



The MSB Board

# annualreport

2003:2004

**Military**  
Super

**Military Superannuation and Benefits Scheme**



msb

**msb board**  
**annual report**  
**2003-04**

*the military superannuation and benefits board of trustees no. 1 |*

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ISSN 1037 7956  
 ISBN 0-9752483-8-3

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Annual report: [www.militarysuper.gov.au/pages/reports.htm](http://www.militarysuper.gov.au/pages/reports.htm)

MSB Fund ABN: 50 925 523 120

SPIN: CMS0103AU

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.

Senator the Hon. Robert Hill  
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 2004, together with financial statements in respect of the management of the Military Superannuation and Benefits Fund during 2003-04, 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 sincerely



Charles Kiefel, BCom, FCA, FAICD  
Chairman  
MSB Board of Trustees

5 October 2004



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# CHAIRMAN'S OVERVIEW

In the three years to 30 June 2003, equity markets around the world performed poorly and for the average investor and superannuation fund member there was little comfort in the knowledge that their superannuation fund performed better than its peers or its benchmark simply because it lost less money than they did. For the member they still lost money.

The MSBS was not insulated from the impacts of falling markets and, like all similar superannuation funds, recorded negative returns in both 2001-02 and 2002-03. However, for 2003-04 the MSB Fund has performed strongly, recording a return on investments in the Growth (default) option of 15.56% for the year. This level of return places the MSBS in the top quartile amongst schemes in its peer universe.

This level of investment return was achieved because of the Fund's high exposure to growth assets (predominantly domestic and international shares). Therefore, as share markets around the world rebounded from the highly volatile and low return environment of the previous two financial years, the MSB Fund was well placed to take advantage of improved market conditions.

Although the Fund's impressive performance in 2003-04 can be directly attributed to the Fund's high exposure to equities, and therefore to market generated returns, this level of exposure to the market was also the cause of the poor performance of the Fund in 2001-02 and 2002-03. Therefore, going forward it is the Board's strong view that it must explore investment strategies that are capable of providing sustainable levels of annual returns above the 10% nominal return target on member investments in all market conditions. This required a fundamental rethink of the way in which the assets of the Fund are invested to see whether or not there are better strategies and investment products available which will enable the Fund to benefit from improved market performance, yet provide protection during periods where markets are falling. This involves looking at strategies and investment products which provide good growth prospects not directly correlated to listed equity (i.e. share) markets or which offer long-term, secure income streams. It also involved the development of investment return objectives which are not linked to a benchmark return but rather are expressed in absolute return measures (i.e. an expected average rate return of no less than 10% pa) and selection of managers with stronger skills to add value.

To enable it to undertake the research required, the Board established an Investment Committee in November 2003,

supported by four investment advisers who are representative of the best investment minds in Australia today. The initial work of this committee was supplemented by discussions and visits during early 2004 with over 50 fund managers in the United States and the United Kingdom and further consultations with some of the world's largest and most successful institutional investors.

A major finding arising from the program of manager visits was that the overwhelming majority are forecasting a low-return environment for markets in the immediate future, with the vast majority of managers forecasting returns of between 7% and 9% pa over the next ten years. In this environment the MSB Fund's current high exposure to equity markets represents a risk to long term, sustainable investment returns.

In addition the general consensus was that large fund managers dealing with large cap stocks were unlikely to generate higher levels of return because of the size of assets under management. The use of small boutique managers, with good processes, strong skills and outstanding performance records, which are independent and usually employee owned, are likely to provide better return opportunities because of their smaller size and nimble approach to rebalancing in response to market events.

These findings were consistent with the intelligence derived from the visits to the large endowment funds such as Yale, Harvard and Columbia Universities and large US pension funds such as the General Motors Pension Fund and the IBM Pension Fund. In these funds there has been an increased move in recent years away from reliance on market returns (or Beta) towards increasing Alpha (i.e. excess returns above Beta). These findings acted to validate the outcomes from the Board's own research which suggested the need to move the Fund to an absolute or Alpha maximising return strategy in which greater emphasis would be placed on manager skill and alternative (i.e. non-listed market) sources of sustainable return. Unlike traditional marketable securities, absolute return investments provide returns which are largely independent of listed market movements. They seek to generate high long-term real returns by exploiting market inefficiencies and also provide significant diversification benefits. They also provide a hedge against unanticipated inflation, geopolitical events and poor performance by listed markets.

Investments which fall into this category comprise private equity (venture capital and buyouts), infrastructure investments, hedge funds and real assets (real estate, timber, commodities, oil and gas).

## changes to investment strategy

Given the expectation of lower investment returns from traditional markets, and acting with the advice of its investment advisers, the Board has developed a revised strategy. Details of this revised strategy can be found on page 6 of this report. However, the new strategy has as its core an absolute return objective of achieving sustainable long-term investment returns of at least 10% pa over the long term with reduced risk of negative return. This will be achieved by reducing the Fund's exposure over time to market-generated returns and seeking to add value from a diverse range of non-traditional asset classes whose return characteristics are not closely aligned to listed equity markets.

Given the nature of the changes, the achievement of target allocation levels will take some years and therefore the process of transition to the new strategic asset allocation will be done in a measured way as investment opportunities in alternative investment classes become available.

However, consistent with the Board's new investment philosophy the Fund is quickly moving to implement changes to investments in traditional asset classes such as International and Domestic Equities.

## transition to new international equity managers

Using sophisticated analytic tools the Board's investment advisers researched the universe of international fund managers and identified a number of small (in funds under management terms) but high-quality international equity managers which have demonstrated a sustained ability to outperform the market in all economic conditions through active management. Although less well known in the Australian market each of the managers has an impressive track record and is highly rated by multiple asset consultants worldwide.

As a result, during June 2004 the Board terminated a number of existing investment mandates for managers whose investment style and approach no longer suited the new investment strategy adopted by the Board and proceeded to reallocate investments held by those managers to eight new International Equity managers.

The process of transition commenced in early June and was completed by 29 June. This was a large task made more difficult by the proximity to the end of the financial year. The in-specie transfers represented 17% of the existing equity

portfolio with net trades of approximately A\$630 million required to complete the transition within the very tight timetable set by the Board. That this task was completed smoothly and on time is of great credit to the Board's transition manager, Citigroup, its Custodian, National Custodian Services, and the team of advisers at Strategic Capital Management and IPAC Financial Services who helped coordinate the process.

The Board is currently reviewing its arrangements in the Domestic Equity sector and expects to implement changes consistent with the new strategy early in the new financial year.

### **other important initiatives**

Although investment activities have dominated the second half of this financial year there were a number of other important events during the year:

- With effect from 16 February 2004 the Board became licensed under the Financial Services Reform legislation.
- Scheme rules were amended to provide for the creation of separate interests in the MSBS for parties subject to the new family law arrangements.
- Improvements to the processes enabling members to access information about their superannuation accounts 'online' were implemented.
- Legislation was enacted recognising certain environmental allowances as salary for superannuation purposes.

### **a strong commitment**

It is the Board's intention that the MSBS be seen as one of the very best funds in Australia, providing valuable service 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. We believe that the changes to investment strategy being undertaken will place the MSB Fund at the forefront of investment philosophy and strategy in Australia.

### **acknowledgements**

I commend my fellow Trustees for their commitment, cooperation, support and hard work during a period of significant change.

On behalf of the Board I would like to particularly commend the work of our four Investment Advisers on the newly formed Investment Committee who, with assistance from the Board Executive, worked tirelessly on the review of investment strategy, the coordination of the large number of manager visits and ultimately on the transition to new manager arrangements in the International Equity portfolio. This was an enormous task which will have long-term benefits for all members of the scheme.

I would also like to express my thanks to the Board Executive for sound advice, assistance and support, to ComSuper, the Scheme Administrator, and to IPAC, the Fund's Portfolio Manager, for their continuing good work throughout the year.

A handwritten signature in black ink, appearing to read "Charles Kiefel". The signature is fluid and cursive, with a large initial "C" and "K".

Charles Kiefel  
Chairman

*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 interest (at the crediting rates of the Fund); 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 on an emerging cost basis) 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 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%.

**table 1: MSBS employer benefit accrual rates**

Years of service	% of FAS* per year
< 7 years	18%
7–20 years	23%
> 20 years	28%

\*FAS (Final Average Salary) is salary averaged over the last three years of service.

MSBS benefit accrual rates are significantly higher than the community average.

Member and employer productivity contributions made each fortnight are paid into an investment fund (the MSB Fund). The management and investment of the Fund is the responsibility of the MSB Board.

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

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 2004 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 and is a Fellow of the Institute of Chartered Accountants and a Fellow of the Australian Institute of Company Directors.

*Minister's Nominees:*



**Dr Michael Sharpe** AO, Hon DScEcon (Syd.), BEc, FCA, FAICD  
Trustee since 29 April 1998

Dr Sharpe is a Director of Australian Stock Exchange Limited. 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 an adviser to Government.



**Mr Phil Charley** MFinMgt, GradDip Strat Studies, GDTax, FCPA, FAICD  
Trustee since 14 September 2000

Mr Charley is the former Director, Superannuation, Department of Defence. He has graduate diplomas in Strategic Studies and Tax and a master's degree in Financial Management. He is also a Fellow of the Australian Society of Certified Practising Accountants and a Fellow of the Australian Institute of Company Directors.



*ADF Nominees:*



**Air Commodore Lee Roberts** CSC, MSc, GradDip Strat Studies, BSc, GAICD  
Trustee since 26 September 2003

Air Commodore Lee Roberts is currently the Director General Workforce Planning, Recruitment & Retention in the Defence Personnel Executive. He has served as a pilot and flying instructor extensively within Australia and overseas during his 32-year Air Force career. He is a Graduate of the Australian Institute of Company Directors, holds a Certificate of Superannuation Trusteeship and has previous experience as an Alternate Trustee of the MSBS. 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 a Staff Officer within the Director General Personnel Airforce. He has served throughout Australia and overseas for 25 years as an Aircrewman 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 nine years he has acted as the Other Rank trustee, and has also been a member of the Board's Audit and Communication Committees.

**indemnity insurance**

The Board is insured with American Home Assurance Company against losses, liabilities, actions, claims or demands arising from the performance of its functions. To date there has never been a claim against the Board or a Trustee that has resulted in the loss of members' moneys, nor have any regulatory penalties been applied.

## schedule of Board meetings

	23 Aug 2003	17 Sep 2003	29 Oct 2003	27 Nov 2003	17 Dec 2003	18–20 Feb 2004	12 May 2004	16 Jun 2004
Mr Charles Kiefel	P	P	P	P	P	P	P	P
Dr Michael Sharpe	P	P	P	P	P	P	P	P
Mr Phil Charley	P	P	P	P	P	P	P	P
BRIG Bob Brown <sup>1</sup>	A	P						
AIRCDRE Lee Roberts <sup>2</sup>			P	P	P	P	P	P
WOFF Robert Swanwick	P	P	P	A	P	P	P	P
WO Michael Doncaster <sup>3</sup>	P	P	P	P	P			

P—present at meeting    A—apologies

- 1 BRIG Bob Brown resigned on 26 September 2003.
- 2 AIRCDRE Lee Roberts was appointed on 26 September 2003.
- 3 WO Michael Doncaster was alternate to WOFF Robert Swanwick. He resigned on 29 December 2003.

*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 MSB investment strategy for 2003–04 was based on an objective of achieving a long-term return of at least 5% above inflation. Performance against that objective is measured by averaging over rolling five-year periods. It is not expected that Fund returns will exceed 5% above inflation each and every year and it is recognised that returns may be negative in some years.

## investment strategy

All investment funds must balance risk against returns. That is, they must determine the mix of growth assets and defensive assets that best suits their members' needs.

Growth assets are investment vehicles (such as shares and property) that are very responsive to market fluctuations. They therefore involve a higher degree of risk, but have the potential to provide a higher return. On the other hand, defensive assets (such as cash and bonds) are less susceptible to market fluctuations, and are therefore less risky investments. However, with this reduction in risk comes a reduced potential for growth.

The main points of the Board's investment strategy for the Growth (default) option (see page 9) in 2003–04 were:

- The strategic or target asset allocation is 85% to growth assets and 15% to defensive assets.
- The MSBS does not have a reserve account. A reserve account is used to smooth out the rates of return members receive. Members of the MSBS benefit by having all Fund earnings distributed to their accounts (after tax and all expenses are deducted). That is, they generally receive a higher crediting rate 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.
- The focus of risk control is the total Fund, not individual sectors. The overall Fund risk is kept within a specified range, so the Fund can be neither too aggressive (creating an excessive possibility of losses), nor too defensive (reducing growth potential).
- The Board's 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. These instruments cannot be used to leverage the Fund or to place the Fund in a position where it is short an asset class.

- No single asset can exceed 7.5% of the Fund's total value. For example, the fund cannot hold more than 7.5% of its total assets in shares of a particular company.
- The exposure to a single economic entity, as an investment issuer or a counterparty, must not exceed 10.0% of the total Fund value (Australian Government debt is excluded from this restriction). For example, if the Fund had 7.5% of its funds in Company 'A' shares, then it could not own more than 2.5% in Company 'A' debentures.

## changes to investment strategy

Given the expectation of lower investment returns from traditional markets, and acting with the advice of its investment advisers, the Board has developed a revised strategy. This has as its core an absolute return objective of achieving sustainable long-term investment returns of at least 10% pa over the long term with reduced risk of negative return. This will be achieved by reducing the Fund's exposure over time to market-generated returns and seeking to add value from non-traditional asset classes whose return characteristics are not closely aligned to equity markets.

Where the Fund retains an exposure to equity markets it will be the Board's intention to seek 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 returns, the manager selection process will favour managers with exceptional bottom-up fundamental research capabilities. Therefore, recognising the difficulty of outperforming the market on a consistent basis, emphasis on manager selection will be on those with high integrity, sound investment philosophies, strong track records, superior organisations, and sustainable competitive advantages.

With the assistance of its investment advisors and drawing from the mountain of research data obtained during the course of the overseas manager visits and discussions with major institutional investors in the United States, the Board has developed the following as the Fund's long-term asset allocation for the Growth (default) option, consistent with the



objective of achieving an absolute return of more than 10% pa over the long term.

**table 2: strategic asset allocation for the MSB Growth option**

	Existing	Proposed
International Equities	32% (including Emerging Markets)	30%
Australian Equities	36%	25%
Property (including Direct/listed)	6%	10%
Private Equity	7%	10%
Infrastructure	Nil	10%
Uncorrelated Alpha	Nil	10%
Bonds/cash/other	19%	5%

Given the nature of the changes, the achievement of target allocation levels will take some years and therefore the process of transition to the new strategic asset allocation will be done in a measured way as investment opportunities in attractive alternative investment classes become available.

However, consistent with its new investment philosophy the Fund is expeditiously moving to implement changes to investments in traditional asset classes such as International and Domestic Equities.

### **transition to new international equity managers**

During June 2004 the Board terminated a number of existing investment mandates for managers whose investment style and approach no longer suited the new investment strategy adopted by the Board and proceeded to reallocate investments held by those managers to eight new International Equity managers.

The process of transition began in June and was effectively completed by 29 June.

The new International Equity mandates which will come into operation from 1 July 2004 are listed in Table 3:

**table 3: new International Equity mandates to operate from 1 July 2004**

Manager	Style	Capitalisation bias	Region	Allocation
Axiom	Growth	Mid to Large	Global	10%
Causeway	Value	Mid to Large	EAFE	16%
Driehaus	Growth	Small Cap	US	6%
Gardner Lewis	Growth	Large	US	9%
Gardner Lewis Long/Short	Growth L/S	Large	US	5%
Hotchkis and Wiley	Value	All Cap	US	8%
Sterling Johnston	Growth	Small	US	6%
Sterling Johnston Long/Short	Growth L/S	Micro to Small	US	4%
TCW Value Opportunities	Fundamental	Small to Mid	US	9%
TCW Pluris	Concentrated	Large	US	6%
T Rowe Price	Growth	Large	EAFE	11%

BGI Global Investors has been retained.

The Board is currently reviewing its arrangements in the Domestic Equity sector and expects to implement changes consistent with the new strategy early in the new financial year.

## 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 advice to assist it with the review of its investment policy, and to examine the performance of funds managers and the adequacy of the returns achieved by the Board.

Increasingly during the latter half of 2003-04 the newly formed Investment Committee, supported by its four specialist investment advisers, played a significant role in the review of the existing investment strategy. This work resulted in the provision of recommendations to the Board which have led to significant change in both long-term strategy and the approach to implementation of that strategy. An ongoing responsibility of the Committee will be to continually review the performance of individual managers and to recommend strategic changes in response to changing economic and market conditions.

## 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 2004 are shown in Table 8.






## 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 Scheme's funds.

## 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 elect an investment choice, the default option (Growth) is applied. The five options are depicted in the following diagram:

Strategy		Type of asset	
	Cash	100% Defensive	
	Conservative	30% Growth	70% Defensive
	Balanced	70% Growth	30% Defensive
	Growth (Default strategy)	85% Growth	15% Defensive
	High Growth	100% Growth	

## how the change in investment strategy impacts on existing choice options

Members will continue to be able to experience choice in relation to their individual tolerance for risk in relation 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 contrast with 'defensive' assets such as fixed interest and cash.

In the current choice options the allocation to growth assets is achieved predominantly by investments in listed domestic and international equities (shares). However, listed equity markets are extremely volatile and recent history has demonstrated the capacity for market-generated returns to swing violently from positive to negative in response to market forces and worldwide events. The Board's research also confirms that, going forward, listed equity markets are unlikely to return other than single-digit performance in the foreseeable future.

Accordingly, 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 will increasingly seek, in line with the new investment strategy, to diversify away from reliance on market-generated returns alone. This will be 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 10%
- Infrastructure 10%
- Uncorrelated Alpha 10%

Accordingly members will continue to be able to exercise choice in relation to their individual tolerance for risk in relation to growth assets. That is, the existing five options will continue to be available, although their composition may differ over time.

### 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.

The Fund will look for increased investment opportunities in all forms of property investment up to the strategic asset allocation limit set for that asset class.

### **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. The Fund has not yet invested in venture capital proposals.

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.

However, the potential for this form of investment to provide returns over the longer term which significantly exceed returns

from listed markets can be seen from the following table which compares the returns achieved from US private equity funds against those from public (listed) markets.

**table 4: returns achieved from US private equity funds compared with those from public (listed) markets**

Top quartile funds	1 year	5 years	10 years
Venture	24.5%	178.9%	57.7%
Buyout	31.9%	17.2%	24.4%
Mezzanine	16.3%	13.6%	14.9%
All Private Equity	29.9%	49.7%	40.0%
Public markets			
Dow Jones	25.3%	2.6%	10.8%
S&P 500	26.4%	-2.0%	9.1%
NASDAQ	50.0%	-1.8%	9.9%

Source: Venture Economics and Bloomberg

## 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.

## 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 (roads, timberland, oil and gas) or in hedge funds which 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.

## investment performance

For the 2003–04 financial year the MSB Fund performed strongly as listed markets around the world rebounded strongly from the disappointing performance in the previous two years.

Global emerging markets recorded an impressive 28.2% return for the financial year, followed by international shares which climbed 24.4% in (\$A) hedged terms and 19.4% in unhedged terms. Australian shares also captured the positive sentiment in equity markets (up 21.7%) and in doing so the local market reached a record high during June, spurred on by expectations of strong company earnings.

Given its high exposure to listed Domestic and International Equity markets, the MSB Fund was well placed to capitalise on the improved market conditions, recording an impressive return of 15.56% in the Growth option (in which the bulk of members' moneys are invested).

The returns achieved in each of the five member investment choice options for the year to 30 June are as follows:

Cash	4.44%
Conservative	8.06%
Balanced	14.15%
Growth (default)	15.56%
High Growth	18.90%

It is important to keep in mind that, with the exception of the 2001–02 and 2002–03 financial years, the Fund has achieved strong positive investment results every year since it began in 1991.

**table 5: average returns over rolling five-year periods for the Growth option**

5 years ending	Average annual rate of return
30 June 2004	3.8%
30 June 2003	2.4%
30 June 2002	4.6%
30 June 2001	10.5%
30 June 2000	11.8%

Table 6 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 6: investment performance by sector 2003-04

Sector	Effective exposure at 30 June 2003		Effective exposure at 30 June 2004		Performance 2003-04	
	\$m	%	\$m	%	Fund <sup>1</sup> %	Benchmark <sup>2</sup> %
Cash <sup>3</sup>	11	1	69	5	5.0	5.3
Australian fixed interest	66	6	66	5	3.0	2.3
International fixed interest	76	7	67	5	4.9	4.1
Australian property securities	55	5	76	5	17.3	16.8
Australian shares	407	37	534	37	21.7	21.7
Private equity <sup>4</sup>	52	5	72	5	15.6	na
International shares <sup>5</sup>	386	35	469	33	22.4	21.9
Hedge funds	29	2	55	4	10.0	5.1
Global emerging markets	24	2	20	1	26.6	28.2

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 Transaction and administration costs are paid out of the cash portfolio.

4 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.

5 Fifty per cent of the international share exposure was hedged.

## fund growth

Fund assets available for investment at 30 June 2004 totalled \$1 428m.

After accounting for non-investment related assets and liabilities the Fund totalled \$1 429m, a 27.6% increase from 2002-03 (see Table 7). Chart 1 shows how the Fund has grown since 1999-2000.

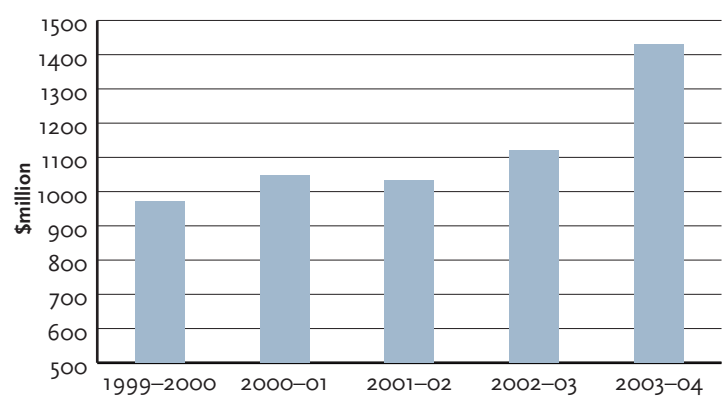
**table 7: Fund net assets at 30 June 2004 (after tax, charges and benefits)**

<b>Fund net assets at 30 June 2003</b>	<b>\$m</b> <b>1 120</b>
Inflow	
Member contributions	112
Employer contributions	63
Appropriation from CRF	120
Investment earnings	218
Outflow	
Benefits paid	(162)
Investment and other expenses	(11)
Tax expenses	(31)
<b>Fund net assets at 30 June 2004</b>	<b>1 429</b>

<b>Value of investments at 30 June 2004</b>	<b>\$m</b> <b>1 428</b>
Less	
Benefits payable	(2)
Other liabilities	(3)
Plus	
Cash on hand	2
Other assets	4
<b>Value of Fund at 30 June 2004</b>	<b>1 429</b>

**chart 1: Fund size at 30 June for the past five years**



## investment choice options

The following series of bar charts in Chart 2 illustrate the existing strategic asset allocation for each investment choice and the revised allocation which will be achieved over a period of time.

chart 2: existing and revised strategic asset allocations for each investment option

### Cash

#### Current

Cash 100%

#### Proposed

Cash 100%

### Conservative

#### Current

Cash 20%  
 Property 7%  
 Australian Equity/Shares 14%  
 International Equity/Shares 9%  
 Australian Fixed Interest 30%  
 International Fixed Interest 20%

#### Proposed\*

Cash 20%  
 Property 7%  
 Australian Equity/Shares 14%  
 International Equity/Shares 9%  
 Australian Fixed Interest 30%  
 International Fixed Interest 20%

\*Infrastructure is not included as this strategy is aimed at members expecting to access their super within 2-5 years.

### Balanced

#### Current

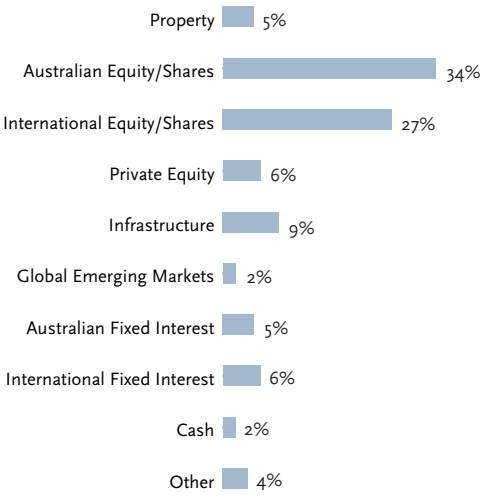
Property 8%  
 Australian Equity/Shares 37%  
 International Equity/Shares 26%  
 Hedge Funds 2%  
 Australian Fixed Interest 14%  
 International Fixed Interest 13%

#### Proposed

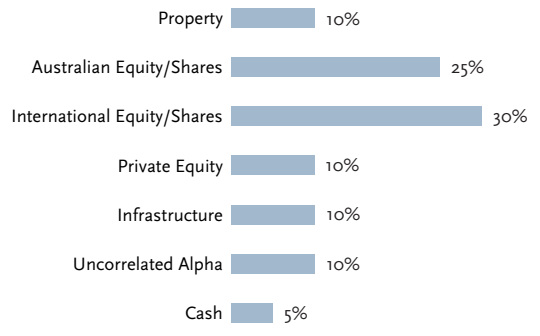
Cash 10%  
 Property 8%  
 Australian Equity/Shares 25%  
 International Equity/Shares 30%  
 Uncorrelated Alpha 7%  
 Infrastructure 20%

## Growth

### Current

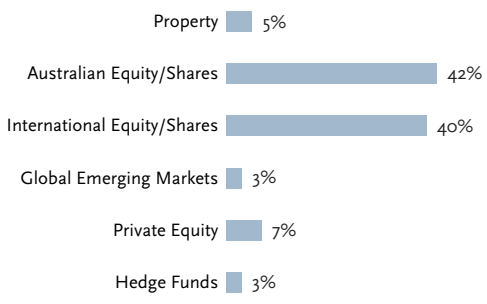


### Proposed



## High Growth

### Current



### Proposed

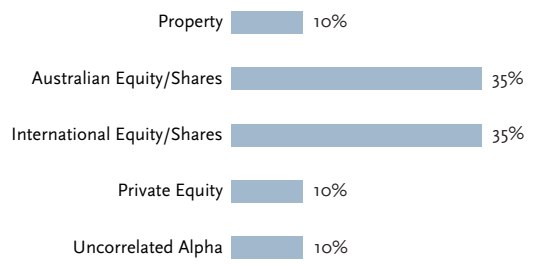


table 8: investment managers as at 30 June 2004

Asset class	Investment manager	Allocation \$m
Cash	National Custodian Services	3.4
	Alliance Capital Management	60.4
	Super Members Home Loans Scheme	5.0
Australian fixed interest	Credit Suisse Investment Management	66.2
International fixed interest	BlackRock Financial Management	33.1
	PIMCO Australia	33.4
Australian property securities	Citigroup Asset Management	37.4
	SG Hiscock & Company	36.9
International property securities	Fiduciary International Real Estate Fund	2.2
Australian shares	Acorn Capital	15.1
	Alpha Investment Management	107.0
	Barclays Global Investors	117.9
	Maple-Brown Abbott	117.8
	Schroder Investment Management	63.2
	SG Hiscock Small Companies Trust	15.8
	UBS Global Investment Management	97.0
International shares	Axiom International Investors	48.2
	Bernstein Investment Management <sup>1</sup>	0.1
	BGI International Alpha Equity Fund	49.7
	Causeway Capital Management	77.1
	Dresdner RCM Global Investors <sup>1</sup>	0.0
	Driehaus International	29.3
	Gardner Lewis	43.1
	Gardner Lewis (long/short)	24.4
	Hotchkis and Wiley Capital Management	38.5
	Sterling Johnston Capital Management	29.1
	TCW Value Opportunities	43.2
	TCW Pluris	28.7
	T Rowe Price	52.3
Wellington International Management <sup>1</sup>	9.2	
<b>Private equity</b>		
<i>Global private equity</i>	CSFB IV	5.8
	HarbourVest VII (Buy-out)	1.7
	HarbourVest VII (Venture)	1.1
	HarbourVest VII (Mezzanine)	1.2
	HarbourVest IV (Partnership)	7.1
	Pantheon US Fund IV	2.3
	Pantheon Europe III	0.7
	Sentient Global Resources	3.7



<i>Domestic private equity</i>	CHAMP Ventures Investment Trust 5a	0.8
	CHAMP Ventures Investment Trust 5b	0.8
	Deutsche Private Equity Fund	8.9
	Gresham Fund No. 1	3.5
	Gresham Fund No. 1A	1.2
	Pacific Equity Partners	1.2
	Pacific Equity Partners Supplementary Fund	1.0
<i>Domestic infrastructure</i>	Macquarie GIF II	5.8
	Macquarie GIF A	9.1
	Macquarie GIF B	9.5
	Macquarie GIF C	3.2
	Macquarie GIF D	3.4
<b>Hedge funds</b>	BGI Equity Market Neutral Fund	31.4
	BGI Total Return GI Equity Market Neutral	23.9
<b>Global emerging markets</b>	Nicholas-Applegate Capital Management	20.4
<b>Currency</b>	Bridgewater Associates	0.3
	FX Concepts	0.4
	Pareto Partners	(5.1)
<b>Total investments</b>		<b>1 428.0</b>
<b>MilitarySuper net assets / (liabilities)<sup>2</sup></b>		<b>1.0</b>
<b>Net assets of Scheme<sup>3</sup></b>		<b>1 429.0</b>

- 1 Terminated 30 June 2004.
- 2 MilitarySuper net assets / (liabilities) represents benefits payable, tax provisions and cash at bank.
- 3 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.

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NO. MSB7

**UNITISATION**

**What is unitisation?**  
Unitisation is an alternative means by which the net assets of the MSB Fund can be attributed to the individual members of the MSB. It essentially results in the MSB Fund being divided into a number of units, and each MSB member (member holding a number of these units) will own a part of the Fund.

Since it is not possible to purchase shares, where MSB members contribute to the Fund they will be allocated additional units depending on the size of their contributions and the unit price at the time the contributions are processed. On the other hand, when members receive a benefit from the Fund they will be effectively 'selling' or 'redeeming' their units at the market value and price.

Earnings arising from the investments of the Fund are to now be reflected in the daily price of the units.

**The benefits of unitisation**

- Having a unit in the Fund means you can equally distribute investment income on a daily basis.
- At the time of unitisation, members will be able to check the Fund's performance on the Military Super website where the unit price will be updated on a daily basis.
- Better visibility of Fund performance – daily updates provided through the unit price.
- Better access to information – unit price updated on the website each morning.

**Why is the MSB Board unitising the Fund?**  
The current interest rates for the MSB require the MSB Board to declare an annual dividend rate and assembly cost rates. The interest rates are a source of uncertainty for the members of the MSB Fund. The MSB Board has decided to unitise the Fund to provide a more stable and predictable investment environment. These interest rates are also applied to the unitised components such as the DFB (dividend value) which track the opening rates of the Fund.

The MSB Board has a policy of distributing all of its investment income to members, but it does not receive a share in interest and fluctuations in investment income.

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## unitisation

The MSB Fund has been 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 are 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 lead to 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 the MSBS). The most current issue and withdrawal prices are provided on the MilitarySuper website for the information of members. The issue and withdrawal prices at 30 June 2004 are provided in Table 9. 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 9: unit prices as at 30 June 2004**

<i>Strategy</i>	<i>Issue price</i>	<i>Withdrawal price</i>	<i>Financial YTD rate of return</i>
Cash	\$1.044388	\$1.044388	+4.4388%
Conservative	\$1.080587	\$1.080587	+8.0587%
Balanced	\$1.141509	\$1.141509	+14.1509%
Growth	\$1.131927	\$1.131927	+15.5564%
High Growth	\$1.188956	\$1.188956	+18.8956%

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



## 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' contributions. 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.

## administrative agreement

The Commissioner for Superannuation and, through that office, the 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.

During the year negotiations commenced on the establishment of a new agreement covering the relationship between the Board, the Department of Defence (as the Employer) and ComSuper (the Scheme Administrator). The purpose of these negotiations is to clarify the roles and responsibilities of each party and to formally acknowledge the accountabilities of each.

## delegations

The Board adopts a practice whereby relevant powers are delegated to ComSuper staff to exercise for and on its behalf.

This practice streamlines the delegation process and allows faster updating of authorisations to accommodate changes.

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, previously the Audit Committee, is a subcommittee of the full Board. During 2003–04 the Committee comprised Dr Michael Sharpe (Chairman), Mr Phil Charley and WOFF Robert Swanwick.

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 adviser 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 and daily unit prices.

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

### **Investment Committee**

The Investment Committee charter sets out the role, composition, authority, responsibilities and operation of the Investment Committee of the Board.

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 Board's General Manager acts as Secretary to the Committee. The Committee met seven times during the year.

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

During the year the former Military Superannuation Communications Advisory Committee (MSCAG) was reconstituted and became the Military Superannuation Communication Committee. The current Chairman is Air Commodore Lee Roberts and membership comprises representatives of the Department of Defence and the DFRDB Authority.

The primary objective of the new 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 through clear, timely and accurate reporting to members and ensures 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.

### **Reconsideration Committee**

The Chairman of this Committee is Brigadier David Buring AM, the MSBS pensioner representative. The Committee includes representatives from the Board and ComSuper as well as an ADF member of the rank of Colonel or equivalent. The Committee met on eleven occasions during the year.

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.

### **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. The Complaints Committee did not consider any complaints during the year.

### **Board Executive**

The Board appointed a General Manager to help oversight the operations of the Board Executive and to assist the Board in meeting the increased legislative and reporting obligations flowing from changes within the superannuation industry generally and the demands of a significant and fast-growing superannuation fund.

Major tasks undertaken during the year included the completion of work required to enable the Board to successfully apply for a licence under the Financial Services Reform legislation. To meet the significant resource cost associated with the development and implementation of systems and procedures for monitoring the work of staff (largely employed by ComSuper) authorised to provide general

product advice under the Board's AFS licence, the Board also appointed a Compliance Officer. The General Manager and the Compliance Officer hold appointments as Responsible Officers under the terms of the Board's AFS licence.

During the year the process of separating the Board Executive from the Administrator in both a physical and an operational sense continued. In particular the Board Executive is pursuing with the Department of Defence processes which would enable the Board to exercise a greater degree of financial independence from the Administrator (ComSuper) in relation to its own administrative expenditure.

## **status under the SIS legislation**

The MSBS is a regulated superannuation fund under the *Superannuation Industry (Supervision) Act 1993* (the SIS Act). All operational and legislative changes are independently reviewed within ComSuper to assess their impact against SIS requirements and to ensure that ComSuper's practices remain in concert with the SIS legislation. Further details of SIS compliance are given at page 57.

## **evaluation**

### **annual effectiveness reviews**

The Board's review of investment is covered on page 5 under 'Fund investment'.

In September 2003 the Board considered a report from ComSuper on the efficiency and effectiveness of the systems and procedures used in the administration of the MSB Scheme. As a result of that review the Board has commenced negotiations for a revised administrative agreement with ComSuper (see page 21).

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 2003–04 the Board's administrator continued to conduct its series of client satisfaction surveys with the assistance of the Canberra-based firm Orima Research. Clients

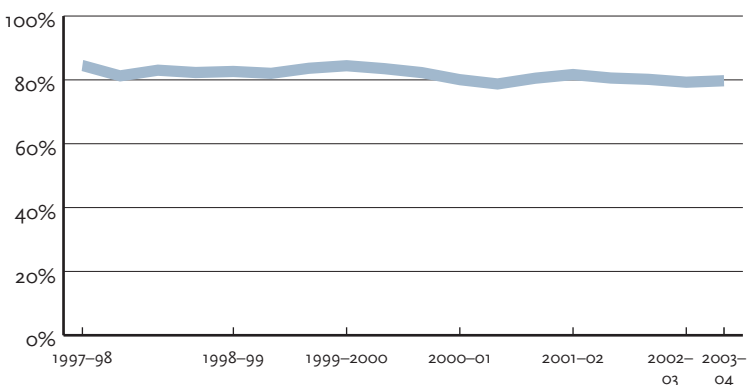


who had recent contact were surveyed once during the year. On a point scale of 1-10 the quality of services surveyed was consistently rated highly.

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 80% satisfaction level, Chart 3, which shows ComSuper's QSI scores for the military schemes in each of the eighteen 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 3: Quality Service Index (QSI) scores for military client satisfaction 1997-98 to 2003-04**



## financial services reform

Since March 2004, in common with most other superannuation funds, the MSBS has operated under the requirements of the Financial Services Reform (FSR) legislation. This legislation is designed to provide increased consumer protection for members of superannuation funds.

As a result of this reform the Board has obtained an Australian Financial Services Licence (number 238395) for the provision of general financial product advice. This is necessary because the MSBS offers members a range of investment choices.

Whilst members can expect the same high standard of service from MilitarySuper as in the past the Board is not permitted to provide them with personal financial advice,

i.e. superannuation advice that takes into account any of their personal circumstances. For the same reason Pay Offices have been instructed not to provide advice on MilitarySuper matters but instead to refer all enquiries to the Military Contact Centre.

### **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 can be found on the MilitarySuper website ([www.militarysuper.gov.au](http://www.militarysuper.gov.au)). It explains what financial services the Board provides for MilitarySuper and who delivers them.

The Product Disclosure Statement for MilitarySuper consists of three documents:

- *The Annual Report to Members;*
- *Take control of your future: your guide to investment choice;* and
- *The MilitarySuper Book.*

Together these documents describe all the main features of MilitarySuper. Members 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 any of a member's objectives, financial situation or needs. 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: 77310752950. ComSuper is an Australian Government entity which provides administrative assistance to the Board.

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 (PS 146).

The Board's General Manager and Compliance Officer have been appointed 'Responsible Officers' for the purposes of the Board's licence and two of the Trustees have successfully undertaken training to enable them to provide general financial product advice in accordance with PS 146.

*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 Administrative 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 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.

The following standards apply to these activities.

<i>standard</i>	<i>outcomes</i>
<p>Receipt of assurance (in a format agreed by the Board) in the annual management representation letter in respect of the systems used to maintain member records.</p> <p>A search for lost members aged 50 years and over will be conducted at six-monthly intervals and the results will be reported to the Board.</p>	<p><b>Management representation letters containing the assurances referred to were presented on 8 September 2003. These letters were subject to internal and external audit scrutiny.</b></p> <p><b>Lost members were regularly identified throughout the year and reported to the ATO as required by law. Similarly, searches for potential unclaimed benefits were also conducted. No cases requiring unclaimed benefits to be transferred to the ATO were identified.</b></p>

## system changes

In the 2002–03 annual report, details were provided of the implementation of the new CAPITAL system that was commissioned on 4 June 2002 and developed for military schemes administration.

During 2003–04 further bedding-in of the system continued, with further functionality enhancements being implemented

during the year. These enhancements allowed for member investment choice for MSBS members, a secure Internet logon for military members and pensioners, a new military contributions system to improve data, and a contributions reversal system that has reduced the number of contribution data fixes required. The CAPITAL system now provides an effective platform for the administration of the military schemes and as a payment system for pensions. The effectiveness of the system is reflected in the standards achieved in benefit processing during the year (see page 39).

## collection, banking, recording and maintaining contributions remittances

The basic rate of member contribution to the MSBS is 5% of salary, including higher duties and Service Allowance, although members can elect to contribute up to 10% of salary. The employer benefit is, for the most part, unfunded except for the 3% productivity contribution which is paid into the Fund by the Department of Defence.

Total contributions to the Fund during 2003-04 were \$174.9m, of which member contributions comprised \$112.2m, as shown in Table 10. Employer-funded contributions amounted to \$62.7m. The net appropriation for benefits for the year was \$119.7m (\$118.2m for 2002-03).

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

**table 10: contributors and contributions for the past five years**

Year	Contributors at year's end	Member contributions (\$m)	Employer-funded contributions (\$m)	Net appropriation contributions from Consolidated Revenue (\$m)
1999-2000	38 829	83.1	45.0	114.7
2000-01	39 513	86.7	47.9	108.3
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

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.

**standard**

**outcomes**

Contribution remittances to be deposited into the Board’s bank account on the same day as received.

**The Department of Defence directly credits all contributions into the MSB bank account on the due date.**

Balance of funds held in the Board’s bank account to be monitored daily and any funds not required for the purpose of paying benefits and other expenses paid to the Board’s investment custodian.

**The balance of the MSB bank account was monitored on a daily basis and excess funds were transferred to the Board’s custodian.**

Contribution remittances to be recorded in the MSBS accounting systems within one week of receipt.

**Contribution remittances were recorded in the MSBS accounting systems generally within one week of receipt.**

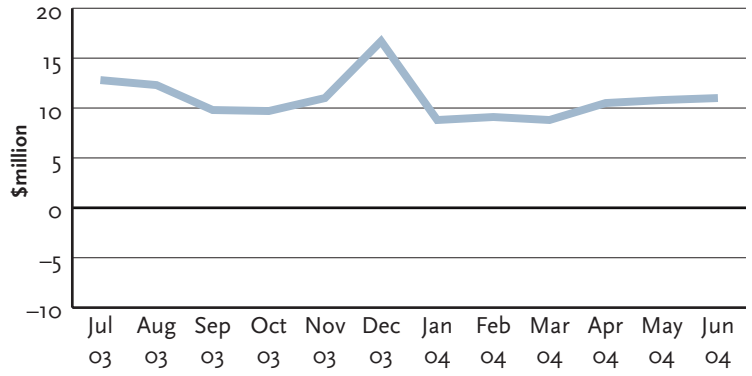
All known contribution remittances not received within 14 days of the due date will be pursued with the Department of Defence and penalty interest will be levied where appropriate.

**All contributions were received from the Department of Defence by the due date.**

Daily reconciliations will be undertaken to ensure that all moneys received are banked.

**Bank reconciliations were performed on a daily basis.**

**chart 4: MSB Fund cashflow (contributions received less benefits paid) 2003-04**



# MEMBER COMMUNICATIONS

**Communication with MSBS contributing, preserved benefit and pensioner members is achieved through a variety of means, including:**

- regular newsletters issued by ComSuper;
- articles in Service newspapers;
- email and the Internet;
- annual member statements;
- the Board's Annual Report to Members;
- written correspondence;
- telephone enquiry services;
- wide distribution of various scheme publications; and
- regular member information seminars throughout Australia.

At the Board's direction, a comprehensive communications program is aimed at improving members' knowledge and understanding of the scheme so that they are in a position to make informed decisions at times when these need to be made. This includes the range of communications required by SIS and FSR and a recognition of the particular needs of members.

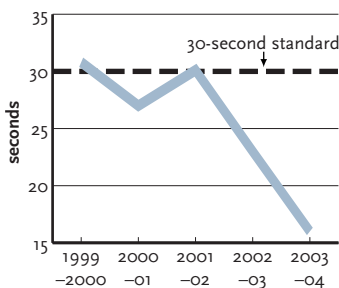
Specifically, a range of communications is provided to members on benefit entitlements and queries relating to the general administration of the scheme in writing, over the phone and by electronic means. The Board continuously seeks ways to improve these communications.

In addition, a range of seminars is offered broadly in accordance with demand, member information statements are issued and various scheme publications made available both in hard copy and electronic format.

The following timeliness standards apply to contributor communications.

<i>standard</i>	<i>outcomes</i>
Process or respond to:	
written enquiries	85% in 10 days 100% in 15 days
email enquiries	95% in 1 day 100% in 2 days
personal counselling in Canberra	urgent—immediately other—within 5 days
telephone average speed of answer	average of 30 seconds or less over a month
website changes	critical updates—1 day routine updates—100% in 5 days
unit price updates	The latest unit price for all options to be posted to the website by 10.00 am each working day
family law enquiries	Respond to 100% of enquiries within 28 days
member statements	automatic by 10 September manual by 15 November replacement within 10 days

**chart 5: contributor telephone call response times in the past five years**





ComSuper will send a benefit estimate and an application form within one day of advice of a member's death.

standard met

## MSCC work plan

The work plan established by the new Military Superannuation Communications Committee is as follows:

- provide targeted communications to members during key periods of their service—for example, on entry to the scheme, annually throughout their membership, on transition from one membership category to another, on exit from the scheme and to beneficiaries on death of a member;
- focus communications activities on key areas of member concern as determined by reference to issues raised through the client Contact Centre;
- continue to deliver a communication/education program to cover the scheme's ancillary benefits initiatives (such as spouse accounts and roll-ins);
- promote the availability of MilitarySuper seminars and increase the accessibility of seminars to new entrants to the ADF;
- continue to deliver an electronic media educational program incorporating existing videos and supplementing with an additional visual presentation—topic to be decided; and
- communicate the Board's approach to proposed new government initiatives (such as financial services reform, family law and budget changes).

## Annual report project

The success of the 2003–04 annual report project will be evaluated using the following criteria:

- Board expectations met;
- key stakeholders comfortable with processes and outcomes;
- level of acceptance through positive feedback;
- costs kept within budget;

- material compliant with MSB Rules, SIS and FSR legislation; and
- level of complaints.

## **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. Also, members may speak to an information officer on a one-to-one basis in Canberra and at some resettlement seminars throughout Australia.

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.

However, the most popular means of contact remains the telephone, with an average of 912 telephone calls per week. A total of 47 463 calls were received during the year.

During the year, ComSuper presented 79 seminars to a total of 4 781 MSBS members and provided personal counselling for 1 727 military members. The seminars were primarily conducted in conjunction with resettlement seminars. A further 14 seminars relating to medical discharge were presented to 528 military members.

A total of 1 229 retirement advice letters were issued during the year.

Additionally, the Contact Centre responded to 658 requests for information about the superannuation entitlements of DFRDB or MSBS members under the new family law arrangements. All family law requests were responded to within 28 days.

## **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.

During the year, the Contact Centre received 34 518 calls related to military pensioners, and responded to 4 578 written enquiries and 2 043 email enquiries.

Additionally, ComSuper responded to 373 requests for information about pensioners under the new family law arrangements. All requests were responded to within 28 days.

## member statements

SIS legislation requires the Board to distribute annual member statements by 31 December each year.

The 2003 MSBS statements included two new features. A balance summary reported the number of units held by a member, the unit price at the start and the end of the reporting period and the balance that the member had when the units were converted to a dollar value. The second new feature was a transaction summary, which reported all member and productivity contributions made by and on behalf of the member, the effective date of the payment, the applicable unit price at the date of the transaction and the number of units purchased with each transaction.

Delays were encountered in the programming and the testing of these additional features, which contributed to the late delivery of statements to members.

Statements for contributing members were distributed by 3 November 2003 and those for preserved members by 29 November 2003. The expected timeframe for completion of the production of manual statements was also delayed. Nineteen preserved statements remained outstanding at 31 December 2003 and these were calculated and despatched by 13 January 2004. As a matter of good governance this technical breach of SIS was notified to the Regulator.

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.

SIS legislation also requires that the Board issue replacement member statements within one month of being advised that a member's statement is missing or incorrect. Under the service level agreement with the MSB Board the relevant

service standard for this function is 10 days (see page 34), which exceeds the SIS requirement. A facility introduced in November 2002 now enables replacement statements to be issued within two working days.

## 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.

Website users were surveyed during the year as part of ComSuper's cyclical research. Key findings of this research were:

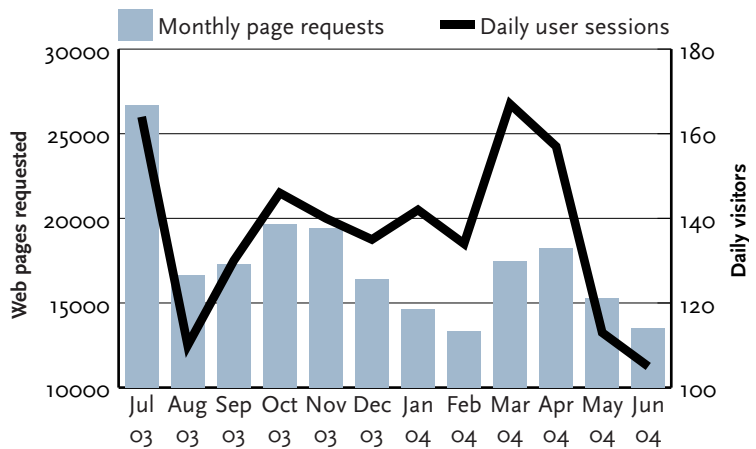
- 76% of members said that the website was easy to find;
- 74% found the website useful;
- 64% said that the website met their information needs.

**table 11: most requested web pages 2003-04**

1	Unitisation
2	Member Services Online
3	The MilitarySuper Book
4	Benefits
5	Contact Us
6	FAQs
7	Form m-access
8	Member Investment Choice
9	MIC Growth Strategy
10	i-Estimator

Chart 6 shows usage of the website in 2003-04. Table 11 shows the ten most requested web pages during the current year.

**chart 6: MilitarySuper website usage 2003-04**



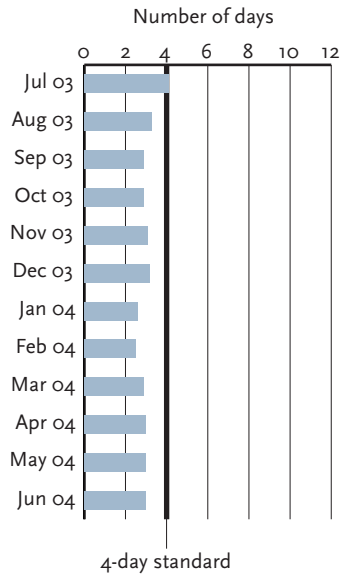
## secure website access

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 9 492 statements were accessed and 10 639 benefit estimates produced online.

# 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.*

**chart 7: average time to process benefit payments 2003–04**



## benefits

### member-financed benefits

The MSBS member benefit is a lump sum of the member’s 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 a funded component while the balance of the defined benefit is unfunded. The total employer benefit payable is not affected by market fluctuations.

### preserved 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 interest earned 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 preserved member benefit that is not compulsorily preserved; however, it must be withdrawn in \$10 000 multiples and at intervals of no less than six months.

**table 12: benefits paid 2003–04**

Pensions	\$81m
Lump sums	\$81m
<b>Total</b>	<b>\$162m</b>
Fund share	\$42m
Consolidated Revenue share	\$120m
<b>Total</b>	<b>\$162m</b>

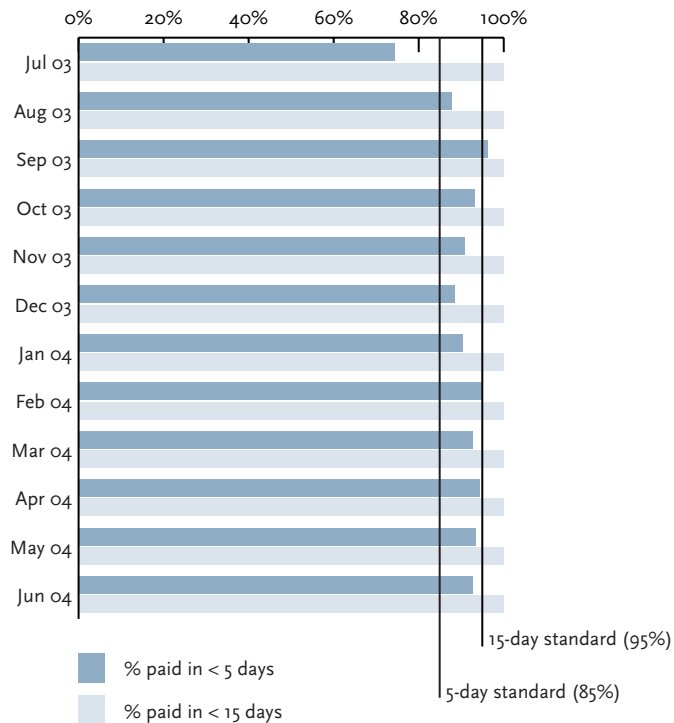
## benefit processing

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 days, late payment interest is added.

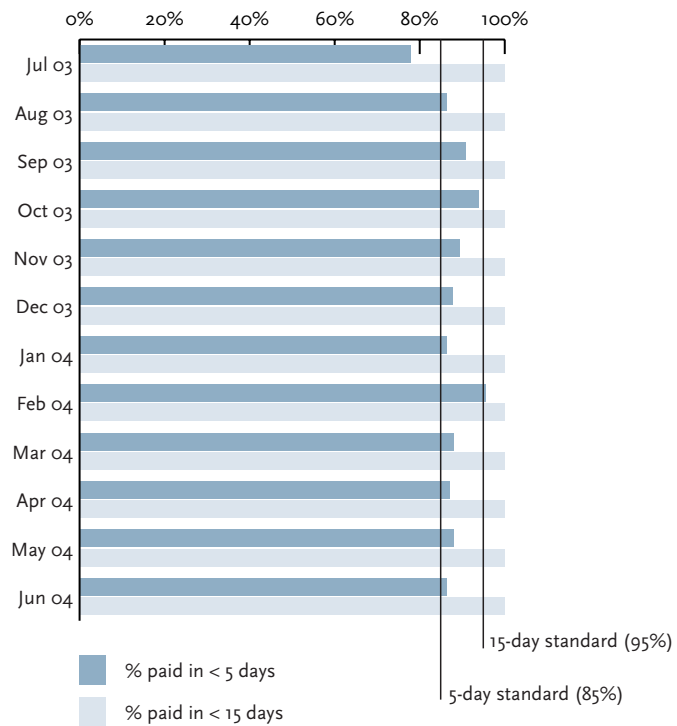
The following are the outcomes against the prescribed standards.

<i>standard</i>	<i>outcomes</i>
<b>Benefit application processing</b>	
85% in 5 days	<b>90.8%</b>
95% in 15 days	<b>100%</b>
average processing time of 4 days over a month	<b>3.0 days</b>

chart 8: contributor benefit processing against standards 2003-04



**chart 9: preserved benefit processing against standards 2003-04**



Failure to meet the five-day standard for the processing of contributor and preserved member benefits in July resulted from a delay, until 8 July, in the receipt of unit prices for 1-7 July. Processing standards were otherwise met or exceeded for the year, as shown in Charts 8 and 9.

**early release of preserved benefits**

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

Of the 1 190 preserved benefits paid in full or part during 2003-04, 374 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.

The following standard applies.

#### standard

All reversionary pensions will be commenced on the next available payday following receipt of application subject to eligibility criteria being clearly met and there being no counterclaims.

#### outcomes

Although performance against this standard is not specifically measured, payment of reversionary pensions is given the highest priority in processing cycles.

### changes to pension payment details

The following standard applies.

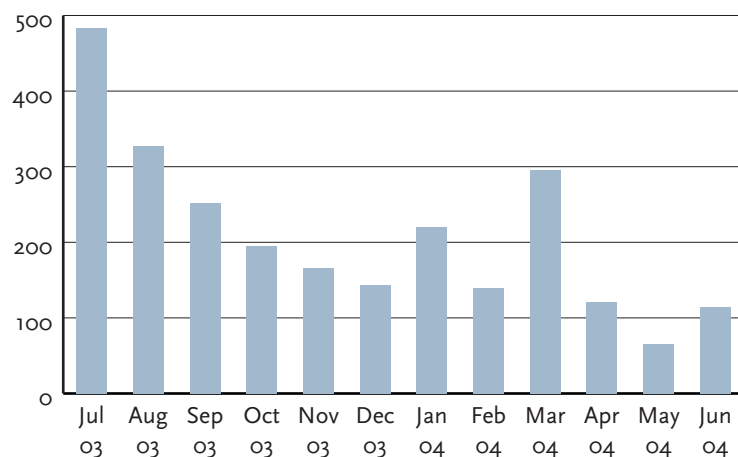
#### standard

Changes to pension payment arrangements will be made within the first available fortnightly pay cycle following receipt of a request.

#### outcomes

standard met

chart 10: pension variations 2003–04





## pension increase/advice

Pension increases are processed in accordance with relevant legislation.

The following standards apply.

<i>standard</i>	<i>outcomes</i>
The July increase is processed for payment on the first payday in July.	standard met
The January increase is processed for payment on the first payday in January.	standard met

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

In 2003-04, the Australian Bureau of Statistics announced a CPI change of 0.6% for the six months to September 2003 and 1.4% for the six months to March 2004.

Pensioners receive a statement in January and July showing their new rate of pension. Their income tax payment summary and other relevant information is included with the July statement.

## pension payments

### employer-financed benefits paid as pension

During the year, 444 new pensions were granted and at 30 June 2004, 5 232 members were receiving MSBS pensions. The total number of pensioners for each class of benefit is detailed in Table 13 for the end of each financial year since 30 June 2000.

**table 13: number of pensioners since 30 June 2000, by type of benefit**

Class of pension benefit	Number of pensioners				
	30 June 2000	30 June 2001	30 June 2002	30 June 2003	30 June 2004
Retirement	531	556	621	707	796
Redundancy	1 748	1 877	1 885	1 901	1 916
Invalidity	1 436	1 724	2 010	2 169	2 356
Reversionary benefits*	62	40	84	145	164
<b>Total</b>	<b>3 777</b>	<b>4 197</b>	<b>4 600</b>	<b>4 922</b>	<b>5 232</b>

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

The total amount paid as pensions during the year was \$81 million. The average pension amounted to \$16 021.

*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.*

## invalidity benefits

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.

The following standards apply to the processing of invalidity claims.

### standard

### outcomes

**Cases for submission to delegate** are submitted within 10 working days of receipt of supporting documentation and any additional information that may be required\* or by date of discharge, whichever is the later.

The standard was met in eleven months of the year.

**Cases for submission to the Board's Incapacity Classification Committee (ICC)** are submitted to the meeting of the Committee immediately prior to the discharge date or to the next available meeting of the Committee after receipt of supporting documentation and any additional information that may be required\*, whichever is the later.

The standard was met throughout the year.

Members are advised of decisions taken within 3 working days.

\*Supporting documentation includes medical documentation, the member's employment experience, advice of conditions causing retirement, confirmation of date and mode of exit, and the member's application.

**INVALIDITY BENEFITS**  
UNIQUE TO THE ADF

**Military Super**  
Military Administration and Benefits Services Information Sheet

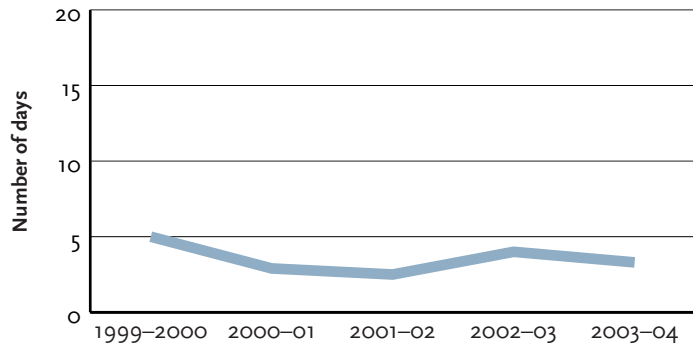
Invalidity benefits are provided to members of the ADF who are unable to perform their duties of their job due to an injury or illness. This is provided to members who are unable to perform their duties of their job due to an injury or illness. This is provided to members who are unable to perform their duties of their job due to an injury or illness.

**What's the procedure?**  
Firstly, the MSB's Incapacity Classification Committee (ICC) will determine if you are eligible for invalidity benefits. They will consider your medical evidence provided. This may include medical reports, and any other evidence provided. If the MSB's Incapacity Classification Committee (ICC) determines that you are eligible for invalidity benefits, you will be advised of the decision and the amount of your invalidity benefits.

**What will I receive?**  
The MSB's Incapacity Classification Committee (ICC) will determine if you are eligible for invalidity benefits. They will consider your medical evidence provided. This may include medical reports, and any other evidence provided. If the MSB's Incapacity Classification Committee (ICC) determines that you are eligible for invalidity benefits, you will be advised of the decision and the amount of your invalidity benefits.

[www.militarysuper.gov.au](http://www.militarysuper.gov.au)

**chart 11: average time taken to determine new invalidity cases in the past five years**



## invalidity classification process

### Incapacity Classification Committee (ICC)

Members of the MSBS retired on invalidity grounds receive an A, B or C classification, 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 34 initial classification decisions during 2003-04.

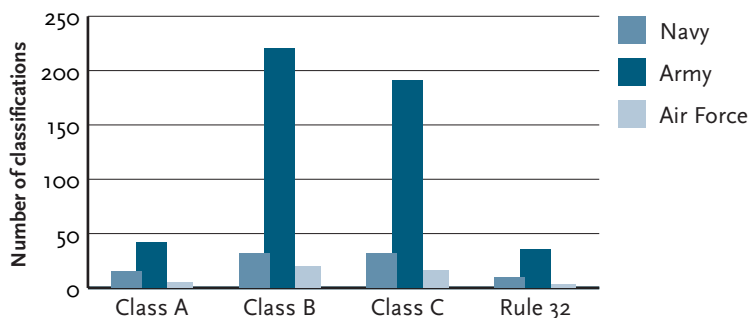
The rate of invalidity pension payable to a recipient member may be altered if the pensioner's degree of incapacity to undertake civilian employment deteriorates or improves. If specialist evidence indicates that a member's classification is no longer appropriate, the review of that case is passed from the ComSuper delegate to the ICC. The ICC made 233 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 2003 to 30 June 2004, 621 members received initial invalidity classifications, although in 48 of these cases Rule 32 (relating to pre-existing conditions) was applied. This is an increase of 96 invalidity cases on the previous year (total 525). Of those who received an invalidity classification, 334 (62 Class A and 272 Class B) became entitled to an invalidity pension. The remaining 239 were classified as Class C incapacity. (Note: These figures vary slightly from the number of invalidity exits quoted elsewhere because some of the cases relate to members who were discharged in a previous financial year.) The proportion of invalidity classifications for each Service is shown in Chart 12.

chart 12: comparison, by service, of invalidity classifications 2003-04



## 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.

The following standards apply to this review process.

<i>standard</i>	<i>outcomes</i>
Reviews will be completed within 20 working days of receipt of all relevant information.	<b>The standard was not met during the year.</b>
Members will be advised of decisions taken within 3 working days.	<b>All members were advised of decisions taken within 3 working days.</b>

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 2003-04, 684 cases were examined, 61 of which were reviews requested by members. As a result of these reviews 215 classifications were changed, as shown in Table 14.

**table 14: invalidity entitlements reviewed in the past five years**

	1999-2000	2000-01	2001-02	2002-03	2003-04
Entitlements examined	677	548	545	475	684
Review with medical exam	215	138	187	222	255
Classification raised	14	23	25	21	38
Classification reduced	121	67	124	123	177
<b>Total classification changes</b>	<b>135</b>	<b>90</b>	<b>149</b>	<b>144</b>	<b>215</b>

## accounts, records and funding of benefit payments

As the Board’s administrator, ComSuper:

- liaises with the Board’s investment custodian to ensure that funds are available to meet benefits and other payments from the Fund as they fall due; and
- maintains proper accounts and records in respect of benefits paid.

The following standards apply to these activities.

<i>standard</i>	<i>outcomes</i>
Immediate availability of funds from Trustees’ bank account to meet benefit payments.	See Chart 4 on page 33 which indicates that the MSB cashflow was positive for all months during the year.
Receipt of assurance (in a format agreed by the Board) in the annual management representation letter that proper accounts and records have been kept.	Standard met.

*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 decision, the application 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. This may be extended 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.

The following timeliness standards apply to this activity.

standard	outcomes						
<p>Processing of reconsideration requests:</p> <table border="1"> <tr> <td>60% in 8 months</td> </tr> <tr> <td>100% in 12 months</td> </tr> <tr> <td>Average—7 months for all requests</td> </tr> </table>	60% in 8 months	100% in 12 months	Average—7 months for all requests	<p>There were 177 MSBS requests for reconsideration received in 2003–04. The proportions of cases completed against the standards were as follows:</p> <table border="1"> <tr> <td>98% in 8 months</td> </tr> <tr> <td>100% in 12 months</td> </tr> <tr> <td>Average—2.9 months for all requests</td> </tr> </table>	98% in 8 months	100% in 12 months	Average—2.9 months for all requests
60% in 8 months							
100% in 12 months							
Average—7 months for all requests							
98% in 8 months							
100% in 12 months							
Average—2.9 months for all requests							
<p>Preparation of submissions to the Reconsideration Committee:</p> <table border="1"> <tr> <td>within 30 days of receipt of supporting documentation</td> </tr> </table>	within 30 days of receipt of supporting documentation	<p>All submissions to the Reconsideration Committee were prepared within 30 days of receipt of supporting documentation.</p> <p>The Board regularly monitored outstanding cases, particularly those remaining unresolved for more than 12 months after having been received. There were no such cases in 2003–04.</p>					
within 30 days of receipt of supporting documentation							

## 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 2003–04, 177 requests for reconsideration of decisions taken by the Board or its delegates of were received, an increase from the 169 requests received the previous year. Five requests for reconsideration of the Reconsideration Committee's decisions were received during 2003–04, compared with four during 2002–03.

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.

One hundred and sixty-five cases were finalised during the year, compared with 177 cases last year. Seventy-three decisions were affirmed and in 24 cases the decision was set aside or varied in favour of the applicant. Another 63 cases lapsed because the applicant failed to pursue the matter. Five requests were withdrawn. Fifty-one cases remained under investigation on 30 June 2004.

**table 15: reconsideration applications for the past five years**

	1999–2000	2000–01	2001–02	2002–03	2003–04
Requests on hand	65	74	55	47	39
Requests received	98	90	141	169	177
Requests resolved	89	109	149	177	165
Carried forward	74	55	47	39	51

## external review

Following the MSB Board's election on 30 June 1995, the MSB became a regulated superannuation fund for 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).

Seven complaints were lodged with the SCT during the year and ten cases were carried over from 2002–03. Eleven complaints were resolved during the year: seven decisions were affirmed, two complaints were withdrawn, and two decisions were set aside. There were six SCT cases outstanding as at the end of June 2004.

In 2003–04 one SCT decision was appealed to the Federal Court and remained outstanding at 30 June 2004. 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.

The standards applying to these activities are as follows.

<i>standard</i>	<i>outcomes</i>
<p>Process all external review cases both objectively and expeditiously—as assessed by six-monthly audit.</p> <p>Report to be provided to the first Board meeting after a decision is handed down.</p>	<p><b>ComSuper complied with the specified procedures and deadlines in the majority of cases considered by the SCT.</b></p>

## family law

Family law has seen significant changes this year, in particular the long-anticipated amendments to the scheme legislation which enable the creation of associate member benefits for non-member spouses in family law splitting situations.

The new amendments have brought a steady increase in the number of members making use of the superannuation splitting arrangements and a subsequent increase in workload for the Board's administrator.

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, between 75 and 170 written responses to members and non-members and their solicitors were completed each month within 28 days of receipt of the enquiries.

## 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*.

### complaints, ministerials and ombudsman enquiries and freedom of information requests

Systems are in place for dealing with SIS-registered complaints and representations made by Parliamentarians and the Ombudsman; requests made under the *Freedom of Information Act 1982* (the FOI Act); and correspondence directed to the Board.

The following timeliness standards apply to these activities.

<i>standard</i>	<i>outcomes</i>
SIS complaints and Parliamentarian/Ombudsman representations: <ul style="list-style-type: none"> <li>90% within 15 working days</li> <li>100% within 25 working days</li> </ul>	Response was made to 85% of SIS complaints within 15 days and 97% within 25 days.  100% of Parliamentarian and Ombudsman requests were processed within 15 days.  99% (94 out of 95) Freedom of Information requests were processed within 7 working days.  All Trustee correspondence was responded to within 15 working days.
FOI requests: <ul style="list-style-type: none"> <li>100% in 7 working days</li> </ul>	
Trustee correspondence: <ul style="list-style-type: none"> <li>90% within 15 working days</li> <li>100% within 30 working days</li> </ul>	

### complaints and parliamentary enquiries

Thirty-three complaints and two parliamentary representations were received during the year. One complaint was carried over as at 30 June 2004.

The complaints covered a range of issues such as payment delay, interest rate concern and inability to withdraw preserved amounts.

Table 16 shows the time taken to respond to complaints and parliamentary representations in 2003–04.

**table 16: responses to complaints and parliamentary representations  
2003-04**

	<15 days		16-25 days		26-90 days		>90 days	
	No.	%	No.	%	No.	%	No.	%
Complaints	28	85	4	12	1	3	-	-
Parliamentary representations	2	100	-	-	-	-	-	-

In addition, ministerials relating to policy issues are received and responded to within the Department of Defence. In 2003-04 those relating to the MSBS totalled 20 (including 10 regarding MSBS employer benefit preservation arrangements). There were also 12 ministerials on the splitting of superannuation benefits and 188 on pension indexation arrangements that related to both the MSBS and the DFRDB Scheme.

## freedom of information

Matters associated with the administration of the *Freedom of Information Act 1982* are dealt with by ComSuper's Corporate Reporting and Parliamentary Liaison Unit.

MSBS members made 95 requests for access to documents during 2003-04. Ninety-two requests were granted in full and one partially. Two requests were refused. The requests took an average of 1.2 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:

Corporate Reporting and Parliamentary Liaison Unit  
ComSuper  
PO Box 22  
Belconnen ACT 2616

Telephone: (02) 6272 9080  
Facsimile: (02) 6272 9802  
TTY: (02) 6272 9827  
Email: [foi@comsuper.gov.au](mailto:foi@comsuper.gov.au)

*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 2004, there were 46 892 contributors to the MSBS, 41 657 (88.8%) of whom were male and 5 235 (11.2%) female. Table 17 shows the number of new entrants and exits and the total contributor membership at 30 June 2004. Table 18 shows the number of contributors by years of service and by gender.

**table 17: contributor composition**

	Male members	Female members	Total
Membership at 30 June 2003	39 600	5 615	45 215
Plus new contributors	5 290	129	5 419
Less members leaving the ADF	3 233	509	3 742
<b>Membership at 30 June 2004</b>	<b>41 657</b>	<b>5 235</b>	<b>46 892</b>

**table 18: male and female contributors by years of service**

Years of service	Male	Female	All
0–9	32 395	3 937	36 332
10–14	4 436	728	5 164
15–19	3 097	466	3 563
20+	1 729	104	1 833
<b>Total</b>	<b>41 657</b>	<b>5 235</b>	<b>46 892</b>

The largest number of contributors in 2003–04 was aged between 20 and 24 years, 28.8% of members being in that age group. The next largest group (25–29 years) comprised 24.1% of the scheme's contributor population.

## commencements

There were 5 419 new MSBS members in 2003–04.

## exits

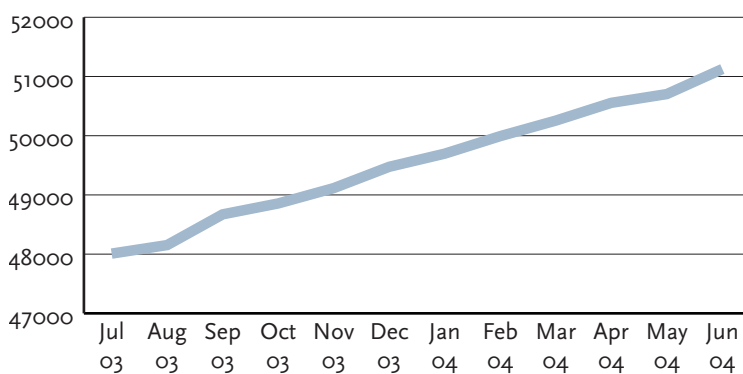
There were 3 742 exits from the MSBS during the year. The types of exit are shown in Table 19.

**table 19: modes of exit in the past five years**

<i>Mode of exit</i>	1999–2000	2000–01	2001–02	2002–03	2003–04
Age retirement	89	103	110	71	71
Resignation	4 084	4 891	3 744	3 426	2 028
Redundancy	29	171	12	11	10
Invalidity retirement	697	623	497	487	397
Death	12	10	17	12	15
Not yet determined	–	–	–	–	388
Other	294	150	–	–	833
<b>Total</b>	<b>5 205</b>	<b>5 948</b>	<b>4 380</b>	<b>4 007</b>	<b>3 742</b>

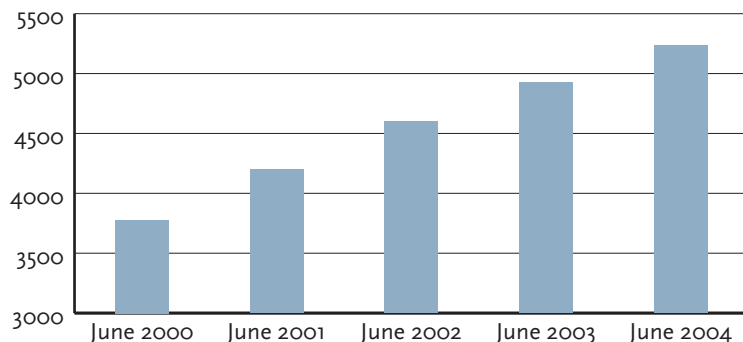
## preserved benefit members

There were 51 126 preserved benefit members in the MSBS as at 30 June 2004. Chart 13 shows the growth of preserved benefit members during 2003–04.

**chart 13: growth in preserved benefit member population 2003–04**

## pensioners

There were 5 232 pensioners in the MSBS as at 30 June 2004. Chart 14 shows the growth of pensioners since 30 June 2000.

**chart 14: growth in pensioner population in the past five years**

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 instalments 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 Audit and Risk Management Committee meetings and to advise on audits completed or in progress;
- provides a quality assurance role on accounting information provided by the Custodian or other sources;
- prepares the Board's administration budget in a form agreed with the Board.

The following standards apply to accounting services.

**standard**

The Board requires its administrator to deliver:

- unqualified financial statements in respect of services provided by ComSuper under this agreement;
- the Board's annual report within the statutory time limits.

**outcomes**

**standard met**

**The 2002–03 Annual Report was presented to the Minister on 30 September 2003.**

**SIS compliance**

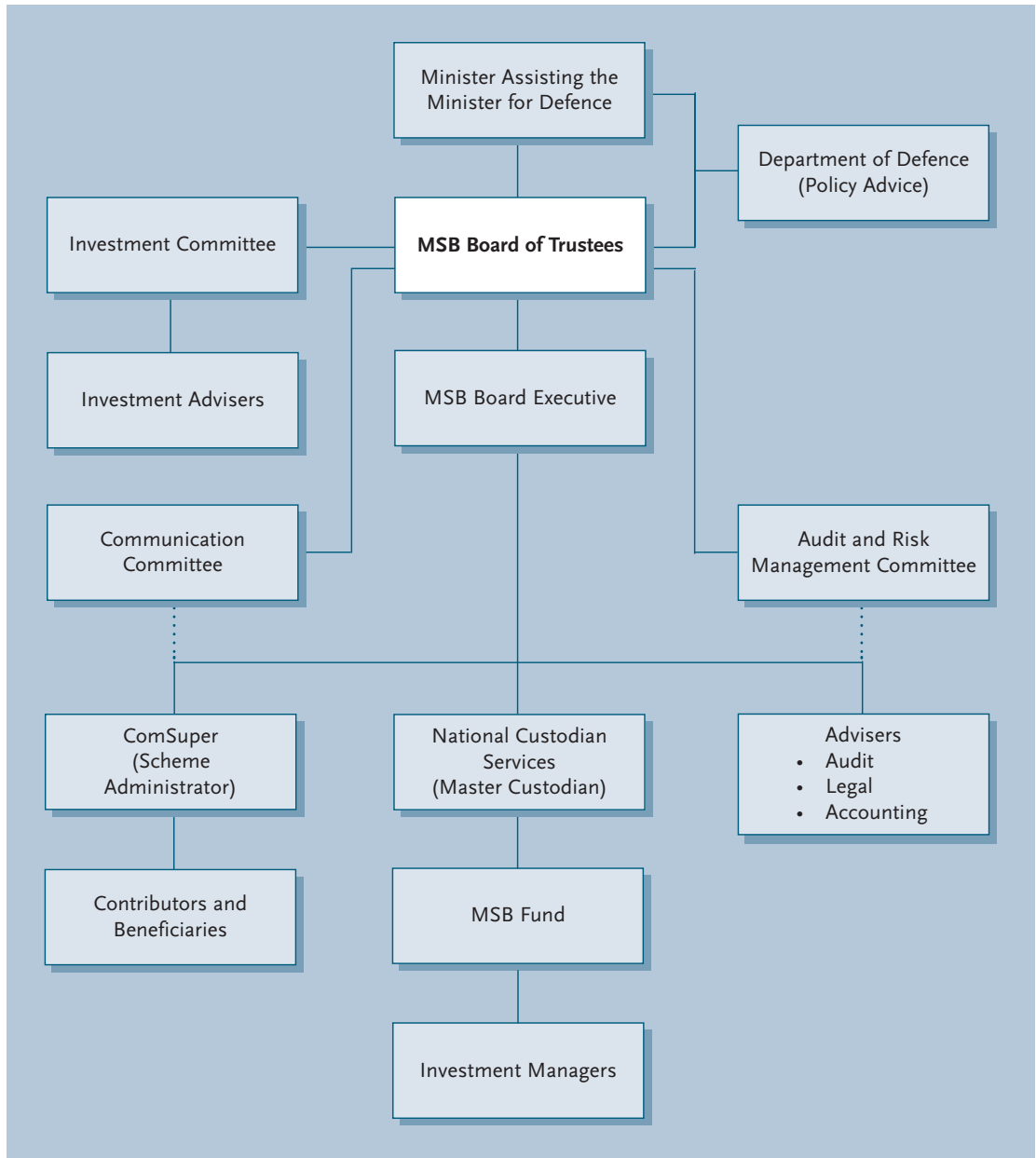
To ensure that the Board complies with the *Superannuation Industry (Supervision) Act 1993*, the Audit and Risk Management Committee has adopted a comprehensive SIS compliance checklist. In order to meet its compliance obligation, the Board has appointed a Compliance Officer whose role is to take responsibility for the MSBS checklist as well as to ensure the Board's compliance with other legislative requirements.

A detailed compliance report was provided to the Board in September 2003 and March 2004.

**audit of financial statements**

The Auditor-General has again been able to provide an unqualified audit opinion on the financial statements of the MSB Scheme.

## organisational structure of the MSBS





## financial resources

The administrative costs of the MSB Board of Trustees for 2003–04 totalled \$2.470m. These costs include 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 earmarked 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 2003–04 is as follows:

MSB Fund	\$2.112m
Department of Defence	\$0.358m
<hr/>	<hr/>
Total	\$2.470m

Further details are contained in the financial statements.

# FINANCIAL STATEMENTS

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## Military Superannuation and Benefits Scheme



### Independent Report by Approved Auditor to the Minister Assisting the Minister for Defence

#### (A) Financial Statements

##### Scope

I have audited the financial statements of the Military Superannuation and Benefits Scheme for the year ended 30 June 2004 as set out on pages 2 to 21 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 you.

My audit has been conducted in accordance with Australian National Audit Office Auditing Standards, which incorporate 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 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
- (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 2004 and the changes in net assets for the year ended 30 June 2004.

#### (B) Compliance

##### Scope

I have conducted tests in accordance with Australian National Audit Office Auditing Standards, which incorporate Australian Auditing and Assurance Standards, as necessary to provide reasonable assurance whether the trustees of the Military Superannuation and Benefits Scheme has, 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* 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, 112, 113, 117, 118, 121, 121A, 122, 124, 125, 152, 153, 154;  
Regulations 2.10(1), 2.13(1), 2.21(3), 2.33(2), 2.43(1), 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* 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* and Regulations:  
 Sections 1012A, 1012B, 1012F, 1012G(3), 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 the Guidelines for preparing risk management statements ("Guidelines") issued by APRA in Circular I.D.7 on Derivatives (to the extent applicable)
- for the year ended 30 June 2004; 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 *Superannuation Industry (Supervision) Act 1993* and Regulations, the *Financial Sector (Collection of Data) Act 2001* and *Corporations Act 2001* and Regulations.

My procedures with respect to Regulation 6.17 included testing whether amounts identified by the trustee as preserved and restricted non-preserved have been cashed or transferred only in accordance with the requirements of Part 6 of the 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 consisted of confirming whether any Risk Management Statement was to be prepared by the superannuation entity's trustees under the Guidelines contained in APRA Circular I.D.7 at any time during the year of income. These procedures indicated that only a Part A Risk Management 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 *Superannuation Industry (Supervision) Act 1993* and Regulations or Guidelines, the *Financial Sector (Collection of Data) Act 2001* or the *Corporations Act 2001* and Regulations apart from those specified. The superannuation entity's trustee is responsible for complying with the *Superannuation Industry (Supervision) Act 1993* and Regulations, the *Financial Sector (Collection of Data) Act 2001* and the *Corporations Act 2001* and Regulations and appropriately applying the Guidelines.

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

#### Audit Opinion

In my opinion the trustees of Military Superannuation and Benefits Scheme have complied, in all material respects, with the requirements of the *Superannuation Industry (Supervision) Act 1993* and Regulations, the Reporting Standards made under section 13 of the *Financial Sector (Collection of Data) Act 2001* and the *Corporations Act 2001* and Regulations and applied the Guidelines specified above for the year ended 30 June 2004.

AUSTRALIAN NATIONAL AUDIT OFFICE



Ian P. Goodwin  
Executive Director

Delegate of the Auditor-General

Canberra  
8 September 2004

## 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:

- (a) the attached financial statements of the Military Superannuation and Benefits Scheme show a true and fair view of the matters required by AAS 25 "Financial Reporting by Superannuation Plans" and Schedule 1 of the *Commonwealth Authorities and Companies (Financial statements for reporting periods ending on or after 30 June 2004) Orders* to the extent that the latter is not inconsistent with the former;
- (b) the attached financial statements of the Military Superannuation and Benefits Scheme show a true and fair view of the net assets of the Scheme at 30 June 2004 and the changes in net assets of the Scheme for the year ended 30 June 2004;
- (c) 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) the financial statements are in a form 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* and have been prepared in accordance with applicable Australian Accounting Standards and mandatory professional requirements;
- (e) the financial statements have been prepared based on properly maintained financial records; and
- (f) the operations of the Fund were in accordance with the *Military Superannuation and Benefits Act 1991* and the requirements of the *Superannuation Industry (Supervision) Act 1993* and Regulations and the relevant requirements of the *Corporations Act 2001* and Regulations (to the extent applicable).

Signed at Canberra this 8th day of September 2004 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 YEAR ENDED 30 JUNE 2004

	Note	2004 \$'000	2003 \$'000
<b>Net Assets Available to Pay Benefits at The Beginning of The Period</b>		1 120 022	1 033 869
<b>Add:</b>			
<b>Revenue from Ordinary Activities</b>			
<b>Investment Revenue</b>			
Interest	4	3 182	5 614
Dividends and Trust Distributions	4	50 681	29 805
Other Investment Income	4	283	130
Changes in Net Market Values	4	164 165	(51 274)
Less: Direct Investment Expenses	6	(8 796)	(6 977)
		<u>209 515</u>	<u>(22 702)</u>
<b>Contributions Revenue</b>			
Member Contributions		112 217	102 130
Employer Contributions		62 747	56 929
Appropriation from Consolidated Revenue Fund (CRF)	5	119 708	118 225
		<u>294 672</u>	<u>277 284</u>
<b>Total Revenue from Ordinary Activities</b>		<u>504 187</u>	<u>254 582</u>
<b>Less:</b>			
<b>Expenses from Ordinary Activities</b>			
General Administration Expenses	6	(2 112)	(1 130)
Benefits Paid and Payable	5	(162 250)	(162 374)
<b>Total Expenses from Ordinary Activities</b>		<u>(164 362)</u>	<u>(163 504)</u>
<b>Total Revenue less Expenses and Benefits Paid Before Tax</b>		<u>339 825</u>	<u>91 078</u>
Income Tax Benefit/(Expense)	7	(30 873)	(4 925)
<b>Total Revenue less Expenses and Benefits Paid After Tax</b>		<u>308 952</u>	<u>86 153</u>
<b>Net Assets Available to Pay Benefits at The End of The Period</b>		<u>1 428 974</u>	<u>1 120 022</u>

*The attached notes form part of these financial statements.*

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

STATEMENT OF NET ASSETS  
AS AT 30 JUNE 2004

	Note	2004 \$'000	2003 \$'000
<b>Investments</b>			
Cash and Short Term Deposits		115 718	26 896
Australian Fixed Interest		68 732	63 930
International Fixed Interest		68 805	76 414
Australian Equities		479 503	363 427
International Equities		437 200	365 331
Property Trusts		113 012	82 594
Currency Contracts		(6 317)	12 999
Private Equity	15a	71 853	52 180
Hedge Funds		55 327	28 468
Emerging Markets		20 411	24 365
Futures and Options		174	–
Total Investments		<u>1 424 418</u>	<u>1 096 604</u>
<b>Other Assets</b>			
Cash at Bank		4 897	3 957
Consolidated Revenue Fund (CRF) Special Account		90	543
Interest Receivable		10	333
Dividends Receivable		3 711	3 387
Trade Settlements Receivable		2 157	7 589
GST Recoverable		258	158
Sundry Debtors		276	276
Benefits Payable to be funded by Appropriation	5	1 638	4 158
Current Tax Recoverable		557	–
Deferred Tax Assets		2 569	22 611
Total Other Assets		<u>16 163</u>	<u>43 012</u>
<b>Total Assets</b>		<u>1 440 581</u>	<u>1 139 616</u>
<b>Less: Liabilities</b>			
Benefits Payable	5	3 415	7 283
Trade Settlements Payable		5 146	4 158
Sundry Creditors	8	3 046	2 101
Current Tax Liability		–	3 161
Deferred Tax Liability		–	2 891
<b>Total Liabilities</b>		<u>11 607</u>	<u>19 594</u>
<b>Net Assets Available to Pay Benefits</b>		<u>1 428 974</u>	<u>1 120 022</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 year ended 30 June 2004

**1. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES****(a) Basis of Preparation**

These financial statements have been prepared in accordance with the Defined Benefit Plan provisions of AAS 25 Financial Reporting by Superannuation Plans, other applicable Australian Accounting Standards (AAS) and Urgent Issues Group Consensus Views. 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 subsection 26(1) of the *Military Superannuation and Benefits Act 1991*. Unless otherwise stated, these accounting policies were also adopted in the corresponding preceding reporting period.

**(b) Revenue**

Investment revenue and contributions are brought to account on an accruals basis. Dividend income is recognised on a receivable basis on the date shares are quoted ex-dividend. 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. Transfers from other funds are brought to account when received.

**(c) Valuation of Investments**

Assets of the Military Superannuation and Benefits Scheme (MSBS) are recorded at net market value as at the 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 values of investments includes an amount for selling costs which would be expected to be incurred if the investments were sold. The bases of market valuations are summarised below.

- (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 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 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 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 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 hedges—these securities are valued at the relevant exchange rate at close of business on 30 June.



## MILITARY SUPERANNUATION AND BENEFITS SCHEME

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**1. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont.)****(c) Valuation of Investments (Cont.)**

- (ix) Private equity—this asset class is 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).

The following table details the valuation of private equity investments as at 30 June 2004:

<b>Fund</b>	<b>Latest valuation</b>
Deutsche Private Equity Fund	30 June 2004
Gresham Private Equity Fund	30 June 2004
Macquarie GIF	31 May 2004
PEP Funds No. 2 and Supplementary No. 2	30 June 2004
CHAM Ventures Trusts No. 5A and 5B	31 May 2004
Sentient Global Resources Trust No. 1	31 March 2004
HarbourVest Partners IV and VII – Fund L.P.A7	31 March 2004
Pantheon USA Fund IV, L.P.	31 December 2003
Pantheon Europe Fund III, L.P.	31 December 2003
CSFB Fund Investment VI-B (Bermuda)	31 December 2003

All valuations are unaudited except for Pantheon and CSFB.

**(d) Foreign Currency Translation**

Foreign currency transactions are converted to Australian currency using the currency exchange rate in effect at the point of recognition of each transaction. Foreign currency balances are converted to Australian currency using the exchange rate as at balance date. Resulting exchange differences are brought to account in determining the change in market value of investments for the year and hence the net assets available to pay benefits at the end of the financial year.

**(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.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**1. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont.)****(f) Taxation**

Tax effect accounting procedures are followed whereby the income tax expense in the Statement of Changes in Net Assets is matched with total revenue less expenses before income tax, after allowing for permanent differences. The deferred tax asset relating to tax losses is not carried forward as an asset unless the benefit is virtually certain of realisation. Income tax on net cumulative timing differences is set aside to deferred tax liability or deferred tax asset accounts at rates which are expected to apply when those timing differences occur.

**(g) Benefits Payable**

Benefits payable include benefits in respect of members who ceased employment with the employer sponsor prior to 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.

The present value reported in the notes is determined by reference to expected future salary levels and by application of a current, market-determined, risk-adjusted discount rate and appropriate actuarial assumptions.

**(i) Superannuation Contributions Surcharge**

The surcharge is accounted for as and when the amount becomes payable to the Australian Taxation Office.

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

Where applicable GST incurred by the Scheme that is not recoverable from the Australian Taxation Office has been recognised as part of the expenses to which it applies. Receivables and payables are stated with any applicable GST included in their carrying amounts.

The amount of any GST recoverable from, or payable to, the Australian Taxation Office is included as an asset or liability in the Statement of Net Assets.

**(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 year ended 30 June 2004

**2. IMPACT OF ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS**

For reporting periods beginning on or after 1 January 2005, the fund must comply with International Financial Reporting Standards (IFRS) as issued by the Australian Accounting Standards Board.

This financial report has been prepared in accordance with Australian accounting standards and other financial reporting requirements (Australian GAAP). The differences between Australian GAAP and IFRS identified to date as potentially having a significant effect on the Fund's financial performance and financial position are summarised below. The summary should not be taken as an exhaustive list of all the differences between Australian GAAP and IFRS. No attempt has been made to identify all disclosure, presentation or classification differences that would affect the manner in which transactions or events are presented.

The Fund has not quantified the effects of the differences discussed below. Accordingly, there can be no assurances that the Fund's performance and financial position as disclosed in this financial report would not be significantly different if determined in accordance with IFRS.

Regulatory bodies that promulgate Australian GAAP and IFRS have significant ongoing projects that could affect the differences between Australian GAAP and IFRS described below and the impact of these differences relative to the Fund's financial reports in the future. The potential impacts on the Fund's financial performance and financial position of the adoption of IFRS, including system upgrades and other implementation costs which may be incurred, have not been quantified as the actual impacts will depend on the particular circumstances prevailing on adoption in the financial year commencing on 1 July 2005.

The key potential implications of the conversion of IFRS on the Fund are as follows:

- Income tax will be calculated based on the 'balance sheet' approach, which may result in the carrying value of deferred tax assets and liabilities being different to those determined under current Australian Accounting Standards.
- Changes in accounting policies will be recognised by restating comparatives rather than making current adjustments with note disclosure of prior year effects.

**3. NATURE OF THE SCHEME**

(a) The Military Superannuation and Benefits Scheme is a hybrid accumulation-defined benefits scheme which provides benefits to its members under the *Military Superannuation and Benefits Act 1991*.

(b) Member and Employee Numbers:

	2004	2003
Number of Members	#	#
– Contributors	46 892	45 215
– Deferred Beneficiaries / Preservers	51 126	47 733
– Pensioners	<u>5 232</u>	<u>4 922</u>
Total Number of Members	<u>103 250</u>	<u>97 870</u>
Number of Employees	<u>4</u>	<u>4</u>

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the year ended 30 June 2004

## 4. INCOME AND CHANGES IN NET MARKET VALUES

	Interest	Dividends and Trust Distributions	Other	Realised Capital Gain (Loss)	Unrealised Capital Gain (Loss)	Total
30 June 2004	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Cash and Short Term Deposits	547	248				795
Australian Fixed Interest	2 018	3		(1 515)	31	537
International Fixed Interest		7 965		(952)	(2 983)	4 030
Australian Equities	475	19 561	84	18 252	53 859	92 231
International Equities	132	6 394	174	44 490	17 099	68 289
Property Trusts		5 969	18	(636)	7 687	13 038
Currency Contracts	7			25 734	(6 317)	19 424
Private Equity	3	8 570	7	(21)	400	8 959
Hedge Fund		1 693			3 166	4 859
Emerging Markets		278		(1 586)	7 354	6 046
Futures and Options				(78)	181	103
Total	3 182	50 681	283	83 688	80 477	218 311

	Interest	Dividends and Trust Distributions	Other	Realised Capital Gain (Loss)	Unrealised Capital Gain (Loss)	Total
30 June 2003	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Cash and Short Term Deposits	1 631		12			1 643
Australian Fixed Interest	3 983			503	2 685	7 171
International Fixed Interest		1 704		176	3 549	5 429
Australian Equities		15 797	19	(17 214)	(7 345)	(8 743)
International Equities		6 036	31	(20 648)	(44 797)	(59 378)
Property Trusts		4 883	9	3 517	(1 168)	7 241
Currency Contracts			10	22 746	9 817	32 573
Private Equity		1 337	8	271	(2 789)	(1 173)
Hedge Fund					3 468	3 468
Emerging Markets		48			(4 045)	(3 997)
Other Revenue			41	-	0	41
Total	5 614	29 805	130	(10 649)	(40 625)	(15 725)

The net gain on foreign currency contracts for the year was \$19.4m (2003: \$32.6m gain). 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 year ended 30 June 2004

**5. 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*.

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 Scheme 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 Scheme in respect of the member are transferred to the Consolidated Revenue Fund which pays out the total benefit (both funded and unfunded components).

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

**Total Benefits Paid and Payable**

	2004 \$'000	2003 \$'000
Lump Sums	81 568	89 357
Pensions	80 682	73 017
Total	<u>162 250</u>	<u>162 374</u>
<b>Financed by:</b>		
Military Super Fund	42 542	44 149
Consolidated Revenue Fund	119 708	118 225
Total	<u>162 250</u>	<u>162 374</u>

Of the \$3.4m benefits payable as at 30 June 2004, the Fund's share amounted to \$1.8m (2003: \$3.1m) with the Consolidated Fund's share being \$1.6m at 30 June 2004 (2003: \$4.2m).

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the year ended 30 June 2004

## 6. COST OF SCHEME ADMINISTRATION AND MANAGEMENT OF THE FUND

Under Clause 9(3) of the Trust Deed set up under section 4 of the *Military Superannuation and Benefits Act 1991*, the costs and expenses of the management and investment of the Fund are met from the Fund. Fund expenses are classified as either direct investment expenses or general administration expenses.

	2004 \$'000	2003 \$'000
<b>Fund management and investment expenses met by Fund</b>		
<b>General administration costs</b>		
Accounting services	271	326
Professional advisers	588	226
Share of trustee fees, travel and incidental costs	528	196
Taxation services	203	100
Communications	187	100
APRA lodgement fees and industry levy	85	46
Insurance	62	41
External audit	42	36
Internal audit	65	20
Non-recoverable GST	81	39
Total	<u>2 112</u>	<u>1 130</u>
<b>Direct investment costs</b>		
Investment management fees	6 895	5 330
Asset consultancy and portfolio management	395	500
Custodian	1 209	1 001
Other	114	-
Non-recoverable GST	183	146
Total	<u>8 796</u>	<u>6 977</u>

The \$0.98m (87%) increase in general administration costs borne by the Fund is largely due to the increase in professional adviser fees arising from the work on establishing investment agreements on new private equity investments and replacement of international fund managers. During the year, trustee costs have increased together with salaries of the Board Executive staff, which reflected the correct allocation of work between investment management and Board administration. Other increases relate to the additional reviews with the introduction of the Financial Services Reform Act.

The \$1.82m (26%) increase in direct investment costs reflects the combined effect of higher average assets under management, an increase in the number of managers and higher transaction costs as a result of restructuring the portfolio.

Direct investment costs do not include management fees of private equity as those fees have been taken into account in the calculation of unit prices by the managers hence reflected in the net asset value of the respective funds. The management fees of private equity in 2003-04 are \$2.0m (2003: \$1.5m).

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**6. COST OF SCHEME ADMINISTRATION AND MANAGEMENT OF THE FUND (Cont.)**

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.

	2004 \$'000	2003 \$'000
<b>Scheme administration costs met by Department of Defence</b>		
<b><i>ComSuper administration fees</i></b>		
Contributors	3 983	3 841
Preservers	2 845	2 630
Pensioners	260	245
Total	<u>7 088</u>	<u>6 716</u>
<b><i>Board administration costs</i></b>		
Share of trustee fees, travel and incidental costs	72	72
Support staff and facilities	178	333
Communication	67	404
Professional advisers	41	49
Total	<u>358</u>	<u>858</u>

The \$0.5m (58%) decrease in 2003–04 Board administration costs is largely due to staff turnover and a large allocation in 2002–03 for communications to prepare for the introduction of member investment choice.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**7. INCOME TAX EXPENSE**

The taxation liability at 30 June 2004 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 MSB Fund at a rate of 15 per cent. The aggregate amount of income tax attributable to the period is not equal to 15 per cent of the Net Investment Revenue and Net Contributions Revenue Before Tax as shown in the Statement of Changes in Net Assets.

The difference is reconciled as follows:

	2004 \$'000	2003 \$'000
Prima facie income tax expense on		
Total Revenue less Expenses and Benefits Paid before Income Tax	<u>339 825</u>	<u>91 078</u>
Prima Facie Income Tax Expense Calculated at 15%	50 974	13 662
Add/(Less) Permanent Differences		
Employee contributions	(16 833)	(15 320)
Benefits Paid	6 381	6 622
Difference between accounting and tax gains	(3 516)	3 930
Less:		
Imputation and Foreign Tax Credits	(6 135)	(3 981)
Underprovision in Prior Years	<u>2</u>	<u>12</u>
Income Tax Expense	<u><u>30 873</u></u>	<u><u>4 925</u></u>
Income Tax Expense comprises:		
Current Tax Recoverable	(557)	3 163
Amount Paid during 2003-04	14 278	7 337
Movement in Deferred Tax balances	17 150	(5 587)
Underprovision in Prior Years	<u>2</u>	<u>12</u>
	<u><u>30 873</u></u>	<u><u>4 925</u></u>

Income tax paid during the period amounted to \$17 440 848 (2003: \$9 947 290).



**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**8. SUNDRY CREDITORS**

	2004 \$'000	2003 \$'000
Investment Expenses Payable	1 384	1 017
Unallocated Contributions	1 084	713
Audit Fees	45	40
Accrued Expenses	442	166
Tax Payable to the ATO	91	165
Total	<u>3 046</u>	<u>2 101</u>

**9. FINANCIAL INSTRUMENT DISCLOSURES**

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.

The Board of Trustees also employs IPAC Portfolio Management Limited (IPAC) to oversee the general management of the portfolio on a day-to-day basis, within the overall investment strategy and asset allocation limits set. IPAC subsequently provides the Board of Trustees with regular reports on the nature of the investments made on their behalf and the associated risks. Such reports include formal Risk Management Statements as required by the Australian Prudential Regulation Authority.

**(a) 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, the notional principal amounts and net fair value of derivatives held by the Fund were as follows:

	Notional Principal Amounts		Net Market Value	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Futures and Options	(62 399)	(16 171)	174	(175)
Currency Contracts	(228 663)	(199 258)	(6 317)	12 999
Total	<u>(291 062)</u>	<u>(215 429)</u>	<u>(6 143)</u>	<u>12 824</u>

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**9. FINANCIAL INSTRUMENT DISCLOSURES (Cont.)****(b) Credit Risk**

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 \$7.7m (2003: \$54.9m).

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

**(c) 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 2004 was as follows:

	Fixed Interest Rate				Non-Interest Bearing	Total
	Floating Interest Rate	1 Year or Less	1-5 Years	Over 5 Years		
30 June 2004	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
<b>Assets</b>						
Cash & Short Term Deposits	55 285				60 433	115 718
Australian Fixed Interest		38 815	14 674	15 243		68 732
International Fixed Interest					68 805	68 805
Australian Equities					479 503	479 503
International Equities					437 200	437 200
Property Trusts					113 012	113 012
Currency Contracts					(6 317)	(6 317)
Private Equity					71 853	71 853
Hedge Fund					55 327	55 327
Emerging Markets					20 411	20 411
Futures and Options					174	174
Other Assets	4 897				8 140	13 037
Current Tax Recoverable					557	557
Deferred Tax Assets					2 569	2 569
<b>Liabilities</b>						
Trade Settlements Payable					(5 146)	(5 146)
Accrued Expenses					(442)	(442)
Sundry Creditors					(2 604)	(2 604)
Benefits Payable					(3 415)	(3 415)
<b>Total</b>	<b>60 182</b>	<b>38 815</b>	<b>14 674</b>	<b>15 243</b>	<b>1 300 060</b>	<b>1 428 974</b>
Weighted Average Interest Rate	1.42%	5.38%	6.09%	4.13%		

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the year ended 30 June 2004

9. FINANCIAL INSTRUMENT DISCLOSURES (Cont.)

(c) Interest Rate Risk (Cont.)

	Fixed Interest Rate				Non-Interest Bearing	Total
	Floating Interest Rate	1 Year or Less	1-5 Years	Over 5 Years		
30 June 2003	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
<b>Assets</b>						
Cash & Short Term Deposits	23 394				3 502	26 896
Australian Fixed Interest	11 514	4 959	26 676	20 956	(175)	63 930
International Fixed Interest					76 414	76 414
Australian Equities					363 427	363 427
International Equities					365 331	365 331
Property Trusts					82 594	82 594
Currency Contracts					12 999	12 999
Private Equity					52 180	52 180
Hedge Fund					28 468	28 468
Emerging Markets					24 365	24 365
Other Assets	3 957				16 444	20 401
Deferred Tax Assets					22 611	22 611
<b>Liabilities</b>						
Trade Settlements Payable					(4 158)	(4 158)
Accrued Expenses					(206)	(206)
Sundry Creditors					(1 895)	(1 895)
Benefits Payable					(7 283)	(7 283)
Current Tax Liability					(3 161)	(3 161)
Deferred Tax Liability					(2 891)	(2 891)
<b>Total</b>	<b>38 865</b>	<b>4 959</b>	<b>26 676</b>	<b>20 956</b>	<b>1 028 566</b>	<b>1 120 022</b>
Weighted Average Interest Rate	3.92%	4.73%	4.93%	4.96%		

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**9. FINANCIAL INSTRUMENT DISCLOSURES (Cont.)****(d) Currency Risk Exposures**

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

	USA A\$'000	JPY A\$'000	GBP A\$'000	EUR A\$'000	Other A\$'000	Total A\$'000
<b>30 June 2004</b>						
Gross investment amounts denominated in foreign currency	307 099	26 836	35 281	51 559	29 033	449 808
Amount effectively hedged	(181 892)	1 500	4 387	(51 269)	(1 389)	(228 663)
Net Exposure	<b>125 207</b>	<b>28 336</b>	<b>39 668</b>	<b>290</b>	<b>27 644</b>	<b>221 145</b>

	USA A\$'000	JPY A\$'000	GBP A\$'000	EUR A\$'000	Other A\$'000	Total A\$'000
<b>30 June 2003</b>						
Gross investment amounts denominated in foreign currency	209 725	20 796	27 940	49 540	20 685	328 686
Amount effectively hedged	(145 222)	(21 301)	(6 668)	(42 548)	16 481	(199 258)
Net Exposure	<b>64 503</b>	<b>(505)</b>	<b>21 272</b>	<b>6 992</b>	<b>37 166</b>	<b>129 428</b>

**(e) 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.

**10. 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:

	2004 \$m	2003 \$m
Funded component	1 435	1 126
Unfunded component	6 968	6 229
Total vested benefits	<b>8 403</b>	<b>7 355</b>

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**10. VESTED BENEFITS (Cont.)**

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

	2004	2003
	\$m	\$m
Funded component	1 435	1 126
Net assets adjusted for benefits payable and cost of disposal	<u>1 435</u>	<u>1 126</u>
Difference	<u><u>0</u></u>	<u><u>0</u></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 2004 and elected the option which is most costly to the Scheme. The likelihood of such an occurrence is remote in the extreme. The value quoted does not in any way represent the scheme's liability under circumstances which have any reasonable possibility of arising.

**11. 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 accrued benefits are comprised of a funded component, which will be met from the Fund (i.e. 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 2002-03. An extract of the Australian Government Actuary's report is attached.

	2002	1999
	\$b	\$b
Funded component	1.0	0.8
Unfunded component	<u>5.9</u>	<u>4.2</u>
Total accrued benefits	<u><u>6.9</u></u>	<u><u>5.0</u></u>

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

	2002	1999
	\$b	\$b
Funded component	1.0	0.8
Net assets	<u>1.0</u>	<u>0.8</u>
Surplus/(deficiency) Reserve	<u><u>0.0</u></u>	<u><u>0.0</u></u>

The liability for accrued benefits has been updated following the comprehensive actuarial review, which was completed early 2003 using data as at 30 June 2002.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**12. RELATED PARTIES****(a) Members of the Board**

The Military Superannuation and Benefits Board of Trustees had the following members during the financial year:

Members of the Board:

Mr C P H Kiefel (Chairman) [Reappointed 14 June 2004]  
 Dr M J Sharpe, AO  
 Air Commodore L Roberts  
 Warrant Officer R C Swanwick  
 Mr P J Charley

**(b) Trustee Related Transactions**

Some members of the Board may, as a result of their current employment, be members of the Scheme and as such would be required to have made contributions to the scheme during the 2003-04 financial year on the same terms and conditions applicable to all scheme members.

The number of trustees is within the following bands:

	2004	2003
\$60 001 to \$70 000	1	1
\$20 001 to \$30 000	1	1
\$10 001 to \$20 000	1	1
\$0 to \$10 000	2	2

The aggregate amount of remuneration paid to trustees during the financial year was \$149 741 (2003: \$137 037). The Scheme share of those remuneration expenses was \$114 869 (2003: \$96 431).

**13. AUDITORS REMUNERATION**

	2004	2003
	\$	\$
The amount paid and payable in respect of audit services provided by ANAO (excludes GST)	<u>41 000</u>	<u>36 000</u>

Deloitte Touche Tohmatsu (Deloitte) have been contracted by the Australian National Audit Office to provide audit services on the ANAO's behalf. Fees for those services are included above.

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

**14. SEGMENT REPORTING**

The MSB Scheme operates in the superannuation industry in Australia and as part of its investment activities maintains significant overseas investments.

## MILITARY SUPERANNUATION AND BENEFITS SCHEME

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the year ended 30 June 2004

**15. CONTINGENT LIABILITIES****(a) Capital Commitments**

At 30 June the Fund had outstanding investment capital commitments of \$181.2m (2003: \$174.9m). These commitments relate to private equity investment funds managed by Deutsche Bank, Credit Suisse First Boston, Gresham Private Equity, Macquarie Specialised Asset Management, Pantheon Private Equity Specialists, HarbourVest Partners, Sentient Global Resources, Pacific Equity Partners and Castle Harlan Australian Mezzanine Partners.

**(b) 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 2004 the Fund had no contingent liabilities (2003: nil).

**16. SUPERANNUATION CONTRIBUTIONS SURCHARGE**

The Superannuation Contributions Surcharge was introduced in the 1996 Federal budget to apply from 20 August 1996, to the surchargeable superannuation contributions of higher earners, whose adjusted taxable income exceeds the surcharge threshold.

MSBS members with adjusted taxable income above the surcharge threshold will incur a surcharge liability which is to be calculated by the Australian Taxation Office (ATO).

A summary of transactions follows:

	2004 \$'000	2003 \$'000
Total Surcharge Liability Outstanding at start of year	9 840	7 649
Surcharge liability recorded against member accounts in respect of surcharge assessments received during the year	2 383	2 409
Adjustments to previous year's balance	<u>(5)</u>	<u>(31)</u>
	12 218	10 027
Less: Amount paid by members	(211)	(195)
Less: Amounts deducted from members' benefit payments	<u>(480)</u>	<u>(461)</u>
<i>Plus:</i>	11 527	9 371
Interest applied to outstanding surcharge liability at 30 June 2004	<u>675</u>	<u>469</u>
Total surcharge liability outstanding at end of year	<u><u>12 202</u></u>	<u><u>9 840</u></u>

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. The above liability of \$12.2m does not include assessments in respect of 2003–04, which have not yet been calculated by the ATO.



1 August, 2003

## MILITARY SUPERANNUATION AND BENEFITS SCHEME SUMMARY OF THE 2002 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 2002 by the Australian Government Actuary. This report was presented to Parliament in June 2003.
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, 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 43 years.
3. These projections showed a progressive fall in the combined cost of the two schemes, due to the phasing out of the more expensive DFRDB. Given the underlying Government guarantee, I was therefore of the opinion that the financial position of the schemes as at 30 June 2002 was satisfactory.
4. The value of net assets of the MSBS available to pay benefits as at 30 June 2002 reported in the audited financial statements of the Fund was \$1,034 million.
5. Vested benefits of the MSBS were not calculated as part of the Long Term Cost Report as at 30 June 2002, but were calculated separately and covered contributors, preserved members and pensioners. They amounted to \$6.7 billion.

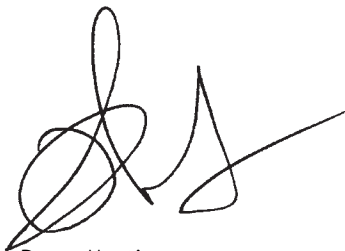
It should be noted that this value of vested benefits represents the liability that would have fallen on the scheme if all members had ceased service on 30 June 2002 and elected the most costly option to the scheme. The likelihood of such an occurrence is extremely remote.

6. The value of Accrued Benefits for the MSBS using the actuarial Projected Unit Credit (PUC) methodology as at 30 June 2002 was \$6.9 billion. This comprised \$5.9 billion in unfunded Accrued Benefits and \$1.0 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 2002. 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. The major assumptions used in the calculations were as follows:
  - Pension increases (CPI): 2.5% per annum  
(unchanged from the 1999 review)
  - Investment return: 3.5% per annum real (net of tax  
and investment expenses)  
(unchanged from the 1999 review)
  - Inflationary salary increases: 1.5% per annum real  
(unchanged from the 1999 review)
  - Promotional salary increases: scales based upon age and length  
of service  
(slightly revised from the 1999 review)
  - GDP increases: a series of rates falling from 3.5% per  
annum (real) in 2003/04 to 1.6% per  
annum (real) in 2044/45  
(the 1999 review used a constant real  
rate of 2.5% per annum)



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

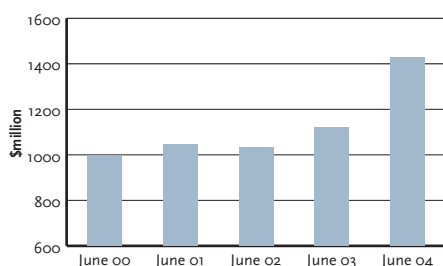
## investment

EFFECTIVE ASSET ALLOCATION				
Sector	30 June 2003		30 June 2004	
	\$m	%	\$m	%
Cash	11	1	69	5
Australian fixed interest	66	6	66	5
International fixed interest	76	7	67	5
Australian property securities	55	5	76	5
Australian shares	407	37	534	37
Private equity <sup>4</sup>	52	5	72	5
International shares <sup>5</sup>	386	35	469	33
Hedge funds	29	2	55	4
Global emerging markets	24	2	20	1
<b>Total under management</b>	<b>1 106</b>	<b>100</b>	<b>1 428</b>	<b>100</b>

INVESTMENT PERFORMANCE				
Sector	2002-03		2003-04	
	Fund %	Benchmark %	Fund <sup>1</sup> %	Benchmark <sup>2</sup> %
Cash <sup>3</sup>	4.3	5.0	5.0	5.3
Australian fixed interest	9.9	9.8	3.0	2.3
International fixed interest	14.1	13.0	4.9	4.1
Australian property securities	13.1	12.2	17.3	17.3
Australian shares	-1.7	-1.6	21.7	21.7
Private equity <sup>4</sup>	-1.5	na	15.6	na
International shares <sup>5</sup>	-7.4	-11.5	22.4	21.9
Hedge funds	13.7	4.0	10.0	5.1
Global emerging markets	-14.1	-10.7	26.6	28.2

## Fund growth in the past five years



## Notes

- Figures shown are gross of management fees and tax.
- The benchmark return for an asset class is the return achieved by the overall market, assuming that all dividends and interest payments are reinvested in the market.
- Transaction and administration costs are paid out of the cash portfolio.
- 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.
- Fifty per cent of the international share exposure was hedged.

## membership

Contributors at 30 June	2003	2004	Increase (decrease)
Males	39 600	41 657	2 057
Females	5 615	5 235	(380)
<b>Total</b>	<b>45 215</b>	<b>46 892</b>	<b>1 677</b>
<b>Total member contributions</b>	<b>\$102.0m</b>	<b>\$112.2m</b>	<b>\$10.2m</b>
<b>Contributor exits</b>			
Age retirement	71	71	0
Resignation	3 426	2 028	(1 398)
Redundancy	11	10	(1)
Invalidity	487	397	(90)
Death	12	15	3
Not yet determined	–	388	388
Other	–	833	833
<b>Total</b>	<b>4 007</b>	<b>3 742</b>	<b>(265)</b>
<b>Pensions in force</b>			
Retirement	707	796	89
Redundancy	1 901	1 916	15
Invalidity	2 169	2 356	187
Reversionary	145	164	19
<b>Total</b>	<b>4 922</b>	<b>5 232</b>	<b>310</b>
<b>Pensions paid</b>	<b>\$73m</b>	<b>\$81m</b>	<b>\$8m</b>
<b>Average pension</b>	<b>\$14 830</b>	<b>\$16 021</b>	<b>\$1 191</b>
<b>Preserved benefits</b>	<b>47 733</b>	<b>51 126</b>	<b>3 393</b>

<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>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 <b>indirect property</b> )
<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



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

*The Military Super Book* is a general information book that intended as a reference book for members and pay officers. A *Summary of the Scheme* leaflet is also available.

The *MSB Fund Investment Policy* 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*  
*Invalidity Benefits*  
*Leave Provisions*  
*Rejoining the ADF*  
*Summary of the Scheme*  
*Superannuation Contributions Surcharge*  
*Taxation Concessions*  
*Taxation of Benefits*  
*The Productivity Benefit*

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

*Death and Dependants' Benefits*  
*Early Access to Military Super Benefits*  
*Family Law and Your Super*  
*Maximum Benefit Limits*  
*Invalidity Benefits—The Classification Process*  
*Unitisation*

Copies of the *MSBS Business Plan* and *Your Guide to Investment Choice* are also available.

Also available is the *ComSuper Service Charter 2004*.

Four videos have been produced:

*Highlights of the Scheme*  
*For the ADF and Their Families*  
*Investments*  
*Military Sooper Quiz*

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 Military Super website ([www.militarysuper.gov.au](http://www.militarysuper.gov.au)).

## APPENDIX 4: SERVICE CHARTER



ComSuper maintains a service charter for scheme members. The service charter for 2004 is available in hard copy and on the MilitarySuper website (see Appendix 3).

Performance against the standards set out in this charter is included in this report.

## APPENDIX 5: 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:

Ministerial Liaison Officer  
ComSuper

*Postal address:* PO Box 22  
Belconnen ACT 2616

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

*Telephone:* (02) 6272 9262

*Facsimile:* (02) 6273 9809

*TTY:* (02) 6272 9827



## Family Law changes

- The *Superannuation Legislation Amendment (Family Law and Other Matters) Act 2004* came into force on 18 May 2004. These amendments allowed for the creation of a separate interest in favour of a non-member spouse where the member's superannuation is split pursuant to the *Family Law Act 1975*.
- The *Family Law (Superannuation) (Methods and Factors for Valuing Particular Superannuation Interests) Approval 2003 (Volume 2)*, as prepared on 18 May 2004, sets out methods and factors for interests of members in the MSBS.
- The *Military Superannuation and Benefits Amendment Trust Deed 2004 (No 1)* introduced changes to the MSB Rules to reflect recent amendments to the *Family Law Act 1975*. Some of these changes came into effect on 12 November 2003, with the remainder on 18 May 2004.
- The *Family Law (Superannuation) (Provision of information —Military Superannuation and Benefits Scheme) Determination 2004* provides rules as to when the Trustee of the MSBS must provide information with respect to Family Law matters.

## Other legislative changes

- The *Military Superannuation and Benefits Amendment Trust Deed 2004 (No 2)* introduced changes to the MSBS Rules to reflect the recognition of the qualification and skill elements of environmental allowances for superannuation salary purposes. This change came into effect on 12 August 2004.
- Further changes to the MSB Rules are expected shortly to reduce the superannuation contributions surcharge rate.

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 2003-04*. Annual reporting requirements that are met in the Commissioner for Superannuation's report are indicated below by an asterisk.

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### 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 2003–04*.

### 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 Governance 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 5 in the Corporate Governance and Parliamentary Liaison 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 prior to submission to the MSB Board for decision under section 54 of the FOI Act.

Officers currently designated to carry out such investigations are APS Level 7 officers in the Reconsideration Section. All decisions on internal reviews are made by the MSB Board.

### 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 Corporate Governance and Parliamentary Liaison 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 Corporate Governance and Parliamentary Liaison Unit at the address and telephone numbers shown on page 53 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)).

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[www.militarysuper.gov.au](http://www.militarysuper.gov.au)

