

APPENDIX C: STATEMENT OF RISKS

OVERVIEW

Full details of fiscal risks and contingent liabilities are provided in Budget Paper No. 1, *Budget Strategy and Outlook 2008-09*. The following statement updates (where necessary) those fiscal risks and contingent liabilities that have changed since the 2008-09 Budget.

The forward estimates of revenue and expenses in the *Mid-Year Economic and Fiscal Outlook 2008-09* (MYEFO) incorporate assumptions and judgments based on information available at the time of publication and are based on a range of economic and other forecasts and projections.

It is important to stress that the MYEFO revenue forecasts have been prepared during a period of very substantial financial and economic uncertainty. There has been significant recent volatility and a generalised downturn in global financial markets. The implications of these financial market developments, and government responses to them, for the overseas and domestic economic outlook are still very uncertain. Part 3 includes a more detailed discussion of the heightened uncertainty around the economic outlook. To the extent that the risks to the economic forecasts materialise or the economic outlook turns out to be different for other reasons, their impact will flow through to the revenue forecasts. In the view of heightened economic risks, there is an increased degree of uncertainty surrounding the revenue forecasts in the MYEFO.

In addition, it should be noted that revenue forecasting necessarily relies heavily on the historical relationships between the economy, tax bases and tax revenues. However, such relationships may shift in the current circumstances, requiring a more than usual degree of caution in their use in predicting future revenues.

In recent years, capital gains tax (CGT) has become an important, though volatile component of individuals, companies and superannuation funds income taxes. The large decline on equity markets during 2008 and continued day-to-day volatility make for particular difficulties in forecasting CGT at this time. There remains considerable uncertainty surrounding the length and magnitude of the declines in equity prices. Moreover, because there is limited information about investor behaviour in the current environment it is more than usually difficult to predict when any gains and losses (even in relation to the movement in equity prices observed to date) may be realised.

DETAILS OF FISCAL RISKS AND CONTINGENT LIABILITIES

New or revised fiscal risks and contingent liabilities with a possible impact on the forward estimates greater than \$20 million in any year, or \$40 million over the forward

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estimates period, that have arisen or changed since the 2008-09 Budget are described below and summarised in Table C1.

Information on contingent liabilities is also provided in the annual financial statements of departments, agencies and non-budget entries.

Table C1: Summary of material changes to Statement of Risks since the 2008-09 Budget

Contingent liabilities — quantifiable	
Defence and Defence Materiel Organisation	
Indemnities	Modified
Finance and Deregulation	
Australian Industry Development Corporation	Modified
Litigation	Modified
Sale of Sydney Airports Corporation Limited	Modified
Foreign Affairs and Trade	
Export Finance and Insurance Corporation	Modified
Treasury	
Guarantees under the Commonwealth Bank Sale Act	Modified
International financial institutions — uncalled capital subscriptions	Modified
Reserve Bank of Australia — guarantee	Modified
Contingent liabilities — unquantifiable	
Agriculture, Fisheries and Forestry	
Exceptional circumstances assistance for drought-affected farmers	New
Compensation claims arising from Equine Influenza (EI) outbreak	Modified
Defence and Defence Materiel Organisation	
HMAS Melbourne and HMAS Voyager damages claims	Modified
Climate Change	
Kyoto Protocol — Emissions Target	New
Carbon Pollution Reduction Scheme	New
Finance and Deregulation	
Commonwealth domestic property	New
Future Fund Board of Guardians — Indemnity	Modified
Sharjade v Darwinia — Breach of Heads of Agreement between the parties	New
Industrial Waste Commission (IWC) Cleanaway	Modified
Superannuation	New
Pan Pharmaceuticals	New
Googong Dam	New
Infrastructure, Transport, Regional Development and Local Government	
Maritime Industry Finance Company Ltd — board members' indemnity	Modified
Treasury	
Guarantee of wholesale funding of authorised deposit-taking institutions	New
Guarantee of deposits of authorised deposit-taking institutions	New
Financial Claims Scheme	New
Contingent Assets — unquantifiable	
Finance and Deregulation	
Tidbinbilla	New

Risks appearing in this Statement but not listed in the table above are substantially unchanged since disclosed in Budget Paper No. 1, *Budget Strategy and Outlook 2008-09*, Statement 8.

CONTINGENT LIABILITIES — QUANTIFIABLE

Defence and Defence Materiel Organisation

Indemnities

The Department of Defence (Defence) and the Defence Materiel Organisation (DMO) carry an extensive range of indemnities and undertakings, normally of a short-term nature, relating to business, training activities and other activities involving contracts, agreements and other Defence and DMO arrangements. Indemnities issued cover potential losses or damages for which the Australian Government would be liable.

Defence carries 410 instances of contingencies that are unquantifiable and remote; and 44 instances of quantifiable contingencies to the value of \$1.8 billion. DMO carries 469 instances of contingencies (including Foreign Military Sales) that are unquantifiable and 57 contingencies that are quantifiable to the value of \$3.0 billion. While these contingencies are considered remote, they have been reported in aggregate for completeness.

Finance and Deregulation

Australian Industry Development Corporation

Under the *Australian Industry Development Corporation Act 1970* certain obligations of the Australian Industry Development Corporation (AIDC) are guaranteed by the Australian Government. As at 30 June 2008, AIDC's contingent liabilities, subject to Australian Government guarantee, were approximately \$90 million in respect of guarantees and credit risk facilities.

In addition, AIDC had outstanding Australian Government guaranteed borrowings which totalled approximately \$11 million as at the most current valuation of 30 June 2008. These borrowing obligations have been matched by AIDC's holdings of Australian Government guaranteed securities of similar value, largely eliminating the Australian Government's guarantee exposure. These securities were purchased on market by UBS Warburg and paid to AIDC as consideration for UBS Warburg's purchase of AIDC Ltd's (a subsidiary of AIDC) financial assets. UBS AG, the international parent company that has taken over from UBS Warburg, manages this borrowing portfolio on behalf of AIDC. The UBS AG arrangement also provides a guarantee to cover any cash flow differences between the interest rate and maturity profiles of the matched borrowings and securities, together with any exchange rate movements in the borrowings. The Australian Government's contingent exposure to these borrowings is therefore negligible and is consequently recorded as zero.

Litigation

The Department of Finance and Deregulation is involved in litigation where a counter-claim for damages has been lodged against the Australian Government. The litigation relates to the Davis Samuel case where the Department is engaged in legal

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action seeking recovery of funds misappropriated during 1998. The counter-claim is from the parties to whom Finance believes the misappropriated funds were channelled.

It is counsel's advice that the counter-claim is without merit. The counter-claim, which will be vigorously defended by the Australian Government, seeks damages of \$4.3 billion although the basis for this amount is yet to be fully provided. Hearing of the Commonwealth's claim, and the counter-claim, commenced in the ACT Supreme Court on 10 June 2008 and is currently continuing.

Sale of Sydney Airports Corporation Limited

An indemnity has been provided to Southern Cross Airports Corporation as purchaser of the Sydney Airports Corporation Ltd in the event of a liability arising under Chapter 3 of the *Duties Act 1997* (New South Wales) by reason of the sale of shares in Sydney Airports Corporation Ltd constituting a relevant acquisition in a land-rich private corporation.

The New South Wales Office of State Revenue issued a notice of assessment on 17 November 2006. The Australian Government maintains that there are no grounds for the assessment. Action has been initiated in the NSW Supreme Court to overturn the assessment. The amount disputed is estimated at \$469.9 million as at 30 September 2008.

Foreign Affairs and Trade

Export Finance and Insurance Corporation (EFIC)

The Australian Government guarantees the due payment by the Export Finance and Insurance Corporation (EFIC) of money that is, or may at any time become, payable by EFIC to any body other than the Australian Government. The Australian Government also has in place a \$200 million callable capital facility available to EFIC on request to cover liabilities, losses and claims. As at 30 September 2008, the Australian Government's total contingent liability was \$3.0 billion, comprising EFIC's liabilities to third parties (\$2.2 billion) and EFIC's overseas investments insurance, contracts of insurance and guarantees (\$0.8 billion).

Treasury

Guarantees under the Commonwealth Bank Sale Act

Under the terms of the *Commonwealth Bank Sale Act 1995*, the Australian Government has guaranteed various superannuation and other liabilities amounting to around \$5.2 billion. Of this amount, \$1.3 billion was attributable to liabilities of the Commonwealth Bank of Australia at 30 June 2008 and \$3.9 billion was attributable to liabilities of the Commonwealth Bank Officers' Superannuation Corporation at 31 December 2007.

International financial institutions — uncalled capital subscriptions

This contingent liability relates to the value of the uncalled portion of the Australian Government's shares in the International Bank for Reconstruction and Development (US\$2.8 billion — estimated value A\$3.5 billion), the Asian Development Bank (US\$2.4 billion — estimated value A\$3.0 billion), the European Bank for Reconstruction and Development (US\$81.7 million plus €77.5 million — estimated value A\$241.4 million), and the Multilateral Investment Guarantee Agency (US\$26.5 million — estimated value A\$33.1 million). All values as at 30 September 2008.

Reserve Bank of Australia — guarantee

This contingent liability relates to the Australian Government's guarantee of the liabilities of the Reserve Bank of Australia. It is measured as the Bank's total liabilities excluding capital, reserves and Australian Government deposits. The major component of the Bank's liabilities are notes (that is, currency) on issue. Notes on issue amount to \$43.6 billion as at 24 September 2008 and the total guarantee is \$65.6 billion.

CONTINGENT LIABILITIES — UNQUANTIFIABLE

Agriculture, Fisheries and Forestry

Exceptional Circumstances assistance for drought-affected farmers

Exceptional Circumstances assistance is available, subject to eligibility criteria, to drought affected farmers and agriculture-dependent small businesses by way of interest rate subsidies and/or income support. The estimates assume that there will be no new drought declarations but that some existing declarations will be extended until 30 September 2009. A continuation of adverse seasonal conditions or a return to severe drought conditions could result in higher than expected expenses for these forms of assistance. It is not possible to quantify the cost arising from such potential developments as this depends on the intensity, duration and scale of future drought conditions.

Compensation claims arising from Equine Influenza (EI) outbreak

The Commonwealth may become liable for compensation should the Department of Agriculture, Fisheries and Forestry (DAFF) be found negligent in relation to the 2007 outbreak of EI. At this stage any potential liability resulting from the EI outbreak cannot be quantified.

On 12 June 2008, the Minister for Agriculture, Fisheries and Forestry released the Equine Influenza Inquiry report. Subsequently, a number of organisations have indicated, in the media, their intention to bring suits against the Commonwealth. To date, one organisation has made a claim. The Department of Finance and Deregulation

has assumed responsibility for claims under its insurance arrangements with the DAFF.

Defence and Defence Materiel Organisation

HMAS Melbourne and HMAS Voyager damages claims

Former crew members of HMAS Melbourne have instituted legal proceedings against the Australian Government claiming damages for injuries allegedly caused by the HMAS Voyager/HMAS Melbourne collision on 10 February 1964. Three claims remain current. The most recent claim was received on 9 October 2008. It is not known whether further claims will be made in connection with the collision.

Climate Change

Kyoto Protocol — emissions target

As a party to the Kyoto Protocol, Australia is required to meet its target level for emissions over the first Commitment Period, 2008-2012. At this stage the best available estimates suggests that Australia is broadly on track to meet the 2008-2012 target. However, given the early stage of the commitment period, it is unclear whether Australia will ultimately report an asset or a liability. Once this information can be more reliably estimated, the Department of Climate Change will account for it accordingly.

Carbon Pollution Reduction Scheme

There are specific risks to the estimates and projections of revenues and expenses relating to the possible design of the Carbon Pollution Reduction Scheme (CPRS), which is intended for introduction in 2010. The Government released a Green Paper on 16 July 2008 outlining the possible design of a CPRS. When implemented, the revenue that is received from the sale of permits under this scheme will impact on budget estimates. The Green Paper also indicated the Government's intention that every cent raised from the CPRS will be used to help Australian households and businesses adjust to the scheme and invest in clean energy options. Once developed, these assistance measures will also impact on budget estimates.

Finance and Deregulation

Commonwealth domestic property

The Commonwealth domestic property portfolio managed by Finance has approximately 100 properties. A small number of these have had potential remediation issues identified which are currently the subject of further investigation.

To date none of these properties have had a provision recognised, as neither the conditions for legal or constructive obligations have been met, nor is a reliable estimate of the obligation currently possible.

Future Fund Board of Guardians — indemnity

The Commonwealth has provided the members of the Future Fund Board of Guardians (the Future Fund Board) with a Deed of Indemnity. The indemnity is intended to apply to cover liabilities in excess of the Future Fund Board's insurance policies.

Members of the Future Fund Board are indemnified, to the maximum extent permitted by law, in relation to all official actions. However, similar to members of Boards that operate under the *Commonwealth Authorities and Companies Act 1997* (the CAC Act), a member of the Future Fund Board is not indemnified:

- i. for conduct he or she engages in other than in good faith;
- ii. in respect of any liability owed to the Board; or
- iii. in respect of any act or omission that contravenes one of the civil penalty provisions of the *Future Fund Act 2006* (Future Fund Act).

Also similar to members of CAC Boards, a member of the Future Fund Board is not indemnified for legal costs incurred by the member in unsuccessfully defending or resisting criminal proceedings, or proceedings against a declaration that the member had breached a civil penalty provision of the Future Fund Act.

The indemnity is financially limited, in broad terms, to the value of the Funds under management by the Future Fund Board.

Sharjade v Darwinia — breach of Heads of Agreement between the parties

The Commonwealth has been joined as second defendant in action in the New South Wales Supreme Court that it induced Darwinia to breach Heads of Agreement in 2000. The agreement relates to land previously owned by the Commonwealth at Turramurra, New South Wales, which was sold to Darwinia for construction of a retirement village for former Royal Australian Air Force servicemen. The hearing finished on 24 July 2008. The Judge's decision is expected shortly.

Industrial Waste Commission (IWC) Cleanaway

Following an unsuccessful appeal by the Commonwealth against Brambles Holdings Limited (on 23 July 2008) seeking declarative relief in relation to a deed of licence between the parties for the 'IWC Cleanaway' site at Lucas Heights, NSW, the Commonwealth is seeking to resolve a dispute concerning remediation responsibility for the site. The Commonwealth's goal is to have the site remediated as soon as practicable with minimal ongoing maintenance costs. Investigations into the nature and extent of contamination, as well as remediation options, are continuing.

Superannuation

On 20 April 2007, the High Court of Australia found against the Commonwealth on a claim for negligent misstatement relating to superannuation benefits for a former employee of the Department of the Interior. There is potential for more claims to arise from other former temporary employees who upon their retirement can demonstrate negligent misstatement over their eligibility to join an Australian Government superannuation scheme. Finance has assumed responsibility for the claims under its insurance arrangements with the relevant agencies or their predecessors.

Pan Pharmaceuticals

On 14 August 2008, the Commonwealth settled a suit brought by Mr Selim against the Therapeutic Goods Administration for the negligent suspension of Pan Pharmaceutical's registration and the resulting liquidation of the company. Subsequently, other shareholders and creditors of Pan Pharmaceuticals have indicated their intention to bring claims against the Commonwealth. Finance assumed responsibility for the claims under its insurance arrangements with the Therapeutic Goods Administration.

Googong Dam

On 4 September 2008, a 150 year lease for Googong Dam was signed between the Commonwealth and the ACT Government. The *Canberra Water Supply (Googong Dam) Act 1974* is the paramount statute in relation to the property. The Commonwealth will be liable to pay compensation in the event that it amends or introduces legislation requiring the acquisition of 'property' from the ACT.

The lease includes a requirement for the Commonwealth to undertake rectification of easements or any defects in title in relation to Googong Dam, and also gives an indemnity in relation to acts or omissions by the Commonwealth. The Commonwealth is also responsible for remediation of any contamination it may have caused to the site.

Infrastructure, Transport, Regional Development and Local Government

Maritime Industry Finance Company Ltd — board members' indemnity

Indemnities for the Maritime Industry Finance Company Ltd board members have been provided to protect them against civil claims relating to their employment and conduct as directors. MIFCO was placed into voluntary liquidation in November 2006 and was deregistered on 24 April 2008. The indemnity is not time limited and continues even though the Company has been liquidated. Until the indemnity agreements are varied or brought to an end, they will remain as contingent and unquantifiable liabilities.

Treasury

Guarantee of wholesale funding of authorised deposit-taking institutions

The Government has announced that it will guarantee eligible wholesale funding of authorised deposit-taking institutions in Australia from 12 October 2008. The guarantee facility will be withdrawn when market conditions normalise.

The expected liability under this guarantee is remote and unquantifiable. Authorised deposit-taking institutions are subject to prudential regulation by the Australian Prudential Regulation Authority in accordance with international standards, which are designed to ensure that financial institutions have the capacity to meet their financial promises. This framework requires institutions to be adequately capitalised and have appropriate risk management systems in place.

Government expenditure would arise under the guarantee only in the unlikely event that an institution fails to meet its obligations with respect to a commitment that is subject to the guarantee and the guarantee is called upon. In this case, the Government is likely to be able to recover any such expenditure through a claim on the relevant institution. The impact on the Government's budget would depend on the extent of the institution's default and its ability to meet the Government's claim.

Guarantee of deposits of authorised deposit-taking institutions

The Government has announced that it will guarantee deposits in authorised deposit-taking institutions in Australia from 12 October 2008. These arrangements will be reviewed after three years.

The expected liability under this guarantee is remote and unquantifiable. Authorised deposit-taking institutions are subject to prudential regulation by the Australian Prudential Regulation Authority in accordance with international standards, which are designed to ensure that financial institutions have the capacity to meet their financial promises. This framework requires institutions to be adequately capitalised and have appropriate risk management systems in place.

Government expenditure would arise under the guarantee only in the unlikely event that an institution fails to meet its obligations with respect to a commitment that is subject to the guarantee and the guarantee is called upon. In this case, the Government is likely to be able to recover any such expenditure through a claim on the relevant institution. The impact on the Government's budget would depend on the extent of the institution's default and its ability to meet the Government's claim.

Financial Claims Scheme

The Government has established a Financial Claims Scheme to provide depositors of authorised deposit-taking institutions and general insurance policyholders with timely access to their funds in the unlikely event of a financial institution failure.

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The Early Access Facility for Depositors established under the *Banking Act 1959* provides a mechanism for making payments to depositors under the Government's guarantee of the deposits of authorised deposit-taking institutions. The risks of this guarantee are detailed under 'guarantee of deposits of authorised deposit-taking institutions' above.

The Policyholder Compensation Facility established under the *Insurance Act 1973* provides a mechanism for making payments to eligible beneficiaries with a valid claim against a failed general insurer. Amounts available to meet payments and administer this facility, in the event of activation, are capped at \$20.1 billion under the legislation.

The expected liability under the Policyholder Compensation Facility is remote and unquantifiable. The likelihood of a collapse that requires the activation of the scheme is low and the payments made under the Scheme would be likely to be recovered through the liquidation of the failed general insurer. If there was a shortfall, a levy would be applied to industry to recover the difference between the amount expended and the amount recovered in the liquidation.

CONTINGENT ASSETS — UNQUANTIFIABLE

Finance and Deregulation

Tidbinbilla

The land associated with the Canberra Deep Space Communication Complex, Tidbinbilla, was declared National Land in 2007-08. The site is managed via Government treaties with the United States of America concerning space tracking in Australia. All improvements are owned by NASA, which has formally indicated ongoing involvement in the site for a minimum 20 year period. As a result, ongoing tenure for the site is uncertain. Responsibilities for the property are to be clarified, and could include being formalised via a Deed of Agreement with NASA.