APPENDIX L

STATEMENT OF RISKS

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Economic Risks

The ACT economy remains resilient. In the face of the challenges posed by the Commonwealth Government's spending cuts and downsizing of the Australian Public Service, the ACT economy, as measured by State Final Demand (SFD), grew by 1.9 per cent in the 2014 calendar year. This is despite a slight fall in employment and a net interstate migration outflow. Expected improvements in investment and expenditure in the second half of 2014-15 lifts the forecast SFD growth to 2¼ per cent for the full financial year.

Although the Commonwealth job cuts appear to have abated, the ACT economic growth forecasts face the risk of lower-than-expected Commonwealth Government spending. A further risk is Commonwealth Government wage restraint, which will affect income and associated household spending growth in the Territory. Other potential risks to the ACT economic outlook are slower-than-anticipated population, employment and price growth in 2015-16.

Business and consumer confidence is expected to improve with the economy; however, there is a risk that it may not recover as quickly as expected.

Partly offsetting these risks are the Commonwealth's *Jobs and Small Business Package* and *Families Package*, low interest rates and the ACT Government's positive fiscal settings which are expected to help boost the ACT economy.

Fiscal Risks

There are a number of other risks that may impact on the Territory's finances; these are described below:

Loose-fill Asbestos Insulation Eradication Scheme

The Government has commenced a scheme to buy back, demolish and remediate all homes in the ACT affected by loose-fill asbestos insulation. The financial impacts of the Asbestos Eradication Scheme (the Scheme) have been modelled using a range of assumptions together with the best estimates available.

Both the timing and quantum of financial impacts associated with the Scheme are subject to uncertainty. Scheme opt in rates, house purchase prices, industry capacity to undertake demolition and remediation, and the actual complexity of the demolition and remediation required present risks to the Budget.

The timing of land sales following demolition and remediation may also impact on the Land Release Program, and the timing of dividend payments from the Land Development Agency.

The National Disability Insurance Scheme

Under the arrangements agreed with the previous Commonwealth Government, the National Disability Insurance Scheme (NDIS) trial (previously referred to as the NDIS launch) in the ACT commenced on 1 July 2014. The trial will run for three years, before transitioning in 2017-18 and 2018-19, with the full Scheme commencing in 2019-20.

The Commonwealth Government is currently in bilateral discussions with States and Territories regarding the distribution of cash and in-kind services provided during the trial. It is anticipated that these bilateral negotiations will be completed and outcomes announced by the end of August 2015.

The ACT and the Commonwealth continue to monitor client transitions into the NDIS and associated funding transfers. At the end of the trial period, an adjustment will be made if either party has contributed more than their expected share of the funding for the Scheme.

The DisabilityCare Australia Fund is managed by the Commonwealth and has been established to administer the revenue collected through the increased Medicare Levy to support the NDIS. The fund was established to assist States and Territories with their contributions to the NDIS.

The 2015-16 Commonwealth Budget funding profile for the DisabilityCare Australia Fund presents a cash flow risk to the Territory as the bulk of the funding becomes available in 2017-18 after completion of the trial. Early access to a larger proportion of the Territory's share of funding from the DisabilityCare Australia Fund will be pursued through the bilateral negotiations with the Commonwealth to be concluded in August 2015.

Land Release Program

The pace at which the ACT economy recovers from the Commonwealth's fiscal consolidation contributes to risk around the capacity of the ACT residential property market to grow and therefore to purchase all sites released at the prices currently forecast. Lower than expected demand or revenue would, through the ACT Government's Land Release program, reduce the Land Development Agency's dividend and the Government's net operating balance. Other risks to the program include achieving statutory clearances, the capacity of industry to deliver infrastructure and estate works, and the capacity of the market to absorb the additional supply offered through the Asset Recycling Initiative.

Commonwealth Government Funding

Goods and Services Tax

As the Goods and Services Tax (GST) is a broad based consumption tax, GST revenue collections are subject to consumer confidence and the state of the economy at the national level. Changes in these factors can lead to variations in the size and growth of the national GST pool and hence, funding provided to the States.

GST revenue grants to the ACT are also subject to annual revisions of State and Territory GST relativities by the Commonwealth Grants Commission (CGC). The CGC is expected to release its *2016 Update Report on GST Revenue Sharing Relativities* in late February 2016, recommending changes to relativities for 2016-17. There is potential for a change in the ACT's share of the GST pool from the outcomes of the Update Report.

Specific Purpose Payments

The Commonwealth's approach to health and education funding in its 2015-16 Budget continues to undermine the stability and certainty of the Specific Purpose Payments (SPPs) which had previously been assured by the Intergovernmental Agreement on Federal Financial Relations (IGA FFR). This significantly raises the level of risk to State and Territory budgets. The 2015-16 Commonwealth Budget confirmed the Commonwealth Government's decisions to cap SPP funding in health and education, and to apply indexation based on the Consumer Price Index and population growth. There is a major risk that such payments will not keep pace with future increases in cost and demand. As a result, there will be greater pressure on future ACT budgets to implement measures to control costs and to manage demand for these services.

National Partnership Payments

The Commonwealth's decision to allow a number of National Partnership Agreements (NPAs) to expire in its 2015-16 Budget have had a negative impact on the capacity of the ACT to deliver services. There are also a number of NPAs where funding for all or some of the years beyond 2015-16 is to be negotiated, or where the Commonwealth will consider further funding as part of the White Paper on *Reform of the Federation*. The short-term nature of National Partnership Payment funding arrangements, and the uncertainty of the Commonwealth's commitment to ongoing funding, pose ongoing risks for the ACT Budget and services.

Funding and outlays related to expiring agreements have not been included in the ACT Budget past their current expiry dates, except where the Commonwealth has made ongoing provision for funding in the Federal Budget.

Government Investments and Borrowings

Investment Returns and Borrowing Costs

The Budget is susceptible to the performance of global financial markets and changes in interest rates. Investment returns below those estimated will have a negative impact on revenues and, in respect of the Superannuation Provision Account, may impact on the Government's fiscal objective of fully funding the defined benefit superannuation liability by 2030. Higher interest rates will result in higher borrowing costs for new borrowings. Conversely, higher than expected returns would have a positive impact on investment returns and lower than expected interest rates would reduce borrowing costs.

Defined Benefit Employer Superannuation Liabilities

The value of accrued superannuation liabilities is calculated as the present value of the future payment of benefits that have actually accrued in respect of service at the calculation date. Due to the complex nature of this liability, small variations to the long-term financial or demographic assumptions can have a significant effect on the accrued liability valuation estimate for the Territory. The valuation of the liability is most sensitive to the discount rate (referenced to a long-term Commonwealth bond rate), inflation, wages growth, rates of retirement and resignation, investment returns, benefit stream election and mortality rates.

Other Commitments

Contingent Liabilities

Contingent liabilities are liabilities resulting from uncertain timing or amounts. They arise from past events which are not recognised because their outflow of economic benefit is not probable or the liability cannot be measured reliably. Contingent liabilities can also occur when a liability is contingent on the outcome of an event outside the Territory's control, such as the outcome of a court case.

Under the *Financial Management Act 1996*, it is the responsibility of the Government to identify contingent liabilities that may affect the budget estimates.

The types of claims lodged against the Territory include property damage, contract disputes, economic loss, personal injury and tax-related claims. Details of the Territory's contingent liabilities are identified in the Australian Capital Territory Consolidated Annual Financial Statements, which are available online.

Outstanding Insurance Claims Liability

The value of insurance liabilities is the present value of the future claim payments that have accrued at the calculation date. This approach is required under Australian Accounting Standard AASB1023 *General Insurance Contracts*.

Accounting for insurance claims is complex and actuarial assumptions are required to estimate the ACT Insurance Authority's obligations and claims expense. There is uncertainty in the estimate of the liability and this can result in actuarial gains or losses when the claims experience differs from the estimates. The liabilities are discounted to allow for the time value of money as claims may be settled many years after the claim is incurred.

Sensitivity to Discount Rate

The outstanding claims liability is calculated by reference to expected future payments. These payments are discounted to adjust for the time value of money. Australian Accounting Standard AASB1023 *General Insurance Contracts* requires the outstanding claims liabilities to be valued using a 'risk free' rate of return, generally accepted to be the discount rate derived from market yields on Commonwealth Government Bonds. The discount rates adopted match the weighted term to maturity of insurance claims. The long-term nature of the projected cashflows from the liability mean that small changes in the discount rate adopted can lead to significant variations in the liability valuations and the claims expense.

The outstanding claims provision as at 31 December 2014 was $259.769 million net of Reinsurance Recoveries. Variations in the discount rate of plus or minus one percentage point results in an estimated change to the liability of between a $12 million decrease and a $12.8 million increase, equivalent to a change of between -4.6 per cent and 4.9 per cent.