Military Super

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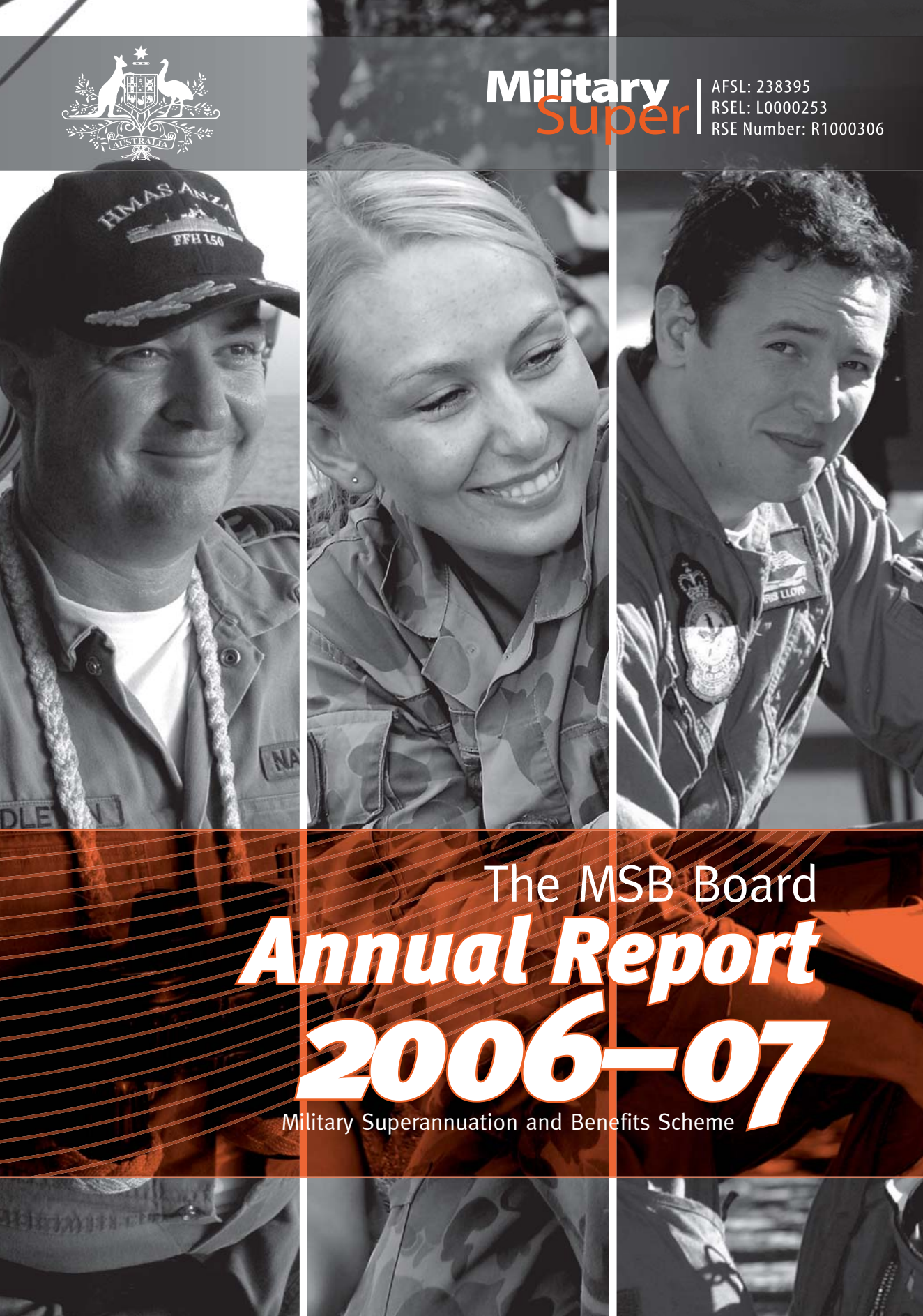

The MSB Board

Annual Report 2006–07

Military Superannuation and Benefits Scheme

MSB Annual Report to Parliament

2006–2007

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

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

Dear Minister

In accordance with section 26 of the *Military Superannuation and Benefits Act 1991* (the MSB Act), the Military Superannuation and Benefits Board of Trustees is pleased to submit to you its annual report on the performance of its functions for the year ended 30 June 2007, together with financial statements in respect of the management of the Military Superannuation and Benefits Fund during 2006–07, and the Auditor-General's report in respect of those statements.

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

Yours faithfully

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

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Section One

MilitarySuper achieves strong investment returns again in 2006-07

It has been a great honour to serve as Chairman of the MilitarySuper Board of Trustees over the past ten years. However, with my increasing business commitments I have reluctantly advised the Minister Assisting the Minister for Defence that I will be unable to continue to serve in this capacity for a further term beyond 31 August 2007. This will therefore be my last report as Chairman of the MilitarySuper Board of Trustees.

Over the past ten years I have seen many changes in both the size and complexity of MilitarySuper and the MSB Fund. Indeed when I first became Chairman, the Fund held assets of less than $400 million, and this has now grown to a fund with assets under management of $2.8 billon.

The investment strategy being employed by the MSB Fund is focused on the achievement of sustainable investment returns for Members in most if not all market conditions. This has involved extensive research both in Australia and internationally to identify asset classes and best of class funds managers with capacity to add value. It has also involved extensive research into the strategies employed by the US Endowment funds which have proven track records in achieving long term sustainable returns by investing in non-traditional asset classes, such as private equity.

With the assistance of its specialist advisors, the Board has also been monitoring investment opportunities in the emerging economies of Brazil, China, India and Russia – the so called BRIC economies. In May 2007, India became the third emerging stock market after China and Russia to surpass $1 trillion in value. Factors such as the economy's fastest growth in 60 years, a strengthening currency and burgeoning foreign investment have helped the surge in the Indian markets.

The developments occurring in these economies have significant implications for global resources and world markets given the emergence of a middle class in each of the BRIC countries. Some commentators are predicting that the number of people with incomes over US$3,000 per capita in BRIC countries – the minimum level which the World Bank uses to define 'higher middle income economies' – could nearly double in the next three years. In a decade over 800 million people across the four economies may have crossed that threshold, creating significant new demand for consumer goods. In China alone the number of people achieving middle income status may increase tenfold over the next decade and by nearly 14 times in India.

It is projected that in GDP terms China's economy will be larger than that of the USA by the year 2050 with India coming in third. Growth in India is aided by the favourable population demographics, with over 50% of its enormous population (representing approximately 10%

of world population) aged under 25 years. India's population is the only one of the BRIC countries which is projected to continue to grow.

MilitarySuper already has established successful investment relationships in China and India in areas of private equity, infrastructure and debt financing which are delivering strong returns for Members and are not correlated to listed equity markets.

It is therefore with personal pride that I note that the Fund has achieved strong returns for the financial year to 30 June 2007; achieving 16.3% net (ie after fees and taxes - 19.1% gross) in the Growth (Default) option - in which over 90% of Members moneys are invested - and 16.4% (19.4% gross) in the High Growth option.

Investment Performance

During the year listed equity markets, but particularly the domestic equities market, continued to perform strongly. The headline All Ordinaries Index set new records during the year breaching 6,000 points for the first time in February 2007 and then soaring above 6,400 before closing the year at 6,310.6 points. This marked not only the market's strongest 12 month return since 1986–87 but also its best four-year run in 20 years.

But it was the abundance of money in a benign interest rate environment that underpinned the most notable phenomenon of 2006–07. That was the emergence of private equity interest in some of Australia's largest listed companies. This is an asset class in which MilitarySuper has been invested for some years.

In Australia many analysts continue to point to strong liquidity as a support for the market in light of government incentives for greater superannuation contributions and the impact of the inflow of funds from these initiatives into equity markets. There is also support for the view that Australia will continue to benefit from the boom in commodity prices, driven in large part by the ongoing demand for commodities from emerging economies such as China.

Underpinning these positives is the cautionary view that volatility will remain a feature of listed equity markets and that double digit returns from listed equities are not sustainable over the long term. This is why MilitarySuper's investment strategy places less reliance on listed equities to achieve long term sustainable returns in most market conditions. This has been achieved by the introduction of alternative asset classes whose return characteristics are not closely correlated to those of listed equities.

Despite the Fund's lower exposure to international and domestic shares during 2006–07 than many of its peers, I am pleased to report that MilitarySuper has achieved strong returns for the fourth consecutive year since implementing its revised investment strategy. In an environment

of significant volatility in listed equity markets, all aspects of the strategy have worked well together, helping to maximise returns whilst at the same time containing investment risks. Indeed some of our alternative investments have achieved returns superior to those of listed markets during the year. For example the Fund's investment in the ANZ Infrastructure Fund (which holds a major interest in the Brisbane Airport Corporation) achieved a return of 36.8% for the year. However, by far the best performing investment for the year was that of our Australian private equity manager, Pacific Equity Partners, which achieved a remarkable 108% return for the year.

More importantly, I am pleased to report that since the implementation of its revised investment strategy in 2003 the Fund has achieved strong returns in each of the subsequent four years; achieving average yearly returns over those four years in the Growth Option of 14.9% Net (17.3% Gross) and 16.9% Net (19.7% Gross) in the High Growth Option.

Returns for Growth and High Growth

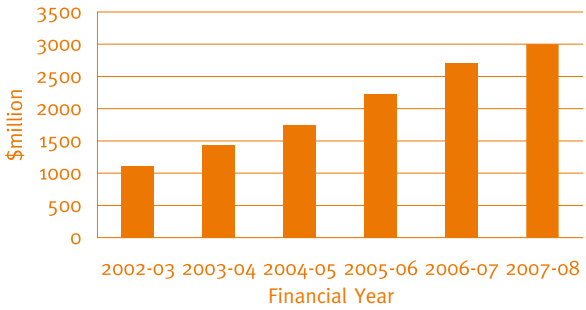
Year	Growth %	HIgh Growth %
2003-04	15.6	18.9
2004-05	12.0	14.1
2005-06	15.7	18.2
2006-07	16.3	16.4

Growth of the Fund

The Fund's assets continued to grow during the year reaching $2.79 billion by 30 June 2007 and are expected to reach $3 billion by the end of 2007-08.

The following chart demonstrates the growth of the Fund over the past five years and projected for 2007-08:

Projected Fund Growth



Regulatory framework

2006–07 was again a year where uncertainty and change continued to be present in relation to the investment, regulatory and taxation environments in which MSBS operates. The investment environment is forecast to remain unpredictable, the regulatory environment continues to strengthen with the implementation of the Financial Services Reform Act, implementation of the APRA licensing regime and continuing discussion and comment surrounding corporate governance. Additionally, managing Member and employer expectations in terms of earnings rates and Scheme design, particularly in the context of significant taxation advantages flowing to fully funded schemes from 1 July 2007, remain a key focus of the Board and its committees. In addition, the continuing enhancement of the Scheme through Member Investment Choice, and Ancillary Benefits (such as salary sacrifice and spouse contributions) continue to provide added challenges to trustees, staff and service providers.

Major taxation reforms come into effect from 1 July 2007. The Board has worked closely with the Scheme Administrator (ComSuper) to ensure that the required systems changes are implemented in a timely manner and strictly in accordance with legislative requirements.

Review of superannuation arrangements for Members of the Australian Defence Force

The review of superannuation arrangements for Members of the ADF has significant potential to impact on the operations of the Board and of the MSB Fund. The Board has made a submission to the review body recommending a number of changes and enhancements to MilitarySuper.

Key principles identified for the purposes of the review terms of reference are the need to recognise the unique nature of military service and the need to understand and recognise the central role that superannuation, invalidity and death benefits play in the ADF's recruitment and retention strategies. The review team is expected to provide its report and recommendations to Government by 31 July 2007.

Acknowledgements

Over the past ten years the Scheme itself has grown and expanded in response to government financial sector reforms and in response to Board initiatives for the introduction of value adding services to Members of the Defence Force. Indeed, throughout my tenure I have been privileged to work with a dedicated Board which has retained focus on serving Members of the Defence Force. I therefore wish to place on record my appreciation of the efforts of all of the trustees, both current and past, with whom I have had the pleasure to work and for the ongoing support of the Minister, the Department of Defence and the Chiefs of the Defence Force.

For 2006–07 I wish to commend my fellow trustees for their continuing commitment, co-operation, support and hard work during a year of significant challenge and change across many areas of the Board's responsibilities. In particular I would like to acknowledge the contribution made by Dr Michael Sharpe AO to the work of the Board over the past nine years. Michael will be retiring from the Board at the end of July 2007.

On behalf of the Board I would also like to commend the work of our investment advisers Strategic Capital Management as Lead adviser, Sovereign Investment Research as adviser in the alternative asset sector, Members of the Board's Investment Committee and the Board's in-house investment team for the significant work undertaken in the research, monitoring and review of the Fund's investment strategy, manager configurations and new investment opportunities. The outcome of this work will have significant long-term benefits for all Members of the Scheme. I would also like to acknowledge the contribution of past advisers to the Board including *ipac* Financial Services, Mercer Human Resource Consulting, Frank Russell and Watson Wyatt.

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

Ongoing commitment

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

With the ongoing support of the Department of Defence, the Scheme Administrator and the Fund's investment advisers and managers, it is the Board's intention to continue to look for opportunities to improve access by Members to a range of value adding services and financial products. This will be done in conjunction with the current review of ADF superannuation arrangements.

I regard it as a great honour to have served the Government and Members of the Australian Defence Force in my role as Chairman and will sincerely miss the opportunity to continue to do so. However, I can look on these past ten years as a period of significant growth and achievement of which I am proud to have played a part.

Charles Kiefel
Chairman

About the Scheme

Section TWO

The Military Superannuation and Benefits Scheme (MilitarySuper) 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 MilitarySuper before 1 October 1992.

Description of the Scheme

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

- a Member component, comprising the Member's own contributions, including amounts notionally brought over from the DFRDB Scheme, plus earnings on these amounts. Investment choice is applicable to this component of the benefit and Members can select from one of the five investment options offered by the Scheme.
- an employer component, which is a defined benefit based on the Member's period of Membership and final average salary. Except for the portion relating to employer three percent productivity contributions, which are paid on a fortnightly basis to the Scheme by the Department of Defence, this component of the benefit is unfunded. That is, the cost is met by the employer on an emerging cost basis from the Commonwealth's Consolidated Revenue Fund when the benefit falls due.

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

At three-monthly intervals MSBS Members may elect to vary their contributions to the scheme from the minimum 5% to a maximum of 10%.

In addition, Members are able to transfer amounts from other superannuation funds into the MilitarySuper Scheme and make pre-tax Member contributions and contributions for the benefit of their spouse to the MilitarySuper scheme. These additional ancillary benefits are invested according to the Member investment choice and are payable in addition to other benefits.

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

The MSB Board

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

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

With the exception of the two current employer representatives, Trustees hold office for a period of up to three years, and can be re-appointed to these positions. When the two current employer representatives cease office their replacements will be appointed for terms of up to three years. Trustees are removed in the same way they are appointed.

Trustees holding office at 30 June 2007 were:

Chairman:

Mr Charles Kiefel BCom, FCA, FAICD
Trustee since 11 July 1997

Mr Kiefel is a Director of a number of private companies and was formerly Managing Director of Corporate Finance at ANZ Investment Bank. He has a Bachelor of Commerce degree, is a Fellow of the Institute of Chartered Accountants and a Fellow of the Australian Institute of Company Directors. In addition to his role as Chairman of the Board, Mr Kiefel is Chairman of the Board's Investment Committee. Mr Kiefel's retirement as Chairman will take effect from 31 August 2007.

Minister's Nominees:

Dr Michael Sharpe AO, Hon DscEcon (Syd.), Bec, FCA, FAICD
Trustee since 29 April 1998

Dr Sharpe is a Director of the Australian Stock Exchange Limited and Babcock and Brown Australia Pty Ltd. During his career, he has served as Chairman of the International Accounting Standards Committee, President of the Institute of Chartered Accountants in Australia, Senior Audit Partner of the firm now known as PricewaterhouseCoopers, a trustee of State Super (NSW), Chairman and Director of many companies, and as an adviser to Government. He serves as Chairman of the Audit and Risk Management Committee and is a Member of the Investment Committee. Dr Sharpe tendered his resignation to take effect from 31 July 2007.

Mr Felix Bleeser
Trustee since 1 March 2005

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

ADF Nominees:

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

Air Commodore Lee Roberts is currently a Member of the Military Superannuation Review Team and was previously the Director General Personnel – Air Force. He has served as a pilot and flying instructor extensively within Australia and overseas during his 35–year Air Force career. He is a Fellow of the Australian Institute of Company Directors, holds a Certificate of Superannuation Trusteeship and has previous experience as an Alternate Trustee of the MilitarySuper Scheme. He currently serves as Chairman of the Military Superannuation Communication Committee.

WOFF Robert Swanwick MAICD, JP
Trustee since 22 September 1997

Warrant Officer Swanwick is Loadmaster with No.37 Squadron RAAF Base Richmond. He has served throughout Australia and overseas for 28 years as a Loadmaster, been posted to Air Force and Army units, and attached to Navy establishments. He holds diplomas in frontline management and aviation and has extensive training in investment and superannuation administration. Over the past ten years, he has held the position of other Rank Trustee, and is a Member of the Audit and Risk Management Committee and a Member and former Chairman of the Military Superannuation Communication Committee.

The MSB Board

Standing (from left)
WOFF Robert Swanwick, Air Commodore Lee Roberts
Seated (from left)
Dr Michael Sharpe, Mr Charles Kiefel, Mr Felix Bleeser

Minister's Statement of Expectations and the Board's Statement of Intent

The Government has agreed that Ministers are required to assess their portfolio bodies against the governance templates of the Review of Corporate Governance of Statutory Authorities and Office Holders (the Uhrig Report). To give effect to that decision the Minister for Defence has issued the following statement of expectations in respect of the performance by the Board of its functions and responsibilities under the *Military Superannuation and Benefits Act 1991*. In response the Board has provided to the Minister a statement of intent which is also reproduced.

STATEMENT OF EXPECTATIONS FOR MEMBERS OF THE MILITARY SUPERANUATION AND BENEFITS BOARD

It is the reasonable expectation of the Government and members of the Scheme of the Military Superannuation and Benefits Board (MSB Board) will:

1. operate the MSBS in accordance with the *Military Superannuation and Benefits Act 1991,* the Trust Deed and Rules as well as the *Superannuation Industry (Supervision) Act 1993,* the *Corporations Act 2001,* and the Service Level Agreement (SLA) between the Board, Defence, the Defence Forces Retirement and Death Benefits Authority and Commonwealth Superannuation Administration (ComSuper).

2. comply with the requirements to undertake significant governance related activities to meet the licensing requirements of both the Australian Prudential Regulatory Authority (APRA) and the Australian Securities and Investment Commission (ASIC).

3. publish this Statement of Expectations and the Statement of Intent for the MSB Board in the MSB Board's annual report.

4. provide a copy of the MSB Board's annual report and annual budget to the responsible Minister, the Secretary of the Department of Defence and the Chief of the Defence Force (CDF).

5. keep the Minister fully informed of the activities of the MSB Board and alert him to any 'significant events' related to the MSB Board's core business in a timely manner.

6. implement the changes recommended in the assessment of the MSB Board against the framework of the 'Review of the Corporate Governance of Statutory Authorities and Office Holders by Mr John Uhrig AC (the Uhrig Report)'.

7. disclose potential conflicts of interest.

BRENDAN NELSON
Minister for Defence

MILITARY SUPERANNUATION & BENEFITS BOARD OF TRUSTEES NO. 1, STATEMENT OF INTENT

In the discharge of its responsibilities for the Administration of the Military Superannuation & Benefits Act 1991 and the management and investment of member's money which comprise the Military Superannuation and Benefits Fund, it is the Board's clear intention that it will:

1. Operate the MSBS in accordance with the Military Superannuation and Benefits Act 1991, the Trust Deed and Rules as well as the Superannuation Industry (Supervision) Act 1993, the Corporations Act 2001, and the Service Level Agreement (SLA) between the Board, Defence, the Defence Forces Retirement and Death Benefits Authority and Commonwealth Superannuation Administration (ComSuper).

2. Comply with the requirements to undertake significant governance related activities to meet the licensing requirements of both the Australian Prudential Regulatory Authority (APRA) and the Australian Securities and Investment Commission (ASIC).

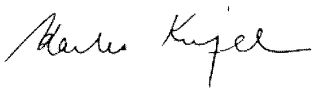
3. Publish the Minister's Statement of Expectations and this Statement of Intent in the MSB Board's annual report to parliament.

4. Provide a copy of the MSB Board's annual report and annual budget to the responsible Minister, the Secretary of the Department of Defence and the Chief of the Defence Force (CDF).

5. Keep the Minister fully informed of the activities of the MSB Board and alert him to any 'significant events' related to the MSB Board's core business in a timely manner.

6. To the extent that this is consistent with its obligations and responsibilities as trustee of a regulated superannuation entity, implement the changes recommended in the assessment of the MSB Board against the framework of the 'Review of the Corporate Governance of Statutory Authorities and Office Holders by Mr. John Uhrig AC (the Uhrig Report)'.

7. Disclose potential conflicts of interest.



CHARLES KIEFEL
CHAIRMAN
MILITARY SUPERANNUATION & BENEFITS BOARD OF TRUSTEES

Indemnity insurance

The Board is required to maintain a Trustee Indemnity Insurance Policy. This is to ensure that the assets of the MSB Fund are protected against losses, liabilities, actions, claims and demands against the Board that may arise from the actions of the Board and staff of the Administrator acting as authorised representatives of the Board under its Australian Financial Services Licence. The Department of Defence also provides an indemnity against errors and omissions by staff of the Board's Administrator, which cause a loss to the Fund. The current policy is held with AIG. To date there have not been any claims against the insurance policy, nor have any regulatory penalties been applied to MilitarySuper.

Schedule of Board meetings

	9 Aug 2006	6 Sept 2006	19 Sept 2006*	18 Oct 2006	13 Dec 2006	21 Feb 2007	18-20 Apr 2007	28 Jun 2007
Mr Charles Kiefel	P	P	P	P	P	P	P	P
Dr Michael Sharpe	P	P	P	P	P	P	P	P
WOFF Robert Swanwick	A*	A*	A*	P	P	A*	P	P
AIRCDRE Lee Roberts	P	P	P	P	P	P	P	P
Mr Felix Bleeser	P	P	P	P	P	P	P	P

* Extra-ordinary meeting of the Board

P = Present
A = Apologies Provided
A* = On active duty with the ADF, apologies provided

Fund Investment

Section three

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

Investment policy

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

Investment objectives

The general investment objectives for the Fund are to:

i. Contribute to the support of Members' lifestyles in retirement, by enhancing the purchasing power of their investment through prudent and efficient management.

ii. Maximise return for the chosen level of risk.

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

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

(i) Return Objective

The return objective is expressed as a margin above cash (UBS Bank Bill Index) over a rolling period after investment fees and taxes for the two investment choice options of Cash and Conservative. However, in respect of the Balanced, Growth (Default) and High Growth options, the investment objectives are expressed in the form of Absolute Return targets of 8% (Balanced),10% (Growth) and 11% (High Growth) all net per annum, respectively, over the long-term.

(ii) Risk Budget

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

Investment strategy

Given the volatility of investment returns from traditional listed markets, and acting with the advice of its professional investment advisors, the Board implemented a revised investment strategy for the Fund in 2003–04. This has at its core an absolute return objective in the Growth (Default) option of achieving sustainable long-term investment returns of 10% (net) per annum over the long-term with an acceptable level of risk of negative return. This investment strategy is leading to a reduction in the Fund's exposure over time to market generated returns as it seeks to add value from a diverse range of non-traditional asset classes whose return characteristics are not closely aligned to listed equity markets.

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

Reserves

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

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

Diversification and risk control

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

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

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

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

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

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

A focus on quality investment performance

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

Adding value through active management

The Board adopts the view, that in some sectors, active investment management can add value to the Fund. To achieve this increase in value requires adherence to well considered strategies throughout different investment circumstances. On average this approach is expected to yield

better returns. Over time these returns should compound to provide substantial increases in the Fund's value, and thus improve the financial position of the Fund's stakeholders.

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

Strategic asset allocations

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

The strategic asset allocation to private equity includes capacity for commitments to both International and Australian private equity without imposing hard commitment targets. Consequently, the Fund is able to allocate its private equity investments on a tactical basis as the best opportunities arise. As commitments are drawn down progressively over time, undrawn commitments are invested in Australian shares and cash.

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

Asset class	Cash option %	Conservative option %	Balanced option %	Growth option %		High Growth option %
				(a)	(b)	
Cash	100	20	5	2	2	0
Debt instruments (1)	0	50	33	7	10	0
Property	0	7	6	6	8	10
Australian shares	0	9	18	34	20	30
Private Equity	0	0	5	14	10	15
International shares	0	9	18	24	20	30
Infrastructure	0	3	8	8	14	5
Uncorrelated alpha products (inc. hedge funds)	0	2	5	5	7	10
Alternative Debt	0	0	2	0	9	0
Total assets	100	100	100	100	100	100
Total growth assets	0	30	62	92	88	100
Illiquid assets	0	12	24	33	39	40

(1) Infrastructure Debt is included in this category
(a) Represents the Growth Option's actual exposure as at 30 June 2007
(b) Represents the long-term Strategic Asset Allocation for the Growth Option

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 and its investment advisers as necessary to discuss strategies, portfolio activity and investment performance.

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

During the year the Board's Investment Committee, supported by its specialist advisors, continued the detailed analysis and review of investment managers and investment products consistent with the implementation of the Fund's revised investment strategy. This research, includes ongoing monitoring and review of the strategies employed by the large US endowment funds which have proven track records in achieving long term sustainable investment returns by investing in non-traditional asset classes such as private equity and infrastructure. It has also involved detailed assessment of the investment risks and opportunities afforded by the emerging economies of India, China and Russia.

Continuing strong economic growth in these emerging economies has kept the key commodities markets booming. This has led not only to strong export revenues but has also identified infrastructure deficiencies and shortages of skilled labour and specialized equipment required to fully capture these opportunities. However, with the United States economy looking likely to reach a soft landing, signs of reasonable growth in Europe, a recovery in Japan and India emerging as a major economic force, China is no longer seen as the only country driving commodity demand.

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 2007 are shown in Table 6 (page 45).

Custodian services

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

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

Member investment choice

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

Impacts of investment strategy on choice options

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

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

The alternative asset classes introduced into the Fund, but particularly Private Equity, direct property and uncorrelated alpha products also display growth characteristics which are

generally unaffected by movements in traditional listed markets such as shares. Investments in infrastructure, on the other hand, may take the form of investments in start up projects or in established facilities. Investments in the latter provide access to strong cash flows and potential for future capital growth. Therefore this form of investment displays similar defensive characteristics to more traditional defensive assets such as cash and bonds. Indeed investments in infrastructure projects may comprise elements of both equity and debt, with the latter providing opportunity for senior debt lending, producing bond-like rates of return.

As the bulk of the assets of the Fund (i.e. over 90%) are invested in the Growth (Default) investment option, it is possible for each of the remaining four options to be balanced on a weekly basis to the long-term asset allocation set for that option. As a result, each of these options is fully exposed to the range of assets (including the new alternative asset classes) set for that option and their returns reflect the full impact of those exposures consistent with the new investment strategy.

Given the volume of funds invested in the Growth option it is not currently possible for that option to be fully transitioned to the new long-term strategic asset allocation set by the Board. This is occurring progressively as new opportunities for investments in alternative asset classes arise. In the interim, the Growth option carries higher physical exposures to listed equities and debt instruments, which will be sold down progressively to fund new investments in those alternative asset classes. As a consequence, the investment returns for the growth option in 2006-07 are not fully reflective of the returns which would have been achieved had it been possible for that option to be fully transitioned to the new strategy. However, because of the higher exposure to listed equities, the Growth option benefitted from the extraordinary and unexpectedly strong returns from Australian and global equity markets.

Despite the strong returns from listed markets in 2006-07, most market analysts agree that this level of return is not sustainable over the longer-term and that some form of correction is clearly overdue. Therefore, although the Fund will retain its growth focus (and will continue to have a significant exposure to listed markets in both Australia and overseas) the Board is increasingly seeking, in line with the revised investment strategy, to diversify away from reliance on market-generated returns alone. This is being achieved by increasing allocations to other forms of assets with return characteristics which are not directly correlated with movements in listed equity markets. These will comprise

- Property (including Direct/Listed)
- Private Equity
- Infrastructure (via both Equity and Debt)
- Uncorrelated Alpha (including Hedge Funds)

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

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

Strategy	Outline	Investment objective	Risk budget (likelihood of a negative return)
Cash	This strategy aims to maximise protection against capital loss. To do this it invests only in secure cash investments such as bank deposits, bills, mortgages and short-term funds.	Achieve returns that match the UBS Bank Bill Index over 1 year period. The investment focus of this option is short-term and is provided for Members expecting to access their funds within 1-2 years and therefore seeking a greater degree of certainty in investment returns.	Very low.
Conservative	This strategy invests in a conservative mix of assets, mostly debt instruments (such as fixed interest, infrastructure debt and cash), with some investment in shares and property.	Achieve returns that are greater than 1% (net) over the UBS Bank Bill Index over most rolling 3 year periods. This strategy is aimed at maintaining an extremely low risk of capital loss and is therefore provided for Members expecting to access their superannuation within 2-5 years and have a low appetite for investment risk.	Low.
Balanced	This strategy invests in a diversified mix of assets such as debt instruments (including infrastructure debt), but with a bias towards growth assets.	Achieve absolute return of 8% (net) per annum over most rolling five year periods.	Approximately 1 year in 8.

Strategy	Outline	Investment objective	Risk budget (likelihood of a negative return)
Growth (default)	This strategy invests mainly in assets with growth characteristics (including Private Equity, Infrastructure and Uncorrelated Alpha products) with some investment in property, debt instruments and cash. This option currently has a strong bias towards listed equity markets (both domestic and international). This bias towards market generated returns is being reduced with greater exposure to unlisted growth asset classes such as Private Equity, Infrastructure (via both equity and debt), Property and Uncorrelated Alpha products such as hedge funds.	Achieve absolute returns of 10% (Net) per annum over most rolling five year periods. This strategy has a long-term investment focus and is provided for those Members seeking higher rates of return over the lifetime of their investment.	Approximately 1 year in 7.
High Growth	This is the most aggressive strategy. It invests totally in growth assets, with no direct investment in cash or debt instruments such as fixed interest. The option's current high dependence on returns generated by listed equity markets was reduced through the introduction of increased allocations to alternative investment growth assets such as Private Equity, Infrastructure, Property and Uncorrelated Alpha products such as hedge funds.	Achieve absolute returns of 11% (Net) per annum over most rolling 7 year periods. This strategy has a long-term investment focus and is provided for those Members seeking higher rates of return over the lifetime of their investment and who are able to tolerate variability in returns over the shorter term.	Approximately 1 year in 6.

investment performance

At the global level, China's mainland sharemarkets were the standout performers in 2007 after quadrupling in value over the past two years. In May 2007 India became the third emerging stock market after China and Russia to surpass $1 trillion in value. China's growth rate is forecast to steady at 10.4% this year and next, from 10.7%. India's growth is forecast to slow to 8.5% next year, from 9% and Russia's, similarly, to 6.5%. These emerging economies are having a fundamental impact on the world economy given their extraordinary growth and demand for commodities.

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

A surprisingly resilient world economy and a boom in take-over activity saw the domestic share market achieve its best performance in more than two decades, despite concerns about possible interest rate increases and nervousness about the volatility in markets both globally and domestically. The benchmark All Ordinaries Index breached 6,000 points for the first time in February 2007, soaring to a high of 6421 by 20th June before closing the year at 6,310. This marked not only the market's strongest twelve month performance since 1986–87 but also its best four year run in twenty years.

However, it was the abundance of money in a benign interest rate environment which underpinned the most notable and surprising factor to emerge in 2006-07. This was the emergence of private equity interest in some of Australia's largest listed companies including Coles and Qantas and growing speculation about other potential targets across the market.

Going forward many analysts point to strong liquidity as an ongoing support for the Australian market particularly in light of government incentives for greater superannuation contributions and the impact these measures will have on the inflow of funds into equity markets. There is also support for the view that Australia will continue to benefit from the boom in commodity prices, driven in part by the continuing strong economic growth of nations like China and India. This has led not only to surging export revenues but also exposed inadequacies in infrastructure and shortages of skilled labour and specialised equipment.

However, underpinning these positives is a cautionary undertone that volatility will persist in equity markets and that double digit returns from listed equities are not sustainable over the long-term. That is why MilitarySuper's investment strategy places less reliance on listed equities to achieve long-term sustainable returns in most market conditions.

As noted in the Chairman's overview, despite the Fund's lower exposure to listed equities than many of its peers, MilitarySuper has achieved strong returns for the fourth consecutive year since the implementation of its revised investment strategy.

For 2006-07 the Fund achieved a return of 16.28% Net (19.14% gross) in the Growth (default) option in which the majority of Members' moneys are invested. The returns for each of the five investment options in both gross and net return terms as identified in Table 2:

Table 2: Returns achieved by each investment option for 2006–07

Option	Net %	Gross %
Cash	5.22	6.46
Conservative	9.46	11.50
Balanced	13.48	16.06
Growth	16.28	19.14
High Growth	16.40	19.37

Those elements of the MilitarySuper Fund which are exposed to listed equity markets have shared fully in that market generated return.

The absolute return objective set for the Growth (default) option is 10% net of all fees, taxes and expenses. The return of 16.28% (net) achieved for 2006-07 has significantly exceeded that objective, notwithstanding that the Fund is still in the process of transition to the new range of alternative assets which form the framework for the long-term investment strategy for this option.

The four other investment options are already fully exposed to the new asset classes and therefore their returns reflect the long-term return expectations for those options; with the High Growth option returning 16.4% (net) for the year.

Importantly, since the implementation of its revised investment strategy in 2003–04, the Fund has achieved average returns in each of the subsequent four years in the Growth option of 14.9% net and 16.9% net in the High Growth Option.

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

Table 3: Investment performance by asset class 2006-07

Sector	Effective exposure at 30 June 2006		Effective exposure at 30 June 2007		Performance 2006-07	
					Fund[1]	Benchmark[2]
	$m	%	$m	%	%	%
Cash	18	1	54	2	6.2	6.4
Debt Instruments	209	9	203	7	7.3	6.4
Property	156	7	184	7	5.1	10
Australian Shares	690	31	842	30	28.4	29.2
Private Equity[3]	219	10	406	15	15.4	15
International Shares[4]	644	29	608	22	23.1	23.7
Uncorrelated Alpha	131	6	180	6	4.0	10
Infrastructure	172	8	248	9	8.1	10
Currency	(7)	(1)	66	2	NA	NA

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

Table 4 : Returns for Growth and High Growth options

Year	Growth (net) %	High Growth (net) %
2003-04	15.6	18.9
2004-05	12.0	14.1
2005-06	15.7	18.2
2006-07	16.3	16.4
Four year average	14.9	16.9

returns from listed equity markets

International equities

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

During 2006–07 MilitarySuper continued the process commenced in 2004 to identify equity managers with demonstrated skill and successful track records in outperforming the relevant market. Such managers seek to add value by pursuing active management strategies, often over a highly concentrated portfolio of stocks.

As indicated above, investments in international markets carry an additional risk related to the value of overseas investments as a result of movements in international exchange rates. MilitarySuper employs an active currency management strategy around a 100% hedge benchmark over the Fund's exposure to overseas currencies. The active strategy enables that exposure to be adjusted regularly through use of currency forwards. This is done in order to minimise losses when the overseas currency loses value (against the AUD) while allowing the Fund to participate in growth when the currency increases in value. During the second half of the financial year, speculation by global investors saw the AUD rise to an 18 year high against the United States Dollar (USD) of 84.80 cents. This increase in appetite for the AUD was driven partly by the popular global trading strategy called the "carry trade". This strategy involves exploiting the differences between interest rates by borrowing or selling low yielding currencies such as the Yen, with its present 0.5% official rate, and investing in higher yielding currencies such as the AUD with its 6.25% rate. Carry trades have flourished in a climate of generally benign global inflation, depressed volatility and abnormally low long-dated bond yields.

Whilst the appreciating AUD was good news for exporters with contracts written in AUD it was less so for overseas investments denominated in USD with much of the unhedged returns from these investments lost when they were translated back to local (AUD) currency. MilitarySuper's dynamic hedge over all of its foreign currency exposure enables the Fund to minimize the impacts of currency movements on investment returns.

The two main choices for strategic currency management are passive hedging or active risk control. The two extremes of passive currency management are to either do nothing or to hedge 100% of the fund's currency exposure. An intermediate stage is to partially hedge the exposure (most commonly a 50% hedge ratio) often described as the benchmark of least regret.

Adoption of either of the extremes of a passive hedge position means that the strategy will either be 100% right or 100% wrong at any point in time. In other words in a weak Australian dollar environment a fully hedged position will be the worst place to be and in a strong Australian dollar environment the unhedged position will be the worst place to be. The MSB Board believes that currency risk is significantly reduced by employing an active currency risk control around the appropriate strategic benchmark (which in this case is 100% hedged for international equities).

With a dynamic approach the hedges can and do move significantly away from the benchmark when an appropriate opportunity is there, assuming it can be prudently exploited. Both hedged and unhedged active strategies have shown the capacity to provide a very good degree of downside protection when the Australian dollar is strong and upside capture when the dollar is weak.

On a fully hedged basis the contribution made by the International Equities portfolio to the gross overall Fund performance was an impressive 23.1% for the year compared to an unhedged return of 8.1%.

Australian equities

As with the International Equities portfolio, MilitarySuper has appointed a range of investment managers in the domestic equities sector with demonstrated skills in adding value through stock selection and active management over a concentrated portfolio of stocks. The manager configuration is comprised of a large number of smaller (in terms of assets under management) managers. Several of these are classified as broad market managers, two are long-biased managers and one specialises in small companies.

Their combined management styles are best suited to periods of falling markets and, whilst the gross return of 28.4% achieved for the year was impressive, it was nonetheless 0.8% below the strong returns of 29.2% achieved by the benchmark S&P/ASX 300 Accumulation Index.

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

Property

In the finance industry, property usually refers to real estate, including land and buildings that can be bought, sold or leased. A Property Trust is a collective investment vehicle which owns a portfolio of real property, thus providing for a wider spread of ownership. Listed Property Trusts are quoted on the stock exchange, and their prices fluctuate with supply and demand. Unlisted Property Trusts are transacted directly with the Trust's manager, who sets prices in relation to the asset backing of the trust based on independent valuation.

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

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

Most of the investments held in the property sector are still in the initial investment growth phase and as such good returns are not expected in the short-term. Therefore, the Fund is yet to see the benefits of capital appreciation from these investments and the contribution to overall gross Fund performance for the year was 5.1%.

Infrastructure

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

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

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

The Fund's existing infrastructure investments have continued to post impressive results with the best performing Fund for the year again being the investment in the ANZ Energy Infrastructure Fund which returned 36.8% for the year.

Importantly with infrastructure investment MilitarySuper has access to co-investment opportunities through its established relationships. These co-investment opportunities will enable the Fund to participate in investment projects not normally available to superannuation schemes, offering access to superior long-term capital growth and stable cashflows. At the time of preparation of this Report, the Board was finalizing negotiations for a co-investment in Wind Farm technology in the USA. This is consistent with the Board's intention to continue to evaluate both the investment risks and opportunities afforded by global warming and noting global concerns about carbon emissions and the push towards greater use of renewable energy sources.

This sector produced an overall return of 8.1% (gross) for the year.

Private Equity

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

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

The Yale University Private Equity program, one of the first of its kind, is generally regarded as among the best in the institutional investment community. The University is frequently cited as the role model by other investors pursuing this asset class. Since the inception of its program in 1973, private equity investments have generated annualised returns for the university of over 30% over a sustained period of time. MilitarySuper's investment strategy shares many of the features of the Yale strategy.

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

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

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

level Private Equity investments provided a return of 15.4% for the year with the Fund's domestic private equity investments in particular continuing to provide strong returns. MilitarySuper's best performing manager for the year was Australian Private Equity manager, Pacific Equity Partners with a remarkable 108% return for the year. This was the result of a strong Initial Public Offering (IPO) through their investment in Emeco. Pacific Equity Partners have also been heavily involved in recent public to private mergers and acquisition transactions.

The Fund's more mature international private equity investments are also starting to provide strong returns, although in 2006/07 these have been diluted somewhat by the impacts of currency exchange.

Uncorrelated alpha

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

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

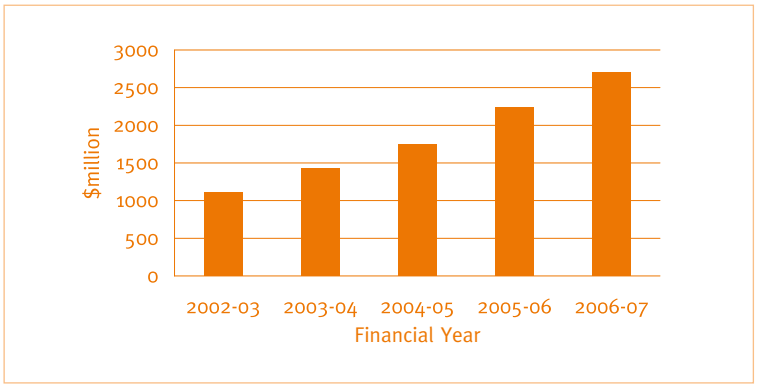
This sector displays defensive characteristics and is generally expected to perform best in falling markets. Given the strength of listed equity markets, the return achieved from this asset class was 3.9% (Gross) for the year.

Fund growth

Fund assets available for investment at 30 June 2007 totalled $2.790 billion.

After accounting for non-investment related assets and liabilities the net assets available to pay benefits were $2.774 billion a 25.1% increase from 2005-06 (see Table 5). Chart 1 shows how the Fund has grown since 2002–03.

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



Fund investment

Table 5 : Fund net assets at 30 June 2007 (after tax, charges and benefits)

Opening value of the Scheme as at 30 June 2006 $m	**2,216**
Plus income	
Contributions	403
Gross earning of the Scheme	426
Other income	-
Less outgoings	
Benefits paid	203
Tax benefit/(expenses)	49
Expenses and charges	19
Closing value of the Scheme as at 30 June 2007	2,774
Value of investments at 30 June 2007 $m	**2,790**
Assets under management	
Cash	54
Debt Instruments	203
Property	183
Australian Shares	842
International Shares	608
Private Equity	406
Infrastructure	248
Uncorrelated alpha	180
Currency	66
Total investments	2,790
Net liabilities[1]	(16)
Net assets available to pay benefits[2]	2,774

1. MilitarySuper net assets/(liabilities) represents benefits payable, tax provisions and cash at bank.

2. The value of the Scheme represents the investments of the Scheme. Net assets of the Scheme shows the amount available to Members at 30 June after allowing for tax, cash at bank and benefits payable to former contributors.

Table 6: investment managers as at 30 June 2007

Asset class	Investment Managers#	Investment $m	% of Fund
Cash		53.73	1.93
	National Australia Bank	53.73	
Debt Instruments		202.66	7.27
	Credit Suisse Cash Enhanced Fund	80.47	
	Yellow Brick Road Debt	10.75	
	Babcock & Brown Mezzanine Debt	46.46	
	Allco Transport Leasing	64.98	
Australian Shares		842.31	30.19
	Australian Equities Cash Holding Account	179.30	
	Acorn Australian Small Company Trust	42.14	
	K2 Australian Absolute Return Fund	54.25	
	PM Australian Opportunities Fund	90.99	
	MIR Australian Equities Fund	114.26	
	Challenger Australian Equities Fund	122.25	
	BGI Equity Market Neutral Fund	51.45	
	Agora Absolute Return Fund	141.02	
	Herschel Concentrated Australian Equities Fund	46.65	
International Shares		607.68	21.78
	Driehaus Small Cap Growth US	19.09	
	Hotchkis & Wiley International Equity	47.05	
	Sterling Johnston Small Cap US	36.79	
	TCW Pluris US	108.84	
	Sterling Johnson Micro Cap	21.70	
	Artha Emerging Markets	39.72	
	Causeway Large Cap Sub Portfolio	102.75	
	Wentworth Hauser Violich	100.50	
	Globeflex Capital Intl Equity	75.29	
	Driehaus Mid Cap US Fund	55.95	
Currency		65.63	2.35
	Pareto Partners Currency	55.60	
	Pareto CCY Alternative	10.03	

Fund investment

Asset class	Investment Managers#	Investment $m	% of Fund
Property		183.38	6.57
	Allco Wholesale Property Fund	23.67	
	Fiduciary International Real Estate Fund	8.08	
	Macquarie ICA Proprty 4	14.06	
	APN Development Fund No 1	5.07	
	Charter Hall Opportunities Fund 4	2.64	
	Domaine Property Fund	53.25	
	Babcock & Brown Alliance	61.07	
	Doughty Hanson EU Real Estate Fund	3.29	
	Ashington Property Fund	10.06	
	Gresham Property Fund 3	2.19	
Uncorrelated Alpha		180.58	6.47
	Harris Alternative Aurora 2	40.24	
	Deutsche/Colonial First State Link Note	37.59	
	Rabobank/Van Hedge Linked Note	33.65	
	Mazuma Structured Note	26.52	
	Bridgewater Pure Alpha Fund II	16.06	
	Mazuma Partners Fund II	26.52	
Infrastructure		248.29	8.90
	Colonial First State Infrastructure	22.41	
	US Power Fund II	17.27	
	ANZ IS Energy	91.53	
	Macquarie Global Infrastructure Fund 1	5.69	
	Macquarie Global Infrastructure Fund III	1.53	
	Macquarie Global Infrastructure Fund 2B	37.12	
	Saltbush Parking Services	21.71	
	TCW CDX Acquisition	23.72	
	SCM Global Energy and Infrastructure Fund	8.55	
	Allco Infrastructure Fund	18.76	
Private Equity		405.63	14.54
	Babcock & Brown Direct Investment	22.85	
	Champ Ventures Investments 5	6.26	
	Crescent Capital Partners II	2.64	
	Deutsche Private Equity No 2	4.96	
	Deutsche Private Fund 1	1.18	
	Gresham Private Equity Fund 1	2.77	
	Gresham Private Equity Fund 2	10.53	

Asset class	Investment Managers[1]	Investment $m	% of Fund
	Archer Capital Fund 3	7.62	
	Pacific Equity Partners Fund 2	14.16	
	Pacific Equity Partners Fund 4*	0.00	
	Credit Suisse FB Bermuda	7.17	
	Yellow Brick Road Feeder Limited Partnership	28.41	
	Pantheon Europe III Partnership	4.17	
	Pantheon USA IV Partnership	3.44	
	Pantheon Global Sec II Partnership	10.89	
	HarbourVest IV	22.29	
	HarbourVest VII Buyout Partnership	19.57	
	HarbourVest VII Venture Partnership	10.49	
	HarbourVest VII Mezzanine Partnership	10.60	
	Northgate Private Equity Part II	15.64	
	Rosemont Partners II LP	3.01	
	Sentient Global Resources 1	4.59	
	Sigular Guff Bric Opportunities Fund	8.86	
	Siguler Guff Small Opportunities Fund*	0.00	
	Siguler Guff WLR Fund*	0.00	
	TCW Shop 5	15.31	
	Rosemont Cadence LLC	6.13	
	NBC Private Equity Fund II	11.72	
	GBS Bioventures III	6.33	
	Champ Buyout II Trust	11.20	
	Pacific Equity Partners Fund 3	23.13	
	Citic Allco Investments Ltd	19.64	
	HarbourVest International Equities Partnership V	16.37	
	Northgate Venture Partners III LP	3.66	
	Champ Ventures Investments 6	2.35	
	Pantheon GL Secondaries Fund III	6.00	
	Sigular Guff Distressed Opportunities Fund II	12.31	
	Terra Firma Capital Partners III	0.65	
	Thomas Weisel India Opportunities Fund	4.89	
	KKR 2006 Fund LP	5.33	
	SCM CDO Equity Fund	38.51	
Total assets		2,789.89	100

An organisation that specialises in the investment of a portfolio of investments which may be by the way of individual portfolio or as a pool of investments.

* Calls against capital commitments for this investment had not been made as at 30 June 2007.

Unitisation

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

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

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

The most current issue and withdrawal prices are provided on the MilitarySuper website for the information of Members. The unit prices at 30 June 2007 are provided in Table 7. 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 7: unit prices as at 30 June 2007

Strategy	Price $	% change YTD
Cash	1.214122	+5.4214
Conservative	1.393861	+9.3179
Balanced	1.653766	+13.3328
Growth	1.690217	+15.997
High Growth	1.839491	+15.6970

Daily unit prices are struck for each day of the year on the basis of the market value of listed investments on the previous day's close of trading, and on the basis of the best available valuation data on non-listed investments. Non-listed investments by their nature are illiquid and the true value of these investments is determined on the basis of periodic independent valuations or as a result of a sales event. Provisions are also made for taxes, fees and expenses on the income derived from those investments on a daily basis. During the year there was a change of policy regarding the treatment of accrued taxation expenses in the striking of daily unit prices. In the past the accrual for tax was ascribed totally to

the Default (Growth) option as this was where the bulk of assets under management were invested. However, as the level of investment in the other investment options, but particularly the High Growth option has increased it was considered more equitable for the accrual of tax to be spread across each of the investment options in proportion to their tax obligations. With the assistance of its taxation advisor, PricewaterhouseCoopers (PwC) the Board determined the amount of the accrual to be ascribed to each of the investment options which resulted in a one time adjustment to unit prices. This resulted in the apparent anomaly in returns of the Growth and High Growth options as at 30 June, with the unit price for the Growth option being similar to that of the High Growth option.

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

Governance

Section four

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

Corporate governance statement

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

Principal duties

The Board's principal duties are to:

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

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

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

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

General governance principles

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

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

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

Continuing qualifications and disclosure of interests

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

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

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

Confidentiality

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

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

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

Legal professional privilege

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

Securities dealing

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

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

Gifts and entertainment

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

Insurance

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

Board committees

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

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

Meetings and agenda

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

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

Professional development

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

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

Board Members and staff who undertake professional development activities are expected, where appropriate, to provide reports to the Board and to distribute relevant papers to other

Board Members and staff. The Board also encourages Board Members to be members of relevant professional bodies such as the Australian Institute of Superannuation Trustees and the Australian Institute of Company Directors and meets the costs of such memberships.

Managing conflicts of interest

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

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

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

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

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

Whistleblower protection

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

- to be a breach of Corporations Law
- may cause financial loss to the Board

- may damage the Board's reputation
  or
- to be behaviour that is not in keeping with the Board's code of conduct.

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

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

(a) effective compliance with relevant laws

(b) efficient fiscal management

(c) healthy and safe work practices

(d) effective management, including unbiased decision making.

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

Review of Corporate Governance of Statutory Authorities and Office Holders (the Uhrig Report)

In November 2002 the Government announced a review of the corporate governance of statutory authorities and office holders. Mr John Uhrig was appointed to conduct the review and on 12 August 2004 the Government released its response to Mr Uhrig's report. In that response the Government agreed that Ministers are to assess their portfolio bodies against the governance templates of the Uhrig Report and implement any improvements to existing governance arrangements that may be required.

During 2006-07 the Minister for Defence initiated a review of the existing governance framework for the MSB Board against the criteria proposed by the Uhrig Report. Based on that assessment the Minister concluded that the existing board template is the preferred governance framework for the MSB Board for the following reasons:

a) the Board acts in a manner similar to commercial superannuation funds

b) the Board predominantly undertakes commercial operations

c) the trustees have "full power to act" within the constraints of the legislation and the Minister's power is limited to the appointment and removal of trustees and to request information from the Board

d) the assets of the MSB Fund managed by the Board belong to the Members of the Fund, rather than the Commonwealth and the Board is able to acquire and dispose of assets in its own right

e) the Board has executive support staff engaged outside the framework of the *Public Service Act.*

The assessment concluded that the Board should continue to operate outside of the governance frameworks established by the *Commonwealth Authorities and Companies Act 1997* and the *Financial Management and Accountability Act 1997*, but recommended that further consideration is given to finding an appropriate governance model that enables the Board to handle public money and operate with a higher degree of financial independence. The assessment also recommended that all Board appointments be limited to a period of three years (with eligibility for reappointment) and that a Ministerial statement of expectation, taking the form of an annual letter from the Minister to the Board, be introduced - with the Board's response forming a statement of intent. Both letters are to be published in the Board's Annual Report to Parliament and in response to this requirement both documents have been reproduced at pages 22–23 of this year's report.

Governance matters outside the Board's control

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

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

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

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

The Board reviews its business plan each year.

Directions for 2006–07

Key features of the Board Business Plan for 2006–07 included:

- renegotiation of the tripartite agreement between the Board, Department of Defence and ComSuper on the delivery of Scheme administration services
- appointment of an independent expert to represent the Board's interests in relation to the redevelopment of ComSuper's IT systems and infrastructure
- pursuit of legislative change required to provide a permanent indemnity in respect of losses arising from the acts or omissions of the administrator
- seeking amendment to the MSB Trust Deed to comply with contemporary superannuation regulatory requirements and to simplify administration
- pursuit of wider legislative reform affecting the financial independence and accountability of the Board in the context of the outcomes from the Uhrig Review

- continuing to refine the Fund's long-term investment strategy and to assess the effectiveness of the introduction of alternative investment approaches and strategies in providing improved opportunities for achieving sustainable returns consistent with the Fund's absolute return objectives
- continuing to improve the content of half yearly mail-outs to Members and monitor the effectiveness of the program in educating and informing Members about the Scheme and changes to investment strategy
- continuing to develop in-house capabilities for the implementation of investment decisions, Treasury management and for performance monitoring and reporting
- monitoring the impacts of the new investment strategy on Members' Investment Choice. In particular monitoring the impacts of Choice on the liquidity requirements of the Fund in the event of any large scale move by Members out of the Growth Strategy and into the more conservative options.

These objectives were either fully implemented or, where legislative or Trust Deed changes were involved, significant progress towards implementation was achieved during the year.

Administrative agreement

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

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

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

During 2006–07 a major review of the existing agreement was undertaken with the expectation that a new agreement will be signed between the parties and operate from 1 July 2007.

Objectives

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

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

Delegations

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

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

Certain powers are retained by the Trustees. These include reconsideration of Board decisions extending the period of time in which a person affected by a decision may seek reconsideration, and cases involving the application of the legislation which produces a result not in keeping with the spirit of the legislation.

Board committees

Audit and Risk Management Committee

The Audit and Risk Management Committee is a subcommittee of the full Board. During 2006–07 the Committee comprised Dr Michael Sharpe (Chairman), WOFF Robert Swanwick and Mr Felix Bleeser.

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

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

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

- its financial statements are derived from appropriate accounting systems and methods and reflect current accounting standards
- the audit arrangements within service-providing agencies are operating effectively
- appropriate audit and fraud control strategies are in place to protect Board and Member interests
- 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
- reviews annual financial statements.

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

Investment Committee

The Investment Committee is a subcommittee of the full Board. During 2006-07 the Committee comprised Mr Charles Kiefel (Chairman) and Dr Michael Sharpe, although any trustee is free to attend meetings of the Committee.

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

The Committee's responsibilities are to:

- keep the Board informed on matters within the Committee's authority
- 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 providers (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

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

The Committee met two times during the year.

Military Superannuation Communication Committee (MSCC)

The Military Superannuation Communication Committee is a subcommittee of the full Board. As at 30 June 2007 the Committee comprised AIRCDRE Lee Roberts (Chairman), WOFF Robert Swanwick, Mr Adrian Wellspring (representative of the Department of Defence) and LCDR Roz Fletcher (representative of the DFRDB Authority).

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

The Committee met six times during the year.

Reconsideration Committee

As at 30 June 2007, the Committee comprised Mr Phil Charley (Chairman and representative of the MSB Board), Colonel M Charles (representative from a service office), Brigadier Peter Bray AM (pensioner representative), and Ms Kirsty Bunfield (representative of ComSuper).

The 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
- to make recommendations to the Board in respect of requests for reconsideration of decisions made either by itself or the Board under the MSB Rules

The Committee met on eleven occasions during the year.

Complaints Committee

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

Board Executive

The role of the Board Executive Unit is to provide high level support to the Board in meeting its responsibilities for the administration of MilitarySuper and the management and investment of the MSB Fund. The focus of the Board Executive Unit during 2006-07 continued to be on the enhancement of in-house capabilities in areas of governance, compliance, scheme administration and investment implementation and monitoring.

The Executive Unit has overall responsibility for the management of the Board's day-to-day operations and the management of the Board's relationships with its key service providers and stakeholders.

In investment matters the Executive Unit is:

- the central co-ordinator of activities related to asset allocation, cash flow management, oversight of the calculation of daily and monthly NAVs, daily unit prices, provision of instructions to the custodian, legal due diligence and negotiation of investment management agreements and legal contracts, mandate and SIS Act compliance
- responsible for treasury management, daily monitoring of portfolio performance, reconciliation of custodian reporting and asset valuation and for providing consolidated performance reporting at portfolio and asset sector level
- solely authorised to issue instructions for the purposes of implementing the Board's investment decisions and to sign documents for that purpose
- co–ordinator of the actions required for the transition of assets between sectors and/or managers
- the link between the Board and its advisors, fund managers and custodian.

On administration matters the Executive Unit:

- manages the relationships between the Board and the Department of Defence (as employer sponsor and on policy matters), the Administrator (ComSuper), External Auditors and the Board's independent audit and tax advisors, and legal counsel

- performs the function of Responsible Officer under the Boards AFS and APRA licences and monitors and manages the Board's obligations as licencee
- monitors the services provided by ComSuper to ensure compliance with the SIS Act, Corporations Law and the Board's licencing obligations
- advises the Administrator on Scheme administration issues and provides direction as required
- provides secretariat support service to the Board and its committees, maintains records of meetings and provides instruction to initiate decisions of the Board
- oversees the preparation by ComSuper of monthly, quarterly and annual Scheme financial statements
- manages the payment of Board administrative expenses and prepares Board financial statements on a monthly, quarterly and annual basis
- participates as a Member of steering committees charged with responsibility for providing guidance and support in the implementation of system changes and in the redevelopment of ComSuper operating systems used for the purposes of the administration of the MilitarySuper Scheme.

Financial issues and budget strategies

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

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

The Service Level Agreement negotiated between the Board, the Department of Defence and ComSuper establishes the services and standards of service to be provided in relation to the administration of MilitarySuper. Although the Board, through its Executive Unit, participates in and influences the level of services to be provided, the costs of delivering those services are negotiated between the Department and ComSuper. Going forward, the Board believes that this is an undesirable situation as the Board, though legislatively responsible for the

administration of the Scheme, is not financially accountable for the costs of that administration. Consequently the Board is strongly of the view that it should be in a position to influence both the level and cost of administrative services provided in the administration of the Scheme to the benefit of its Members. The Board will therefore continue to actively negotiate with the Minister, Government and the Department of Defence on the implementation of changes which it sees as central to the proper functioning of the Board in the discharge of its responsibilities for the administration of the Scheme.

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

Required funding for the systems modernization project was approved in the context of the 2007–08 Budget. This will flow to ComSuper over a three year period, commencing from 1 July 2007, commensurate with the expected timeframe for the specification and build of any replacement system. The Board, through its Executive Unit, will be represented on committee's formed to consider replacement options and will be involved throughout the tender and build phases of the project. The Board has selected and will shortly appoint an independent expert to assist it during the extended period of the project to ensure that the outcomes achieved are consistent with the business expectations of the Board and the needs of Members. This is an extensive project requiring significant ongoing input from the Board Executive Unit.

Status under the SIS Act and corporations legislation

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

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

These requirements have added a significant additional layer of compliance obligations to the Board's administration of the Scheme and have changed significantly the relationship between the Board and it Administrator (ComSuper). Although the MSB Act remains the primary determinant of the relationship, under the AFS licensing arrangements staff of ComSuper must be appropriately trained and, provided they meet the required competency requirements, be authorised directly by the Board under its licence to provide general financial product advice. To meet the Board's obligations as licencee, a detailed process of compliance reporting has been implemented by which the Board can obtain assurance that the Commissioner for Superannuation (and through him ComSuper) has appropriate processes and controls in place to ensure that the Board's Licensing obligations are being met.

The Board was also granted an APRA Licence with effect from 26th September 2005 and the MSB Fund became a Registered Entity for APRA licensing purposes.

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

Product Disclosure Statement

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

The Financial Services Guide explains what financial services the Board provides for MilitarySuper and who delivers them, and can be found on the MilitarySuper website **www.militarysuper.gov.au**.

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

- Your Guide to Investment Choice
- The MilitarySuper Book

Together these documents describe all the main features of MilitarySuper. Members are provided with these documents on joining MilitarySuper together with the latest annual report to contributing Members. Electronic copies can be obtained from the MilitarySuper website. Hard copies can be ordered online from the website.

Financial product advice the Board can provide

The Board is only licensed to provide general financial product advice. General financial product advice means that the Board has not considered the Member's individual objectives, financial situation or needs in providing the information or advice. If Members wish to have

financial product advice in circumstances where the provider of that advice has considered one or more of a Member's objectives, financial situation or needs, the Member is advised to consult a licensed financial planner.

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

General product advice provided by authorised representatives of the Board

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

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

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

Evaluation

Annual effectiveness reviews

The Board conducts an annual effectiveness review of its own operation as a Board, its Executive Unit and all its major outsourced service providers as part of its annual business planning process.

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

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

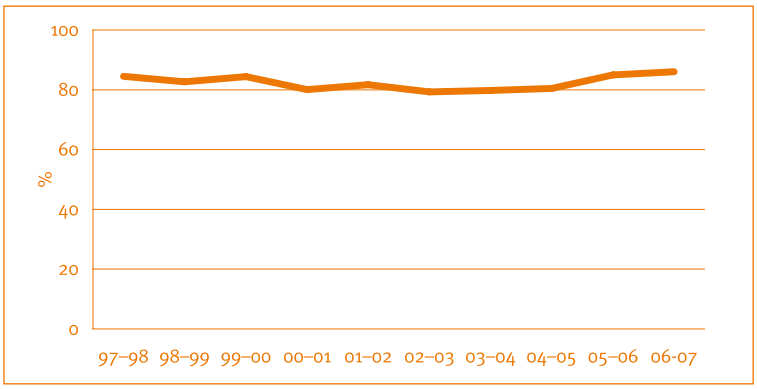
Client feedback

During 2006–07 the Board's administrator continued to conduct client satisfaction surveys with the assistance of the Canberra-based firm Orima Research. Clients who had recent contact were surveyed once during the year. On a point scale of 1–10 the quality of services surveyed was consistently rated highly.

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

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

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



Account maintenance

Section five

The maintenance of MiltiarySuper Contributing Member, Preserved Benefit Member and Pension Member accounts is a major function provided by the Board's legislated administrator (ComSuper) in conjunction with the Department of Defence. The principal aims of this function are defined by the enabling legislation for the Scheme and are articulated in the Service Level Agreement between the MSB Board, ComSuper and the Defence organisation.

Collection, recording and maintenance of Member information

The Board's administrator:

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

System changes

In providing administration services to the Board and the MilitarySuper Members, ComSuper is critically dependant on its computerised administration platforms. In 2005-06, ComSuper reported that it had commenced work on a strategic plan to retire and replace existing defined benefit processing platforms. That work progressed with the approval of a business case for funding replacement of these systems. The Administration Platform Modernisation project has been established to implement the change of the next few years. Until the replacement systems are in place significant changes will continue to be made to the existing administration platforms and related business processes. In 2006-07 changes included:

- inclusion of Management Fee reporting with Military Statements issued in 2006
- the collection and update of Tax File Numbers to support the Government's "Better Super" legislation
- inclusion in the Mid Year Mailout of information to all scheme members to notify them of the Government's "Better Super" legislation

- new logos to cater for colour printing and incorporate the new licence numbers for the Board
- enhancing the coverage of automated testing
- development of a secure remote access solution
- progressing the ancillary contributions migration for MilitarySuper
- developing an information management strategy and information management architecture
- enhancing the change and release management functions
- implementing IT security monitoring products, including patch management, and asset and configuration management software.

Collection, banking, recording and maintaining contributions remittances

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

Total contributions to the Fund during 2006–07 were $255.3m, of which Member contributions comprised $154.2m, as shown in Table 8. Employer contributions amounted to $85.7m. Co–contributions received totalled $15.4m. The net appropriation for benefits for the year was $147.9m ($137.4m for 2005–06).

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

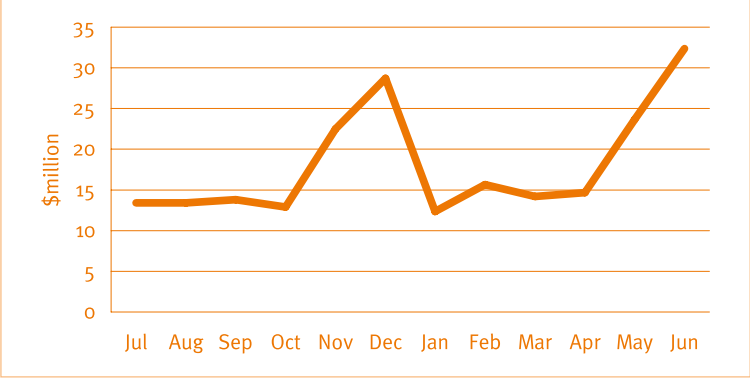
Table 8: contributors and contributions for the past five years

Year	Contributors at year's end	Member contributions $m	Employer contributions $m	Co–contributions $m	Net appropriation contributions from Consolidated Revenue $m
2002-03	45,215	102.1	57.0	-	118.2
2003-04	46,892	112.2	62.7	-	119.7
2004-05	45,861	126.6	70.8	5.5	131.5
2005-06	46,402	141.9	74.9	14.0	137.4
2006-07	47,721	154.2	85.7	15.4	147.9

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
- monitors the collection of contributions and pursues any late remittance of contributions with the Department of Defence.

Chart 3: MSB Fund cashflow (contributions received less benefits paid) 2006–07



Member Communications

Section SIX

Member communications

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

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

MSCC's role is to:

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

Objectives

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

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

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

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

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

Performance indicators

The success in meeting the Board's communication objectives is identified by:

- benchmarking of the Board's communications activities against industry best practice
- the number of requests received for additional information
- the number and subject matter of Complaints
- client satisfaction as measured through responses to an annual communication survey
- timely provision of annual Member statements and reports consistent with SIS Act and Financial Services Reform requirements and industry best practice
- the Minister's satisfaction with the MSB Board's administration of the Scheme
- external assessment by independent communications consultants
- costs for each project kept to within the agreed budget

2006–07 priorities

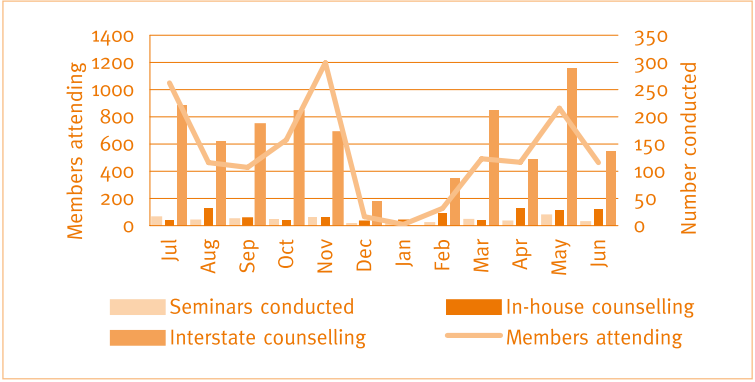
- continued development of the form and content of the half yearly mail out to Members (Mid-year Update). The purpose of the Mid-year Update is to inform Members of changes in scheme design or strategy which might impact on their current and future Member contributions
- deliver a communication/education program based on the use of audio visual technologies and drawing on the experience of previous video presentations
- increased access to web enabled interactive tools for Member communications
- delivery of a communication/education program to cover the Scheme's ancillary benefits initiatives
- promotion of the availability of Military Super seminars and increased accessibility to seminars for new entrants to the ADF
- focussed initial Member education at the point of entry into the ADF, consistent with the Board's obligations as an AFS licence holder
- continuing to leverage off the MilitarySuper website for increasing access by Members to interactive sources of information about their Scheme membership and benefit entitlements. This includes providing secure facilities for Members to lodge applications to change investment strategies or to lodge benefit applications
- communication of the Board's approach to proposed new Government initiatives.

Counselling and information services

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

During the year, ComSuper presented 56 seminars to a total of 6,471 MSBS Members and provided personal counselling for 1,904 military Members. The seminars were primarily conducted in conjunction with transition seminars. A further 16 seminars relating to medical discharge were presented to 231 military Members.

Chart 4: information seminars



With the development of the MilitarySuper website there has been a significant increase in the general information available to those with Internet access.

Most Member contacts are by telephone, with an average of 1,781 telephone calls recorded per week compared with 1,506 in 2005–06. The Interactive Voice Response (IVR) telephone service recorded receipt of 92,625 calls from military (MilitarySuper and DFRDB) Members, compared with 81,391 in 2005–06.

Emails from military Members answered totalled 9,894, an increase on the 6,411 completed in 2005–06.

ComSuper staff responded to 4,630 written enquiries from military Members.

Chart 5: monthly call volume comparisons

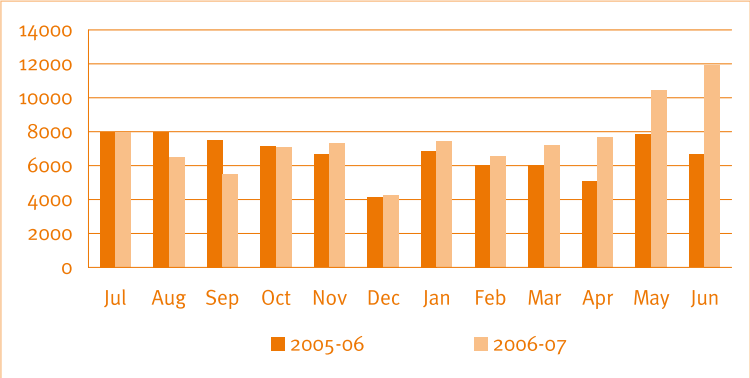


Chart 6: monthly email volume comparisons

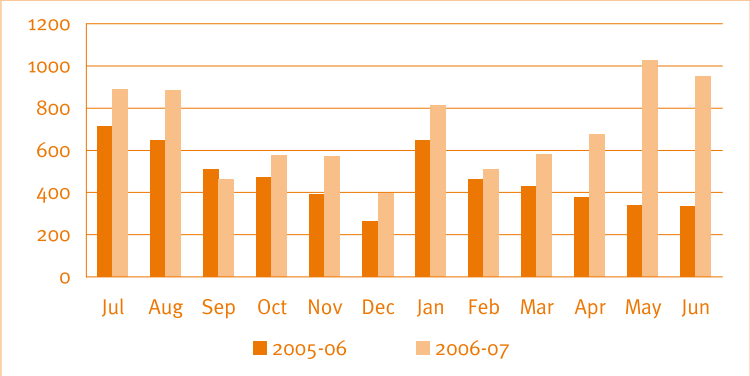
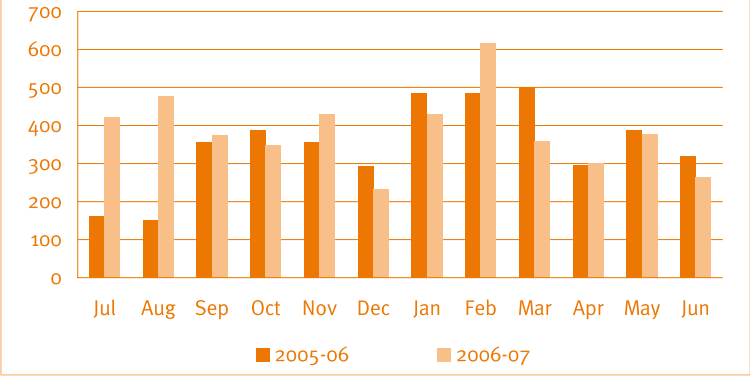


Chart 7: monthly written volume comparisons



Pensioner communications

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

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

Annual report project

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

The 2005–06 Annual Report to Members was distributed in October 2006 and received a positive response from Members. The 2006–07 Annual Report to Members will be issued with the annual Member statements to Members in October 2007.

Member statements

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

Statements for preserved Members were distributed by the 20th of October 2006 and those for contributors by 7 November 2006. Manual statements were distributed to Members during mid December 2006.

During the dispatch of Preserved Member Statements, an issue was identified where some 15,000 members did not receive a transaction summary with their member statement. The transaction summary is a mandatory document which displays the overall cost of managing a members investment in the Fund. These 15,000 preserved member statements were re-issued on 10 November 2006 with a transaction summary. Procedures have been incorporated into the statement process to prevent this issue from re-occurring.

Mid year newsletter

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

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

MilitarySuper branding

In 2006–07 The MilitarySuper Communications Committee focused on unifying the brand of MilitarySuper products and services to its Members. The year was influenced by the superannuation changes to legislation and this posed many new opportunities and challenges in communications. In 2007, the Military Communications and Marketing area conducted a review of MilitarySuper's products and services via customer surveys and focus groups. This produced strategies to improve its market awareness and ensure that the fund is positioned for long-term commitment from Members.

The resulting changes across the fund have begun to impact on a number of areas including repositioning the MilitarySuper brand, with an emphasis on engaging MilitarySuper's largest demographic, the 18–27 year age group, to ensure they understand their superannuation and to highlight the Board's commitment to engage its Members.

Marketing and education are important elements in a fund that relies on people making choices about their superannuation. Members must be confident that the system is fairly administered and be aware of their choices. MilitarySuper use marketing and education to encourage Members to understand their investments, and to cultivate a positive attitude towards their superannuation.

This year MilitarySuper aimed to show that recent changes to Superannuation were managed openly and accountably in order to build Member confidence. To achieve this, MilitarySuper reviewed is entire communication channels to Members to ensure they were effective and accessible by all Members.

The Board continues to publish booklets and fact sheets covering areas of particular interest. In 2007 the Mid-year Update was published, detailing our approach to Budget Tax Changes or "Better" Super.

Building the brand

Since the launch of MilitarySuper in 1991, its profile has steadily increased. Regular Administration report results have shown that Member communication has improved steadily over time. To increase brand strength, MilitarySuper is moving to a more consistently branded product line and applying the new MilitarySuper brand throughout its services and online facilities. The aim is to complete the Brand transition across all communications by the end of 2007.

The compliance model is supported by the MilitarySuper Style Guide. Using this guide enables the Board to apply a consistent approach to all products, forms and channels of communication to make it easier for Members to understand and manage their Super.

The Board's ability to develop and deliver products and services benefitted from the implementation of a new brand this year. The brand provides a consistent style for communications and interactions with Members.

What is the brand?

The brand is the combined set of impressions and expectations that a customer has of MilitarySuper.

The Scheme brand is a mixture of attributes, symbolised by the Scheme name and logo, that create influence and generate value for MilitarySuper.

At the heart of the new approach are brand intent, positioning and qualities, supported by a design that ensures a consistent and continuous brand style and presentation across all communication, products and services.

The Board has adopted four brand qualities that reflect its role in different situations:

- A fund that caters for Military Members (past and present)
- Stability and long-term strength of the fund
- Fair administrator
- Professional service.

The communications strategy is aimed at building awareness and increasing uptake of the upcoming services including a pilot for online training in the second half of 2007.

Website development

Online services have become an important component of modern business and MilitarySuper continues to enhance and expand its range of online services designed to make access to services easier for Members. Once the new services are released we will be working on delivering the message – online is the quick, easy and convenient way to deal with MilitarySuper.

In 2007 there will be the launch of two improved online services including a new MilitarySuper website and Member Services Online. We have considered Members viewpoints and are attempting to broaden the range of online services for Members in the coming year.

This year, the MilitarySuper website received 1,282,753 hits throughout Australia. With advances in our online systems, we want to give Members a view of how their funds are performing online, how they can forecast and estimate their future benefits.

Chart 8 shows usage of the website in 2006–07.

Chart 8: MilitarySuper website page requests 2006–07

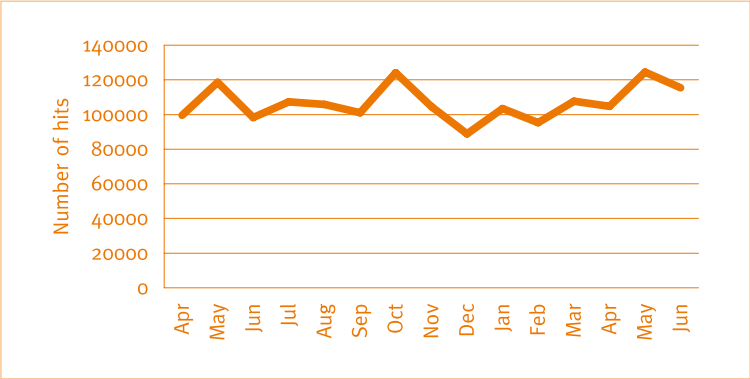


Table 9 shows the ten most requested web pages during 2006–07, and Table 10 shows the number of website page requests over the past four years.

Table 9: most requested web pages 2006–07

Rank	Web page
1	MilitarySuper Book
2	Unit Price
3	Member Services Online
4	Frequently Asked Questions
5	Member Investment Choice Booklet
6	Access Number Request Form
7	Application for Invalidity Benefits Form
8	About to Leave the ADF Leaflet
9	Annual Report to Parliament 2005-06
10	SIS Regulations 1994

Table 10: website page requests over past four years

Year	Number
2003–04	208,676
2004–05	665,973
2005–06	1,159,783
2006–07	1,282,753

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

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.

Section Seven

Membership

There are two main groups of contributors to MilitarySuper, those who transferred from the DFRDB and those who have become Members of MilitarySuper 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 MilitarySuper.

Contributors

At 30 June 2007, there were 47,721 contributors to MilitarySuper, 43,802 (91.8%) of whom were male and 3,919 (8.2%) female. Table 11 shows the number of new entrants and exits and the total contributor Membership at 30 June 2007. Table 12 shows the number of contributors by years of service and by gender.

Table 11: contributor composition

	Male	Female	Total
Membership at 30 June 2006	42,165	4,237	46,402
Plus new contributors	6,796	385	7,181
Less Members left the ADF	5,159	703	5,862
Membership at 30 June 2007	43,802	3,919	47,721

Table 12: male and female contributors by years of service

Years of service	Male	Female	All
0–9	31,895	2,212	34,107
10–14	6,090	967	7,057
15–19	3,379	505	3,884
>19	2,438	235	2,673
Total	43,802	3,919	47,721

New Members

There were 7,181 new MilitarySuper Members in 2006–07.

Exits

There were 5,862 exits from MilitarySuper during the year. The types of exit are shown in Table 13.

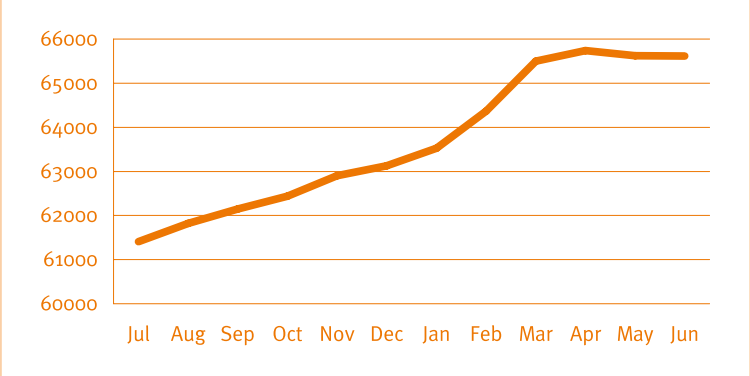
Table 13: modes of exit in the past five years

	2002–03	2003–04	2004–05	2005–06	2006-07
Age Retirement	71	71	80	51	90
Resignation	3,426	2,028	2,299	2,110	2,057
Redundancy	11	10	5	6	4
Invalidity retirement	487	397	456	450	395
Death	12	15	19	17	25
Other	-	1,221	1,840	3,135	3,291
Total	4,007	3,742	4,699	5,769	5,862

Preserved Benefit Members

There were 65,615 preserved benefit Members in MilitarySuper as at 30 June 2007. Chart 9 shows the growth of preserved benefit Members during 2006–07.

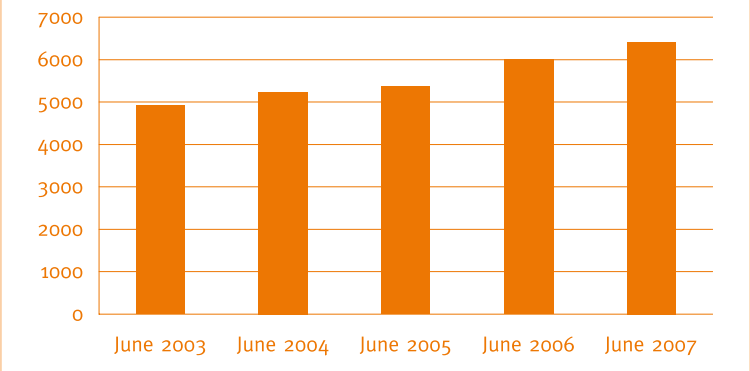
Chart 9: growth in preserved benefit Member population 2006–07



Pensioners

There were 6,409 pensioners in the MSBS as at 30 June 2007. Chart 10 shows the growth of pensioners since 30 June 2002.

Chart 10: growth in pensioner population in the past five years



Section eight

Benefit payments

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

Benefits

Member-financed benefits

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

Employer-financed benefits

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

Discharge benefits

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

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

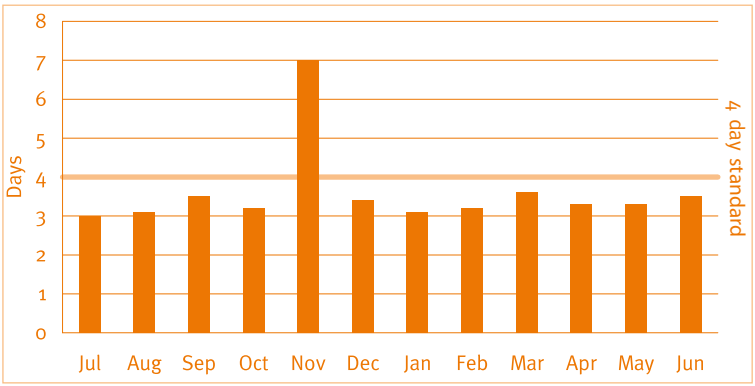
Table 14: benefits paid 2006–07

Pensions $m	115
Lump sums $m	88
Total $m	**203**
Fund share $m	55
Consolidated Revenue Share $m	148
Total $m	**203**

Benefit payments

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

Chart 11: average time to process benefit payments 2006–07



Early release of preserved benefits

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

Of the 814 preserved benefits paid in full or part during 2006–07, 193 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.

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

In 2006-07, the Australian Bureau of Statistics announced changes in the CPI . To arrive at the CPI rate applied to pensions, a calculation is actioned. The rates were 2.5% for the September 2006 period and 0.0% for the March 2007 period.

Pensioners received statements in July 2006 and January 2007 showing their new rate of pension. Their income tax payment summary and other relevant information were also included with the July statement.

Pension payments

Employer-financed benefits paid as pension

During the year, 412 new pensions were granted and at 30 June 2007, 6,409 Members were receiving MilitarySuper pensions. The total number of pensioners for each class of benefit is detailed in Table 15 for the end of each financial year since 30 June 2002.

The total amount paid as pensions during the year was $115,368,000. The average pension amounted to $18,000 per annum.

Table 15: number of pensioners since 30 June 2002, by type of benefit

	Number of pensioners					
Class of pension benefit	**30 June 2002**	**30 June 2003**	**30 June 2004**	**30 June 2005**	**30 June 2006**	**30 June 2007**
Retirement	621	707	796	881	962	1,013
Redundancy	1,885	1,901	1,916	1,916	1,919	1,916
Invalidity	2,010	2,169	2,356	2,573	2,908	3,243
Reversionary benefits*	84	145	164	194	213	237
Total	4,600	4,922	5,232	5,564	6,002	6,409

* payable on the death of a Member, former Member or Pensioner

Invalidity benefits

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

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

Invalidity classification process

Incapacity Classification Committee (ICC)

As at 30 June 2007, the Committee comprised Simon Lawson (Chairperson and Team Leader of Military Invalidity Reversionary and Release Section, ComSuper), Wing Commander Bob Harris (Directorate of Personnel – Air Force), and Ms Heather Gill (Superannuation Directorate, Defence). The Committee's Secretary is Ms Lara McKinstry (Military Invalidity).

Members of MilitarySuper retired on invalidity grounds receive an A, B or C classification of invalidity, reflecting the Member's loss of capacity to obtain appropriate civilian employment. If there is a conflict in the medical information, or reasonable doubt as to the classification, the case is passed from the ComSuper delegate to the Incapacity Classification Committee (ICC) for decision. The ICC is established under the provisions of MSB Rule 17 and is required to determine the classification of Members retired on invalidity grounds and to review the existing classification of invalidity pension recipients. The ICC made 18 initial classification decisions during 2006–07.

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 16 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 2006 to 30 June 2007, 575 Members received initial invalidity classifications; although in 8 of these cases Rule 32 (relating to pre-existing conditions) was applied. Of those who received an invalidity classification, 425 (130 Class A and 295 Class B) became entitled to an invalidity pension. (Note that these figures vary slightly from the number of invalidity exits quoted elsewhere because some of these cases relate to Members who were discharged in a previous financial year).The remaining 142 were classified as Class C incapacity. The proportion of invalidity classifications for each Service is shown in Chart 12.

Chart 12: comparison, by service, of invalidity classifications 2006–07

Invalidity classification review

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

Decisions by the Board to classify Members as Class A or B are reviewable at intervals determined by the Board. A Member who believes that his or her classification has altered since it was last considered may request that the classification be reviewed. During 2006–07, 841 cases were examined, 16 of which were reviews requested by Members. As a result of these reviews 168 classifications were changed, as shown in Table 16.

Table 16: invalidity entitlements reviewed in the past five years

	2002–03	2003–04	2004–05	2005–06	2006–07
Entitlements examined	475	684	829	325	841
Review with medical exam	222	255	274	147	841
Classification raised	21	38	12	34	66
Classification reduced	123	177	121	61	102
Total classification changes	144	215	133	95	168

Dispute resolution

Section nine

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

Internal review

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

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

Reconsideration of decisions

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

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 2006–07, 108 requests for reconsideration of decisions were received, a decrease from the 145 requests received the previous year. Of these, five requests related to reconsideration of a decision of a Reconsideration Committee or the Board compared with eight during 2005–06.

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

During 2006–07 a total of 133 cases were finalised, compared with 182 cases in 2005–06. Thirty decisions were affirmed and in 65 cases the decision was set aside or varied in favour of the applicant. Another 38 cases were lapsed or withdrawn with the applicant failing to pursue the matter. Forty–eight cases remained under investigation at 30 June 2007.

Table 17: reconsideration applications for the past five years

	2002–03	2003–04	2004–05	2005–06	2006-07
Requests on hand	47	39	51	110	73
Requests received	169	177	231	145	108
Requests resolved	177	165	172	182	133
Carried forward	39	51	110	73	48

External review

On 29 June 1995, the Trustees of the MSBS signed an election to become a regulated superannuation fund for the purposes of the SIS Act. 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).

Six complaints were lodged with the SCT during the year and six cases were carried over from 2005-06. Eight complaints were resolved during the year; three complaints were treated as withdrawn, one decision was affirmed, two matters were conceded and two decisions were varied.

In 2006-2007 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. No SCT decisions were appealed to the Federal Court.

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.

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

Family law

The *Family Law Act 1975* states that where a Member proposes to split his or her superannuation interest, the Trustee of the superannuation fund where the interest is held

must be notified and given an opportunity to object to the terms of the split if it wishes. The Family Law Rules 2004 state that the Trustee has a period of 28 days from the date of notification to state its objections.

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

Enquiries and complaints

The Board has established formal procedures for dealing with Members' complaints received in accordance with section 101 of the SIS Act. These procedures require the Board Executive to acknowledge and respond to all complaints.

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

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

Complaints, ombudsman and parliamentary enquiries

Ninety complaints and six Ministerial representations were received during the year. No Ombudsman enquiries were received.

A substantial proportion of these complaints related to the employer benefit preservation arrangements as prescribed by the MSBS Rules. There were also a number of complaints expressing dissatisfaction with the level of service provided by ComSuper.

The Board, through its Executive Unit monitors all complaints to ensure that ComSuper has internal processes to identify and resolve systemic issues and to continually improve the service provided to Members.

In addition, Ministerial Representations relating to policy issues are received and responded to within the Department of Defence. In 2006–07 those relating to MilitarySuper totalled 28 (including 18 regarding MilitarySuper employer benefit preservation arrangements).

There were also 187 Ministerial Representations that related to both MilitarySuper and DFRDB Schemes. Of these there were 74 on pension indexation arrangements and 25 on the Australian Governments proposed taxation changes to superannuation benefits effective from 1 July 2007.

Legal claims

The Board received three legal claims in the 2006–07 financial year, with three claims carried over from the previous financial year. Two claims were accepted. The total compensation paid was $2,323.68. No claims were outstanding at the end of the financial year.

Freedom of information

MilitarySuper Members made 50 requests for access to documents during 2006–07. Forty–five requests were granted in full and two partially. Three requests were withdrawn and no requests were refused. The requests took an average of eight 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 FOI Act should be directed to:

Freedom of Information Officer

ComSuper
PO Box 22
Belconnen ACT 2616

Telephone: 1300 033 732

Facsimile: (02) 6272 9804

TTY: (02) 6272 9827

Email: foi@enq.militarysuper.gov.au

Accounting services

Section ten

SIS Act and corporations law compliance

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

A detailed compliance report was provided to the Audit and Risk Management Committee in September 2006 and March 2007.

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 approved by the Board and the Minister
- prepares monthly (unaudited) financial statements in a form agreed with the Board
- assists the Board Executive in the preparation of 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 and Board Executive
- calculates daily unit prices for five options in accordance with the Board's Unit Pricing Policy and in concert with the Fund Custodian and Board Executive
- provides annual letters of comfort to the Board and to the Board's external auditor regarding information provided for annual financial statements
- liaises with the Board's specialist advisers on Scheme accounting and taxation issues
- provides the Board with the opportunity to participate in the development of ComSuper's annual internal audit program to identify areas of mutual interest and to examine reports of specific internal audits where there is a coincidence of interest
- provides reasonable access to internal audit staff to attend Board's Audit and Risk Management Committee meetings and to advise on audits completed or in progress
- provides a quality assurance role on accounting information provided by the Custodian or other sources

Audit of financial statements

The Auditor-General has issued an unqualified audit opinion in respect of the financial statements of the Scheme and Board for the 2006–07 financial year.

However, in the course of the audit the Auditor-General noted that the Board had recorded in its breaches register a number of instances of breakdown in procedures used by the administrator (ComSuper) in the administration of the Scheme on the Board's behalf. Of these only one matter was considered material. This related to the Board's failure to issue Product Disclosure Statements to a small number of new entrants to MilitarySuper.

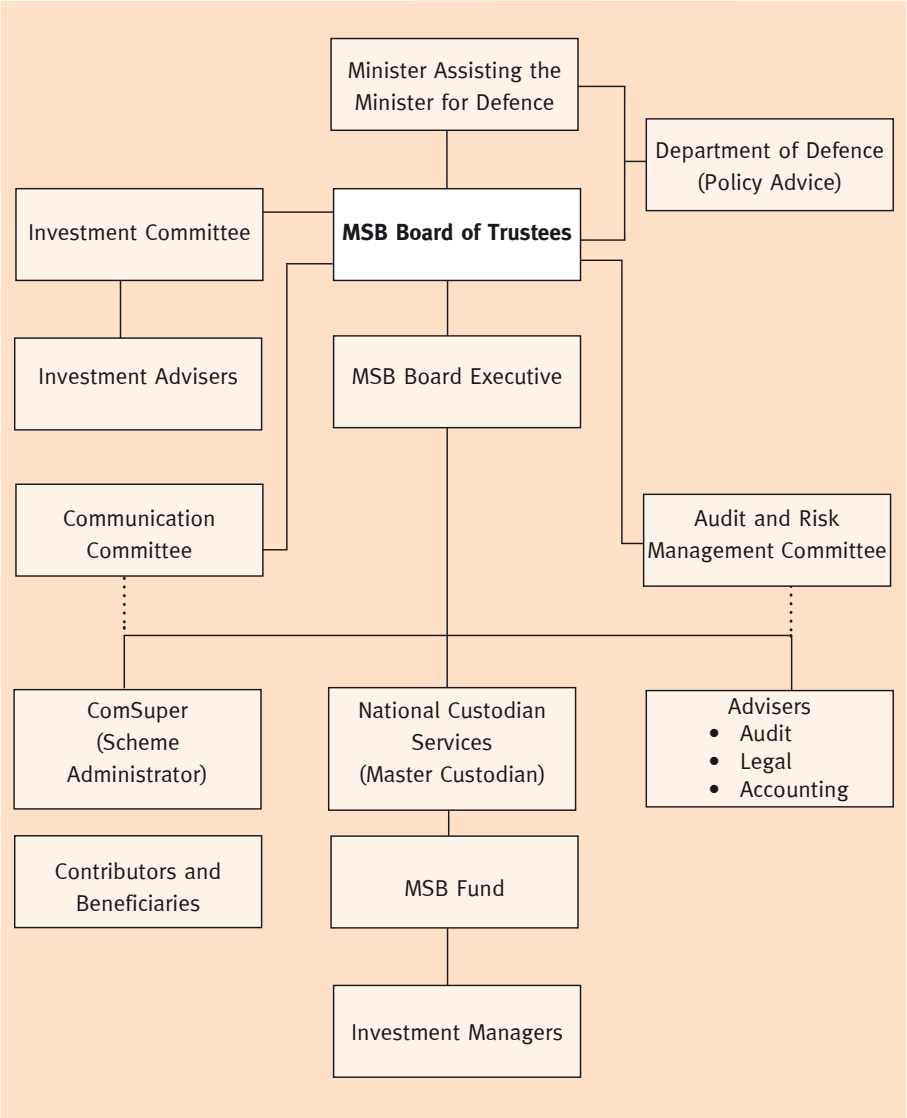
The Auditor-General has therefore issued a qualified opinion in relation to the Board's compliance with SIS and the Corporations law in respect of this matter.

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

Administrative arrangements

Section eleven

Organisational structure of MilitarySuper



Financial resources

The administrative costs of the MSB Board of Trustees for 2006-07 totalled $4.105m. These costs include office accommodation lease and operating costs, fees paid to trustees, trustee travel costs and the cost of Board Executive and ComSuper accounting staff.

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

The breakdown of administrative expenses met by the MSB Fund and the Department of Defence in respect of 2006-07 is as follows:

MSB Fund	$3.385m
Department of Defence	$0.720m
Total	$4.105m

Further details are contained in the financial statements.

Section twelve

Scheme financial statements

Australian National
Audit Office

MILITARY SUPERANNUATION AND BENEFITS SCHEME

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

(A) *Financial Statements*

Matters relating to the Electronic Presentation of the Audited Financial Statements

This auditor's report relates to the financial statements published on the website of Military Superannuation and Benefits Scheme for the year ended 30 June 2007. The superannuation entity's trustee is responsible for the integrity of the web site.

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

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

Scope

I have audited the financial statements of Military Superannuation and Benefits Scheme for the year ended 30 June 2007 as set out on pages 2 to 27 attached.

Trustees' Responsibility for the Financial Statements

The superannuation entity's trustees are responsible for the preparation and fair presentation of the financial statements in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the form agreed with the Minister Assisting the Minister of Defence and the requirements of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations). The trustee's responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on my audit. I have conducted an independent audit of the financial statements in order to express an opinion on them to the members of Military Superannuation and Benefits Scheme and the Minister Assisting the Minister for Defence.

My audit has been conducted in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. These Auditing Standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

GPO Box 707 CANBERRA ACT 2601
19 National Circuit BARTON ACT 2600
Phone (02) 6203 7300 Fax (02) 6203 7777

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the trustee's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the trustee's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the trustees, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Independence

In conducting the audit, I have followed the independence requirements of the Australian National Audit Office, which incorporate the ethical requirements of the Australian accounting profession.

Audit Opinion

In my opinion:

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

(ii) The financial statements present fairly, in all material respects, in accordance with applicable Australian Accounting Standards (including Australian Accounting Interpretations), the net assets of Military Superannuation and Benefits Scheme as at 30 June 2007 and the changes in net assets for the year ended 30 June 2007.

(B) Compliance

Trustees' Responsibility for Compliance

The superannuation entity's trustees' are responsible for complying with the requirements of the SIS Act, SIS Regulations, the Reporting Standards made under Section 13 of the *Financial Sector (Collection of Data) Act 2001* (FSCODA Reporting Standards), the *Corporations Act 2001* (Corporations Act) and *Corporations Regulations 2001* (Corporations Regulations).

Auditor's Responsibility

My responsibility is to express an opinion on the trustee's compliance with the requirements of the SIS Act, SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporations Regulations based on the audit. My audit has been conducted in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. These Auditing Standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit. I have conducted tests in accordance with these Auditing 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 SIS Act and SIS Regulations:

Sections 19(2), 19(3), 36, 65, 66, 67, 69 to 85, 86 to 93A, 95, 97, 98, 101, 103, 104, 105, 106, 107, 109, 111, 113, 117, 118, 121, 122, 124, 125, 152, 154;

Regulations 2.33(2), 3.10, 4.08(3), 5.08, 6.17, 7.04, 7.05, 9.09, 9.14, 9.29, 9.30, 13.14, 13.17, 13.17A; and

(b) complied with the FSCODA Reporting Standards 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 and Corporations Regulations:

Sections 1012B, 1012F, 1012H(2), 1012I, 1013D, 1013K(1), 1013K(2), 1016A(2), 1016A(3), 1017B(1), 1017B(5), 1017C(2), 1017C(3), 1017C(5), 1017C(8), 1017D(1), 1017D(3), 1017D(3A), 1017DA(3), 1017E(2), 1017E(3), 1017E(4), 1020E(8) and 1020E(9); and

Regulation 7.9.32(3); and

(d) complied with the requirement to prepare and lodge the respective forms comprising the APRA Annual Return

for the year ended 30 June 2007.

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

These tests have not been performed continuously throughout the period, were not designed to detect all instances of non-compliance, and have not covered any other provisions of the SIS Act and SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporations Regulations apart from those specified. The superannuation entity's trustees are responsible for complying with the SIS Act and SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporations Regulations.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Qualification

Sections 1012B and 1012F of the *Corporations Act 2001* require that new members receive a Product Disclosure Statement within a specified timeframe. This requirement was breached, in that 100 new recruits to the Defence Force did not receive their new member kit, which includes the Scheme's Product Disclosure Statement, within the prescribed three months of entry. This information has now been distributed to these members.

Qualified Audit Opinion

In my opinion, except for the matter referred to in the qualification paragraph, the trustees of Military Superannuation and Benefits Scheme have complied, in all material respects, with the requirements of the SIS Act and SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporations Regulations for the year ended 30 June 2007.

Australian National Audit Office

Carla Jago
Executive Director

Delegate of the Auditor-General

Canberra

6 September 2007

MILITARY SUPERANNUATION AND BENEFITS SCHEME

Statement by the Trustees of the Military Superannuation and Benefits Fund

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

(a) of the matters required by AAS 25 and Schedule 1 of the *Commonwealth Authorities and Companies (financial statements for reporting periods ending on or after 30 June 2006), Orders*, as amended from time to time except where there is a conflict between Schedule 1 and Australian Accounting Standard AAS 25 *Financial Reporting by Superannuation Plans* (AAS 25), the latter shall take precedence;

(b) of the net assets of the Scheme as at 30 June 2007 and the changes in net assets of the Scheme for the financial year ended 30 June 2007;

(c) that at the date of this statement there are reasonable grounds to believe that the Scheme will be able to pay its debts as and when they fall due;

(d) that the financial statements are in a form approved by the Minister Assisting the Minister for Defence and the MSB Board in accordance with subsection 26(1) of the *Military Superannuation and Benefits Act 1991* and have been prepared in accordance with Australian Accounting Standards and other mandatory professional reporting requirements;

(e) that the financial statements have been prepared based on properly maintained financial records;

(f) that the operations of the Scheme were in accordance with the *Military Superannuation and Benefits Act 1991*; and

(g) that the Scheme complied with the requirements of the *Superannuation Industry (Supervision) Act 1993* and Regulations and the relevant requirements of the *Corporations Act 2001* and Regulations except for certain breaches which have been reported to the Regulator. These included the following material matters:

- Product Disclosure statements were not issued to a small number of new entrants of MSBS.

Signed at Canberra this 6th day of September 2007 in accordance with a resolution of members of the Military Superannuation and Benefits Board of Trustees.

Member

Member
Military Superannuation and Benefits Board of Trustees No. 1

STATEMENT OF CHANGES IN NET ASSETS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2007

	Note	2007	2006
		$'000	$'000
Net Assets Available to Pay Benefits at The Beginning of The Financial Year		**2,215,983**	1,749,340
Add:			
Investment Revenue			
Interest	3	**14,535**	5,761
Dividends and trust distributions	3	**162,489**	105,149
Changes in net market values	3	**246,519**	221,689
Other investment income	3	**2,733**	2,568
Direct investment expenses	5	**(16,232)**	(17,443)
Net Investment Revenue		**410,044**	317,724
Contribution Revenue			
Member contributions		**154,204**	141,926
Employer contributions		**85,656**	74,875
Co-contributions		**15,434**	13,937
Appropriation from Consolidated Revenue Fund (CRF)	4	**147,890**	137,401
Other income		**-**	4,382
Total Contribution Revenue		**403,184**	372,521
Total Revenue		**813,228**	690,245
Less:			
General administration expenses	5	**3,385**	2,072
Benefits paid and payable	4	**203,003**	186,980
Other expenses		**-**	4,382
Benefits Paid and expenses		**206,388**	193,434
Increase in Net Assets for the Year Before Income Tax		**606,840**	496,811
Less income tax expense	6(a)	**48,969**	30,168
Increase in Net Assets for the Year After Income Tax		**557,871**	466,643
Net Assets Available to Pay Benefits at the End of The Financial Year		**2,773,854**	2,215,983

The attached notes form part of these financial statements

MILITARY SUPERANNUATION AND BENEFITS SCHEME

STATEMENT OF NET ASSETS AS AT 30 JUNE 2007			
	Note	**2007**	2006
		$'000	$'000
Investments			
Cash and short term deposits		**53,731**	17,514
Debt instruments		**202,651**	209,464
Australian equities		**842,312**	689,718
International equities		**607,692**	643,860
Property trusts		**183,365**	156,469
Currency contracts		**65,629**	(7,016)
Private equity		**405,647**	218,935
Uncorrelated Alpha (Hedge) Fund		**180,585**	130,989
Infrastructure		**248,292**	171,708
Total Investments		**2,789,904**	2,231,641
Other Assets			
Cash at bank		**26,663**	19,253
Interest receivable		**1,772**	969
Dividends receivable		**4,180**	3,597
Trade settlements receivable		**30,159**	8,983
GST recoverable		**463**	265
Sundry debtors		**1,104**	992
Benefits payable to be funded by appropriation	4	**5,889**	1,896
Total Other Assets		**70,230**	35,955
Total Assets		**2,860,134**	2,267,596
Less Liabilities			
Benefits payable	4	**8,974**	3,291
Trade settlements payable		**9,839**	8,805
Sundry creditors	7	**23,283**	9,146
Current tax liability	6(b)	**15,622**	11,596
Deferred tax liability	6(c)	**28,562**	18,775
Total Liabilities		**86,280**	51,613
Net Assets Available to Pay Benefits		**2,773,854**	2,215,983

The attached notes form part of these financial statements

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statement of Compliance

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

The financial statements were authorised for issue by the Military Superannuation and Benefits Board of Trustees on 6 September 2007.

Basis of Preparation

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

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

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

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

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

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

Accounting Standards and Interpretations Issued, but not yet effective

At the date of authorisation of the financial report, the following Standards which are expected to be relevant to the Scheme were in issue but not yet effective.

The trustees anticipate the adoption of these Standards will have no material financial impact on the financial report of the Scheme.

- AASB 7 *Financial Instruments: Disclosures* and consequential amendments to other accounting standards resulting from its issue replace the presentation requirements of financial instruments specified by AASB 132. AASB 7 is applicable for annual reporting periods beginning on or after 1 January 2007.
- AASB 2007-4 Amendments to Australian Accounting Standards arising from ED 151 and Other Amendments. AASB 2007-4 applies to annual reporting periods beginning on or after 1 July 2007.
- AASB 2005-10 Amendments to Australian Accounting Standards (September 2005) makes consequential amendments to AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 101 *Presentation of Financial Statements*, AASB 114 *Segment Reporting*, AASB 117 *Leases*, AASB 133 *Earnings Per Share*, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts* arising from the release of AASB 7. AASB 2005-10 is applicable for annual reporting periods beginning on or after 1 January 2007.
- AASB 8 *Operating Segments* replaces the requirements of segment disclosures in AASB 114 Segment Reporting. AASB 8 is applicable for annual reporting periods beginning on or after 1 January 2009.
- AASB 101 *Preparation of Financial Statements* has been revised to include some text from IAS 1 Presentation of Financial Statements and has fewer additional Australian disclosure requirements than the existing AASB 101. AASB 101 applies to annual reporting periods beginning on or after 1 January 2007.

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

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

The accounting policies set out below have been applied in preparing the financial statements for the year ended 30 June 2007 and the comparative information presented in these financial statements for the year ended 30 June 2006.

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

(a) Cash and Cash Equivalents

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

(b) Revenue Recognition

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

Investment Revenue

Dividend revenue

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

Interest revenue

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

Movement in net market value of investments

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

Movement in net market value of financial liabilities

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

Contribution Revenue

Employer and Member Contributions

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

Government Co-contributions

Superannuation co-contributions from the Australian Government are recognised on an allocation basis as this is the only point at which measurement is reliable. Accordingly amounts are recognised when superannuation co-contribution receipts are received by the Scheme and allocated through the Administration software to individual members. This involves matching the data file received from the Australian Taxation Office with the appropriate members.

Transfer from other funds

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

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

(c) Valuation of Investments

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

(i) Short-term Money Market - these securities are valued by marking to market using yield supplied by independent valuers.

(ii) Fixed-interest - these securities are valued by marking to market using yields supplied by independent valuers.

(iii) Futures Contracts - open futures contracts are revalued to closing price quoted at close of business on 30 June 2007 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 2007 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 2007 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 2007 by the relevant securities exchange. In the case of UK securities, the basis of valuation is the average of the bid and offer prices.

(vii) Units in Property Trusts - units are valued at their net realisable value.

(viii) Currency contracts - these securities are valued at the relevant exchange rate at close of business on 30 June 2007.

(ix) Private equity, Infrastructure and Direct Property – these asset classes are valued according to the most recent valuation obtainable from:
- an independent external valuer;
- a third party arms length transaction;
- the current and future earnings of companies or assets in the portfolio; or
- cost (less any diminution in value) in cases where investments have been held for a short time and Trustees are satisfied that significant diminution in value has not occurred.

(x) Debt Instruments – Certain investments are valued by marking to market using yields supplied by independent valuers. The remainder of this class of investments is valued by the most recent valuation obtainable from:
- an independent external valuer;
- a third party arms length transaction; or
- the current and future earnings on corporate debt instruments in the portfolio.

(xi) Uncorrelated Alpha (Hedge) Funds – Investments via unit trusts are valued at their net realisation value. The remainder of this class of investments is valued by the issuing bank having regard to the net realisable value of the underlying financial instruments.

The following table details the latest date of valuation of private equity investments as at 30 June 2007:

Fund	Latest valuation
Domestic Private Equity	
Archer Capital fund 3, 3A and 3B (previously GS)	30 June 2007
Babcock and Brown Direct Investment Fund	30 June 2007
CHAMP Ventures Trusts No. 5A and 5B	30 June 2007
CHAMP Ventures Trusts No. 6A and 6B	30 June 2007
CHAMP Buyout II Trust	30 June 2007
Crescent Capital Partners II	30 June 2007
Deutsche Private Equity Fund	30 June 2007
Deutsche Private Equity Fund No. 2	30 June 2007
GBS BioVentures III	30 June 2007
Gresham Private Equity Fund 1 & 1a	30 June 2007
Gresham Private Equity Fund No. 2A and 2B	30 June 2007
NBC Private Equity Fund 2A and 2B	30 June 2007
PEP Funds No. 2 and Supplementary No. 2	30 June 2007
Pacific Equity Partners Fund 3 and Supp No. 3	30 June 2007
International Private Equity	
** Citic Allco Investments Ltd	31 March 2007
** CSFB Fund Investment VI Bermuda	31 March 2007
** HarbourVest Partners IV	31 March 2007
** HarbourVest Partners VII Buyout	31 March 2007
** HarbourVest Partners VII Mezzanine	31 March 2007
* HarbourVest Partners VII Venture	31 March 2007
** HarbourVest Partners V	31 March 2007
KKR 2006 Fund, L.P.	31 March 2007
** Pantheon Europe Fund III, L.P.	31 March 2007
** Pantheon Global Secondary Fund II, L.P.	31 March 2007
** Pantheon Global Secondary Fund III, L.P.	31 March 2007
** Pantheon USA Fund IV, L.P.	31 March 2007
** Northgate Private Equity Part II	31 March 2007
** Northgate Venture Partners III	31 March 2007
Rosemont Partners II, L.P.	30 June 2007
Rosemont Cadence LLC	30 June 2007
*SCM CDO Equity Fund	New
Sentient Global Resources Trust No. 1	31 March 2007
** Siguler Guff Bric Opp Fund	31 March 2007
** Siguler Guff Distressed Opportunities Fund II, L.P.	31 March 2007
** TCW Shared Opportunity Fund V, L.P.	31 March 2007
*Terra Firma Capital Partners III, L.P.	New
** Thomas Weisel India Opportunity Fund, L.P.	31 March 2007
YBR Feeder Limited Partnership	30 June 2007

* New funds - cash flows only
** Estimated valuations received as at 30 June 2007
All valuations are un-audited

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

(d) Foreign Currency Translation

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

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

(e) Use of Derivatives

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

(f) Taxation

Current Tax

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

Deferred Tax

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

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

Temporary differences may be either:

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

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

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

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

(g) Benefits Payable

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

(h) Liability for Accrued Benefits

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

(i) Superannuation Contributions (surcharge) Tax

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

(j) Goods and Services Tax (GST)

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

i. where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or

ii. for receivables and payables which are recognised inclusive of GST.

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

(k) Sundry Debtors and Creditors

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

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

2. DESCRIPTION OF THE SCHEME

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

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

The principal place of business of the Scheme is:

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

(b) Member Numbers:

	2007	2006
Number of Members	**#**	#
- Contributors	**47,721**	46,402
- Deferred Beneficiaries / Preservers	**65,615**	61,044
- Pensioners	**6,409**	6,002
Total Number of Members	**119,745**	113,448

(c) Employees of the Board:

	2007	2006
	#	#
Total Number of Employees	**8**	7

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

3. INCOME AND CHANGES IN NET MARKET VALUES

	Interest	Dividends and Trust Distributions	Other	Realised Capital Gain (Loss)	Unrealised Capital Gain (Loss)	Total
30 June 2007	**$'000**	**$'000**	**$'000**	**$'000**	**$'000**	**$'000**
Cash and Short Term Deposits	**2,072**	**55**	**446**	**(417)**	**(514)**	**1,642**
Debt Instruments	**941**	**27,054**	**107**	**(1,958)**	**(12,821)**	**13,323**
Australian Equities	**3,766**	**55,747**	**113**	**83,174**	**52,957**	**195,757**
International Equities	**717**	**7,964**	**7**	**942**	**39,013**	**48,373**
Property Trusts	**6,920**	**5,322**	**1,840**	**(68)**	**(4,315)**	**9,699**
Currency Contracts	**68**	**-**	**-**	**20,791**	**65,629**	**86,488**
Private equity	**29**	**47,531**	**162**	**(3,201)**	**308**	**44,829**
Uncorrelated Alpha (Hedge) Fund	**7**	**-**	**58**	**(359)**	**1,821**	**1,527**
Infrastructure	**15**	**19,086**	**-**	**121**	**5,416**	**24,638**
Total	**14,535**	**162,489**	**2,733**	**99,025**	**147,494**	**426,276**
30 June 2006	**$'000**	**$'000**	**$'000**	**$'000**	**$'000**	**$'000**
Cash and Short Term Deposits	1,427	(3,014)	496	25,649	29	24,587
Debt Instruments	2,380	6,532	1,025	26	2,736	12,699
Australian Equities	604	45,064	125	28,233	63,660	137,686
International Equities	376	8,027	93	52,342	68,026	128,864
Property Trusts	782	13,764	35	(3,739)	(577)	10,265
Currency Contracts	136	-	-	(15,922)	(6,955)	(22,741)
Private equity	13	22,404	245	(21,616)	6,791	7,837
Uncorrelated Alpha (Hedge) Fund	23	2,.293	-	4,410	6,759	13,485
Infrastructure	20	10,078	550	(440)	12,277	22,485
Total	5,761	105,149	2,568	68,943	152,746	335,167

The net gain/(loss) on foreign currency contracts for the year was $86.5m (2006: $(22.8)m). This amount does not include gains and losses on foreign currency transactions that may have occurred in the pooled trust investments.

Changes in Investment Classification

The methodology for classifying investments has been changed to ensure consistency between the classifications in the Statement of Net Assets and the classifications for Investment Revenue reported in the Statement of Changes in Net Assets. Each fund manager has been classified according to their overall nature. Previously the balance for an individual fund manager may have been split between asset classes. This change does not impact on the total balance of investments and investment revenue, however, the amounts for each asset class have changed. The 2005-06 comparatives have been updated accordingly.

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

4. FUNDING ARRANGEMENTS

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

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

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

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

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

Total Benefits Paid and Payable

	2007	2006
	$'000	$'000
Lump Sums	**87,635**	86,688
Pensions	**115,368**	100,292
Total	**203,003**	186,980

Financed by:

Military Super Scheme	**55,113**	49,579
Consolidated Revenue Fund	**147,890**	137,401
Total	**203,003**	186,980

Of the $8.974m benefits payable as at 30 June 2007, the Scheme's share amounted to $3.085m (2006: $1.4m) with the Consolidated Revenue Fund's share being $5.889m at 30 June 2007 (2006: $1.9m).

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

5. COST OF ADMINISTERING THE SCHEME AND MANAGING THE SCHEME

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

	2007	2006
	$'000	$'000
Fund Management and Investment Expenses met by Fund		
General Administration Expenses		
Accounting services	**272**	223
Professional advisers	**409**	717
Share of trustee fees, travel and incidental costs	**990**	596
Taxation services	**213**	83
Communications	**63**	45
APRA lodgement fees and industry levy	**366**	134
Insurance	**317**	-
External audit	**130**	63
Internal audit	**378**	166
ATO Revised assessment interest charge	**41**	
Other Expenses	**83**	
Non recoverable GST	**123**	45
Total	**3,385**	2,072
Direct Investment Expenses		
Investment management fees	**9,876**	10,985
Asset consultancy and portfolio management	**3,875**	4,309
Custodian	**2,226**	1,929
Other investment expenses	**198**	3
Non recoverable GST	**57**	217
Total	**16,232**	17,443

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

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.

	2007	2006
	$'000	$'000
Scheme Administration Expenses met by Department of Defence		
ComSuper Administration Fees	**11,636**	11,383
Board Administration Expenses		
Share of trustee fees, travel and incidental costs	**92**	90
Support staff and facilities	**613**	684
Professional advisers	**15**	28
Total	**720**	802

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

6. INCOME TAX

The taxation liability at 30 June 2007 has been calculated on the basis that the Scheme complies with the standards contained in the *Superannuation Industry (Supervision) Act 1993* and Regulations and that tax will be payable on the income received by the Scheme at a rate of 15 per cent. There has been no change in the superannuation tax rate when compared with the previous reporting period.

(a) Income Tax Recognised in Profit or Loss

	2007	2006
	$'000	$'000
Tax Expense (Income) comprises:		
Current tax expense/income	**39,597**	22,070
Deferred tax expense/(income)	**9,787**	10,010
Under/(over) provided in prior years	**(415)**	(1,912)
Total tax expense/(income)	**48,969**	30,168
Income tax expense is attributable to:		
Profit from continuing operations	**48,969**	30,168
Aggregate income tax expense	**48,969**	30,168
Deferred income tax (revenue) expense included in income tax expense comprises:		
Decrease (increase) in deferred tax assets	**1,711**	(8,152)
(Decrease) increase in deferred tax liabilities	**8,076**	18,162
	9,787	10,010
The prima facie income tax expense on pre-tax changes in net assets reconciles to the income tax expense in the financial statements as follows:		
Profit from continuing operations before income tax expense	**606,840**	496,811
	606,840	496,811
Income tax expense calculated at 15%	**91,026**	74,522
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Non-taxable member contributions	**(47,629)**	(43,989)
Non-deductible benefit payments	**30,450**	28,047
Difference between accounting and tax gains	**(11,298)**	(15,676)
Imputation and foreign tax credits	**(13,165)**	(10,824)
Under/(over) provision of income tax in previous year	**(415)**	(1,912)
	48,969	30,168

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

(b) Current tax liabilities

	2007	2006
	$'000	$'000
Current tax payables:		
Income tax payable	**15,622**	11,596
	15,622	11,596

(c) Deferred tax balances

	2007	2006
	$'000	$'000
Deferred tax liabilities comprise:		
Temporary differences	**28,562**	18,775
	28,562	18,775

Taxable and deductible temporary differences arise from the following:

	2007	2006
	$'000	$'000
Amounts received in profit or loss:		
Unrealised capital gains	**25,203**	26,550
Realised capital losses	**-**	-
Accrued income	**3,466**	(7,775)
Accrued expenses	**(107)**	-
Net deferred tax liabilities	**28,562**	18,775
Movements:		
Opening Balance as at 1 July	**18,775**	8,766
Charged/(credited) to the income statement	**9,787**	10,010
	28,562	18,775

7. SUNDRY CREDITORS

	2007	2006
	$'000	$'000
Investment expenses payable	**6,196**	7,397
Unallocated contributions	**16,072**	1,354
Accrued expenses	**872**	343
Tax payable to the ATO	**143**	52
Total	**23,283**	9,146

8. FINANCIAL INSTRUMENT DISCLOSURES

(a) Financial Risk Management Objectives

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

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

(b) Significant Accounting Policies

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

(c) Use of Derivative Financial Instruments

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

At 30 June 2007, the notional principal amounts and net fair value of derivatives held by the Fund was as follows:

	Notional Principal Amounts		**Net Market Value**	
	2007	2006	**2007**	2006
	$'000	$'000	**$'000**	$'000
Australian Equities	**190,664**	762	**(6)**	28
Currency contracts	**(950,334)**	(582,924)	**(65,629)**	(6,956)
Private Equity	**10,505**	-	**(121)**	-
Total	**(749,165)**	(582,162)	**(65,756**	(6,928)

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

(d) Credit Risk Management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Fund. The net market value of financial assets, with the exception of derivative positions, included in the statement of net assets represents the Fund's exposure to credit risk in relation to those assets. For derivative positions, the credit risk is equal to the net market value of positive (asset) derivative positions which amount to $0.3m (2006: $3.3m).

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

(e) Interest Rate Risk

The Fund invests in financial investments for the primary purpose of obtaining a return on investments on behalf of its members. As such, the Fund's investments are subject to interest rate risks and the return on the investments will fluctuate in accordance with movements in market interest rates. The Fund's exposure to interest rate movements on investments at 30 June 2007 was as follows:

			Fixed Interest Rate			
	Weighted Average Effective Interest Rate	Floating Interest Rate	1 Year or Less	1-5 Years	Over 5 Years	Non-Interest Bearing	Total
30 June 2007	%	$'000	$'000	$'000	$'000	$'000	$'000
Financial Assets							
Cash & short term deposits	4.50	49,923	3,951	-	-	(143)	53,731
Debt instruments	0.49	-	-	-	11,146	191,505	202,651
Australian equities	1.84	276,215	-	211	-	565,886	842,312
International equities	0.06	12,539	-	-	-	595,153	607,692
Property trusts	-	-	-	-	-	183,365	183,365
Currency contracts	-	-	-	-	-	65,629	65,629
Private equity	-	196	-	-	-	405,451	405,647
Uncorrelated Alpha (Hedge) fund	-	-	-	124,283	-	56,302	180,585
Infrastructure	-	20,395	-	-	-	227,897	248,292
Other assets	2.32	26,663	-	-	-	43,567	70,230
Financial Liabilities							
Benefits payable	-	-	-	-	-	(8,974)	(8,974)
Trade settlements payable	-	-	-	-	-	(9,839)	(9,839)
Sundry creditors	-	-	-	-	-	(22,411)	(22,411)
Accrued Expenses	-	-	-	-	-	(851)	(851)
Current tax liability	-	-	-	-	-	(15,622)	(15,622)
Deferred tax liability	-	-	-	-	-	(28,562)	(28,562)
Total		**385,931**	**3,951**	**124,494**	**11,146**	**2,248,353**	**2,773,875**

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

			Fixed Interest Rate				
	Weighted Average Effective Interest Rate	Floating Interest1 Rate	Year or Less	1-5 Years	Over 5 Years	Non-Interest Bearing	Total
30 June 2006	%	$'000	$'000	$'000	$'000	$'000	$'000
Financial Assets							
Cash & short term deposits	4.43	17,514	-	-	-	-	17,514
Debt Instruments	7.73	-		94,130	12,050	103,283	209,464
Australian equities	6.50	-	-	75	-	689,643	689,718
International equities	-	-	-	-	-	643,860	643,860
Property trusts	-	-	-	-	-	156,469	156,469
Currency contracts	-	-	-	-	-	(7,016)	(7,016)
Private equity	-	-	-	-	-	218,935	218,935
Uncorrelated Alpha (Hedge) Fund	-	-	-	-	-	130,989	130,989
Infrastructure	-	-	-	-	-	171,708	171,708
Other Assets	4.43	19,253	-	-	-	16,702	35,955
Financial Liabilities							
Benefits payable	-	-	-	-	-	(3,291)	(3,291)
Trade settlements payable	-	-	-	-	-	(8,805)	(8,805)
Sundry creditors	-	-	-	-	-	(8,803)	(8,803)
Accrued expenses	-	-	-	-	-	(343)	(343)
Current tax liability	-	-	-	-	-	(11,596)	(11,596)
Deferred tax liability	-	-	-	-	-	(18,775)	(18,775)
Total		**36,767**	**-**	**94,205**	**12,050**	**2,072,960**	**2,215,983**

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

(f) Currency Risk Exposures

The Scheme's exposure at 30 June 2007 to foreign exchange rate movements on its international investments was as follows:

	USA	JPY	GBP	EUR	Other	Total
	A$'000	A$'000	A$'000	A$'000	A$'000	A$'000
30 June 2007						
Gross investment amounts denominated in foreign currency	934,990	23,440	48,869	142,288	47,995	1,197,582
Amount effectively hedged	(545,407)	(114,451)	(51,517)	(228,320)	(135)	(939,830)
Net exposure	**389,583**	**(91,011)**	**(2,648)**	**(86,032)**	**47,860**	**257,752**

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

Amounts effectively hedged are based on total portfolio value exposed to foreign currency rather than the investment amounts in a particular currency and consequentially the values of the hedge contracts may exceed the value of investments denominated in foreign currency. The hedge is actively managed such that at individual currency level amounts effectively hedged at any point in time will be impacted by the timing of contract valuations and rollovers. In alternative investments it is also the case that amounts committed may be drawn in a particular currency but underlying investments may be made in another.

(g) Net Fair Values of Financial Assets and Liabilities

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

(h) Liquidity Risk Management

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

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

9. VESTED BENEFITS

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

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

	2007	2006
	$m	$m
Funded component	**2,775**	2,205
Unfunded component	**10,484**	9,261
Total vested benefits	**13,259**	11,466

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

	2007	2006
	$m	$m
Funded component	**2,775**	2,205
Net assets adjusted for benefits payable and cost of disposal	**2,782**	2,223
Surplus	**7**	18

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 2007 and elected the option which is most costly to the Scheme. The likelihood of such an occurrence is extremely remote.

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

10. LIABILITY FOR ACCRUED BENEFITS

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

	2005	2002
	$b	$b
Funded component	1.7	1.0
Unfunded component	8.8	5.9
Total accrued benefits	10.5	6.9

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

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

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

11. GUARANTEED BENEFITS

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

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

12. KEY MANAGEMENT PERSONNEL COMPENSATION

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

The Trustees of the MSB Board of Trustees No. 1

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

Executive of the MSB Board of Trustees No. 1

Mr K J McCullagh (Chief Executive Officer)

(a) Key Management Personnel Compensation

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

	2007	2006
	$'000	$'000
Short-term employee benefits	**486,021**	372,833
Post-employment benefits	**-**	-
Other long-term employee benefits	**4,346**	7,375
Termination benefits	**-**	-
Share-based payments	**-**	-
	490,367	380,208

13. AUDITORS REMUNERATION

	2007	2006
	$	$
The amount paid and payable in respect of audit services provided by ANAO (exclude GST)	**71,340**	60,325

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

Other services provided by the Australian National Audit Office included an audit of the RSE and FSR licensee requirements. This service was provided for a fee of $20,830.

No other services were provided by the Australian National Audit Office or Deloitte Touche Tohmatsu during the reporting period.

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

14. SEGMENT REPORTING

Business Segments

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

Geographical Segments

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

15. COMMITMENTS FOR EXPENDITURE

At 30 June 2007 the Fund had outstanding investment capital commitments of $774m (2006: $537m). These commitments relate to investments in private equity, infrastructure and direct property. These commitments may be called upon during the specified investment period by the underlying investment manager depending on their requirements to fund new investments.

16. CONTINGENT LIABILITIES

Benefit Entitlements

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

There were no other contingent liabilities which have been identified as at 30 June 2007 (2006:$Nil).

17. SUPERANNUATION CONTRIBUTIONS SURCHARGE

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

A summary of transactions follows:

	2007	2006
	$'000	$'000
Total surcharge liability outstanding at start of year	**17,635**	14,859
Surcharge liability recorded against member accounts in respect of surcharge assessments received during the year	**1,396**	2,607
Adjustments to previous years balance	**-**	-
	19,031	17,466
Less Amount paid by members	**(148)**	(132)
Less Amounts deducted from members' benefit payments	**(669)**	(650)
Plus:		16,684
Interest applied to outstanding surcharge liability at 30 June 2006	**1,136**	951
Total surcharge liability outstanding at end of year	**19,350**	17,635

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

MILITARY SUPERANNUATION AND BENEFITS SCHEME

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the financial year ended 30 June 2007

18. RELATED PARTIES

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

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

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

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

Employer Sponsor

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

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

Contributions and Retirement Benefits of Key Management Personnel

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

Superannuation contributions were paid on behalf of all other key management personnel who received compensation during the year to a superannuation fund of their choice.

Other Related Party Disclosures

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

The Chief Executive Officer has been appointed, at the Board's request, as a Director of a company in which the Scheme has an investment.

19. SUBSEQUENT EVENTS

There have not been any matters or circumstances arising since 30 June 2007 that have significantly affected or may significantly affect the Scheme.

Mr C P H Kiefel retires as Chairman with effect from 31 August 2007 and Dr M J Sharpe, AO retires as trustee with effect from 31 July 2007. Mr T Hyams and Mr G Szondy will respectively replace these members.

Australian Government

Australian Government Actuary

17 August, 2006

MILITARY SUPERANNUATION AND BENEFITS SCHEME

SUMMARY OF THE 2005 LONG TERM COST REPORT

1. A report on the long term cost of the Military Superannuation and Benefits Scheme (MSBS) and the Defence Force Retirement and Death Benefits Scheme (DFRDB) was carried out using data as at 30 June 2005 by the Australian Government Actuary.

2. The MSBS is partially funded and the DFRDB (closed to new entrants since October 1991) is unfunded. Both schemes have an underlying Government guarantee. For the MSBS, member contributions and the employer 3% Productivity contributions are paid into the MSBS Fund. Any MSBS benefit payment amounts not paid from Fund assets are paid from Consolidated Revenue. Projections of the actual annual employer costs of the two schemes combined as a percentage of Gross Domestic Product (GDP) were made over a period of 40 years.

3. These projections showed a progressive fall in the combined cost of the two schemes as a percentage of GDP. Given the underlying Government guarantee, I was therefore of the opinion that the financial position of the schemes as at 30 June 2005 was satisfactory.

4. The value of net assets of the MSBS available to pay benefits as at 30 June 2005 reported in the audited financial statements of the Fund was $1,749 million.

5. Vested benefits of the MSBS were not calculated as part of the Long Term Cost Report as at 30 June 2005, but were calculated separately and covered contributors, preserved members and pensioners. They amounted to $9.6 billion.

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

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

7. As would be expected in a substantially unfunded arrangement, the value of total Accrued Benefits is more than the audited value of scheme assets at the same date.

2

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

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

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

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

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

Appendixes

Section thirteen

Appendix 1: MilitarySuper in brief

Investment

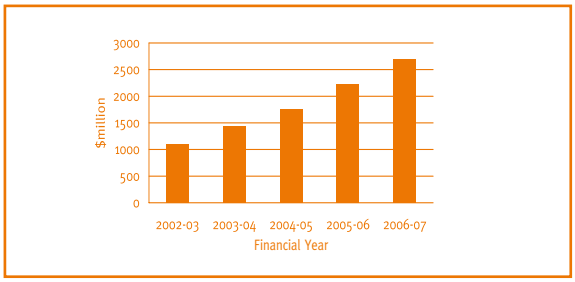
Effective asset allocation	30 June 2006		30 June 2007	
Sector	$m	%	$m	%
Cash	18	1	54	2
Debt Instruments	209	9	203	7
Property	156	7	184	7
Australian Shares	690	31	842	30
Private Equity	219	10	406	15
International Shares	644	29	608	22
Uncorrelated Alpha	131	6	180	6
Infrastructure	172	8	248	9
Currency	(7)	(1)	66	2
Investment performance	**30 June 2006**		**30 June 2007**	
Sector	Fund %[1]	Benchmark %[2]	Fund %[1]	Benchmark %[2]
Cash	5.8	5.8	6.2	6.4
Debt instruments	8.6	5.8	7.3	6.4
Property	10.6	16.8	5.1	10
Australian Shares	22.8	24	28.4	29.2
Private Equity [3]	22.8	NA	15.4	15
International Shares[4]	19.9	17.4	23.1	23.7
Uncorrelated Alpha	13.4	10	4.0	10
Infrastructure	23.3	10	8.1	10

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

Membership

Contributors at 30 June	2006	2007	Increase (decrease)
Males	42,165	43,802	1,637
Females	4,237	3,919	(318)
Total	46,402	47,721	1,319
Total Member contributions	$141.9m	$154.2m	$12.3m
Contributor Exits			
Age retirement	51	90	39
Resignation	2,110	2,057	(53)
Redundancy	6	4	(2)
Invalidity	450	395	(55)
Death	17	25	8
Other	3,135	3,291	156
Total	5,769	5,862	93
Pensions in force			
Retirement	962	1,013	51
Redundancy	1,919	1,916	(3)
Invalidity	2,908	3,243	335
Reversionary	213	237	24
Total	6,002	6,409	407
Pensions paid	$100m	$115m	$15m
Average pension	$16,702	$18,000	$1,298
Preserved benefit Members at 30 June	61,044	65,615	4,611

Fund growth in the past five years



Appendix 2: glossary

active management	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.
ADF	Australian Defence Force
AD(JR) Act	*Administrative Decisions (Judicial Review) Act 1977*
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investment Commission
Board	Military Superannuation and Benefits Board of Trustees No 1
CDF	Chief of the Defence Force
ComSuper	Commonwealth Superannuation Administration
core manager	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
CPI	Consumer Price Index
defensive assets	assets (such as cash and bonds) that are not very susceptible to market fluctuations
derivatives	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
DFRDB	Defence Force Retirement and Death Benefits
direct property	property that is purchased by an investor to be held by that investor (see also indirect property)
FSA	Financial Services Australia
FSG	Financial Services Guide
FSR	Financial Services Reform
growth assets	assets (such as shares and property) which provide investment returns (comprising both capital growth and income) which outperform inflation

ICC	Incapacity Classification Committee
indirect property	an investment in property made by purchasing units in a property trust, or shares in a property company
IVR	Interactive Voice Response telephone system
LWOP	leave without pay
MilitarySuper	Military Superannuation and Benefits Scheme
MSB	Military Superannuation and Benefits
MSBS	Military Superannuation and Benefits Scheme
MSCC	Military Superannuation Communication Committee
passive management	a style of investment management that seeks to achieve performance equal to the market or index without making any active investment decisions
PDS	Product Disclosure Statement
RC	Reconsideration Committee
SCT	Superannuation Complaints Tribunal
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SRC Act	*Superannuation (Resolution of Complaints) Act 1993*
surcharge	*Superannuation Contributions Tax (Assessment and Collection) Act 1997*, a tax on employer-financed superannuation contributions
unitisation	the conversion of Member interest-bearing accounts to unit-based accounts within the MSB Fund

Appendix 3: publications

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

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

The MilitarySuper Book
Your Guide to Investment Choice

These are general information books that are intended as a reference for Members and pay officers.

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

The Board also publishes a series of fact sheets that deal with specific topics in more depth. The fact sheets are entitled:

About to Leave the ADF?
Dependants' Benefits
Invalidity Benefits
Leave Provisions
The Productivity Benefit
Rejoining the ADF
Summary of the Scheme
Superannuation Contributions Surcharge
Taxation of Benefits
Early Access to MilitarySuper Benefits
Invalidity Benefits - The Classification Process
Family Law and Your Super
Maximum Benefit Limits
Reaching the Maximum Pension Limit
Taxation Concessions for Pensions
Unitisation
Additional Personal Contributions
Government (Super) Co-contributions
Salary Sacrifice Contributions
Spouse Contributions
Transfer Amounts

Also available is the *ComSuper Service Charter 2005.*

All of these publications can be obtained from Members' Pay Offices; Canprint on 1300 889 873; or the MilitarySuper website **www.militarysuper.gov.au**.

Appendix 4: legislation

Better Superannuation

A number of Commonwealth statutes were passed by Federal Parliament during the 2005-06 financial year in order to implement the Government's package of Better Superannuation reforms, which apply to the 2007–2008 financial year and beyond.

These statutes have a direct impact on the taxation of MilitarySuper benefits.

MilitarySuper Legislation

MilitarySuper is established under:

- the *Military Superannuation and Benefits Act 1991*
- the Military Superannuation and Benefits Trust Deed issued under section 4 of the Act
- the Military Superannuation and Benefits Rules. (The Rules are a Schedule to the Trust Deed.)

Amendments to the Act

There were no amendments to the *Military Superannuation and Benefits Act 1991* during the 2006-07 financial year.

Amending Trust Deeds

Four amending Trust Deeds were issued during the 2006-07 financial year.

- Military Superannuation and Benefits Amendment Trust Deed 2006 (No. 1)

  ComLaw ref: F2006L04096

The Trust Deed was amended to implement recommendations agreed to by the Minister for Finance and Administration in accordance with the Government's acceptance of the principles set out in the recent Review of Corporate Governance of Statutory Authorities and Office Holders undertaken by Mr John Uhrig. In particular, the requirement that the Minister for Finance and Administration be consulted on the appointment of the Chair, or acting Chair, of the MSB Board was removed.

- Military Superannuation and Benefits Amendment Trust Deed 2007 (No. 1)

  ComLaw ref: F2007L00231

The MSB Rules were amended to clarify when a Member reaches his or her pension Maximum Benefit Limit (MBL) or their lump sum MBL. Schedule 3 of the Rules was amended to correct a drafting error; and Schedule 8 was amended to update the formulae using current styles and to correct a drafting error.

- Military Superannuation and Benefits Amendment Trust Deed 2007 (No. 2)

  ComLaw ref: F2007L01762

Schedule 1 of the Rules was amended to provide consistent terminology throughout the Rules. The definition of DFRDB Member was amended and a typographical error was corrected. Schedules 3, 6 and 8 were amended to provide clarity in administering the calculation of MBLs, eligible service and the employer benefit. Schedule 8 was also amended to add clarity to a number of definitions that relate to MBLs.

- Military Superannuation and Benefits Amendment Trust Deed 2007 (No. 3)

  ComLaw ref: F2007L02209

The MSB Rules were amended to provide for the treatment of Member contributions that are paid into the MSBS where no tax file number has been provided. Superannuation funds will not be able to accept after-tax Member contributions if the Member does not provide a tax file number to the fund from 1 July 2007. A definition of tax file number was also inserted into the Rules.

ComLaw

The consolidated *Military Superannuation and Benefits Act 1991*, Trust Deed and Rules and each Amending Trust Deed are available from the ComLaw website **www.comlaw.gov.au**

Appendix 5: compliance

While this report is not a Departmental annual report, the Board has endeavoured to comply with the 'Requirements for Departmental Annual Reports', where applicable. Details of ComSuper's operations are provided in the Commissioner for Superannuation Annual Report 2006–07. Annual reporting requirements that are met in the Commissioner for Superannuation's report are indicated below by an asterisk.

Requirement	Page
Letter of transmittal	3
Aids to access	
Table of contents	5
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Compliance index	155
Glossary	150
Corporate overview	*
Organisation chart	158
Social justice and equity	*
Internal and external scrutiny	*
Industrial democracy	*
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Appendix 6: freedom of information

Freedom of Information Act statement

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

Functions of ComSuper

The general functions of ComSuper are described in the main body of this report and in the Commissioner for Superannuation Annual Report 2006–07.

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 Freedom of Information Officer. 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 Officer.

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

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

Facilities for access

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

Information about facilities for access by people with disabilities can be obtained by contacting the Freedom of Information Officer.

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.

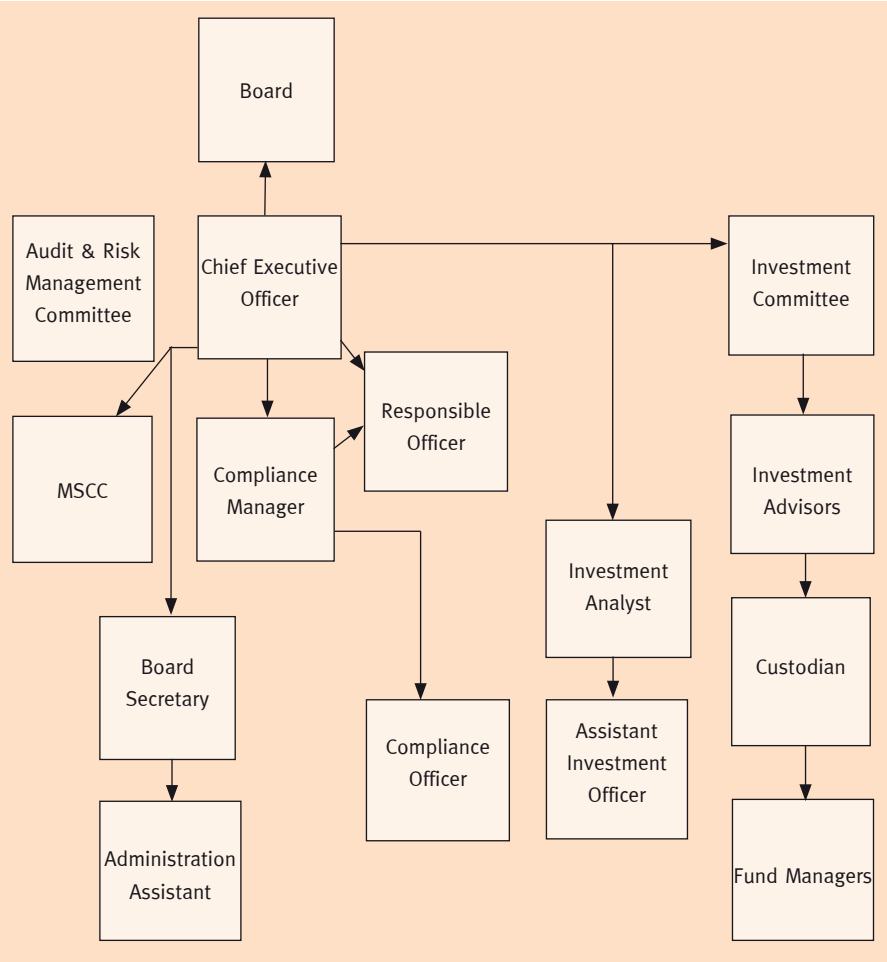
Books, leaflets and fact sheets that describe various aspects of the Military Superannuation and Benefits Scheme, and annual reports, are made available to the public free of charge upon request. They are also available free of charge via the MilitarySuper website **www.militarysuper.gov.au**

Contact Officer

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:

	Freedom of Information Officer ComSuper
Postal address:	PO Box 22 Belconnen ACT 2616
Street address:	Unit 4 Cameron Offices Chandler Street Belconnen ACT 2616
Telephone:	1300 033 732
Facsimile:	(02) 6272 9804
TTY	(02) 6272 9827

Appendix 7: MSB Board Executive Unit



Staff resources

During 2006-07 the staff resources of the Board Executive Unit comprised staff employed directly by the Board on fixed term contracts.

Professional development

Ongoing staff training and development is an important component of the Board's human resource management as well as a specific requirement for the Board in maintaining its Australian Financial Services (AFS) Licence. During 2006-07 all Trustees and Board staff had access to a range of continuing professional development activities including attendance at major industry conference and education forums as part of the Board's education and training policy.

Occupational health and safety

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

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

Financial resources

Board administration costs

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

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

Funding arrangements

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

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

The Board Executive Unit has assumed responsibility from ComSuper for the processing of Board accounts, maintaining accounting records and for the production of Board financial statements.

Ecologically sustainable developments and environmental performance

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

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

Fraud control

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

Appendix 8: staffing statistics of the MSB Board Executive Unit

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

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