



# **COMMONWEALTH GRANTS COMMISSION**

**DRAFT ASSESSMENT PAPER CGC 2003/54**

## **SUPERANNUATION**

Prepared for the Commission's 2003 Conferences on Draft Assessments

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## **NOTE**

Included in this paper are the results of preliminary calculations based on the methods proposed throughout the paper and using the data currently available. Those results are indicative only and should be seen as work in progress. Ongoing changes are being made to standards and factor calculations as new data come to hand. Moreover, the calculations have been done using a prototype assessment system and are subject to ongoing revision as checking processes proceed.

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# SUPERANNUATION

## INTRODUCTION

1. This paper presents a draft assessment for the Superannuation category for the 2004 Review. It builds on staff proposals set out in *Discussion Paper CGC 2002/39 Superannuation*, and State comments provided in the 2003 Rejoinder Submissions.

2. In the 1999 Review, the category included expenditure on the contributions of governments to superannuation funds or superannuation payments for those employees and holders of public office whose salaries are included in the Commission's standard budget, together with associated administrative expenditures. An assessment of needs relating to this cash standard was undertaken using standardised levels of wages and salaries of government employees. In 1998-99, the Australian Bureau of Statistics (ABS) Government Financial Statistics (GFS) moved to an accrual basis. The Commission was asked to review its superannuation assessment in the 2001 Update.

## 2001 UPDATE

3. The 2001 Update terms of reference asked the Commission to 'review and adopt a standard and method for the superannuation category assessment which optimises fiscal equalisation'. In particular, the review considered whether the standard should be cash or accrual, and whether the large one-off payments being made for past unfunded liabilities should be taken into account. As a result, the Commission decided that an accrual based standard and method of assessment should be adopted in the 2001 Update.

4. The Commission decided that optimising equalisation required transitional arrangements to ensure that, over time, the needs associated with State unfunded superannuation liabilities were recognised in the equalisation process. It reached this conclusion because it considered that, while full equalisation could be achieved under either a cash or an accrual standard<sup>1</sup>, this would not necessarily be true in any transition from cash to accrual standards. Without transitional arrangements, a move from a cash to an accrual superannuation standard would be inconsistent with the equalisation of all superannuation

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<sup>1</sup> Under cash accounting, all payments towards State superannuation costs in a year were treated as expenditure and included in the superannuation standard. If cash accounting had continued, all relevant costs would have been included in the standard at least when benefits were eventually paid. Thus, in the very long term, all State superannuation costs would be equalised. Under accrual accounting, the operating statement includes accrued expenses, whether or not the expenses are funded, and nominal interest on unfunded liabilities. If the superannuation standard had always been based on the operating statement, all relevant costs would have been taken into account, and thus equalised when they accrued. Either a cash or an accrual approach would therefore eventually equalise all superannuation costs.

costs. This was because any unfunded superannuation liabilities at the point of change would not be included in either the old cash standard (because they were not yet funded) nor in the new accrual standard (because the relevant superannuation expenses had accrued prior to the introduction of the accrual standard).

5. Thus special arrangements were introduced to take into account unfunded superannuation liabilities. The overarching principle was, over time, to give each State the capacity to provide services at the same standard. The Commission noted that equalisation would not be achieved fully for each service in each given year, but that it should be fully achieved over time.

6. **Category definition.** This category comprised, until 1997-98, expenditure on the contributions of governments to superannuation funds or superannuation payments for those employees and holders of public office whose salaries were included in the Commission's standard budget. A cash assessment was applied in 1997-98 to the cash standard.

7. From 1998-99, the category comprised:

- (i) States' accrued expenses for superannuation for those employees and holders of public office whose salaries were included in the Commission's standard budget;
- (ii) nominal interest on equalised and non-equalised unfunded liabilities; and
- (iii) a transitional component of 10 per cent of the outstanding unfunded liabilities as at the beginning of the 1998-99 financial year.

It excluded superannuation relating to trading enterprises because the operating transactions of these were excluded from the standard budget.

8. A two-part assessment was adopted for the category for those years where an accrual standard was used (1998-99 onwards). It comprised:

- (i) *an assessment of needs* associated with accrued expenses, with nominal interest on unfunded liabilities which have been already equalised assessed by the equal per capita method; and
- (ii) *transitional arrangements* over the ten year period which commenced in 1998-99, so the States' unfunded liabilities and nominal interest on unfunded liabilities will be brought into the equalisation process.

9. Table 1 shows gross standard expenses for this category in the 2003 Update.

**Table 1** SUPERANNUATION — GROSS STANDARD EXPENSES, 2003 UPDATE

	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02
\$pc	208.04	221.85	610.84	540.31	578.72	587.07
% of total gross standard expenses	5.65	5.75	13.42	11.66	11.92	11.72

Source: CGC Working Papers 2003 Update, Vol. 5.

10. In 2001-02, the standard for this category was \$587.07 per capita. It represented 11.72 per cent of total standard expenses. Compared with an equal per capita assessment the Superannuation assessment redistributed \$246.3 million away from New South Wales, Victoria and the ACT, to the other States. Table 2 shows the redistribution.

**Table 2** EFFECT OF ASSESSMENT ON GRANTS DISTRIBUTION

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust <sup>(a)</sup>
Contribution to U2003 relativities (\$m)	-56.6	-146.5	-4.8	80.3	28.8	42.9	-38.3	94.4	246.3

(a) Total redistribution.

Source: CGC Working Papers 2003 Update, Vol. 5.

11. *Assessment Structure.* Table 3 shows the assessment structure and component weights for the year of the cash standard. Table 4 shows the assessment structure and component weights for the subsequent years that had an accrual standard. The component weights for the accrual standard were different for each year.

**Table 3** ASSESSMENT STRUCTURE — CASH STANDARD, 1997-98

Expenditure component	Component weight	Factors	Basis of calculation
Scale-affected expenditure	0.42	Input costs	General method with weights of 80% for wages, 2% for accommodation and 1% for electricity.
		Administrative scale	General Method.
Superannuation services	99.58	Expenditure relativities	Based on the wages and salaries disabilities of those expenditure categories which include a wages and salaries component.

**Table 4** ASSESSMENT STRUCTURE — ACCRUAL STANDARD AND TRANSITIONAL ARRANGEMENTS, 1998-99 – 2001-2002

Expense component	Component weight	Factors	Basis of calculation
	%		
Accrued expenses	1998 — 30.40 1999 — 33.10 2000 — 34.18 2001 — 35.22	Expenditure relativities	Based on the wages and salaries disabilities of those expenses categories which include a wages and salaries component, including CSS adjustment.
Nominal interest on equalised unfunded liabilities	1998 — 0 1999 — -1.71 2000 — -0.03 2001 — 1.83	None	EPC.
Nominal interest on unequalised unfunded liabilities	1998 — 28.65 1999 — 26.52 2000 — 23.64 2001 — 20.70	Historical factor  Interest rate cost factor	Based on the average of the superannuation category factors for the last 20 years.  As used in the Debt Charges category.
Outstanding liabilities	1998 — 40.95 1999 — 42.09 2000 — 42.21 2001 — 42.25	Historical factor	Based on the average of the superannuation category factors for the last 20 years.

Source: CGC Working Papers 2003 Update, Vol. 5.

## 2004 ASSESSMENT

12. The Commission proposes to continue the method of assessment developed for the 2001 Update. This is because what States are continuing to do regarding the funding of superannuation continues to make this approach appropriate.

### CATEGORY DEFINITION AND STRUCTURE

13. **2001 Update.** The structure of the assessment is contained in Table 3 and Table 4 above.

14. **State views.** Despite the comprehensive consideration of the issues in the 2001 Update, New South Wales and Victoria did not accept the outcome and argued for a change. In particular, they said that assessing unfunded superannuation liabilities was a flawed approach.

15. **Staff proposals.** *Discussion Paper CGC 2002/39 Superannuation* stated that the Commission was not inclined to change its approach to the Superannuation assessment. It maintained the view it set out in the 2001 Update Report that the decisions it took in response to the terms of reference for the 2001 Update should apply in the 2004 Review.

16. **Further State views.** No new arguments were advanced regarding the structure of the assessment in the rejoinder submissions.

17. **Analysis.** State arrangements for funding and accounting for superannuation have not changed since the 2001 Update. It is still the case that the accrual assessment better reflects State annual costs and the way States are choosing to manage and account for their superannuation expenses. Similarly, to optimise equalisation, the transitional arrangements are still necessary to allow for unfunded superannuation liabilities because:

- (i) not all annual accrued expenses had been equalised in the past;
- (ii) what had been equalised depended on the different policies of the States; and
- (iii) the costs of holding and meeting presently unfunded liabilities were real costs to State governments, regardless of when they were brought to book.

18. Consequently, the Commission proposed to continue the two part assessment:

- (i) an accrual assessment of needs associated with accrued expenses and an equal per capita (EPC) assessment of nominal interest on unfunded liabilities which have been already equalised; and
- (ii) transitional arrangements which will bring States' unfunded liabilities and nominal interest on unfunded liabilities into the equalisation process over a ten year period which commenced in 1998-99.

19. The use of a cash based assessment in the earlier years of the review period and an accrual assessment in the later years was necessary in the 2001, 2002 and 2003 Updates for reasons of data availability. It was also consistent with the approach used in other categories. In the 2004 Review, a mix will not be necessary as accrual data will be available for all five assessment years.

20. **Commission decision.** The method of assessment developed for the 2001 Update remains the most appropriate method of assessing State superannuation expenses. The accrual assessment better reflects State annual costs and the way States are now choosing to manage and account for their superannuation expense. The transitional arrangements are necessary to equalise unfunded superannuation liabilities. Table 5 shows Commission decisions regarding the structure of the Superannuation category assessment.

**Table 5** COMMISSION DECISIONS — STRUCTURE OF ASSESSMENT

Decision	Reason
The Commission maintains that the decisions it took in response to the terms of reference for the 2001 Update should apply in the 2004 Review. An assessment comprising an accrual assessment and transitional arrangements will be continued.	The accrual assessment better reflects State annual costs and the way they are now choosing to manage and account for their superannuation expense. The transitional arrangements are necessary to equalise unfunded superannuation liabilities.

### ACCRUED EXPENSES COMPONENT

21. This component assesses accrued superannuation expenses for those employees and holders of public office whose salaries are included in the Commission's equalisation budget. The expenditure relativities factor is the only factor assessed for this component. It provides a policy neutral measure of State wages and salaries.

#### *Expenditure relativities factor*

22. **2001 Update.** The expenditure relativities factor was calculated for each year of review and for each State using the wages and the salary proportions of gross standardised expenses for all categories. These proportions provided a standardised measure of the salaries for which States accrue superannuation expenses. The standardised wages and salaries related expenses of the ACT and the Northern Territory were multiplied by a factor of 1.05 to account for higher employer costs because some employees remain in the Commonwealth Superannuation Scheme (CSS).

23. **Preliminary State views.** The ACT and the Northern Territory sought an increase in the 5 per cent disability that recognised the additional unavoidable costs they face in providing superannuation payments to those of their employees who are members of the CSS. They also sought recognition of the additional administrative costs they face. The ACT also sought an allowance for the above standard cost of the Public Sector Superannuation Scheme (PSS) that replaced the CSS in 1990, arguing that it must offer comparable superannuation arrangements to the Commonwealth if it is to attract comparable staff.

24. The Northern Territory submitted that its costs due to CSS membership of its employees were 15 per cent greater than they would have been had all employees been members of the Northern Territory Government and Public Authorities Superannuation Scheme (NTGPASS). This scheme has an actuarially assessed cost of 10 per cent, compared with 18 per cent for the CSS (and 9 per cent at the Superannuation Guarantee (SG) minimum rate). The Northern Territory said that its additional costs, on average, over the next 8 years, have been estimated by the New South Wales Government Actuary to be

about \$17 million per annum. The actuary also estimated that the Northern Territory incurred an additional \$110 000 per annum in Comsuper administration fees, which were rightly the Commonwealth's responsibility. This was because the fees represented the Commonwealth's share of the fee for employees with prior Commonwealth service.

25. The ACT said that it spent \$30.7 million more per annum on CSS members (at an actuarially assessed cost of 24.3 per cent employer contribution) and \$6.8 million more on PSS members (14.2 per cent) than if it provided superannuation at the SG rate. The ACT submitted that the disability should be calculated in a way that recognised the difference in unit costs of the scheme and the number of employees in the scheme.

26. The ACT stated that it incurred an additional \$2.5 million in 2001-02 on administration costs. It argued that the Commission should recognise these administrative costs as a disability because, unlike the majority of superannuation schemes, the CSS and the PSS have the employer paying the administration charge rather than the employee.

27. **Staff proposals.** Discussion Paper 2002/39 presented the following provisional positions on the issues raised:

- (i) the CSS imposed some unavoidably high superannuation costs on the ACT and the Northern Territory, with evidence indicating that:
  - additional superannuation costs incurred by the Territories for members of the CSS inherited at the time of self-government should continue to be recognised;
  - the present allowance of 5 per cent may underestimate the disabilities of the Northern Territory and the ACT; and
  - there should be no disability associated with CSS membership after self government (or after some date close to self government);
- (ii) a disability for PSS costs would not be included because its costs reflected standard levels;
- (iii) the ACT does not have to offer the same superannuation conditions as the Commonwealth Government to allow it to obtain comparable staff;
- (iv) the Territories could have established their own schemes from close to the time of self-government, or from the time of the establishment of separate public services from the Commonwealth; and
- (v) the Commonwealth share of the administration fees currently incurred by the Northern Territory is a disability.

28. **Further State views.** Queensland stated that current average policy would equate to an employer contribution of approximately 10 per cent. It submitted that the disability for the ACT and the Northern Territory arising from Commonwealth Superannuation arrangements should not recognise the full costs of carrying over these schemes. It said that the Commission should measure the actual costs of the CSS minus the

costs the Territories would face if they had an ‘average’, more generous scheme at the time of self-government. It said that the costs of the PSS were no greater than standard levels.

29. Western Australia said that the ACT and the Northern Territory had a case for costs for CSS membership at the time of self government, but not for subsequent members. It stated that it previously had more expensive superannuation schemes but has since closed these schemes to new employees. It said that the Territories could have done likewise and that leaving these schemes open was a policy choice.

30. South Australia stated that the standard policy for superannuation should be based on what States actually do, not on the SG. It considered it reasonable to assess an allowance for inherited members of the CSS, but said that the Commission should be sceptical about further claims. Regarding ACT competition with Commonwealth arrangements, South Australia considered that the ACT had a choice as to whether it competed with Commonwealth arrangements. It said that this did not warrant special recognition. It said that the Territories could have established their own superannuation schemes under self-government.

31. Regarding standard policy, the ACT pointed out that most States would carry a legacy of superannuation schemes that were typically more costly to the States than the present schemes. The ACT restated that the current CSS adjustment underestimated the additional costs it imposed. It provided a latest estimate of employer contributions for the CSS of 18.1 per cent.

32. The ACT said that the ACT Public Service directly competed for public sector employees with the Commonwealth to attract and retain quality employees. The ACT stated that it did not have control over the closure of the PSS. This attempt to close it was halted by industrial action and the failure of the relevant legislation to pass in the Federal Parliament.

33. The Northern Territory stated that for new employees the majority of State governments pay superannuation benefits at the SG level. Employees of longer standing receive a higher benefit, which reflects the more generous schemes in the past. The Northern Territory said that the actual costs of its current scheme, NTGPASS, show a 10 per cent employer contribution. This does not include the 3 per cent National Wage Case productivity bonus.

34. The Northern Territory costed employer contributions for the CSS at 18 per cent, not including the additional 3 per cent National Wage Case productivity bonus. It calculated a disability of 1.15.

35. The Northern Territory said that the ACT did not have to tie its superannuation arrangements to those of the Commonwealth. The Territory shifted its initial position that only the Commonwealth share of the administration costs should be assessed as a disability to maintain that all administration costs should be assessed.

36. *Analysis — standard policy.* All States have substantial schemes that require greater than the SG minimum amount to be paid by the employer. For example, Queensland’s Accumulation account requires the employer to contribute 7.75 per cent as

well as the equivalent of that contributed by the member — for a standard member contributing 5 per cent this is 12.75 per cent. This is Queensland's largest fund with 66 per cent of its State superannuation scheme members. The scheme remains open<sup>2</sup>. Western Australia has a Gold State Superannuation scheme, now closed, which has employer contributions on average of 12 per cent<sup>3</sup>. For a number of State schemes, the employer contribution is linked in some way with the employee contribution and increases as the employee contribution increases.

37. South Australia stated that its payroll tax calculations were based on employer superannuation contributions at a rate of 10 per cent to allow for those employers who contribute above the required amount. The Northern Territory uses 10 per cent as a standard in calculations relating to employer contributions of NTGPASS. Queensland stated that current average policy would equate to an employer contribution of approximately 10 per cent.

38. Standard policy, as the term suggests, should be based on what States are doing. Evidence indicates that an employer contribution standard of 10 per cent would reflect current State practice and employer contributions greater than the SG amount because of higher cost superannuation schemes (closed and open to new members). There is a strong basis for setting 10 per cent as the standard rate of employer contribution.

39. **Commission decision.** The Commission consider that evidence indicates that 10 per cent is an appropriate level at which to set the standard policy for employer contributions.

40. **Analysis — CSS disability.** There is a conceptual case that the ACT and the Northern Territory should be compensated for higher costs incurred by the legacy of the CSS. Data on the cost of superannuation to the Northern Territory confirm that the current disability associated with the CSS is too low. Analysis has showed that different disabilities should be applied to each Territory. The analysis consisted of:

- Calculating the ACT and the Northern Territory's total liability for all employees, assuming that they contribute at a standard rate of 10 per cent of a standard wage.
- Calculating the Territories' liability incorporating the number of CSS members contributing an above standard rate of a standard wage (18.1 per cent for the ACT and 18.0 per cent for the Northern Territory). Liabilities for non-CSS employees were based on a standard contribution rate of 10 per cent of a standard wage.
- Obtaining a ratio for each State by dividing the liability calculated at standard rate by the total liability incorporating the higher contribution rates for the CSS.

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<sup>2</sup> 2001-2002 Annual Report, *Qsuper Board of Trustees and the Government Superannuation Office*, pp. 16 and 22.

<sup>3</sup> 2001-2002 Annual Report, *Government Employees Superannuation Board*, Western Australia, Financial Statements, p. 25.

41. The result showed that the ACT should receive an adjustment of 1.05 and the Northern Territory an adjustment of 1.15.

42. There is no conceptual case for including the 3 per cent associated with the National Wage Case productivity bonus in the analysis as suggested by the Northern Territory. This ruling affected all States, not just the ACT and the Northern Territory.

43. **Commission decision.** The Commission considers that there is a conceptual case for including a disability for extra costs incurred by the ACT and the Northern Territory as a result of the CSS. Evidence indicates that these extra costs due to the CSS result in a disability of 5 per cent for the ACT and 15 per cent for the Northern Territory.

44. **Analysis — PSS disability.** There is no conceptual case that the ACT incurs disabilities as a result of the PSS scheme. When the PSS was introduced, it was consistent with standard policy. It does not incur higher costs than many of the higher cost schemes across the States.

45. Further, maintenance of the PSS is a policy choice. While the ACT is not in full control of the choice to close the PSS, there is no legislation preventing the ACT moving new employees to a SG based arrangement. The issue of mobility between the ACT Public Service and the Commonwealth Public Service does not distinguish the ACT from other States. All States compete with other employers, such as the Commonwealth government, using a range of measures, such as a policy of offering attractive superannuation schemes.

46. **Commission decision.** There is no conceptual case to include a disability for the PSS because it does not impose costs greater than standard.

47. **Analysis — CSS administrative costs.** There is no conceptual case that the ACT and Northern Territory should be compensated for having to pay extra administrative costs associated with the CSS. Examination of State superannuation policy showed that it is not clear that standard policy is to pass on administrative costs to the employee. For example, South Australia's State Lump Sum Superannuation scheme, now closed to new members, covers all administration costs<sup>4</sup>.

48. There is a conceptual case for assessing a disability relating to the Commonwealth share of administration costs. However, the evidence provided by the Northern Territory indicates that such costs consisted of 0.05 per cent of its category expenses (\$110 000). The ACT did not provide figures for such costs. The Northern Territory data indicated that the impact of such costs on the ACT and Northern Territory budgets is of a level that the Commission does not consider material.

49. **Commission decision.** There is no conceptual case that the ACT and Northern Territory should be compensated for having to pay extra administrative costs associated with the CSS. The CSS is not unique in not passing on administrative costs to employees.

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<sup>4</sup> State Lump Sum Superannuation scheme, *Member Booklet*, p. 9.

50. There is a conceptual case that the ACT and Northern Territory should not bear the Commonwealth's portion of administrative costs. However, we have been supplied with limited data on these costs. The available figures for such costs show that the amount is not material to the assessment.

51. Table 6 shows Commission decisions regarding the expenditure relativities factor.

**Table 6** COMMISSION DECISIONS — EXPENDITURE RELATIVITIES FACTOR

Decision	Reason
To continue the 2001 Update method of assessment for this factor.	This is a policy neutral measure of State wages and salaries.
To set the standard policy for employer contributions at 10 per cent.	All States have older superannuation schemes that entail employer contributions at a higher level than the superannuation guarantee.
To accept that the CSS incurs extra costs for the ACT and the Northern Territory. An adjustment of 1.05 will be applied to the ACT and of 1.15 to the Northern Territory. This does not include the costs of the National Wage Case productivity bonus.	These adjustments were based on an analysis of data relating to the cost of the CSS. Costs incurred by the National Wage Case productivity bonus are not included as this ruling affected all States.
To not include an adjustment for the ACT because of costs associated with the PSS scheme.	The PSS scheme operates at a standard policy.
To not assess a disability for administration costs associated with the CSS.	There is no conceptual case supporting the inclusion of a disability for the total administration costs of the CSS because it is not unique in not passing on administration costs to the employee. There is a conceptual case for assessing a disability relating to the Commonwealth share of administration costs but data indicated that the impact of such costs is of a level that the Commission does not consider material.

52. ***Proposed method and results.*** The factor was calculated using the following method:

- (i) the gross standardised expenses of all categories that included input costs<sup>5</sup> were recalculated with the disability factors not related to

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<sup>5</sup> Relevant categories were: Pre-school Education, Government Primary School Education, Government Secondary School Education, Vocational Education and Training, Inpatient services, Non-inpatient and Community Health Services, Population and Preventive Health, Family and Child Services Aged and Disabled Services, Homeless and General Welfare, Housing, Services to Indigenous Communities, Police, Administration of Justice, Corrective Services, Public Safety, Culture and Recreation National Parks and Wildlife Services, National Parks and Wildlife Services, Electricity and Gas, Water Sanitation and Protection of the Environment, Non-urban Transport, Roads, Urban Transit, Primary Industry, Mining Fuel and Energy, Tourism, Manufacturing and Other Industry, General Public Services and Depreciation.

salaries (ie. the accommodation and electricity components of the input costs disability, dispersion and isolation) set to one;

- (ii) the category standardised expenses calculated above were weighted by the proportions that wage and salary expenses represented in each category;
- (iii) the weighted standardised expenses were aggregated to derive the total standardised expenses which related to wages and salaries;
- (iv) the standardised wages and salaries related expenses of the ACT were multiplied by a factor of 1.05 to account for higher employer costs because some employees remain in the CSS scheme;
- (v) the standardised wages and salaries related expenses of the Northern Territory were multiplied by a factor of 1.15 to account for higher employer costs because some employees remain in the CSS scheme; and
- (vi) the category expenditure relativities factors were derived by dividing the adjusted standardised expenses (per capita) by the Australian average.

53. Table 7 shows the elements of the calculation of the factor using the new adjustments applied to Update 2003 salaries data. It shows the 2003 Update factor to highlight the impact of the increased CSS adjustment for the Northern Territory.

**Table 7** ELEMENTS OF THE CALCULATION OF THE EXPENDITURE RELATIVITIES FACTORS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aus
<b>ACT and NT adjustment for its employees' access to CSS</b>									
All Years	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.05000	1.15000	1.00000
<b>ACT phase-in adjustment</b>									
1997-98	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	0.80000	1.00000	1.00000
1998-99	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
1999-2000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
2000-01	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
2001-02	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
<b>Per capita adjusted wage-and-salary related standardised expenses (\$)</b>									
1997-98	1939.78	1791.20	1928.57	1989.25	1931.21	2066.21	1698.28	5054.13	1934.45
1998-99	2257.35	2084.96	2275.09	2315.50	2246.32	2398.92	2428.32	5920.63	2256.66
1999-2000	2358.28	2172.60	2361.24	2422.95	2309.02	2484.61	2583.07	6035.00	2349.71
2000-01	2493.50	2288.08	2486.37	2529.54	2424.47	2590.90	2632.25	6294.19	2472.63
2001-02	2578.95	2431.57	2582.14	2637.45	2526.58	2675.11	2752.03	6495.77	2579.03
<b>Review 2004 expenditure relativities factor</b>									
1997-98	1.00275	0.92595	0.99696	1.02832	0.99832	1.06811	0.87791	2.61269	1.00000
1998-99	1.00031	0.92391	1.00817	1.02607	0.99542	1.06304	1.07607	2.62363	1.00000
1999-2000	1.00365	0.92463	1.00491	1.03117	0.98268	1.05741	1.09932	2.56840	1.00000
2000-01	1.00844	0.92536	1.00556	1.02302	0.98053	1.04783	1.06456	2.54555	1.00000
2001-02	0.99997	0.94282	1.00120	1.02265	0.97966	1.03725	1.06708	2.51869	1.00000
<b>Update 2003 expenditure relativities factor</b>									
1997-98	0.99745	0.94117	0.98697	1.05384	1.00591	1.10429	0.89920	2.10237	1.00000
1998-99	0.98540	0.93610	0.99344	1.05301	1.00254	1.11840	1.11667	2.14969	1.00000
1999-2000	0.98740	0.93615	0.99288	1.05404	0.99842	1.10924	1.11617	2.13439	1.00000
2000-01	0.98546	0.93732	0.99231	1.05242	1.00278	1.10936	1.13424	2.13555	1.00000
2001-02	0.98601	0.94084	0.99115	1.04750	0.99649	1.11093	1.13048	2.16167	1.00000

54. **Updateability.** These factors will be updated each year to reflect changes to standard wages and salaries.

#### NOMINAL INTEREST OF EQUALISED UNFUNDED LIABILITIES

55. Since the 2001 Update this component has been assessed equal per capita.

56. **Commission decision.** Table 8 shows Commission decisions regarding this component.

**Table 8** COMMISSION DECISIONS — NOMINAL INTEREST OF EQUALISED UNFUNDED LIABILITIES COMPONENT

Decision	Reason
	To continue assessing the factor equal per capita. These expenses have been equalised.

### NOMINAL INTEREST ON UNEQUALISED UNFUNDED LIABILITIES COMPONENT

57. This component measures the nominal interest on unequalised unfunded liabilities over the twenty year period from 1978-79 to 1997-98.

#### *Historical factor*

58. **2001 Update.** The historical factor was assessed to measure the disabilities influencing the quantity of the unfunded liabilities States would have accrued over a twenty year period on a standardised basis. It was calculated as the average of the category disability factors for the 20 years from 1978-79 to 1997-98. It took account of the non-policy differences in the size of each State's unfunded liabilities.

59. **State views.** New South Wales proposed that the Commission apply the same disabilities to the unfunded liability as are applied to the accruing expense<sup>6</sup>. It argued that this would be simpler, consistent with the original cash assessment and not double count superseded disabilities from earlier years.

60. Victoria restated that 10 years was a completely arbitrary timeframe for the transitional arrangements, which reflected neither the time over which States had accumulated the liabilities nor the period in which they intended to fund them<sup>7</sup>.

61. **Staff proposals.** *Discussion Paper CGC 2000/39* stated that staff were not inclined to apply the same disabilities to both the accruing expense and the unfunded liabilities. It said that it would be simpler but not appropriate. It said that the disabilities which were most relevant to unfunded liabilities were those which applied in the year in which the liabilities accrued. Although those disabilities were calculated using different methods to those used at present, they had not been applied to the unfunded liabilities and were the best estimate available of the disabilities that were relevant at that time. As an historical accumulation, the average of the disabilities assessed over the period in which the liabilities were acquired gave a reasonable measure of relative need.

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<sup>6</sup> Salary related expenditure relativities are used to construct the disability applied to accruing expenses. An average of an historical series of expenditure relativities, calculated using the methods which applied in each review, are applied to the unfunded liabilities.

<sup>7</sup> Victoria said that 35 years would more closely approximate the time frame in which they intended to fund liabilities. It did not suggest, however, that we substitute 35 years for the 10 presently in use. Doing so would move the standard closer to a cash basis and may or may not better reflect what States are doing.

62. Although not inclined to accept the New South Wales proposal, staff proposed examining ways of better constructing the historical disability factor. As a minimum, staff suggested applying weights based on the size of the category standard in each year to the historical factors before they were added and averaged. This required the assumption that unfunded liabilities were accumulated at the same time and rate as States incurred superannuation standard expenses.

63. **Further State views.** Queensland submitted that it was not appropriate to apply the same disabilities to both the accruing expense and the unfunded liabilities because the current expenditure relativities were not as relevant to the unfunded liabilities. It said that weighting the historical factors by the size of the category standard, before they were added and averaged, would improve the methodology. Western Australia agreed that historical disabilities were relevant to unfunded liabilities and that the disabilities from different years should be weighted according to category standard expenses in those years.

64. For the historical factor, South Australia advocated the use of a simple average of the 20 assessment years till 1997-98. It wanted to see some evidence that showed that unfunded liabilities were accumulated at the same time and rate as States incurred cash expenditures before making such a change to the way the factor was previously calculated.

65. **Analysis.** There is a strong conceptual case and evidence to support weighting the historical factors by the category standard. The unfunded liabilities had a close relationship to the time and rate that States incurred cash expenditures. However, after examining historical data, we have concluded that the growth in total standard expenses is a better representation of growth in superannuation expenses over the period. This is because it does not reflect changes in accounting practices over the period as acutely as the superannuation category standard. We consider that the weighting should reflect growth in expenses rather than volatility due to changes in accounting practices.

66. Total standard expenses per capita in 1997-98 were 4.8 times that of total per capita expenditure in 1978-79. While the change in total expenses might not exactly parallel the shift in size of accumulated unfunded liabilities, the Commission considers that including such a weighting would be better than not including one.

67. **Commission decision.** There is a strong case to support weighting the historical factors by total standard expenses because superannuation expenses and the standard budget have grown so markedly over the 20 year period. The Commission considers that weighting the historical factors produces a more accurate result than would otherwise be the case.

#### ***ACT adjustment to the historical factor***

68. **2001 Update.** No adjustment to the historical factors was made because the ACT was judged to be accruing unfunded liabilities at a higher rate than the other States in the period between 1987-88 and 1997-98.

69. **ACT view.** The ACT submitted that its historical factor needed adjustment to recognise that the Commission’s past cash-based assessment meant that it was accruing above standard unfunded liabilities in the period between 1987-88 and 1997-98. This is because the cash-based assessment included a phase-in adjustment for the ACT that recognised its emerging costs following self-government were less than standard emerging costs. The corollary of this, however, was that it was accruing more than the standard amount of unfunded liabilities because it had been given the capacity to fund only a proportion of the standard cash superannuation payments.

70. **Analysis.** In the years following self-government, the ACT incurred lower emerging costs. This was recognised in the cash-based assessment. However, it was still accruing a full liability for its staff. Thus, the ACT was not given the standard capacity to fund its accruing liabilities with cash. It was therefore accruing more than standard liabilities. Adjusting the historical factor to recognise the size of the phase-in adjustment is a suitable way of recognising this.

71. **Commission decision.** The Commission accepts that, because of the previous assessment design, the ACT accrued an above standard amount of unfunded liabilities in the period between 1987-88 and 1997-98. This is affecting the ACT’s present needs. The impact of this is material and a sound method exists to recognise the extent of the above standard amount of unfunded liabilities that the ACT accrued. The Commission has decided to adjust the historical factor in this component so these needs will be recognised.

72. Table 9 shows Commission decisions regarding the historical factor and an adjustment for the ACT.

**Table 9** COMMISSION DECISIONS — HISTORICAL FACTOR

Decision	Reason
To continue the 2001 Update method of assessment with the following adjustment:  to weight the historical factors by total standard per capita expenses in the relevant year.	There is a strong case to support weighting the historical factors by total standard expenses because the standard expenses budget has grown so markedly over the 20 year period. Weighting the historical factors produces a more accurate result than would otherwise be the case.
To adjust the historical factor to reflect additional unassessed liabilities faced by the ACT.	Because of the previous assessment design, the ACT accrued an above standard amount of unfunded liabilities in the period between 1987-88 and 1997-98. This is affecting its present needs. The impact of this is material and a sound method exists to recognise the extent of the above standard amount of unfunded liabilities that the ACT accrued.

73. **Proposed method and results.** The historical factor is assessed to measure the disabilities influencing the quantity of the unfunded liabilities States would have accrued over a twenty year period on a standardised basis. It is calculated as the weighted

average of the category disability factors for the 20 years from 1978-79 to 1997-98. It takes account of the non-policy differences in the size of each State's unfunded liabilities.

74. As the ACT did not accrue any superannuation liabilities before self-government, the Commission calculated the twenty year average for the ACT by assuming that its category factor was zero before self-government.

75. Table 10 shows the method used to adjust the ACT's historical factors for the phase-in adjustment used in the cash assessment. The adjustment was based on the amount that was deducted from standard expenses because of the phase-in adjustment. This was calculated as a proportion of the corresponding year's category standard and the factor adjusted accordingly.

**Table 10** ADJUSTMENT TO ACT'S HISTORICAL FACTOR

Year	Super Category Standard	ACT standard	Proportion of standard received by ACT	Proportion of standard not required by ACT to meet cash needs	Existing Historical Factor	Adjusted Historical Factor
	(a)	(b)	(c=b/a)	(d=1-c)	(e)	(f=e*(1+d))
	\$pc	\$pc				
1987-88	77.42	10.32	0.13	0.87	1.02900	1.92083
1988-89	86.69	17.34	0.20	0.80	1.02851	1.85131
1989-90	99.39	26.51	0.27	0.73	1.02834	1.78242
1990-91	101.68	33.89	0.33	0.67	1.02896	1.71497
1991-92	140.85	56.34	0.40	0.60	1.02088	1.63341
1992-93	145.48	67.90	0.47	0.53	1.02071	1.56505
1993-94	231.95	123.70	0.53	0.47	1.12007	1.64281
1994-95	196.57	117.94	0.60	0.40	1.11987	1.56781
1995-96	196.37	130.92	0.67	0.33	1.12273	1.49693
1996-97	208.11	152.61	0.73	0.27	1.11213	1.40874
1997-98	222.11	177.69	0.80	0.20	1.12182	1.34618

76. For the first three years of self-government, the Northern Territory was only responsible for a proportion of its superannuation liabilities. The balance remained the responsibility of the Commonwealth Government. For these three years the Commission assessed actual per capita factors for the Northern Territory. These were of a much smaller order than the factors for other States.

77. Table 11 shows the calculation of the historical factors. The historical factors for each year are weighted by the total per capita standard expenses for the year. The same factors are used for each year and the average of the weighted factors will always be calculated over the 20 years immediately preceding the change to an accrual standard.

**Table 11** CALCULATION OF HISTORICAL FACTORS: UNWEIGHTED FACTORS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Weight for size of standard budget
1978-79	0.97014	0.98086	0.95827	1.14280	1.14548	1.31164	0	0	1.0
1979-80	0.96908	0.98208	0.95116	1.14371	1.13247	1.32853	0	0	1.1
1980-81	0.97325	0.99004	0.95504	1.11696	1.12351	1.30393	0	0	1.3
1981-82	0.96454	0.99948	0.96920	1.11646	1.09110	1.29710	0	0.17521	1.5
1982-83	0.96661	1.00257	0.95783	1.10595	1.09803	1.30908	0	0.09974	1.6
1983-84	0.96920	1.00383	0.95256	1.09966	1.09985	1.31178	0	0.15857	1.8
1984-85	0.97391	0.94747	1.05839	1.05732	1.07915	1.21952	0	2.45040	2.1
1985-86	0.97398	0.94764	1.05854	1.05756	1.07919	1.21967	0	2.45057	2.3
1986-87	0.97701	0.93546	1.05889	1.04921	1.06817	1.17964	0	2.65618	2.5
1987-88	0.98224	0.91628	1.02347	1.08929	1.00154	1.09492	1.92083	2.28220	2.7
1988-89	0.98146	0.91760	1.02434	1.08561	0.99804	1.09848	1.85131	2.30670	2.9
1989-90	0.98131	0.91746	1.02418	1.08544	0.99788	1.09830	1.78242	2.30632	3.1
1990-91	0.98185	0.92009	1.02124	1.08423	0.99423	1.10118	1.71497	2.28640	3.2
1991-92	0.98294	0.91828	1.01799	1.08581	0.99602	1.10216	1.63341	2.32148	3.4
1992-93	0.98277	0.91813	1.01782	1.08563	0.99585	1.10197	1.56505	2.32109	3.5
1993-94	0.99105	0.93954	0.99067	1.04620	1.00385	1.09542	1.64281	2.09462	4.2
1994-95	0.98938	0.94060	0.98789	1.04746	1.00457	1.10461	1.56781	2.11482	4.4
1995-96	0.99130	0.93905	0.98377	1.04854	1.00686	1.10003	1.49693	2.12370	4.5
1996-97	0.99203	0.93432	0.98712	1.05064	1.00519	1.10510	1.40874	2.14925	4.6
1997-98	0.99284	0.93553	0.98325	1.05231	1.00173	1.10273	1.34618	2.15528	4.8
Historical factors <sup>(a)</sup>	0.98296	0.94019	1.00270	1.07201	1.02631	1.14409	1.16940	1.93834	1.00000

(a) After weighting for size of standard budget. Not population weighted.

78. Table 12 shows the final weighted historical factors.

**Table 12** CALCULATION OF HISTORICAL FACTORS: WEIGHTED FACTORS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Historical factors	0.98296	0.94019	1.00270	1.07201	1.02631	1.14409	1.16940	1.93834

79. **Updateability.** This factor will not change.

**Cost of borrowing factor (previously interest costs factor)**

80. The Superannuation assessment for the 2003 Update used the interest costs factor as developed in the Debt Charges category.

81. **1999 Review.** In the Debt Charges category, an interest rate disability was assessed to account for differences in the unit borrowing costs faced by States. In the 1999 Review, the interest rate disability for the smaller States was reduced, based on information on differences in long-term bond rates between States, with an adjustment for policy differences. Per capita standardised net borrowings were multiplied by the interest rate disability to provide per capita adjusted standardised net borrowings.

82. Table 13 shows the interest rate disability factors for the 2003 Update.

**Table 13** INTEREST RATE DISABILITY FACTOR — 2003 UPDATE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Interest rate disability	1.00000	1.00000	1.00000	1.00500	1.01500	1.03000	1.03000	1.03000

83. **Staff proposals.** For the Superannuation category, staff proposed to adopt the cost of borrowing factor developed for the Debt Charges category. This assessment is briefly discussed below and more detail can be found in *Draft Assessment Paper CGC 2003/57 Debt Charges*.

84. **State views.** Victoria was concerned that a large part of the interest rate differentials between States reflected past and present policies, which they said were the main drivers of the assessments of sovereign debt prepared by ratings agencies. Victoria asked the Commission to remove these policy influences in its adjustment of interest rates.

85. **Analysis.** The available evidence indicates that, all other things (such as policy) being equal, the size of a State does influence the interest rates it faces. For example, the ratings agency Standard and Poors told the Commission in the past that ‘An analysis of State economies plays a role in assessing each State’s exposure to economic risks’, and that size and diversity are both important in this regard. In particular, those ‘States with larger and more diverse economic bases can be regarded as having superior debt repayment capabilities’. However, staff at Standard and Poors have recently told the Commission that they are unable to separately identify the influence of a State’s size on its overall rating.

86. **Commission decision.** The Commission has decided not to include the cost of borrowing factor in the Debt Charges category unless it can be better justified. (see *Draft Assessment Paper CGC 2002/57 Debt Charges*). The Superannuation assessment must be consistent with this decision and not use the cost of borrowing factor unless better

justification for the factor can be found. Table 14 shows the Commission decisions regarding this factor.

**Table 14** COMMISSION DECISIONS — COST OF BORROWING FACTOR

Decision	Reason
A cost of borrowing factor will not be included in the Superannuation assessment.	This factor is developed in the Debt Charges category. The Debt Charges assessment will not include this factor unless it can be better justified. The Superannuation assessment will be consistent with this decision.

### OUTSTANDING LIABILITIES

87. This component measures the outstanding liabilities over the twenty year period from 1978-79 to 1997-98. The historical factor is the only factor assessed.

#### *Historical factor*

88. For the discussion of historical factor see paragraph 58 above.

### SUMMARY OF RESULTS – EXPENSES

#### *Calculating the Category Factor*

89. Table 15 summarises the components, component weights and disability factors assessed for this category for 2001-02. It shows the calculation of the category factor.

90. The following formulas (with the symbols defined in Table 15) were used to calculate the contribution of each expenses component to the overall category factor. In each case, the contributions are calculated as the expenses component weight multiplied by the component factor (the bracketed terms in the formulas). Each contribution to category factor was rescaled to ensure that, for each of them, the sum of standardised equals the sum of actual expenses.

$$\begin{aligned}
 \text{AE} &= 0.3520 \text{ (er)} \\
 \text{NEQ} &= 0.0180 \text{ (epc)} \\
 \text{NUNEQ} &= 0.2070 \text{ (hist)} \\
 \text{OL} &= 0.4230 \text{ (hist)} \\
 \text{Category factor} &= \text{AE} + \text{NEQ} + \text{NUNEQ} + \text{OL}
 \end{aligned}$$

**Table 15** SUPERANNUATION — DERIVATION OF CATEGORY FACTOR, 2001-02

Factors	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
<b>Accrued expenses (AE) (Component weight = 35.20%)</b>								
Accrued Expenses Expenditure								
Relativities Factor (er)	0.99997	0.94282	1.00120	1.02265	0.97966	1.03725	1.06708	2.51869
Component factor	0.99580	0.93889	0.99703	1.01839	0.97558	1.03293	1.06263	2.50818
Cont. to category factor	0.35072	0.33068	0.35115	0.35868	0.34360	0.36380	0.37426	0.88338
<b>Nominal Interest on Equalised Unfunded Liabilities (NEQ) (Component weight = 1.80%)</b>								
EPC Factor (epc)	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Component factor	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Cont. to category factor	0.01830	0.01830	0.01830	0.01830	0.01830	0.01830	0.01830	0.01830
<b>Nominal Interest on Unequalised Unfunded Liabilities (NUNEQ) (Component weight = 20.70%)</b>								
Historical factor (hist)	0.98296	0.94019	1.00270	1.07201	1.02631	1.14409	1.16940	1.93834
Component factor	0.97823	0.93566	0.99787	1.06684	1.02136	1.13857	1.16376	1.92900
Cont. to category factor	0.20249	0.19368	0.20656	0.22084	0.21142	0.23568	0.24090	0.39930
<b>Outstanding Liabilities (OL) (Component weight = 42.30%)</b>								
Historical factor (hist)	0.98296	0.94019	1.00270	1.07201	1.02631	1.14409	1.16940	1.93834
Component factor	0.97823	0.93566	0.99787	1.06684	1.02136	1.13857	1.16376	1.92900
Cont. to category factor	0.41330	0.39532	0.42160	0.45074	0.43152	0.48105	0.49169	0.81500
<b>CATEGORY FACTOR 2004</b>	0.98481	0.93797	0.99761	1.04855	1.00484	1.09883	1.12515	2.11599

### *Standardised expenses*

91. Table 16 shows the category factors calculated for the draft assessment for the 2004 Review compared with the category factors assessed for this category in the 2003 Update.

**Table 16** COMPARISON OF CATEGORY FACTORS, 2003 UPDATE AND THE DRAFT ASSESSMENT FOR THE 2004 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Category factor 2004	0.98481	0.93797	0.99761	1.04855	1.00484	1.09883	1.12515	2.11599
Category factor 2003	0.98397	0.94910	0.99824	1.07191	1.03309	1.16155	0.79117	1.81432

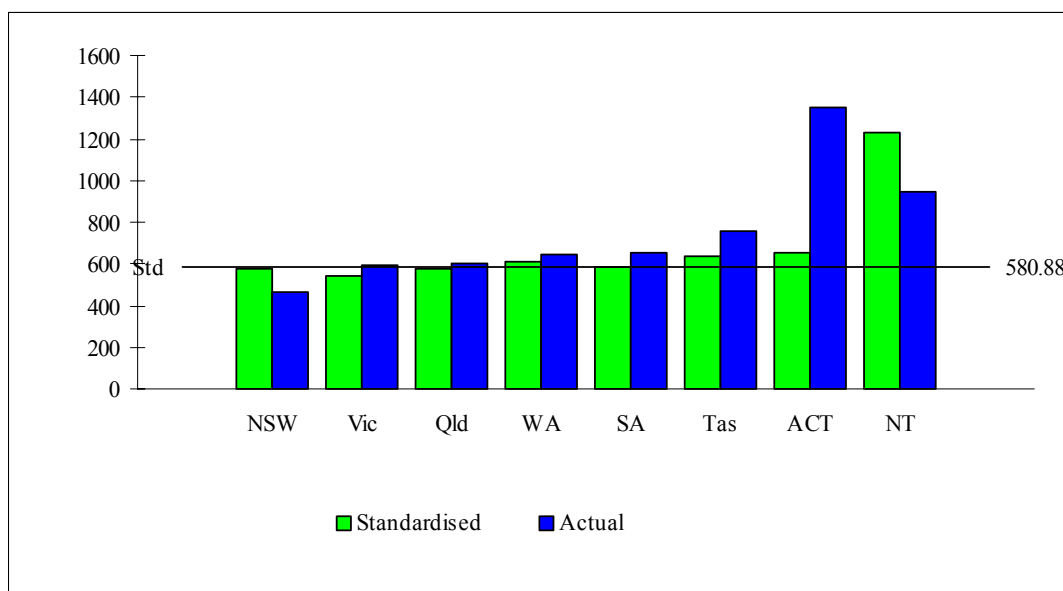
92. Table 17 shows the standardised expenses assessed for this category for 2001-02 in the draft assessment compared with that assessed in the 2003 Update.

**Table 17** ACTUAL AND STANDARDISED AND EXPENSES, 2001-02

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
<b>Actual Expenses</b>									
\$ per capita	580.88	462.30	596.81	601.06	641.11	655.49	758.04	1353.79	950.48
<b>2003 Update - Standardised Expenses</b>									
\$'000		3 836 143 2 705 116 2 151 015 1 207 086 9 21 039	322 661	149 871	212 959				
\$ per capita	587.07	577.65	557.18	586.18	629.28	606.28	681.90	464.47	1065.12
<b>2004 Review Draft Assessment - Standardised Expenses</b>									
\$'000		3 798 954 2 645 223 2 126 992 1 168 332 886 415 302 021	210 888	245 750					
\$ per capita	580.88	572.05	544.85	579.49	609.08	583.69	638.28	653.57	1229.12

93. Figure 1 shows the gross expenses per capita for 2001-02 for the 2004 Review in terms of standardised, actual and standard expenses.

**Figure 1** SUPERANNUATION— GROSS EXPENSES PER CAPITA — STANDARDISED, ESTIMATED AND STANDARD, 2001-02



**Effect of assessment on grants**

94. Table 18 shows changes to redistribution between 2004 Draft Assessment and the 2003 Update.

**Table 18** EFFECT OF ASSESSMENT ON GRANT DISTRIBUTION — SUPERANNUATION

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total <sup>(a)</sup>
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Contribution to 2003 Update relativities <sup>(b)</sup>	-58.8	-152.1	-5.0	83.3	29.9	44.5	-39.8	98.0	255.7
Contribution to 2004 Review Draft Assessments relativities <sup>(c)</sup>	-62.4	-212.0	-3.2	65.1	8.7	33.0	24.9	145.8	277.6
Total change	-3.6	-59.9	1.8	-18.2	-21.1	-11.4	64.7	47.8	114.3

(a) Total redistribution.

(b) Assuming same pool and a constant population.

(c) This figure shows the change in the amount redistributed among the States between the 2003 Update and the 2004 Review Draft Assessment. It does not necessarily equal the difference in the total contributions to the relativities between the two inquiries.

95. Compared to the 2003 assessment, the draft assessment redistributed \$115.3 million away from New South Wales, Victoria, Western Australia, South Australia and Tasmania to Queensland, the ACT and the Northern Territory.

96. The main reasons for change are:

- changes to category assessments that effect the wages and salary expenses on which the expenditure relativities factor is based;
- increasing the Northern Territory adjustment for extra costs due to the CSS from 1.05 to 1.15;
- weighting the historical factors according to total per capita standard expenses; and
- including an adjustment to the ACT's historical factor because the ACT accrued an above standard amount of unfunded liabilities between 1987 and 1997-98.