

## 1.5 STATEMENT OF RISK

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This statement of risks is made in line with Section 11(d) of the *Financial Management Act 1996*.

The risks to Budget estimates are related to Economic Risk, Commonwealth Funding, General Government Borrowings and Investments, Superannuation Liabilities, Insurable Risk, Non-Government Sector Risk Initiatives, Contingent Liabilities and Operational Risk.

### **Economic Risk**

The ACT economy, while not immune to risk, tends to be insulated from many of the uncertainties faced by the national economy due to its significant public sector. The main risk factors for the ACT economy relate to changes in public sector expenditure and movements in interest rates.

#### *Public sector expenditure*

While Commonwealth Government expenditure per capita continues to be significantly higher in the Territory than in other jurisdictions, the growth rate of Commonwealth expenditure in the ACT has fallen below the national average. The possibility of the Territory receiving a smaller share of planned increases in Commonwealth Government expenditure in forward years constitutes a downside risk to future economic activity in the Territory.

#### *Interest Rates*

Changes in interest rates will impact on private consumption expenditure. If interest rates rise, households will need to devote more of their income to servicing the interest component of their outstanding mortgage and consumer debt, resulting in less disposable income for discretionary spending. The potential contractionary impact of interest rate rises is likely to be magnified by the recent growth in household debt.

A rise in interest rates is also likely to have a negative impact on investment, particularly private investment in dwellings. The residential construction sector has relatively high multiplier flow-on effects through the economy and, therefore, the negative impact on State Final Demand (SFD) of any downturn in this sector will be magnified.

#### *Risk to endogenous revenue*

Economic risk extends to the Territory tax revenue. Payroll Tax, Stamp Duty, Rates and Land Tax, are exposed to risk associated with employment levels and wages in the ACT, which are driven largely by expenditure in the public sector. A decline in Commonwealth public sector expenditure, particularly in the form of ACT based staffing levels would have an adverse affect on the value of property in the ACT, and the decline in the level of economic activity would be reflected in lower collections of Payroll Tax.

## **Commonwealth Funding**

Adverse economic conditions could result in moderating of Goods and Services Tax (GST) revenues, particularly as the GST is not imposed on a range of necessities, but rather on discretionary expenditure. Any deterioration would automatically place at risk the expected growth in additional funding to the States.

Similarly, a change of government at the federal level could reinvigorate the call for a major overhaul of fiscal equalisation by States receiving less than an equal per capita share of the GST (donor States). Any further attempt to destabilise the current distribution arrangements could pose some risk for the Territory.

## **General Government Borrowings and Investment**

Government borrowings and investments are exposed to 'market risk'. That is, they are exposed to an adverse variation in costs or returns resulting from a change in a market price or rate. The Territory is exposed to market risk mainly through its financial investments and, to a lesser extent, through its borrowings.

### *Financial Investments*

The Territory's general government financial investments are diversified across a number of asset classes including cash, short-term debt instruments (maturity less than 12 months), and fixed interest bonds (maturity greater than 12 months), each of which has its own unique risk/return characteristics. The diversification between these asset classes provides an efficient trade-off between returns and market risk. Changes in the fair market valuations of investments will have a direct impact on the current and future operating results of the Territory.

### *Borrowings*

Territory borrowings are presently accounted for on an historic cost basis and are typically held to maturity, or repaid on an amortising basis. Additionally, a large proportion of borrowings are held on a fixed interest rate basis. Accordingly, there is little if any significant market risk attributable to Territory borrowings.

### *Interest Rate Risk*

Interest rate risk is the exposure of the Territory's financial position to adverse movements in interest rates. Accepting this risk is a normal part of financial operations, however, excessive interest rate risk can pose a significant threat to the Territory's earnings and capital base.

The Territory is exposed to changes in interest rates, primarily due to its financing, investing and cash management activities, which include long and short-term borrowings.

## **Superannuation Liabilities**

The Territory's superannuation liabilities are sensitive to:

- the level of ACT public sector wages;
- changes in domestic and overseas share prices;

- demographic assumptions (e.g., life expectancy assumptions);
- financial assumptions (e.g., the assumed propensity for retiring members to opt for the indexed pension rather than the lump sum payment benefit); and
- forthcoming results from the current investigation of possible inconsistencies with the application of appropriate superannuation arrangements for Totalcare employees.

## **Contingent Liabilities**

Contingent liabilities are possible liabilities that arise from past events, and can only be confirmed by the incidence or non-occurrence of uncertain future events, which are not within the control of the entity.

Under the *Financial Management Act 1996*, it is the responsibility of the ACT Government to disclose its Contingent Liabilities as it relates to the presentation of financial statements in accordance with Accounting Standards (AASB 1044). This should be done by way of a note in the Financial Statements.

Due to the nature of the liabilities it is difficult to put an exact value on these claims. To this end, all claims made against the Territory have been assessed and where the decision is likely to favour the plaintiff, the amounts in dispute have been provided for as a liability.

Claims lodged against the Territory include property damage, contract disputes, economic loss, personal injury and tax related claims. Further details of the Territory's contingent liabilities is provided in the Australian Capital Territory Consolidated Annual Financial Statements for the 2002-03 financial year at: [www.treasury.act.gov.au](http://www.treasury.act.gov.au). The total contingent liabilities reported in the 2002-03 ACT Consolidated Financial Statements were \$109m.

## **Operational Risk**

### *Insurable Risk*

The Government has implemented an enterprise-wide risk management framework. The risk management framework is based on the Risk Management Standard (AS/NZS 4360:1999). This standard defines risk, provides guidelines on policies, strategies and procedures to manage it, and leads the user to assess both the positive and negative aspects of risk.

In respect of insurable losses, such as property, public liability and professional indemnity, each agency meets the cost of claims below the level of an agreed deductible or excess. The ACT Insurance Authority (ACTIA) purchases insurance to protect the Territory against large claims or losses, or a series of such events. Because of worldwide insurance events and the bushfires in January 2003, this protection is becoming increasingly difficult and expensive to purchase. As a result, ACTIA's self-insured retentions are being reviewed to ensure an appropriate balance between risk transferred and risk retained.

### *Non-Government Sector Risk Initiatives*

The Government has established new guidelines on public liability insurance for community groups using or occupying ACT Government property under the terms of written agreements.

The guidelines apply whether or not the Government funds the community group. The controlling and sole determinant with respect to the operation of these guidelines is the occupation of ACT Government property under the terms of a written agreement.

Governments throughout Australia have agreed to introduce professional standards legislation and proportionate liability for economic loss. This legislation will apply liability caps in exchange for risk management, designed to assist small businesses to understand and apply principles such as continuous service improvement. There will also be minimum appropriate levels of insurance.

### *Business and Integrity Risks*

The operation of government agencies and the provision of government services involves a range of business and integrity risks, including delivery failures, unforeseen costs and the possibility of fraud or corruption. Many of these may not be readily insurable, or effective risk management will mitigate the likely insurance cost.

The ACT Public Service Integrity Policy was launched on 18 March 2004. The key elements of the policy include:

- an integrity risk assessment to underpin Departmental Fraud and Corruption Plans;
- the importance of Departmental Audit Committees to provide independent opinion on integrity activities;
- the development of a Public Service Integrity Management Standard;
- regular and systematic assessment of potential areas for theft, fraud and corruption to ensure control procedures are being followed and are effective;
- the appointment of Senior Executives responsible for Business and Integrity risks; and
- the use of qualified investigators to undertake fraud investigations.

The Government Procurement Board has also proscribed appropriate risk management practices and the preparation of risk plans as part of the procurement planning requirements. This process identifies and provides for the reduction of the impact of those risks that are part of the procurement process. The procurement plans also require a probity plan to further ensure reduced risk.

### *Community Threats*

The impact of the January 2003 bushfire is still being felt. The insurance regime in place did provide some financial protection to the Territory and highlighted the importance of effective insurance arrangements. The emergency recovery arrangements in place provided immediate and on-going support to the community. The broader impact on individuals and the community will however continue for some time.

Considerable attention has been given to mitigating those risks, and other potential community threats, through acceptance of the recommendations of the McLeod Report and the strengthening of emergency service arrangements. The ongoing operation of the Emergency Management Committee, review of the Emergency Management Plan and the creation of the Emergency Services Authority are based around identifying, mitigating and effectively managing community threats and having effective recovery plans.

## *Corporations and Public Enterprises*

The Government is exposed to a range of financial and operational risks through its ownership of corporations and public enterprises.

The governing board are primarily responsible for identifying, monitoring and controlling risks that might affect their operations. There is also a broad range of prudential controls contained in the *Financial Management Act 1996* and the *Territory Owned Corporations Act 1990* and the enabling legislation of statutory authorities. In particular the accountability arrangements require regular reports be provided to the Government so that performance and any associated risks can be properly monitored and assessed.

Accountability arrangements are continually kept under review. In order to strengthen the existing accountability framework the Government has released several guidelines and has also recently agreed to the preparation of various legislative changes.

Two important documents that serve as a guide for the governance of ACT Government entities include the Internal Audit Framework and the Guiding Principles for Establishing and/or Reviewing ACT Government Entities.

The proposed legislative changes will require amendments to the *Financial Management Act 1996*, the *Territory Owned Corporations Act 1990* and the enabling legislation of various statutory authorities. Included in the legislative changes will be the requirement to notify the Government of significant events, formalising the roles of the Chair, Board and Chief Executive Officer, and standardising the requirements to provide information to responsible Ministers and disclosure of conflicts of interest. The impacts, however, will be presentational rather than an immediate change in the Territory's finances.

## **Accounting Standards**

Australia will adopt the International Accounting Standards from 1 January 2005.

The value of superannuation liability and the Territory's investments could be impacted by the introduction of the new accounting standard. The impact of the standard will require the liabilities to be valued using the national government bond rate.

Changes in the current accounting treatment, where the changes in liability for the actuarial assessments are amortised over several periods, will also have an impact on the forecast operating results.

