

TITLE: Accounting for a super mystery

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We've all heard that the Australian Public Service's superannuation schemes are generous, and a look at the budget papers would seem to confirm this, revealing that the Government is spending \$14.1 billion on this entitlement. Put another way, public servants' super appears to be a staggering 73 per cent of the \$19.2 billion spent on wages and salaries. And, despite this large expenditure, there is still a massive \$134 billion "unfunded superannuation liability" also recorded in the budget papers.

So, clearly the public service scheme is good, but is it really that good? Somehow the figures don't quite gel. A closer look at this entitlement raises a number of awkward questions. But first, we must explain where the \$14.1 billion comes from.

This year, the Government will pay \$3.0 billion in superannuation benefits to retired public servants. In addition, there is the payment of \$3.5 billion in super contributions for present staff, most of whom are members of defined-benefits schemes. The bulk of the \$3.5 billion is an accrual or fictional item; that is, the notional value of the increase in obligations for members of the defined-benefits schemes.

As well as this, tucked away in the budget papers under spending on "other purposes", is \$7.6 billion in "nominal superannuation interest". The history to this budget item lies with the former Howard government's decision to include "unfunded superannuation liabilities" as a notional debt in its published liabilities. If there is a debt, you normally pay interest on that debt. Likewise, if there is a notional debt then there should be a notional interest expense associated with that debt. Hence, corresponding with the unfunded super liability, there is a \$7.6 billion notional interest expense associated with maintaining that debt.

Add it all up and it brings the total bill for public servants' super to \$14.1 billion; about three-quarters of the total wage and salary cost.

Given that the government's contribution to public servants' super has typically been about 25 per cent, why do the budget papers suggest it has reached 75 per cent of wages and salaries? What seems to have happened is this: cash accounting, which the Treasury used to use, and accrual accounting are usually alternatives—you would use one or the other—but effectively the Commonwealth is now using both, with the result that it double-counts the

superannuation expenses in the budget papers. On top of that is the notional interest on the “unfunded superannuation liability”.

Had we kept the old super accounting system whereby the Government paid out super entitlements to retired public servants on a pay-as-you-go basis, then payments would probably be running a bit over the present amount of \$3.0 billion. If instead we had always operated a fully-funded scheme, we would be making payments of around \$3.5 billion into an accumulation fund. Depending on our history, we would have been paying one or the other. However, when the Howard government decided to adopt an accrual accounting system, it recognised the \$3.5 billion in the budget and kept recording the \$3.0 billion paid to retired public servants. It also accepted the notion or “fiction” of the “unfunded superannuation liability”, and so now pays a notional interest on that debt; the \$7.6 billion.

Because of the way accrual accounting was introduced, taxpayers now effectively pay three times to fund public servants’ super.

A private company would have to fund its obligations under a defined-benefit super scheme, but most of the government’s \$3.5 billion is notional. For some reason, the Howard government decided against setting up a real fund, at least until it came up with the idea of the Future Fund. But the question remains as to whether the sum of both the actual and accrual amounts should be put into the budget papers as real spending.

We must ask whether the \$7.6 billion in notional interest is a real cost and whether the \$134 billion is a real debt, and whether either should be recorded in the budget papers. Why does the budget treat super as an unfunded liability but not treat other government obligations (such as the age pension) in a similar way? The distinction seems arbitrary.

The unfunded superannuation liability has been growing quite rapidly. It was estimated to be \$78 billion with the introduction of accrual accounting in the 2000-01 budget papers and is now \$134 billion. That \$78 billion should have been an estimate of what the government would have needed to put away to fund all future entitlements arising out of employing public servants up until it introduced accrual accounting. That could have been put in a notional fund, with notional earnings that could have notionally funded entitlements as they became due. In that case, the unfunded superannuation liability would gradually fade away, assuming no major errors on the part of the actuaries who came up with the \$78 billion figure. Now, we must ask why the unfunded super liability keeps growing despite the transition to accrual accounting.

The government must have had many options for creating the initial values at the time it made the transition to accrual accounting. For example, since it had indeed been paying super benefits the government could have declared those past payments to have been contributions to a notional fund that would have had a certain balance at the transition. There should be a serious examination of exactly why the government chose the methods it did and whether they need to be reconsidered.

There may also be some important omissions in the budget papers. The \$3.5 billion notional accrual expense for superannuation liabilities has been recognised now for more than a decade, yet there appears to be no fund to account for where those payments went. That must be made transparent.

We know that the inclusion of notional amounts in the operating statement means the government is actually accumulating financial assets by more than the fiscal balance would otherwise suggest. So, somewhere, the government is accumulating assets that match the \$3.5 billion and the \$7.6 billion in notional payments. To appreciate what that means, suppose you pretend you spend \$100 a fortnight more than you actually do. At the end of 12 months, you would find your bank balance is \$2600 higher than you expected.

If the superannuation expense recorded in the budget over the past decade or so was genuinely for retirement benefits, then eventually all payments for retired public servants would come out of the notional accounts and should not appear as an explicit outlay in the budget papers. That transition might not be fully complete for many decades, but it should be already underway to some extent. Yet there does not seem to be any indication that some of the actual payments to retired public servants is now coming out of the notional accumulation of super assets. Why don't the budget papers show that part of the payments to super beneficiaries are paid as pay-as-you-go and that part are paid out of the accrual expenses? That was part of the rationale for establishing accrual accounting in the first place; that expenses would be recognised when they are incurred rather than years later when they are paid.

The Howard government established the Future Fund and former Treasurer Peter Costello now helps to manage it. But the actual role of the fund in public servants' superannuation is still unclear. Are there arrangements to integrate the fund with the receipt of accrual payments and for the payment of entitlements? How is that going to work?

Unfortunately, there are many gaps in the government's treatment of public servants' super in the budget papers. There are many questions to be answered and, until then, there is a suspicion that the budget figures overstate the true cost of providing superannuation. If it turned out that the true costs are indeed 25 per cent, and not 75 per cent, of the wage and salary bill, then the budget outlays and deficit would be overstated by about \$10 billion. That's a rather large "white hole".

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