



**Military**  
**Super**

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the msb board  
**annual report**

**2005-06**

Military Superannuation and Benefits Scheme







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**annual report**

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Note: All contribution, benefit, membership and exit statistics are derived solely from records available to the Commissioner for Superannuation as they stood at the time these statistics were compiled. Where statistics for earlier financial years are quoted, these may vary from those previously published due to the application of retrospective adjustments that are now reflected in this report. For similar reasons statistical information in this report may also vary from that presented by other agencies.

The Hon. Bruce Billson, MP  
Minister Assisting the Minister for Defence  
Parliament House  
Canberra ACT 2600

Dear Minister

In accordance with section 26 of the *Military Superannuation and Benefits Act 1991* (the MSB Act), the Military Superannuation and Benefits Board of Trustees is pleased to submit to you its annual report on the performance of its functions for the year ended 30 June 2006, together with financial statements in respect of the management of the Military Superannuation and Benefits Fund during 2005–06, and the Auditor-General's report in respect of those statements.

Subsection 26(3) of the MSB Act requires you to cause a copy of the report to be laid before each House of the Parliament within 15 sitting days after you receive it.

Yours faithfully



Charles Kiefel, BCom, FCA, FAICD  
Chairman  
MSB Board of Trustees  
29 September 2006



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# chairman's overview

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- > acknowledgements
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## Chairman's overview

I am pleased to report that MilitarySuper has achieved strong returns for the third consecutive year since implementing its revised investment strategy, achieving 15.7% (net of fees and taxes; 18.6% gross) in the Growth (Default) Option to 30 June and 18.2% (net of fees and taxes; 21.4% gross) in the High Growth Option. This has been a most pleasing outcome as the new investment strategy is still in a period of transition. Notwithstanding this, all aspects of the strategy have worked well together, helping to maximise returns whilst at the same time containing investment risks.

MilitarySuper does not participate in industry performance surveys as they generally reflect gross returns; whereas your fund reports performance net of all fees and taxes. That is, our returns reflect the amounts that members receive. However, had we participated in such surveys our net returns for 2005-06 would rank MilitarySuper among the top quartile of comparable superannuation funds in Australia.

## Investment returns for 2005–06

Growth in China and India, the world's most populous nations, was the international development which had the most far reaching consequences for the global economy. Fuelled by huge populations, technology, globalisation and urbanisation, the economies of these two countries are booming. Countries such as Australia have been well placed to capitalize on that growth through the ever increasing and almost insatiable appetite, particularly by China, for commodities.

Investment markets around the world continued to surprise the experts with the Australian Stock market reaching record highs during the year. The Headline All Ordinaries Index breached the 5000 point barrier for the first time, reaching a record 5366.21 points by 11 May 2006. International markets also returned strong performances with the positive global outlook reflecting expectations for continued growth in the United States, strong growth in China, increasingly solid growth in Japan and continuation of the moderate recovery under way in Europe. On an annual basis the Australian market outperformed world markets for the sixth consecutive year.

However, during May and June a significant proportion of those gains were given up as the global sell-off of shares and commodities gathered pace in response to higher than expected inflation in the US and increases in interest rates by the Federal Reserve - to a five year high of 5% with further rises predicted in order to keep US inflation in check. This downturn in expectation spread to other regional markets with all major markets showing marked declines in May and June.

Notwithstanding this short-term volatility, listed equity markets (particularly the domestic markets) posted strong full year returns.

The year saw increasing demand and opportunity for investment in non-listed investment classes such as Private Equity and Infrastructure, areas of investment in which MilitarySuper has participated for some time.

Those elements of the MilitarySuper Fund which are exposed to listed equity markets have shared fully in that market generated return. Importantly, in our international equity portfolio, the new managers appointed by MilitarySuper have consistently outperformed the market, notwithstanding the impact that currency movements have on international investments.

## Fund Performance

Returns from listed equity markets during 2005-06 continued to display high levels of volatility, surging to new highs, only to retreat to lower ground in response to global events and market sentiment. These are the very characteristics which distort investment returns and which have prompted the MilitarySuper Board to seek investments in alternative asset classes which provide access to long term stable income streams and investment returns.

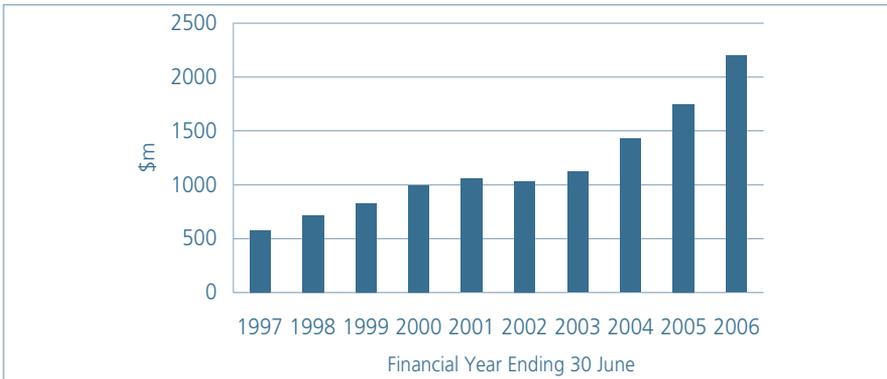
Notwithstanding this volatility, the MSB Fund achieved strong returns for members (net of all fees and taxes) as described in my opening remarks. Details of the performance achieved by each of the investment options are contained in the body of this report.

The results achieved have been most pleasing given that we are continuing to transition the Fund to its long term strategic asset allocation. Particularly pleasing was the fact that all aspects of the strategy have worked well together, helping to maximise returns in the extremely volatile market conditions which prevailed during much of 2005-06. Of significance was the contribution made by our alternative investments, particularly in Private Equity and Infrastructure. However, going forward the expectation by most experts is that double digit returns from traditional listed equity markets is not sustainable in the long term. That is why the Board is continuing with its strategy of seeking alternative investment opportunities whose characteristics are not closely aligned with those of listed equities. We have begun to see the benefits of this strategy with existing investments in Private Equity and Infrastructure, providing the Fund with access to long term sustainable income streams over long time horizons. The returns achieved by the Fund's infrastructure investments alone have been an impressive 23.3% (gross of fees and taxes) over the 12 month period to 30 June.

## Investment milestone

During the first week in January 2006 MilitarySuper achieved a major milestone with the Fund's total investment assets exceeding \$2 billion for the first time. The Fund's assets continued to grow during the year reaching \$2.2 billion by 30 June 2006 and these are expected to reach \$3 billion by the end of 2007-08.

The following chart demonstrates the growth of the Fund over the past 10 years:



## Regulatory framework

In response to Government Financial Services Reform initiatives, the Board successfully applied for an APRA Licence and the MSB Fund became a Registered Entity for APRA Licensing purposes. In so doing MilitarySuper was one of the first superannuation funds to successfully apply for a licence.

The importance of licencing is that from 1 July 2006 onwards superannuation funds must be licensed in order to be able to continue to receive contributions from members and to receive taxation concessions in respect of investment income. To qualify for a license a superannuation fund had to be able to demonstrate that they are able to comply with the new Regulatory framework and the newly prescribed operating standards. They also had to demonstrate that there were policies and processes in place to deal with the risks associated with their operations as Trustees of a Registered Superannuation Entity.

Many funds, including some large corporate funds, found that they were unable to comply with the stringent new requirements and either amalgamated with other schemes or transferred their membership to other complying superannuation schemes.

## Ancillary benefits

The necessary legislative changes to enable the Board to implement its long term goal of providing members with access to a range of value adding “ancillary” benefits were made during 2005. With the passage of these changes the Board has been able to expand the design of the Scheme to enable members to make personal, salary sacrifice and spouse contributions into the Fund and to allow members to transfer benefits held in other superannuation schemes into MilitarySuper. These new

features were introduced from 1 August 2005 and since their introduction over 4,863 members have taken advantage of them involving payments into the Fund exceeding \$17,500,000.

## Acknowledgements

I commend my fellow trustees for their continuing commitment, co-operation, support and hard work during a year of significant challenge and change across many areas of the Board's responsibilities.

On behalf of the Board I would also like to commend the work of our investment advisers, Strategic Capital Management as Lead adviser, to Ipac Financial Services as adviser in the Domestic Equities Sector, to members of the Board's Investment Committee and to the Board's in-house investment team for the significant work undertaken in the research, monitoring and review of the Fund's investment strategy, manager configurations and new investment opportunities. The outcome of this work will have significant long-term benefits for all members of the Scheme.

I would also like to express the Board's thanks to the Board Executive for sound advice, assistance and support, to the Scheme Administrator (ComSuper) for their ongoing commitment to servicing members of the Scheme in a year of considerable challenge, to the Fund Custodian (National Custodian Services) and to all of the members of the Board's committees and the Board's advisers for their continuing good work throughout the year.

## Ongoing commitment

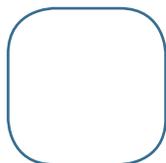
Your Board remains focused and committed to making MilitarySuper one of the best superannuation schemes in Australia; providing efficient administration and valuable services to its members and ensuring that members' moneys entrusted to its care achieve good and sustainable investment returns over the lifetime of a member's investment.

With the ongoing support of the Department of Defence, the Scheme Administrator, the Fund's investment advisers and managers, your Board will continue to focus on continuous improvement in scheme design and administration and in maximising investment returns whilst containing investment risk within acceptable bounds.



Charles Kiefel  
Chairman





# about the MSBS

- > description of the scheme
- > the MSB Board
- > indemnity insurance
- > schedule of Board meetings



***The Military Superannuation and Benefits Scheme (MSBS) was established by the Military Superannuation and Benefits Act 1991 (the MSB Act). It replaced the Defence Force Retirement and Death Benefits (DFRDB) Scheme for new entrants to the Defence Force on 1 October 1991, following government initiatives to improve Defence Force superannuation arrangements. Existing DFRDB contributors were given the option of transferring to the MSBS before 1 October 1992.***

## **description of the scheme**

The MSBS is a hybrid defined contribution and defined benefit scheme with benefits being derived from two sources:

- a member component, which is paid as a lump sum only (or rollover) of the member's own contributions, including amounts notionally brought over from the DFRDB Scheme, plus earnings (based on the member's investment choice) on these amounts; and
- an employer component, which is a defined benefit related to a member's period of membership and final average salary that must be preserved in the Fund until age 55. This benefit is unfunded (that is, the cost is met by the employer on an emerging cost basis from the Commonwealth's Consolidated Reserve Fund when the benefit falls due) except for the portion relating to employer productivity contributions.

Membership of the scheme for new entrants to the Defence Force is compulsory and the minimum member contribution rate is 5% of fortnightly salary for superannuation purposes.

At three-monthly intervals MSBS members may elect to vary their contributions to the scheme between 5% and 10%.

Where a member resigns from the Defence Force the member benefit accrued to 30 June 1999 can be paid as a lump sum to the member but the balance of the member benefit must be preserved, either in the Fund or in another complying superannuation fund selected by the member, until the member's preservation age. The employer component, including productivity contributions, must be preserved in the Fund until the member reaches age 55, or another complying superannuation fund until the member's preservation age.

# the MSB Board

## membership

The Board consists of five Trustees appointed by the Minister Assisting the Minister for Defence (the Minister) under section 21 of the MSB Act.

Two of the Trustees, nominated by the Minister, must have experience in, and knowledge of, the formulation of government policy and public administration. Two additional Trustees must be members of the Defence Force—one an Officer and the other a member other than an Officer. They are nominated by the Chief of the Defence Force (CDF) and appointed by the Minister.

The fifth Trustee, who is also the Chairperson of the Board, is appointed by the Minister after consultation with the Minister for Finance and Administration. The Chairperson and the Trustees nominated by the CDF are appointed for a period not exceeding three years (but are eligible for reappointment), whereas the remaining two Trustees hold office at the Minister's pleasure.

Trustees holding office at 30 June 2006 were:

*Chairman:*

### **Mr Charles Kiefel BCom, FCA, FAICD**

Trustee since 11 July 1997

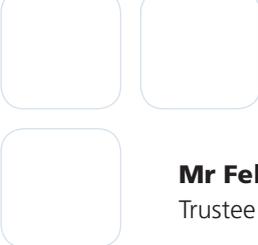
Mr Kiefel is a Director of a number of private companies and was formerly Managing Director of Corporate Finance at ANZ Investment Bank. He has a Bachelor of Commerce degree, is a Fellow of the Institute of Chartered Accountants and a Fellow of the Australian Institute of Company Directors. In addition to his role as Chairman of the Board, Mr Kiefel is Chairman of the Board's Investment Committee.

*Minister's Nominees:*

### **Dr Michael Sharpe AO, Hon DScEcon (Syd.), BEc, FCA, FAICD**

Trustee since 29 April 1998

Dr Sharpe is a Director of the Australian Stock Exchange Limited and Babcock and Brown Australia Pty Ltd. During his career, he has served as Chairman of the International Accounting Standards Committee, President of the Institute of Chartered Accountants in Australia, Senior Audit Partner of the firm now known as PricewaterhouseCoopers, a trustee of State Super (NSW), Chairman and Director of many companies, and as an adviser to Government. He serves as Chairman of the Audit and Risk Management Committee and is a member of the Investment Committee.



**Mr Felix Bleeser**

Trustee since 1 March 2005

Mr Bleeser is the Assistant Secretary Financial Training in the Defence Chief Finance Office and was previously the Director General Defence Occupational Health Safety and Compensation. He has extensive experience in personnel policy and management in Defence, and has been a member of numerous Defence review bodies, including the review of the Defence Force Retirement and Death Benefits Scheme, the Defence Efficiency Review and the Strategic Review of Defence Personnel Policies into the 21st Century. He is a past Director of superannuation policy in Defence and an alternate member of the Defence Force Retirement and Death Benefits Authority, the Military Rehabilitation and Compensation Commission and the Government's Safety Rehabilitation and Compensation Commission. He is a member of the Audit and Risk Management Committee.

*ADF Nominees:*

**Air Commodore Lee Roberts CSC, MSc, GradDip Strat Studies, BSc, FAICD**

Trustee since 26 September 2003

Air Commodore Lee Roberts is currently the Director General Personnel - Air Force. He has served as a pilot and flying instructor extensively within Australia and overseas during his 34-year Air Force career. He is a Fellow of the Australian Institute of Company Directors, holds a Certificate of Superannuation Trusteeship and has previous experience as an Alternate Trustee of the Military Super Scheme. He currently serves as Chairman of the Military Superannuation Communication Committee.

**WOFF Robert Swanwick MAICD, JP**

Trustee since 22 September 1997

Warrant Officer Swanwick is Loadmaster with No.37 Squadron RAAF Base Richmond. He has served throughout Australia and overseas for 27 years as a Loadmaster, been posted to Air Force and Army units, and attached to Navy establishments. He holds diplomas in frontline management and aviation and has extensive training in investment and superannuation administration. Over the past ten years, he has held the position of other Rank Trustee, and is a member of the Audit and Risk Management Committee and a member and former Chairman of the Military Superannuation Communication Committee.

## indemnity insurance

The Board is insured with American Home Assurance Company against losses, liabilities, actions, claims or demands on the MilitarySuper Fund arising from the performance of its functions. To date there has never been a claim against the insurance policy, nor have any regulatory penalties been applied.

## schedule of Board meetings

	16 Aug 05	17 Aug 05 <sup>1</sup>	7 Sept 05	13 Oct 05	15 Dec 05	1-3 Feb 06	19 Apr 06	14 Jun 06	27 Jun 06 <sup>1</sup>
Charles Kiefel	P	P	P	P	P	P	P	P	P
Dr Michael Sharpe	P	P	P	P	P	P	P	P	P
WOFF Robert Swanwick	A*	A*	P	P	P	P	A*	P	P
Air Commodore Lee Roberts	P	P	P	P	P	P	P	P	P
Felix Bleeser	P	P	P	P	P	P	P	P	P

<sup>1</sup> Extra-ordinary meeting of the Board

P-present at meeting    A-apologies    A\*-absent on operational duties with the ADF



**The MSB Board of Trustees**

Standing (from left)

WOFF Robert Swanwick, Air Commodore Lee Roberts

Seated (from left)

Dr Michael Sharpe, Mr Charles Kiefel, Mr Felix Bleeser





- > investment policy
- > investment objectives
- > investment strategy
- > strategic asset allocations
- > investment management
- > investment managers
- > custodian services
- > member investment choice
- > investment performance
- > fund growth
- > unitisation



***In formulating an investment policy for the MSB Fund, the Board focuses on two primary objectives: to maximise long-term Fund returns; and to manage and control business and investment risks.***

## investment policy

The investment of funds must comply with the legislative and regulatory requirements promulgated under the *Superannuation Industry (Supervision) Act 1993* and the *Corporations Act*. These Acts provide general prudential guidelines for superannuation trustees, and specifically address non-arms length transactions, borrowing, loans to members, “in-house” assets, insider trading and derivative controls.

## investment objectives

The general investment objectives for the Fund are to:

- i. Contribute to the support of members’ lifestyles in retirement, by enhancing the purchasing power of their investment through prudent and efficient management.
- ii. Maximise return for the chosen level of risk.

The Board has set investment objectives for the Fund and developed strategies to pursue them. As a general principle Fund assets should be allocated in a way that provides the best chance of meeting the Fund’s objectives within the risk tolerances set for each investment choice option. Subject to specific risk controls and the other fund investment principles specified below, the best return on assets should therefore always be sought.

The Board has adopted the following principles regarding the expression of its investment objectives:

(i) Return Objective

The return objective is expressed as a margin above cash (UBS Bank Bill Index) over a rolling period after investment fees and taxes for the three investment choice options of Cash, Conservative and Balanced. However, in respect of the Growth (Default) and High Growth options, the investment objectives are expressed in the form of Absolute Return targets of 10% and 11% (Net) per annum, respectively, over the long-term.

(ii) Risk Budget

The Risk Budget is an expression of the level of risk that the Fund is prepared to accept to achieve its target return. Standard deviation is used as the main

measure of risk. The Risk Budget is expressed as a standard deviation for each of the investment options. The focus of risk control is for the Strategy as a whole and not just the individual components. This focus is designed to prevent the individual mandates from causing the Strategy to be either too aggressive (thus creating an excessive possibility of loss) or too defensive, given the return objective of the Strategy.

## investment strategy

Given the volatility of investment returns from traditional listed markets, and acting with the advice of its professional investment advisors, the Board has developed a revised investment strategy for the Fund. This has at its core an absolute return objective in the Growth (Default) option of achieving sustainable long-term investment returns of 10% (net) per annum over the long-term with an acceptable level of risk of negative return. This investment strategy is leading to a gradual reduction in the Fund's exposure over time to market generated returns as it seeks to add value from a diverse range of non-traditional asset classes whose return characteristics are not closely aligned to listed equity markets.

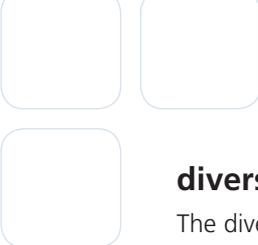
Where the Fund retains an exposure to listed markets it seeks to add value by pursuing active management strategies capable of delivering above market returns. Because superior stock selection provides the most consistent and reliable opportunity for generating excess return, the manager selection process favours managers with exceptional bottom-up fundamental research capabilities. Therefore, recognising the difficulty of outperforming the market on a consistent basis, emphasis is on selection of managers with high integrity, sound investment philosophies, strong track records, superior organisations, and sustainable competitive advantage.

The process of transitioning the Fund to its new long-term strategic asset allocation commenced in 2004 and is continuing.

### reserves

The Board does not maintain a reserve account. In general terms a reserve account is used to smooth rates of return members receive. Members of MilitarySuper benefit by having all Fund earnings distributed to their accounts (after tax and all expenses are deducted). That is, they generally receive a higher return than would be the case if some of the funds were diverted to a reserve. It also follows that any losses are also passed on to members as they occur, which means that remaining members are not subsidising those who leave.

Fund earnings are fully reflected in the unit prices declared each day for each of the investment options.



## **diversification and risk control**

The diversification and risk control philosophy of the Board is to manage the risk of the total Fund, not just its components. This requires the positions taken by Fund Managers to be combined and managed so that the Fund's five separate investment options adopt the targeted level of risk (or meets its risk budget), in the expectation that this will allow value to be added over the long term. This will be achieved by ensuring the proper co-ordination of Managers, so that the Fund does not pay active management fees for one Manager to nullify the active positions of others, or leaving unchecked, risks that combine for the Fund Strategies in total (for example all Managers investing heavily in interest rate sensitive securities).

Business risk can result from poor performance by suppliers. Some important suppliers to the Fund are the Custodian, the Asset Sector Advisors/managers the Fund Managers, and the Fund Administrator. The Board has adopted a due process to control business risk.

Investment risk results from the concentration of a Fund's investments in fewer than the total universe of available investments. While the Fund ideally seeks to eliminate business risk, it does not seek to eliminate investment risk. Investment risk can only be eliminated by adopting a passive investment strategy. This approach is inconsistent with the Fund's policy, which is to add value through active management.

The Board's investment policy allows managers to use derivatives subject to strictly controlled limits. Derivatives such as options, futures and forward foreign exchange contracts may be used to reduce the Fund's exposure to market fluctuations, but cannot be used to leverage the Fund.

In addition, no single share holding can exceed 7.5% of the Fund's total value.

The exposure to a single economic entity, as an investment issuer or counterparty, must not exceed 10% of the total Fund value (Australian Government debt is excluded from this).

## **a focus on quality investment performance**

The Board is concerned with the quality and reliability of the investment strategy that is implemented on behalf of members. The Board prefers a portfolio philosophy that is likely to perform well through the full economic cycle rather than one which is very dependent on specific market conditions that are not likely to last a full cycle or are subject to investment market shocks.

## adding value through active management

The Board adopts the view that in some sectors active investment management can add value to the Fund. To achieve this increase in value requires adherence to well considered strategies throughout different investment circumstances. On average this approach is expected to yield better returns. Over time these returns should compound to provide substantial increases in the Fund's value, and thus improve the financial position of the Fund's stakeholders.

Adding value over a passive investment requires active positions to be taken compared to the benchmark (typically a market index such as the S&P/ASX 300 Accumulation Index for Australian shares). These positions represent a risk to the Fund and are incorporated into the Risk Budget for each of the investment options.

## strategic asset allocations

Consistent with its objectives of reducing dependence on market generated returns (Beta) the Board has begun to implement investments in Alternative Asset classes; such as Private Equity, Unlisted Property, Infrastructure, and Uncorrelated Alpha products such as Hedge Funds whose return characteristics are not aligned with the returns of traditional listed markets. Although it is the Board's intention to maintain the current five choice options, with their current exposure to assets with growth and defensive characteristics, the new asset classes being introduced may, from time to time, display characteristics of both a growth and a defensive nature.

**Table 1: long-term strategic asset allocation for the investment options**

asset class	cash option %	conservative option %	balanced option %	growth option %		high growth option %
				(a)	(b)	
Cash	100	20	5	1	0.5	0
Debt instruments (1)	0	50	25	10	7	0
Property	0	8	7	7	10	10
Australian shares	0	11	22	28	25	30
Private equity	0	0	7	10	15	15
International shares	0	11	22	28	25	30
Infrastructure	0	0	7	8	12.5	5
Uncorrelated alpha products (inc. hedge funds)	0	0	5	8	5	10
Total assets	100	100	100	100	100	100
Total growth assets	0	30	70	89	92.5	100
Illiquid assets	0	8	26	33	42.5	40

(1) Infrastructure Debt is included in this category.

(a) Represents the Growth Option's actual exposure as at 30 June 2006

(b) Represents the long-term Strategic Asset Allocation for the Growth Option.

The strategic allocation to private equity includes an amount of funds committed but not yet invested. As these funds are required they will be drawn from Australian and International shares as per the following:

60% invested in International shares

40% invested in Australian shares

## investment management

The Board reviews its long-term investment strategy and plan on an annual basis and monitors the performance of its fund managers against that plan progressively throughout the year. Assessments of the long-term performance of each fund manager are made on an ongoing basis. For this purpose each fund manager meets with the Board as necessary to discuss strategies, portfolio activity and investment performance.

The Board employs professional consultancy advisors to assist it with the review of its investment policy, to examine the performance of funds managers, new investment opportunities and the adequacy of the returns achieved by the MSB Fund.

During the year the Board's Investment Committee, supported by its specialist advisors, continued the detailed analysis and review of investment managers and investment products consistent with the implementation of the Fund's revised investment strategy. This research, included visits to a number of US Endowment Funds with which the MSB Investment Strategy has many similarities, and visits to a number of managers in the US. In co-operation with the executives of a number of large Australian superannuation funds, MilitarySuper co-ordinated a study tour of China during the year. This study tour provided opportunity to examine first hand, issues and opportunities for investment in this emerging economy – which is having a fundamental impact on the world economy given its extraordinary growth and almost insatiable appetite for commodities.

MilitarySuper has been one of the first Australian superannuation funds to invest in the emerging Chinese economy. Although it is early days the results to date have been very encouraging with our first private equity investment achieving strong positive returns in its first year. This is a result not normally expected in the world of private equity. The Fund is pursuing other opportunities through relationships forged with key Chinese government agencies.

## investment managers

The investment managers appointed by the Board manage their portfolios in accordance with specific mandates agreed by the Board. Those mandates include directions as to the types of investments to be pursued, the maximum and minimum holdings for each type of investment, and the expected rates of return.

The Board does not, however, involve itself in individual stock selection, relying on the demonstrated skills of the manager in the area of the market in which it has been selected to operate on behalf of the MSB Fund.

The Board's investment managers at 30 June 2006 are shown in Table 6 (page 31).

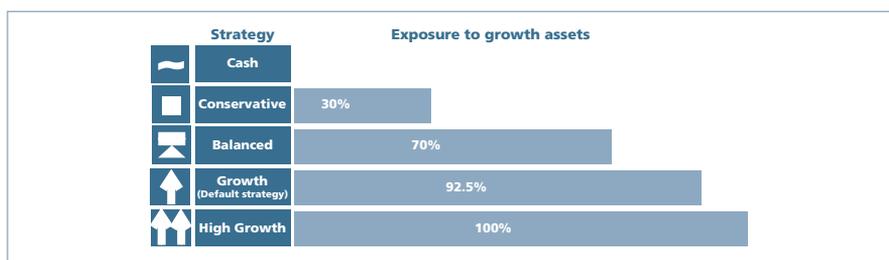
## custodian services

The Master Custodian safeguards and maintains the assets of the Scheme on behalf of the Board, performing various functions such as settlement of trades, physical custody and safekeeping of securities, collection of dividends and preparation of accounts.

The Board has appointed National Custodian Services Limited as Master Custodian of the Fund's assets.

## member investment choice

Members have the choice of five investment strategies for investing their member benefit. They can choose one or a combination of the strategies and, if a member chooses not to make an investment choice, their member benefit is invested in the Growth (Default) option. The five options are depicted in the following diagram:



### impacts on choice options of new investment strategy

Members continue to be able to experience choice in relation to their individual tolerances for risk and appetites for exposure to “Growth Assets”.

Growth Assets is a general term for assets such as shares and property, which provide investment returns (comprising both capital growth and income), which are generally expected to outperform inflation. Growth Assets compare with more defensive assets such as fixed interest and cash.

The new alternative asset classes introduced into the Fund, but particularly Private Equity, direct property and uncorrelated alpha products also display growth characteristics which are generally unaffected by movements in traditional listed markets such as shares. Investments in infrastructure, on the other hand, may take the form of investments in start up projects or in established facilities. Investments in the latter provide access to strong cash flows and potential for future capital growth. Therefore this form of investment displays similar defensive characteristics to more traditional defensive assets such as cash and bonds. Indeed investments in infrastructure project may comprise elements of both equity and debt, with the latter providing opportunity for senior debt lending, producing bond-like rates of return.

As the bulk of the assets of the Fund (i.e. approximately 95%) are invested in the Growth (Default) investment option, it is possible for each of the remaining four options to be balanced on a daily basis to the long-term asset allocation set for that option. As a result, each of these options is fully exposed to the range of assets (including the new alternative asset classes) set for that option and their returns reflect the full impact of those exposures consistent with the new investment strategy.

Given the volume of funds invested in the growth option it is not currently possible for that option to be fully transitioned to the new long-term strategic asset allocation set by the Board. This is occurring progressively as new opportunities for investments in alternative asset classes arise. In the interim the growth option carries higher physical exposures to listed equities and debt instruments, which will be sold down progressively to fund new investments in those alternative asset classes. As a consequence the investment returns for the growth option in 2005-06 are not fully reflective of the returns which would have been achieved had it been possible for that option to be fully transitioned to the new strategy.

Although the Fund will retain its growth focus (and will continue to have a significant exposure to listed markets in both Australia and overseas) the Board is increasingly seeking, in line with the new investment strategy, to diversify away from reliance on market-generated returns alone. This is being achieved by increasing allocations to other forms of assets with return characteristics which are not directly correlated with movements in listed equity markets. These will comprise:

- Property (including Direct/Listed) 10%
- Private Equity 15%
- Infrastructure 12.5%
- Uncorrelated Alpha 5%

Allocations to each of these asset classes may vary according to the quality of the investment options available in each asset class.

The Board has adopted the following specific investment objectives for each of the five investment strategies of the Fund.

Strategy	Outline	Investment Objective	Risk Budget (likelihood of a negative return)
Cash	This strategy aims to maximise protection against capital loss. To do this it invests only in secure cash investments such as bank deposits, bills, mortgages and short-term funds.	Achieve returns that match the UBS Bank Bill Index over 1 year period.  The investment focus of this option is short term and is provided for members expecting to access their funds within 1-2 years and therefore seeking a greater degree of certainty in investment returns.	Very low
Conservative	This strategy invests in a conservative mix of assets, mostly debt instruments (such as fixed interest, infrastructure debt and cash), with some investment in shares and property.	Achieve returns that are greater than 1% over the UBS Bank Bill Index over most rolling 3 year periods.  This strategy is aimed at maintaining an extremely low risk of capital loss and is therefore provided for members expecting to access their superannuation within 2-5 years and have a low appetite for investment risk.	Low
Balanced	This strategy invests in a diversified mix of assets such as debt instruments (including infrastructure debt), but with a bias towards Growth Assets.	Achieve returns that are greater than 2% over the UBS Bank Bill Index over most rolling 5 year periods.	Approx 1 year in 8.
Growth (default)	This strategy invests mainly in assets with growth characteristics (including Private Equity, Infrastructure and Uncorrelated Alpha products) with some investment in property, debt instruments and cash. This option currently has a strong bias towards listed equity markets (both domestic and international). However, over the coming years this bias towards market generated returns will be reduced through the introduction of unlisted growth asset classes such as Private Equity, Infrastructure (via both equity and debt), real property and hedge funds.	Achieve absolute returns of 10% (Net) per annum over most rolling 5 year periods.  This strategy has a long-term investment focus and is provided for those members seeking higher rates of return over the lifetime of their investment.	Approx 1 year in 7.
High Growth	This is the most aggressive strategy. It invests totally in growth assets, with no direct investment in cash or debt instruments such as fixed interest.  The option's high dependence on returns generated by listed equity markets was reduced through increased allocations to unlisted growth assets such as Private Equity, Property and Uncorrelated Alpha products such as hedge funds. This option does not have exposure to infrastructure investments.	Achieve absolute returns of 11% (Net) per annum over most rolling 7 year periods.  This strategy has a long-term investment focus and is provided for those members seeking higher rates of return over the lifetime of their investment and able to tolerate variability in returns over the shorter term.	Approx 1 year in 6.

## investment performance

As reported in the Chairman's overview, growth in China and India, the world's most populous nations, was the international development which had the most far reaching consequences for the global economy. Fuelled by huge populations, technology, globalization and urbanization the economies of these two countries are booming. Countries such as Australia have been well placed to capitalize on that growth through the ever increasing and almost insatiable appetite, particularly by China, for commodities.

Market volatility continued to be the feature of investment markets during 2005–06 with the Australian Stock Market reaching record highs during the year; the Headline All Ordinaries Index reaching the 5000 point barrier for the first time and achieving a record 5,366.21 points by 11 May 2006. International markets also returned strong performances with the positive global outlook reflecting expectations for continued growth in the United States, strong growth in China, increasingly solid growth in Japan and continuation of the moderate recovery under way in Europe. On an annual basis the Australian market outperformed world markets for the sixth consecutive year.

However, during May and June a significant proportion of those gains were given up as the global sell-off of shares and commodities gathered pace in response to higher than expected inflation in the US and increases in interest rates by the Federal Reserve - to a five year high of 5% with further rises predicted in order to keep US inflation in check. This downturn in expectation spread to other regional markets with all major markets retreating in May and June. By 30 June the All Ordinaries Index had fallen to 5,068.88 points, or by approximately 5.5%.

As the 2006-07 financial year began, the decline in world markets has continued as Middle East violence pushed oil prices to a record high and drove investors to safe haven assets such as bonds and gold. It is this volatility in listed equity markets which led the MilitarySuper Board to develop its revised investment strategy in 2004. This has at its heart a considered move away from traditional reliance on market generated returns. This is being done by introducing into the portfolio a range of alternative investments whose return characteristics are not directly correlated to those of listed equities. The objective being to provide to members consistent investment returns in most, if not all, market conditions.

A growing number of Australian superannuation funds have moved to adopt similar strategies. As a result, the year saw increasing demand and opportunity for investment in non-listed investment classes such as Private Equity and Infrastructure, areas of investment in which MilitarySuper has participated for some time.

Those elements of the MilitarySuper Fund which are exposed to listed equity markets have shared fully in that market generated return. Importantly in our international equity portfolio the new managers appointed by MilitarySuper have consistently outperformed the market, notwithstanding the impact that currency movements have on international investments.

The absolute return objective set for the Growth (default) options is 10% net of all fees, taxes and expenses. The return of 15.7% (net) achieved for 2005–06 is consistent with that objective, notwithstanding that the Fund is still in the process of transition to the new range of alternative assets which will underpin the long-term investment strategy for this option.

The four other investment options are already fully exposed to the new asset classes and therefore their returns reflect the long-term return expectations for those options; with the High Growth option returning 18.2% (Net) for the year.

**Table 2: returns achieved by each investment option**

Option	Net %	Gross %
Cash	5.73	5.76
Conservative	9.43	11.34
Balanced	13.97	16.54
Growth	15.70	18.60
High Growth	18.20	21.40

The negative returns achieved by the Fund in 2001–02 and 2002–03 had a significant impact on average fund investment returns over the last five years. However, since inception in 1991 the Fund has achieved an average return of 8.25% in the Growth Option. This compares favourably with the Fund's investment objectives at that time of achieving returns of CPI + 4%.

Table 3 shows the percentage return on investments achieved in each sector, compared with the benchmark for that sector. Effective asset exposure takes into account the impact on liquids/cash holdings of derivative positions held in international shares.

**Table 3: investment performance by sector 2005–06**

Sector	Effective exposure at 30 June 2005		Effective exposure at 30 June 2006		Performance 2005-06	
	\$m	%	\$m	%	Fund <sup>1</sup>	Benchmark <sup>2</sup>
					%	%
Cash	286	17	71	3	5.8	5.8
Debt instruments	-	-	210	9	8.6	5.8
Property	170	10	190	8	10.6	16.8
Australian Shares	513	29	584	26	22.8	24
Private Equity <sup>3</sup>	91	5	218	10	22.8	NA
International Shares <sup>4</sup>	478	27	623	28	19.9	17.4
Uncorrelated Alpha	128	7	175	8	13.4	10
Infrastructure	78	5	168	8	23.3	10
Currency	6	0	-7	0	NA	NA

1. Figures shown are gross of management fees and tax.
2. The benchmark return for an asset class represents the minimum performance objective, assuming that all dividends and interest payments are reinvested in the market.
3. Private equity is a long-term investment and does not generally show a return in the early years of the investment because of set-up and management costs. The investment gains usually come in the later years as the underlying companies mature and increase in value. The effect of this timing is known as the J-curve Effect.
4. All international currency exposures are fully hedged back to the Australian dollar.

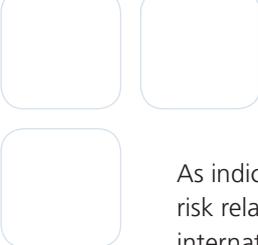
## returns from listed equity markets

### international equities

Investments in international markets carry two distinct forms of risk; one related to the impact of local market forces on the underlying value of the investment in local currency terms. The second relates to the value of that same investment when viewed in Australian dollars (AUD) terms due to movements (both positive and negative) in international currency exchange rates.

During 2005 and 2006 MilitarySuper continued the process commenced in 2004 to identify equity managers with demonstrated skill and successful track records in outperforming the relevant market. Such managers seek to add value by pursuing active management strategies, often over a highly concentrated portfolio of stocks.

The new managers appointed by the Board in this sector posted strong returns for the year, out performing the benchmark (MSCI World ex Australia Index) by an impressive 4.8% on an unhedged basis and 2.5% on a fully hedged basis.



As indicated above investments in international markets carries an additional risk related to the value of overseas investments as a result of movements in international exchange rates. MilitarySuper employs a 100% hedge over the Fund's exposure to overseas currencies whereby that exposure is adjusted regularly through use of currency forwards. This is done in order to minimise losses when the overseas currency loses value (against the AUD) but allowing the Fund to participate in growth when the currency increases in value. The AUD declined slightly against the major currencies for much of the year and resulted in the hedge detracting slightly from potential performance assuming the Fund's preparedness not to insure against currency risk.

On a fully hedged basis the contribution made by the International Equities portfolio to the gross overall Fund performance was 19.9% for the year.

Importantly the new manager configuration has significantly outperformed the old, consistent with the Board's belief that it is possible to add value through use of active management. With the new manager configuration the Fund is well placed to take advantage of any upswing in growth and any recovery in the small cap end of international markets (that is, companies listed outside the top 100 shares on a stock exchange) particularly in the US.

### **Australian equities**

As with the International Equities portfolio, MilitarySuper has appointed a range of new investment managers in the domestic equities sector over the past two years. The new manager configuration is comprised of a large number of smaller (in terms of assets under management) managers. Several of these are classified as broad market managers, two are long-biased managers and two specialise in small companies.

Their combined management styles are best suited to periods of falling markets and, whilst the gross return of 22.8% achieved for the year was impressive, it was nonetheless 1.19% below the strong returns of 24.0% achieved by the benchmark S&P/ASX 300 Accumulation Index.

Going forward the Fund believes that the new managers will provide increased opportunity to achieve above benchmark returns reflecting the concentrated and index insensitive approach of the individual managers.

The contribution made by this sector to overall Fund performance for the year was 22.8%

### **property**

In the finance industry, property usually refers to real estate, including land and buildings that can be bought, sold or leased. A Property Trust is a collective investment vehicle which owns a portfolio of real property, thus providing for

a wider spread of ownership. Listed Property Trusts are quoted on the stock exchange, and their prices fluctuate with supply and demand. Unlisted Property Trusts are transacted directly with the Trust's manager, who sets prices in relation to the asset backing of the trust based on independent valuation.

Many property investments have fixed income streams attached to them that ensure a minimum level of return on the investment, unaffected by movements in investment markets. Accordingly, many property investments will exhibit characteristics similar to traditional defensive assets.

Consistent with its strategy of moving away from reliance on listed markets, during 2005-06 the Fund replaced its exposure to property through listed equity trusts with direct exposure via co-investment opportunities both domestically and internationally. These opportunities enable the Fund to take both equity and debt positions in both property development projects and in established property investments. The equity exposure provides opportunity for high rates of return via capital growth, whilst the debt exposure provides access to long-term sustainable cash flows.

The Fund's most recent investments have been in an office and retail development project in Queensland and co-investment involving holdings in some 60 residential complexes spread across 22 states in the USA. Although the Fund is yet to see the benefits of capital appreciation from these investments the contribution to overall gross Fund performance for the year was nonetheless 10.6%.

## **infrastructure**

Infrastructure involves investment in the development of facilities and services required by the community and for production, such as government buildings, airports, toll roads, power, telecommunications and water supply.

Investment in infrastructure may take the form of investments in start-up projects or in established facilities. Investments in the latter provide access to strong cashflows and potential for future capital growth. Therefore, this form of investment displays similar defensive characteristics to more traditional defensive assets.

The Fund continues to develop its exposure to this asset class as suitable opportunities arise. However, this is being done in a measured way to ensure that the Fund's exposure is achieved through access to high quality assets.

The Fund's existing infrastructure investments have continued to post impressive results; with the exposure to Brisbane Airport via the Colonial First State Airports Fund returning 27.96% for the year and the investment in the ANZ Energy Infrastructure Fund returning 20.27% for the six months to 30 June 2006.



Although it is too early to see meaningful returns from the Fund's most recent investments in the US Power Fund and its co-investment in the CDX acquisition (CDX is a large petroleum and gas exploration company in the USA), the Fund expects these investments to post strong returns through capital appreciation.

Importantly with infrastructure investment the Fund has access to co-investment opportunities through its established relationships. These co-investment opportunities will enable the Fund to participate in investment projects not normally available to superannuation schemes, offering access to superior long-term capital growth and stable cashflows.

This sector produced an overall return of 23.3% (Gross) for the year.

### **private equity**

Private equity is generally described as acquiring an equity interest in an unlisted company or enterprise. This type of investment usually refers to investments in relatively small, unlisted companies which have an established track record in their field of business and which require new sources of funding to finance their expansion. This contrasts with venture capital, which in Australian usage tends to refer to investments in start-up companies only.

Private equity investments offer extremely attractive long-term risk-adjusted return characteristics consistent with the absolute return focus of the Fund's new investment strategy. This type of investment has return characteristics which are of a growth nature.

The Yale University Private Equity program, one of the first of its kind, is generally regarded as among the best in the institutional investment community. The University is frequently cited as the role model by other investors pursuing this asset class. Since the inception of its program in 1973, private equity investments have generated a 30.7% annualised return for the university.

Private equity is a long-term investment and does not generally show a return in the early years of the investment because of initial set-up and management costs. The investment gains usually come in later years as the underlying portfolio of companies mature and increase in value. This timing is known as the J-curve effect.

The Fund made its first investment in Private Equity in 2000 and has since made regular additional commitments to this asset sector, both domestically and internationally.

As the initial investments are maturing, the Fund is now starting to see the benefits from this asset class, with significant returns starting to flow back to the Fund. Indeed at the portfolio level Private Equity investments provided a return

of 22.8% for the year; with the Fund's domestic private equity investments in particular continuing to provide strong returns.

The Fund's more mature international private equity investments are also starting to provide strong returns, although in 2005-06 these have been diluted somewhat by the impacts of currency exchange.

### **uncorrelated alpha**

This asset class involves investment in a range of assets whose performance is not directly correlated to the performance of listed equity markets. This type of investment includes investments in real assets (eg, timberland) or in hedge funds which can act as a powerful diversification tool and a generator of strong returns.

Such investments also display characteristics which are of a growth nature but with returns which are not directly correlated with performance in listed markets.

This sector produced an overall return of 13.4% (Gross) for the year.

## **fund growth**

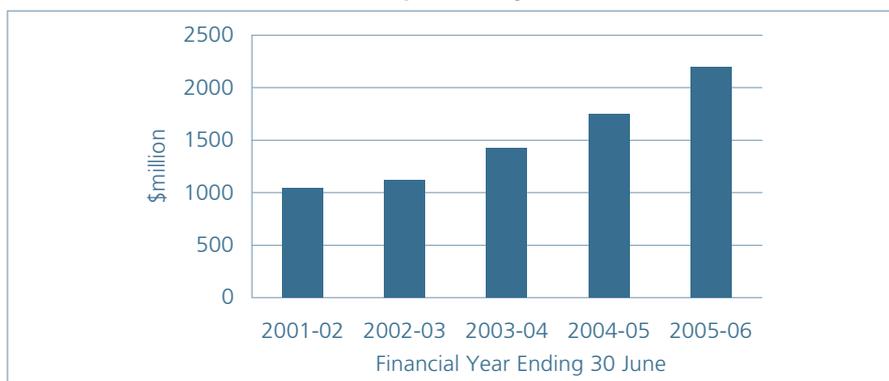
Fund assets available for investment at 30 June 2006 totalled \$2.232m.

After accounting for non-investment related assets and liabilities the net assets available to pay benefits was \$2.216m, a 26.7% increase from 2004-05 (see Table 4). Chart 1 shows how the Fund has grown since 2000-01.

**Table 4: Fund net assets at 30 June 2006 (after tax, charges and benefits)**

		\$m
<b>Opening value of the Scheme as at 30 June 2005</b>		<b>1,749</b>
Plus income		
Contributions		369
Gross earning of the Scheme		335
Other income		4
Less outgoings		
Benefits paid		(187)
Tax benefit/(expenses)		(30)
Expenses and charges		(24)
Closing value of the scheme as at 30 June 2006		2,216
		\$m
<b>Value of investments at 30 June 2006</b>		<b>2,232</b>
Asset under management		
Cash		71
Debt instruments		210
Property		190
Australian shares		584
International shares		623
Private equity		218
Infrastructure		168
Un-correlated alpha		175
Currency		(7)
Total investments		2,232
Net liabilities <sup>1</sup>		(16)
Net assets available to pay benefits <sup>2</sup>		2,216

1. MilitarySuper net assets / (liabilities) represents benefits payable, tax provisions and cash at bank.
2. The value of the Scheme represents the investments of the Scheme. Net assets of the Scheme shows the amount available to members at 30 June after allowing for tax, cash at bank and benefits payable to former contributors.

**Chart 1: fund size at 30 June for past five years**

**Table 5: investment managers as at 30 June 2006**

Asset Class	Investment Managers#	Investment \$m	% of Fund
Cash			3.16
	National Australia Bank	17.083	
	Cash Holdings - International	41.428	
	Cash Holdings - Australian	12.005	
Debt Instruments			9.39
	Credit Suisse Cash Enhanced Fund	102.435	
	Allco Transport Leasing	37.854	
	Babcock & Brown Mezzanine Debt	57.224	
	Yellow Brick Road Debt	12.050	
Australian Shares			26.16
	MS SG Hiscock Small Co Trust	21.099	
	K2 AUST ABSOLUTE	43.277	
	PM AUSTRALIAN OPP	75.992	
	Herschel Index Insensitive	29.079	
	JM Australian Equities	80.388	
	MIR Australian Equities	68.600	
	Challenger Australian Equities	82.696	
	Tyndall Australian Equities	65.996	
	AXA RBERG Aust Eq long	51.571	
	Acorn Australian Equities	23.732	
	BGI Equity market Neutral Fund	41.308	
International Shares			27.93
	Hotchkis & Wiley International Equity	44.581	
	T Rowe Price International Equity	38.228	
	Sterling Johnston Small Cap US	19.213	
	Gardner Lewis Long Short US	44.214	
	Artha Emerging Markets	18.194	
	Causeway Large Cap Sub Portfolio	91.231	
	Acorn Australian Equities	1.625	
	BGI Australian Equities	0.831	
	MIR Australian Equities	3.520	
	Tyndall Australian Equities	6.441	
	Wentworth Hauser Viliach	80.952	
	Globeflex Capital Intl Equity	66.547	
	Herschel Index Insensitive	4.345	
	Driehaus Mid Cap Recovery	41.855	
	Doughty Hanson EU Real Estate	3.244	
	Driehaus International Equity	15.530	
	Sterling Johnson Micro Sml	34.674	
	Trust Company West Large	108.107	

Asset Class	Investment Managers#	Investment \$m	% of Fund
Property			8.50
	Allco Wholesale Property Fund	20.052	
	MSBS Property Trust	0.010	
	Fiduciary Int Real Est Fund	6.516	
	Macquarie ICA Property 4	8.196	
	APN Development Fund 1	2.840	
	Ex Acorn Australian Equities	0.833	
	BGI Australian Equities	4.903	
	Challenger Australian Equities	6.542	
	Herschel Index Insensitive	1.309	
	JM Australian Equities	5.629	
	MIR Australian Equities	14.946	
	Tyndall Australian Equities	3.073	
	MSBF Charter Hall Opportunities 4	1.312	
	Domaine Property Fund	39.860	
	Babcock Brown Alliance JV	70.931	
	Ashington Property Fund	2.688	
Non-correlated Alpha			7.85
	BGI Equity market Neutral Fund	44.089	
	Harris Alternative Aurora 2	36.825	
	Deutsche/Colonial First State Link Note	32.555	
	Rabobank/ Van Hedge Linked Note	31.319	
	Mazuma Structured Note	30.287	
	BGI Tot Return GI Eq Mkt Neut	0.004	
Infrastructure			7.55
	US Power Fund II	12.611	
	ANZ IS Energy	44.755	
	Macquarie Global Infrastructure 1	16.496	
	Macquarie Global Infrastructure 2B	26.233	
	Saltbush Parking Services	21.713	
	Colonial First State Infrastructure	19.871	
	TCW CDX Acquisition	26.825	

Asset Class	Investment Managers#	Investment \$m	% of Fund
Private Equity			9.78
	Babcock Brown Direct Investment	31.224	
	Champ Ventures Investments Trust 5	6.589	
	Crescent Capital Partners II	2.789	
	Deutsche Private Equity No.2	4.342	
	Deutsche Private Eq Part Paid	1.494	
	Gresham Private Equity Fund 1	2.815	
	Gresham Private Equity Fund 2	4.662	
	GS Private Equity Fund 3	4.717	
	Pacific Equity Partners Fund 2	18.172	
	Credit Suisse FB Bermuda	7.453	
	YBR Feeder Limited Partnership	24.013	
	Pantheon Europe III Partnership	2.413	
	Pantheon USA IV Partnership	3.083	
	Pantheon Gbl Sec II Partnership	8.648	
	HarbourVest IV	15.719	
	HarbourVest VII Buyout P'ship	9.543	
	HarbourVest VII Venture P'ship	7.140	
	HarbourVest VII Mezzanine P'ship	5.738	
	Northgate Private Equity Part II	7.028	
	Rosemont Partners II LP	3.616	
	Sentient Global Resources 1	5.821	
	Siguler Guff Bric Opp Fund	7.128	
	TCW Shop 5	10.219	
	Rosemont Cadence LLC	6.641	
	NBC Private Equity	2.174	
	GBS Bioventures III	1.302	
	Champ Buyout II Trust	3.199	
	Champ Ventures Investment Trust 6*	0.000	
	Pacific Equity Partners Fund 3	7.466	
	Citic Allco Investments Ltd	0.047	
	HarbourVest Intl Eq PR V LP	2.070	
	Northgate Venture Partners III LP	1.006	
Currency			(0.32)
	Bridgewater Associates Curr	(4.537)	
	FX Concepts Currency Managers	(0.065)	
	Pareto Partners Currency Mgrs	(2.044)	
	Pareto Ccy Alternative Overlay	(0.370)	
<b>Total Assets</b>		<b>2,231.6</b>	<b>100</b>

# An organisation that specialises in the investment of a portfolio of investments which may be by way of individual portfolio or as a pool of investments. Investment Managers include Fund Managers, Trusts and limited liability partnerships.

\* Calls against capital commitments for these investments had not been made as at 30 June 2006.

## unitisation

The MSB Fund was unitised with effect from 1 July 2002. Unitisation refers to the conversion of member interest bearing accounts to unit based accounts within the Fund. Since 1 July 2002, Fund earnings have been reflected in a change in the value of a unit.

Members' closing account balances as at 30 June 2002 (after the application of the crediting rate for 2001–02) were converted to units, with each unit having a value of \$1.00 at 30 June 2002. This unit holding became the members' opening balance with the introduction of unitisation on 1 July 2002.

From 1 July 2002, contributions to the MSB Fund have resulted in the issue of new units at the issue price for the day the money is received by the Fund. Benefit payments result in the withdrawal of existing units at the withdrawal price on the day the completed application for payment is received (but this can be no earlier than the day after the applicant ceases to be a member of MilitarySuper).

The most current issue and withdrawal prices are provided on the MilitarySuper website for the information of members. The unit prices at 30 June 2006 are provided in Table 6. If there is a difference between the unit price figures on the website and what is on the Scheme's administration system, the figures in the administration system apply.

**Table 6: unit prices as at 30 June 2006**

Strategy	Price \$	% change YTD*
Cash	1.151684	+5.7047
Conservative	1.275052	+9.5070
Balanced	1.459212	+14.2185
Growth	1.457119	+15.4592
High Growth	1.589921	+17.6102

Daily unit prices are struck for each day of the year on the basis of the market value of listed investments on the previous day's close of trading, and on the basis of the best available valuation data on non-listed investments. Provisions are also made for taxes, fees and expenses on the income derived from those investments on a daily basis.

Non-listed investments by their nature are illiquid and the true value of these investments is determined on the basis of periodic independent valuations or as a result of a sales event.

\* At the end of a financial year Fund performance is calculated on the basis of "hard close" data which only becomes available some time after 30 June. Given this timing difference the unit price for each investment option declared for 30 June may vary from the investment performance of that option subsequently determined on the basis of fully audited accounting and taxation information.



# governance

- > corporate governance statement
- > business plan
- > administrative agreement
- > delegations
- > Board committees
- > status under the SIS and corporations legislation
- > evaluation



*During the year the Board continued to give particular attention to processes supporting decision-making, accountability and standards of service.*

## corporate governance statement

The MSB Board is constituted under the *Military Superannuation and Benefits Act 1991* (MSB Act) and the associated Trust Deed and Scheme Rules. The Board stands independent of the government of the day and independent of any other constituency. It is accountable to the members of the Scheme under the MSB Act, under the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) and under general corporate legislation. The principal responsibility of the Board is to act in good faith, with prudence and in the members' best interests in respect of the investment and administration of the Scheme.

### Principal duties

The Board's principal duties are to:

- manage and invest moneys to meet the purposes of the Scheme;
- ensure the scheme is administered in accordance with the scheme rules and regulatory obligations;
- cause the payment of moneys in and out of the Scheme to occur as prescribed;
- safeguard the assets of the Scheme and the interests of the beneficiaries;
- inform all relevant parties of the Scheme's condition and conduct; and
- cause proper records and accounts to be maintained about the operation and financial activities of the Scheme.

In undertaking these duties, the Board has wide discretions. However in pursuing its responsibilities it is essential that the Board, its officers, employees and delegates act at all times in a manner that is appropriate to the fiduciary duties owed to the members.

The following statement sets out the principles which the Board, its officers, employees and delegates are intended to uphold as they each carry out their duties.

The Board does not intend this statement to be read as a strict set of rules, where each word is scrutinized for its legal meaning. It intends to convey in plain words the obligations placed on, and the behavior expected of, both trustees as individuals and those other persons covered by this statement. The Board reviews this statement annually, and updates or expands it as appropriate to ensure it remains effective and current.

## **Governance matters outside the Board's control**

The Board does not control its own composition or its own remuneration. The power to appoint Board members is vested in the Minister Assisting the Minister for Defence under the Act, subject to consultations specified in the Act. The Board has, however, as part of its application for its APRA licence documented the skills and experience necessary for the Board as a whole to meet the “fit and proper” operating standard. When individual Trustees are being replaced consideration has to be given to the knowledge gap left by the departing Trustee and this is taken into account by the Department of Defence in sourcing a replacement.

The Remuneration Tribunal sets the remuneration of Board members, including their remuneration for committee representation and expense reimbursement.

## **General governance principles**

The Board's own behaviours reflect its overriding general governance principles, and where appropriate, mirror the behaviour which the Board expects from companies in which the Board invests and with whom it has commercial dealings. The Board's duties must be carried out in good faith, prudently, and in accord with the relevant legislation so that the best interests of the members are served.

The Board must at all times act ethically and impartially. No person covered by this Statement may place their own interests above that of the members in respect of the fiduciary duties owed to the members. Trustees and Board staff are expected to avoid placing themselves in situations of perceived or actual conflicts of interest. Where such situations do occur they are to be resolved in accordance with the Board's policy for managing conflicts of interest.

The Board's responsibilities for the Fund and the Scheme are supported by business planning, business risk assessment, management reporting, and arrangements for audit, internal control and compliance, all conducted on a regular basis. The Board's appointments and delegations (including appointments and terminations of authorised representatives) are in writing and the Board regularly reviews its own activities and the activities of the persons through whom it works, to ensure that a clear and proper set of accountabilities remains in effect. The Board undertakes an annual review of its performance.

## **Continuing qualifications and disclosure of interests**

Board members must lodge, on appointment and annually thereafter, a Disclosure of Interests Statement and a Declaration of Related Party Transactions. Board members are required to advise no later than the start of the next Board or Committee meeting:

- If any event has changed their continuing compliance with the trustee qualification requirements set out in the *Superannuation Industry (Supervision) Act 1993*; or
- If any agenda item requires a disclosure of interest; or
- If any change in their business relationships has occurred that might have a connection with the Board's duties or activities. In accordance with the Board's policy for managing conflicts of interest where a Board member has a conflict of interest in respect of any matter, that member will not engage in discussion of or decision on the matter.

The Board's responsible officers under its Australian Financial Services licence (Chief Executive Officer and Compliance Manager) must certify on an annual basis that there has been no change to their circumstances, including loss of professional qualifications, impacting on their suitability as Responsible Officers. In addition the Board Secretary and Investment Analyst must certify on an annual basis that they have not lost any professional qualifications.

## **Confidentiality**

Board members are required to keep confidential all information or material provided or made available to them, dealing with or related to their functions as Board members, except where such information or material is publicly available or is required by law to be disclosed. Board members continue to be bound by this obligation of confidentiality after they cease to be a Board Member.

In this context, 'Board members' include persons appointed to the Board, staff employed by the Board, service providers to the Board, and any person to whom Board papers, documents or information is made available.

Communications, contracts or arrangements between the Board and service providers will generally be entered into on a 'commercial-in-confidence' basis.

## **Legal professional privilege**

The general policy of the Board is that legal advice provided to the Board for the performance of its functions and duties will not be made available or disclosed.

## **Securities dealing**

The Board is mindful of its obligations under the law to not misuse non-public information of which it becomes aware in the course of carrying out its duties. Board members will maintain appropriate records of their dealings in securities and will provide a copy of these records to the Board Executive Unit if requested by the Board.

This requirement applies to the Board's staff, and any other persons connected with the Board who have access to the investment information of the Board.

## **Gifts and entertainment**

As a general principal Board members should decline or disclose instances of repeated or significant entertainment or gift from any service provider. Board member contact with current and potential service providers is recognised as useful to enhance the knowledge and understanding of the Boards. It is recognised that service providers to the Board provide modest entertainment and small gifts from time to time. Details of gifts or entertainment that are more than a token must be supplied to the Board's Chief Executive Officer for inclusion in a register. The Board's policy on Managing Conflicts of Interest forms part of the Board's Code of Conduct and provides guidance on how to determine whether a benefit is more than a token.

## **Insurance**

The Board will maintain insurance in respect of its own actions and in respect of past Board members in order to protect the interests of Scheme members and the assets of the Fund.

## **Board committees**

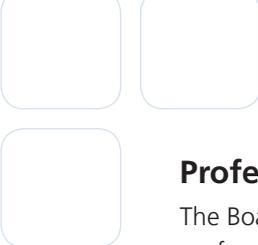
The Board has constituted several committees to increase its own efficiency and to provide a means of more detailed consideration of matters important to the running of the Scheme. The governance structures and processes of the Board's committees include formal risk management and reporting arrangements. These reinforce the commitment of the Board to scrutinize its own processes to ensure transparency in identification of conflicts and separation of functions. Board committees are subject to written terms of reference and care is taken to ensure the activities of each committee remain consistent with the Board's duty of governance over the Scheme's activities.

Each committee reviews its performance annually and the Chair of each committee reports to the Board following each review.

## **Meetings and agenda**

The Board meets at least six times each year and ensures that it receives appropriate and reliable reporting on the condition of the Scheme and the actions of its staff, delegates and other service providers.

Although the Board's agenda is initiated by the Board Executive Unit on behalf of the Board, the Board or any Board member may require a matter to be brought before the Board at its next or any subsequent meeting.



## Professional development

The Board's policy is that Board members and staff should engage in continuing professional activities relevant to the operation of the Board as a whole and their individual Board member or staff duties. This is an essential component of the Board's obligations as the APRA licensee of a registered superannuation fund. The Board provides organisational and financial support for such professional development activities.

Professional development activities may include local and international conferences, seminars and workshops, training courses and study tours on specific matters relevant to the Board's functions. Once a year the Board will consider attendance to the major industry conferences (both in Australia and overseas) to be held over the forthcoming year.

Board members and staff who undertake professional development activities are expected, where appropriate, to provide reports to the Board and to distribute relevant papers to other Board members and staff. The Board also encourages Board members to be members of relevant professional bodies such as the Australian Institute of Superannuation Trustees and the Australian Institute of Company Directors and meets the costs of such memberships.

## Managing conflicts of interest

Wherever possible, Trustees should avoid placing themselves in situations where conflicts of interest might result. However, Trustees and committee members, particularly the investment committee may have personal investments and business interests/activities outside their Fund responsibilities. The Board has adopted a code of conduct to form the framework whereby Trustees and other Committee members may continue their personal and/or non-fund interests and activities while ensuring there are no conflicts of interests and no personal activities are based on confidential information acquired as a consequence of Fund activities.

The strategies which the Board has adopted to manage conflicts of interest require that Trustees and members of the Board's Committees must disclose any related interests and must not engage in activities or employment which may result in, or create the perception of :

- Using the influence of their position with the Fund for the member's personal financial gain or advantage, or for the gain or advantage of another party;
- Using confidential information acquired as a consequence of Fund activities for the member's personal financial gain or advantage of another;
- Being unduly influenced by a member's personal or other non-Fund interest.

Those Trustees who are members of the Investment Committee must confirm at the commencement of each calendar year that they will declare any interest in an investment (actual or potential) being considered by the Investment Committee.

The Trustees are also aware of their obligations under the law not to misuse non-public information of which they become aware in the course of carrying out their duties. The Board and the Investment Committee will maintain appropriate records of their dealings in securities.

## Whistleblower protection

Trustees and employees of the Board are encouraged and have a responsibility to report any matters that they believe, on reasonable grounds:

- to be a breach of Corporations Law;
- may cause financial loss to the Board;
- may damage the Board's reputation; or
- any behaviour that is not in keeping with the Board's code of conduct.

The Board is committed to protecting all genuine whistleblowers against reprisal action. The Board's commitment is enhanced by the *Corporations Act* which provides a regime for persons making what are called "protected disclosures". These are disclosures relating to breaches of the Corporations Law made in good faith and on reasonable grounds provided that certain criteria are met. These criteria are reflected in the Board's policy. Neither the Board's commitment nor the statutory protection extends to shielding whistleblowers who themselves are involved in the reported improper conduct.

The intention of the Board's whistle blowing policy is to encourage:

- (a) effective compliance with relevant laws;
- (b) efficient fiscal management;
- (c) healthy and safe work practices; and
- (d) effective management, including unbiased decision making.

The Board's Code of Conduct outlines the Board's principle statutory obligations and documents standards required of Trustees and also staff of the Board. While the Board cannot offer statutory protection to those who report a breach of the Board's Code of Conduct as distinct from a breach of Corporations Law it is, nonetheless, the Board's intention that Trustees, staff of the Board and contractors should be able to report in good faith and on reasonable grounds suspected breaches of the Board's Code of Conduct without fear of reprisal.



## business plan

The Board's Business Plan sets out the main objectives of the MSBS. For each of the significant spheres of investment, administration, communications and corporate governance, the plan identifies the desired outcomes, performance indicators and monitoring arrangements.

The Business Plan identifies areas of Board responsibility and accountability and articulates the framework of internal and external governance measures employed by the Board to ensure that those responsibilities and accountabilities are properly discharged. The Plan has also been developed as a means of clarifying the roles and functions of the MSB Board and its service providers. It identifies environmental and other factors which will impact on the Board's responsibility for the administration of the Scheme and the management and investment of members' moneys which comprise the MSB Fund. The Board's approach to control of the main business risks is also covered.

From an investment perspective the Plan has regard to the current membership and liabilities of the Scheme and makes some assumptions regarding the future growth of the scheme given the ever-changing superannuation environment. As such it provides the basis for monitoring long-term Fund performance having regard to market influences and the changing demographics and needs of Scheme members.

The Board reviews its business plan each year.

### directions for 2005–06

Key features of the Board Business Plan for 2005–06 included:

- Continuing the process commenced in 2004 to implement the Fund's long-term investment strategy by introducing alternative investment approaches and strategies aimed at providing improved opportunities for achieving sustainable above benchmark returns.
- Continuing to improve the content of half yearly mail outs to members and monitor the effectiveness of the program in educating and informing members about the Scheme and changes to investment strategy.
- Reviewing the ongoing effectiveness of arrangements for the provision of investment advisory and portfolio management services.
- Continuing to develop in-house capabilities for the implementation of investment decisions, Treasury management and for performance monitoring and reporting.

- Monitoring the impacts of the new investment strategy on the exercise by members of Investment Choice. In particular monitor the impacts of Choice on the liquidity requirements of the Fund in the event of any large scale move by members out of the Growth Strategy and into the more conservative options.

## administrative agreement

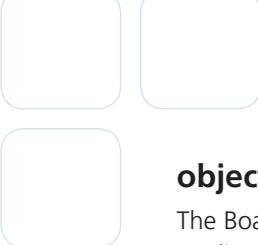
The Commissioner for Superannuation and, through that office, Commonwealth Superannuation Administration (ComSuper), is the legislated provider of administration services to the Board. The cost of these services is met by the Department of Defence.

Recognising that it is not currently possible to create any legally binding or enforceable arrangements between parties, during 2005 a service level agreement was negotiated covering arrangements between the Defence Organisation (comprising the Department of Defence and the Australian Defence Force), the MSB Board and ComSuper. This agreement reflects the shared understanding of the commitments each of the parties is providing under the agreement. These are matters which would otherwise be reflected if the parties were able to contract with each other.

An important factor impacting on the achievement of Scheme objectives is the financial environment within which the Scheme is administered. Under the MSB Act, the costs of administration of the Scheme, other than the costs of and incidental to management and investment of the MSB Fund, are met from moneys appropriated to the Department of Defence. The Department in turn purchases administration services from ComSuper.

During 2004 an issue arose which drew attention to the legislated nature of the Board's relationship with the Commissioner for Superannuation and through him staff of ComSuper. That issue, and subsequent legal advice, focused attention on the extent of the indemnities provided to the Commissioner and ComSuper under the MSB Act and Trust Deed and the extent to which the Board and the MSB Fund are responsible for the financial implications of acts done or omitted to be done by the Administrator.

As a result of actions and representations initiated by the MSB Board, the MSB Fund has been granted a temporary indemnity by the Department of Defence in respect of acts or omissions on the part of the administrator which give rise to financial loss by the Fund pending amendment to the MSB Act to provide a permanent solution.



## objectives

The Board's administration objectives are to have continuing access to high quality, cost effective administration services which meet the needs of the Board and members of the Scheme by:

- Having executive support services which efficiently and effectively respond to the Board's needs;
- Delegating Board powers and functions under the Act and Trust Deed to ComSuper, in order to facilitate good service to members;
- Having arrangements with its major service providers which ensure that each party is accountable for their own acts and that the assets of the MSB Fund are protected;
- Having access to ongoing sources of funding to ensure that the costs incurred directly by the Board in pursuit of its responsibilities for the administration of the Scheme, other than in respect to its responsibilities for the management and investment of the MSB Fund, are met by the Department of Defence.
- Having processes in place which enable the Board to influence the standards of services provided to members;
- Managing key relationships with stakeholders and service providers; and
- Clear-cut and streamlined administration at competitive costs commensurate with above average service levels.

## delegations

The Board has delegated the majority of its general administrative powers and functions to the Commissioner for Superannuation and to ComSuper staff.

The major areas of delegation include the maintenance of membership records, the receipt of member and employer contributions and the calculation and payment of benefits.

Certain powers are retained by the Trustees. These include reconsideration of decisions and cases involving the application of the legislation which produces a result not in keeping with the spirit of the legislation.

# Board committees

## Audit and Risk Management Committee

The Audit and Risk Management Committee is a subcommittee of the full Board. During 2005-06 the Committee comprised Dr Michael Sharpe (Chairman), WOFF Robert Swanwick and Mr Felix Bleeser.

The Committee was established to advise the Board on accountability and audit-related matters. It operates as a check on the Board's own accountability arrangements as well as on the management practices of the Scheme Administrator, Fund Investment advisers and managers, the Master Custodian and other service providers.

The role of the Committee encompasses the Board's responsibilities for risk management.

Primary responsibilities of the Committee are to assure the Board that:

- its financial statements are derived from appropriate accounting systems and methods and reflect current accounting standards;
- the audit arrangements within service-providing agencies are operating effectively;
- appropriate audit and fraud control strategies are in place to protect Board and member interests; and
- proper assessment of risks is carried out for consideration by the Board.

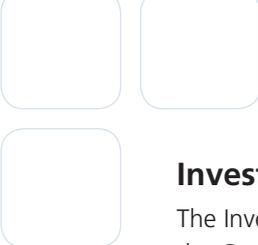
The Committee met four times during the year.

The Committee has appointed the accounting firm PricewaterhouseCoopers (PwC) to act in the role of Audit Adviser. PwC is also the Board's taxation consultant and tax agent.

In assisting the Board in meeting its prudential and fiduciary responsibilities, PwC:

- provides advice to the Board on significant industry-wide developments;
- assists in the annual review of the prudential and regulatory requirements of the Fund and the Trustees; and
- reviews annual financial statements.

At the request of the Board, PwC also undertakes specific reviews of the Board's various service providers.



## Investment Committee

The Investment Committee is a subcommittee of the full Board. During 2005–06 the Committee comprised Mr Charles Kiefel (Chairman) and Dr Michael Sharpe, although any trustee is free to attend meetings of the Committee.

The primary objective of the Committee is to act as a stimulant to the promotion of new investment ideas and concepts and to act as a filter for those investment ideas and concepts. Its primary role is to advise the Board on investment issues and related matters that are central to the Board's functions of managing and investing the MSB Fund. It acts as the point of contact and focus between the Board and its key external advisers on investment matters. For this purpose it meets regularly with the Board's primary advisers to monitor Fund performance and actions taken to implement the Board's investment strategy.

The Committee's responsibilities are to:

- keep the Board informed on matters within the Committee's authority; and
- provide analysis and advice to the Board on outcomes relating to new investment opportunities.

The Committee's responsibilities do not extend to the establishment of investment strategy or the selection of investment products or service provider (although it might advise on these issues). These responsibilities remain the province of the full Board, which may have regard to recommendations of the Committee.

The specific duties the Committee is expected to undertake in meeting its principal purpose are to:

- consider, review and advise on the Fund's investment objectives;
- consider and review the Fund's investment strategies and make recommendations to the Board;
- review and evaluate the investment performance of the Fund;
- evaluate and advise the Board on specific strategic investment proposals;
- monitor investment manager performance;
- review and evaluate the performance of asset consultants and other investment related service providers;
- evaluate appropriate investment structures for the holding of the Fund's assets and make recommendations to the Board;
- consider and advise on investment manager mandates; and

- report and make recommendations to the Board on investment matters, including risk and overlay matters.

The Committee met four times during the year.

## **Military Superannuation Communication Committee (MSCC)**

The Military Superannuation Communication Committee is a subcommittee of the full Board. During 2005–06 the Committee comprised AIRCDRE Lee Roberts (Chairman), WOFF Robert Swanwick, Mr Brian Paule (representative of the Department of Defence) and Major Ron Tattersall (representative of the DFRDB Authority) until February 2006 when he was replaced by LCDR Roz Fletcher.

The primary objective of the Committee is to act as an agent of and an advisory body to the full Board in relation to ensuring the Board meets the information disclosure requirements flowing from the Board's AFS Licensing obligations and as otherwise imposed by SIS. This is done through clear, timely and accurate reporting to members and ensuring that members are informed of Trustee decisions and other developments which may affect members' interests. It also provides a forum by which the communications activities of the MSBS can be coordinated with those related to members and beneficiaries of the DFRDB Scheme.

The Committee is, therefore, the point of communication between the Board, the DFRDB Authority, the Department of Defence, the scheme administrator and other service providers for communication issues relating to members and beneficiaries of the MSB and DFRDB schemes.

The Committee met six times during the year.

## **Reconsideration Committee**

As at 30 June 2006, the Committee comprised Mr Phil Charley (Chairman and representative of the MSB Board), Colonel M Charles (representative from a service office), Brigadier Peter Bray AM (pensioner representative), and Ms Kirsty Bunfield (representative of ComSuper). The former appointments of Brigadier David Buring AM (Chair and pensioner representative) and Mr Noel Cock (ComSuper representative) ceased in June 2006.



The Committee's role is:

- to consider requests for reconsideration of a delegate's decision made under the MSB Rules and either affirm the decision, vary it or set it aside and substitute another decision for it; and
- to make recommendations to the Board in respect of requests for reconsideration of decisions made either by itself or the Board under the MSB Rules

The Committee met on eleven occasions during the year.

## **Complaints Committee**

The powers of the Reconsideration Committee are limited to reconsidering decisions made under the MSB Rules and do not currently extend to decisions made under the MSB Act. Pending legislative change to remove this restriction, the Board approved the establishment of a Complaints Committee, with the same membership and chairman as the Reconsideration Committee.

## **Board Executive**

The role of the Board Executive Unit is to provide high level support to the Board in meeting its responsibilities for the administration of the MSB Scheme and the management and investment of the MSB Fund. The focus of the Board Executive Unit during 2005–06 continued to be on the development and enhancement of in-house capabilities in areas of governance, compliance, scheme administration and investment implementation and monitoring. This involved the assumption of functions and responsibilities previously performed on the Board's behalf by the Administrator, Custodian and Investment Portfolio Manager.

The Executive Unit continued the process commenced in 2004 of refining operating processes and procedures related to the operation of the Scheme under the new Australian Financial Services (AFS) license regime. Both the Chief Executive Officer and Compliance Manager hold appointments as Responsible Officers under the terms of the Board's AFS licence. These new requirements add a significant additional layer of compliance obligations to the Board's administration of the Scheme and change significantly the relationship between the Board and its Administrator (ComSuper). Although the MSB Act remains the primary determinant of the relationship, under the AFS licencing arrangements staff of ComSuper must be appropriately trained and, provided they meet the required competency requirements, be authorised directly by the Board under its licence to provide general financial product advice. To meet the Board's obligations as licensee, a detailed process of compliance reporting has been agreed with the Administrator by which the Board can obtain assurance that the

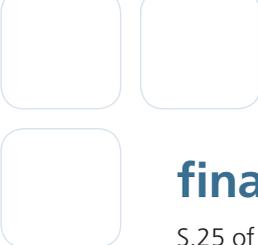
Commissioner for Superannuation (and through him ComSuper) has appropriate processes and controls in place to ensure that the Board's Licensing obligations are being met.

During 2005 the Board Executive undertook a major project to document processes and procedures required to enable the Board to successfully apply for an APRA licence and for the MSB Fund to become a Regulated Superannuation Entity. To be granted a licence the MSB Trustees had to demonstrate that they are able to comply with the SIS Act and the newly prescribed operating standards. They had also to demonstrate that there were policies and processes in place to deal with the risks associated with their operations as a trustee and the operations of the MSB Fund as a registered entity. The task involved in the preparation of documentation to support the Board's application was considerable and involved close liaison between the Board Executive Unit and the Regulator. Because the Board had resolved that it wanted to achieve licensed status as a matter of priority, Military Super was one of the first major superannuation funds to commence the application process. As a result the Board Executive Unit entered into early dialogue with the Regulator and this was instrumental in resolving issues related to the Board's ability to meet aspects of the new Operating Standards, given the legislated nature of its relationship with its Administrator. As a result Military Super was one of the first of the major superannuation funds to achieve licensed status; being granted its licence on 26 September 2005 and the Fund achieving status as a Regulated Superannuation Entity on 25 October 2005. This was well ahead of the deadline of 30 June 2006.

During 2005 the Government implemented the major recommendations flowing from the Uhrig review of Government entities, requiring Departments to review existing governance arrangements for Statutory Authorities and Statutory Office Holders in entities for which that Department has Portfolio responsibilities. Military Super is subject to that review process with the outcome of the initial review expected in the second half of 2006.

Separately the Department of Finance advised of a review of the Government's role in superannuation. The Board Executive Unit has worked closely with the Departments of Defence and Finance on both reviews which can be expected to have significant strategic implications for Military Super.

During the year the resources of the Executive Unit were expanded by the recruitment of two additional staff members. These were engaged to assist the Executive Unit in meeting the Board's significantly expanded compliance, governance and investment responsibilities; both as an AFS and as an APRA Licensee. These responsibilities and obligations are significant and ongoing.



## financial issues and budget strategies

S.25 of the MSB Act prescribes that the Board must pay all moneys received by it in respect of the Fund into an account maintained by it with a bank. Clause 9 defines the assets that comprise the Fund.

Moneys related to the administration of the MSBS are appropriated to the Department of Defence which pays ComSuper a user charge based on a charge per member. The user charge includes a component for administering the Scheme on the Board's behalf and a component for costs incurred by the Board and its Executive Unit in respect of their administrative activities. ComSuper provides the Board with a notional budget in relation to that second element, which includes moneys that are recoverable from the MSB Fund in accordance with the legislation.

The Service Level Agreement negotiated between the Board, the Department of Defence and ComSuper establishes the services and standards of service to be provided in relation to the administration of the MSB Scheme. Although the Board, through its Executive Unit, participates in and influences the level of services to be provided, the costs of delivering those services are negotiated between the Department and ComSuper. Going forward, the Board believes that this is an undesirable situation as the Board, though legislatively responsible for the administration of the Scheme, is not financially accountable for the costs of that administration. Consequently the Board is strongly of the view that it should be in a position to influence both the level and cost of administrative services provided in the administration of the Scheme to the benefit of its members. The Board will therefore continue to actively negotiate with the Minister, Government and the Department of Defence on the implementation of changes which it sees as central to the proper functioning of the Board in the discharge of its responsibilities for the administration of the Scheme.

The Administrator has recently identified a number of administrative errors which have raised concerns about the operating systems used for Scheme Administration. The Administrator has implemented manual processing for a small category of administrative functions pending the implementation of a number of system "fixes" to effect permanent solutions. Longer term it is the Administrator's intention to migrate existing legacy systems to a single operating platform covering all the Commonwealth Schemes it administers. The Board and its Executive Unit have actively supported the Administrator's submission for funding to enable this to occur, but considers the current identified shortcomings of the existing CAPITAL system, and its planned migration to a new platform, to

be areas of increased business risk to MilitarySuper. As a result the Board has revised its risk assessment and initiated an enhanced program of audit review.

As a result of the operating deficiencies in Capital, a small number of overpayments were identified going back over a number of years. The Board determined that it would be uneconomical to pursue recovery given the amounts involved and the extended period which had elapsed since the overpayments occurred. As a consequence these amounts were written-off.

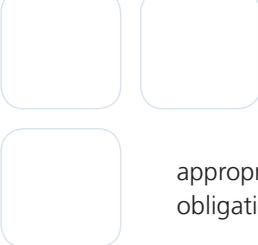
The Board and its Executive Unit have commenced discussions with the Minister, the Department of Defence and ComSuper on a process of administrative change aimed at strengthening the independence of the Board and its Executive Unit and to place the relationship between the Board and the Legislated Administrator (ComSuper) on a more arms length basis. The Board believes that ultimately this will include taking actions necessary to enable the Board to operate independently and to control its own budget and be accountable for its own non-investment related administrative expenditures.

## status under the SIS and corporations legislation

The MSBS is a regulated superannuation fund under the *Superannuation Industry (Supervision) Act 1993* (the SIS Act). The Board has established extensive compliance arrangements to ensure that operational and legislative changes are independently reviewed to assess their impact against SIS requirements and to ensure that ComSuper's practices remain in concert with the SIS legislation.

In response to the Government's Financial Services Reform initiatives the MSBS applied for and was granted (with effect from 16 February 2004) an Australian Financial Services (AFS) Licence covering the provision, by the Board and its Authorised Representatives, of general financial product advice.

These new requirements add a significant additional layer of compliance obligations to the Board's administration of the Scheme and change significantly the relationship between the Board and its Administrator (ComSuper). Although the MSB Act remains the primary determinant of the relationship, under the AFS licensing arrangements staff of ComSuper must be appropriately trained and, provided they meet the required competency requirements, be authorised directly by the Board under its licence to provide general financial product advice. To meet the Board's obligations as licensee, a detailed process of compliance reporting has been agreed with the Administrator by which the Board can obtain assurance that the Commissioner for Superannuation (and through him ComSuper) has



appropriate processes and controls in place to ensure that the Board's Licensing obligations are being met.

As reported earlier, during 2005 the Board applied successfully for an APRA Licence and the MSB Fund became a Registered Entity for APRA licensing purposes.

In accordance with its licence obligations the Board is required to report breaches to the appropriate Regulator. During the year two of the Board's service providers reported a number of administrative errors which, although of minor impact, nonetheless were required to be identified as breaches and reported.

## **product disclosure statement**

One of the key requirements of the Financial Services Reform legislation is for MilitarySuper to issue a Financial Services Guide (FSG) and a Product Disclosure Statement (PDS).

The Financial Services Guide explains what financial services the Board provides for MilitarySuper and who delivers them, and can be found on the MilitarySuper website ([www.militarysuper.gov.au](http://www.militarysuper.gov.au)).

The Product Disclosure Statement for MilitarySuper consists of the following four documents:

- The Annual Report to Members;
- Your Guide to Investment Choice;
- The MilitarySuper Book; and
- Supplementary PDS.

Together these documents describe all the main features of MilitarySuper. Members are provided with these documents on joining MilitarySuper and can obtain electronic copies of them, and order paper copies, from the website.

## **what financial product advice the Board can provide**

The Board is only licensed to provide general financial product advice. General financial product advice means that the Board has not considered the member's individual objectives, financial situation or needs in providing the information or advice. If members wish to have financial product advice in circumstances where the provider of that advice has considered one or more of a member's objectives, financial situation or needs, the member is advised to consult a licensed financial planner.

The only kind of financial product the Board is licensed to provide, and in respect of which it may provide financial services, is the Military Superannuation and Benefits Scheme (MSBS). In providing its authorised services, whether directly, or through its authorised representatives, the Board is acting for itself. Entitlement to join the MSBS, and benefits derived from it, are determined by the MSB Act and Rules.

## **general product advice provided by authorised representatives of the Board**

General financial product advice can also be provided by authorised representatives of the Board who are employees of Commonwealth Superannuation Administration (ComSuper) ABN: 77 310 752 950.

Authorised representatives are trained to provide general financial product advice in accordance with the standards set out in the Australian Security and Investments Commission's Policy Statement Number 146 (PS146).

The Board's Chief Executive Officer and Compliance Manager have been appointed 'Responsible Officers' for the purposes of the Board's AFS licence and one Trustee has successfully undertaken training to enable him to provide general financial product advice in accordance with PS146.

## **evaluation**

### **annual effectiveness reviews**

The Board conducts an annual effectiveness review of all its major outsourced service providers as part of its annual business planning process.

In addition, the Scheme's internal auditor undertakes a review of one major service provider (the Administrator, Custodian and Asset Consultant/Advisor) each year, so that all major service providers are reviewed once over a three year cycle.

The performance standards referred to in this report are those defined in the current administrative agreement notwithstanding that the higher service levels did not apply for the whole of the financial year. Performance against the standards, and the standards themselves, are the subject of ongoing annual effectiveness reviews.

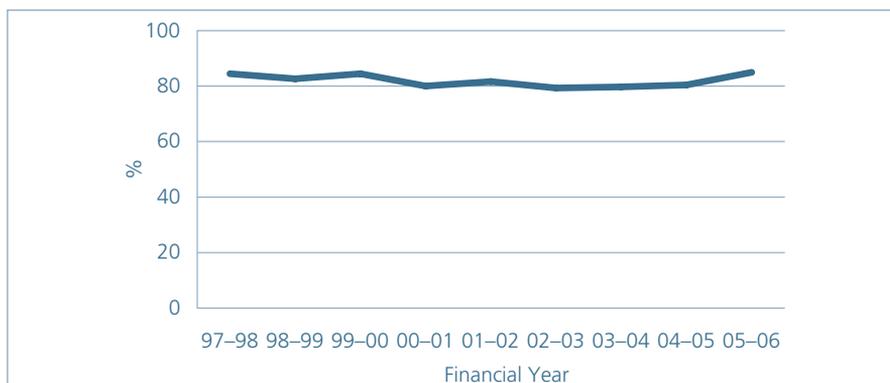
## client feedback

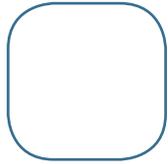
During 2005–06 the Board’s administrator continued to conduct client satisfaction surveys with the assistance of the Canberra-based firm Orima Research. Clients who had recent contact were surveyed once during the year. On a point scale of 1–10 the quality of services surveyed was consistently rated highly.

The Quality Service Index (QSI) for military clients, introduced to measure the survey results and to enable comparison between survey periods, currently ranks in the region of an 85% satisfaction level. Chart 2, which shows ComSuper’s QSI scores for the military schemes in each of the twenty survey periods since data collection began in 1997–98, shows a consistent level of client satisfaction within the 80–85% range.

The survey results feed into a continuous improvement process. Action plans are derived and reported against, and changes made to procedures as a result of the survey feedback, with the objective of improving client service.

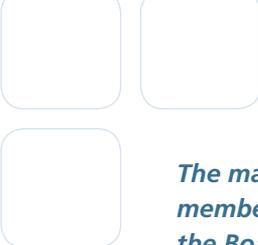
**Chart 2: Quality Service Index (QSI) scores for military client satisfaction**





# account maintenance

- > collection, recording and maintenance of member information
- > system changes
- > collection, banking, recording and maintenance of contributions remittances



*The maintenance of MSBS contributing member, preserved benefit member and pension member accounts is a major function provided by the Board's administrator (ComSuper) in conjunction with the Department of Defence. The principal aims of this function are defined by the Service Level Agreement between the MSB Board and ComSuper.*

## collection, recording and maintenance of member information

The Board's administrator:

- maintains records of contributing members, preserved benefit members and pension members to facilitate, among other things, the accurate and timely publication of member statements, accurate and timely communications, the accurate and timely payment of benefits, various reporting requirements and reconciliation against Fund accounts;
- ensures that adequate systems, procedures and controls are in place to meet the administration and reporting requirements of the Act and associated legislation;
- at the direction of the Audit and Risk Management Committee of the Board, arranges for an independent audit of those systems and controls to be undertaken from time to time; and
- maintains a system for locating and reporting lost members.

## system changes

In providing administration services to the Trustees and their members, ComSuper is critically dependant on its computerised administration platforms. Over the past four years ComSuper has made significant changes to its existing administration platforms and related business processes. These have been in response to the requirements of the FSR Act 2001; the Australian Prudential Regulation Authority (APRA) licensing regime; and the introduction of a range of new legislative and Board initiatives.

During 2005-06 ComSuper commissioned an independent risk review to gauge the ongoing sustainability of it's current systems. The results highlighted that these systems were not sustainable into the future and the level of risk increased over time. To address the risks identified during the review, ComSuper has commenced work on a strategic plan to retire and replace existing defined benefit processing platforms.

This work has culminated in the development of a detailed business case to modernise its IT platforms. This business case is currently being evaluated through the Australian Government budget allocation process in which significant additional funding is being sought. On the basis of anticipated funding ComSuper has committed to a range of risk mitigation activities to be undertaken to address short term risks.

Major work carried out on the Capital administration system for 2005-06 included:

- The introduction of functionality to allow for the cancellation of invalid memberships.
- The inclusion of ancillary accounts into the existing investment switching functionality.
- Enhancement of the ETP reporting process to include payments from ancillary accounts and ancillary memberships.
- The introduction of functionality to allow for the reversal of benefits.
- Support, fault rectification and tuning of the ongoing system.

## collection, banking, recording and maintaining contributions remittances

The basic rate of member contribution to the MSBS is 5% of salary, including higher duties and Environmental Allowance, although members can elect to contribute up to 10% of salary, and from early in 2005–06 will be able to make additional pre and post tax contributions. The employer benefit is unfunded except for the 3% productivity contribution which is paid into the Fund by the Department of Defence. Members may also be entitled to superannuation co-contributions from the Australian Government.

Total contributions to the Fund during 2005–06 were \$230.8m, of which member contributions comprised \$141.9m, as shown in Table 7. Employer contributions amounted to \$74.9m. Co-contributions received totalled \$14.0m. The net appropriation for benefits for the year was \$137.4m (\$131.5m for 2004–05).

Member and employer productivity contributions for MSBS members are remitted fortnightly and paid by direct credit to the Board's bank account.

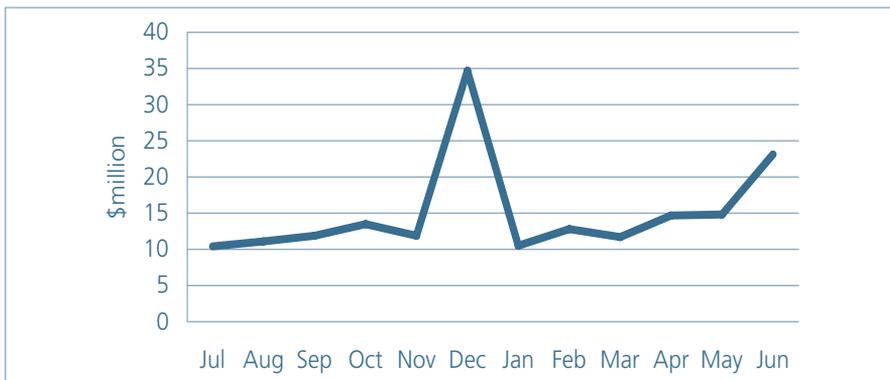
**Table 7: contributors and contributions for the past five years**

Year	Contributors at year's end	Member contributions \$m	Employer contributions \$m	Co-contributions \$m	Net appropriation contributions from Consolidated Revenue \$m
2001-02	42,703	93.2	51.6	-	119.9
2002-03	45,215	102.1	57.0	-	118.2
2003-04	46,892	112.2	62.7	-	119.7
2004-05	45,861	126.6	70.8	5.5	131.5
2005-06	46,402	141.9	74.9	14.0	137.4

As the Board's administrator, ComSuper:

- maintains appropriate banking arrangements for the payment of contribution remittances into the Fund;
- lodges moneys with the Board's custodian for investment by investment managers to the extent that moneys held in the Board's bank account are not required for the purpose of the payment of benefits and other expenses;
- maintains appropriate accounting systems for the recording of contribution remittances received; and
- monitors the collection of contributions and pursues any late remittance of contributions with the Department of Defence.

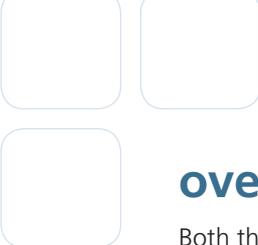
**Chart 3: MSB Fund cashflow (contributions received less benefits paid) 2005-06**





# member communications

- > overview
- > communications focus for 2005–06
- > counselling and information services
- > annual report project
- > member statements
- > mid year newsletter
- > website development



## overview

Both the MSB Act and *The Superannuation Industry (Supervision) Act 1993* impose significant responsibilities on the Board of Trustees in relation to communications with members.

The Board has established the Military Superannuation Communication Committee (MSCC) to ensure the effective and timely provision of quality information and education on superannuation matters to ADF members. Membership of MSCC includes a representative from the DFRDB Authority to recognize the role played by the Board in communications with all members of the ADF, including those who are members of the now closed DFRDB Scheme.

MSCC's role is to:

- Ensure smooth liaison between each of the Scheme's stakeholders;
- Provide advice on communications matters to the Board;
- Monitor the quality and effectiveness of the Board's communication products;
- Review existing communication products and methods; and
- Monitor, review and make recommendations on the implementation of a superannuation communication strategy for the ADF.

## objectives

For the purposes of reviewing its communications strategy the Board undertook an evaluation of the Scheme and its demographics which confirmed:

- a) the Scheme membership is Male dominated;
- b) the average age of members is 28.7 years;
- c) the most common form of exit from the Scheme is by way of resignation after less than 10 years service;
- d) although contributing member numbers will increase only slightly over the next ten years, the number of preserved benefit members will double in this same period to more than 100,000;
- e) although small in number, the pensioner population will double in the next the years to 10,000; and
- f) electronic means of communication are increasingly becoming relevant as members of the ADF increasingly gain access to the Internet both at work and at home.

Utilising the outcomes from that review the Board has established its objectives in communication as to:

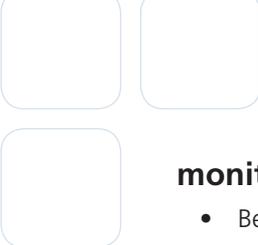
- provide Scheme members with user-friendly, targeted and timely information that increases their knowledge and understanding of MilitarySuper (and DFRDB) and the benefits derived from scheme membership and value the services provided by the Board;
- use written, telephonic and electronic communication to:
  - have available for the membership at all times key information about the scheme;
  - provide specific information to each member annually about their stake in the scheme and at six monthly intervals provide a second personal mail out providing Scheme specific information and/or updates on investment strategy and investment performance; and
  - provide tailored information to members on entry to the Scheme or when considering retirement or resignation.
- Keep the Minister well informed on matters relevant to the investment and administration of the MSB Scheme and respond in a timely manner to Ministerial requests.
- Respond to member-initiated information needs, and assist in their superannuation decisions.

In meeting these objectives the Board, as a minimum is committed to complying with the information disclosure requirements prescribed by SIS but which also comply with the Board's requirements and obligations as an AFS license holder.

The Board's approach to communications is provided in greater detail in the separate "Communications Strategy" document.

### **performance indicators**

- The number of requests received for additional information.
- Number and subject matter of Complaints
- Client satisfaction as measured through responses to an annual communication survey.
- Timely provision of annual member statements and reports consistent with SIS and FSR requirements and industry best practice.
- Satisfaction of Minister with MSB Board.



## monitoring

- Benchmarking of the Board's communications activities against industry best practice.
- Most frequently asked questions directed to the Member Communications Cell or received by way of "hits" on the MilitarySuper Website.
- Reports from MSCC and the Department of Defence.
- External assessment by independent communications consultants.

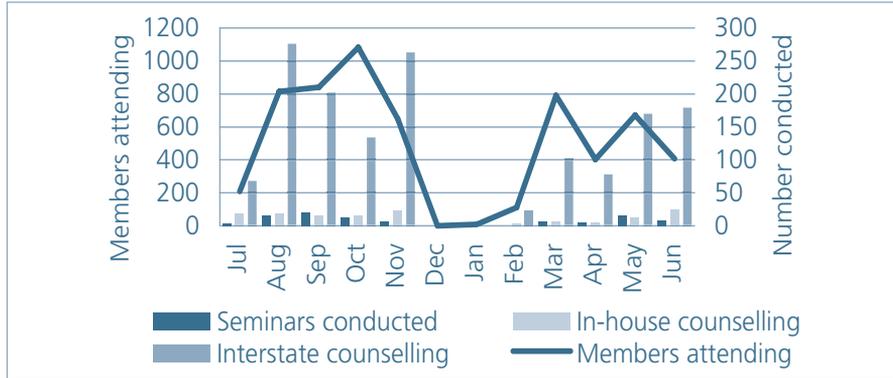
## initiatives for 2006-07

- Continue to develop the form and content of the half yearly mail out to members. The purpose of this second mail out is to inform members of changes in scheme design or strategy which might impact on their current and future member contributions.
- Deliver a communication/education program based on the use of audio visual technologies and drawing on the experience of previous video presentations.
- Increase access to web enabled interactive tools for member communications.
- Deliver a communication/education program to cover the Scheme's ancillary benefits initiatives.
- Promote the availability of Military Super seminars and increase the accessibility of seminars to new entrants to the ADF.
- Focus initial member education at the point of entry into the ADF consistent with the Board's obligations as an AFS license holder.
- Continue to leverage off the MilitarySuper website for increasing access by members to interactive sources of information about their scheme membership and benefit entitlements. This includes providing secure facilities for members to lodge applications to change investment strategies or to lodge benefit applications.

## counselling and information services

Information about the scheme is provided to members over the telephone, in writing, by email, and through presentations at resettlement seminars at various bases and units throughout Australia. Members may also speak to an information officer on a one-to-one basis in Canberra and at some resettlement seminars throughout Australia.

**Chart 4: information seminars**



With the development of the MilitarySuper website there has been a significant increase in the general information available to those with Internet access. Also, greater computer awareness among the members has seen an increasing number of email enquiries received.

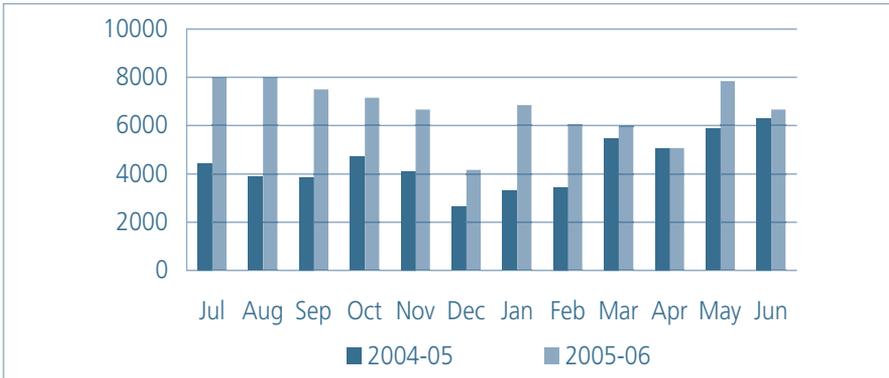
Most member contacts are by telephone, with an average of 1,506 telephone calls recorded per week compared with 1,275 last year. The Interactive Voice Response (IVR) telephone service recorded receipt of 81,391 calls from military (MSBS and DFRDB) members, an increase from last year's figure of 66,321.

Emails from military members answered totalled 6,411, an increase on the 5,787 completed last year.

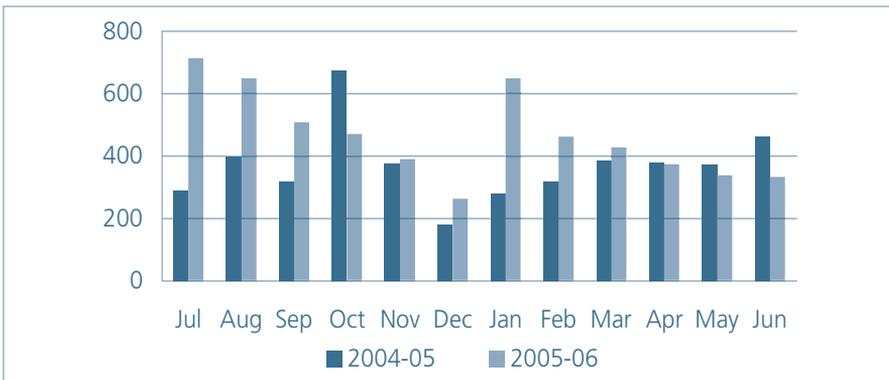
ComSuper staff responded to 7,930 written enquiries from military members, an increase on 2,724 completed last year.

During the year, ComSuper presented 50 seminars to a total of 4,625 MSBS members and provided personal counselling for 1,568 military members. The seminars were primarily conducted in conjunction with transition seminars. A further 19 seminars relating to medical discharge were presented to 333 military members.

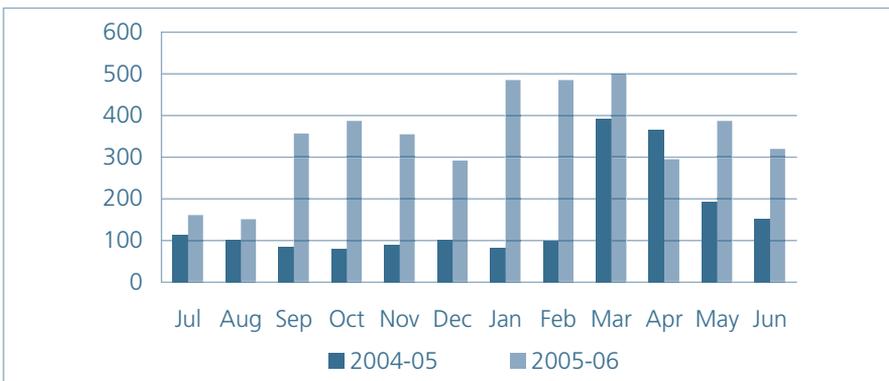
**Chart 5: monthly call volume comparisons**



**Chart 6: monthly email volume comparisons**



**Chart 7: monthly written volume comparisons**



## **pensioner communications**

The Contact Centre assists military pensioners to understand their superannuation entitlements and maintain their pension accounts in accordance with the service standards agreed between the Board and ComSuper.

Information officers can be contacted by telephone, letter, facsimile or email. Pensioners with hearing impairments can use a special teletypewriter (TTY) facility. Information officers are available for personal counselling at ComSuper's office. Pensioners who use the Internet can get general information from the MilitarySuper website.

## **annual report project**

A key communication from the Board to the MilitarySuper members is through the Annual Report to Members, which is distributed to all contributory and preserved benefit members.

The 2004-05 Annual Report to Members was distributed in October 2005 and received a positive response from members. The 2005-06 Annual Report to Members will be issued with the annual member statements to members in October 2006.

## **member statements**

Corporations law requires the Board to distribute annual member statements by 31 December each year. The statements provide members with equity figures and withdrawal benefits at the beginning and end of the financial year. Members are also sent a copy of the MSB Fund Annual Report to Members and an About Your Statement leaflet in their statement kit.

Statements for preserved members were distributed by the 10th of October 2005 and those for contributors by 28th October 2005. Manual statements were distributed to members during early December.

In January 2006 a system error was identified that resulted in 152 members not receiving an annual statement for 2004-05. The consequence of the error resulted in a reportable breach (under the Corporations Act) for the MSBS Board. ComSuper rectified the error by issuing all required statements by April 2006.

ComSuper has refined the reconciliation controls since the error occurred to ensure the error is not repeated and all members receive their 2005-06 statement.

## mid year newsletter

The Board continuously seeks ways to improve communications with members. An example of this was the introduction of a mid year newsletter from the Board to members. The purpose of the newsletter is to advise members of issues of interest or significance in relation to MilitarySuper and in respect of development in superannuation policy within the wider community.

The first newsletter was issued in March 2005 and informed members of the developments relating to the investment of the Fund, and in particular, the implementation of the Fund's revised investment strategy and the implications for member investment choice. Subsequent newsletters have concentrated on educating and informing members of changes to superannuation arrangements impacting on their membership of the Scheme.

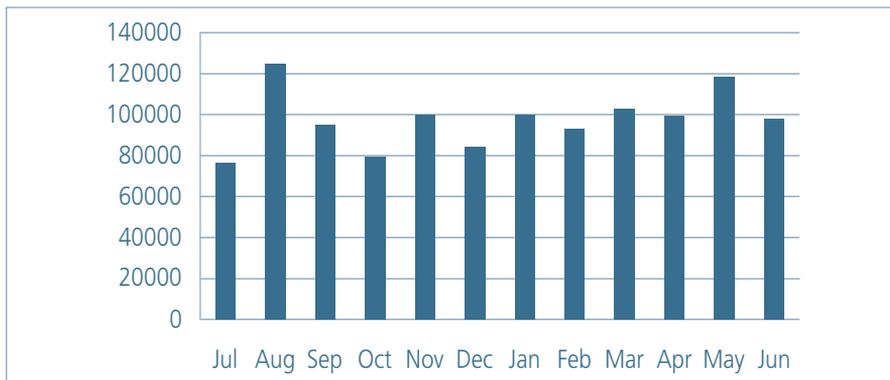
## website development

The MilitarySuper website ([www.militarysuper.gov.au](http://www.militarysuper.gov.au)) is designed to position it as a primary communications channel to reach scheme members.

Chart 8 shows usage of the website in 2005–06. Table 8 shows the ten most requested web pages during the current year. It also demonstrates that member website access has peaked at times when the Board has communicated to members via the mid year newsletter and annual report.

The Board remains committed to further enhancing its web facility and the development of online services.

**Chart 8: MilitarySuper website page requests 2005–06**



**Table 8: most requested web pages 2005–06**

Rank	Web page
1	Unit Prices
2	Member Services Online
3	MilitarySuper Book
4	Contact Us
5	Benefits
6	FAQs
7	Annual Report to Parliament 2004–05
8	MIC Booklet
9	Access Number Application Form
10	Retirement Benefit Application Form

**Table 9: website page requests over past four years**

Year	Number
2002–03	426,561
2003–04	208,676
2004–05	665,973
2005–06	1,159,783

### **secure website access**

Member Services Online provides members with a range of secure services including the calculation of benefits and the ability to view their annual statement online. During the year 14,156 statements were accessed and 12,376 benefit estimates produced using the *i*-Estimator.





# benefit payments

- > **benefits**
- > **benefit payments**
- > **pension variations**
- > **pension payments**
- > **invalidity benefits**
- > **invalidity classification process**
- > **invalidity classification review**
- > **accounts, records, and funding of benefit payments**

*All exiting members are entitled to a member-financed benefit regardless of their reason for leaving the ADF. Members are also entitled to an employer-financed benefit, which varies according to the reason for exit.*

## benefits

### member-financed benefits

The MSBS member benefit is derived from the member's own contributions, including any amounts notionally brought over from the DFRDB Scheme, plus the earnings on those contributions in the Fund. Members can exercise choice of investment strategy for this component of their benefit. The member benefit is payable as a lump sum, and cannot be converted to a pension.

### employer-financed benefits

Employer benefits provided under the MSBS are defined benefits guaranteed by the Commonwealth. Part of the benefit, the productivity benefit, is funded while the balance of the defined benefit is unfunded. The total employer benefit payable is not affected by market fluctuations.

### discharge benefits

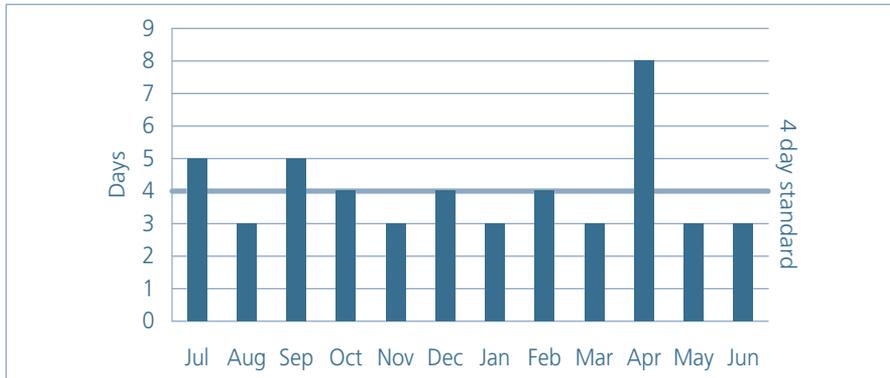
Members who leave the MSBS without a pension entitlement must preserve their total employer component until they reach their compulsory preservation age. From age 55, they can roll it over to another complying fund of their choice until their preservation age is reached and they have retired from the workforce.

Discharging members may preserve their total benefit or take that part of their member benefit that accrued up to 30 June 1999. Any contributions paid and earnings after that date must either be preserved in the scheme or rolled over and preserved in another complying fund until preservation age. Members may withdraw from the MSB Fund part of a member benefit that has been preserved in the scheme that is not compulsorily preserved; however, it must be withdrawn in \$10 000 multiples and at intervals of no less than six months.

**Table 10: benefits paid 2005–06**

Pensions \$m	100
Lump sums \$m	87
<b>Total \$m</b>	<b>187</b>
Fund share \$m	50
Consolidated Revenue Share \$m	137
<b>Total \$m</b>	<b>187</b>

**Chart 9: average time to process benefit payments 2005–06**



## benefit payments

All applications for benefits from contributors and preserved benefit members are processed in accordance with relevant legislation and within the timeframes agreed between the Board and its administrator. For members whose applications are processed outside 15 working days, late payment interest is added.

Since 2004–05, the Board adopted a soft close policy on year end prices that allowed the processing of benefit payments to continue during the first week of July.

### early release of preserved benefits

Under certain circumstances, a compulsorily preserved benefit may be paid before retirement.

Of the 998 preserved benefits paid in full or part during 2005–06, 284 were released on permanent physical or mental incapacity, severe financial hardship, or compassionate grounds.

## pension variations

### reversionary benefits

All applications for reversionary benefits following the death of a member or a pensioner (that is, eligible spouses, children and orphan pensions) are processed in a timely manner and in accordance with relevant legislation.

MSBS pensions are automatically increased twice yearly in line with upward movements in the Consumer Price Index (CPI) for the period ending 31 March and 30 September each year. The increases are paid on the first pension payday in January and July each year.

In 2005–06, the Australian Bureau of Statistics announced a CPI change. To arrive at the CPI rate a calculation is actioned. The rates were 1.4% for the period to March 2005 and 1.6% for the period to September 2005.

Pensioners received statements in July 2005 and January 2006 showing their new rate of pension. Their income tax payment summary and other relevant information were also included with the July statement.

## pension payments

### employer-financed benefits paid as pension

During the year, 413 new pensions were granted and at 30 June 2006, 6,002 members were receiving MSBS pensions. The total number of pensioners for each class of benefit is detailed in Table 11 for the end of each financial year since 30 June 2001.

The total amount paid as pensions during the year was \$100,246,598. The average pension amounted to \$16,702 per annum.

**Table 11: number of pensioners since 30 June 2001, by type of benefit**

Class of pension benefit	Number of pensioners					
	30 June 2001	30 June 2002	30 June 2003	30 June 2004	30 June 2005	30 June 2006
Retirement	556	621	707	796	881	962
Redundancy	1,877	1,885	1,901	1,916	1,916	1,919
Invalidity	1,742	2,010	2,169	2,356	2,573	2,908
Reversionary benefits*	40	84	145	164	194	213
<b>Total</b>	<b>4,197</b>	<b>4,600</b>	<b>4,922</b>	<b>5,232</b>	<b>5,564</b>	<b>6,002</b>

\* payable on the death of a member, former member or pensioner

## invalidity benefits

The Defence Force retires members on the grounds of invalidity if they do not meet the required standard of fitness, even though they may be capable of employment of a similar nature in the civilian workforce.

In determining invalidity benefits it is ensured that due process is followed, that claims are processed expeditiously, that legislative requirements are met and that guidelines issued by the Board are followed.

# invalidity classification process

## **Incapacity Classification Committee (ICC)**

As at 30 June 2006, the Committee comprised Simon Lawson (Chairperson and Team Leader of Military Invalidity Reversionary and Release Section, ComSuper), Wing Commander Bob Harris (Directorate of Personnel – Air Force), and Ms Heather Gill (Superannuation Directorate, Defence).

Members of the MSBS retired on invalidity grounds receive an A, B or C classification of invalidity, reflecting the member's loss of capacity to obtain appropriate civilian employment. If there is a conflict in the medical information, or reasonable doubt as to the classification, the case is passed from the ComSuper delegate to the Incapacity Classification Committee (ICC) for decision. The ICC is established under the provisions of MSB Rule 17 and is required to determine the classification of members retired on invalidity grounds and to review the existing classification of invalidity pension recipients. The ICC made 52 initial classification decisions during 2005–06.

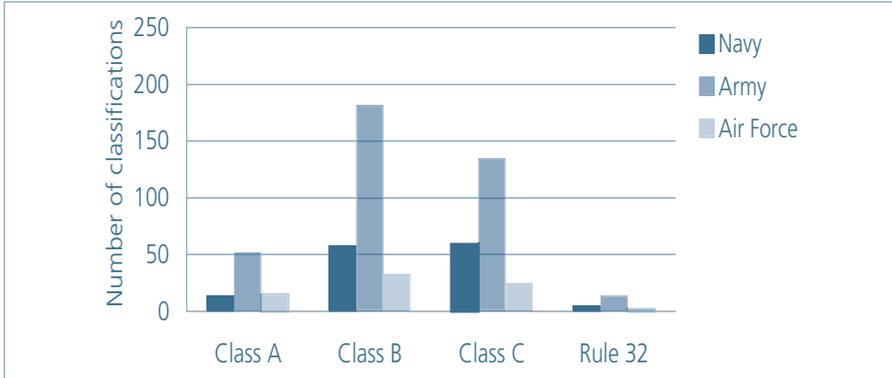
The rate of invalidity pension payable to a recipient member may be altered if the pensioner's degree of incapacity to undertake civilian employment deteriorates or improves. If specialist evidence indicates that a member's classification is no longer appropriate, the review of that case is passed from the ComSuper delegate to the ICC. The ICC made 95 reclassification decisions during the year.

After a classification decision has been made, the member is advised in writing and informed of the right to request reconsideration of the decision. Members receive advice of decisions of the Board and the ICC and also receive a copy of the minute recording the decision.

## **invalidity retirements by classification**

From 1 July 2005 to 30 June 2006, 594 members received initial invalidity classifications; although in 21 of these cases Rule 32 (relating to pre-existing conditions) was applied. Of those who received an invalidity classification, 354 (81 Class A and 273 Class B) became entitled to an invalidity pension. (Note that these figures vary slightly from the number of invalidity exits quoted elsewhere because some of these cases relate to members who were discharged in a previous financial year). The remaining 219 were classified as Class C incapacity. The proportion of invalidity classifications for each Service is shown in Chart 10.

**Chart 10: comparison, by service, of invalidity classifications 2005–06**



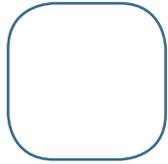
## invalidity classification review

The Board or its delegates may from time to time review the classification of invalidity pensioners either of their own volition or at the request of pensioners.

Decisions by the Board to classify members as Class A or B are reviewable at intervals determined by the Board. A member who believes that his or her classification has altered since it was last considered may request that the classification be reviewed. During 2005–06, 324 cases were examined, 31 of which were reviews requested by members. As a result of these reviews 95 classifications were changed, as shown in Table 12.

**Table 12: invalidity entitlements reviewed in the past five years**

	2001–02	2002–03	2003–04	2004–05	2005–06
Entitlements examined	545	475	684	829	325
Review with medical exam	187	222	255	274	147
Classification raised	25	21	38	12	34
Classification reduced	124	123	177	121	61
Total classification changes	149	144	215	133	95



# dispute resolution

- > internal review
- > reconsideration of decisions
- > external review
- > family law
- > enquiries and complaints
- > freedom of information



***Decisions by the Board and its delegates, including the Incapacity Classification Committee and the Reconsideration Committee, are subject to internal reconsideration and external review by the Superannuation Complaints Tribunal. These processes are managed by ComSuper.***

## internal review

A person affected by a decision of the Board or a delegate may apply in writing to have the decision reconsidered. If the Board or the Reconsideration Committee took the original decision, the application for reconsideration must be supported by new and relevant evidence. Applications for the reconsideration of a delegate's decision need not be supported by new evidence. The time limit for requesting reconsideration is within 30 days of receiving advice of the decision. The Board may extend this period in special circumstances.

Requests for reconsideration are investigated in a thorough, objective and effective manner and in accordance with any guidelines issued by the Board.

## reconsideration of decisions

Requests for reconsideration are treated as complaints for the purposes of section 101 of the *Superannuation Industry (Supervision) Act 1993*.

Following determination of a request for reconsideration each applicant receives a comprehensive written statement of reasons for the decision. Applicants are also advised of further appeal rights.

During 2005–06, 145 requests for reconsideration of decisions were received, a decrease from the 231 requests received the previous year. Of these, eight requests related to reconsideration of a decision of a Reconsideration Committee or the Board compared with seven during 2004–05.

The majority of requests for reconsideration concerned invalidity retirement benefit classification or reclassification decisions, the latter rising, as expected, as the invalidity pensioner membership grows. The primary issue to be determined in these cases is the member's level of physical or mental incapacity to undertake suitable civilian employment. Additional medical evidence is usually obtained as part of the reconsideration process.

One hundred and eighty-two cases were finalised during the year, compared with 172 cases last year. Forty two decisions were affirmed and in 73 cases the decision was set aside or varied in favour of the applicant. Another 67 cases were lapsed or withdrawn with the applicant failing to pursue the matter. Seventy three cases remained under investigation on 30 June 2006.

**Table 13: reconsideration applications for the past five years**

	2001–02	2002–03	2003–04	2004–05	2005–06
Requests on hand	55	47	39	51	110
Requests received	141	169	177	231	145
Requests resolved	149	177	165	172	182
Carried forward	47	39	51	110	73

## external review

On 29 June 1995, the Trustees of the MSBS signed an election to become a regulated superannuation fund for the purposes of the *Superannuation Industry (Supervision) Act 1993*. As a regulated fund any decision taken by the Board can be the subject of a complaint before the Superannuation Complaints Tribunal (SCT), which was established under the *Superannuation (Resolution of Complaints) Act 1993* (the SRC Act).

Eight complaints were lodged with the SCT during the year and ten cases were carried over from 2005–06. Five complaints were resolved during the year: three complaints were treated as withdrawn, one decision was set aside and one was varied.

In 2005–06 one SCT decision was appealed to the Federal Court and was resolved in favour of the Board. There were no applications for review lodged with the Federal Court under the AD(JR) Act in respect of decisions of the Board or its delegates.

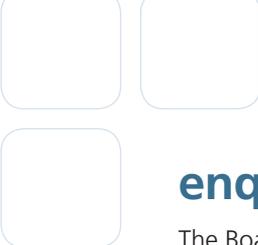
Systems are in place to facilitate the expeditious processing of matters that go to the Superannuation Complaints Tribunal, the Federal Court and other jurisdictions such as the Human Rights and Equal Opportunity Commission (HREOC).

The Board also monitors the outcome of external appeals and their implications.

## family law

The *Family Law Act 1975* states that where a member proposes to split his or her superannuation interest, the Trustee of the superannuation fund where the interest is held must be notified and given an opportunity to object to the terms of the split if it wishes. The Family Law Rules 2004 state that the Trustee has a period of 28 days from the date of notification to state its objections.

During the year there was an average of 85 written responses to members, non-members and their solicitors. These responses were completed within 28 days of receipt of the enquiry.



## enquiries and complaints

The Board has established formal procedures for dealing with members' complaints received in accordance with section 101 of the *Superannuation Industry (Supervision) Act 1993*. These procedures require the Board Executive to acknowledge and respond to all complaints.

ComSuper's Legal and Compliance Unit has systems in place for dealing with SIS-registered complaints which involves investigating a complaint and preparing a response for the Board Executive to provide to the member.

ComSuper also handles all Ombudsman enquiries, prepares responses to parliamentary representations and responds to requests made under the *Freedom of Information Act 1982* (the FOI Act).

### **complaints, ombudsman and parliamentary enquiries**

Fifty-eight complaints, seven parliamentary representations and five Ombudsman enquiries were received during the year. Two complaints were carried over as at 30 June 2006.

The complaints covered a range of administrative issues such as queries about the benefit payment process, and the receipt and content of information statements. Additionally, a substantial proportion of these complaints related to the employer benefit preservation arrangements as prescribed by the MSBS Rules.

ComSuper has introduced an internal process to identify and resolve systemic issues as a measure to continually improve the service provided to members.

In addition, Ministerial Representations relating to policy issues are received and responded to within the Department of Defence. In 2005-06 those relating to the MSBS totalled 54 (including 15 regarding MSBS employer benefit preservation arrangements). There were also 66 on pension indexation arrangements and 13 on the Government's proposed taxation changes to final superannuation benefits that were announced in the 2006 Budget that related to both the MSB and the DFRDB Schemes.

## freedom of information

MSBS members made 58 requests for access to documents during 2005–06. Fifty five requests were granted in full and two partially. One request was withdrawn. No requests were refused. The requests took an average of three days to process.

Enquiries relating to the documentary disclosure of information about the personal affairs of clients of the agency under the provisions of the Freedom of Information Act should be directed to:

Freedom of Information Unit

ComSuper  
PO Box 22  
Belconnen ACT 2616

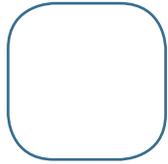
Telephone: 1300 033 732

Facsimile: (02) 6272 9804

TTY: (02) 6272 9827

Email: [foi@enq.militarysuper.gov.au](mailto:foi@enq.militarysuper.gov.au)





# membership

- > contributors
- > preserved benefit members
- > pensioners

*There are two main groups of contributors to the MSBS, those who transferred from the DFRDB and those who have become members of the MSBS upon joining the ADF. There is also a small group of members who had been receiving a DFRDB benefit, rejoined the ADF and elected to join the MSBS.*

## contributors

At 30 June 2006, there were 46,402 contributors to the MSBS, 42,165 (90.8%) of whom were male and 4,237 (9.2%) female. Table 14 shows the number of new entrants and exits and the total contributor membership at 30 June 2006. Table 15 shows the number of contributors by years of service and by gender.

**Table 14: contributor composition**

	Male members	Female members	Total
Membership at 30 June 2005	41,196	4,665	45,861
Plus new contributors	6,035	275	6,310
Less members left the ADF	5,066	703	5,769
Membership at 30 June 2006	42,165	4,237	46,402

**Table 15: male and female contributors by years of service**

Years of service	Male	Female	All
0–9	31,280	2,501	33,781
10–14	5,142	880	6,022
15–19	3,663	563	4,226
>19	2,080	293	2,373
Total	42,165	4,237	46,402

## commencements

There were 6,310 new MSBS members in 2005–06.

## exits

There were 5,769 exits from the MSBS during the year. Another 2,882 unclaimed cases from previous years were also processed. The types of exit are shown in Table 16.

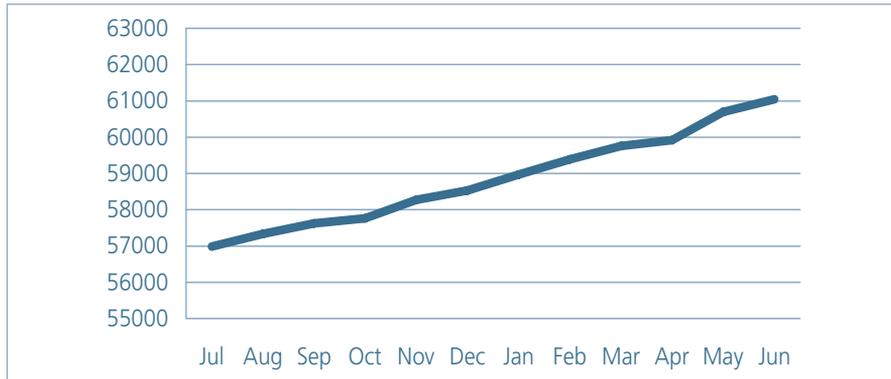
**Table 16: modes of exit in the past five years**

	2001–02	2002–03	2003–04	2004–05	2005–06
Age retirement	110	71	71	80	51
Resignation	3,744	3,426	2,028	2,299	2,110
Redundancy	12	11	10	5	6
Invalidity retirement	497	487	397	456	450
Death	17	12	15	19	17
Other	-	-	1,221	1,840	3,135
Total	4,380	4,007	3,742	4,699	5,769

## preserved benefit members

There were 61,044 preserved benefit members in the MSBS as at 30 June 2006. Chart 11 shows the growth of preserved benefit members during 2005–06.

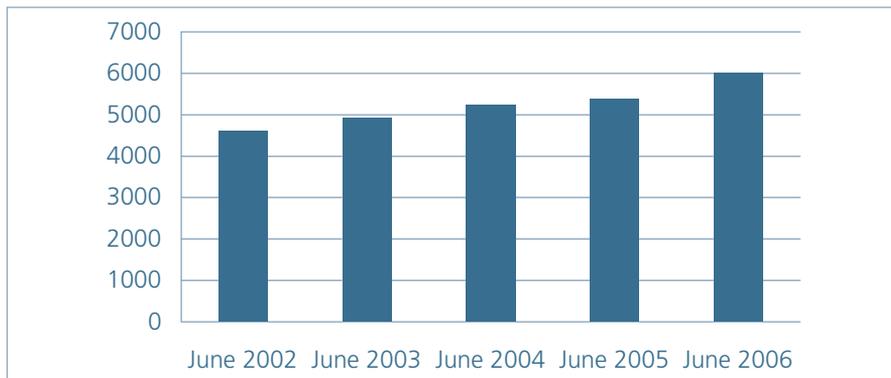
**Chart 11: growth in preserved benefit member population 2005–06**



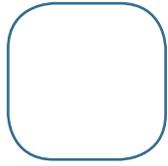
## pensioners

There were 6,002 pensioners in the MSBS as at 30 June 2006. Chart 12 shows the growth of pensioners since 30 June 2002.

**Chart 12: growth in pensioner population in the past five years**







# accounting services

- > SIS and corporations law compliance
- > audit of financial statements

## SIS and corporations law compliance

To ensure that the Board complies with the *Superannuation Industry (Supervision) Act 1993*, the Audit and Risk Management Committee has adopted a comprehensive SIS/corporations law checklist. The Board's Compliance Manager is responsible for the SIS/corporations checklist as well as ensuring the Board's compliance with other legislative requirements.

A detailed compliance report was provided to the Audit and Risk Management Committee in September 2005 and March 2006.

As the Board's administrator, ComSuper:

- maintains the Fund's general ledger summarising monthly contributions, benefits and investment transactions as reported by the Fund Custodian;
- prepares the annual financial statements of the Scheme in a form agreed by the Board and the Minister;
- prepares monthly (unaudited) financial statements in a form agreed with the Board;
- prepares annual APRA returns and the annual report to the Minister in accordance with relevant guidelines for reporting by Government agencies and the directions of the Board;
- prepares quarterly BAS and pays tax installments by the due date;
- manages the annual taxation return in collaboration with the Fund's taxation adviser;
- calculates daily unit prices for five options in concert with the Fund Custodian;
- provides annual letters of comfort to the Board and to the Board's external auditor regarding information provided for annual financial statements;
- arranges payment of the Board's administrative expenses;
- liaises with the Board's specialist advisers on accounting, taxation and investment issues;
- provides the Board with the opportunity to participate in the development of ComSuper's annual internal audit program to identify areas of mutual interest and to examine reports of specific internal audits where there is a coincidence of interest;
- provides reasonable access to internal audit staff to attend Board's Audit and Risk Management Committee meetings and to advise on audits completed or in progress; and

- provides a quality assurance role on accounting information provided by the Custodian or other sources.

## audit of financial statements

The Auditor-General has issued an unqualified audit opinion in respect of the financial statements of the Scheme and Board for the 2005–06 financial year.

However, in the course of the audit the Auditor-General noted that the Board had recorded in its breaches register a number of instances of breakdown in procedures used by the administrator (ComSuper) in the administration of the Scheme on the Board's behalf. These included the following material matters:

- Product Disclosure Statements were not issued to a small number of new entrants and associates of the MSBS;
- 2004–05 annual information packages were not issued within the prescribed time to a small number of Class A and B beneficiaries of the MSBS with a preserved member benefit; and
- 2004–05 Annual Member Statements for preserved benefit members incorrectly described an amount as restricted non-preserved instead of preserved.

The Auditor-General has therefore issued a qualified opinion in relation to the Board's compliance with SIS and the Corporations law in respect of those material issues.

Corrective action has been taken by the Administrator in respect of all these matters. The Board and its Executive Unit are working closely with ComSuper on the ongoing review and update of systems and procedures required for scheme administration.

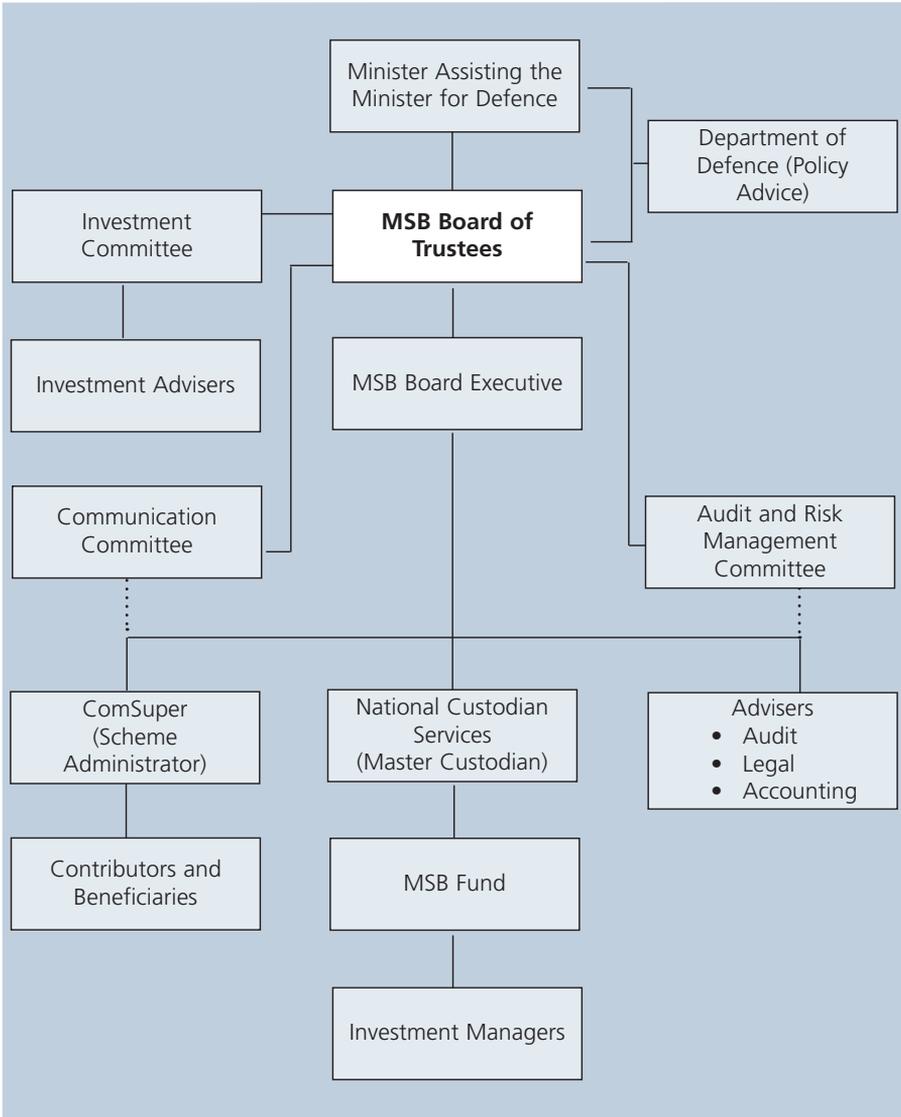




# administrative arrangements

- > organisational structure of the MSBS
- > financial resources

# organisational structure of the MSBS



## financial resources

The administrative costs of the MSB Board of Trustees for 2005–06 totalled \$2.87m. These costs include office accommodation lease and operating costs, fees paid to trustees, trustee travel costs and the cost of Board Executive and ComSuper accounting staff.

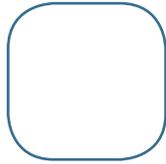
In accordance with section 4 of the *Military Superannuation and Benefits Act 1991* only those expenses of the Board in respect of its responsibilities for the management of the MSB Fund and investment of its moneys are paid from the MSB Fund. Under section 27 of the Act the Commissioner for Superannuation and the staff of ComSuper provide scheme administration services to the Board. The Department of Defence pays ComSuper for the costs of administering the scheme on the Board's behalf, including a component of the administration fee which is provided specifically to meet administration costs directly incurred by the Board and its staff.

The breakdown of administrative expenses met by the MSB Fund and the Department of Defence in respect of 2005–06 is as follows:

MSB Fund	\$2.072m
Department of Defence	\$0.802m
Total	\$2.874m

Further details are contained in the financial statements.





# scheme financial statements

- > Auditor-General's report
- > statement by the Trustees
- > financial statements for the MSB Fund
- > actuarial report



## MILITARY SUPERANNUATION AND BENEFITS SCHEME

### INDEPENDENT REPORT BY APPROVED AUDITOR TO THE MINISTER ASSISTING THE MINISTER FOR DEFENCE AND MEMBERS OF THE SCHEME

#### (A) *Financial Statements*

##### Matters relating to the Electronic Presentation of the Audited Financial Statements

This audit report relates to the financial statements published in both the annual report and on the website of the Military Superannuation and Benefits Scheme for the year ended 30 June 2006. The superannuation entity's trustee is responsible for the integrity of both the annual report and the web site.

The audit report refers only to the financial statements, schedules and notes named below. It does not provide an opinion on any other information which may have been hyperlinked to/from the audited financial statements.

If the users of this report are concerned with the inherent risks arising from electronic data communications they are advised to refer to the hard copy of the audited financial statements in the Military Superannuation and Benefits Scheme's annual report.

##### Scope

I have audited the financial statements of Military Superannuation and Benefits Scheme for the year ended 30 June 2006 as set out on pages 2 to 28 attached. The superannuation entity's trustees are responsible for the financial statements. I have conducted an independent audit of the financial statements in order to express an opinion on them to the members of Military Superannuation and Benefits Scheme and the Minister Assisting the Minister for Defence.

My audit has been conducted in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing and Assurance Standards, to provide reasonable assurance whether the financial statements are free of material misstatement. My procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion whether, in all material respects, the financial statements are presented fairly in accordance with Accounting Standards and other mandatory professional reporting requirements in Australia, so as to present a view which is consistent with my understanding of the superannuation entity's net assets and changes in net assets.

The financial statements audit opinion expressed in this report has been formed on the above basis.

##### Audit Opinion

In my opinion:

- (i) The financial statements are in the form as agreed by the Minister assisting the Minister for Defence in accordance with sub-section 26(1) of the *Military Superannuation and Benefits Act 1991*; and

GPO Box 707 CANBERRA ACT 2601  
Centenary House 19 National Circuit  
BARTON ACT  
Phone (02) 6203 7300 Fax (02) 6203 7777

- (ii) The financial statements present fairly in accordance with applicable Accounting Standards and other mandatory professional reporting requirements in Australia, the net assets of Military Superannuation and Benefits Scheme as at 30 June 2006 and the changes in net assets for the year ended 30 June 2006.

## **(B) Compliance**

### Scope

I have conducted tests in accordance with Australian Auditing Standards as necessary to provide reasonable assurance whether the trustees of the Military Superannuation and Benefits Scheme have, in all material respects:

- (a) complied with the relevant requirements of the following provisions (to the extent applicable) of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) and Regulations:  
Sections 19(2), 19(3), 36, 65, 66, 67, 69 to 85, 86 to 93A, 95, 97, 98, 101, 103, 104, 105, 106, 107, 109, 111, 113, 117, 118, 121, 121A, 122, 124, 125, 152, 154;  
Regulations 2.33(2), 3.10, 4.08(3), 5.08, 6.17, 7.04, 7.05, 9.09, 9.14, 9.29, 9.30, 13.14, 13.17, 13.17A; and
- (b) complied with the Reporting Standards made under section 13 of the *Financial Sector (Collection of Data) Act 2001* (FSCODA) that are subject to audit (to the extent applicable); and
- (c) complied with the relevant requirements of the following provisions (to the extent applicable) of the *Corporations Act 2001* (the Corporations Act) and Regulations:  
Sections 1012A, 1012B, 1012F, 1012H(2), 1012I, 1013D, 1013K(1), 1013K(2), 1016A(2), 1016A(3), 1017B(1), 1017B(5), 1017C(2), 1017C(3), 1017C(5), 1017C(8), 1017D(1), 1017D(3), 1017D(3A), 1017DA(3), 1017E(2), 1017E(3), 1017E(4), 1020E(8) and 1020E(9); and  
Regulation 7.9.32(3); and
- (d) adhered to Regulation 13.15A of the *Superannuation Industry (Supervision) Regulations 1994* (the SIS Regulations) and the guidelines for preparing Derivative Risk Statements (“guidelines”) issued by APRA in Circular ILD.7 (to the extent applicable)  
for the year ended 30 June 2006; and
- (e) complied with the requirement to prepare and lodge the respective returns comprising the APRA Annual Return.

My procedures included examination, on a test basis, of evidence supporting compliance with those requirements of the SIS Act and Regulations, the FSCODA and the Corporations Act and Regulations.

My procedures with respect to SIS Regulation 6.17 included testing whether amounts identified by the trustees as preserved and restricted non-preserved have been cashed or transferred only in accordance with the requirements of Part 6 of the SIS Regulations. These procedures did not include testing of the calculation of the preserved and restricted non-preserved amounts beyond a broad assessment of the apparent reasonableness of the calculations.

My procedures with respect to the guidelines included confirming whether any Derivatives Risk Statement was to be prepared by the superannuation entity’s trustees under the guidelines contained in APRA Circular ILD.7 at any time during the year of income. These procedures indicated that only a Part A Derivatives Risk Statement should be prepared by the superannuation entity’s trustees. This has been prepared and is broadly consistent with the requirements of the guidelines.

These tests have not been performed continuously throughout the period, were not designed to detect all instances of non-compliance, and have not covered any other provisions of the SIS Act and

Regulations or guidelines, the FSCODA or the Corporations Act and Regulations apart from those specified. The superannuation entity's trustees are responsible for complying with the SIS Act and Regulations, the FSCODA and the Corporations Act and Regulations and appropriately applying the guidelines.

The opinion on compliance expressed in this report has been formed on the above basis.

#### Qualification

- (a) Section 1017D(1) of the *Corporations Act 2001* requires that members receive periodic statements regarding their entitlements in the Scheme. This requirement was breached, in that:
- (i) 152 members did not receive periodic statements for one or more years since 2002. The trustees have addressed this matter through the Schemes administrator and all affected members have now received their outstanding annual periodic statements; and
  - (ii) 26,466 preserved benefit members were provided with a member statement for the year ended 30 June 2005 containing incorrect information regarding their preserved benefits. This error will be corrected in the member periodic statements for the year ended 30 June 2006.
- (b) Sections 1012B and 1012F of the *Corporations Act 2001* require that new members receive a Product Disclosure Statement within a specified timeframe. This requirement was breached, in that 105 new recruits to the Defence Force over the period 1 January 2006 to 31 March 2006 did not receive their new member kit, which includes the Scheme's Product Disclosure Statement, within the prescribed three months of entry. In addition, some 1,139 DFRDB contributors did not receive a Product Disclosure Statement in the specified timeframe upon the receipt of their government co-contributions into the Scheme. This information has now been distributed to these members.

#### Qualified Audit Opinion

In my opinion, except for the matters referred to in the qualification paragraph, the trustees of Military Superannuation and Benefits Scheme have complied, in all material respects, with the requirements of the SIS Act and Regulations, the Reporting Standards made under Section 13 of the FSCODA and the Corporations Act and Regulations and applied the guidelines specified above for the year ended 30 June 2006.

Australian National Audit Office



Carla Jago  
Executive Director

Delegate of the Auditor-General

Canberra  
8 September 2006

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

### Statement by the Trustees of the Military Superannuation and Benefits Fund

The Board of Trustees hereby states that in its opinion the attached financial statements give a true and fair view:

- (a) of the matters required by AAS 25 and Schedule 1 of the *Commonwealth Authorities and Companies (financial statements for reporting periods ending on or after 30 June 2005), Orders*, as amended from time to time except where there is a conflict between Schedule 1 and Australian Accounting Standard AAS 25 *Financial Reporting by Superannuation Plans (AAS 25)*, the latter shall take precedence;
- (b) of the net assets of the Scheme as at 30 June 2006 and the changes in net assets of the Scheme for the financial year ended 30 June 2006;
- (c) that at the date of this statement there are reasonable grounds to believe that the Scheme will be able to pay its debts as and when they fall due;
- (d) that the financial statements are in a form agreed by the Minister Assisting the Minister for Defence and the MSB Board in accordance with subsection 26(1) of the *Military Superannuation and Benefits Act 1991* and have been prepared in accordance with Australian Accounting Standards and other mandatory professional reporting requirements;
- (e) that the financial statements have been prepared based on properly maintained financial records;
- (f) that the operations of the Scheme were in accordance with the *Military Superannuation and Benefits Act 1991*; and
- (g) that the Scheme complied with the requirements of the Superannuation Industry (Supervision) Act 1993 and Regulations and the relevant requirements of the Corporations Act 2001 and Regulations except for certain breaches which have been reported to the Regulator. These included the following material matters:
  - Product Disclosure Statements were not issued to a small number of new entrants and associates of the MSBS;
  - 2004 -2005 Annual information packages were not issued within the prescribed time to a small number of class A and B beneficiaries of the MSBS with a preserved member benefit; and
  - 2004-2005 Annual member statements for preserved benefit members incorrectly described an amount as restricted non-preserved instead of preserved.

Signed at Canberra this <sup>9<sup>th</sup></sup> day of September 2006 in accordance with a resolution of members of the Military Superannuation and Benefits Board of Trustees.

  
C.P.H Kiefel  
Chairman

  
M. Sharpe, AO  
Member  
*Military Superannuation and Benefits  
Board of Trustees*

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

### STATEMENT OF CHANGES IN NET ASSETS FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Note	2006 \$'000	2005 \$'000
<b>Net Assets Available to Pay Benefits at The Beginning of The Period</b>		<b>1,749,340</b>	1,428,974
<b>Add:</b>			
<b>Investment Revenue</b>			
Interest	3	5,761	2,722
Dividends and trust distributions	3	105,149	79,268
Changes in net market values	3	221,689	127,614
Other investment income	3	2,568	383
Direct investment expenses	5	(17,443)	(13,888)
<b>Net Investment Revenue</b>		<b>317,724</b>	196,099
<b>Contribution Revenue</b>			
Member contributions		141,926	126,638
Employer contributions		74,875	70,840
Co-contributions		13,937	5,445
Appropriation from Consolidated Revenue Fund (CRF)	4	137,401	131,489
Other income		4,382	-
<b>Total Contribution Revenue</b>		<b>372,521</b>	334,412
<b>Total Revenue</b>		<b>690,245</b>	530,511
<b>Less:</b>			
General administration expenses	5	2,072	2,083
Benefits paid and payable	4	186,980	181,093
Other expenses		4,382	-
<b>Benefits Paid and expenses</b>		<b>193,434</b>	183,176
<b>Increase/(decrease) in Net Assets for the Year Before Income Tax</b>		<b>496,811</b>	347,335
Less income tax expense/(benefit)	6(a)	30,168	26,969
<b>Increase/(decrease) in Net Assets for the Year After Income Tax</b>		<b>466,643</b>	320,366
<b>Net Assets Available to Pay Benefits at the End of the Period</b>		<b>2,215,983</b>	1,749,340

The attached notes form part of these financial statements.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

STATEMENT OF NET ASSETS AS AT 30 JUNE 2006			
	Note	2006 \$'000	2005 \$'000
<b>Investments</b>			
Cash and short term deposits		70,714	285,997
Debt instruments		209,563	-
Australian equities		583,738	513,078
International equities		623,325	478,492
Property trusts		189,630	170,506
Currency contracts		(6,956)	5,840
Private equity		218,213	90,871
Hedge funds		175,044	127,769
Infrastructure		168,500	77,786
Futures and options		28	79
<b>Total Investments</b>		<u>2,231,799</u>	<u>1,750,418</u>
<b>Other Assets</b>			
Cash at bank		19,095	15,064
Consolidated Revenue Fund (CRF) special account		138	86
Interest receivable		969	14
Dividends receivable		3,597	3,959
Trade settlements receivable		8,983	5,398
GST recoverable		265	299
Sundry debtors		854	239
Benefits payable to be funded by appropriation	4	1,896	1,010
<b>Total Other Assets</b>		<u>35,797</u>	<u>26,069</u>
<b>Total Assets</b>		<u>2,267,596</u>	<u>1,776,487</u>
<b>Less Liabilities</b>			
Benefits payable	4	3,291	2,215
Trade settlements payable		8,805	6,130
Sundry creditors	7	9,146	6,065
Current tax liability	6(b)	11,596	3,971
Deferred tax liability	6(c)	18,775	8,766
<b>Total Liabilities</b>		<u>51,613</u>	<u>27,147</u>
<b>Net Assets Available to Pay Benefits</b>		<u>2,215,983</u>	<u>1,749,340</u>

The attached notes form part of these financial statements.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Statement of Compliance

The financial report is a general purpose financial report which has been prepared in accordance with Accounting Standards, Urgent Issues Group Interpretations, the Superannuation Industry (Supervision) Act 1993 and provisions of the Trust Deed. Accounting Standards include Australian equivalents to International Financial Reporting Standards ('AEIFRS') to the extent they are not inconsistent with AAS 25 Financial Reporting by Superannuation Plans.

The financial statements were authorised for issue by the Military Superannuation and Benefits Board of Trustees on the 6 September 2006.

Australian Accounting Standards require the financial statements of the Military Superannuation and Benefits Scheme (Scheme) to disclose Australian Accounting Standards that have not been applied in regard to standards that have been issued but are not yet effective.

The AASB has issued amendments to existing standards. These amendments are denoted by year and then number, for example 2005-1 indicates amendment 1 issued in 2005.

The table below illustrates standards and amendments that will become effective for the Military Superannuation and Benefits Scheme in the future. The nature of the impending change within the table has been out of necessity abbreviated and users should consult the full version available on the AASB's website to identify the full impact of the change. The expected impact on the financial report of adoption of these standards is based on the Scheme's initial assessment as this date, but may change. The Scheme's Board of Trustees intends to adopt all of the standards upon their application date.

Title	Standard affected	Application date	Nature of impending change	Impact expected on financial report
2005-1	AASB 139	1 Jan 2006	Amends hedging requirements of foreign currency risk of a highly probable intra-group transaction.	No expected impact
2005-4	AASB 139, AASB 132, AASB 1, AASB 1023 and AASB 1038	1 Jan 2006	Amends AASB 139, AASB 1023 and AASB 1038 to restrict the option to fair value through profit or loss and makes consequential amendments to AASB 1 and AASB 132.	No expected impact
2005-6	AASB 3	1 Jan 2006	Amends the scope to exclude business combinations involving entities or businesses under common control.	No expected impact
2005-9	AASB 4, AASB 1023, AASB 139 and AASB 132	1 Jan 2006	Amended standards in regards to financial guarantee contracts.	No expected impact
2005-10	AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 and AASB 1038	1 Jan 2007	Amended requirements subsequent to the issuing of AASB 7.	No expected impact
	AASB7 Financial Instruments: Disclosures	1 Jan 2007	Revise the disclosure requirements for financial instruments from AASB 132 requirements.	No expected impact, changes disclosure requirements

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### Basis of Preparation

The financial statements have been prepared on the basis required by the Defined Benefit Plan provisions of AAS 25, which provides specific measurement requirements for assets, liabilities and for accrued benefits. To the extent that they do not conflict with AAS 25, other accounting standards have been applied in the preparation of the financial statements. A Defined Benefit Plan refers to a superannuation plan where the amounts to be paid to members on retirement are determined at least in part by a formula based on years of membership and salary levels.

The Scheme has adopted the provisions of AAS 25 whereby the financial statements include a Statement of Net Assets, a Statement of Changes in Net Assets and Notes thereto. The form of these financial statements has been agreed by the Minister Assisting the Minister for Defence and the Military Superannuation and Benefits Board of Trustees in accordance with sub-section 26(1) of the *Military Superannuation and Benefits Act 1991*.

In the application of accounting standards, including AEIFRS, management is required to make judgments, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making the judgments. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments made by management in the application of accounting standards that have significant effects on the financial statements and estimates with a significant risk of material adjustments in the next year are disclosed, where applicable, in the relevant notes to the financial statements.

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concept of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

The Scheme changed its accounting policies on 1 July 2004 to comply with AEIFRS to the extent they are not inconsistent with AAS 25 Financial Reporting by Superannuation Plans. The financial effect of these changes on the Statement of Net Assets as at 30 June 2006 and the Statement of Changes in Net Assets for year ended 30 June 2006 including the comparative information for year ended 30 June 2005 was immaterial and limited to disclosure requirements. Refer to Note 19.

The accounting policies set out below have been applied in preparing the financial statements for the year ended 30 June 2006 and the comparative information presented in these financial statements for the year ended 30 June 2005.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

The following significant accounting policies have been adopted in the preparation and presentation of the financial report:

### (a) Cash and Cash Equivalents

Cash and cash equivalents include deposits held at call with a bank or financial institution and highly liquid investments with short periods to maturity which are readily convertible to cash-on-hand at the managers' option and are subject to insignificant risk of changes in value.

### (b) Revenue Recognition

To the extent to which it is probable that the economic benefits will flow to the Scheme and the revenue can be reliably measured, revenue is recognised. The following recognition criteria relates to the different revenues the Scheme has recognised:

#### Investment Revenue

##### Dividend revenue

Revenue from dividends is recognised on the date the shares are quoted ex-dividend, and if not received at balance date, is reflected in the Statement of Net Assets as a receivable.

##### Interest revenue

Revenue on money market and fixed interest securities is recognised using the effective interest rate method, and if not received at balance date, is reflected in the Statement of Net Assets as a receivable.

##### Movement in net market value of investments

Changes in the net market value of investments are recognised as income and are determined as the difference between the net market value at year end or consideration received (if sold during the year) and the net market value as at the prior year end or cost (if the investment was acquired during the period).

##### Movement in net market value of financial liabilities

Changes in the net market value of financial liabilities are recognised as income (or expense) and are determined as the difference between the net market value at year end or consideration paid (if settled during the year) and the net market value as at the prior year end or amount originally incurred (if the financial liabilities were incurred during the period).

#### Contribution Revenue

##### Employer and Member Contributions

Contributions are recognised when control of the asset has been attained and are recorded in the period to which they relate.

##### Government Co-contributions

Superannuation co-contributions from the Australian Government are recognised on a cash basis as this is the only point in which measurement is reliable. Accordingly amounts are recognised when superannuation co-contribution receipts are received by the Scheme.

##### Transfer from other funds

Transfers from other funds are recognised on a cash basis as this is the only point in which measurement is reliable. Accordingly amounts are recognised when transfer receipts are received by the Scheme.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### (c) Valuation of Investments

Investments of the Military Superannuation and Benefits Scheme (MSBS) are included in the Statement of Net Assets at net market value as at reporting date and changes in the net market value of assets are recognised in the Statement of Changes in Net Assets in the periods in which they occur. Net market value of investments includes an amount for selling costs which would be expected to be incurred if the investments were sold. Net market values have been determined as follows:

- (i) Short-term Money Market - these securities are valued by marking to market using yield supplied by independent valuers.
- (ii) Fixed-interest - these securities are valued by marking to market using yields supplied by independent valuers.
- (iii) Futures Contracts - open futures contracts are revalued to closing price quoted at close of business on 30 June 2006 by the futures exchange.
- (iv) Equities - listed securities, including listed property trusts, are valued based on the last sale price quoted at close of business on 30 June 2006 by the relevant stock exchange, or last bid where a sale price is unavailable.
- (v) Exchange Traded Options - options are valued as the premium payable or receivable to close out the contracts at the last buy price quoted at close of business on 30 June 2006 by the relevant stock exchange.
- (vi) International Investments - international securities are valued on the basis of last sale price quoted at close of business on 30 June 2006 by the relevant securities exchange. In the case of UK securities, the basis of valuation is the average of the bid and offer prices.
- (vii) Units in Property Trusts - units are valued at their net realisable value.
- (viii) Currency contracts - these securities are valued at the relevant exchange rate at close of business on 30 June 2006.
- (ix) Private equity and Infrastructure – these asset classes are valued according to the most recent valuation obtainable from:
  - an independent external valuer;
  - a third party arms length transaction;
  - the current and future earnings of companies in the portfolio; or
  - cost (less any diminution in value) in cases where investments have been held for a short time and Trustees are satisfied that significant diminution in value has not occurred.
- (x) Debt Instruments – certain investments are valued by marking to market using yields supplied by independent valuers. The remainder of this class of investments is valued by the most recent valuation obtainable from:
  - an independent external valuer;
  - a third party arms length transaction; or
  - the current and future earnings on corporate debt instruments in the portfolio.
- (xi) Hedge Funds – investments via unit trusts are valued at their net realisation value. The remainder of this class of investments is valued by the issuing bank having regard to the net realisable value of the underlying financial instruments.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS  
For the financial year ended 30 June 2006

The following table details the latest date of valuation of private equity investments as at 30 June 2006:

<b>Fund</b>	<b>Latest valuation</b>
<b><i>Domestic Private Equity</i></b>	
Archer Capital fund 3, 3A and 3B (previously GS)	30 June 2006
Babcock and Brown Direct Investment Fund	30 June 2006
CHAMP Venures Trusts No. 5A and 5B	30 June 2006
* CHAMP Ventures Trusts No. 6A and 6B	New
CHAMP Buyout II Trust	30 June 2006
Crescent Capital Partners II	30 June 2006
Deutsche Private Equity Fund	30 June 2006
Deutsche Private Equity Fund No. 2	30 June 2006
GBS BioVentures III	30 June 2006
Gresham Private Equity Fund 1 & 1a	30 June 2006
Gresham Private Equity Fund No. 2A and 2B	30 June 2006
NBC Private Equity Fund 2A and 2B	30 June 2006
PEP Funds No. 2 and Supplementary No. 2	30 June 2006
Pacific Equity Partners Fund 3 and Supp No. 3	30 June 2006
<b><i>International Private Equity</i></b>	
* Citic Allco Investments Ltd	New
CSFB Fund Investment VI Bermuda	31 March 2006
HarbourVest Partners IV	31 March 2006
HarbourVest Partners VII Buyout	31 March 2006
HarbourVest Partners VII Mezzanine	31 March 2006
HarbourVest Partners VIII Venture	31 March 2006
* HarbourVest Partners V	New
Pantheon Eurpoe Fund III, L.P.	31 March 2006
Pantheon Global Secondary Fund II, L.P.	31 March 2006
Pantheon USA Fund IV, L.P.	31 March 2006
Northgate Private Equity Part II	31 March 2006
* Northgate Venture Partners III	New
Rosemont Partners II, L.P.	31 March 2006
Rosemont Cadence LLC	31 March 2006
Sentient Global Resources Trust No. 1	31 March 2006
Sigular Guff Bric Opp Fund	31 March 2006
TCW Shared Opportunity Fund V, L.P.	31 March 2006
YBR Feeder Limited Partnership	30 June 2006

\* New funds - cash flows only

All valuations are un-audited

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### (d) Foreign Currency Translation

All foreign currency transactions during the financial year are brought to account using the exchange rate in effect at the date of the transaction. Foreign currency monetary items at reporting date are translated at the exchange rate existing at reporting date.

Exchange differences are recognised in profit or loss in the period in which they arise except exchange differences on transactions entered into in order to hedge certain foreign currency risks.

### (e) Use of Derivatives

The investment fund managers use a number of financial instruments such as futures, options and forward exchange contracts which are known as 'derivatives'. The objective of their use is to reduce the risks in the equity, bond and currency markets and to increase or decrease the Scheme's exposure to a particular market. The use of derivatives for this purpose is called hedging in the various markets. The likely effect of their use is reduction of risk to the Scheme. Derivatives are not used for speculation in any of these markets or for gearing the portfolios. Derivatives are measured at net market value in accordance with AAS 25. Further details of derivative financial instruments are disclosed in Note 8 to the financial statements.

### (f) Taxation

#### Current Tax

Current tax assets and liabilities for current and prior periods are measured at the amount expected to be recovered from, or paid to, the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

#### Deferred Tax

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. The tax base of an asset is the amount that will be deductible for tax purposes against any taxable benefits that will flow to the entity when it recovers the carrying amount of the asset. The tax base of a liability is its carrying amount less any amount that will be deductible for tax purposes in respect of that liability in future periods.

Temporary differences may be either:

- *Taxable temporary differences*: arise when the carrying amount of an asset exceeds its tax base, as the future recovery of its carrying amount will generate taxable profit with an obligation to pay the resulting taxes in future periods. Further, a taxable temporary difference arises when the carrying amount of a liability is less than its tax base, as the future settlement of its tax base will generate taxable profit.
- *Deductible temporary differences*: arise when the carrying amount of a liability exceeds its tax base, as the future settlement of its carrying amount will be deductible in determining taxable income. Further, a deductible temporary difference arises when the carrying amount of an asset is less than its tax base, as its future recovery will generate a tax deduction.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### *Deferred tax liability*

A deferred tax liability is recognised when there is a taxable temporary difference between the tax base of an asset or liability and its carrying amount in the balance sheet.

### *Deferred tax asset*

A deferred tax asset is recognised when there is a deductible temporary difference between the tax base of an asset or liability and its carrying amount in the balance sheet, but only to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

A deferred tax asset is also recognised for the carry-forward of unused tax losses and credits, but only to the extent that it is probable that the future taxable profit will be available against which the unused tax losses and credits can be utilised.

### **(g) Benefits Payable**

Benefits payable include benefits in respect of members who ceased employment with the employer sponsor prior to financial year end who are entitled to receive a benefit but had not been paid by that date.

### **(h) Liability for Accrued Benefits**

The liability for accrued benefits is not included in the statement of net assets, but the liability at the latest measurement date is reported by way of note. Where accrued benefits are measured during the reporting period, the benefits which have accrued since the latest measurement date are also reported by way of note. The liability for accrued benefits is actuarially measured on at least a triennial basis, and represents the value of the Scheme's present obligation to pay benefits to members and other beneficiaries at the date of measurement. The liability is determined as the present value of expected future payments which arise from membership of the Scheme up to the date of measurement.

### **(i) Superannuation Contributions (surcharge) Tax**

The Trustee recognises amounts paid or payable in respect of the surcharge tax as an expense of the Scheme. The expense (and any corresponding liability) is brought to account in the period in which the assessments are received by the Trustee and are properly payable by the Scheme. All amounts paid are allocated back against the member accounts to which the surcharge relates.

### **(j) Goods and Services Tax (GST)**

Revenues, expenses and assets are recognised net of the amount of Goods and Services Tax (GST), except:

- i. where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- ii. for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the Australian Taxation Office is included as part of receivables or payables.

### **(k) Sundry Debtors and Creditors**

Sundry debtors are recognised at the amounts receivable which approximate net fair value. Sundry creditors represent liabilities for goods and services provided to the Scheme prior to the end of financial year and which are unpaid. The amounts are unsecured. Sundry debtors and creditors are subject to normal trade credit terms.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### 2. DESCRIPTION OF THE SCHEME

- (a) The Military Superannuation and Benefits Scheme (ABN 50 925 523 120) is a hybrid accumulation-defined benefits scheme which provides benefits to its members under the *Military Superannuation and Benefits Act 1991*. The Trustee at balance date is the Military Superannuation and Benefits Board of Trustees No. 1 (ABN 72 406 779 248). The Scheme is operated for the purpose of providing for members (and their dependants or beneficiaries) of the Australian Defence Force, lump sum and pension benefits upon retirement, termination of service, death or disablement.

Administration of the Scheme is conducted by Commonwealth Superannuation Administration (ComSuper).

The principal place of business of the Scheme is:

Suite 3-07  
3rd Floor  
Perpetual Building  
10 Rudd Street  
CANBERRA ACT 2601

- (b) Member Numbers:

	2006	2005
Number of Members	#	#
- Contributors	<b>46,402</b>	45,860
- Deferred Beneficiaries / Preservers	<b>61,044</b>	56,530
- Pensioners	<b>6,002</b>	5,565
Total Number of Members	<b>113,448</b>	107,955

- (c) Employees of the Board:

	2006	2005
	#	#
Total Number of Employees	<b>7</b>	6

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS  
For the financial year ended 30 June 2006

### 3. INCOME AND CHANGES IN NET MARKET VALUES

	Interest	Dividends and Trust Distributions	Other	Realised Capital Gain (Loss)	Unrealised Capital Gain (Loss)	Total
<b>30 June 2006</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Cash and Short Term Deposits	1,271	-	223	-	-	1,494
Debt Instruments	2,380	6,532	1,024	235	2,734	12,905
Australian Equities	604	42,403	125	24,904	55,280	123,316
International Equities	472	8,034	121	54,778	70,516	133,921
Property Trusts	790	13,764	44	2,787	598	17,983
Currency Contracts	135	-	-	(15,943)	(6,958)	(22,766)
Private Equity	66	19,383	481	(1,806)	6,967	25,091
Hedge Fund	23	4,955	-	4,450	10,327	19,755
Infrastructure	20	10,078	550	(480)	13,225	23,393
Futures and Options	-	-	-	18	57	75
<b>Total</b>	<b>5,761</b>	<b>105,149</b>	<b>2,568</b>	<b>68,943</b>	<b>152,746</b>	<b>335,167</b>

	Interest	Dividends and Trust Distributions	Other	Realised Capital Gain (Loss)	Unrealised Capital Gain (Loss)	Total
<b>30 June 2005</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Cash and Short Term Deposits	918	3,251	35	-	-	4,204
Debt Instruments	938	1,332	-	(233)	-	2,037
International Fixed Interest	6	4,644	-	(468)	-	4,182
Australian Equities	621	20,472	121	27,980	59,927	109,121
International Equities <sup>(1)</sup>	118	7,615	217	(20,956)	14,931	1,925
Property Trusts	8	6,761	4	107	13,803	20,683
Currency Contracts	51	-	-	34,625	5,842	40,518
Private Equity	46	24,392	6	(4,701)	(10,660)	9,083
Hedge Fund	-	6,484	-	-	3,628	10,112
Infrastructure	16	4,317	-	2,605	(1,283)	5,655
Futures and Options	-	-	-	2,547	(80)	2,467
<b>Total</b>	<b>2,722</b>	<b>79,268</b>	<b>383</b>	<b>41,506</b>	<b>86,108</b>	<b>209,987</b>

<sup>(1)</sup>Includes amounts that were previously classified under Emerging Markets.

The net gain/(loss) on foreign currency contracts for the year was \$(22.8)m (2005: \$40.5m). This amount does not include gains and losses on foreign currency transactions that may have occurred in the pooled trust investments.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### 4. FUNDING ARRANGEMENTS

The Military Superannuation and Benefits Scheme is a hybrid accumulation defined benefit scheme governed by a Trust Deed and Rules established under the *Military Superannuation and Benefits Act 1991*. This legislation also established the Military Superannuation and Benefits Fund No. 1 ("the Fund").

Members contribute to the Scheme each fortnight at optional rates ranging from a minimum of 5% of salary to a maximum of 10% of salary. The Department of Defence contributes to the Scheme each fortnight in respect of each member at the rate of 3% of the member's salary. These member and employer contributions, accumulated with investment earnings, equate to the net assets available to pay benefits as shown in the Statement of Net Assets.

The benefits payable from the Fund comprise a lump sum of accumulated member contributions and a defined benefit financed by the employer and calculated on the basis of the member's final average salary and length of service. The defined benefit may be taken as a lump sum or as a pension or as a combination of lump sum and pension. The defined benefit consists of a funded component (the accumulated value of the 3% of salary contributions made to the Scheme by the Department of Defence) and an unfunded component (the balance of the defined benefit).

In general, when a benefit becomes payable to a member, the accumulated member and employer contributions held in the Fund in respect of the member are transferred to the Consolidated Revenue Fund (CRF) which pays out the total benefit (both funded and unfunded components).

Appropriation refers to the total amount paid from the CRF. The appropriation from CRF shown in the Statement of Changes in Net Assets is the net amount after taking into account transfers from the Fund to the CRF.

#### Total Benefits Paid and Payable

	2006	2005
	\$'000	\$'000
Lump Sums	86,688	91,767
Pensions	100,292	89,326
Total	<u>186,980</u>	<u>181,093</u>

#### Financed by:

Military Super Scheme	49,579	49,604
Consolidated Revenue Fund	137,401	131,489
Total	<u>186,980</u>	<u>181,093</u>

Of the \$3.291m benefits payable as at 30 June 2006, the Scheme's share amounted to \$1.395m (2005: \$1.2m) with the Consolidated Revenue Fund's share being \$1.896m at 30 June 2006 (2005: \$1.0m).

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### 5. COST OF ADMINISTERING THE SCHEME AND MANAGING THE SCHEME

Under Clause 9(3) of the Trust Deed set up under section 4 of the *Military Superannuation and Benefits Act 1991*, the Scheme shall be used to pay costs and expenses of the management and investment of the Scheme.

	2006	2005
	\$'000	\$'000
<b>Fund Management and Investment Expenses met by Fund</b>		
<b>General Administration Expenses</b>		
Accounting services	223	271
Professional advisers	717	315
Share of trustee fees, travel and incidental costs	596	739
Taxation services	83	100
Communications	45	98
APRA lodgement fees and industry levy	134	234
Insurance	-	78
External audit	63	43
Internal audit	166	177
Non recoverable GST	45	28
Total	<u>2,072</u>	<u>2,083</u>
<b>Direct Investment Expenses</b>		
Investment management fees	10,985	10,015
Asset consultancy and portfolio management	4,309	2,049
Custodian	1,929	1,612
Other investment expenses	3	16
Non recoverable GST	217	196
Total	<u>17,443</u>	<u>13,888</u>

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

Under section 27 of the *Military Superannuation and Benefits Act 1991* the Commissioner for Superannuation and the staff of ComSuper provide scheme administration services to the Board. The Department of Defence pays ComSuper for the costs of scheme administration and ComSuper recognises this administration revenue in the annual financial statements prepared by the Commissioner for Superannuation. A component of the ComSuper administration fees is used to meet administration costs directly incurred by the Board and its staff.

	2006	2005
	\$'000	\$'000
<b>Scheme Administration Expenses met by Department of Defence</b>		
<b><i>ComSuper Administration Fees</i></b>	<b>11,383</b>	9,232
<b><i>Board Administration Expenses</i></b>		
Share of trustee fees, travel and incidental costs	90	74
Support staff and facilities	684	348
Communication	-	5
Professional advisers	28	20
Total	<b>802</b>	447

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### 6. INCOME TAX

The taxation liability at 30 June 2006 has been calculated on the basis that the Scheme complies with the standards contained in the *Superannuation Industry (Supervision) Act 1993* and Regulations and that tax will be payable on the income received by the Scheme at a rate of 15 per cent. There has been no change in the superannuation tax rate when compared with the previous reporting period.

#### (a) Income Tax Recognised in Profit or Loss

	2006	2005
	\$'000	\$'000
<b>Tax Expense (Income) comprises:</b>		
Current tax expense/income	22,070	16,010
Deferred tax expense/(income)	10,010	11,335
Under/(over) provided in prior years	(1,912)	(376)
Total tax expense/(income)	<u>30,168</u>	<u>27,345</u>
Income tax expense is attributable to:		
Profit from continuing operations	<u>30,168</u>	26,969
Aggregate income tax expense	<u>30,168</u>	<u>26,969</u>
Deferred income tax (revenue) expense included in income tax expense comprises:		
Decrease (increase) in deferred tax assets	(8,152)	9,622
(Decrease) increase in deferred tax liabilities	18,162	1,713
	<u>10,010</u>	<u>11,335</u>
<b>The prima facie income tax expense on pre-tax changes in net assets reconciles to the income tax expense in the financial statements as follows:</b>		
Profit from continuing operations before income tax expense	<u>496,811</u>	347,335
	<u>496,811</u>	347,335
Income tax expense calculated at 15%	74,522	52,100
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Non-taxable member contributions	(43,989)	(19,813)
Non-deductible benefit payments	28,047	7,441
Difference between accounting and tax gains	(15,676)	(6,490)
Imputation and foreign tax credits	(10,824)	(5,893)
Under/(over) provision of income tax in previous year	(1,912)	(376)
	<u>30,168</u>	<u>26,969</u>

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### (b) Current tax liabilities

	2006	2005
	\$'000	\$'000
<b>Current tax payables:</b>		
Income tax payable	11,596	3,971
	<u>11,596</u>	<u>3,971</u>

### (c) Deferred tax balances

	2006	2005
	\$'000	\$'000
<b>Deferred tax liabilities comprise:</b>		
Temporary differences	18,775	8,766
	<u>18,775</u>	<u>8,766</u>

Taxable and deductible temporary differences arise from the following:

	2006	2005
	\$'000	\$'000
<b>Amounts received in profit or loss:</b>		
Unrealised capital gains	26,550	13,016
Realised capital losses	-	(5,584)
Accrued income	(7,775)	1,340
Accrued expenses	-	(6)
Net deferred tax liabilities	<u>18,775</u>	<u>8,766</u>

### Movements:

Opening Balance as at 1 July	8,766	(2,569)
Charged/(credited) to the income statement	10,010	11,335
	<u>18,775</u>	<u>8,766</u>

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS  
For the financial year ended 30 June 2006

### 7. SUNDRY CREDITORS

	<b>2006</b>	2005
	<b>\$'000</b>	\$'000
Investment expenses payable	<b>7,397</b>	4,394
Unallocated contributions	<b>1,354</b>	1,151
Accrued expenses	<b>343</b>	435
Tax payable to the ATO	<b>52</b>	85
Total	<b>9,146</b>	6,065

### 8. FINANCIAL INSTRUMENT DISCLOSURES

#### (a) Financial Risk Management Objectives

The investments of the Fund (other than cash held for meeting daily administrative and benefit expenses), are managed on behalf of the Board of Trustees by specialist sector fund managers who are required to invest the assets allocated for management in accordance with the terms of a written investment mandate. The Board of Trustees has determined that the appointment of these managers is appropriate for the Fund and is in accordance with the Board of Trustees' investment strategy.

National Custodian Services acts as master custodian on behalf of the Board of Trustees and as such provides services including physical custody and safekeeping of assets, settlement of trades, collection of dividends and accounting of investment transactions.

#### (b) Significant Accounting Policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 1 to the financial statements.

#### (c) Use of Derivative Financial Instruments

The Fund's investment managers use a number of financial instruments such as futures, options and forward exchange contracts to both facilitate increases or decreases in exposures in the equity, bond and currency markets and to reduce risk consistent with the investment policy of the Fund. Derivatives are not used for speculation in any of these markets or for 'gearing' the portfolio.

At 30 June 2006, the notional principal amounts and net fair value of derivatives held by the Fund was as follows:

	<b>Notional Principal Amounts</b>		<b>Net Market Value</b>	
	<b>2006</b>	2005	<b>2006</b>	2005
	<b>\$'000</b>	\$'000	<b>\$'000</b>	\$'000
Futures and options	<b>762</b>	748	<b>28</b>	79
Currency contracts	<b>(582,924)</b>	(457,122)	<b>(6,956)</b>	5,840
Total	<b>(582,162)</b>	(456,374)	<b>(6,928)</b>	5,919

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### (d) Credit Risk Management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Fund. The net market value of financial assets, with the exception of derivative positions, included in the statement of net assets represents the Fund's exposure to credit risk in relation to those assets. For derivative positions, the credit risk is equal to the net market value of positive (asset) derivative positions which amount to \$3.32m (2005: \$1.1m).

The Fund does not have significant exposures to any individual counterparty or industry.

### (e) Interest Rate Risk

The Fund invests in financial investments for the primary purpose of obtaining a return on investments on behalf of its members. As such, the Fund's investments are subject to interest rate risks and the return on the investments will fluctuate in accordance with movements in market interest rates. The Fund's exposure to interest rate movements on investments at 30 June 2006 was as follows:

	Fixed Interest Rate							Total \$'000
	Weighted Average Effective Interest Rate %	Floating Interest Rate \$'000	1 Year or Less \$'000	1-5 Years \$'000	Over 5 Years \$'000	Non- Interest Bearing \$'000		
<b>30 June 2006</b>								
<b>Financial Assets</b>								
Cash & short term deposits	4.43	70,714	-	-	-	-	70,714	
Debt instruments	7.73	-	-	94,130	12,050	103,383	209,563	
Australian equities	6.50	-	-	75	-	583,663	583,738	
International equities	-	-	-	-	-	623,325	623,325	
Property trusts	-	-	-	-	-	189,630	189,630	
Currency contracts	-	-	-	-	-	(6,956)	(6,956)	
Private equity	-	-	-	-	-	218,213	218,213	
Hedge fund	-	-	-	-	-	175,044	175,044	
Infrastructure	-	-	-	-	-	168,500	168,500	
Futures and options	-	-	-	-	-	28	28	
Other assets	4.43	19,094	-	-	-	16,702	35,796	
<b>Financial Liabilities</b>								
Trade settlements payable	-	-	-	-	-	(8,805)	(8,805)	
Accrued expenses	-	-	-	-	-	(343)	(343)	
Sundry creditors	-	-	-	-	-	(8,803)	(8,803)	
Benefits payable	-	-	-	-	-	(3,291)	(3,291)	
Current tax liability	-	-	-	-	-	(11,596)	(11,596)	
Deferred tax liability	-	-	-	-	-	(18,775)	(18,775)	
<b>Total</b>		<b>89,808</b>		<b>94,205</b>	<b>12,050</b>	<b>2,019,919</b>	<b>2,215,983</b>	

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

	Weighted Average Effective Interest Rate	Floating Interest Rate	Fixed Interest Rate			Non- Interest Bearing	Total
			1 Year or Less	1-5 Years	Over 5 Years		
30 June 2005	%	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
<b>Financial Assets</b>							
Cash & short term deposits	4.37	91,347	-	-	-	194,650	285,997
Australian equities	4.85	-	-	1,893	-	511,185	513,078
International equities	-	-	-	-	-	478,492	478,492
Property trusts	-	-	-	-	-	170,506	170,506
Currency contracts	-	-	-	-	-	5,840	5,840
Private equity	-	-	-	-	-	90,871	90,871
Hedge fund	-	-	-	-	-	127,769	127,769
Infrastructure	-	-	-	-	-	77,786	77,786
Futures and options	-	-	-	-	-	79	79
Other assets	4.37	14,910	-	-	-	11,159	26,069
<b>Financial Liabilities</b>							
Trade settlements payable	-	-	-	-	-	(6,130)	(6,130)
Accrued expenses	-	-	-	-	-	(435)	(435)
Sundry creditors	-	-	-	-	-	(5,630)	(5,630)
Benefits payable	-	-	-	-	-	(2,215)	(2,215)
Current tax liability	-	-	-	-	-	(3,971)	(3,971)
Deferred tax liability	-	-	-	-	-	(8,766)	(8,766)
<b>Total</b>		<b>106,257</b>		<b>1,893</b>		<b>1,641,190</b>	<b>1,749,340</b>

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### (f) Currency Risk Exposures

The Scheme's exposure at 30 June 2006 to foreign exchange rate movements on its international investments was as follows:

	USA	JPY	GBP	EUR	Other	Total
	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000
<b>30 June 2006</b>						
Gross investment amounts denominated in foreign currency	711,043	23,920	50,341	129,079	52,590	966,973
Amount effectively hedged	(334,787)	(35,496)	(38,307)	(177,414)	3,079	(582,924)
Net exposure	<b>376,256</b>	<b>(11,576)</b>	<b>12,034</b>	<b>(48,335)</b>	<b>55,669</b>	<b>384,049</b>

	USA	JPY	GBP	EUR	Other	Total
	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000
<b>30 June 2005</b>						
Gross investment amounts denominated in foreign currency	370,849	16,742	42,459	62,928	36,999	529,977
Amount effectively hedged	(216,157)	(24,174)	(34,897)	(150,509)	(31,385)	(457,122)
Net exposure	<b>154,692</b>	<b>(7,432)</b>	<b>7,562</b>	<b>(87,581)</b>	<b>5,614</b>	<b>72,855</b>

### (g) Net Fair Values of Financial Assets and Liabilities

The Fund's financial assets, liabilities and derivative instruments are included in the Statement of Net Assets at amounts that approximate net fair value.

### (h) Liquidity Risk Management

The Fund has a high level of net inward cash flows (through new contributions) which provides significant scope for liquidity risk management. The Fund also manages liquidity risk by maintaining adequate banking facilities and through the continuous monitoring of forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. As a further risk mitigation strategy, it is the Board's policy that the Fund cannot have an exposure of less than 50% of assets invested in liquid asset classes at any one point in time.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### 9. VESTED BENEFITS

Vested benefits are benefits which are not conditional upon continued membership of the Scheme (or any other factor other than resignation from the Scheme) and include benefits which members were entitled to receive had they terminated their plan membership as at the reporting date.

The Australian Government Actuary has advised that the estimated amount of vested benefits is as follows:

	<b>2006</b>	2005
	<b>\$m</b>	\$m
Funded component	<b>2,205</b>	1,746
Unfunded component	<b>9,261</b>	7,839
Total vested benefits	<b><u>11,466</u></b>	<u>9,585</u>

The net assets of the Scheme compared to the vested benefits are as follows:

	<b>2006</b>	2005
	<b>\$m</b>	\$m
Funded component	<b>2,205</b>	1,746
Net assets adjusted for benefits payable and cost of disposal	<b>2,223</b>	1,755
Surplus	<b><u>18</u></b>	<u>9</u>

The value of vested benefits represents the liability that would have fallen on the Scheme in the unlikely event that all members ceased service on 30 June 2006 and elected the option which is most costly to the Scheme. The likelihood of such an occurrence is extremely remote.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### 10. LIABILITY FOR ACCRUED BENEFITS

The amount of accrued benefits has been determined on the basis of the present value of expected future payments which arise from membership of the Scheme up to the membership date. The figure reported has been determined by reference to expected future salary levels and by application of a market-based, risk-adjusted discount rate and relevant actuarial assumptions. The accrued benefits are comprised of a funded component, which will be met from the Fund, (ie. accumulated member contributions and, where applicable, productivity contributions, plus interest) and an unfunded component to be financed, by the Commonwealth, from the Consolidated Revenue Fund, at the time the superannuation benefits become payable. The valuation of the accrued benefits was undertaken by the Australian Government Actuary as part of a comprehensive review during 2005-06. An extract of the Australian Government Actuary's report is attached.

	2005	2002
	\$b	\$b
Funded component	1.7	1.0
Unfunded component	8.8	5.9
Total accrued benefits	<u>10.5</u>	<u>6.9</u>

The net assets of the fund compared to the accrued benefits are as follows:

	2005	2002
	\$b	\$b
Funded component	1.7	1.0
Net assets	1.7	1.0
Surplus/(deficiency) Reserve	<u>0.0</u>	<u>0.0</u>

The liability for accrued benefits has been updated following the comprehensive actuarial review, which was completed early 2006 using data as at 30 June 2005. The next valuation of accrued benefits is as at 30 June 2008 and is expected to be completed by June 2009.

### 11. GUARANTEED BENEFITS

No guarantees have been made in respect of any part of accrued benefits.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS  
For the financial year ended 30 June 2006

### 12. KEY MANAGEMENT PERSONNEL COMPENSATION

The key management personnel of the Military Superannuation and Benefits Scheme during the year were:

The Trustees of the MSB Board of Trustees No. 1

Mr C P H Kiefel (Chairman)  
Dr M J Sharpe, AO  
Air Commodore L Roberts  
Warrant Officer R C Swanwick  
Mr F Bleeser

Executive of the MSB Board of Trustees No. 1

Mr K J McCullagh (Chief Executive Officer)

#### (a) Key Management Personnel Compensation

The aggregate compensation of the key management personnel of the Scheme is set out below:

	2006	2005
	\$'000	\$'000
Short-term employee benefits	372,833	370,942
Post-employment benefits	-	-
Other long-term employee benefits	7,375	-
Termination benefits	-	-
Share-based payments	-	-
	<u>380,208</u>	<u>370,942</u>

### 13. AUDITORS REMUNERATION

	2006	2005
	\$	\$
The amount paid and payable in respect of audit services provided by ANAO (exclude GST)	<u>60,325</u>	<u>42,000</u>

Deloitte Touche Tohmatsu (Deloitte) has been contracted by the Australian National Audit Office (ANAO) to assist the ANAO in providing the audit services to the Scheme. Fees for those services are included above.

No other services were provided by the Auditor-General during the reporting period.

## **MILITARY SUPERANNUATION AND BENEFITS SCHEME**

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### **14. SEGMENT REPORTING**

#### ***Business Segments***

The Fund operates solely to provide benefits for its members in accordance with the Trust Deed and the provisions of the *Superannuation Industry (Supervision) Act 1993*.

#### ***Geographical Segments***

The Fund operates in Australia and the primary assets it invests in on behalf of its members are managed and administered both in Australia and overseas. The members of the Fund are based in Australia.

### **15. COMMITMENTS FOR EXPENDITURE**

At 30 June 2006 the Fund had outstanding investment capital commitments of \$537m (2005: \$411m). These commitments relate to investments in private equity, infrastructure and direct property.

### **16. CONTINGENT LIABILITIES**

#### **Benefit Entitlements**

In the normal course of business, requests are made by members and former members for the review of decisions relating to benefit entitlements of the Scheme which could result in additional benefits becoming payable in the future. Each request is considered on its merits prior to any benefit becoming payable. In the opinion of the Board of Trustees, these requests do not represent a material liability on the Scheme.

At 30 June 2006 the Scheme had no contingent liabilities (2005: \$0.27m).

There were no other contingent liabilities which have been identified as at 30 June 2006 (2005: \$Nil).

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS  
For the financial year ended 30 June 2006

### 17. SUPERANNUATION CONTRIBUTIONS SURCHARGE

Under the *Superannuation Contributions Tax (Assessment and Collection) Act 1997*, the holder of surchargeable contributions for the financial year is liable to pay the superannuation contributions surcharge. The surcharge is levied on surchargeable contributions depending on the individual member's adjusted taxable income. The Scheme has recognised the surcharge liability when the assessment (including advance instalment) is received from the Australian Taxation Office. The surcharge is no longer levied on surchargeable contributions made after 1 July 2005, however assessments relating to the period prior to this date continue to be received.

A summary of transactions follows:

	<b>2006</b>	2005
	<b>\$'000</b>	\$'000
Total surcharge liability outstanding at start of year	<b>14,859</b>	12,202
Surcharge liability recorded against member accounts in respect of surcharge assessments received during the year	<b>2,607</b>	2,626
Adjustments to previous years balance	-	(10)
	<b>17,466</b>	14,818
Less Amount paid by members	<b>(132)</b>	(164)
Less Amounts deducted from members' benefit payments	<b>(650)</b>	(514)
<i>Plus:</i>	<b>16,684</b>	14,140
Interest applied to outstanding surcharge liability at 30 June 2006	<b>951</b>	719
Total surcharge liability outstanding at end of year	<b>17,635</b>	14,859

No liability is recognised in the 'Statement of Net Assets' for the estimated value of the surcharge liability because the liability will be either met by the members during their period of membership or will be recovered from member benefits when they are paid.

## **MILITARY SUPERANNUATION AND BENEFITS SCHEME**

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### **18. RELATED PARTIES**

The Trustee of the Military Superannuation and Benefits Scheme is the Military Superannuation and Benefits Board of Trustees No. 1 (ABN 72 406 779 248). The names of the members of the Board who held office during the year are:

Mr C P H Kiefel (Chairman)  
Dr M J Sharpe, AO  
Air Commodore L Roberts  
Warrant Officer R C Swanwick  
Mr F Bleeser

The Chief Executive of the MSB Board of Trustees No. 1 is Mr K J McCullagh.

The compensation received by the members of the Board and the Chief Executive Officer is disclosed in Note 12(a).

#### **Employer Sponsor**

The Department of Defence is the employer sponsor of the Scheme. There have been no transactions between the employer sponsor and the Scheme other than the employer contributions disclosed in the Statement of Changes in Net Assets.

As disclosed in Note 5 the Department of Defence pays ComSuper for the costs of scheme administration and ComSuper recognises this administration revenue in the annual financial statements prepared by the Commissioner for Superannuation. A component of the ComSuper administration fees is used to meet administration costs directly incurred by the Board and its staff.

#### **Contributions and Retirement Benefits of Key Management Personnel**

With the exception of one Trustee, members of the Board or of its Executive Unit are not eligible to contribute to the Scheme. Contributions paid by the Trustee, who is eligible to do so as a member of the Australian Defence Force, were in accordance with the normal terms and conditions of the Trust Deed.

Superannuation contributions were paid on behalf of all other key management personnel to a superannuation fund of their choice.

#### **Other Related Party Disclosures**

A member of the Board is also a Director of a company which manages investments in which the Scheme has investments. The Director takes no part in any decisions affecting this investment.

## **MILITARY SUPERANNUATION AND BENEFITS SCHEME**

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2006

### **19. IMPACT OF ADOPTING AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS**

As stated in significant accounting policies Note 1, these are the Scheme's first financial statements prepared in accordance with AEIFRS.

The policies set out in the significant accounting policies of this report have been applied in preparing the financial statements for the year ended 30 June 2006, the comparative information presented in these financial statements for the year ended 30 June 2005 and in the preparation of the opening AEIFRS Statement of Net Assets as at 1 July 2004, the Scheme's AEIFRS transition date.

In preparing the Scheme's opening AEIFRS Statement of Net Assets, no adjustments were made to any amounts previously reported in the financial statements prepared in accordance with the superseded Australian Accounting Standards and generally accepted accounting principles (AGAAP) because the impact was deemed immaterial. Consequently, no adjustments have been made to the Scheme's net assets as at the date of transition to AEIFRS and there have been no adjustments affecting the Statement of Net Assets or the Statement of Changes in Net Assets for the year ended 30 June 2006 and the comparative year ended 30 June 2005.

The principal effects of adopting AEIFRS in the financial statements were limited to enhanced disclosures in the area of compensation to key management personnel, and financial instruments. In addition, under AEIFRS income tax is being accounted for under the comprehensive balance sheet liability method as compared to the profit and loss method under previous AGAAP. However, as the Scheme values its assets at net market value there is minimal financial affect of adopting the AEIFRS methodology for income tax accounting.

### **20. SUBSEQUENT EVENTS**

There have not been any matters or circumstances arising since 30 June 2006 that have significantly affected or may significantly affect the Scheme.



17 August, 2006

**MILITARY SUPERANNUATION AND BENEFITS SCHEME**  
**SUMMARY OF THE 2005 LONG TERM COST REPORT**

1. A report on the long term cost of the Military Superannuation and Benefits Scheme (MSBS) and the Defence Force Retirement and Death Benefits Scheme (DFRDB) was carried out using data as at 30 June 2005 by the Australian Government Actuary.
2. The MSBS is partially funded and the DFRDB (closed to new entrants since October 1991) is unfunded. Both schemes have an underlying Government guarantee. For the MSBS, member contributions and the employer 3% Productivity contributions are paid into the MSBS Fund. Any MSBS benefit payment amounts not paid from Fund assets are paid from Consolidated Revenue. Projections of the actual annual employer costs of the two schemes combined as a percentage of Gross Domestic Product (GDP) were made over a period of 40 years.
3. These projections showed a progressive fall in the combined cost of the two schemes as a percentage of GDP. Given the underlying Government guarantee, I was therefore of the opinion that the financial position of the schemes as at 30 June 2005 was satisfactory.
4. The value of net assets of the MSBS available to pay benefits as at 30 June 2005 reported in the audited financial statements of the Fund was \$1,749 million.
5. Vested benefits of the MSBS were not calculated as part of the Long Term Cost Report as at 30 June 2005, but were calculated separately and covered contributors, preserved members and pensioners. They amounted to \$9.6 billion.

It should be noted that this value of vested benefits represents the liability that would have fallen on the scheme if all members had ceased service on 30 June 2005 and elected the most costly option to the scheme. The likelihood of such an occurrence is extremely remote.

6. The value of Accrued Benefits for the MSBS using the actuarial Projected Unit Credit (PUC) methodology as at 30 June 2005 was \$10.5 billion. This comprised \$8.8 billion in unfunded Accrued Benefits and \$1.7 billion in funded Accrued Benefits. The value of Accrued Benefits is the present value of the portion of projected benefit payments that had accrued in respect of membership of the MSBS to 30 June 2005. The employer component of the benefits for contributors was apportioned on a pro-rata basis using the ratio of current length of membership to the total length of projected membership at exit for each individual.
7. As would be expected in a substantially unfunded arrangement, the value of total Accrued Benefits is more than the audited value of scheme assets at the same date.

8. A summary of the data used for the valuation is set out below:

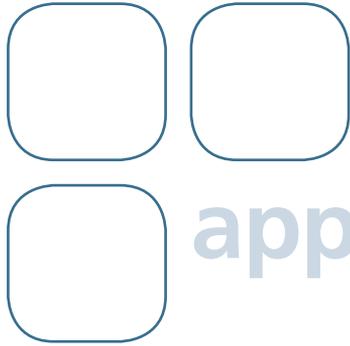
- 44,491 contributors with total superannuation salaries of \$2,359m
- 57,631 preserved beneficiaries with total nominal preserved benefits of \$2,893m
- 5,509 pensioners with total annual pensions of \$93m.

9. The major assumptions used in the calculations were as follows:

- Pension increases (CPI): 2.5% per annum  
(unchanged from the 2002 review)
- Interest Rate: 3.5% per annum real (unchanged from the  
2002 review)
- Inflationary salary increases: 1.5% per annum real (unchanged from the  
2002 review)
- Promotional salary increases: scales based upon age and length of service  
(slightly revised from the 2002 review)
- GDP increases: a series of rates starting at 2.2% (real) for  
2005/06, increasing to 3.0% (real) for 2006/07  
and then falling to 2.0% per annum (real) in  
2044/45 (slightly revised from the 2002  
review)



Peter Martin  
Fellow of the Institute of Actuaries of Australia  
Australian Government Actuary

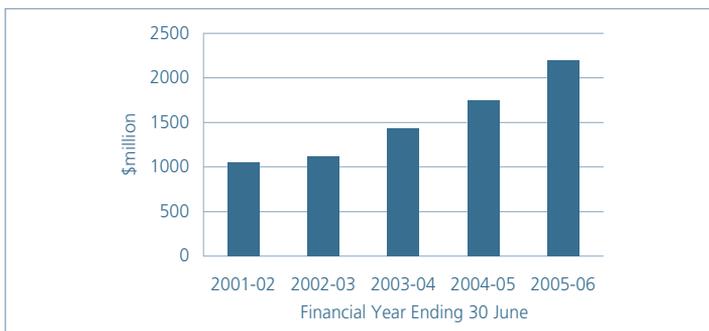


# appendixes

- > MSBS in brief
- > glossary
- > publications
- > contact officer
- > legislation
- > compliance
- > freedom of information
- > MSB Board Executive Unit
- > staffing statistics

## appendix 1: MSBS in brief

### fund growth in the past five years



### investment

Effective asset allocation	30 June 2005		30 June 2006	
Sector	\$m	%	\$m	%
Cash	286	17	71	3
Debt instruments	0	0	210	9
Australian and International Property	170	10	190	8
Australian Shares	513	29	584	26
Private Equity	91	5	218	10
International Shares	478	27	623	28
Uncorrelated Alpha	128	7	175	8
Infrastructure	78	4	168	8
Currency <sup>4</sup>	6	1	(7)	(1)
Investment performance	30 June 2005		30 June 2006	
Sector	Fund % <sup>1</sup>	Benchmark % <sup>2</sup>	Fund % <sup>1</sup>	Benchmark % <sup>2</sup>
Cash	5.8	5.6	5.8	5.8
Debt instruments	1.2	1.5	8.6	5.8
Property	17	16.8	10.6	16.8
Australian Shares	23.3	26	22.8	24
Private Equity <sup>3</sup>	11.1	NA	22.8	NA
International Shares <sup>4</sup>	8.7	13.3	19.9	17.4
Uncorrelated Alpha	13	5.3	13.4	10
Infrastructure	11.7	10	23.3	10

1. Figures shown are gross of management fees and tax.
2. The benchmark return for an asset class represents the minimum performance objective, assuming that all dividends and interest payments are reinvested in the market.
3. Private equity is a long-term investment and does not generally show a return in the early years of the investment because of set-up and management costs. The investment gains usually come in the later years as the underlying companies mature and increase in value. The effect of this timing is known as the J-curve Effect.
4. All international currency exposures are fully hedged back to the Australian dollar.

## membership

Contributors at 30 June	2005	2006	Increase (decrease)
Males	41,196	42,165	969
Females	4,665	4,237	(428)
Total	45,861	46,402	541
Total member contributions	\$126.6m	\$141.9m	\$15.3m
<b>Contributor exits</b>			
Age retirement	80	51	(29)
Resignation	2,299	2,110	(189)
Redundancy	5	6	1
Invalidity	456	450	(6)
Death	19	17	(2)
Other	1,840	3,135	1,295
Total	4,699	5,769	1,070
<b>Pensions in force</b>			
Retirement	881	962	81
Redundancy	1,916	1,919	3
Invalidity	2,573	2,908	(335)
Reversionary	194	213	19
Total	5,564	6,002	438
Pensions paid	\$89m	\$100m	\$11m
Average pension	\$16,461	\$16,702	\$241
<b>Preserved benefit members at 30 June</b>	<b>56,530</b>	<b>61,044</b>	<b>4,514</b>

## appendix 2: glossary

<b>active management</b>	an approach to investment where the manager varies its strategy depending on current market conditions. Active managers regularly review their investments with a view to benefiting from changes in the market or from growth in specific assets.
<b>ADF</b>	Australian Defence Force
<b>AD(JR) Act</b>	<i>Administrative Decisions (Judicial Review) Act 1977</i>
<b>APRA</b>	Australian Prudential Regulation Authority
<b>ASIC</b>	Australian Securities and Investment Commission
<b>CDF</b>	Chief of the Defence Force
<b>ComSuper</b>	Commonwealth Superannuation Administration
<b>core management</b>	a manager whose portfolio is constructed so as to provide a high probability of capturing the market return for a particular asset class. Core managers are used to control liabilities
<b>CPI</b>	Consumer Price index
<b>defensive assets</b>	assets (such as cash and bonds) that are not very susceptible to market fluctuations
<b>derivatives</b>	investment products (such as an option on a share) that are derived from other securities or assets. Their value is linked to the value of the underlying security
<b>DFRDB</b>	Defence Force Retirement and Death Benefits
<b>direct property</b>	property that is purchased by an investor to be held by that investor (see also indirect property)
<b>FSG</b>	Financial Services Guide
<b>FSR</b>	Financial Services Reform
<b>growth assets</b>	assets (such as shares and property) that are very responsive to market fluctuations.
<b>ICC</b>	Incapacity Classification Committee
<b>indirect property</b>	an investment in property made by purchasing units in a property trust, or shares in a property company

<b>IVR</b>	Interactive Voice Response telephone system
<b>LWOP</b>	leave without pay
<b>MilitarySuper</b>	Military Superannuation and Benefits Scheme
<b>MSB</b>	Military Superannuation and Benefits
<b>MSBS</b>	Military Superannuation and Benefits Scheme
<b>MSCC</b>	Military Superannuation Communication Committee
<b>passive</b>	an approach where the manager does not actively change the proportions held in the various investment sectors according to market conditions, but fixes them for an extended period
<b>PDS</b>	Product Disclosure Statement
<b>RC</b>	Reconsideration Committee
<b>SCT</b>	Superannuation Complaints Tribunal
<b>SIS</b>	<i>Superannuation Industry (Supervision) Act 1993</i>
<b>SRC Act</b>	<i>Superannuation (Resolution of Complaints) Act 1993</i>
<b>surcharge</b>	<i>Superannuation Contributions Tax (Assessment and Collection) Act 1997</i> , a tax on employer-financed superannuation contributions
<b>unitisation</b>	the conversion of member interest-bearing accounts to unit-based accounts within the MSB Fund

## appendix 3: publications

The Board publishes four booklets and a series of leaflets for the benefit of members.

The following four documents together form the Product Disclosure Statement for MilitarySuper:

*The MilitarySuper Book*  
*Supplementary PDS*  
*Your Guide to Investment Choice*  
*Annual Report to Members*

The MilitarySuper Book and Supplementary PDS are general information books that are intended as a reference book for members and pay officers.

The Your Guide to Investment Choice Booklet is an overview of the general objectives that underpin the Board's investment policy and the specific strategy through which these objectives will be realised.

The Board also publishes a series of leaflets that deal in more depth with a specific topic. The leaflets are entitled:

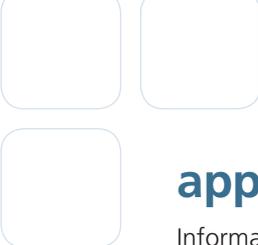
*About to leave the ADF?*  
*Dependants' Benefits*  
*Family Law and Splitting Super*  
*Invalidity Benefits*  
*Leave Provisions*  
*Rejoining the ADF*  
*Summary of the Scheme*  
*Superannuation Contributions Surcharge*  
*Taxation of Lump Sums*  
*The Productivity Benefit*

A series of fact sheets has been produced. Titles released to date are:

*Additional Personal Contributions*  
*Death and Dependants' Benefits*  
*Early Access to MilitarySuper Benefits*  
*Family Law and Your Super*  
*Government (Super) Co-Contributions*  
*Maximum Benefit Limits*  
*Salary Sacrifice Contributions*  
*Spouse Contributions*  
*Taxation Concessions for Pensioners*  
*Transfer Amounts*  
*Invalidity Benefits—The Classification Process*  
*Unitisation*

Also available is the *ComSuper Service Charter 2005*.

All of these publications can be obtained from members' Pay Offices; National Mailing and Marketing on telephone (02) 6269 1020 or facsimile (02) 6260 2770; or the MilitarySuper website ([www.militarysuper.gov.au](http://www.militarysuper.gov.au)).



## appendix 4: contact officer

Information is available to Members of Parliament, Senators and members of the public on request.

In the interests of timeliness and conciseness, this report has been designed to provide fundamental information. Requests for more detailed information should be directed to:

Parliamentary Liaison Officer  
ComSuper

Postal address: PO Box 22  
Belconnen ACT 2616

Street address: Unit 4  
Cameron Offices  
Chandler Street  
Belconnen ACT 2616

Telephone: 1300 033 732  
Facsimile: (02) 6272 9804  
TTY (02) 6272 9827

## appendix 5: legislation

### legislation amendments

The Military Superannuation and Benefits Trust Deed was amended once in the 2005–2006 financial year. The Military Superannuation and Benefits Amendment Trust Deed 2005 (No. 1) recognised ancillary benefits for the first time. The effect of the amendment is that the Board can now accept ancillary contributions from members of the MSBS and also members of the Defence Force Retirement and Death Benefits (DFRDB) Scheme. There are five categories of ancillary contributions: (i) amounts paid by the Australian Taxation Office as a Government co-contribution or a superannuation guarantee charge payment; (ii) salary sacrifice amounts; (iii) additional personal contributions; (iv) transfers from other regulated superannuation funds; and (v) contributions for the benefit of a spouse.

The *Defence Legislation Amendment Act (No. 1) 2005* (Act No. 121, 2005) made a number of technical amendments to the *Military Superannuation and Benefits Act 1991* in order to ensure that various instruments provided for in the Act, such as amending Trust Deeds, are “legislative instruments” for the purposes of the *Legislative Instruments Act 2003* with effect from 1 January 2005. The amending Act also abolished the retention benefit for new members of the scheme with effect from 6 October 2005; a savings provision ensures the retention benefit continues to apply to people who were already members when the amending Act took effect.

The *Superannuation Laws (Abolition of Surcharge) Act 2005* (Act No. 102, 2005) abolished the superannuation contributions surcharge that had previously applied to the MSBS.

## appendix 6: compliance

While this report is not a Departmental annual report, the Board has endeavoured to comply with the 'Requirements for Departmental Annual Reports', where applicable. Details of ComSuper's operations are provided in the Commissioner for Superannuation Annual Report 2004–05. Annual reporting requirements that are met in the Commissioner for Superannuation's report are indicated below by an asterisk.

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## appendix 7: freedom of information

### Freedom of Information Act statement

This statement is provided in accordance with section 8 of the *Freedom of Information Act 1982* (the FOI Act).

### functions of ComSuper

The general functions of ComSuper are described in the main body of this report and in the Commissioner for Superannuation Annual Report 2005–06.

### decision-making powers

The decision-making powers of the MSB Board are set out in clause 3 of the MSB Trust Deed. The authority for the MSB Board to delegate its powers and functions is contained in clause 12 of the MSB Trust Deed.

### FOI internal procedures

All requests for documents are referred to ComSuper's Corporate Reporting and Parliamentary Liaison Unit. Compliance with the application fee provisions of the FOI Act are verified and the request is registered and acknowledged. The documents are then obtained and the request is considered by the unit.

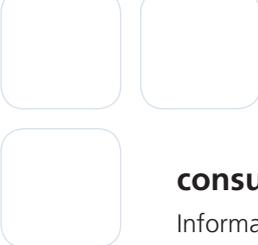
Decisions to grant access, levy charges, or refuse access are made by an APS Level 6 in the Legal and Compliance Unit.

Requests for internal review of FOI decisions are also referred to the unit. They are then forwarded to the Reconsideration Section where they are investigated by Executive Level 1 officers prior to submission to the Authority for decision under section 54 of the FOI Act.

### facilities for access

Facilities for viewing documents are provided only at the ComSuper office in Canberra, as ComSuper has no regional offices. Publications may be inspected at ComSuper's Parliamentary, FOI and Complaints Unit, and copies (for which there may be a charge) can be obtained by writing to ComSuper.

Information about facilities for access by people with disabilities can be obtained by contacting the Freedom of Information Unit at the address and telephone numbers shown on page 79 of this report.



## **consultative arrangements**

Informal and ad hoc arrangements exist whereby the national, State and Territory branches of the Regular Defence Force Welfare Association may make representations relating to the general administration of the scheme. Representations are also received which relate to the determination of individual contributors' benefit entitlements.

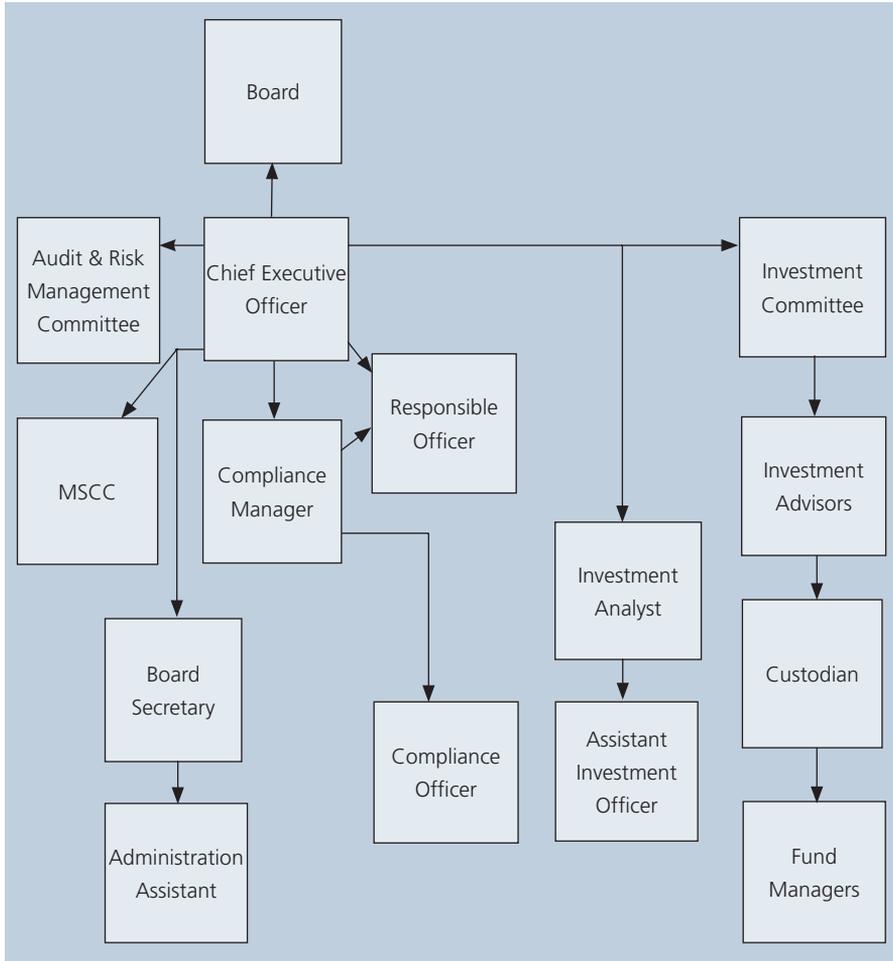
Requests for consultation and/or representations relating to policy aspects of the schemes and their underlying legislation are referred to the Superannuation Branch of the Department of Defence which has responsibility for advising the Minister Assisting the Minister for Defence and the Minister for Veterans' Affairs on such matters.

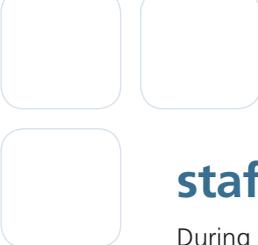
## **categories of documents**

The MSB Board maintains no categories of documents that are open to public access as part of a public register or otherwise, in accordance with an enactment other than the FOI Act, where that access is subject to a fee or other charge.

Books, leaflets and fact sheets that describe various aspects of the Military Superannuation and Benefits Scheme, and annual reports, are made available to the public free of charge upon request. They are also available free of charge via the MilitarySuper website ([www.militarysuper.gov.au](http://www.militarysuper.gov.au))

## appendix 8: msb board executive unit





## staff resources

During 2005-06 the staff resources of the Board Executive Unit comprised staff employed directly by the Board together with three employees of ComSuper who were made available by the Administrator to assist the Board Executive on a cost recovery basis. However during the year these three ComSuper employees resigned their positions in order to accept full-time employment with the Board. Staff employed by the Board are engaged on fixed term contracts.

### professional development

Ongoing staff training and development is an important component of the Board's human resource management as well as a specific requirement for the Board in maintaining its Australian Financial Services (AFS) Licence. During 2005-06 all Trustees and Board staff had access to a range of continuing professional development activities including attendance at major industry conference and education forums as part of the Board's education and training policy.

### occupational health and safety

Under the *Occupational Health and Safety (Commonwealth Employment) Act 1991* and the *Safety, Rehabilitation and Compensation Act 1988*, the MSB Board has a general duty of care which must be met by taking all reasonably practicable steps to protect the health and safety of its employees and third parties at work. Staff employed by the MSB Board are covered by Workers' Compensation which is managed by Comcare. During the year:

- there were no dangerous occurrences under section 68 of the *Occupational Health and Safety (Commonwealth Employment) Act 1991*;
- there were no workplace inspections carried out by Comcare; and
- there were no remedial Provisional Improvement Notices issued.

## financial resources

### Board administration costs

The MSB Board is responsible for the administration of the MSB and the management and investment of the MSB Fund. Costs of the MSB Board which are related to its responsibilities for the management of the MSB Fund and the investment of its monies are a charge against the Fund. Fees paid to the Chairman of the MSB Board and a proportion of those paid to Board members are also a charge against the Fund.

All other costs incurred by the MSB Board are met from moneys appropriate to the Department of Defence and paid to ComSuper in relation to the administration of the MSB Scheme.

## **funding arrangements**

The MSB legislation only allows the Board to hold monies belonging to the MSB Fund. The legislation does not provide any capacity for the Board to hold monies in respect of an administration activity.

The Board has sought legislative change to enable it to be financially accountable and responsible for its own administration expenses. Until such time as separate funding arrangements can be made administration expenses related to the MSB Board's non-investment activities are drawn by ComSuper from the administration fees paid by Defence and maintained separately from ComSuper's own operating budget. These funds may only be used to meet Board administrative expenditure as determined by the Board.

During 2005–06 the Board Executive Unit assumed responsibility from ComSuper for the processing of Board accounts, maintaining accounting records and for the production of Board financial statements.

## **ecologically sustainable developments and environmental performance**

In conducting its operations, the MSB Board makes every effort to minimise the environmental impact of its activities by ensuring that:

- all waste paper and cardboard are recycled;
- lighting and energy use are minimised; and
- the Board's offices, where practicable, use recycled paper and other products in its activities.

## **fraud control**

The Board's Fraud Control and Fraud Risk Assessment Plan is reviewed and updated at least annually and forms an integral part of the Board's overall risk management strategy.

## appendix 9: staffing statistics

Employment category	Male	Female	Total
Full-time	2	5	7
Part-time	1	-	1
Totals	3	5	8

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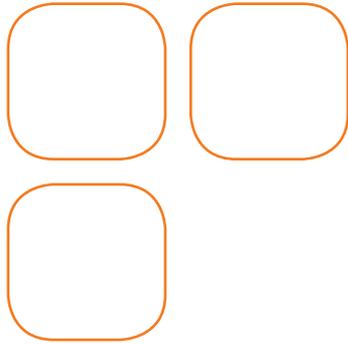
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**MSB Fund ABN:**

50 925 523 120

**SPIN:**

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