

CHAPTER 5: ASSET AND LIABILITY MANAGEMENT

- ◆ A reduction in net financial liabilities of the General Government Sector of \$7,339 million over the four years to June 2000 and a further \$5,172 million by June 2004.
- ◆ General Government net debt more than halved over eight years to June 2004.
- ◆ In 2000-01, reductions in General Government net financial liabilities of \$2,586 million and net debt of \$3,329 million.
- ◆ Interest costs to fall from 8.1 percent of Budget Receipts to 3.0 percent over eight years to June 2004.
- ◆ Total State net financial liabilities to fall by \$6,919 million between June 1996 and June 2001.

5.1 INTRODUCTION

This chapter outlines the Government's asset and liability management policies and the financial outcomes arising therefrom. These policies are important in achieving the Government's priorities in meeting community service delivery needs and achieving its fiscal targets, primarily the reduction of General Government net financial liabilities and net debt and maintaining or increasing General Government net worth.

Balance sheet management includes the management of both assets and liabilities. Such management focuses on management of the net financial liabilities (financial liabilities less financial assets), management of the non-financial assets (assets excluding financial assets), and management of equity investments, principally equity in the Public Trading Enterprise (PTE) and Public Financial Enterprise (PFE) Sectors.

The non-financial assets in the Balance Sheet of the General Government Sector are dominated by fixed assets, principally land, buildings and physical infrastructure. Sound management of these assets is required to ensure that public services are delivered in the most efficient and effective manner. This chapter examines the Government's fixed asset management strategies that focus on both increasing the capacity to deliver services to the community and minimising the cost of an agency's broad capital investment, maintenance and asset disposal decisions.

Net financial liabilities are principally borrowings (net of financial assets), unfunded superannuation and insurance liabilities. The focus of the various liability management strategies outlined in this chapter is to reduce these net liabilities and the costs of servicing them so that funding can be redirected to core services.

Financial assets of the General Government Sector (on a GFS basis) include equity in the Public Trading Enterprise (PTE) Sector and the Public Financial Enterprise (PFE) Sector, estimated to be \$44.0 billion at 30 June 2000. However, this equity is excluded from the General Government balance sheet prepared under Australian Accounting Standard AAS31. This is budgeted to reduce to \$43.2 billion at 30 June 2001 largely due to an equity restructure offset by revaluations and new asset acquisitions. The equity restructure involves a payment to the General Government Sector of \$2.4 billion, recorded as abnormal income, and allows the equivalent market value redemption of General Government debt.

In the General Government Sector, assets and liabilities are subject to close oversight and management by central Government agencies, including the NSW Treasury. The equity investment in the PTE and PFE Sectors is subject to the NSW Commercial Policy framework whereby the Boards and Chief Executives are accountable to Shareholding and/or Portfolio Ministers.

5.2: FIXED ASSET MANAGEMENT IN THE GENERAL GOVERNMENT SECTOR

The non-financial assets of the General Government Sector include land, buildings and infrastructure assets, inventories and other assets (including the emerging right to receive assets such as the Sydney Harbour Tunnel in the future).

Land, building and infrastructure assets are commonly termed fixed assets. These include assets as diverse as hospitals, schools and prisons, national parks and botanical gardens, sporting venues such as the Olympic facilities, and the collections of museums and other cultural institutions.

Around 99 percent of General Government total non-financial assets as at 30 June 2000 are fixed assets. These fixed assets (as shown in Table 5.1) are projected to increase by 1.5 percent (\$1.0 billion) from \$65.5 billion as at 30 June 2000 to \$66.5 billion as at 30 June 2001.

Table 5.1: General Government Sector Non-Financial Assets

<i>As at 30 June</i>	<i>1997</i> <i>Actual</i> <i>\$m</i>	<i>1998</i> <i>Actual</i> <i>\$m</i>	<i>1999</i> <i>Actual</i> <i>\$m</i>	<i>2000</i> <i>Estimate</i> <i>\$m</i>	<i>2001</i> <i>Budget</i> <i>\$m</i>
Non Financial Assets					
Property, Infrastructure, Plant and inventory	53,631	59,627	64,066	65,532	66,521
Other	556	549	671	745	849
Total Non Financial Assets	54,187	60,176	64,737	66,277	67,370

The Asset Acquisition Program for 2000-01 is \$2.5 billion. However, with budgeted depreciation of \$1.0 billion and asset disposals, net fixed assets will increase by \$1.0 billion for the Budget year.

This investment plays a key role in the growth and development of the State economy by providing the source of physical infrastructure required by industry and for urban and rural development throughout New South Wales, and is important in maintaining the State's economic performance. In addition, it provides essential social, cultural and recreational facilities and simultaneously creates employment.

The key priorities of the State's capital investment strategy for 2000-01 and future years (as detailed in Budget Paper No. 3 and No. 4) are:

- ◆ ongoing investment in the State's infrastructure with particular emphasis on regional and rural New South Wales;
- ◆ improvement of the State's road network;
- ◆ transformation of the State's public transport network for the next century; and
- ◆ improvement to the health system, including the continuation of major upgrading and redevelopment projects at Central Sydney, Coffs Harbour, Royal North Shore, Sutherland and Wollongong as well as significant investment in health facilities in regional and rural New South Wales.

Sound management of the existing asset base and newly acquired assets is required to ensure that public services are delivered in the most efficient and effective manner. This is necessary to achieve the priorities and objectives of the Government in meeting current and future community needs and to achieve the Government's fiscal targets, which include the reduction of Government net financial liabilities and maintaining or increasing General Government net worth.

Fixed assets are held by the Government to ensure that it has the capacity to deliver the services needed by the community over the long term. An excess level of fixed assets however, unnecessarily increases the overall cost of the delivery of community services, reducing efficiency. The Government therefore seeks to achieve an appropriate balance between the acquisition of new fixed asset capacity to meet community needs and the efficient utilisation of the existing fixed asset stock.

This balance is achieved through the implementation of the Government's Total Asset Management (TAM) strategies. TAM strategies require agencies to take a holistic and strategic approach to fixed asset management, by developing long-term plans that focus on the agency's broad capital investment, maintenance and asset disposal decisions. The TAM strategies aim to minimise the "whole-of-life" costs of strategic asset management decisions, as discussed below.

First, to ensure that Government agencies can deliver the services needed by the community requires strategic investment in fixed assets to create the capacity to deliver services over the long term.

Strategic capital investment involves reviewing service delivery options, including breaking the nexus between service delivery and asset acquisition. This helps to remove the past bias towards the acquisition of new capital assets at the expense of proper asset maintenance. Opportunities for reducing asset dependency by non-asset or less asset-intensive solutions, including inter-agency solutions, and more efficient use of existing assets, should also be explored. Alternatives to asset acquisition can include leasing, strategic demand management and private sector ownership, such as Build, Own, Operate and Transfer (BOOT) or Build, Own and Operate (BOO) arrangements.

Second, fixed assets are held to ensure that an agency has the capacity to deliver the services needed by the community over the long term. Therefore, in evaluating capital investment options long-term demand drivers, financial and economic appraisals, and risks need to be assessed.

Third, all existing assets (as well as new acquisitions) need to be appropriately maintained to ensure that they can continue to provide services efficiently and effectively during the asset's estimated useful life. An appropriate level of maintenance at the optimum time can be significant in reducing the whole-of-life cost of an asset.

Agencies are therefore required to implement asset maintenance plans to properly maintain all physical assets to ensure that the assets can continue to deliver the services over the life of the asset.

Budget dependent General Government agencies with a total non-current physical asset base of \$5 million or more are required to develop asset maintenance plans which identify all assets, set out a maintenance program for each asset or grouping of assets, identify any deferred maintenance requirements and establish a long term maintenance plan.

Among the 30 General Government agencies required to submit asset maintenance plans, 27 (or 90 percent) complied in 1999-2000 (compared with 57 percent in the previous year), of which 26 plans have been deemed satisfactory. Asset maintenance plans for the remaining agencies are expected to be finalised in 2000-01.

The outcome of this process is the endorsement of an asset maintenance program and the broad commitment by government to provide sufficient funding for this within the context of the annual budgeting process. This does not preclude major periodic maintenance proposals being reviewed in light of the Government's budget priorities, in the same way as major new capital works.

Fourth, asset disposal strategies are needed to ensure the best utilisation of scarce capital resources, including disposing of unnecessary and non-performing assets. Proceeds from the disposal of these assets can be applied to a more valuable use.

It is important that the assets in the State's balance sheet are recorded at values that are relevant to decision-making. Therefore, fixed assets of the General Government Sector (and Total State Sector) are recognised in the respective balance sheets at current values. This provides meaningful information for pricing, investment and ownership decisions.

To ensure that this information is up to date, all agencies are required to revalue their physical non-current assets at least every five years. This is particularly important for infrastructure assets that have very long lives.

5.3: ASSET MANAGEMENT IN THE PUBLIC FINANCIAL ENTERPRISE AND PUBLIC TRADING ENTERPRISE SECTORS

The Government has strategic investments in the Public Trading Enterprise (PTE) and Public Financial Enterprise (PFE) Sectors of the NSW Public Sector.

The Government's major objective in terms of asset management of these commercial enterprises is to ensure that the assets and liabilities are managed efficiently and effectively to add value to the Government as shareholder. By ensuring that their fixed asset investments earn a rate of return greater than the enterprises' cost of capital, the Government seeks an appropriate return on its equity in these enterprises.

To effect this, the Government negotiates performance agreements with each of these enterprises, which are signed by the Chief Executive, Board Chair, the Portfolio/Shareholding Minister and the Treasurer. These agreements specify, amongst other things, expected rates of return on capital and the expected level of financial distribution payments (dividends and tax equivalents) payable to the Government. The commercial performance of these enterprises is then monitored against these agreements and advice provided to both the Treasurer and Portfolio/Shareholding Minister of progress through regular reports.

In regard to asset management, investment decisions undertaken by these enterprises are required to be consistent with the principles underlying the Government's Total Asset Management (TAM) strategies. This includes ensuring that financial appraisal analyses are conducted on any new assets acquisitions or major refurbishment proposals and that any proposed acquisitions meet the benchmark rate of return for that enterprise.

In addition, given the Government's role as shareholder in these enterprises, Public Trading Enterprises and Public Financial Enterprises are required to submit any projects classified as Projects of State Significance for Budget Committee approval. Projects in this category include: Olympics projects; any joint public/private sector infrastructure projects; any projects with an estimated total cost in excess of \$100 million or any projects of substantial risk with estimated total cost of over \$20 million.

The following table shows the trend in the level of non-financial assets for the General Government Sector and the PTE and PFE as well as for the Total State Sector. For 2000-01, non-financial assets will increase for the General Government Sector by \$1.1 billion and for the combined PTE and PFE Sectors by \$1.4 billion.

Table 5.2: State Non-Financial Assets

	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>
	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Estimate</i>	<i>Budget</i>
	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>
Non Financial Assets					
General Government Sector	54,187	60,176	64,737	66,277	67,370
PTE and PFE Sectors	52,582	52,867	53,801	56,924	58,370
State Non Financial Assets	106,769	113,043	118,538	123,201	125,740

5.4 GENERAL GOVERNMENT NET FINANCIAL LIABILITIES

The General Government Sector primarily comprises Budget Dependent agencies which are reliant on the Crown for over 50 percent of their funding requirements. As detailed in Table 5.3, the \$7.3 billion decrease in net financial liabilities to approximately \$25 billion for the four year period ending 30 June 2000 reflects the Government's continuing commitment to reducing General Government net financial liabilities as part of its fiscal strategy.

Table 5.3: General Government Net Financial Liabilities

<i>As at 30 June</i>	<i>1996 Actual \$m</i>	<i>1997 Actual \$m</i>	<i>1998 Actual \$m</i>	<i>1999 Actual \$m</i>	<i>2000 Revised Estimate \$m</i>
Gross Debt					
Borrowings	18,192	18,314	18,046	15,816	14,980
	<u>18,192</u>	<u>18,314</u>	<u>18,046</u>	<u>15,816</u>	<u>14,980</u>
Financial Assets					
Cash	2,192	2,169	2,898	1,665	175
Investments**	3,326	3,649	3,349	2,944	3,624
Advances	1,825	1,679	1,641	1,654	1,668
	<u>7,343</u>	<u>7,497</u>	<u>7,888</u>	<u>6,263</u>	<u>5,467</u>
Underlying Net Debt	10,849	10,817	10,158	9,553	9,513
Prepayment of Superannuation Contributions	...	...	...	3,264	2,250
Total Net Debt	10,849	10,817	10,158	12,817	11,763
Unfunded Superannuation	13,654*	12,337	12,293	7,959	6,671
Net Debt and Superannuation Liabilities	24,503	23,154	22,451	17,512	16,184
Other Net Financial Liabilities***	7,911	6,211	6,437	6,800	6,641
Net Financial Liabilities	32,414	29,365	28,888	27,576	25,075

* Represents Budget Sector liability. No General Government Sector comparative available.

** Equity investment in the Public Financial and Non-Financial Corporation sectors is excluded. This equity investment is discussed at section 5.1 above. The equity in Public Trading and Financial Enterprises is excluded to give a truer picture of the General Government overall financial obligations.

*** Other Net Financial Liabilities include other employee entitlements, insurance, payables, receivables and prepayments.

Government initiatives aimed at reducing the various categories of liability (net debt, unfunded superannuation and insurance liabilities) and the cost of servicing these liabilities include:

- ◆ generating Budget cash surpluses which are dedicated to debt reduction in accordance with the medium term fiscal target of lowering General Government net debt to a sustainable level;
- ◆ adjusting the capital structure of Public Trading Enterprises to establish commercially based gearing ratios, with capital repayments applied to the reduction of General Government debt;
- ◆ implementing a plan to reduce unfunded superannuation liabilities in accordance with the *General Government Debt Elimination Act, 1995*;

- ◆ increasing Crown employer contributions above the required funding plan levels to accelerate the move towards full funding of superannuation debts and also to allow for future Budget flexibility;
- ◆ offering members of defined benefit superannuation schemes the opportunity to transfer to the First State Superannuation scheme with the aim of winding down the closed schemes and associated liabilities more quickly; and
- ◆ reviewing investment practices in order to generate better returns from financial assets over the long term within prudent risk parameters.

Further, General Government cash balances are being actively utilised to reduce gross debt. Short term seasonal funding requirements will be met by the provision of overdraft facilities by NSW Treasury Corporation.

Over the forward estimates period, it is projected that General Government net financial liabilities will be further reduced by over \$5 billion to under \$20 billion as shown in Table 5.4. Over the eight year period ending 30 June 2004, General Government net financial liabilities are expected to fall by around \$12.5 billion or 39 percent.

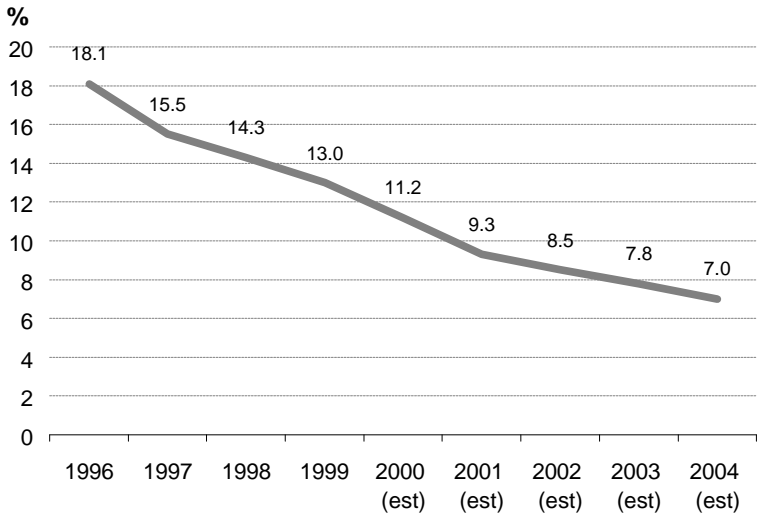
Table 5.4: Forecast General Government Net Financial Liabilities

<i>As at 30 June</i>	<i>2000 Revised Estimates \$m</i>	<i>2001 Budget \$m</i>	<i>2002 Forecast \$m</i>	<i>2003 Forecast \$m</i>	<i>2004 Forecast \$m</i>
Underlying Net Debt	9,513	7,255	6,631	5,968	5,126
Prepayment of Superannuation Contributions	2,250	1,179	...	...	...
Unfunded Superannuation	6,671	7,314	8,332	8,076	7,759
Other	6,641	6,741	6,776	6,930	7,018
Net Financial Liabilities	25,075	22,489	21,739	20,974	19,903

The Government borrowed an additional \$3.26 billion in 1998-99 in order to pre-pay three years Crown superannuation contributions to the defined benefit superannuation schemes. These borrowings are being repaid over a three-year period to 30 June 2002.

It is projected that General Government sector net financial liabilities will fall by more than sixty percent as a percentage of GSP for the eight year period ending 30 June 2004, as shown in Chart 5.1.

Chart 5.1: General Government Net Financial Liabilities as percentage of Gross State Product, as at 30 June



GENERAL GOVERNMENT NET DEBT

General Government net debt, excluding borrowings to prepay superannuation contributions, is estimated to have fallen by approximately \$1.3 billion for the four-year period ending 30 June 2000. The ratio of General Government net debt to GSP is expected to fall from 6.1 percent to 4.2 percent.

The reduction in net debt since 1996 was achieved by the utilisation of budget surpluses, equity restructure receipts from the electricity distribution industry and other agencies and TAB sales proceeds.

Net debt would be \$420 million lower had the opportunity not been taken to lock in historically low interest rate levels by buying back bonds with high coupon rates and reissuing at lower coupon rates for the four year period ended 30 June 2000. This initiative has made a major contribution to reducing General Government cash interest costs. By 30 June 2002, cash interest costs are forecast to be approximately one-half the levels prevailing in 1996. A further factor impacting the movement in net debt was the assumption of \$230 million of debt from various Public Trading Enterprises.

Another major distortion to the underlying debt trend has been the prevalence of State Bank post-sale costs which are forecast to total over \$250 million. In accordance with Government Finance Statistics methodology the initial sale proceeds were not taken into account in the 1994-95 Budget result and thus the resultant post-sale costs are not incorporated in the actual and forecast Budget results for the period. The cash outlays to Colonial State Bank, however, does result in an increase in net debt.

Taking these three factors into account, the reduction in General Government net debt for the four year period ended 30 June 2000 would approximate \$2.2 billion.

Over the four-year period to 30 June 2004, General Government net debt is expected to continue to decline as a result of the repayment of borrowings resulting from forecast cash surpluses totalling \$2.4 billion throughout the period and the utilisation of \$2.4 billion electricity industry capital receipts in 2000-01. The net debt to GSP ratio is expected to fall to 1.8 percent by 2004.

In general, the debt to equity ratios for the NSW electricity distributors are relatively low compared to equivalent private sector firms. In March 2000 the Treasurer announced a capital restructure which will increase the total debt of some of the businesses by \$2.4 billion and allow the equivalent market value redemption of General Government debt.

The General Government loans selected for prepayment have high interest rates, generally exceeding 10 percent, and in order to repurchase them in the market an additional amount or premium has to be paid to the existing bondholders. Thus the reduction in book value borrowings is expected to be \$270 million less than the market value.

The capital restructure is designed to move the gearing levels of the NSW Government-owned electricity businesses back towards those of comparable private sector organisations. This will help to ensure that the NSW electricity agencies continue to face the same sorts of commercial disciplines as private firms, including the raising of funds for new projects.

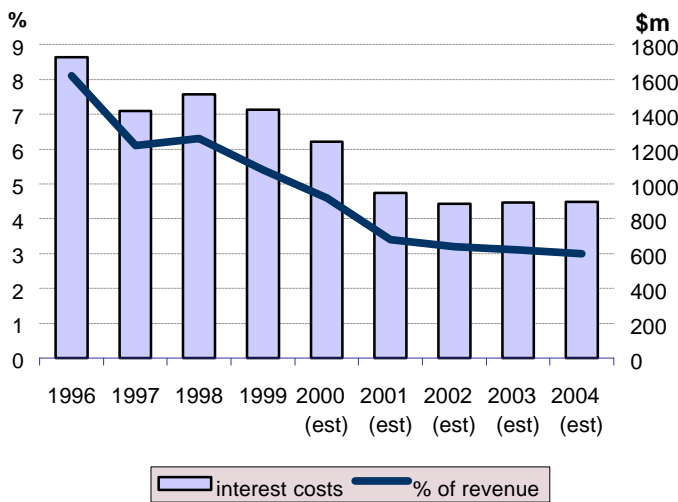
The increased debt means that the electricity agencies dividends will be reduced. However, paying down high coupon rate General Government sector debt results in significantly reduced interest costs. The resultant interest savings are greater than the decline in distributions.

GENERAL GOVERNMENT CASH INTEREST COST TRENDS

Ongoing reductions in net debt through the utilisation of budget surpluses, the receipt of electricity industry equity restructure payments and the sale of the TAB have been key factors in reducing interest costs since 1996 from approximately \$1.7 billion to an estimated \$1.2 billion for 1999-2000. The lower level of interest rates compared with 1996 has a lagged effect on debt servicing costs, reducing interest costs as existing debt matures. Interest costs are expected to decline further, to approximately \$900 million per annum by 2003-04.

As shown in Chart 5.2, the ratio of interest costs to State Budget receipts is projected to fall from 8.1 percent to 3.0 percent over the eight-year period ending 30 June 2004.

Chart 5.2: General Government Cash Interest Costs and as percentage of State Budget Receipts as at 30 June



GENERAL GOVERNMENT SUPERANNUATION LIABILITIES

General Government sector net superannuation liabilities are estimated to be \$7 billion lower for the four year period ending 30 June 2000. Table 5.5 includes the liabilities and assets of both employers and employees. The proportion of accrued liabilities that is funded will have increased significantly from well below one-half at 30 June 1996 to about three quarters at 30 June 2000.

Table 5.5: Total General Government Sector Unfunded Superannuation Liabilities

<i>As at 30 June</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Revised Estimate</i>
	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>
General Government Sector					
Past service liabilities	22,936	24,248	26,034	26,242	26,291
Financial assets	9,282	11,911	13,741	18,283	19,620
Net liabilities	13,654	12,337	12,293	7,959	6,671
Assets as proportion of accrued liabilities (%)					
	40.4	52.7	55.1	69.7	74.6

The large increase in financial assets over the period is a result of an ongoing high level of Government employer contributions, higher portfolio investment returns and the accelerated payment of Crown contributions in 1998-99.

In addition, a number of one-off adjustments to employer asset reserves were made in 1996-97, reflecting recalculation of interest and tax credits for the previous ten years.

The reduction in gross liabilities in 1999-2000 partly reflects a change in the actuarial valuation basis used for 30 June 2000 liability estimates by the Superannuation Trustee Corporation's actuary, W M Mercer. The actuarial valuation basis used is now comparable with the bases used by other States for estimating their superannuation liabilities.

ESTIMATED GENERAL GOVERNMENT UNFUNDED SUPERANNUATION LIABILITIES

The estimated unfunded superannuation liabilities shown in Table 5.6 do not include the effects of acceptances of conversion offers by State and Police Superannuation Scheme contributors. This reflects the uncertainty about the final acceptance level, which will not be known until after the offer closes on 31 May 2000.

Table 5.6: Total General Government Sector Unfunded Superannuation Scheme Liabilities

As at 30 June	Actual				Revised Estimate	Budget	Forecasts		
	1996	1997	1998	1999	2000	2001	2002	2003	2004
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
General Government									
STC schemes	13,442	12,073	12,080	7,711	6,438	7,079	8,088	7,823	7,496
Judges	147	194	195	221	229	236	252	268	285
Parliamentary	65	70	18	27	4	(1)	(8)	(15)	(22)
TOTAL	13,654	12,337	12,293	7,959	6,671	7,314	8,332	8,076	7,759

The forecast rises in General Government sector unfunded liabilities in 2001 and 2002 result primarily from having brought forward to 1999 accelerated Crown funding plan contributions from those years.

SUPERANNUATION FUNDING PLAN CONTRIBUTIONS

Table 5.7: Crown Superannuation Annual Cash Contributions

to 30 June	Actual				Revised Estimate	Budget	Forecasts		
	1996	1997	1998	1999	2000	2001	2002	2003	2004
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Defined Benefit									
Closed schemes	866	1,021	1,145	4,301	510	320	...	1,293	1,325
Open schemes	17	18	23	23	25	25	28	29	30
Accumulation									
First State Super	194	238	273	348	387	472	510	618	666
TOTAL	1,077	1,277	1,441	4,672	922	817	538	1,940	2,021

The high and rising level of actual Government employer contributions made over the period shown, after allowance for the accelerated payment of Crown contributions, reflects the Government's fiscal strategy objective of moving towards full funding of superannuation liabilities.

The planned defined benefit closed scheme contributions in 2000 and 2001, totalling \$830 million, are in excess of funding plan requirements and thus shorten the timeframe for full funding and/or allow additional budget flexibility.

First State Superannuation contributions will grow rapidly in the short term because of the increase in employer contributions from the current 7 percent of salary to 8 percent of salary from 1 July 2000, and then to 9 percent of salary from 1 July 2002. These increases are required in order to reflect the rise in minimum contributions required for the Superannuation Guarantee Charge.

There is also a longer term labour turnover influence from the gradual replacement of retiring public sector employees who are members of the closed defined benefit schemes by new recruits who join accumulation schemes, generally First State Superannuation.

GENERAL GOVERNMENT INSURANCE

The Insurance Ministerial Corporation (IMC) holds the insurance liabilities and financial assets of the Treasury Managed Fund (TMF), the Governmental Workers' Compensation Account and the Transport Accidents Compensation Fund.

The TMF holds the ongoing insurance liabilities and assets for General Government Budget dependent agencies. The TMF provides a comprehensive risk management and self insurance arrangement across the five basic classes of risk, which are workers' compensation, motor vehicle, property, public liability and miscellaneous.

The Governmental Workers' Compensation Account and the Transport Accidents Compensation Fund relate primarily to workers compensation and third party motor vehicle claims respectively, incurred before 1 July 1989.

As Table 5.8 shows, the growth in assets has exceeded the growth of liabilities, resulting in a gradual decline in the net insurance deficit.

**Table 5.8: Insurance Net Financial Liabilities
(Insurance Ministerial Corporation)**

<i>As at 30 June</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Revised Estimate</i>
	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>
Financial Liabilities					
Outstanding Claims	2,110	2,374	2,509	2,604	2,580
Accounts Payable	9	9	9	23	22
Total Financial Liabilities	2,119	2,383	2,518	2,627	2,602
Financial Assets					
Cash	251	161	114	47	52
Investments	805	1,173	1,374	1,563	1,655
Other	45	42	42	69	75
Total Financial Assets	1,101	1,376	1,530	1,679	1,782
Net Insurance Deficit	1,018	1,007	988	948	820
Assets as proportion of liabilities (%)	52.0	57.7	60.8	63.9	68.5
Rate of change (%)					
Insurance liabilities	n/a	12.5	5.7	4.3	(1.0)
Financial assets	n/a	25.0	11.2	9.7	6.1
Net insurance deficit	n/a	(1.1)	(1.9)	(4.0)	(13.5)

The management of insurance claims is outsourced. GIO Australia has been re-appointed in this role for a further three year term from July 2000.

The Treasury Managed Fund insurance liabilities stabilised in 2000 due in part to the 1998 amendments to the Workers' Compensation Act, resulting in greater focus on early injury management and improved return to work rates, and a higher rate of commutation of weekly benefit payments to lump sums.

As Table 5.9 shows, the trend for the growth of assets to exceed the growth of liabilities is expected to continue.

**Table 5.9: Forecast Insurance Net Financial Liabilities
(Insurance Ministerial Corporation)**

<i>As at 30 June</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>
	<i>Budget</i>	<i>Forecasts</i>		
	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>
Financial Liabilities	2,654	2,755	2,894	3,054
Financial Assets	1,902	2,098	2,329	2,550
Net Insurance Deficit	752	657	565	504
Assets as proportion of liabilities (%)	71.7	76.2	80.5	83.5

5.5 TOTAL STATE NET FINANCIAL LIABILITIES

For the five-year period ended 30 June 2001 the estimated reduction of approximately \$6.9 billion in State net financial liabilities will result in the State Sector ratio of net financial liabilities to Gross State Product falling from 25 percent to 15.5 percent.

TOTAL STATE NET FINANCIAL LIABILITIES

Table 5.10: Total State Net Financial Liabilities

As at 30 June	1996 Actual \$m	1997 Actual \$m	1998 Actual \$m	1999 Actual \$m	2000 Revised Estimate \$m	2001 Budget \$m
GENERAL GOVERNMENT SECTOR						
Gross Debt	18,192	18,314	18,046	15,816	14,980	12,518
Financial Assets	7,343	7,497	7,888	6,263	5,467	5,263
Underlying Net Debt	10,849	10,817	10,158	9,553	9,513	7,255
Prepayment of superannuation contributions	...	...	...	3,264	2,250	1,179
Total Debt	10,849	10,817	10,158	12,817	11,763	8,434
Unfunded Superannuation	13,654	12,337	12,293	7,959	6,671	7,314
Other Financial Liabilities	7,911	6,211	6,437	6,800	6,641	6,741
Net Financial Liabilities	32,414	29,365	28,888	27,576	25,075	22,489
PUBLIC TRADING ENTERPRISE SECTOR						
Gross Debt	11,113	10,375	10,029	9,995	9,914	12,757
Financial Assets	2,619	3,110	2,593	2,568	1,883	1,698
Net Debt	8,494	7,265	7,436	7,427	8,031	11,059
Unfunded Superannuation	1,780	452	137	230	(114)	7
Other Financial Liabilities	...*	3,815	3,765	4,178	4,380	3,544
Net Financial Liabilities	...*	11,532	11,338	11,835	12,297	14,610
PUBLIC FINANCIAL ENTERPRISE SECTOR						
Gross Debt	26,906	28,446	29,981	33,428	26,745	...
Financial Assets	26,851	27,803	28,940	32,364	25,804	...
Net Debt	55	643	1,041	1,064	941	941**
Unfunded Superannuation	1	...	...	...	...	...
Other Financial Liabilities/(Assets)	...*	(47)	(124)	79	(308)	(318)
Net Financial Liabilities	...*	596	917	1,143	633	623
TOTAL STATE SECTOR						
Total Net Financial Liabilities	44,641	41,493	41,143	40,554	38,005	37,722

* No actual sector net financial liability figures are available.

** No Estimate available. Nil movement assumed

The increase in the 1999-2000 Public Trading Enterprise sector net debt estimate primarily reflects the utilisation of financial assets by Sydney Water Corporation and Sydney Catchment Authority to fund capital works. The forecast increase in 2000-01 is mainly due to the equity restructure payments to the Crown by electricity industry distribution agencies made in order to establish appropriate debt/equity ratios and cash levels. Other major factors include the utilisation of cash and raising of new borrowings by water and electricity agencies to fund various capital works projects.

Projected 1999-2000 net debt reduction for the Public Financial Enterprise sector results from NSW Treasury Corporation (TCorp) being required to repurchase securities in the financial markets in order to ensure the liquidity of TCorp stocks. This activity in the current rising interest rate environment involves the redemption of bonds with lower interest rates but higher bond book capital values.

STATE SUPERANNUATION LIABILITIES

Total State sector net superannuation liabilities are forecast to have reduced by approximately \$9 billion in the four years to 30 June 2000.

Table 5.11: State Sector Superannuation Liabilities

	1996	1997	1998	1999	2000
<i>As at 30 June</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Revised Estimate</i>
	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>
General Government Sector					
Past service liabilities	22,936	24,248	26,034	26,242	26,291
Financial assets	9,282	11,911	13,741	18,283	19,620
Net liabilities	13,654	12,337	12,293	7,959	6,671
Public Trading Enterprise Sector					
Past service liabilities	4,950	5,369	5,116	4,970	4,543
Financial assets	3,170	4,917	4,979	4,740	4,657
Net liabilities (surplus)	1,780	452	137	230	(114)
Public Financial Enterprise Sector					
Past service liabilities	1	1	1	1	1
Financial assets	...	1	1	1	1
Net liabilities (surplus)	1	...	...	...	...
Total State Public Sector					
Past service liabilities	27,887	29,618	31,151	31,213	30,835
Financial assets	12,452	16,829	18,721	23,024	24,278
Net liabilities	15,435	12,789	12,430	8,189	6,557
Assets as proportion of past service					
accrued liabilities (%)	44.6	56.8	60.0	73.8	78.7
Rate of change (%)					
Past service liabilities	n/a	6.2	5.1	...	(1.2)
Financial assets	n/a	35.2	11.2	23.0	5.4
Net liabilities	n/a	(17.1)	(2.8)	(34.1)	(19.9)

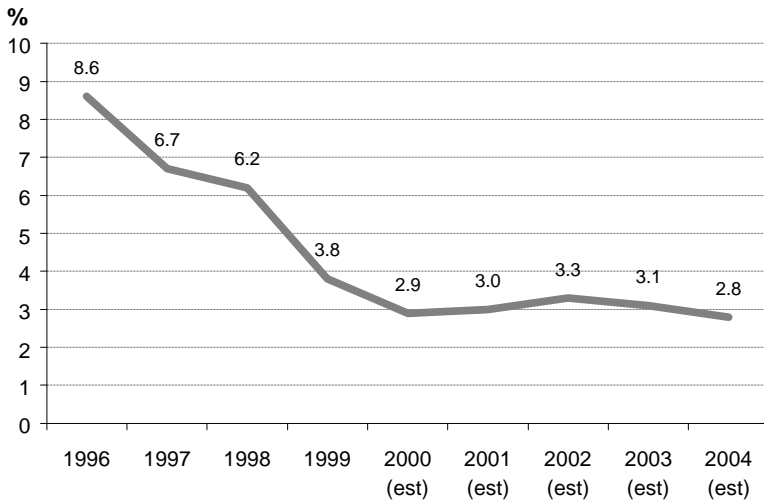
Table 5.12: Forecast Total State Sector Superannuation Liabilities

	<i>Actual</i>				<i>Revised Estimate</i>	<i>Budget</i>	<i>Forecasts</i>		
	1996	1997	1998	1999	2000	2001	2002	2003	2004
<i>As at 30 June</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>
General Government									
As per	13,654	12,337	12,293	7,959	6,671	7,314	8,332	8,076	7,759
Table 5.6									
Public Trading and Financial Enterprises									
STC schemes	1,781	452	289	411	54	128	206	291	381
Electricity	...	...	(152)	(181)	(168)	(121)	(76)	(31)	...
Industry Scheme (surplus)									
TOTAL	15,435	12,789	12,430	8,189	6,557	7,321	8,462	8,336	8,140

The unfunded liabilities for Public Trading and Financial Enterprises in the Superannuation Trustee Corporation schemes are dominated by the State Rail Authority, with over \$400 million in unfunded liabilities. Options for funding these liabilities are under consideration. The surplus for the Electricity Industry Superannuation Scheme is expected to continue to decline as a result of current employer funding holidays. Contributions will resume when the surplus is extinguished.

As shown in Chart 5.3, State Sector unfunded superannuation liabilities as a proportion of Gross State Product in 2000 and forward years will be less than one third the level of 1996.

Chart 5.3: Total State Net Superannuation Liabilities, as percentage of Gross State Product as at 30 June



5.6 LIABILITY MANAGEMENT

SUPERANNUATION LIABILITY MANAGEMENT INITIATIVES

Review of actuarial valuation basis

Gross liabilities are estimates based on actuarial calculation of the present value of the obligations to meet defined benefits. Estimation is based on numerous assumptions, including salary growth rate, scheme exit rates, type of benefit payable, longevity of beneficiaries and the consumer price index. Future cash flows are discounted to a present value by the assumed rate of investment return.

These assumptions will be reviewed during the forthcoming triennial actuarial valuation of the major defined benefit schemes.

Pending the triennial valuation, the gross liabilities have been estimated using the relevant economic parameters provided in section 1.3, which are consistent with recent actuarial advice.

Closure of defined benefit schemes

Almost all of the liabilities for the Total State sector have been capped in real terms by the closure to new members of the major defined benefit schemes.

These scheme closures were as follows:

- ◆ State Superannuation Scheme: 1985;
- ◆ Police Superannuation Scheme: 1988; and
- ◆ State Authorities Superannuation Scheme and State Authorities Non-contributory Superannuation Scheme: 1992.

From 1989 to February 2000, Senior Executive Service officers were able to join their own accumulation scheme, the Public Sector Executives' Superannuation Scheme. This scheme was closed on 1 March 2000 and most members transferred to First State Superannuation. Since 1992, all new public sector employees have joined an accumulation scheme, generally First State Superannuation.

FUNDING PLAN

The State's net unfunded superannuation liabilities represent the difference between the present value of estimated future benefits accrued to date (gross liabilities) and the market value of the superannuation funds' financial assets.

In accordance with the Government's fiscal strategy and the *General Government Debt Elimination Act, 1995* the Government has established target dates by which the unfunded liabilities will be eliminated and the Government's superannuation obligations fully funded.

Under this approach, the level of future employer contributions required depends on the actuarial estimation of the value of gross liabilities and the proportion of gross liabilities matched by the pool of financial assets.

The value of unfunded liabilities is volatile on an annual basis, because it depends on the value of financial assets, which in turn depends on returns from volatile equity markets. Over recent years the actual investment return has exceeded the assumed rate of return in ex ante actuarial estimates.

When returns of capital from Public Trading Enterprises, proceeds of asset sales or surplus cash in the Treasury banking system are available, they will be used to reduce debt or superannuation liabilities, or a combination of both. A comparative financial analysis is undertaken on a case by case basis.

The target dates for financial assets to equal liabilities are 2022 for Public Trading and Financial Enterprises and 2045 for defined pension benefit schemes for the General Government sector. For the State Authorities Superannuation Scheme that provides lump sum benefits, liabilities and assets will both reduce towards zero by about 2030, which is when the scheme's last contributors are expected to claim their retirement benefits.

Based on current trends, full funding will occur earlier than these target dates. The target dates and the level of future employer contributions required to meet them will therefore be reviewed after the 30 June 2000 triennial actuarial valuation, which is scheduled for completion by 31 December 2000.

STRATEGIC ASSET ALLOCATION

The Schemes' trustee reviews the strategic asset allocation annually. The asset allocation to bonds and cash is generally around one quarter of investments, with three quarters in growth assets, namely equities and property. About a quarter of the fund assets is with market index investment managers, the remainder with active investment managers.

SUPERANNUATION CONVERSION OFFERS

Offers were made in January 2000 to most members of the closed pension benefit schemes (State Superannuation Scheme and Police Superannuation Scheme) to crystallise and transfer their accrued benefit to the First State Superannuation scheme.

The offer was made on a purely voluntary basis and members have been provided with subsidised access to professional financial advice to enable them to assess the offer, taking into account their individual circumstances.

From a liability management perspective the offer provided the opportunity of crystallising benefits earlier and winding down membership of the closed defined benefit schemes more rapidly. It would also reduce the present value of future pension benefits accruing under these schemes.

The offer is open until 31 May 2000 and at this stage the number of acceptances and the financial impact on the schemes are uncertain. Accordingly, there has been no allowance made for the impact of acceptances on the unfunded superannuation liabilities in the foregoing commentary.

The favourable impact on unfunded liabilities of the utilisation of contribution tax credits and forecast investment returns on borrowed funds exceeding their cost of debt has been incorporated in the liability estimates.

DEBT PORTFOLIO MANAGEMENT

NSW Treasury Corporation (TCorp) manages the Crown portfolio and the primary debt management objective is to minimise the market value based cost of debt subject to specified risk constraints over the longer term. This cost is derived from the change in market value of the debt portfolio, adjusted for cash flows to and from the portfolio.

TCorp employs an active management style, characterised by positioning the portfolio according to an interest rate view, with an expectation of adding value relative to the benchmark portfolio. Positioning of the Crown debt portfolio is achieved by:

- ◆ Changing the composition of loans in the Treasury portfolio; and
- ◆ Using derivative instruments, including (but not limited to) futures, forward rate agreements, swaps, and over the counter and exchange traded options.

TCorp's views on medium term interest rate movements in consultation with Treasury are formed through its:

- ◆ Assessments of economic fundamentals;
- ◆ Market intelligence; and
- ◆ Technical analysis.

Constraints on the management of the portfolio are detailed in a memorandum of understanding between TCorp and Treasury. They include the following:

- ◆ At all times the portfolio is to maintain an average bond maturity range of 3.25 years to 3.65 years as the basis of its benchmark portfolio. The manager is able to vary the range +/- 0.5 years relative to the benchmark.
- ◆ The portfolio is not permitted to exceed a maximum exposure of 20 percent to floating rates. The floating rate exposure is defined as an interest rate reset of 12 months or less, with the proportion defined on a face value basis.
- ◆ Prior to the commencement of each financial year, Treasury and TCorp are required to set an agreed debt cost servicing target calculated in accordance with GFS principles as applied in the NSW General Government Sector. This target is not to be breached materially by TCorp without prior permission from Treasury.

INSURANCE PORTFOLIO MANAGEMENT

Following a review of Insurance Ministerial Corporation investments by actuarial consultants Tillinghast - Towers Perrin, the strategic asset allocation was revised, with the allocation to bonds being reduced to an average of 60 percent of investments and the average duration of the bond portfolio being lengthened to around 5 years.

NSW Treasury Corporation (TCorp) undertakes asset management directly for the bond portfolio and TCorp acts as manager of managers for the other asset sectors. A Memorandum of Understanding between TCorp and the Crown details investment policies and procedures and appropriate benchmarks for each asset class.