

## CHAPTER 6: BALANCE SHEET MANAGEMENT

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- ◆ The State's net worth, which comprises all assets and liabilities, is expected to increase by \$15.6 billion over the four year period ending June 2012.
- ◆ The value of assets in the general government and public trading enterprise (PTE) sectors will continue to rise from 2008 to 2012, reflecting \$57.6 billion in capital expenditure.
- ◆ The majority of capital expenditure will be financed by cash operating surpluses with the balance largely financed by debt and asset sales.
- ◆ Net debt will remain at prudent levels with low interest expense to revenue ratios.
- ◆ As a percentage of gross state product, net debt remains at relatively low historical levels, particularly in the general government sector. Higher borrowings in the PTE sector will fund capital works, mainly in the commercial PTE sector.
- ◆ Net financial liabilities are forecast to grow, mainly reflecting increased borrowings and unfunded superannuation liabilities. Growth in insurance and other financial liabilities is expected to remain moderate.
- ◆ Higher superannuation liabilities in 2008 follow negative investment returns due to the global credit crisis and sub-prime loan failures in the United States. In 2010, superannuation liabilities will increase sharply reflecting a decrease in the discount rate used to estimate liabilities from 6.35 per cent to 5.85 per cent.
- ◆ The use of AASB 119 as a valuation methodology underpinning the State's superannuation funding plan is not considered appropriate as it generally overstates liability obligations.
- ◆ Full funding of general government superannuation liabilities by 2030 remains on track.

## **6.1 INTRODUCTION**

The combination of assets and liabilities determines the net worth of the general government sector, the public trading enterprise (PTE) sector, the public financial enterprise (PFE) sector and the net worth of the State as a whole.

Asset holdings are made up of non-financial assets (such as property and infrastructure) and financial assets (such as cash, investments and receivables). Liabilities include borrowings, obligations to employees, payables and other provisions.

Net debt is a measure of accumulated borrowings that allows for the offsetting value of cash and investments. The level of net debt differs in each sector and reflects the extent to which assets generate cash returns, enabling debt to be repaid.

Net financial liabilities are a measure of the financial obligations of the Government, after allowing for the value of financial assets. Equity investments in the PTE and PFE sectors are excluded from the net financial liability measure for general government.

A key non-debt liability of the general government sector is unfunded superannuation. Cash employer contributions are being made to ensure full funding by 2030. As outlined on page 6-18, NSW Treasury has concerns with the methodology used to value superannuation liabilities.

Insurance obligations in the general government sector are also a substantial liability. Funding arrangements are in place for a number of insurance schemes.

Financial asset and risk management arrangements help to ensure that financial obligations are met at a minimum cost and risk to Government.

## **6.2 NET DEBT**

### **GENERAL GOVERNMENT NET DEBT**

The general government sector provides core services such as schools, hospitals and policing. Operating expenditure in this sector is financed mainly from State taxation and Commonwealth grants. Debt is used to part finance capital expenditure.

Net debt at June 2008 is forecast to be around \$5 billion, \$354 million lower than estimated for the 2007-08 Budget. The lower net debt is mainly due to a lower borrowing requirement after better than expected budget results.

**Table 6.1: General government sector net debt**

|                                       | June 2005    | June 2006    | June 2007    | June 2008    | June 2009    | June 2010         | June 2011    | June 2012    |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|-------------------|--------------|--------------|
|                                       | Actual       | Actual       | Actual       | Revised      | Budget       | Forward estimates |              |              |
|                                       | \$m          | \$m          | \$m          | \$m          | \$m          | \$m               | \$m          | \$m          |
| <b>Gross Debt</b>                     |              |              |              |              |              |                   |              |              |
| Borrowings                            | 11,392       | 12,035       | 12,705       | 13,775       | 15,881       | 17,453            | 18,971       | 20,386       |
| Advances received                     | 1,641        | 920          | 892          | 865          | 836          | 807               | 778          | 748          |
| Deposits held                         | 50           | 75           | 92           | 67           | 77           | 76                | 76           | 76           |
|                                       | 13,083       | 13,030       | 13,689       | 14,707       | 16,794       | 18,336            | 19,825       | 21,210       |
| <b>Financial Assets<sup>(a)</sup></b> |              |              |              |              |              |                   |              |              |
| Cash and deposits                     | 1,465        | 2,458        | 2,421        | 2,451        | 2,681        | 2,985             | 3,371        | 3,818        |
| Investments                           | 8,040        | 8,621        | 7,165        | 6,417        | 7,014        | 7,517             | 8,063        | 8,661        |
| Advances paid                         | 1,258        | 837          | 795          | 861          | 908          | 912               | 924          | 922          |
|                                       | 10,763       | 11,916       | 10,381       | 9,729        | 10,603       | 11,414            | 12,358       | 13,401       |
| <b>Net Debt<sup>(a)(b)</sup></b>      | <b>2,320</b> | <b>1,114</b> | <b>3,308</b> | <b>4,978</b> | <b>6,191</b> | <b>6,922</b>      | <b>7,467</b> | <b>7,809</b> |
| <b>% of GSP</b>                       | <b>0.8</b>   | <b>0.4</b>   | <b>1.0</b>   | <b>1.4</b>   | <b>1.6</b>   | <b>1.7</b>        | <b>1.7</b>   | <b>1.7</b>   |

(a) Includes financial assets which have been allocated to fund insurance claims, but excludes balances held in the General Government Liability Management Fund.

(b) Net debt estimates for 2005 and 2006 have been restated in accordance with AASB 1049 principles.

Over the four years to 2012, net debt is forecast to rise by \$2.8 billion from \$5 billion to \$7.8 billion. The overall rise in net debt follows a \$6.6 billion increase in borrowings. This increase is partly offset by additional financial assets of \$3.7 billion, with cash holdings forecast to rise by \$1.4 billion and investments increasing by \$2.2 billion. The growth in financial assets mainly reflects higher self insurance assets.

The increase in net debt will help finance capital expenditure in the general government sector over the next four years, as shown in Table 6.2. Net operating balances (representing the surplus between operating revenues and expenses, after allowing for depreciation) are forecast to fund around 66 per cent of capital expenditure. The level of funding is lower than in recent years, when operating balances funded around 80 per cent. This is due to the significant step up in the capital works program. Asset sales also provide a significant source of funding.

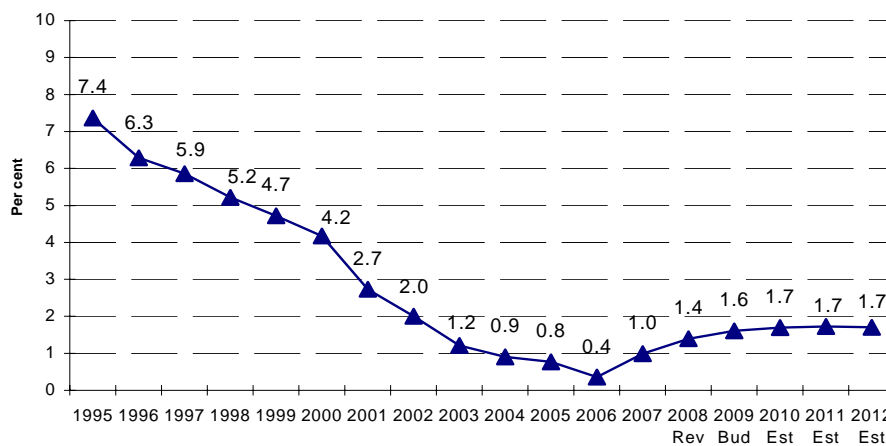
**Table 6.2: Estimated funding sources for the general government capital program**

|   | 4 years to June |               |
|---|-----------------|---------------|
|   | 2008<br>\$m     | 2012<br>\$m   |
| <b>Capital Expenditure</b>                          | <b>16,417</b>   | <b>21,280</b> |
| Funded by:  |                 |               |
| Net Operating Balance (surplus net of depreciation) | 13,086          | 14,015        |
| Asset Sales   | 1,913           | 2,568         |
| Increase in Net Debt <sup>(a)</sup>                 | 2,402           | 2,831         |
| Accruals/Provisions/Other                           | (984)           | 1,866         |
| <b>Total Sources of Funding</b>                     | <b>16,417</b>   | <b>21,280</b> |

(a) The change in net debt excludes transactions of the General Government Liability Management Fund.

Net debt is forecast to increase to 1.4 per cent of gross state product by June 2008 and then rise to 1.7 per cent by 2012, well below the level prevailing in 1995.

**Chart 6.1: General government sector net debt as a percentage of gross state product, as at 30 June<sup>(a)(b)</sup>**

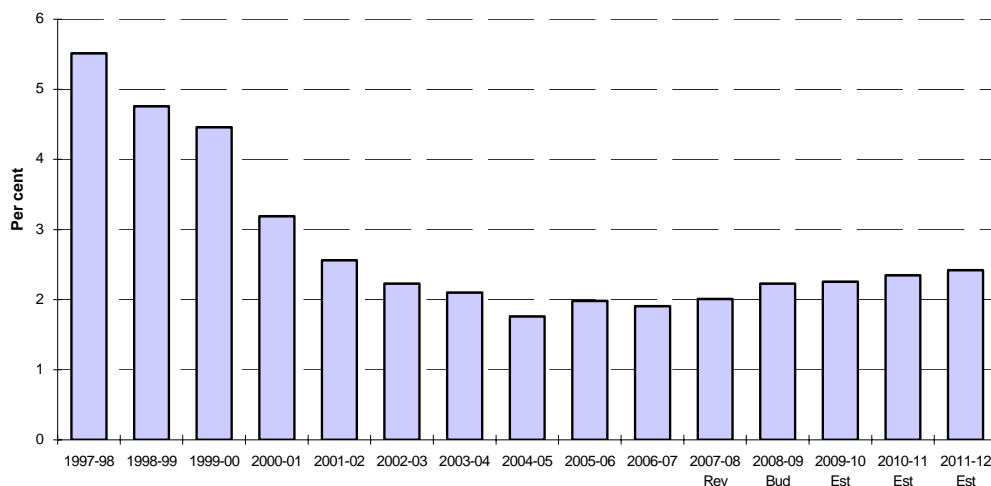


(a) Net debt has been adjusted to exclude the impact of prepaid superannuation contributions and transactions of the General Government Liability Management Fund.

(b) Net debt estimates have been restated in accordance with AASB 1049 principles.

The interest expense<sup>1</sup> on gross borrowing is expected to rise from \$930 million to \$1.3 billion between 2007-08 and 2011-12, following additional borrowing and interest rate increases. As a per cent of general government revenue, interest expense remains comfortably within manageable levels, being only 2.4 per cent of general government revenue in 2011-12 compared with 2 per cent in 2007-08 and 4.8 per cent in 1998-99.

**Chart 6.2: General government sector interest expense on borrowings as a percentage of budget revenue<sup>(a)</sup>**



(a) Interest expense excludes the cost of unwinding of discounts on provisions.

## PUBLIC TRADING ENTERPRISE NET DEBT

The public trading enterprise (PTE) sector can be split into commercial PTEs (businesses which generate commercial returns – primarily electricity, water and ports) and non-commercial PTEs (housing and transport businesses).

The PTE sector is mainly funded by user charges and operates under commercial disciplines described in the Government’s *Commercial Policy Framework*.

Total net debt for the PTE sector is forecast to reach \$18.6 billion in June 2008, rising to \$37 billion in June 2012.

<sup>1</sup> Excluding the cost of unwinding of discounts of provisions for SICorp, Workers Compensation (Dust Diseases) Board, and other agencies.

Net debt is rising as a consequence of increased capital expenditure by PTEs. More details on PTE capital expenditure are provided in Chapter 7 and in Budget Paper No. 4 *Infrastructure Statement*.

Most capital expenditure for the non-commercial PTE sector is directly funded by budget grants. As set out in Chapter 7, borrowing by commercial PTEs to fund capital investments is an important part of imposing commercial disciplines.

**Table 6.3: Public trading enterprise net debt**

|                               | June 2005     | June 2006     | June 2007     | June 2008     | June 2009     | June 2010         | June 2011     | June 2012     |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|-------------------|---------------|---------------|
|                               | Actual        | Actual        | Actual        | Revised       | Budget        | Forward estimates |               |               |
|                               | \$m           | \$m           | \$m           | \$m           | \$m           | \$m               | \$m           | \$m           |
| <b>Gross Debt</b>             |               |               |               |               |               |                   |               |               |
| Borrowings <sup>(a)</sup>     | 13,677        | 15,269        | 19,126        | 19,964        | 24,631        | 28,927            | 33,329        | 37,499        |
| Advances received             | 1,041         | 599           | 573           | 528           | 515           | 501               | 488           | 475           |
| Deposits held                 | 84            | 98            | 131           | 102           | 102           | 102               | 103           | 104           |
|                               | 14,802        | 15,966        | 19,830        | 20,594        | 25,248        | 29,530            | 33,920        | 38,078        |
| <b>Financial Assets</b>       |               |               |               |               |               |                   |               |               |
| Cash and deposits             | 1,435         | 1,806         | 1,675         | 1,323         | 751           | 585               | 449           | 575           |
| Investments                   | 398           | 503           | 1,226         | 632           | 664           | 677               | 689           | 533           |
|                               | 1,833         | 2,309         | 2,901         | 1,955         | 1,415         | 1,262             | 1,138         | 1,108         |
| <b>Net Debt<sup>(b)</sup></b> | <b>12,969</b> | <b>13,657</b> | <b>16,929</b> | <b>18,639</b> | <b>23,833</b> | <b>28,268</b>     | <b>32,782</b> | <b>36,970</b> |
| <b>% of GSP</b>               | <b>4.3</b>    | <b>4.3</b>    | <b>5.1</b>    | <b>5.2</b>    | <b>6.2</b>    | <b>6.9</b>        | <b>7.6</b>    | <b>8.1</b>    |

(a) Borrowings in 2006-07 include allowances for hedging reserves for derivative exposures in the electricity sector following high electricity prices in June 2007. The Report on State Finances for 2006-2007 has further details.

(b) Net debt estimates for 2005 and 2006 have been restated in accordance with AASB 1049 principles.

Table 6.4 shows how capital spending in the PTE sector is being financed over time. As a proportion of PTE capital spending, net debt as a source of funding is forecast to rise to average more than 50 per cent over the four years to 2012, compared to 33 per cent over the four years to 2008.

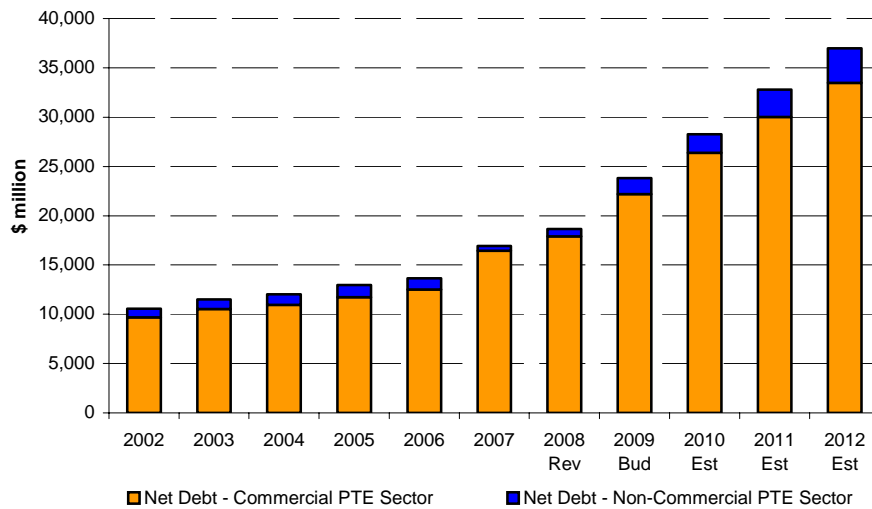
**Table 6.4: PTE capital spending and net debt**

|   | 4 years to June |               |
|---|-----------------|---------------|
|   | 2008            | 2012          |
|   | \$m             | \$m           |
| <b>Capital Expenditure</b>                          | <b>20,079</b>   | <b>36,389</b> |
| Funded by:  |                 |               |
| Net Operating Balance (surplus net of depreciation) | 11,963          | 17,546        |
| Asset Sales   | 1,375           | 1,487         |
| Increase in Net Debt                                | 6,621           | 18,331        |
| Accruals/Provisions/Other                           | 120             | (975)         |
| <b>Total Sources of Funding</b>                     | <b>20,079</b>   | <b>36,389</b> |

(a) Net operating balance after accrued dividends.

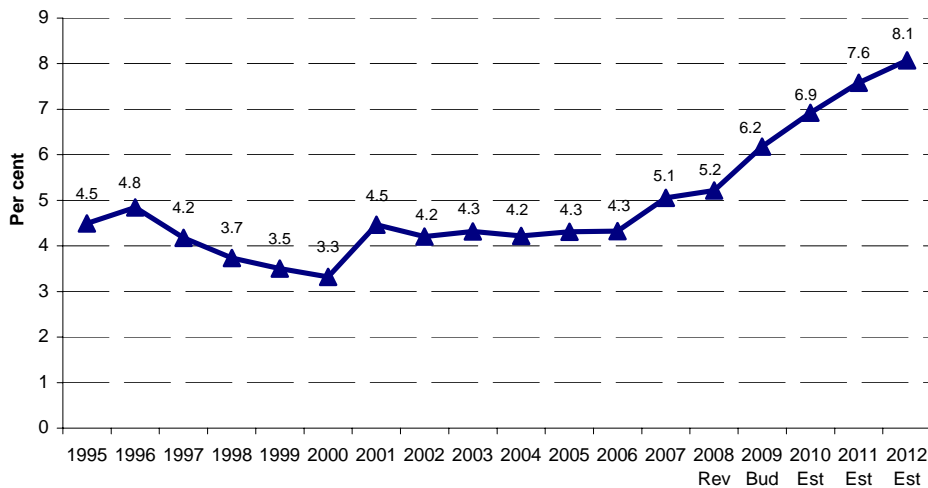
Chart 6.3 demonstrates the relative proportion of debt for the commercial and non-commercial PTE sectors.

**Chart 6.3: PTE sector net debt as at 30 June**



As a percentage of gross state product, net debt in the PTE sector is forecast to reach 5.2 per cent by June 2008, rising to 8.1 per cent by 2012.

**Chart 6.4: Public trading enterprise net debt as a percentage of gross state product as at 30 June<sup>(a)(b)</sup>**



(a) Net debt estimates have been restated in accordance with AASB 1049 principles.

(b) Estimates prior to 1998 include a small amount of PFE net debt.

## TOTAL STATE SECTOR NET DEBT

Total state sector debt combines general government and PTE debt and includes the PFE sector. The NSW Government's fiscal strategy differs for each sector and is based on the use to which funds are applied. (See Chapter 2 for further details on fiscal strategy). In the commercial PTE sector, debt is used to finance capital expenditure which generates a commercial return.

Total state sector debt is measured on a market value basis, leading to a slightly lower net debt estimate than the sum of fair value estimates used for specific sectors. Table 6.5 shows the movement of net debt for the total state sector.

**Table 6.5: Total state sector net debt**

|                                       | June 2005     | June 2006     | June 2007     | June 2008     | June 2009     | June 2010         | June 2011     | June 2012     |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|-------------------|---------------|---------------|
|                                       | Actual        | Actual        | Actual        | Revised       | Budget        | Forward estimates |               |               |
|                                       | \$m           | \$m           | \$m           | \$m           | \$m           | \$m               | \$m           | \$m           |
| <b>Gross Debt</b>                     |               |               |               |               |               |                   |               |               |
| Borrowings <sup>(a)</sup>             | 29,012        | 28,969        | 34,658        | 36,503        | 43,226        | 49,026            | 54,868        | 60,391        |
| Advances received                     | 1,641         | 923           | 892           | 865           | 836           | 807               | 778           | 748           |
| Deposits held                         | 861           | 430           | 483           | 262           | 269           | 263               | 291           | 287           |
|                                       | 31,514        | 30,322        | 36,033        | 37,629        | 44,331        | 50,096            | 55,936        | 61,426        |
| <b>Financial Assets<sup>(b)</sup></b> |               |               |               |               |               |                   |               |               |
| Cash and deposits                     | 3,217         | 4,319         | 4,303         | 4,334         | 4,016         | 4,360             | 4,821         | 5,630         |
| Investments                           | 12,496        | 11,020        | 12,321        | 10,765        | 11,679        | 12,321            | 13,053        | 13,650        |
| Advances paid                         | 245           | 242           | 223           | 333           | 393           | 410               | 436           | 448           |
|                                       | 15,958        | 15,581        | 16,847        | 15,432        | 16,088        | 17,091            | 18,310        | 19,728        |
| <b>Net Debt<sup>(c)</sup></b>         | <b>15,555</b> | <b>14,741</b> | <b>19,186</b> | <b>22,198</b> | <b>28,243</b> | <b>33,005</b>     | <b>37,626</b> | <b>41,698</b> |
| <b>% of GSP</b>                       | <b>5.2</b>    | <b>4.7</b>    | <b>5.7</b>    | <b>6.2</b>    | <b>7.3</b>    | <b>8.1</b>        | <b>8.7</b>    | <b>9.1</b>    |

(a) Borrowings for the total state sector are estimated on a market value basis from 2006 onwards. This basis of valuation reduces estimated debt by around \$300 million in 2006 and \$950 million per annum in later years.

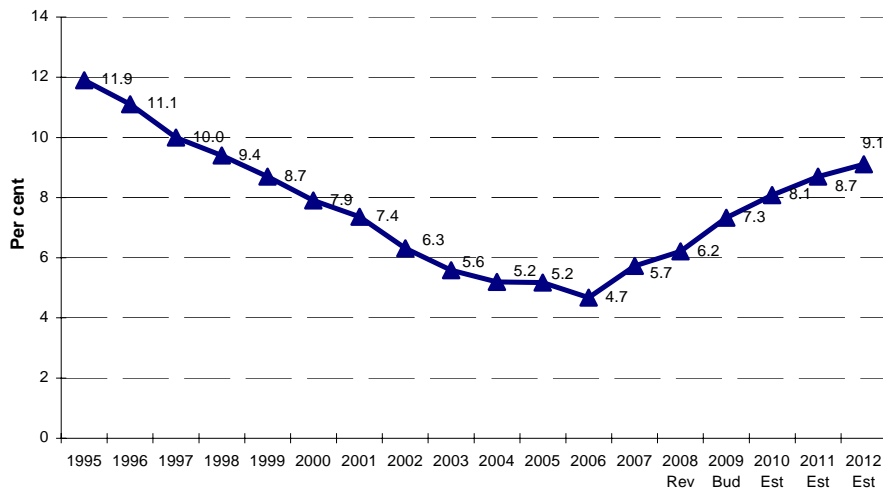
(b) Includes financial assets which have been allocated to fund insurance claims, but excludes balances held in the General Government Liability Management Fund.

(c) Net debt estimates for 2005 and 2006 have been restated in accordance with AASB 1049 principles.

Total state sector net debt is forecast to rise by \$19.5 billion over the next four years, with borrowings rising by nearly \$24 billion. Debt will help fund capital expenditure of \$57.6 billion over the same period. Budget Paper No. 4 *Infrastructure Statement* provides details of projects that make up the State capital program.

Chart 6.5 shows the history of net debt for the total state sector as a percentage of GSP. The forecast rise in net debt from 6.2 per cent to 9.1 per cent is mainly due to an increase in net debt in the PTE sector. As a percentage of gross state product, net debt in the general government sector remains at relatively low levels.

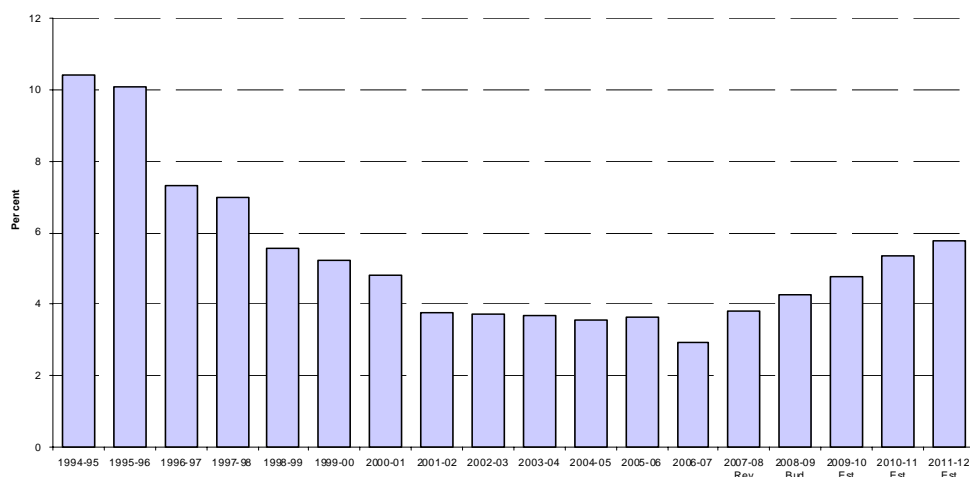
**Chart 6.5: Total state sector net debt as a percentage of gross state product as at 30 June**



Higher interest rates and the increased borrowing program have resulted in a steadily rising proportion of revenue spent on interest as shown in Chart 6.6. The level of forecast interest expense on gross borrowings<sup>2</sup> will rise to 5.8 per cent of total revenue in 2011-12 but remains well below levels of the mid 1990s.

<sup>2</sup> Excluding the cost of unwinding of discounts of provisions for SICorp, Workers Compensation (Dust Diseases) Board, State owned energy corporations and other agencies.

**Chart 6.6: Total state sector interest expense on borrowings as a percentage of total revenue<sup>(a)(b)(c)</sup>**



- (a) Interest rate estimates are based on market valuations from 2005-06 onwards.  
 (b) Interest expense from 2004-05 onwards excludes the cost of unwinding of discounts of provisions.  
 (c) Estimates from 1994-95 to 1996-97 are based on State financial reports and may not be strictly comparable with estimates for 1997-98 and subsequent years.

## 6.3 NET FINANCIAL LIABILITIES

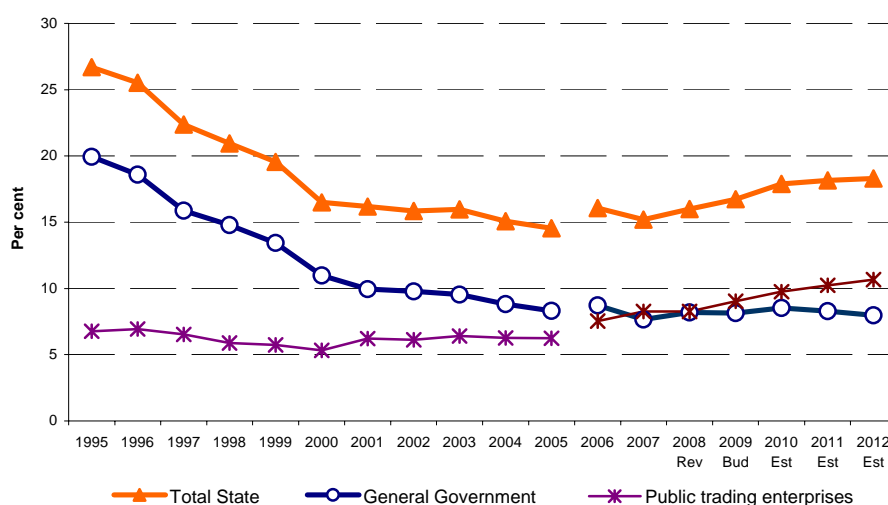
### NET FINANCIAL LIABILITY TRENDS AND FORECASTS

Net financial liabilities include most financial assets and all financial liabilities. For the general government sector, equity investments in the PTE and PFE sector are excluded from net financial liability measures.

Chart 6.7 shows financial liabilities for each sector measured as a percentage of gross state product. Total state sector net financial liabilities are forecast to rise from 16 per cent to 18.3 per cent of gross state product from 2008 to 2012.

The majority of this growth is due to increased borrowings in the PTE sector and their use to finance capital works. Net financial liabilities in the general government sector are forecast to rise from 8.2 per cent to 8.5 per cent of gross state product by 2010 and then decline to 8 per cent by 2012.

**Chart 6.7: Net financial liabilities as a percentage of gross state product as at 30 June<sup>(a)(b)(c)</sup>**



(a) Series break in 2005-06 is due to the adoption of Australian Equivalents to International Financial Reporting Standards, which has increased the reported level of net financial liabilities.

(b) Net financial liability estimates have been restated in accordance with AASB 1049 principles.

(c) Estimates prior to 1998 include PFE liabilities.

Estimates of general government sector net financial liabilities include a provision of \$1 billion for liabilities associated with land claims granted to local Aboriginal Land Councils where the land has not yet transferred.

Since 2006, unfunded liabilities for superannuation have been valued using a conservative accounting standard (AASB 119). The standard requires that the discount rate used to value long-term liabilities be based on the government bond rate rather than the long-term earning rate for superannuation assets, which was the case under the previous accounting standard (AAS 25).

In 2007, the valuation methodology mandated under AASB 119 reduced the growth in superannuation liabilities by increasing the discount rate from 5.9 per cent to 6.4 per cent. In both 2008 and 2009 unfunded superannuation has been valued using a discount rate of 6.35 per cent. Over the forward estimates period, it is assumed that the long-term bond rate will return to trend, resulting in a lower discount rate being used and a sharp rise in the reported value of unfunded superannuation liabilities in 2010.

As discussed in Section 6.5, adoption of the revised accounting standard will not impact on the funding plan in place to fully fund superannuation liabilities by 2030.

## GENERAL GOVERNMENT NET FINANCIAL LIABILITIES

Table 6.6 shows that most of the growth in net financial liabilities in the general government sector from 2008 onwards is due to higher borrowings.

**Table 6.6: General government net financial liabilities**

|  | June 2005      | June 2006      | June 2007      | June 2008      | June 2009      | June 2010         | June 2011      | June 2012      |
|--|----------------|----------------|----------------|----------------|----------------|-------------------|----------------|----------------|
|  | Actual         | Actual         | Actual         | Revised        | Budget         | Forward estimates |                |                |
|  | \$m            | \$m            | \$m            | \$m            | \$m            | \$m               | \$m            | \$m            |
| <b>ASSETS</b>                                  |                |                |                |                |                |                   |                |                |
| <b>Non-Financial Assets</b>                    | <b>85,566</b>  | <b>90,831</b>  | <b>94,430</b>  | <b>97,413</b>  | <b>100,821</b> | <b>104,128</b>    | <b>107,175</b> | <b>109,884</b> |
| Cash and Advances                              | 2,723          | 3,295          | 3,216          | 3,312          | 3,589          | 3,897             | 4,295          | 4,740          |
| Investments                                    | 8,040          | 8,621          | 7,165          | 6,417          | 7,014          | 7,517             | 8,063          | 8,661          |
| Receivables                                    | 5,988          | 9,151          | 11,193         | 10,570         | 10,217         | 10,515            | 10,527         | 10,649         |
| PTE/PFE Equity                                 | 67,991         | 64,206         | 68,040         | 70,842         | 72,426         | 74,870            | 77,801         | 81,177         |
| Other Equity Assets                            | 589            | 1,490          | 1,523          | 1,623          | 1,737          | 1,803             | 1,853          | 1,896          |
| <b>Total Financial Assets</b>                  | <b>85,331</b>  | <b>86,763</b>  | <b>91,137</b>  | <b>92,764</b>  | <b>94,983</b>  | <b>98,602</b>     | <b>102,539</b> | <b>107,123</b> |
| <b>TOTAL ASSETS</b>                            | <b>170,897</b> | <b>177,594</b> | <b>185,567</b> | <b>190,177</b> | <b>195,804</b> | <b>202,730</b>    | <b>209,714</b> | <b>217,007</b> |
| Gross Debt                                     | 13,083         | 13,030         | 13,689         | 14,707         | 16,794         | 18,336            | 19,825         | 21,210         |
| Superannuation <sup>(a)</sup>                  | 12,461         | 17,822         | 14,363         | 17,126         | 17,389         | 19,921            | 20,016         | 20,024         |
| Other Employee Benefits                        | 5,586          | 6,130          | 6,336          | 6,716          | 6,819          | 7,023             | 7,106          | 7,176          |
| Insurance claims <sup>(c)</sup>                | 6,805          | 6,483          | 6,390          | 6,195          | 6,412          | 6,702             | 7,047          | 7,405          |
| Other Provisions                               | 698            | 712            | 747            | 710            | 723            | 744               | 744            | 736            |
| Payables                                       | 2,350          | 2,508          | 3,013          | 2,415          | 2,457          | 2,546             | 2,634          | 2,738          |
| Other Liabilities                              | 1,349          | 3,400          | 4,254          | 3,316          | 3,299          | 3,244             | 3,196          | 3,168          |
| <b>TOTAL LIABILITIES</b>                       | <b>42,332</b>  | <b>50,085</b>  | <b>48,792</b>  | <b>51,185</b>  | <b>53,893</b>  | <b>58,516</b>     | <b>60,568</b>  | <b>62,457</b>  |
| <b>NET WORTH</b>                               | <b>128,565</b> | <b>127,509</b> | <b>136,775</b> | <b>138,992</b> | <b>141,911</b> | <b>144,214</b>    | <b>149,146</b> | <b>154,550</b> |
| Net debt <sup>(d)</sup>                        | 2,320          | 1,114          | 3,308          | 4,978          | 6,191          | 6,922             | 7,467          | 7,809          |
| <b>Net Financial Liabilities<sup>(d)</sup></b> | <b>24,992</b>  | <b>27,528</b>  | <b>25,695</b>  | <b>29,263</b>  | <b>31,336</b>  | <b>34,784</b>     | <b>35,830</b>  | <b>36,511</b>  |
| <b>% of GSP</b>                                | <b>8.3</b>     | <b>8.7</b>     | <b>7.7</b>     | <b>8.2</b>     | <b>8.1</b>     | <b>8.5</b>        | <b>8.3</b>     | <b>8.0</b>     |

(a) GGLMF assets are excluded from net debt estimates and included in estimates of unfunded superannuation.

(b) Unfunded superannuation liabilities rose in 2006 following the adoption of AASB 119.

(c) Insurance liabilities are not disclosed separately in the General Government Balance Sheet (Table 10.4). Instead, insurance liabilities are either classified under provisions or under other employee benefits.

(d) Net financial liability estimates for 2005 and 2006 have been restated in accordance with AASB 1049 principles.

In 2007, unfunded superannuation liabilities fell mainly as a result of an increase in the discount rate as outlined above. In 2008, unfunded superannuation liabilities have increased following negative investment returns during 2007-08. Section 6.5 below has further details on the impact of the superannuation discount rate.

Insurance liabilities are forecast to resume their normal growth throughout the period, following a series of favourable actuarial adjustments in recent years. As explained in Section 6.6, the growth in liabilities is more than offset by the anticipated growth in insurance related investments. Apart from cash and investments, other financial assets and most other liabilities in the general government sector are forecast to grow at relatively slow rates.

## PUBLIC TRADING ENTERPRISE NET FINANCIAL LIABILITIES

Trends for the PTE sector are similar to the general government sector for gross debt but not for other financial liabilities and assets. As Table 6.7 shows, rising debt is causing most of the growth in PTE sector net financial liabilities from 2008 to 2012. Growth in gross borrowings is forecast at \$17.5 billion while growth in net financial liabilities is forecast at \$19.3 billion over this period.

**Table 6.7: Public trading enterprise net financial liabilities**

|  | June 2005<br>Actual<br>\$m | June 2006<br>Actual<br>\$m | June 2007<br>Actual<br>\$m | June 2008<br>Revised<br>\$m | June 2009<br>Budget<br>\$m | June 2010<br>Forward estimates<br>\$m | June 2011<br>Forward estimates<br>\$m | June 2012<br>Forward estimates<br>\$m |
|--|----------------------------|----------------------------|----------------------------|-----------------------------|----------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| <b>ASSETS</b>                                  |                            |                            |                            |                             |                            |                                       |                                       |                                       |
| Cash and Advances                              | 1,435                      | 1,806                      | 1,675                      | 1,323                       | 751                        | 585                                   | 449                                   | 575                                   |
| Investments                                    | 398                        | 503                        | 1,226                      | 632                         | 664                        | 677                                   | 689                                   | 533                                   |
| Receivables                                    | 2,003                      | 2,085                      | 2,886                      | 2,230                       | 2,313                      | 2,629                                 | 2,862                                 | 3,063                                 |
| Equity Investments                             | 5                          | 16                         | ...                        | 3                           | 18                         | 23                                    | 47                                    | 37                                    |
| <b>Total Financial Assets</b>                  | <b>3,841</b>               | <b>4,410</b>               | <b>5,787</b>               | <b>4,188</b>                | <b>3,746</b>               | <b>3,914</b>                          | <b>4,047</b>                          | <b>4,208</b>                          |
| <b>Non-Financial Assets</b>                    | <b>87,111</b>              | <b>87,968</b>              | <b>94,991</b>              | <b>99,593</b>               | <b>106,424</b>             | <b>113,895</b>                        | <b>121,224</b>                        | <b>129,210</b>                        |
| <b>TOTAL ASSETS</b>                            | <b>90,952</b>              | <b>92,378</b>              | <b>100,778</b>             | <b>103,781</b>              | <b>110,170</b>             | <b>117,809</b>                        | <b>125,271</b>                        | <b>133,418</b>                        |
| Gross Debt                                     | 14,802                     | 15,966                     | 19,830                     | 20,594                      | 25,248                     | 29,530                                | 33,920                                | 38,078                                |
| Superannuation                                 | 29                         | 427                        | (294)                      | 404                         | 444                        | 784                                   | 808                                   | 826                                   |
| Other Employee Benefits                        | 1,830                      | 2,078                      | 1,917                      | 1,924                       | 1,894                      | 1,946                                 | 2,006                                 | 2,068                                 |
| Payables                                       | 2,229                      | 1,517                      | 2,973                      | 2,412                       | 2,474                      | 2,722                                 | 2,777                                 | 2,805                                 |
| Other Provisions                               | 1,245                      | 2,389                      | 1,519                      | 1,543                       | 1,485                      | 1,485                                 | 1,500                                 | 1,579                                 |
| Other Liabilities                              | 2,458                      | 5,857                      | 7,509                      | 6,848                       | 6,981                      | 7,252                                 | 7,240                                 | 7,674                                 |
| <b>TOTAL LIABILITIES</b>                       | <b>22,593</b>              | <b>28,234</b>              | <b>33,454</b>              | <b>33,725</b>               | <b>38,526</b>              | <b>43,719</b>                         | <b>48,251</b>                         | <b>53,030</b>                         |
| <b>NET WORTH</b>                               | <b>68,359</b>              | <b>64,144</b>              | <b>67,324</b>              | <b>70,056</b>               | <b>71,644</b>              | <b>74,090</b>                         | <b>77,020</b>                         | <b>80,388</b>                         |
| Net Debt                                       | 12,969                     | 13,657                     | 16,929                     | 18,639                      | 23,833                     | 28,268                                | 32,782                                | 36,970                                |
| <b>Net Financial Liabilities<sup>(a)</sup></b> | <b>18,752</b>              | <b>23,824</b>              | <b>27,667</b>              | <b>29,537</b>               | <b>34,780</b>              | <b>39,805</b>                         | <b>44,204</b>                         | <b>48,822</b>                         |
| <b>% of GSP</b>                                | <b>6.2</b>                 | <b>7.5</b>                 | <b>8.3</b>                 | <b>8.3</b>                  | <b>9.0</b>                 | <b>9.7</b>                            | <b>10.2</b>                           | <b>10.7</b>                           |

(a) Net financial liability estimates for 2005 and 2006 have been restated in accordance with AASB 1049 principles.

Unfunded superannuation and insurance liabilities are much smaller in the PTE sector. Employee benefits are mostly made up of annual and long service leave liabilities. Provisions are largely for distributions from the PTE sector.

## PUBLIC FINANCE ENTERPRISE NET FINANCIAL LIABILITIES

The Public Finance Enterprise (PFE) sector is made up of investment and financial agencies such as TCorp and the Lifetime Care and Support Authority. These authorities have substantial liabilities and financial asset holdings, consistent with their functions. However the net value of assets over liabilities is relatively low. Over the period to 2012, the average value of net financial assets is forecast to exceed net financial liabilities by around \$800 million.

## 6.4 NET WORTH

The combination of financial assets and liabilities and non-financial assets establishes each sector's net worth. Adding the sectors together establishes the net worth of the total state sector. Table 6.8 shows the net worth of the State.

**Table 6.8: Total state sector net worth**

|  | June 2005<br>Actual<br>\$m | June 2006<br>Actual<br>\$m | June 2007<br>Actual<br>\$m | June 2008<br>Revised<br>\$m | June 2009<br>Budget<br>\$m | June 2010<br>Forward estimates<br>\$m | June 2011<br>Forward estimates<br>\$m | June 2012<br>Forward estimates<br>\$m |
|--|----------------------------|----------------------------|----------------------------|-----------------------------|----------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| <b>ASSETS</b>                                  |                            |                            |                            |                             |                            |                                       |                                       |                                       |
| <b>Non-Financial Assets</b>                    |                            |                            |                            |                             |                            |                                       |                                       |                                       |
| Physical assets <sup>(a)</sup>                 | 168,623                    | 171,813                    | 180,848                    | 189,057                     | 198,906                    | 209,180                               | 219,088                               | 228,769                               |
| Investment property                            | ...                        | 1,513                      | 1,474                      | 1,552                       | 1,590                      | 1,615                                 | 1,789                                 | 2,588                                 |
| Assets held for sale                           | 278                        | 326                        | 298                        | 220                         | 172                        | 219                                   | 192                                   | 131                                   |
| Biological assets                              | 1,595                      | 1,559                      | 1,409                      | 1,435                       | 1,470                      | 1,512                                 | 1,555                                 | 1,599                                 |
| Intangible and other assets                    | 1,774                      | 2,964                      | 3,639                      | 3,892                       | 4,339                      | 4,733                                 | 4,992                                 | 5,212                                 |
| <b>Total Non-Financial Assets</b>              | <b>172,270</b>             | <b>178,175</b>             | <b>187,668</b>             | <b>196,156</b>              | <b>206,477</b>             | <b>217,259</b>                        | <b>227,616</b>                        | <b>238,299</b>                        |
| <b>Financial Assets</b>                        |                            |                            |                            |                             |                            |                                       |                                       |                                       |
| Cash and Deposits                              | 3,217                      | 4,319                      | 4,303                      | 4,334                       | 4,016                      | 4,360                                 | 4,821                                 | 5,630                                 |
| Advances paid                                  | 246                        | 242                        | 223                        | 333                         | 394                        | 410                                   | 436                                   | 448                                   |
| Investments <sup>(b)</sup>                     | 12,496                     | 11,020                     | 12,321                     | 10,765                      | 11,679                     | 12,321                                | 13,053                                | 13,650                                |
| Receivables                                    | 4,699                      | 5,200                      | 6,328                      | 5,847                       | 5,413                      | 5,612                                 | 5,723                                 | 5,792                                 |
| Equity Assets                                  | 595                        | 1,506                      | 1,523                      | 1,626                       | 1,754                      | 1,826                                 | 1,900                                 | 1,933                                 |
| <b>Total Financial Assets</b>                  | <b>21,253</b>              | <b>22,287</b>              | <b>24,698</b>              | <b>22,905</b>               | <b>23,256</b>              | <b>24,529</b>                         | <b>25,933</b>                         | <b>27,453</b>                         |
| <b>TOTAL ASSETS</b>                            | <b>193,523</b>             | <b>200,462</b>             | <b>212,366</b>             | <b>219,061</b>              | <b>229,733</b>             | <b>241,788</b>                        | <b>253,549</b>                        | <b>265,752</b>                        |
| <b>LIABILITIES</b>                             |                            |                            |                            |                             |                            |                                       |                                       |                                       |
| Deposits Held                                  | 861                        | 430                        | 483                        | 262                         | 269                        | 263                                   | 291                                   | 287                                   |
| Advances Received                              | 1,641                      | 923                        | 892                        | 865                         | 836                        | 807                                   | 778                                   | 748                                   |
| Borrowing                                      | 29,012                     | 28,969                     | 34,658                     | 36,503                      | 43,226                     | 49,026                                | 54,868                                | 60,391                                |
| Superannuation <sup>(b)</sup>                  | 12,490                     | 18,249                     | 14,068                     | 17,530                      | 17,833                     | 20,705                                | 20,824                                | 20,850                                |
| Other Employee Entitlements                    | 9,350                      | 10,172                     | 10,268                     | 10,695                      | 10,845                     | 11,202                                | 11,465                                | 11,719                                |
| Payables                                       | 5,895                      | 5,565                      | 5,971                      | 5,240                       | 5,337                      | 5,644                                 | 5,758                                 | 5,869                                 |
| Other Provisions and Liabilities               | 5,708                      | 8,645                      | 9,251                      | 8,975                       | 9,476                      | 9,927                                 | 10,419                                | 11,338                                |
| <b>TOTAL LIABILITIES</b>                       | <b>64,957</b>              | <b>72,953</b>              | <b>75,591</b>              | <b>80,069</b>               | <b>87,822</b>              | <b>97,574</b>                         | <b>104,403</b>                        | <b>111,202</b>                        |
| <b>NET WORTH</b>                               | <b>128,565</b>             | <b>127,509</b>             | <b>136,775</b>             | <b>138,992</b>              | <b>141,911</b>             | <b>144,214</b>                        | <b>149,146</b>                        | <b>154,550</b>                        |
| Gross debt                                     | 31,514                     | 30,322                     | 36,033                     | 37,629                      | 44,331                     | 50,096                                | 55,936                                | 61,426                                |
| Assets <sup>(b)</sup>                          | 15,959                     | 15,581                     | 16,847                     | 15,432                      | 16,089                     | 17,091                                | 18,310                                | 19,728                                |
| <b>Net Debt</b>                                | <b>15,555</b>              | <b>14,741</b>              | <b>19,186</b>              | <b>22,198</b>               | <b>28,243</b>              | <b>33,005</b>                         | <b>37,626</b>                         | <b>41,698</b>                         |
| <b>% of GSP</b>                                | <b>5.2</b>                 | <b>4.7</b>                 | <b>5.7</b>                 | <b>6.2</b>                  | <b>7.3</b>                 | <b>8.1</b>                            | <b>8.7</b>                            | <b>9.1</b>                            |
| Total Liabilities                              | 64,957                     | 72,953                     | 75,591                     | 80,069                      | 87,822                     | 97,574                                | 104,403                               | 111,202                               |
| Financial Assets <sup>(b)</sup>                | 21,253                     | 22,287                     | 24,698                     | 22,905                      | 23,256                     | 24,529                                | 25,933                                | 27,453                                |
| <b>Net Financial Liabilities<sup>(c)</sup></b> | <b>43,705</b>              | <b>50,664</b>              | <b>50,893</b>              | <b>57,164</b>               | <b>64,567</b>              | <b>73,045</b>                         | <b>78,471</b>                         | <b>83,749</b>                         |
| <b>% of GSP</b>                                | <b>14.5</b>                | <b>16.0</b>                | <b>15.2</b>                | <b>16.0</b>                 | <b>16.7</b>                | <b>17.9</b>                           | <b>18.2</b>                           | <b>18.3</b>                           |

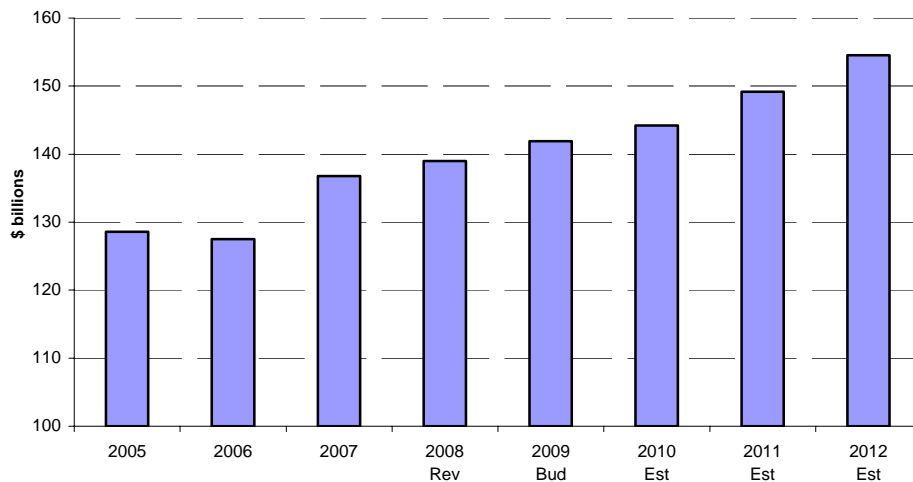
(a) Excludes RTA land under roads.

(b) GGLMF assets are excluded from net debt estimates and included in estimates of unfunded superannuation.

(c) Net financial liability estimates for 2005 and 2006 have been restated in accordance with AASB 1049 principles.

Total state sector net worth is expected to increase by \$2.2 billion in 2007-08 and by \$15.6 billion between June 2008 and June 2012. The value of non-financial assets is expected to increase by more than \$42 billion over this time, from \$196.2 billion in 2008 to \$238.3 billion in 2012. Net debt is forecast to rise by \$19.5 billion in this period from \$22.2 billion in 2008 to \$41.7 billion in 2012, a rise of 2.9 per cent as a percentage of gross state product.

**Chart 6.8: Total state sector net worth, as at 30 June**



The ongoing increase in the net worth of the state reflects the funding of a significant component for the \$57.6 billion infrastructure investment program from cash operating surpluses.

As shown in Tables 6.2 and 6.4, operating surpluses (net of depreciation) are forecast to fund around 66 per cent of capital expenditure in the general government sector and nearly 50 per cent in the PTE sector.

Net debt has risen, mostly in the PTE sector. As a percentage of gross state product, net debt levels in the general government sector remain low.

Apart from net debt, growth in superannuation and other net financial liabilities is expected to be restrained, rising from \$35 billion in 2008 to \$42 billion in 2012. As a percentage of gross state product, the value of non-debt related net financial liabilities is forecast to fall from 9.8 per cent in 2008 to 9.2 per cent in 2012.

## 6.5 UNFUNDED SUPERANNUATION

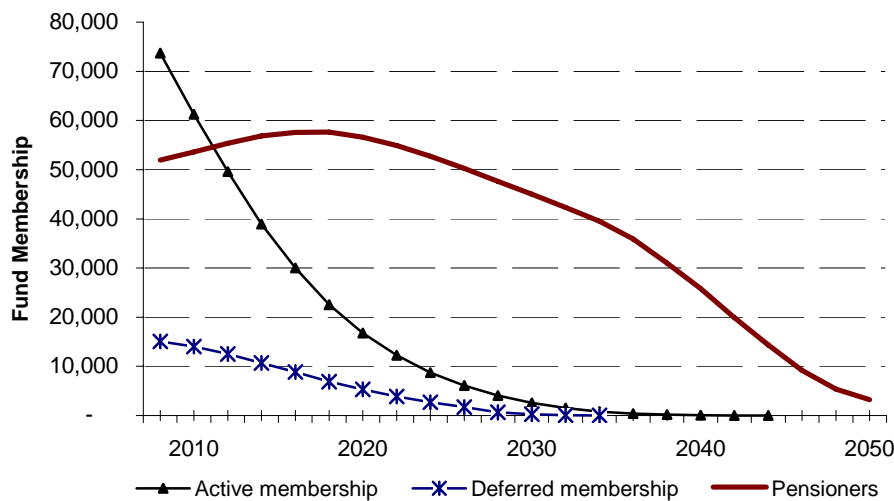
### GENERAL GOVERNMENT SUPERANNUATION LIABILITIES

Approximately 73 per cent of the NSW public sector workforce are members of accumulation schemes, primarily First State Super (FSS), where employers contribute the 9 per cent Superannuation Guarantee Charge (SGC).

The balance of the NSW public sector workforce are members of closed defined benefit schemes: the pension based State Superannuation Scheme (SSS) and Police Superannuation Scheme (PSS); and the lump sum based State Authorities Superannuation Scheme (SASS) and State Authorities Non-Contributory Superannuation Scheme (SANCS). The administration and investment functions for the schemes are the responsibility of the State Authorities Superannuation Trustee Corporation (STC).

As shown in Chart 6.9, there will be a pronounced decline in active STC scheme members and an increasing number of pensioners over the next twenty years. Pensioner numbers are expected to peak at approximately 58,000 in 2017 and then decline slowly over the following thirty years.

**Chart 6.9: STC scheme membership projection to 2050<sup>(a)</sup>**



(a) Graph provided by the STC.

Other public sector schemes are dedicated to specific activities, being the Electricity Industry Superannuation Scheme (EISS), the Judges Pension Scheme (JPS) and the Parliamentary Contributory Superannuation Fund (PCSF). Apart from the Judges Pension Scheme, these schemes have also been closed to new members for some time. The PCSF has currently been granted an employer contribution funding holiday due to the level of funding being within the Scheme's actuarial target range.

Superannuation scheme liabilities are funded by financial assets, invested and managed by the superannuation trustees of the respective schemes. The margin between liabilities and assets is defined as the unfunded liability. Specifically, the unfunded liability is the difference between the present value of future benefits that have accrued during past service (the gross liability) and the market value of superannuation fund assets.

The unfunded liabilities of the NSW Government sector are actuarially calculated by actuaries Mercer Human Resource Consulting. The estimates of liabilities, assets, earnings and unfunded liabilities are based on numerous economic and demographic assumptions, including salary growth rates, consumer price index forecasts, liability discount rates, investment earning rates, scheme exit rates and the type of benefit taken (pension or lump sum). These assumptions can vary significantly over time, leading to ongoing revision to the level of unfunded liabilities.

**Table 6.9: General government sector unfunded superannuation liabilities**

|  | June 2005     | June 2006     | June 2007     | June 2008      | June 2009     | June 2010                | June 2011     | June 2012     |
|--|---------------|---------------|---------------|----------------|---------------|--------------------------|---------------|---------------|
|  | Actual<br>\$m | Actual<br>\$m | Actual<br>\$m | Revised<br>\$m | Budget<br>\$m | Forward estimates<br>\$m |               |               |
| Liabilities(a)   | 34,959        | 44,065        | 43,847        | 44,999         | 46,138        | 49,188                   | 49,667        | 49,938        |
| <b>Less:</b>   |               |               |               |                |               |                          |               |               |
| Assets   | 18,497        | 20,936        | 29,484        | 27,872         | 28,749        | 29,267                   | 29,651        | 29,913        |
| Reserves held in General<br>Government Liability<br>Management Fund <sup>(b)</sup> | 4,001         | 5,307         | ...           | ...            | ...           | ...                      | ...           | ...           |
| <b>Net Unfunded Liabilities<sup>(c)</sup></b>                                      | <b>12,461</b> | <b>17,822</b> | <b>14,363</b> | <b>17,126</b>  | <b>17,389</b> | <b>19,921</b>            | <b>20,016</b> | <b>20,024</b> |

(a) The large increase in liabilities in June 2006 is due to the adoption of AASB 119.

(b) The General Government Liability Management Fund paid \$7.175 billion to the State Super Fund in June 2007.

(c) Includes assets and liabilities of employers and employees. Includes STC Pooled Fund schemes, Parliamentary Contributory Superannuation Scheme and Judges' Pension Scheme.

Since 2006, liabilities for statutory reporting have been required to be estimated under the AASB 119 *Employee Benefits*. Under this standard, the discount rate for forecast liabilities is based on long-term government bond rates, whereas under the previous Australian Accounting Standard the basis was the forecast long-term asset earning rate. Table 6.9 shows estimates of unfunded superannuation liabilities under AASB 119.

For funding purposes, NSW Treasury believes that the AASB 119 approach is inappropriate as it generally overstates the liability obligation when scheme assets are invested in growth portfolios and are available to offset the liability. Long-term investment history shows that equity returns exceed bond rates due to the equity risk premium. In addition, as outlined below, the use of fluctuating bond rates also distorts underlying comparisons from year to year.

In 2008, unfunded superannuation liabilities increase sharply due to the effect of forecast negative investment returns of 3.8 per cent in 2007-08. Compared with forecasts in the 2007-08 Budget, unfunded superannuation liabilities in 2007 are lower due to an increase in the discount rate from 5.9 per cent to 6.4 per cent.

## **GENERAL GOVERNMENT SECTOR SUPERANNUATION FUNDING PLAN**

The objective of the Government's funding plan is to ensure that sufficient, but not excessive cash employer contributions are made to the defined benefit schemes to ensure full funding by 2030, as required by the *Fiscal Responsibility Act 2005*. This funding approach ensures that scarce Government financial resources are not diverted unnecessarily to the superannuation funds but are available to meet core government services such as health, education and transport. The cash funding plan uses a forecast scheme investment earning rate to estimate future liabilities as well as forecast assets.

Until 2005, the scheme investment earning rate was used to forecast liabilities as well as assets in the Budget, under the Australian Accounting Standard AAS 25 *Financial Reporting by Superannuation Plans*. Although AAS 25 has now been replaced by AASB 119 for statutory reporting purposes, Treasury believes AAS 25 remains an appropriate basis for funding as it provides a better indication of the level of unfunded liabilities and therefore the amount of employer funding required over the long-term to meet future member benefits obligations.

The trustees of public sector defined benefit schemes still use AAS 25 to report the financial position of their superannuation funds.

Chart 6.10 shows the forecast reduction in unfunded liabilities resulting from the State's long-term superannuation funding plan for the four defined benefit superannuation schemes that make up the State Super Fund (also known as the Pooled Fund). Using the funding basis methodology and current forecasts, gross liabilities as at 30 June 2008 are expected to be 72 per cent funded and will be fully funded by 2030.

Chart 6.10 also shows the liability over time as estimated by AASB 119. The Chart illustrates that AASB 119 overestimates the unfunded liability position and leads to a reported unfunded liability in 2030, despite the schemes being fully funded under AAS 25 with no further government contributions being required.

**Chart 6.10: Comparison of STC pooled fund general government unfunded liabilities (funding basis) and AASB 119 (reporting basis)**

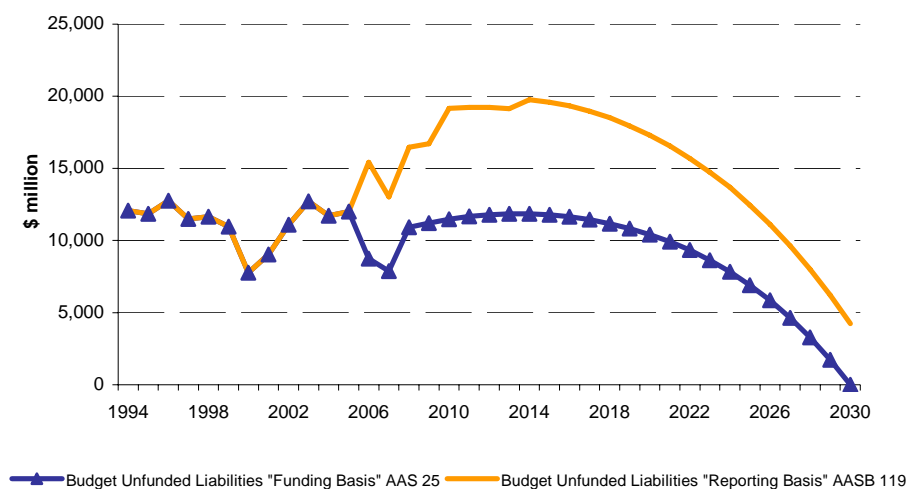


Table 6.10 shows the impact of changes in the discount rate for superannuation liabilities for the STC required under AASB 119. In 2007, 2008 and 2009, an increase in the relevant discount rate reduced unfunded liabilities. However, under current assumptions this reduction will be unwound in 2010, resulting in a sharp increase in reported unfunded superannuation liabilities.

**Table 6.10: STC pooled fund general government unfunded superannuation liability estimates under AASB 119**

|                                 | June 2006     | June 2007     | June 2008      | June 2009     | June 2010                | June 2011 | June 2012 |
|---------------------------------|---------------|---------------|----------------|---------------|--------------------------|-----------|-----------|
|                                 | Actual<br>\$m | Actual<br>\$m | Revised<br>\$m | Budget<br>\$m | Forward estimates<br>\$m |           |           |
| AASB 119 Super liability        | 15,427        | 13,027        | 16,451         | 16,701        | 19,158                   | 19,241    | 19,239    |
| Actual/Forecast Discount rate % | 5.90          | 6.40          | 6.35           | 6.35          | 5.85                     | 5.85      | 5.85      |
| AASB 119 Super liability        | 15,660        | 15,788        | 18,752         | 18,990        | 19,158                   | 19,241    | 19,239    |
| Constant Discount rate %        | 5.85          | 5.85          | 5.85           | 5.85          | 5.85                     | 5.85      | 5.85      |
| Difference                      | (233)         | (2,761)       | (2,301)        | (2,289)       | ...                      | ...       | ...       |
| AAS 25 Super liability          | 8,743         | 7,885         | 10,903         | 11,205        | 11,462                   | 11,659    | 11,789    |

For funding purposes, and with the help of the (STC) fund actuary Mercer Human Resource Consulting, planned employer cash contributions are currently set at a level where general government sector net unfunded superannuation liabilities should peak in 2013 and be fully funded by 2030.

Forecast employer contributions are based on an earning rate assumption of 7.9 per cent over time, following advice from Mercer Investment Consulting. By comparison, the earning rate assumption is 7.5 per cent for Queensland superannuation schemes and is up to 8 per cent for Victorian schemes. The Commonwealth has adopted a 6 per cent discount rate reflecting the fact that its schemes have no employer assets. As shown in the following table, actual State Super investment earnings over the last 50 years have averaged 8.3 per cent.

**Table 6.11: State super long-term investment returns**

|                           |       |
|---------------------------|-------|
| Average for Last 50 Years | 8.3%  |
| Average for Last 40 Years | 9.0%  |
| Average for Last 30 Years | 9.6%  |
| Average for Last 20 Years | 8.2%  |
| Average for Last 10 Years | 6.9%  |
| Average for Last 5 Years  | 10.4% |

The funding plan also makes allowance for certain tax concessions available to public sector superannuation funds, in particular, that asset earnings available to meet pension liabilities are tax free. The availability of Australian share franking credits ensures that STC schemes are generally eligible for a tax refund in most tax years.

Forecast assets from ongoing funding, plus future expected investment returns, should ensure no further Crown employer contributions will be required past 2030.

Table 6.12 demonstrates the financial benefits of the Government policy of fully funding superannuation liabilities. If the Government had adopted a pay-as-you-go approach, contributions would have had to equal benefits paid. With higher rates of funding of liabilities as they accrue over time, cash contributions to the State Super Fund are significantly below actual benefits paid to members.

**Table 6.12: State superannuation fund total state sector**

|                        | <i>June 2008<br/>Budget</i> | <i>June 2008<br/>Revised</i> | <i>June 2009<br/>Budget</i> | <i>Forward estimates</i> |            |            | <i>4 year to<br/>2012 Total</i> |
|------------------------|-----------------------------|------------------------------|-----------------------------|--------------------------|------------|------------|---------------------------------|
|                        | <i>\$m</i>                  | <i>\$m</i>                   | <i>\$m</i>                  | <i>\$m</i>               | <i>\$m</i> | <i>\$m</i> | <i>\$m</i>                      |
| Total Benefit Payments | 2,995                       | 3,022                        | 3,176                       | 3,659                    | 3,865      | 4,052      | 14,752                          |
| Employer Contributions | 967                         | 1,039                        | 1,138                       | 1,168                    | 1,200      | 1,233      | 4,739                           |
| Cash Saving            | 2,028                       | 1,983                        | 2,038                       | 2,491                    | 2,665      | 2,819      | 10,013                          |

For most of the period prior to 1995, superannuation was largely funded on a pay-as-you-go basis.

## 6.6 INSURANCE

### SELF INSURANCE

Insurance estimates in the general government sector reflect a number of self insurance schemes, closed insurance schemes and other specific insurance based arrangements, including the Treasury Managed Fund (TMF), the Workers Compensation (Dust Diseases) Board, HIH, various WorkCover administered schemes such as the Emergency Rescue Workers' and Bush Fire Fighters' Compensation Funds, as well as other arrangements. Self insurance liabilities arise primarily from the TMF and WorkCover administered schemes.

The total insurance liabilities for the general government sector are shown in Table 6.13.

**Table 6.13: General government insurance estimates**

|  | June 2007  | June 2008  | June 2009  | June 2010         | June 2011  | June 2012  |
|--|------------|------------|------------|-------------------|------------|------------|
|  | Actual     | Revised    | Budget     | Forward estimates |            |            |
|  | \$m        | \$m        | \$m        | \$m               | \$m        | \$m        |
| <b>Outstanding Claim Liabilities</b>                 |            |            |            |                   |            |            |
| Treasury Managed Fund                                | 4,029      | 3,957      | 4,193      | 4,502             | 4,863      | 5,236      |
| Dust Diseases  | 1,517      | 1,533      | 1,547      | 1,557             | 1,563      | 1,566      |
| WorkCover Authority <sup>(a)</sup>                   | 173        | 106        | 100        | 95                | 91         | 88         |
| Managed closed schemes <sup>(b)</sup>                | 278        | 257        | 393        | 389               | 385        | 380        |
| HIH  | 130        | 95         | 70         | 50                | 36         | 26         |
| Crown Finance Entity <sup>(c)</sup>                  | 155        | 138        | ...        | ...               | ...        | ...        |
| Police & Fire Death and Disability Schemes           | 104        | 105        | 105        | 105               | 105        | 105        |
| Other (self funded schemes) <sup>(d)</sup>           | 4          | 4          | 4          | 4                 | 4          | 4          |
|  | 6,390      | 6,195      | 6,412      | 6,702             | 7,047      | 7,405      |
| <b>Assets<sup>(e)</sup></b>                          |            |            |            |                   |            |            |
| Treasury Managed Fund <sup>(f)</sup>                 | 4,902      | 4,451      | 4,800      | 5,187             | 5,580      | 6,008      |
| Dust Diseases  | 1,517      | 1,533      | 1,547      | 1,557             | 1,563      | 1,566      |
| WorkCover Authority                                  | 360        | 242        | 230        | 217               | 205        | 194        |
| Managed closed schemes                               | 260        | 229        | 403        | 401               | 406        | 414        |
| Crown Finance Entity                                 | ...        | 138        | ...        | ...               | ...        | ...        |
| Police & Fire Death and Disability Schemes           | 14         | 14         | 14         | 14                | 14         | 14         |
| Other (self funded schemes)                          | 4          | 4          | 4          | 4                 | 4          | 4          |
|  | 7,057      | 6,611      | 6,998      | 7,380             | 7,772      | 8,200      |
| <b>Assets as proportion of claim liabilities (%)</b> | <b>110</b> | <b>107</b> | <b>109</b> | <b>110</b>        | <b>110</b> | <b>111</b> |

(a) Does not include liabilities under the workers compensation scheme for private sector employees.

(b) Closed schemes include the Transport Accident Compensation Fund, Government Workers Fund and the Pre Managed Fund Reserve.

(c) The workers compensation insurance liabilities of the State Rail Authority assumed by the Crown Finance Entity. The liabilities will be transferred to the NSW Self Insurance Corporation, included as Managed Closed Schemes, from 1 July 2008.

(d) The Maritime Authority of NSW has a closed fund of the workers compensation liabilities of the former Maritime Services Board incurred between 1989 and 1995.

(e) Gross amount of insurance assets are included in financial assets for net debt reporting purposes in accordance with Australian Bureau of Statistics standards.

(f) TMF financial assets after forecast transfer of surplus reserves. Includes investments and recoveries receivables.

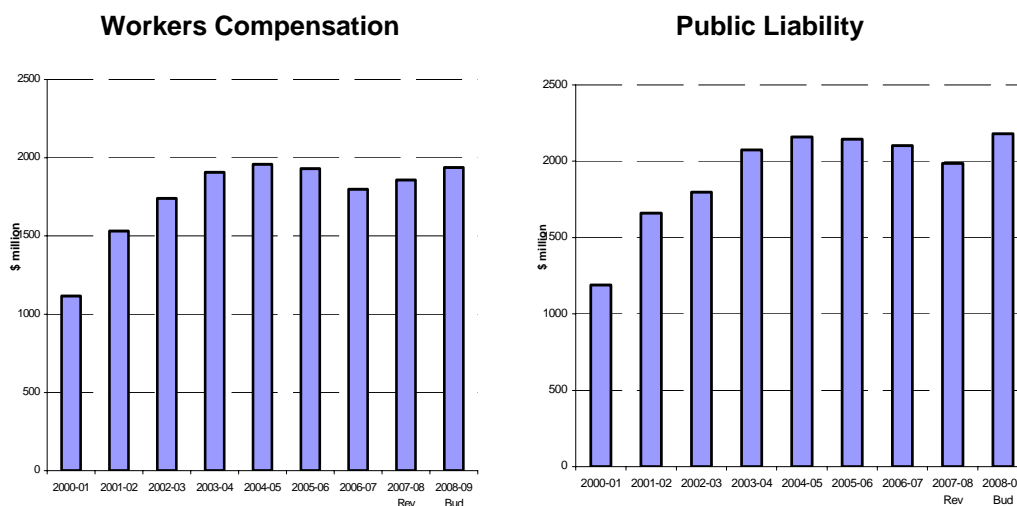
The largest self insurance scheme is the TMF, which is owned and underwritten by the Government. It covers workers compensation, public liability and other insurance liabilities for all general government sector Budget dependent agencies. Other public sector agencies may apply to join the TMF on a voluntary basis.

The TMF's overall purpose is to assist member agencies in reducing risk exposures and thereby maximise resources available to support their core business activities. The TMF provides incentive "hindsight adjustments" to member agency premiums to encourage best management practices.

TMF workers compensation claims management is distributed between three claims managers, Employers Mutual Limited, Allianz Insurance Limited and GIO General Limited. GIO provides all other general insurance claims management. There are also separate long-term contracts for risk management (Suncorp), reinsurance (Benfield) and actuarial services (PricewaterhouseCoopers and Taylor Fry). This claims management model allows for more active in-house management and effectively reduces the systemic risk associated with a single provider. This model provides a more competitive environment, contributing to lower overall costs of insurance to the Government.

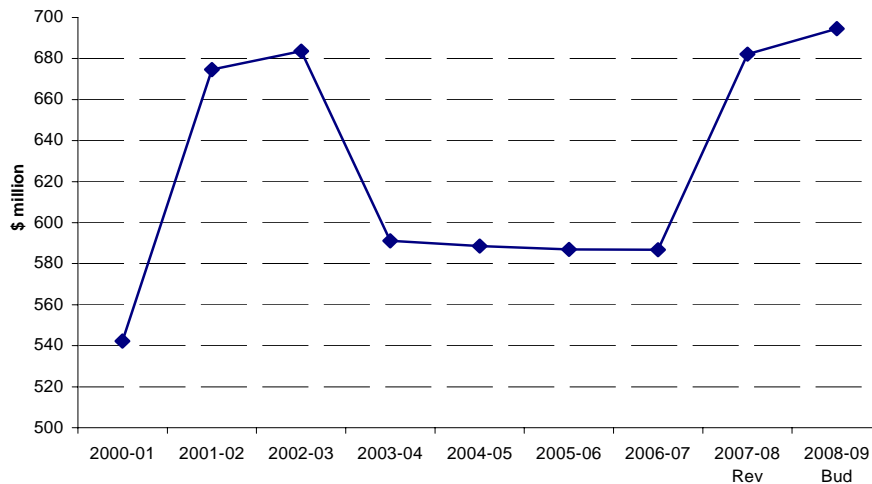
Chart 6.11 shows a general trend of stability or decline in outstanding claims liabilities in recent years for both workers compensation and public liability. This situation is a result of continued favourable impact of the workers compensation and tort reform legislative changes, the new claims management model, and improved internal risk and claims management practice of public sector agencies.

**Chart 6.11: TMF outstanding claims liabilities**



In 2008-09, the TMF actuary has allowed for some growth in claims. The projected growth in liabilities is not an indication of any adverse claims experience.

**Chart 6.12: TMF claim cash payments<sup>(a)</sup>**

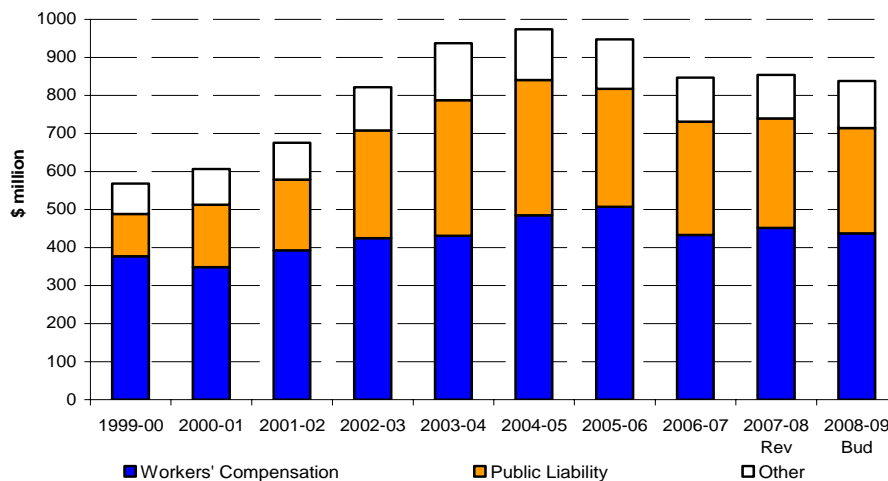


(a) The increase in 2007-08 follows a number of large existing claim settlements for significant amounts as well as payments for natural disasters.

The TMF target premium for 2008-09 has been reduced by 1.9 per cent from 2007-08 levels. Compared to 2007-08, workers compensation premiums have fallen by 3.3 per cent (\$14.7 million) and public liability premiums have fallen by 3.5 per cent (\$10.2 million).

Reduced workers compensation premiums follow reduced ongoing claims and payment experience plus prospective changes in rehabilitation management practices. Reduced public liability premiums reflect significant reductions in Visiting Medical Officer premiums, after some years of good claims experience.

**Chart 6.13: Total TMF premiums by line of business**



For public liability, this is the fifth year that premiums have been reduced. The 3.5 per cent fall in 2008-09 follows a 3.4 per cent fall in 2007-08, a 4.2 per cent fall in 2006-07, a 12.6 per cent fall in 2005-06 and a 0.2 per cent in 2004-05. Chart 6.13 shows the trend in premiums by the major lines of business.

Liabilities under the Dust Diseases Scheme are expected to grow moderately over the forward estimates period. These liabilities are fully offset by an asset receivable which recognises the Dust Diseases Board's legislative power to adjust employer premiums in order to fund future claims. Other insurance liabilities are expected to fall, reflecting the closed nature of these schemes.

## **NET ASSETS HOLDING LEVEL POLICY**

In March 2006, Treasury established the *Net Assets Holding Level Policy* (previously referred to as the *Insurance Reserve Policy*) that dictates an appropriate level of surplus assets held for the TMF. This policy sets TMF's surplus assets at 10 per cent above outstanding claims liabilities, plus the amount of reinsurance retention that the Fund would incur for a single loss. The surplus is reviewed based on the financial results as at 31 December each year.

Consistent with the superannuation funding plan, the *Net Assets Holding Level Policy* uses a forecast Treasury Managed Fund investment earning rate to estimate future liabilities as well as forecast assets.

Following the review of the fund as at 31 December 2007, a surplus above the requirement level was identified and \$300 million will be transferred to the Consolidated Fund before 30 June 2008. This follows previous surplus payments to the Consolidated Fund of \$910 million in 2007 and \$1 billion to the General Government Liability Management Fund in 2006. These contributions reflect reductions in claims incurred and overall higher than expected investment returns during the period.

## **HIH LIQUIDATION**

In order to maintain the community's confidence in the insurance industry after the collapse of the HIH/FAI Insurance Group in 2001, the NSW Government assumed in excess of \$700 million in claims liabilities. These liabilities are for outstanding compulsory third party motor vehicle policies in force with HIH prior to 31 December 2000, plus home warranty insurance policies in force with HIH prior to 15 March 2001.

The assumption of HIH liabilities by the Government has ensured that persons injured in a motor vehicle accident and persons with home warranty claims against HIH can seek recourse for compensation in respect of their injuries and losses.

Outstanding HIH liabilities are expected to reduce to \$95 million by 30 June 2008, with payments to policyholders and for third party compensation estimated at approximately \$48 million for 2007-08. During 2007-08, HIH liquidators paid the Government \$67 million. A further \$10 million payment is expected in 2008-09.

The HIH collapse also had an adverse impact on a number of local councils insured with HIH. The NSW Government negotiated with the Commonwealth to provide financial assistance to local councils which had judgements against them that would have been met by HIH policies.

The NSW Government has provided assistance to Evans Shire Council, Balranald Shire Council, Ballina Shire Council, Berrigan Shire Council, Clarence Valley Council and Nundle Shire Council since the commencement of the scheme. By June 2008, the NSW Government will have paid \$15 million to local councils which experienced financial difficulty meeting HIH debts.

## **6.7 FINANCIAL ASSET MANAGEMENT**

### **THE ROLE OF ASSETS IN FINANCIAL MANAGEMENT**

The State accumulates financial assets in order to meet employee superannuation benefit payments and the Government's insurance liability costs as they fall due rather than place an undue burden on future generations.

There are two major asset portfolios, the State Superannuation Fund (State Super) and the Treasury Managed Fund (TMF).

### **INVESTMENT INCOME**

Despite the recent falls in Australian and overseas equity markets due to the global credit crisis, following the impact of the United States sub-prime loan failures, forecast State Super and TMF returns over the medium term have been positive as shown in Table 6.14.

Forward budget estimates assume investment earnings will return to long-term trend levels of 7.9 per cent for State Super and 7.2 per cent for the TMF. The higher return for State Super reflects a greater weighting in growth assets in line with the longer term nature of its liabilities.

**Table 6.14: Forecast average investment returns**

| to 30 June 2008     | <i>State Super</i><br>% | <i>TMF</i><br>% |
|---------------------|-------------------------|-----------------|
| One Year (estimate) | -3.8                    | -2.5            |
| Average 2 Years     | 5.1                     | 3.3             |
| Average 3 Years     | 8.6                     | 5.8             |
| Average 5 Years     | 10.4                    | 7.3             |

The value of forecast investment income from the portfolio financial assets is shown in Table 6.15. Income is influenced by the volume of funds (including transfer of funds) and the rate of earnings on funds. In 2007-08, forecast earnings on State Super and TMF investments are lower than budgeted reflecting the negative return on equities expected this financial year.

**Table 6.15: General government forecast investment income for superannuation and TMF**

|                            | <i>June 2006</i>     | <i>June 2007</i>     | <i>June 2008</i>     |                       | <i>June 2009</i>     | <i>June 2010</i>         | <i>June 2011</i> | <i>June 2012</i> |
|----------------------------|----------------------|----------------------|----------------------|-----------------------|----------------------|--------------------------|------------------|------------------|
|                            | <i>Actual</i><br>\$m | <i>Actual</i><br>\$m | <i>Budget</i><br>\$m | <i>Revised</i><br>\$m | <i>Budget</i><br>\$m | <i>Forward estimates</i> |                  |                  |
|                            |                      |                      |                      |                       |                      | \$m                      | \$m              | \$m              |
| <b>Superannuation</b>      |                      |                      |                      |                       |                      |                          |                  |                  |
| AASB 119 Investment Income | 1,289                | 1,690                | 1,927                | 2,227                 | 2,095                | 2,147                    | 2,183            | 2,211            |
| Actual Investment income   | 4,023                | 4,184                | n.a.                 | (1,108)               | n.a.                 | n.a.                     | n.a.             | n.a.             |
| <b>Insurance</b>           |                      |                      |                      |                       |                      |                          |                  |                  |
| TMF                        | 601                  | 539                  | 355                  | (138)                 | 339                  | 364                      | 388              | 414              |

In accordance with AASB 119, State Super investment income, based on a constant investment return rate (currently 7.9 per cent) is offset against superannuation expenses in the budget estimates. The difference between the AASB 119 and actual investment income is recorded as an actuarial gain or loss which, in accordance with AASB 1049 reporting standards, is not incorporated in the budget result. Accordingly, variations in budgeted investment returns on superannuation assets only influence the budget results through a variation in asset opening balances during the forward estimates period.

## PORTFOLIO MANAGEMENT

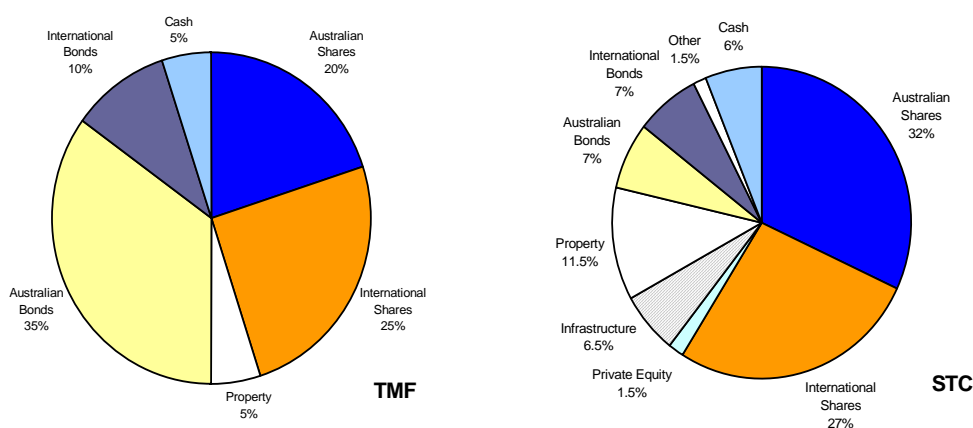
As a result of significantly lower insurance expenses and strong investment returns in prior years, the TMF remains fully funded. The TMF financial asset portfolio is expected to approximate \$4.3 billion at 30 June 2008 after allowing for the NSW Self Insurance Corporation (SICorp) surplus under the *Net Assets Holding Level Policy*, and the consequent transfer of \$300 million to the Consolidated Fund.

Growth assets, equities and property currently represent about 48 per cent of investments in TMF on average, with the remainder in bonds and a small cash allocation. The investments are held by TCorp in its HourGlass facilities or directly in a managed bond portfolio.

A memorandum of understanding (MOU) between TCorp and NSW Treasury details investment policies and procedures and sets benchmarks for each asset class. Investment performance is monitored by the Crown Entity Asset Management Committee, which co-ordinates the management of funds held centrally by the State. The Committee has Treasury and TCorp representatives.

State Super assets are managed by an independent trustee, the State Authorities Superannuation Trustee Corporation (STC). Given the long-term nature of the liabilities, a growth strategy has been adopted. The strategic asset allocation of TMF and State Super is shown in Chart 6.14.

**Chart 6.14: Strategic asset allocation**



## 6.8 FINANCIAL RISK MANAGEMENT

The major net financial liabilities of the State also represent the major financial risks, and are centrally managed and monitored.

### DEBT MANAGEMENT

Debt management has two long-term objectives: first to minimise the market value of debt within specified risk constraints, and second to minimise the cost of debt.

To minimise debt, the Crown debt portfolio comprises core, strategic and tactical portfolios. TCorp, as debt manager, adopts a passive approach except for the tactical portfolio where an active management style aims to add value relative to a benchmark portfolio.

The management of these portfolios is governed by a memorandum MOU between NSW Treasury and TCorp. The MOU includes a requirement to adhere to finance expense budget allocations, which are agreed at the beginning of each financial year. The General Government Debt Management Committee, consisting of representatives of TCorp, Treasury and the Roads and Traffic Authority, meets quarterly to monitor debt strategy.

As part of the debt management process, TCorp has now started to issue longer term inflation indexed bonds, following a review of debt benchmarks and debt management processes. Use of these bonds will help reduce debt volatility and help to minimise the cost of debt over time.

## **SUPERANNUATION MANAGEMENT**

Mercer Human Resource Consulting undertakes an annual review of liabilities using data maintained by Pillar Administration (the contracted scheme administrator) for the SAS Trustee Corporation, and the most recent Triennial Review actuarial economic assumptions.

## **INSURANCE MANAGEMENT**

TMF agencies have no exposure to reinsurance failure and are not affected by exclusions to reinsurance or gaps in the cover reinsurers provide (e.g. terrorism). The TMF purchases a comprehensive reinsurance program to protect its exposure to catastrophic events.

The TMF, in consultation with risk manager provider Suncorp, is able to analyse the TMF data warehouse and identify areas of risk and design risk management strategies that target risk areas.

The Treasury Managed Fund Advisory Board also assists in assessing agency responsiveness to the risk management philosophy of the fund. The Board is representative of the broad spectrum of agencies in the fund and includes representatives from seven agencies as well as representatives of the Public Sector Risk Management Association and NSW Treasury. Members are generally from the finance area or occupational health and safety area of their agencies.

The Board's role includes recommending the allocation of TMF risk management resources, monitoring the performance of sponsored projects and assisting with the monitoring of fund managers' performance in accordance with contract undertakings and service level agreements.

## **PUBLIC AUTHORITIES (FINANCIAL ARRANGEMENTS) ACT 1987**

The *Public Authorities (Financial Arrangements) Act 1987* (the Act) contains controls to manage risks resulting from government agencies' financial arrangements. It regulates government agencies' powers to borrow, use derivatives, invest, use funds managers and enter into joint ventures or joint financing arrangements. The Act also provides for government guarantees of financial arrangements entered into under the Act.

Treasury and its PAFA risk management advisor, Deloitte, review the risk management policies and procedures of selected agencies based on an assessment of their risk levels. High risk agencies are reviewed annually and medium risk agencies every two years, whilst for low risk agencies reliance is placed on Audit Office annual audits.

The number of PAFA risk reviews expected to be undertaken by Deloitte and Treasury, in 2008-09, are shown in the following table.

**Table 6.16: PAFA risk review program: number of reviews**

| <i>Reviewed by</i>   | <i>2007-08</i> | <i>2008-09</i> |
|--|----------------|----------------|
| Deloitte:  |                |                |
| Mainly public trading enterprises<br>and public financial corporations | 17             | 20             |
| Treasury:  |                |                |
| Mostly general government agencies                                     | 19             | 21             |

The Act has been updated on an incremental basis since 1987 to reflect particular changes in financial risk management.

Amendments to the Act to update, simplify and strengthen the regulatory framework are currently being prepared. The objective of the proposed amendments is to enhance the prudential measures of the NSW public sector and to provide an updated and more flexible legislative framework.