there must be a figure. You cannot say, vaguely, that it will be better when you cannot tell the Committee how much better. That is not specific.

Ms McKENZIE: The simple answer is, strictly speaking there is not a new target. I guess what we are trying to say is that it is going to change over time. We are setting up an evaluation process to say this is what we set out to do, and this is how the system is tracking. If it is tracking well, we will be saying, "Well, we can do better by ramping it up." If it is tracking badly, we will have to go back and revisit what we have done and think about whether we need to do something differently. It is just the nature of these schemes that there are all these variables, and that is the best that anyone can really do.

CHAIR: So the target will stay the same, but you may exceed the target?

Ms McKENZIE: Yes.

CHAIR: But the target is staying the same.

The Hon MICHAEL GALLACHER: Mr Chairman, could I clarify that, because we have now heard the terms "old targets" and "new targets" and "there are no new targets". So that, when we get the information, we know which target we are looking at—

The Hon GREG PEARCE: It is a moving target!

Mr McINNES: It is a moving target.

The Hon MICHAEL GALLACHER: This is starting to sound like a Seinfeld episode. In fact, the old targets therefore are the new targets because there are no new targets, is that correct?

Mr McINNES: We are in the process of developing specific targets against a range of outcomes.

The Hon MICHAEL GALLACHER: Am I right in assuming that what we have been referring to for the last 10 minutes as the old targets, albeit somewhat perhaps out of date, are in fact the current targets?

Mr McINNES: The only targets that we have at this stage.

Ms McKENZIE: The only targets.

The Hon MICHAEL GALLACHER: So those are the ones that we will get when we are given documentation on targets?

Ms McKENZIE: Yes.

Mr McINNES: Yes.

The Hon MICHAEL GALLACHER: Will you table to the Committee, Mr McInnes, correspondence between yourself and Tillinghast from 21 November last year to 14 January this year? That will give us a greater understanding of the dialogue that took place leading up to the amended report.

CHAIR: You did indicate that some of the dialogue was verbal and some was face-to-face.

Mr McINNES: Obviously, the verbal advice and face-to-face advice I cannot table, but there is written correspondence.

CHAIR: And the written correspondence may not show the complete picture.

The Hon MICHAEL GALLACHER: What sort of correspondence would that include?

Mr McINNES: To be honest, without looking, I could not tell you.

The Hon MICHAEL GALLACHER: Could we take it then that you are talking about all correspondence? If it is over the top and we are talking about huge files, perhaps you could raise that with the Committee secretariat.

Ms McKENZIE: As a suggestion, would you put that on notice so that we could have written down exactly what you want, so that we can make sure we respond accurately to the request?

The Hon MICHAEL GALLACHER: I think the easiest way is to take it as all correspondence between Rod McInnes and Tillinghast from 21 November last year to 14 January this year.

Ms McKENZIE: Okay.

CHAIR: Is that clear enough?

Ms McKENZIE: Yes.

CHAIR: It relates to the reports and so on.

The Hon MICHAEL GALLACHER: Just all correspondence.

The Hon GREG PEARCE: Mr McInnes, I assume you went through this 14 January report with Tillinghast, tested the numbers, and you understand what is behind the numbers.

Mr McINNES: I have certainly reviewed it, yes.

The Hon GREG PEARCE: With them?

Mr McINNES: Partly with them, partly by myself, then sat down with them and provided the feedback.

The Hon GREG PEARCE: In relation to the \$809 million and \$1-plus billion, what is the breakdown of those totals against the headings that they have used in other parts, where they have broken it known into annual scheme savings, restructure of disputes resolution, common law and commutations? What is the split-up, roughly?

Mr McINNES: I really do not have that figure. I do not think the figures are in the report.

The Hon GREG PEARCE: They are not in the report; that is why I am asking you.

Mr McINNES: I suspect that is a question you should direct to Tillinghast.

The Hon GREG PEARCE: So you would not have discussed that with them?

Mr McINNES: I have. If you prefer, I can take it on notice. It is just that I do not know off the top of my head what those numbers are.

The Hon GREG PEARCE: If you could, that would be fine.

CHAIR: It seems there has been a change in the appropriate valuation methodology from that based on the settlement year, as distinct from the accident year. Why was the settlement year basis used for all costing during 2001 then changed to the accident year basis? Whose decision was that?

Mr McINNES: I think the short answer again is that that is largely a Tillinghast decision. Tillinghast need accident year results in order to calculate the impact on the deficit and factor it into their valuation. However, in setting up their modelling originally—and it was originally set up in relation to dispute resolution processes—structuring around settlement year was the simplest way to do that at that time. It focused on claims that were being settled, and then that could be compared to numbers of claims that were actually being handled by the dispute resolution process at the time. The original modelling was set up on that basis. It was always envisaged that it would need to be changed to an accident year basis to assess the impact on the deficit. It was always a case of finding the time to do that in what was a reasonably hectic period.

CHAIR: Would changing that method have the effect of reducing the deficit?

Mr McINNES: The method, in a sense, does not directly impact on the deficit per se, because the deficit is not affected until they do a valuation report. So it is really understanding what the implications of the changes are. Certainly, it was known at the time that they were doing it on a settlement year basis that that would need to be converted to an accident year basis down the track.

CHAIR: So you will continue in the future on the accident year basis?

Ms McKENZIE: We will not redo a specific report about scheme savings, but for the purposes of the valuation report we would use an accident year basis.

CHAIR: From now on?

Ms McKENZIE: That will evolve over time, in the light of experience of what happens with the scheme.

CHAIR: Is that a recommendation from Tillinghast, just to get it clear where the idea arose?

Ms McKENZIE: At the end of the day, it is up to Tillinghast, because they are our professional advisers. We are not going to tell them what methodology to use or not to use.

The Hon GREG PEARCE: Could you tell me how much has been allocated for the grants to employer or employee organisations, whatever that is—I have forgotten.

Ms McKENZIE: The WorkCover Assist Program?

The Hon GREG PEARCE: Yes.

Ms McKENZIE: It is \$5 million.

The Hon GREG PEARCE: And how many applicants have you had?

Ms McKENZIE: Once again, I do not know the total numbers off the top of my head. We had more applicants than we could fund.

The Hon GREG PEARCE: Has the money been disbursed yet?

Ms McKENZIE: Yes. The process is not completed, and I can obtain an accurate figure of exactly how many contracts we signed, but we have signed up a significant number of contracts already.

The Hon GREG PEARCE: Are you going to be releasing a list of those?

Ms McKENZIE: Yes.

The Hon MICHAEL GALLACHER: You are required to do so.

Ms McKENZIE: Yes, absolutely.

Mr McINNES: A list was released.

Ms McKENZIE: Yes, I think we have already released a list of those who have won. Because we had more applicants than we had money, we went through a merit-based process to pick those applicants that seemed to have the best ideas of what they were going to do. I must say that we got some very good quality applications, which is quite encouraging. Hopefully this will mean that we can roll out across employer groups and the unions a lot of information about how the new scheme is intended to operate. We are hoping that that will really help with the smooth implementation of it because there will be a greater understanding over time as these programs roll out about what is supposed to be happening under the new regime. As members of the committee would know, it involves the occupational health and safety regime as well as the workers compensation regime, so we have got a good cross-section of propositions put to us by various groups. That is all being rolled out now.

CHAIR: I am just trying to get it clear in my mind about who influences whom. I think the Leader of the Opposition has already raised this matter by correspondence. Is Tillinghast working independently, doing things with WorkCover, or is Tillinghast trying to satisfy you? Are you influencing them in their methods and operations?

Ms McKENZIE: No, I think it is very clear that Tillinghast is working independently. When it comes to their professional judgment about what should be in the reports or what the numbers are, that is Tillinghast and there is no question about it. But, like in any client relationship, Tillinghast is dependent on us to give them the data to do that accurately. There would always be a dialogue. If Tillinghast came back with a draft report and we thought that they had misunderstood some piece of data or had not taken into account something, we would point that out to them and they would decide: yes, they agree and that should have been taken into account, or no, they do not agree. But in the end, they are independent, professional advisers, and it is up to them what they right.

CHAIR: So they suggest a change to an accident year basis to you, and you agree with that? That is as a way in which it works? You do not suggest it to them and they agree to it?

Mr McINNES: I really do not know that there was any real process of suggestion and agreement. I think it was always known that that would have to be done on an accident year basis at some point in time.

CHAIR: So that decision was made some time ago. It was just a matter of implementing it?

Ms McKENZIE: It would have to be done on an accident year basis at some time, in time to be factored into the valuation report.

Mr McINNES: I think that was implicitly always known. When it was first discussed, to be honest I could not recall.

The Hon MICHAEL GALLACHER: How did you first communicate with Tillinghast following your evidence on 21 November that they had missed the information in the guidelines and everything else that resulted in significant changes in their position? Was that done verbally or was that done in writing? I am sure you would have remembered signing on the file, "Whoops, you have missed \$1.3 billion."

Mr McINNES: Firstly, that figure was not known at that point in time, obviously. It was not until they subsequently did the work and reported back that it was \$1.3 billion that we knew what the magnitude of it was. I guess from WorkCover's perspective—I think we said that on the day, on 21 November—we felt there would be some significant savings from the reforms and that there would be some impact on the deficit. I think we gave that in evidence on that day. I guess we did have a discussion, I suppose, with Tillinghast about that. I suspect it was over the telephone.

The Hon MICHAEL GALLACHER: So do I.

Mr McINNES: I cannot recall.

The Hon MICHAEL GALLACHER: We will see when the files come in.

CHAIR: So you are happy with Tillinghast to continue in the role they have with WorkCover?

Mr McINNES: They are our consulting actuaries.

CHAIR: Is that a contract for a certain period?

Mr McINNES: Yes, it is. It is due to expire in October next year.

CHAIR: What action will you take then?

Ms McKENZIE: The practice is to go through a tendering process.

Mr McINNES: There will be a tendering process.

Ms McKENZIE: To see who looks like the best applicant.

The Hon TONY KELLY: Based on past experience?

CHAIR: You are not proposing any changes at this stage?

Ms McKENZIE: No.

Mr McINNES: No.

CHAIR: Are there any other questions from Committee members?

The Hon MICHAEL GALLACHER: No more at this stage, but will you take further questions on notice, however, following examination of the evidence that has been given today?

Mr McINNES: Yes.

CHAIR: The Committee thanks you for your appearance today and for your co-operation with our forum that will be coming up. We hope that will help this whole scheme design situation and that some positive proposals come from it. You probably now know that Sir Laurence Street has agreed to be the facilitator on that day. He has a lot of knowledge about WorkCover and workers compensation. I think he will be a very good facilitator.

Ms McKENZIE: It will be a very good forum.

CHAIR: I thank you for appearing as witnesses and I wish you all the best.

(The witnesses withdrew)

(The Committee adjourned at 3.21 p.m.)