3.1 **LASF DEFINED BENEFITS SHORTFALL**  
(DJW:File No.FIN13)

Responsible Director: Tom Evans

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**RECOMMENDATION**

**That Council:**

- Resolves to pay the unfunded superannuation liability of $12,319,576 by 1 February 2013; and

- Commits to funding the unfunded superannuation through a mix of savings of the order of a minimum $500K p.a. borrowings over four years, fee and rate increases; and

- Finalises its funding mix as part of its 2013/14 budget process. In so doing, Council recognises that liquidity and financial ratios will be impacted and resolves to address this as a priority in its Long-term Financial Plan (LTFP).

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**INTRODUCTION**

It was announced at the beginning of July 2012 that the latest actuarial investigation of the Local Authority Superannuation Fund (LASF) Defined Benefit Plan (The Plan) identified a $453M (net of contributions tax) unfunded liability. Monash Council’s share of this liability is $10.48M plus contributions tax of $1.85M, a total of $12.32M payable on 1 July 2013.

At 30 June 2012 Council recognised the $12.32M as an employee expense in the Income Statement and as a non-current liability in the Balance Sheet. The non-current status of the debt is based on referring a decision on the payment options of the $12.32M to the new Council.

Council also recognised the need to minimise the impact of future calls by allocating $800k per annum in the Strategic Resource Plan from 2013/14 year to be used specifically for the repayment of any unfunded liability amounts. The next actuarial review of the LASF fund will take place on 31st December 2014.

**BACKGROUND**

**Unfunded Liability as at 31 December 2011**

The latest Call (related to the actuarial review as at 31 December 2011) is made up of several components (listed in *Table 1 Defined Benefits Call Components*):

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Table 1: Defined Benefits Call Components

<table>
<thead>
<tr>
<th>Components</th>
<th>Monash City Council</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unfunded Pension Liability</td>
<td>$2,096,614</td>
</tr>
<tr>
<td>Pre 30 June 1993 Service (active members)</td>
<td>$2,222,074</td>
</tr>
<tr>
<td>Post 30 June 1993 Service (active members)</td>
<td>$6,152,952</td>
</tr>
<tr>
<td>Unfunded Liability (pre tax)</td>
<td>$10,471,639</td>
</tr>
<tr>
<td>Contribution Tax</td>
<td>$1,847,937</td>
</tr>
<tr>
<td>Unfunded Liability (incl. tax)</td>
<td>$12,319,576</td>
</tr>
</tbody>
</table>

**Pre 30 June 1993 Component:**
- Unfunded lifetime pension liabilities, apportioned on the basis of each Authority’s share of the Plan’s total defined benefit salaries as at 30 June 1993 (The scheme was closed by the State Government in 1993).
- Unfunded liability for active members’ pre 30 June 1993 apportioned the same way.

**Post 30 June 1993 component:**
- Unfunded liability for active members post 30 June 1993 apportioned to each Authority’s share of the Plan’s total defined benefits salaries at 31 December 2011.

**DISCUSSION**

Although the payment is due on 1 July 2013 the recommendation is to pay the liability early to take advantage of a discounted rate. This figure is based on using cash reserves and savings to pay the $12.32M liability at a discount rate of 7.5% (the equivalent earning rate of the fund) and to replenish those reserves via a contribution of savings, borrowings and fee and rate increases. The pay early discount figures are listed in the following table:

Table 3: Early Repayment Schedule

<table>
<thead>
<tr>
<th>EARLY REPAYMENT SCHEDULE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment Date</td>
</tr>
<tr>
<td>Total Liability (Excl. Tax)</td>
</tr>
<tr>
<td>Contribution Tax</td>
</tr>
<tr>
<td>Total Liability (Incl. Tax)</td>
</tr>
</tbody>
</table>
Financial Risk

Financial performance reporting by Councils is monitored by the Victorian Auditor General's Office (VAGO) which monitors local government financial management. The financial indicators used provide insights into the financial sustainability of Councils. The two key indicators of high risk of short-term and immediate sustainability concerns are indicated by either:

- **red underlying result indicator** – Councils that do not generate enough revenue to cover operating costs (including the cost of replacing assets reflected in depreciation expense)—underlying result, or
- **red liquidity indicator** - having sufficient working capital to meet short-term commitments—liquidity.

In 2011/12 Monash Council recorded a medium level of risk with regards to its underlying deficit position, however it has shown a trend moving toward a positive underlying surplus position. Liquidity, measuring the ability to pay existing liabilities in the next 12 months, has always been positive, however the reduction in cash reserves below the budgeted position, will cause a red liquidity indicator as it not proposed to access loan funds until the new financial year and after the budget deliberations on the funding mix.

Another risk Council may face is the likelihood of further calls while servicing the debt related to the current liability. If Council decides to accept a longer-term option to pay (e.g. in excess of 5 years) it may be faced with debt servicing on multiple calls.

**POLICY IMPLICATIONS**

A decision to pay the LASF Defined Benefit shortfall to take advantage of the discount is outside the current budget and requires Council approval to pay in this financial year.

**FINANCIAL IMPLICATIONS**

Paying early, utilising cash reserves, will impact interest earnings in the current financial year, however this will be offset by the discount received on paying the LASF liability in February 2013. This will likely cause a negative liquidity ratio as at 30 June 2013, however this will be addressed as part of the funding options considered during the 2013/14 Budget process.

**CONCLUSION**

To take advantage of the discounted figure Council can resolve to pay the unfunded superannuation liability of $12,319,576 by 1 February 2013. Consideration of funding methodology, through a mix of savings (indicative $500K), borrowings, fee and rate increases can be referred to the 2013/14 Budget process. In so doing, Council recognises that liquidity and financial ratios may be impacted.