THORNTON'S OPEN LETTER TO PARLIAMENT (AMENDED) – 22 APRIL 2012

Questions immediately arise as to how the Government or the Parliament for that matter, could apparently find up to $US15Billion of which $US7Billion has now been deposited into the IMF's "Firewall Fund"; a fund designed to prop up the European economic contagion.

This question emerges because in the same breath, the Government supposedly can't find at least $100M in cash over the economic cycle to ameliorate the superannuation pension indexation woes of (not least) 57,000 Military retirees.

By its own hand, the Commonwealth has caused the significant erosion in the purchasing power and therefore the material living standards of its former employees by:

1. Skimming 2% off the top of the indexation crediting rates of affected retiree's "defined benefit" superannuation pensions between 1986-1988, without providing any constitutional compensation;

2. Manipulating the calculation of the CPI by adopting the 1989 International Standard that introduced "Quality" offsets (amongst other things) into the calculations, thereby changing the underlying parameters of the Consumer Price Index markedly forever;

3. Breaking the nexus between CPI & Wages by the abandonment of the centralised wage arbitration system; irrevocably undermining the structural integrity of a retiree's defined benefit retirement pension, again with no constitutional compensation offered to protect affected retirees; and

4. Reneging on the 2007 framework in maintaining the parity of Veterans' Disability Pensions relative to the structural adjustments that were subsequently implemented for the Age / Service Pensions in September of 2009.

Figure 1 helps to illustrate the magnitude of some of these concerns with respect to the significant erosion in Commonwealth provided retirement incomes for former Military and Commonwealth employees: erosion that affects invalidity pensioners, war widows, widows and orphans also.

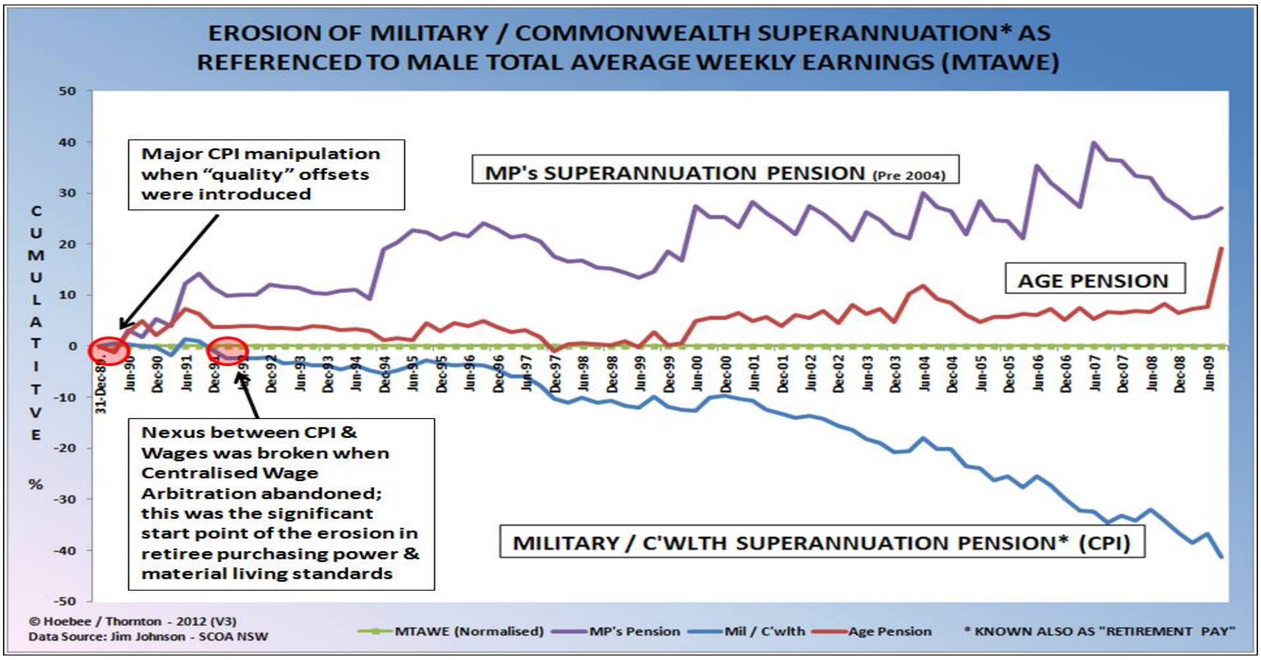

Figure 1

Successive Governments have cited cost as a barrier in preventing them doing the right thing to correct the indexation of Commonwealth retirement incomes, but evidence clearly shows that some of their cost estimates are underpinned by rubbery data, ill-conceived ideas and bogus actuarial assumptions.

This situation could not have been any clearer, when in 2010 an independent actuarial firm (Cumpston Sergeant) was commissioned by the Commonwealth to review and report, in broad terms, on the *"reasonableness"* of the increased liabilities that would result from correcting retirement pay / pension indexation.

On reading this report, Cumpston Sergeant placed very clear caveats of its assessment of *"reasonableness"* with respect to some of the Department of Finance (DoFD) assumptions and estimates given. This was particularly the case when referring to the *"pension take up rate"* assumptions for the Public Sector Superannuation and Military Superannuation Benefits Schemes, where the Review stated that the assumptions were *"reasonable, but highly uncertain." (Emphasis added)*

Cumpston Sergeant's caveats were substantiated not least by the fact that when interviewing the actuaries' concerned, it was disclosed that there was *"no* [historical] *data available"* on which to base the assumption, and that in one interview with an actuary concerned, it was disclosed that the *"pension take-up represented perhaps 20-30% of the initial increase in liability, although he* [the actuary] *had not directly quantified it"*. In other words, the actuary concerned had just plucked the parameters of an already unsubstantiated assumption out of thin air; an assumption representing anywhere between 18-20% of the total projected liability for each scheme considered; adding billions of dollars to the cost estimate.

If the foregoing was not enough to raise major concerns in the minds of readers, then perhaps the snapshot at Figure 2 below of official FOI data received from COMSUPER late last year by this commentator might peak your interest.

As is clearly shown and as reported at 30 June 2011: pensions were still being recorded (and perhaps even paid) against dead recipients; there were some recipients who apparently joined their respective Commonwealth & Military Super Schemes when they were a negative number (e.g. minus 75 years of age); and where one person supposedly lived to the ripe old age of 125 years and another seven who reached 123 years; setting eight new world records for life expectancy!

	SCHEME	FUND ENTRY DATE	AGE AT FUND ENTRY	AGE CURRENT	LAST DAY OF SERVICE	PEN COMM DATE	PENS ANNUAL GROSS PEN 2011	PENSION STATUS	PENSION TYPE	PENSION REASON	TERMINATION DATE	TERMINATION REASON
5	1922 Act	1/01/1922	4	94	2/01/1974	30/06/1988	0	Terminated	Death	Spouse of Cor	24/10/2001	Death
6	DRDB	17/02/1947	23	87	2/10/1961	1/07/1988	0	Terminated	Death	Spouse of Cor	9/01/1995	Death
7	DRDB	17/04/1939	24	96	30/12/1961	1/07/1988	**26107.64**	Terminated	Retirement	Contributor	2/07/2007	**Death**
8	1922 Act	1/01/1922	8	97	18/05/1972	19/05/1972	**26346.32**	Terminated	Death	Spouse of Cor	19/12/2006	**Death**
9	DRDB	9/08/1949	26	88	15/02/1968	1/07/1988	**25464.66**	Terminated	Retirement	Contributor	16/05/2009	**Death**
10	1922 Act	1/01/1922	11	101	20/04/1975	21/04/1975	0	Terminated	Retirement	Contributor	6/06/1998	Death
11	DRDB	29/09/1939	23	95	27/11/1957	1/07/1988	0	Terminated	Invalidity	Contributor	21/04/1991	Death
12	1922 Act	1/01/1922	11	101	23/03/1975	24/03/1975	0	Terminated	Retirement	Contributor	2/09/1990	Death
13	DRDB	29/09/1939	25	97	27/11/1957	22/04/1991	**17435.6**	Terminated	Death	Spouse of Pen	22/12/2006	**Death**
14	DFRDB	1/10/1972	39	78	7/06/1974	1/07/1988	**33301.06**	Terminated	Retirement	Contributor	10/12/2004	**Death**
15	1922 Act	1/01/1922	8	97	23/03/1975	3/09/1990	**33496.06**	Terminated	Death	Spouse of Pen	6/02/2007	**Death**
16	1922 Act	1/01/1922	**-75**	14	15/08/1961	16/08/1961	0	Terminated	Invalidity	Contributor	27/01/1989	Death
17	1922 Act	1/01/1922	35	**125**	8/03/1949	9/03/1949	0	Terminated	Death	Spouse of Cor	31/01/1989	Death
18	MSBS	8/10/1992	52	70	19/08/1995	20/08/1995	**33861.36**	Terminated	Retirement	Contributor	7/08/2004	**Death**
19	DFRDB	5/06/1973	**-6**	32	25/05/1981	1/07/1988	0	Terminated	Death	Child Student	29/03/1996	Terminated
20	DFRDB	5/06/1973	**-7**	30	25/05/1981	1/07/1988	0	Terminated	Death	Child Student	7/11/1997	Terminated
21	PSS	1/07/1990	50	71	30/06/1999	21/08/2002	**8285.16**	Terminated	Retirement	Contributor	31/01/2007	**Death**
22	PSS	24/11/1997	52	65	31/08/2006	1/09/2006	**19045**	Terminated	Redundancy	Contributor	23/09/2008	**Death**

Figure 2

If this didn't grab reader's attention, then perhaps you might like to review what Mr. David Richardson from *'The Australia Institute'* had to say in the Canberra Time's Public Sector Informant. After analysing and referring to the budget papers, and after conferring with a number of learned colleagues as I understand, Mr. Richardson seriously questioned the Government's approach to accrual accounting with respect to its reporting of Superannuation liabilities; highlighting major deficiencies and concluding that "double accounting" was occurring; creating what he thought might be a **"10 Billion dollar white hole"**.
(A link to Mr. Richardson's article is here).

In addition to Mr. Richardson's exposure of budgetary reporting shortfalls; there is no doubt that the current Government is employing the ***"Dark Arts of mixing cash and accrual accounting"*** to fend off legitimate claims by disenfranchised retirees; retirees that are now armed with professional advice and research and who challenge the Government to publicly reveal their financial calculations and assumptions behind their decisions.

In this vein, the Government would have you believe that their cost projections to fix the indexation woes of just the DFRDB Military retirement scheme alone, would add a supposed **$1.7Billion** cost to the budget over the forward estimates. But it would appear that not all members of Parliament have been duped into accepting such fallacious "fiscal balance" numbers. This is because on the 16th of April 2012 Senator Michael Ronaldson (Lib) disclosed on Radio 4BC (when discussing and supporting the mounting concerns of Military Retirees) that:

"... the Government Actuary, who made it quite clear that the fiscal balance figures that they* [the Government] *have been using are totally inappropriate when it comes to talking about unfunded superannuation liability and, indeed, it can only be used in the first year otherwise it is quite meaningless."

AGA's "Fiscal Balance" Table[31]

- Highest of MTAWE, PBLCI and CPI

Year	Opening additional liability $m	Additional accrual cost $m	Additional interest cost $m	Additional payments $m	Closing additional liability $m	Additional fiscal balance $m
2011/12	8,676.7	30.9	520.9	19.6	9,208.9	551.8
2012/13	9,208.9	25.1	551.9	47.9	9,738.0	577.0
2013/14	9,738.0	20.4	582.6	77.9	10,263.2	603.0
2014/15	10,263.2	16.6	613.0	109.6	10,783.2	629.6

Figure 3

To expose some of the underpinnings of the **"Dark Arts"** ever so slightly, Figure 3 shows in part a table compiled by the Australian Government Actuary that contains elements of the accrual cost, derived from a 40 year cash flow projection, which is associated with one of the proposed indexation options to help ameliorate the significant erosion in DFRDB retirement pay, as reflected in Figure 1 above.

In reference to the column marked "additional payments", the reader will see on the first row a figure of $19.6M; a figure that represents the actual gross cash cost that would ultimately end up in the pockets of 57,000 DFRDB military retirees, if indeed their pensions were to be indexed correctly by this specific measure. As you will see when glancing across to the next column to the left, the cash cost of $19.6M is significantly over shadowed by a whopping $520.9M in "additional interest cost" ; a term also known as "notional interest". This interest "notionally" accrues against the present value of a 40 year cash flow projection; creating a liability that the Government would have you believe is a "debt" even though a "debt" in the true sense does not actually exist (i.e. whilst the obligation to pay a retirement income for life exists, the realisation of those annual pension payments from Consolidated Revenue are, in the main, balanced by revenue receipts on an annual basis; revenue receipts that generally increase in line with the growth in GDP over time).

The Commonwealth's current approach to accrual accounting of its superannuation liabilities appears deficient because it would seem they only want to show the "fire and brimstone side" of the balance sheet. In my opinion, they do not account for or report the true "net cost" that accrual accounting demands because their balance sheet fails to record assets and associated interest earnings (both actual and notional) that are associated with the Future Fund, ARIA funds under management and the employer's "notional" contributions amongst others. As Richardson so aptly points out, this deficiency seems to have been there since the inception and adoption of accrual accounting.

What is interesting is that the Department of Finance's own explanation of Fiscal Balance states: '*The fiscal balance is an accrual measure that shows whether the Government has to borrow from financial markets to covers its activities. The purpose of this measure is to meet the central fiscal objective to ensure that the Government, over the economic cycle, is saving enough to cover its own investment needs and not drawing on private sector savings.'*

This begs the question: If the Government did indeed seek borrowings from "financial markets" then why would they incur such exorbitant interest bills as those shown in the "additional interest cost" column if the actual net cost in underlying cash terms to fix the indexation problem is only approximately $100M over the forward estimates; a cost estimate that has been clearly articulated publicly by the Liberal / National Coalition; an estimate that is consistent with this author's calculations and that of other third parties also?

Logic would suggest that "Notional interest" as applied to Commonwealth superannuation liabilities is a falsity in the real world because if the federal budget is balanced or in surplus then there is no actual interest payable. If any actual interest was payable from year to year with respect to the Commonwealth's obligation to pay retirement incomes (i.e. when the budget is in deficit); then such interest should only be proportionate to the overall debt that exists across all Commonwealth programmes for that specific Financial Year; not some arbitrarily derived notional interest figure that is based on a 40 year cash flow projection.

With the foregoing in mind, politicians and media pundits who feel they have now fallen prey to the **"Dark Arts",** might in turn like to press the Government for a full explanation of how their $1.7Billion figure has been derived and what it actually means in real terms.

About the Author

Peter Thornton is a retired member of the Defence Force and the Commonwealth who acts as an independent researcher and commentator on matters relating to Commonwealth and Military Superannuation. Peter's independence aims to support all affected retirees and to aid the representational activities of national peak bodies such as the Defence Force Welfare Association (plus alliance partners), the Superannuated Commonwealth Officers Association, member associations of the Australian Council of Public Sector Retiree Organisations, and the Returned Services League; many of which he is an ordinary member. Peter has graduate qualifications in Economics and Engineering with post-graduate qualifications in Management.