Australian Capital Territory Government

# Management Discussion and Analysis
# For the Financial Year Ended 30 June 2014

The 2013-14 Management Discussion and Analysis represents the consolidated ACT Government's Total Territory financial results.

**Risk Management**

The Commonwealth Government's fiscal restraint and downsizing presents the highest risk for the Territory. The full extent of this restraint and downsizing is yet to be realised by the ACT economy and its fiscal results.

The Territory also experiences revenue raising disadvantages as a significant part of economic activity in the Territory is generated by the Commonwealth. Commonwealth Government employment is exempt from payroll tax. The Territory also has small scale manufacturing and wholesale trades. While the Territory does receive compensation through the Commonwealth Grants Commission, it has limitations to raise its own revenue.

The Territory has a moderate private employment base in the education and small scale manufacturing sectors, and wholesale trade. Employment in agricultural and mining industries, important contributors to the diversity and growth in other jurisdictions' payroll tax bases, is small in the Territory.

The ACT Government is currently investigating options in relation to loose fill (Mr Fluffy) asbestos in homes. The Territory is in negotiation with the Commonwealth regarding an enduring solution in relation to this issue.

**Economic**

The State Final Demand result for the ACT for 2013-14 was 0.13 per cent. This was the lowest annual growth rate in 25 years, and is considerably below the long-run average growth of 4.3 per cent over this period.

A key reason for this is the reduction in spending by the Commonwealth Government. Private investment also weakened, driven by a significant drop in business investment and dwelling construction as major building works approached completion. Household consumption did grow, albeit at half the rate it did in 2012-13.

Employment growth had a marginal increase of 0.6 per cent in 2013-14, driven wholly by gains in part time employment. There was a significant decrease in full-time employment in the Commonwealth Government Australian Public Service and in the construction and related industries.

The ACT unemployment rate remained relatively low throughout 2013-14 because of a sharp decline in the participation rate, which meant that people chose to exit the workforce rather than seek alternative employment.

ACT Population growth also slowed, driven by a net outflow in interstate migration which is consistent with the reduction in employment opportunities.

Much of this experience was anticipated in the 2014-15 Budget.

Australian Capital Territory Government

# Management Discussion and Analysis

## For the Financial Year Ended 30 June 2014

**Economic Outlook 2014-15**

Commonwealth Government fiscal restraint and downsizing remain the key down-side risks to the Territory's economic outlook.

The Territory's economic growth in 2014-15 is expected to remain constrained as a result of Commonwealth Government spending cuts and the impact of reduced real wages and weak employment growth on household consumption into 2014-15.

Despite these challenges, a number of positives will continue to support economic growth in 2014-15. A low interest rate environment will help to balance the fiscal pressures from the Commonwealth Government, and investment in the pipeline appears to have stabilised. This is supported by the ACT Government's taxation reform agenda and economic stimulus initiatives. In addition, the ACT Government's own infrastructure and capital program will help to support growth throughout 2014-15.

**Administrative Changes**

The Capital Metro Agency was created in 2013-14 for the initial design of light rail between Gungahlin and the City. The Capital Metro Agency is a General Government Sector agency for the Territory's reporting purposes.

**Highlights**

The UPF Net Operating Balance for the Total Territory is a deficit of $309 million which is lower than the Budget deficit of $438 million and the 2012-13 deficit of $456 million.

The improvement in the UPF Net Operating Balance compared to 2012-13 arose from an increase in Commonwealth Grants revenue, taxation revenue and increased dividend and distribution revenue. This was partially offset by a decrease in revenue from joint ventures.

Total expenditure increased by $69 million compared to 2012-13. This was largely the result of increased employee expenses and interest expense partially offset by decreased other operating expenditure.

Net Worth declined principally due to an increase in the valuation of superannuation liability, although this was partially offset by higher investments.

The Total Territory's Net Debt increased by $306 million compared to the 30 June 2013 outcome of $1,311 million. This was mainly due to increased borrowings undertaken. Net Financial Liabilities were also higher by $810 million compared to the 30 June 2013 result of $6,250 million predominantly due to an increase in the superannuation liability.

**Total Territory**

**Financial Performance**

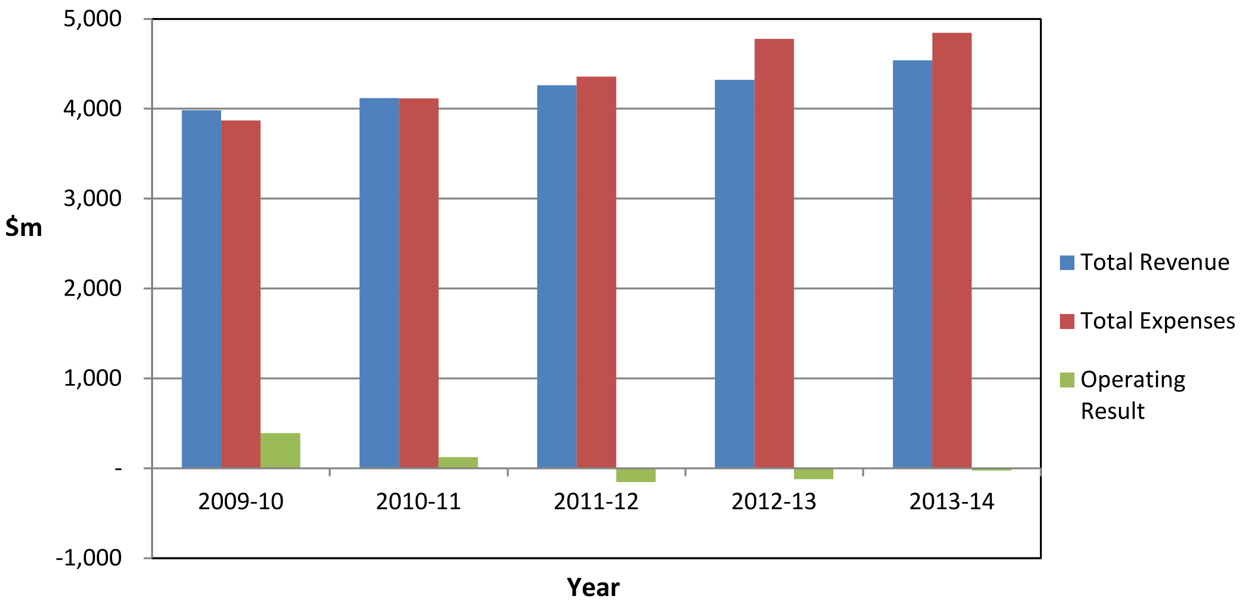
Table 1.1 shows the Territory has a Uniform Presentation Framework (UPF) Operating Result deficit of $309 million for 2013-14, which is an improvement of $129 million from the annual budget deficit of $438 million and $147 million from the previous year deficit of $456 million. Major variations in total revenue, expenses and economic inflows/(outflows) are explained below.

**Table 1.1**
**Total Territory - Operating Result**

| | 2013-14 Actual $m | 2013-14 Annual Budget $m | 2012-13 Actual $m |
|---|---|---|---|
| Total Revenue | 4,538 | 4,432 | 4,321 |
| Total Expenses | 4,846 | 4,870 | 4,777 |
| **UPF Net Operating Balance** | **-309** | **-438** | **-456** |
| Economic Inflows/(Outflows) | 282 | 303 | 334 |
| **Operating Result** | **-26** | **-134** | **-122** |

As shown below in Chart 1.1, total expenditure has exceeded total revenue for the past three financial years.

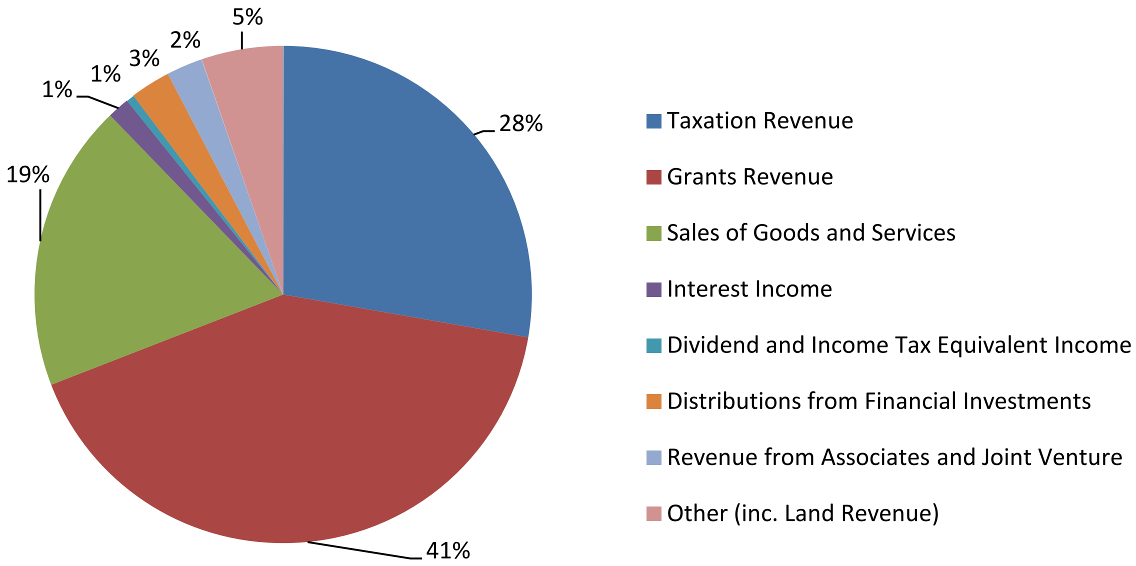
**Chart 1.1**
**Total Territory - Operating Result**



**Revenue**

Total revenue for the 2013-14 financial year was $4,538 million. As demonstrated below in Chart 1.2, the majority of the Territory's revenue is from Commonwealth Government grants (41 per cent) followed by taxation (28 per cent).

**Chart 1.2**
**Total Territory - Revenue Sources**




Total revenue was $106 million higher than the annual budget of $4,432 million mainly due to:

- the higher than anticipated Dividends and Distributions from Financial Investments of $59 million largely as a result of higher levels of underlying agency investment balances;
- higher than estimated Commonwealth Grants of $47 million associated with the timing of Commonwealth Grants to the ACT Government for the Majura Parkway Project; and
- higher Other Revenue of $26 million mainly due to the recoupment of GST input tax credits for Housing ACT that were overpaid in prior years. In addition, ACTEW Corporation received an insurance recovery due to flood damage at the Enlarged Cotter Dam.

Total revenue increased by $216 million compared to the 2012-13 financial year result of $4,321 million. The main drivers for this were:

• increased Taxation Revenue of $59 million largely due to indexation of General Rates revenue. The rate of indexation reflects the ACT Government's taxation reforms which phase out conveyance duty and replace this revenue with General Rates;

• higher Commonwealth Grants revenue of $126 million associated with an increase in the National Specific Purpose and Reform Grants mainly due to higher payments received under the National Health Reform Agreement and the National Education Reform Agreement and higher GST revenue;

• higher Distributions from Financial Investments of $45 million mainly due to the divestment of private equity investments and large distributions received from currency-hedged pooled unit trust investments on the Territory's superannuation investments; and

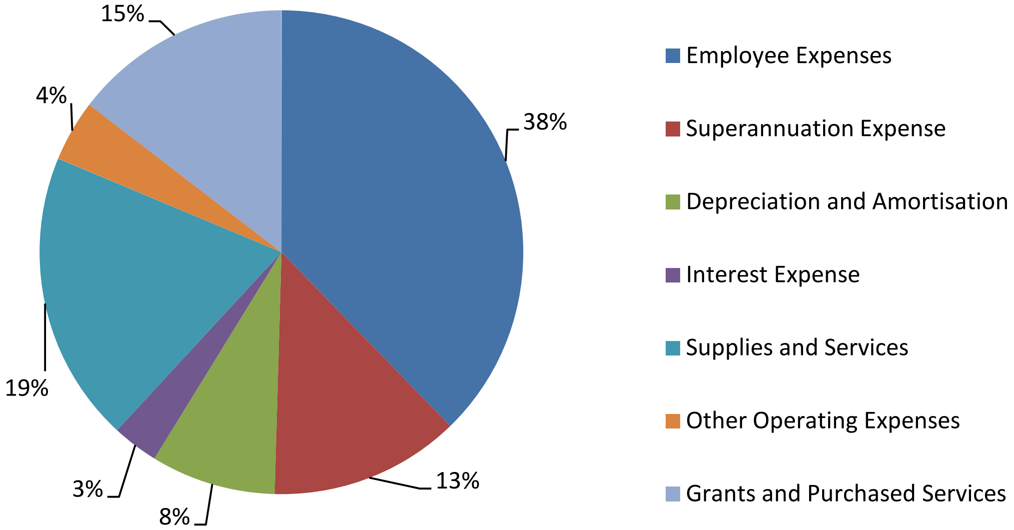
• increased Other Revenue of $30 million mainly due to the receipt of a GST windfall gain following a review into public housing operations. In addition there was an increase in income and lease revenue held by ACTEW Corporation.

The increase in total revenue was partially offset by a decrease of $42 million in revenue from Joint Ventures mainly due to decreased land sales, the sale of the Land Development Agency's share in the Woden East Joint Venture to Hindmarsh in 2012-13 and ActewAGL Joint Ventures sale of the water and sewerage business in 2012-13.

**Expenses**

As shown below in Chart 1.3, the majority of the Territory's expenses are employee expenses (38 per cent). Total expenses for the 2013-14 financial year was $4,846 million.

**Chart 1.3**
**Total Territory - Areas of Expenditure**




Total expenses of $4,846 million were $24 million lower than the budget forecast of $4,870 million. This was mainly due to lower than anticipated supplies and services expenses associated with capitalisation of expenses for the Constitution Avenue project.

Total expenses increased compared to the 2012-13 financial year by $69 million from $4,777 million mainly as a result of an increase in:

• employee expenses of $85 million largely due to growth in staff and service activity associated with the implementation of new budget initiatives and wage increases in line with Enterprise Bargaining Agreements; and

• interest expense of $27 million mainly due to increased borrowings, as budgeted to fund the Territory's Infrastructure Program.

The increase in expenses was partially offset by a decrease in other operating expenses of $52 million. This was mainly due to decreased cost of land sold expenses associated with lower demand for land in addition to ACTEW Corporation's sale of the water and sewerage business in 2012-13.

**Economic Inflows/(Outflows)**

The total operating result, which includes the economic inflows/(outflows) for the 2013-14 financial year was a deficit of $26 million, which is $95 million lower than the 2012-13 deficit of $122 million. This is due to the impacts on the UPF Net Operating Balance as discussed above in addition to a decrease of $51 million in Net Losses on the Sale of Non-Financial Assets as a result of changes in the rates used to value insurance claim expenses, long service leave and annual leave employee benefit liabilities. In 2013-14 the rate used to value long service leave related liabilities increased to 103.5 per cent from 101.3 per cent in 2012-13. The rate used to value annual leave liabilities also increased from 100 per cent in 2012-13 to 100.9 per cent.

**Financial Position**

**Table 2.1**
**Total Territory - Financial Position**

| | 2013-14 Actual $m | 2013-14 Annual Budget $m | 2012-13 Actual $m |
|---|---|---|---|
| Financial Assets | 5,701 | 4,930 | 5,378 |
| Non-Financial Assets | 21,619 | 21,838 | 21,188 |
| Total Assets | 27,320 | 26,768 | 26,567 |
| Total Liabilities | 12,127 | 10,139 | 11,019 |
| **Net Assets** | **15,193** | **16,629** | **15,550** |
| **Net Financial Liabilities** | **7,060** | **5,851** | **6,250** |
| **Net Debt (excluding Superannuation related Investments)** | **1,617** | **2,208** | **1,311** |

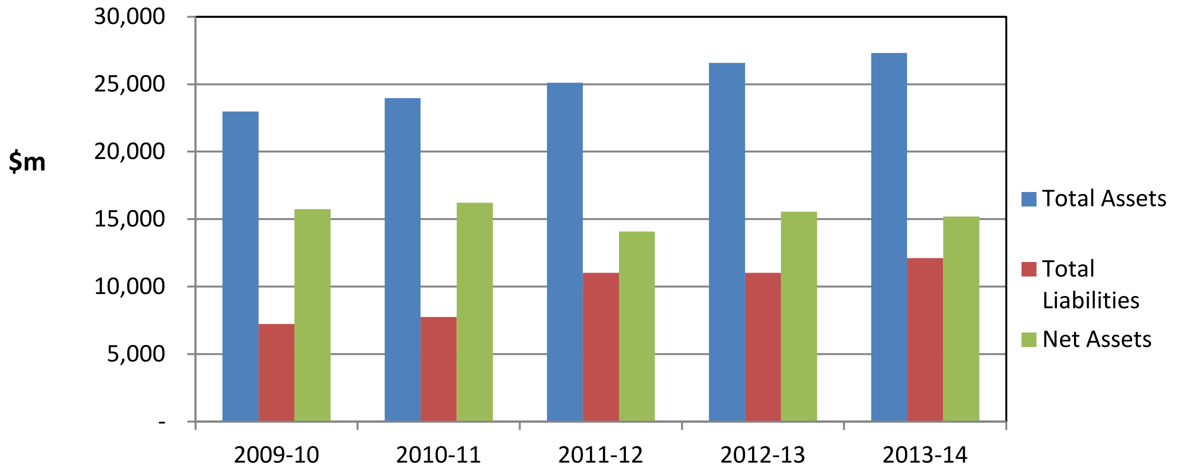
The value of Net Assets at 30 June 2014 was lower than the 2013-14 budget estimate of $16,629 million by $1,436 million and was $357 million lower than the previous year of $15,550 million. Major variances in total assets and liabilities are explained below.

Net Financial Liabilities as at 30 June 2014 were $7,060 million, $810 million higher than the 30 June 2013 result of $6,250 million. This variance is mainly due to an increase in the superannuation liability driven by a change in the valuation rate from 4.29 per cent at 30 June 2013 to 4.08 per cent at 30 June 2014.

Net Debt, excluding superannuation investments, was $1,617 million, an increase of $306 million from the 30 June 2013 result of $1,311 million. This variance is mainly due to an increase in borrowings to fund the Government's capital investment program.

Chart 2.1 below demonstrates the Territory's strong Balance Sheet over time.

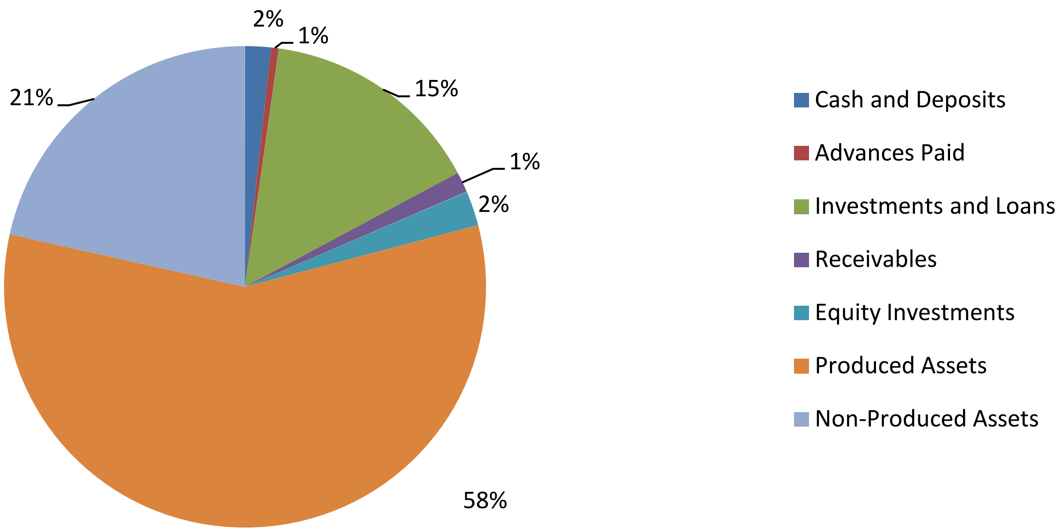
**Chart 2.1**
**Total Territory - Balance Sheet**



## Assets

Total assets for the 2013-14 financial year were $27,320 million. As can be seen from Chart 2.2 below, the majority of the Territory's assets are produced assets, specifically property, plant and equipment (58 per cent).

**Chart 2.2**
**Total Territory - Asset Types**



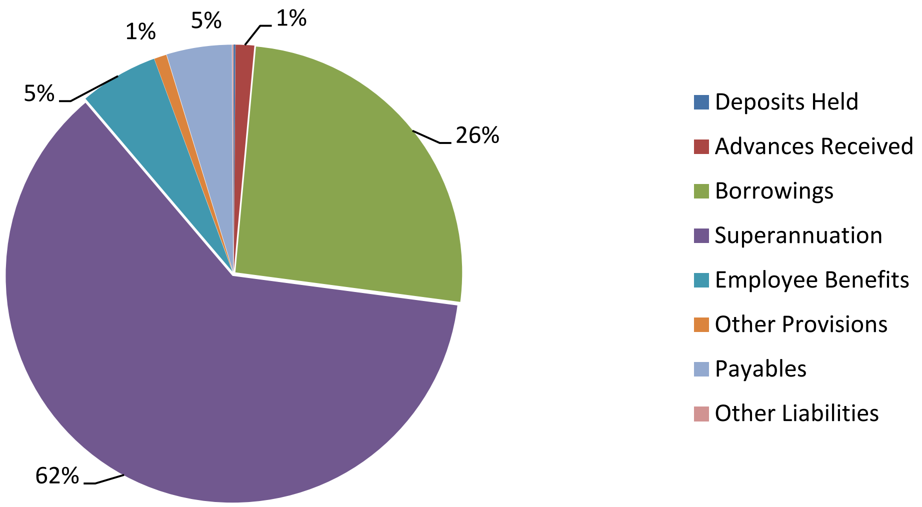

Total assets were $552 million higher than the annual budget of $26,768 million mainly due to an increase of $708 million in investments and loans as a result of a higher than anticipated level of funds held in investments with the Territory Banking Account and higher than anticipated value of investments held by the Superannuation Provision Account due to strong global market investment returns.

Total assets increased compared to the 2012-13 financial year by $753 million from $26,567 million mainly as a result of higher interest earnings achieved by the Territory's Investment Managers as a result of strong returns on global share markets which increased the investment portfolio return of the Superannuation Provision Account and a higher value of property, plant and equipment.

**Liabilities**

Total Liabilities for the 2013-14 financial year were $12,127 million. As can be seen from Chart 2.3 below, the majority of the Territory's liabilities are related to superannuation (62 per cent).

**Chart 2.3**
**Total Territory - Liability Types**




Total liabilities were $1,988 million higher than the budget of $10,139 million. This was mainly due to higher than budgeted superannuation liability of $2,110 million as a result of the discount rate of 4.08 per cent used to value the liability at 30 June 2014, compared to the long term budget discount rate assumption of 6 per cent.

Total liabilities increased by $1,108 million compared to the 2012-13 financial year result of $11,019 million. This was mainly due to an increase in superannuation liability of $696 million as a result of the decrease in the present value factor used to value the liability from 4.29 per cent in 2012-13 to 4.08 per cent in 2013-14. This is in addition to an overall increase in borrowings of $341 million for the Territory to fund the Territory's Infrastructure Program.

While the unfunded superannuation position is material, the defined benefit schemes (CSS and PSS) to which the liability relates are closed to new members. Since 1 July 2005, all new employees that do not have an existing CSS or PSS membership, are members of an accumulation superannuation fund that requires the Territory to fund the accruing superannuation liability as it accrued by employer contributions to the relevant superannuation scheme.

In relation to the unfunded liability, a key financial objective of the ACT Government is to extinguish these liabilities by accumulating funds in the Superannuation Provision Account which are sourced from both annual budget appropriation and investment earnings. In their most recent credit rating review of the Territory, Standard and Poor's said "We consider the government's plan to extinguish the liability by 2030 as credible, and therefore, the liability does not affect the ACT's already moderate debt burden".

**Cash Flows**

**Table 3.1**
**Total Territory - Cash Flow Position**

| | 2013-14 Actual $m | 2013-14 Annual Budget $m | 2012-13 Actual $m |
|---|---|---|---|
| Net Cash Flows from Operating Activities | 443 | 189 | 182 |
| Net Cash Flows from Investments in Non-Financial Assets | -621 | -843 | -789 |
| **Cash Surplus (+) / Deficit (-)** | **-178** | **-654** | **-607** |

Net Cash Flows from Operating Activities were $443 million which is $254 million more than the 2013-14 Budget of $189 million and $261 million more than 2012-13 outcome of $182 million. This is mainly due to the settlement of health cross border activities with NSW and the increase in Commonwealth Grants discussed above.

Net Cash Flows from Investments in Non-Financial Assets was $222 million less than the 2013-14 Budget of ($843) million and $168 million less than 2012-13 outcome of ($789) million. The decrease is largely attributed to the completion of major capital works including the Enlarged Cotter Dam, Community Health Centres, the Canberra Region Cancer Centre, the Centenary Hospital for Women and Children and the Canberra Hospital Emergency Department.

As a result, the Cash Surplus / Deficit was $476 million less than the 2013-14 Budget of ($654) million and $429 million less than 2012-13 outcome of ($607) million.

**Infrastructure Investment**

**Table 4.1**
**Total Territory - Infrastructure Investment**

| | 2013-14 Actual $m | 2013-14 Annual Budget $m | 2012-13 Actual $m |
|---|---|---|---|
| Infrastructure Investment | 510,218 | 695,650 | 578,774 |

The 2013-14 whole of government infrastructure investment for the Territory was $510 million. This was $185 million less than the 2013-14 Budget of $696 million and $69 million less than the 2012-13 infrastructure investment of $579 million.

Major infrastructure investment during 2013-14 included:
- Transport for Canberra – Majura Parkway – $288 million
- John Gorton Drive Extension to Molonglo 2 and Group Centre – $65 million
- Constitution Avenue – $42 million
- Clinical Services and Inpatient Unit Design and Infrastructure Expansion – $41 million

Major infrastructure physically completed during 2013-14 included:
- Women and Children's Hospital – $111 million
- Enhanced Community Health Centre – Belconnen – $51 million
- Bonner Primary School – $46 million
- Gungahlin Pool – $26 million
- ESA Station Upgrade and Relocation – Charnwood Station – $16 million