APPENDIX C

STATEMENT OF RISK

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Economic Risks

Commonwealth Government fiscal restraint and downsizing remains the key down-side risk for the Territory's economic outlook. The economic forecasts face the risk of lower-than-expected Commonwealth Government spending, Australian Public Service (APS) job cuts and the possibility of protracted APS wage negotiations that could see a delay in wage increases.

The 2014-15 Commonwealth Budget is expected to suppress economic growth in the short-to-medium term, largely as a result of cuts to spending and jobs in federal government departments in the ACT. The 'budget repair strategy' is anticipated to have a disproportionally large impact on the ACT economy as public consumption and investment are significant components of economic growth.

The Australian economy continues to face global risks tilted towards the downside, which could have a significant impact on domestic economic growth, employment and income. Challenges faced by the global economy include the exit of a low inflationary environment in the Euro area alongside geopolitical uncertainty in the Ukraine and Thailand, slower than expected growth in Asia – specifically in Japan and China – and the gradual tapering of quantitative easing in the United States. Any changes to global economic conditions will affect the ACT through financial, trade, tourism and confidence channels.

The accommodative monetary policy stance taken by the Reserve Bank of Australia is expected to support domestic economic growth as the economy transitions to more balanced growth; however, the risk of a larger-than-expected fall in mining investment remains. The elevated Australian dollar continues to have an adverse impact on certain areas of the economy, which could limit job growth particularly in the manufacturing industry. Furthermore, with the release of the Commonwealth Government Budget, lower consumer confidence is expected to place downward pressure on economic growth.

Fiscal Risks

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

The National Disability Insurance Scheme (NDIS)

Under the arrangements agreed with the previous Commonwealth government, the NDIS trial (previously referred to as the NDIS launch) in the ACT will commence on 1 July 2014 and run for three years, before transitioning to a full rollout site in 2017-18 and 2018-19, with the full scheme commencing in 2019-20.

During the trial and transition periods the ACT's share of the NDIS costs will be 59.4 per cent and will reduce to 49 per cent with the commencement of the full scheme from 2019-20. The Commonwealth Government is yet to commit to this timetable. The Commonwealth Commission of Audit has recommended that the phasing be slowed down. The ACT's share of the costs will be at a higher level for a longer period, if the recommendation is implemented.

A slower phasing would also impact negatively on the ACT in delaying the offsetting impact of increased GST payments which the ACT is expected to receive on full implementation of NDIS. In addition, slower phasing would increase uncertainty about the amounts and timing of draw-downs which the ACT will be able to make from the Medicare Levy surcharge.

According to the 2014-15 Commonwealth Budget papers, there is a reduction of about $2 million per year in the National Disability SPP. It is expected that the finalisation of National Partnership on transitioning responsibilities for aged care and disability services will reduce the funding shortfall. However, should this not eventuate and the reduction is confirmed, it will negatively impact on the capability of the current service delivery system.

Land Release Program

The uncertainty created by the Commonwealth Government's continued fiscal consolidation creates risk around the capacity of the market to purchase all sites released at the prices currently forecast in the 2014-15 Budget. Lower than expected demand or revenue would negatively impact on the Land Development Agency's dividend and the Government's net operating balance. Other risks to the program include achieving statutory clearances and the capacity of industry to deliver infrastructure and estate works.

Commonwealth Government Funding

GST

As the 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 of the funding for the States.

In the 2014-15 Federal Budget the Commonwealth revised its 2013-14 and forward year projections for GST revenue collections. Estimated GST collections were increased substantially over the Commonwealth's forecasts in the MYEFO, rising by $4.5 billion over four years. However, the Commonwealth also revised down its forecast of the ACT's population growth, so that the ACT's share of the national population is now forecast to be static over the Budget out years. There is some risk that the ACT's population share may actually decline over this period, with consequent negative effects on its GST share, as well as on other payments which are distributed on the basis of population share.

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 *2015 Methodology Review on GST Revenue Sharing Relativities* (the Review) in late February 2015, recommending changes to relativities for 2015-16 and determining the methodology to be used in assessing each State's relativity for the next 5 years. The outcomes of the Review present a potential longer term risk to the ACT's share of the GST pool.

Specific Purpose Payments (SPPs)

Under the 2008 *Intergovernmental Agreement on Federal Financial Relations (IGA FFR)*, the National Skills and Workforce Development SPP and National Affordable Housing SPP will transition to a full equal per capita (population share) distribution by July 2014.

In the 2014-15 Federal Budget the Commonwealth has made significant unilateral changes to the NSPPs for Health and Education. The Commonwealth's approach has undermined the stability and certainty of the Specific Purpose Payments which had previously been assured by the IGA FFR, significantly raising the level of risk to State and Territory budgets.

The decisions to cap SPP funding in Health and Education, and to apply indexation based on the CPI and population growth, create a major risk that Commonwealth SPP 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.

The Commonwealth is also undertaking reviews of policy in relation to Housing and Homelessness during 2014, with potential impact on future payments which are currently received through the Affordable Housing SPP.

National Partnership Payments (NPPs)

Decisions by the Commonwealth in the 2014-15 Federal Budget to allow a number of National Partnership Agreements (NPAs) to expire, and to terminate some others in advance of their scheduled expiry dates, have had a negative impact on the capacity of the ACT to deliver services. While the rationalisation program has substantially reduced the number of continuing NPAs, with consequent reduced risk to the ACT's funding in the medium term, there remains risk in the short-term nature of these funding arrangements and the uncertainty of Commonwealth commitment to ongoing funding.

The 2014-15 Budget contains a provision for involvement in the new Asset Recycling NPA. As this NPA involves a capped funding pool to be allocated to States and Territories on a first-come, first-served basis, there are risks to the ACT's potential to participate in the initiative from delays in bringing forward asset sale proposals.

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.

Other Payments

The ACT was also negatively affected by the Commonwealth's decision in the Federal Budget to freeze Financial Assistance Grants to local government for three years from 2014-15. This means a decline in the real value of the payments and resumption of indexation from a substantially lower base than would otherwise have been the case. Should the Commonwealth Government extend this indexation freeze, this would have further negative impacts on the ACT.

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 SPA, 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.

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 nature of this liability, small variations to the financial or demographic assumptions can lead to large impacts on the accrued liability estimate for the Territory. The liabilities are most sensitive to inflation, the discount rate (long-term Commonwealth bond rate), wages growth, rates of retirement and resignation, and the proportion of benefits taken in pension form.

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 FMA, 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 is 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 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, which are 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 2013 was $287.341 million net of Reinsurance Recoveries. A 1 percentage point variation in the discount rate results in an estimated change to the liability of approximately $13-14 million (actuarial gain or loss), equivalent to a 4.5 to 4.9 per cent change.