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Specific Fiscal Risks

The Statement of Specific Fiscal Risks is required by the Public Finance Act 1989 to set out, to the fullest extent possible, all government decisions and other circumstances known to the Government at the date of the finalisation of the fiscal forecasts that may have a material effect on the fiscal and economic outlook, but are not certain enough in timing or amount to include in the fiscal forecasts. Although the process for disclosure of specific fiscal risks involves a number of parties, including government departments, the Treasury and the Minister of Finance, there remains a possibility that not every significant risk is identified. Disclosure of known risks is also subject to specific requirements and materiality thresholds, which are described after the Statement of Specific Fiscal Risks.

Overview

Specific fiscal risks can be positive or negative and can affect revenue or spending or the balance sheet. The links between external events and spending are indirect because new policies that change spending and revenue usually require a decision by the Government and approval from Parliament. The approach taken in this chapter is to disclose those potential policy decisions and key areas of uncertainty that may have a material effect on the fiscal outlook.

Established practice is that the Government sets aside allowances of new funding for future Budgets to manage uncertainty and cost pressures. These allowances are included in the fiscal forecasts. Current fiscal management policy is for future policy decisions affecting expenses or capital expenditure to be met through reprioritisation or from within existing provisions included in the fiscal forecasts. Future policy decisions are risks to the fiscal forecasts only to the extent that they cannot be managed from within:

- for operating expenditure, existing baselines or the allowance in the fiscal forecasts for forecast new operating expenditure, or
- for capital, the existing Crown balance sheet, including the Future Investment Fund (FIF), or the allowance in the fiscal forecasts for forecast new capital spending.

Notwithstanding this, known material policy risks are identified as specific fiscal risks, even though the Government has more control in managing such risks through reprioritisation, the existing Crown balance sheet and the Budget allowances. This is done to ensure a prudent approach to the disclosure of risks, improve transparency and not pre-judge future decisions by governments.

The specific fiscal risks are categorised into:

- **Potential policy decisions affecting revenue**: For example, changes to tax policy or ACC levies could reduce or increase government income.
- **Potential policy decisions affecting expenses (expected to be funded from reprioritisation or the Budget operating allowance)**: Costs of policy proposals could increase or decrease expenses depending on decisions taken, and they are risks to the fiscal forecasts only to the extent that they cannot be managed within existing baselines or Budget allowances.
- **Potential capital decisions (expected to be funded from the existing Crown balance sheet, including the FIF, or the Budget capital allowance)**: Capital investment decisions are risks to the fiscal forecasts only to the extent that they cannot be managed within the existing Crown balance sheet, including the FIF, or the Budget capital allowance.
- **Matters dependent on external factors**: The Crown's liability for costs is sometimes dependent on external factors such as the outcome of negotiations or international obligations.

A range of generic risks to the fiscal forecasts are not recognised as specific fiscal risks:

- Risks from changes to economic assumptions; the most significant economic risks have been identified in Chapter 3.
- Business risks and volatility in the returns from the Crown's investments relating to the broader economic and commercial environment.
- General cost pressures, such as those associated with demographic changes (eg, an ageing population).
- Potential risks from changes in demand for government services or transfer payments owing to underlying structural factors (such as changes in demand for Jobseeker Support).
- The costs of future individual natural disasters, and other major events, as they usually occur infrequently and their occurrence, nature and timing cannot be predicted. Once a disaster does occur, a number of choices arise about how to respond and when potential liabilities are recognised (eg, through setting aside an allocation of funding). Specific risks are disclosed at this point based on the range of possible responses.

The final part of the chapter contains a current list of contingent liabilities and contingent assets. Contingent liabilities are costs that the Crown will have to face if a particular event occurs or are present liabilities that are unable to be measured. Typically, contingent liabilities consist of guarantees and indemnities, legal disputes and claims on uncalled capital. The largest quantified contingent liabilities are to international financial organisations and mostly relate to uncalled capital and promissory notes. Contingent assets are possible assets that have arisen from past events but the value of the asset, or whether it will eventuate, will not be confirmed until a particular event occurs.

Statement of Specific Fiscal Risks

Summary Table

The matters listed below are disclosed as specific fiscal risks because they meet the rules for disclosure outlined after this Statement. Full descriptions of the risks listed below are set out in the next section. Where quantification is possible, this is included in the description of the risk.

Specific fiscal risks as at 24 November 2014	**Status**[11]
Potential policy decisions affecting revenue	
ACC – Funding Policy Review	Unchanged
Revenue – Income-sharing Tax Credits	Unchanged
Services Funded by Third Parties	Unchanged
Potential policy decisions affecting expenses (expected to be funded from reprioritisation or the Budget operating allowance):	
ACC – Work-related Gradual Process Disease and Infection	Unchanged
Budget Operating Initiatives	Unchanged
Canterbury Earthquake Recovery – Christchurch Central Recovery Plan – Anchor Projects	Changed
Christchurch City/Crown Cost Sharing – Horizontal Infrastructure	Changed
Communications – Ultra-Fast Broadband Initiative	Unchanged
Concessionary Loans	Changed
Defence Force – Operating and Capital Costs	Unchanged
Government Response to Wai 262	Unchanged
Health – Health Benefits Limited	New
Housing/Social Development – Social Housing Reform	Changed
Internal Affairs – All-of-Government Common Capabilities Sustainable Funding	Unchanged
Revenue – KiwiSaver One-off Enrolment	Unchanged
Revenue – Transformation and Technology Renewal	Unchanged
Social Development – Child, Youth and Family Modernisation	New
Social Development – Welfare Reform Costs	Unchanged
Social Development – Welfare Reform Forecast Benefit Savings	Unchanged
State Sector Employment Agreements	Unchanged
Support for Children in Hardship	New
Vulnerable Children White Paper	Unchanged

[11] *Unchanged – risks* where the nature and/or scale of the risk has not changed substantively since the previous *Economic and Fiscal Update*.

Changed – risks where the nature and/or scale of the risk has changed substantively since the previous *Economic and Fiscal Update*.

Specific fiscal risks as at 24 November 2014	Status[11]
Potential capital decisions (expected to be funded from the existing Crown balance sheet, including the FIF, or the Budget capital allowance):	
Arts, Culture & Heritage – Review of Military History Museum Arrangements	Unchanged
Agency Capital Intentions	Unchanged
Communications – Ultra-Fast Broadband Expanded Scope	New
Earthquake Strengthening for Crown-owned Buildings	Unchanged
Finance – Crown Overseas Properties	Unchanged
Parliamentary Service – Parliamentary Accommodation	Unchanged
Primary Industries – Investment in Water Infrastructure	Unchanged
Transport – Auckland Transport Projects	Unchanged
Transport – Regional State Highways	Unchanged
Transport – Support for KiwiRail	Unchanged
Matters dependent on external factors	
ACC – Work, Earners' and Motor Vehicle Accounts	Unchanged
ACC – Non-earners' Account	Unchanged
Canterbury Earthquake Recovery – Residential Red Zone	Unchanged
Caregiver Employment Conditions	Changed
Communications – Impairment in Value of Broadband Investment	Unchanged
Defence Force – Potential Rationalisation, Revaluation and Disposal of NZDF Assets	Unchanged
Energy – Crown Revenue from Petroleum Royalties	Unchanged
Finance – EQC	Changed
Finance – Goodwill on Acquisition	Unchanged
Finance – Solid Energy	Changed
Finance – Southern Response Earthquake Services Support	Changed
Housing – Divestment of Housing	Unchanged
Revenue – Cash Held in Tax Pools	Unchanged
Revenue – Student Loans	Unchanged
Treaty Negotiations – Treaty Settlement Forecasts	Unchanged
Treaty Negotiations – Relativity Clause	Unchanged

Potential Policy Decisions Affecting Revenue

ACC – Funding Policy Review (Unchanged)

The Government has been reviewing ACC's funding policy and intends that there be further levy reductions across all accounts but decisions have not yet been taken on the nature and timing of those reductions. Such reductions would reduce Crown revenue and Crown assets, with a flow-on impact to the operating balance and net worth.

Revenue – Income-sharing Tax Credits (Unchanged)

The Government has introduced legislation to establish an income-sharing tax credit. If passed as introduced, the legislation will allow couples with children under the age of 18 to pool their earnings for income tax purposes if they meet certain criteria. If implemented, the changes will reduce tax revenues by $500 million per annum once the scheme is fully operational. The Finance and Expenditure Committee has recommended that the significant fiscal cost of the package be addressed before the Bill proceeds further.

Services Funded by Third Parties (Unchanged)

A wide range of government services are funded through third party fees and charges. Demand for these services can vary with a direct impact on revenue received. There is a risk the Government may need to provide additional funding if revenue collected is lower than the total costs of providing the services. There is also a risk that changes will be required to the way government services are delivered, which could result in costs to the Crown.

Potential Policy Decisions Affecting Expenses (Expected to be Funded from Reprioritisation or the Budget Operating Allowance)

ACC – Work-related Gradual Process Disease and Infection (Unchanged)

Under current legislation, the Government incurs an obligation for Work-related Gradual Process Disease and Infection claims when the claim is made, and an expense is recognised at this point. The liability for commercial accident and sickness insurance contracts would usually be recognised when exposure to conditions that will give rise to a claim occurs. An amendment to legislation would be required to recognise claims at the same time as for commercial contracts. An initial adjustment to the liability and an expense of about $1 billion would need to be reported if such an amendment were to be enacted.

Budget Operating Initiatives (Unchanged)

Future Budgets may well include new operating initiatives other than those identified in other specific fiscal risks. Such new operating initiatives are risks to the fiscal forecasts only to the extent they cannot be managed through reprioritisation or from within the existing provision in the fiscal forecasts for forecast new operating spending. The Government's stated intention is that all new operating initiatives will be managed through these mechanisms.

Canterbury Earthquake Recovery – Christchurch Central Recovery Plan – Anchor Projects (Changed)

The Crown is partially funding the construction of Anchor Projects as part of the Christchurch Central Recovery Plan as set out in the cost-sharing agreement with the Christchurch City Council. The extent of funding will vary from project to project, dependent on final scope, ownership decisions and implementation and project costs. Some funding will eventually be recovered. Business cases are progressing through the decision-making process and construction costs and the Crown share of this will become increasingly clear during the business case process and the subsequent procurement phase. The Crown's contribution may differ from that included in the fiscal forecasts.

Christchurch City/Crown Cost Sharing – Horizontal Infrastructure (Changed)

The Crown is partially funding the recovery of local infrastructure in Canterbury as set out in the cost-sharing agreement with the Christchurch City Council. The agreement includes a review clause. The review is yet to be completed, so the Crown cannot yet consider it. Any additional costs or savings to the Crown that may arise from the review will have a corresponding fiscal impact.

Communications – Ultra-Fast Broadband Initiative (Unchanged)

The Government's expectation is that the current funding envelope for the roll out of Ultra-Fast Broadband (UFB) will not be breached and that the objective of rolling out UFB to 75% of New Zealanders by the end of 2019 will be met. Until the Commerce Commission issues a final decision, the largest partner in the roll out, Chorus, will face some degree of uncertainty which could give rise to a fiscal risk in achieving these targets.

Concessionary Loans (Changed)

The Crown has provided loans to local government and iwi-based organisations on a concessionary basis to achieve public policy purposes. Because of their concessionary nature, these loans are written down on draw down to reflect existing market conditions. There is a risk that future market conditions may require a different adjustment. The current carrying value of these loans on the Crown's balance sheet is $475 million.

Defence Force – Operating and Capital Costs (Unchanged)

In 2013, the Government reconsidered New Zealand Defence Force (NZDF) funding, output requirements and capability intentions, through the Defence Mid-Point Rebalancing Review. The review has resulted in a baseline increase for NZDF in Budget 2014. Further operating and capital decisions may be required to achieve Defence White Paper (2010) policy and enable NZDF to manage additional cost pressures over the forecast period.

Government Response to Wai 262 (Unchanged)

The Waitangi Tribunal's report on the Wai 262 claim focuses on the protection of Māori culture and identity, with a particular focus on mātauranga Māori and associated taonga. The Tribunal's recommendations are directed towards a number of government agencies individually, as groups and across sectors. The Government has yet to respond to the Tribunal's report and recommendations.

Health – Health Benefits Limited (New)

Health Benefits Ltd (HBL) was established in July 2010 to deliver back-office cost savings, helping DHBs to live within their means in the face of increasing costs and tightening budget constraints. In November 2014 the Minister of Health announced that the implementation of HBL's business cases should be transferred to a DHB-owned vehicle by July 2015 following a due diligence process. HBL has a significant and complex change management programme currently underway with DHBs. This requires that four major national business case initiatives are progressed simultaneously by HBL and DHBs, which will be a significant challenge, particularly during this transition period. Until the business cases have been completed and implemented, there is a risk that the anticipated savings may not be achieved.

Housing/Social Development – Social Housing Reform (Changed)

The Government is considering further changes to the delivery of social housing. Changes include a larger role for non-government providers of social housing, exploring how some Housing New Zealand Corporation (HNZC) properties might be transferred to them, and increasing the effectiveness of housing assistance. Decisions relating to the scope, scale and speed of change and how it is effected may increase costs to the Crown.

Internal Affairs – All-of-Government Common Capabilities Sustainable Funding (Unchanged)

A central component of the Department of Internal Affairs' responsibilities as functional lead for All-of-Government ICT and the ICT Strategy and Action Plan is the development and delivery of All-of-Government common capabilities. The Government has agreed that departments and some Crown entities should migrate to common ICT capabilities, including RealMe. Many of these common capabilities have been developed and are being used and some are still in development. To the extent that these costs cannot be met within agencies' baselines, they may require new funding.

Revenue – KiwiSaver One-Off Enrolment (Unchanged)

The Government has announced its intention to consult on the design of a one-off KiwiSaver auto-enrolment exercise to increase the number of KiwiSaver members. The Government will proceed with a one-off KiwiSaver enrolment exercise only when it is confident that such a step poses no risks to returning to, and maintaining, an operating surplus and debt repayment is on track. An auto-enrolment exercise is likely to entail a one-off cost for kick-start payments to new members and ongoing additional costs for the Member Tax Credit. Depending on the timing, design features and take-up rate, these costs could be in the order of $100 million to $290 million over the first four years after the auto-enrolment takes place, and are expected to be funded out of the operating allowance.

Revenue – Transformation and Technology Renewal (Unchanged)

The Government is exploring options that will change the way Inland Revenue (IRD) manages its processes and data. Any changes could impact tax revenue collections and may have material costs to implement. IRD has commenced the development of detailed business case(s) for Stage 1: Enabling secure digital services. The business case(s) will inform the Government's decision-making for the first stage of transformation and may require significant reprioritisation or new funding.

Social Development – Child, Youth and Family Modernisation (New)

Child, Youth and Family is working on developing a new operating model that sets outs the structure, systems and resources needed to help improve the outcomes for children and young people by strengthening and enhancing the way it operates. While funding for 2014/15 has been included in the fiscal forecasts, future costs of the proposal are still being developed. To the extent that these cannot be funded from reprioritisation, additional funding from the operating allowance may be required.

Social Development – Welfare Reform Costs (Unchanged)

The Welfare Reform package of changes to the benefit system was introduced from July 2013, following amendments to the Social Security Act 1964. The current phase is to review programmes with a view to reducing future benefit dependency and long-term liability. Additional funding was appropriated at Budget 2014. The extent of any further costs associated with the ongoing implementation of the Investment Approach is uncertain.

Social Development – Welfare Reform Forecast Benefit Savings (Unchanged)

A conservative estimate of the likely benefits from Welfare Reform has been included in the fiscal forecasts. The actual impact may differ owing to behavioural factors and the complexity in implementing the reforms, with a corresponding impact on benefit expenditure.

State Sector Employment Agreements (Unchanged)

A number of large collective agreements are due to be negotiated in the short-to-medium term. As well as direct fiscal implications from any changes to remuneration, the renegotiation of these agreements can have flow-on effects to remuneration in other sectors. The Government has signalled an expectation of restraint given its current fiscal stance and that agreements will be managed within the current fiscal forecasts.

Support for Children in Hardship (New)

The Government has signalled it will target reducing material hardship affecting children. The details and costs of the proposals are still being developed. To the extent that these cannot be funded from reprioritisation, additional funding from the Budget operating allowance may be required.

Vulnerable Children White Paper (Unchanged)

The Government has begun to implement proposals to better identify and provide assistance to vulnerable children. While funding for 2014/15 has been included in the fiscal forecasts, future costs of the proposal are still being developed. To the extent that these cannot be funded from reprioritisation, additional funding from the operating allowance may be required.

Potential Capital Decisions (Expected to be Funded from the Existing Crown Balance Sheet, Including the FIF, or the Budget Capital Allowance)

Arts, Culture and Heritage – Review of Military History Museum Arrangements (Unchanged)

In June 2014, the Government agreed to review the current arrangements around the recording, collecting and exhibiting of New Zealand's military history with a focus on the national level. At this stage it is unclear what the outcome of this business case will be, but this could result in further provision of military history exhibitions. This could require substantial Crown investment.

Agency Capital Intentions (Unchanged)

Future Budgets may well include new capital initiatives other than those identified in other specific fiscal risks. Such initiatives are likely to be primarily from the 16 capital-intensive agencies or sectors that are required to identify their capital spending intentions over the next 10 years based on current policy settings and certain demographic and inflation assumptions. The Government expects that these intentions will be managed back through a range of measures such as prioritisation, changes to asset utilisation, alternative methods of service delivery and changes to policy settings. New capital initiatives and agency capital intentions are risks to the fiscal forecasts only to the extent they cannot be managed through existing balance sheets, including the FIF, and the provision in the fiscal forecasts for forecast new capital spending

Communications – Ultra-Fast Broadband Expanded Scope (New)

The Government has committed to providing between $152 million and $210 million from the FIF to extend the Ultra-Fast Broadband programme to an additional 5% of New Zealand's population. The timing and details of this project are yet to be confirmed.

Earthquake Strengthening for Crown-owned Buildings (Unchanged)

There is a possibility that the Crown will incur costs for earthquake strengthening some of its buildings that do not meet modern building standards. The Government is currently undertaking a stocktake of Crown-owned earthquake-prone buildings. The likelihood, timing and fiscal impact of any earthquake strengthening are uncertain.

Finance – Crown Overseas Properties (Unchanged)

The Government holds New Zealand House in London on a long-term lease from the Crown Estate (UK). Depending on the outcome of ongoing discussions with the Crown Estate and feasibility study of suitable available options, an upgrade to the building or alternative solution will be required. Should a decision be taken to refurbish existing premises, a rough-order cost estimate for this upgrade is $100 million over the forecast period.

Parliamentary Service – Parliamentary Accommodation (Unchanged)

With the expiry of the lease on Bowen House in December 2018, the Parliamentary Service is identifying and assessing options for future office accommodation which may require capital expenditure with estimates ranging from $40 million to $130 million.

Primary Industries – Investment in Water Infrastructure (Unchanged)

In addition to $120 million already appropriated, the Government will consider providing up to a further $280 million in future Budgets to Crown Irrigation Investments Limited as schemes reach the "investment-ready" stage.

Transport – Auckland Transport Projects (Unchanged)

The Government has signalled its intention to accelerate transport projects in the Auckland Council's Auckland Plan, including Auckland Manukau Eastern Transport Initiatives, the East-West Link and support for the City Rail Link and a second Waitemata Harbour Crossing. Decisions on further Crown financial assistance for Auckland Manukau Eastern Transport Initiatives and the East-West Link will be made as part of future Budgets.

Transport – Regional State Highways (Unchanged)

A regional state highway acceleration package of $212 million was announced by the Government in June 2014. $115 million of this is subject to the outcome of further investigations. Further funding decisions will be considered as part of Budget 2015.

Transport – Support for KiwiRail (Unchanged)

The Government in Budgets 2010 to 2014 supported KiwiRail Holdings Limited (KiwiRail) with around $1 billion invested in its plan to become a commercially viable network. Further funding is being sought by KiwiRail in support of this objective. A major review of the business has commenced and will be assessed to inform Budget 2015 and any further investment.

Matters Dependent on External Factors

ACC – Work, Earners' and Motor Vehicle Accounts (Unchanged)

Revenue from the levies set for the Work, Earners' and Motor Vehicle accounts may be more or less than is required to cover the cost of claims, if factors such as claims experience, ACC performance and economic assumptions (particularly discount rates) turn out differently from what has been forecast. Any such variance will have a corresponding impact on the operating balance.

ACC – Non-earners' Account (Unchanged)

The amount of funding provided by the Crown (and included in the fiscal forecasts) for the Non-earners' Account may be more or less than is required to cover the cost of claims, if factors such as claims experience, ACC performance and economic assumptions (particularly discount rates) turn out differently from what has been forecast. Any such variance will have a corresponding fiscal impact.

Canterbury Earthquake Recovery – Residential Red Zone (Unchanged)

Some recoveries from the EQC and private insurers remain outstanding and there is a risk that final recoveries may be greater or less than forecast. In addition, potential costs associated with the future use of residential red zone are uncertain. The future value may change depending on any future alternate uses of the land. The fiscal impact of this is not yet certain.

Caregiver Employment Conditions (Changed)

Several cases and funding claims in the disability support and aged care sectors relating to interpretation of the Minimum Wage Act 1983, the Equal Pay Act 1972 and the Government's policy of paying certain family members through its Funded Care Policy may involve significant costs to the Crown. Changes to the existing policy could require additional funding. Successful litigation may have implications for agencies that target assistance based on family circumstances and/or employ workers under contracts in circumstances within the ambit of the Courts' decisions.

Communications – Impairment in Value of Broadband Investment (Unchanged)

The Government has set aside $1.345 billion to progressively capitalise Crown Fibre Holdings so that it can invest with private partners in a new network delivering ultra-fast broadband services. Given the contracts entered into, the extent of the recovery of this investment is somewhat dependent on the number of connections made to the network. The fiscal forecasts include a provision for impairing this investment, but the final amount of the impairment may vary from this provision.

Defence Force – Potential Rationalisation, Revaluation and Disposal of NZDF Assets (Unchanged)

The Government is considering the potential to dispose of a number of NZDF assets, including the Seasprite helicopters and Unimog trucks. Depending on market conditions, the timing of disposal and sale price received could have an impact on the Government's overall financial position. NZDF is also completing an analysis of inventory that is surplus to requirements and is over and above the existing provision for obsolescence. The existing provision is also being reviewed to ensure that all items comprising the provision are still relevant.

Energy – Crown Revenue from Petroleum Royalties (Unchanged)

Crown revenue from petroleum royalties is dependent upon extraction rates, the US dollar value per barrel and the US dollar/NZ dollar exchange rate. Movements up or down in any of these variables could result in a significant decrease or increase in Crown revenue. The overall impact for the Crown could be positive or negative.

Finance – EQC (Changed)

EQC is forecasting a cash deficiency in the National Disaster Fund (NDF) arising towards the end of the financial year (or early 2015/16). Under section 16 of the Earthquake Commission Act 1993 the Crown shall provide funding to meet a deficiency in the NDF. Such funding will impact net debt but not the operating balance or OBEGAL. The financial position of EQC and the amount of any Crown funding carry a high level of uncertainty owing to the nature of EQC's claims liability. An actuarial estimate of the net claims liability and its rate of settlement is included in the forecasts; however, the estimates are sensitive to underlying assumptions such as damage estimates, legal challenges, reinsurance recoveries and the forecast profile of settlements. Of particular note is the declaratory judgment currently being sought to clarify the nature of EQC's cover in relation to properties with increased flood and liquefaction vulnerability. The Crown's financial position may be adversely impacted if these assumptions are modified over time. Because the net claims liability is large, small percentage changes in the liability can have a material impact on costs and forecasts.

Finance – Goodwill on Acquisition (Unchanged)

As at 30 June 2014, the Government had goodwill on acquisition of a number of sub-entities totalling $628 million. Under New Zealand accounting standards (NZIAS 36), such goodwill items are required to be assessed annually for impairment. If there is any indication that the goodwill may be impaired, the recoverable amount of the cash generating units to which the goodwill is allocated is required to be estimated. If the recoverable amount is less than the carrying amount of those units, the units and the goodwill allocated to them are regarded as impaired and the Government is required to recognise impairment losses in the operating statement. Such assessments will be conducted at the end of the financial year, and the fiscal forecasts currently make no allowance for such impairment losses.

Finance – Solid Energy (Changed)

International coal prices have deteriorated significantly since Solid Energy's financial restructure in 2013. In September 2014 the Government provided an indemnity for the company's costs of environmental remediation obligations that allowed it to continue operating. The company continues to implement a business strategy to adapt to market conditions; however, there are large challenges ahead. In particular, the international coal price remains depressed with market forecasts recently revised downwards and the company has a large tranche of debt maturing in 2016. As the value of mining assets is determined by future coal price forecasts, changes to these forecasts can impact the company's equity position. Asset impairments are due to be reported in the company's upcoming half-year accounts. Any changes to the support arrangements in place, or any further deterioration in market conditions or the company's financial position, may adversely impact the Crown.

Finance – Southern Response Earthquake Services Support (Changed)

The ultimate cost to the Crown of settling earthquake claims remains subject to significant uncertainty. Forecasts assume that the actual cost to settle claims will align with the actuary's central estimate of the claims provision. There is a risk that the actual cost could vary from this estimate which is sensitive to its underlying assumptions such as damage estimates, repair and/or rebuilding requirements, legal challenges, reinsurance recoveries and the forecast profile of claims settlement. The Crown's financial position may be adversely impacted as these assumptions are modified over time. The declaratory judgment currently being sought regarding properties categorised by EQC as sustaining a form of land damage owing to increased flood vulnerability is also of particular note. The Crown's financial position may be adversely impacted if it is determined that this also represents a form of damage to buildings and imposes additional obligations on Southern Response under its building insurance policies.

Housing – Divestment of Housing (Unchanged)

The forecasts reflect related divestments and redevelopments of some housing property as part of HNZC's business as usual asset management strategy and other developments in which the Crown has an interest. Property sales are subject to market conditions and therefore there is an inherent level of uncertainty about the return to the Crown associated with forecast divestments and to the proposed funding of these and other developments in which the Crown has an interest.

Revenue – Cash Held in Tax Pools (Unchanged)

Funds held in tax pools are recognised as a Crown asset. There is a risk that funds held in these pools, over and above a taxpayer's provisional tax liability, may be withdrawn by that taxpayer, resulting in a reduction in the Crown's available cash reserves.

Revenue – Student Loans (Unchanged)

The value of student loans is sensitive to assumptions such as the borrower's future income, and general economic factors such as interest rates, unemployment levels, salary inflation and the CPI. As new lending occurs, an initial write-down to fair value will be made, and an expense will be incurred, reflecting the cost the Crown incurs in making an interest free loan. The forecasts for this initial write-down assume that loans issued after 1 January 2015 with similar repayment characteristics to student loans would attract an effective interest rate of 6.73%. The effective interest rate actually applied for these loans will be updated early in 2015.

Treaty Negotiations – Treaty Settlement Forecasts (Unchanged)

The fiscal forecasts include provision for the cost of future Treaty settlements. Given settlements are finalised through negotiations; there is a risk that the timing and amount of the settlements could differ from the profile included in the fiscal forecasts.

Treaty Negotiations – Relativity Clause (Unchanged)

The Deeds of Settlement negotiated with Waikato-Tainui and Ngāi Tahu include a relativity mechanism. Now that the total redress amount for all historical Treaty settlements exceeds $1 billion in 1994 present-value terms, the mechanism provides that the Crown is liable to make payments to maintain the real value of Ngāi Tahu and Waikato-Tainui's settlements as a proportion of all Treaty settlements. The agreed relativity proportions are 17% for Waikato-Tainui and approximately 16% for Ngāi Tahu. There is a risk that the timing and amount of the expense for the relativity payments may differ from that included in the fiscal forecasts. There is also uncertainty on how various disputes concerning the interpretation of the mechanism will be resolved.

Risks Removed Since the 2014 *Pre-election Update*

The following risk has been removed since the 2014 *Pre-election Update*:

Expired risk	**Reason**
Transport – Cycleways	Risk materialised

Criteria and Rules for Inclusion in the Fiscal Forecasts or Disclosure as Specific Fiscal Risks

The Public Finance Act 1989 requires that the Statement of Specific Fiscal Risks sets out all government decisions, contingent liabilities or contractual obligations known to the Government and subject to specific requirements that may have a material effect on the economic or fiscal outlook.[12]

The criteria and rules set out below are used to determine if government decisions or other circumstances should be incorporated into the fiscal forecasts, disclosed as specific fiscal risks or, in some circumstances, excluded from disclosure.

12 The Statement of Specific Fiscal Risks is a requirement set out in sections 26Q and 26U of the Public Finance Act 1989.

Criteria for Including Matters in the Fiscal Forecasts

Matters are incorporated into the fiscal forecasts provided they meet the following criteria:

- The matter can be quantified for particular years with reasonable certainty.
- A decision has been taken, or a decision has not yet been taken but it is reasonably probable[13] the matter will be approved, or it is reasonably probable the situation will occur.

Additionally, any other matters may be incorporated into the forecasts if the Secretary to the Treasury considers, using best professional judgement, that the matters may have a material effect on the fiscal and economic outlook and are certain enough to include in the fiscal forecasts.

Rules for the disclosure of specific fiscal risks

Matters are disclosed as specific fiscal risks if:

- the likely impact is more than $100 million over five years, and either
- a decision has not yet been taken but it is reasonably possible[14] (but not probable) that the matter will be approved or the situation will occur, or
- it is reasonably probable that the matter will be approved or the situation will occur, but the matter cannot be quantified or assigned to particular years with reasonable certainty.

Additionally, any other matters may be disclosed as specific fiscal risks if the Secretary to the Treasury considers, using best professional judgement, that the matters may have a material effect (more than $100 million over five years) on the fiscal and economic outlook but are not certain enough to include in the fiscal forecasts.

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[13] For these purposes “reasonably probable” is taken to mean that the matter is **more likely than not** to be approved within the forecast period (by considering, for example, whether there is a better than 50% chance of the matter occurring or being approved).

[14] For these purposes “reasonably possible” is taken to mean that the matter **might** be approved within the forecast period (by considering, for example, whether there is a 20% to 50% chance of the matter occurring or being approved).

Exclusions from Disclosure

Matters are excluded from disclosure as specific fiscal risks if they fail to meet the materiality criterion (ie, are less than $100 million over five years), or if they are unlikely[15] to be approved or occur within the forecasting period.

Additionally, the Minister of Finance may determine, under section 26V of the Public Finance Act 1989, that a matter be included in the fiscal forecasts or a specific fiscal risk not be disclosed, if such disclosure would be likely to:

- prejudice the substantial economic interests of New Zealand
- prejudice the security or defence of New Zealand or international relations of the Government
- compromise the Crown in a material way in negotiation, litigation or commercial activity, or
- result in a material loss of value to the Crown.

If possible, the Minister of Finance should avoid withholding the matter, either by making a decision on it before the forecasts are finalised, or by disclosing it without quantifying the risk.

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[15] For these purposes "unlikely" is taken to mean that the matter **will probably not** be approved within the forecast period (by considering, for example, whether there is a less than 20% chance of the matter occurring or being approved).

Contingent Liabilities and Contingent Assets

Contingent liabilities are possible costs that have arisen from past events, but the amount of the liability, or whether it will eventuate, will not be confirmed until a particular event occurs or present liabilities that are unable to be measured with sufficient reliability to be recorded in the financial statements (unquantifiable liabilities).

Typically, contingent liabilities consist of guarantees and indemnities, uncalled capital and legal disputes and claims. The contingent liabilities facing the Crown are a mixture of operating and balance sheet risks, and they can vary greatly in magnitude and likelihood of realisation.

In general, if a contingent liability were realised, or the amount becomes sufficiently reliable to record as a liability, it would reduce the operating balance and net worth and increase debt. In the case of contingencies for uncalled capital, the negative impact would be restricted to core Crown net debt because the cost would be offset by the acquisition of capital.

Where contingent liabilities have arisen as a consequence of legal action being taken against the Crown, the amount shown is the amount claimed and thus the maximum potential cost. It does not represent either an admission that the claim is valid or an estimation of the amount of any award against the Crown.

Contingent assets are possible assets that have arisen from past events but the amount of the asset, or whether it will eventuate, will not be confirmed until a particular event occurs.

Only contingent liabilities and contingent assets involving amounts of over $100 million are separately disclosed. Quantifiable contingencies less than $100 million are aggregated in the “other quantifiable” total.

Some contingencies of the Crown are not able to be quantified. We have disclosed all unquantifiable contingent liabilities and unquantifiable contingent assets that are not expected to be remote.[16]

The contingencies have been stated as at 31 October 2014, being the latest set of reported contingencies.

[16] “Remote” is defined as being an item with less than a 10% chance of occurring.

Quantifiable Contingent Liabilities and Contingent Assets

Contingent liabilities		
Guarantees and indemnities	**Status**[17]	**31 October 2014 ($millions)**
Other guarantees and indemnities	Unchanged	217
		217
Uncalled capital		
Asian Development Bank	Unchanged	2,920
International Monetary Fund – promissory notes	Unchanged	1,077
International Bank for Reconstruction and Development	Unchanged	1,047
International Monetary Fund – arrangements to borrow	Unchanged	1,027
Other uncalled capital	Unchanged	18
		6,089
Legal proceedings and disputes		
Tax disputes	Unchanged	429
Other legal proceedings and disputes	Unchanged	52
		481
Other quantifiable contingent liabilities		
Unclaimed monies	Unchanged	113
Other quantifiable contingent liabilities	Unchanged	268
		381
Total quantifiable contingent liabilities		**7,168**
Contingent assets (all under $100 million)		**156**

[17] Status of contingent liabilities or assets when compared to the *Financial Statements of the Government of New Zealand for the year ended 30 June 2014.*

Unquantifiable Contingent Liabilities and Contingent Assets

Contingent liabilities	
Indemnities:	**Status**
Air New Zealand	Unchanged
Contact Energy Limited	Unchanged
Earthquake Commission (EQC)	Unchanged
Genesis Energy Limited	Unchanged
Housing New Zealand Corporation	Unchanged
Justices of the Peace, Community Magistrates and Disputes Tribunal Referees	Unchanged
Maui Contracts	Unchanged
Maui Partners	Unchanged
New Zealand Aluminium Smelter and Comalco	Unchanged
New Zealand Local Authorities	Unchanged
New Zealand Railways Corporation	Unchanged
Persons exercising investigating powers	Unchanged
Synfuels-Waitara Outfall Indemnity	Unchanged
Westpac New Zealand Limited	Unchanged
Legal claims and proceedings:	
Accident Compensation Corporation (ACC) litigation	Unchanged
Air New Zealand litigation	Changed
Kiwibank	Unchanged
Ministry of Education litigation	Unchanged
Television New Zealand	Unchanged
Treaty of Waitangi claims	Unchanged
Other unquantifiable contingent liabilities:	
Criminal Proceeds (Recovery) Act 2009	Unchanged
Environmental liabilities	Unchanged
Treaty of Waitangi claims – settlement relativity payments	Unchanged

Description of Contingent Liabilities

Quantifiable contingent liabilities over $100 million

Uncalled capital

As part of the Crown's commitment to a multilateral approach to ensure global financial and economic stability, New Zealand, as a member country of these organisations, contributes capital by subscribing to shares in certain institutions.

The capital (when called) is typically used to raise additional funding for loans to member countries or, in the case of the quota contributions, to directly finance lending to members. For New Zealand and other donor countries, capital contributions comprise both "paid in" capital and "callable capital or promissory notes".

The Crown's uncalled capital subscriptions over $100 million are as follows:

Uncalled capital	**31 October 2014**	**30 June 2014**
	$millions	**$millions**
Asian Development Bank	2,920	2,728
International Monetary Fund – promissory notes	1,077	1,013
International Bank for Reconstruction and Development	1,047	968
International Monetary Fund – arrangements to borrow	1,027	937

In addition to the uncalled capital above, the Crown Support Deed agreed with Southern Response Earthquake Services Ltd includes two capital subscriptions:

- a $500 million preference share facility under the Crown's agreement dated 5 April 2012 of which $100 million has already been called and paid, with the other $400 million called but unpaid as at 31 October 2014. The balance is forecast to be paid progressively over the period 2015 to 2017, and
- $500 million of uncalled ordinary shares under an amended Crown Support Deed dated 30 January 2013 by which Southern Response may issue a call notice following the payment or redemption of all preference shares. The extent to which this subscription will be called and paid depends on the ultimate cost of settling earthquake claims, which remains subject to significant uncertainty. See risk page 74.

Legal proceedings and disputes

Tax disputes

When a taxpayer disagrees with an assessment issued following the dispute process, the taxpayer may challenge that decision by filing proceedings with the Taxation Review Authority or the High Court. This contingent liability represents the maximum liability IRD has in respect of these cases.

$429 million at 31 October 2014 ($591 million at 30 June 2014)

Other quantifiable contingent liabilities

Unclaimed monies

Under the Unclaimed Money Act 1971, entities (eg, financial institutions, insurance companies) hand over money not claimed after six years to IRD. The funds are repaid to the entitled owner on proof of identification.

$113 million at 31 October 2014 ($112 million at 30 June 2014)

Unquantifiable contingent liabilities

This part of the Statement provides details of those contingent liabilities of the Crown that are not quantified, excluding those that are considered remote, reported by the following categories:

a Indemnities

b Legal disputes, and

c Other contingent liabilities.

a) Indemnities

Indemnities are legally binding promises where the Crown undertakes to accept the risk of loss or damage that another party may suffer or to hold the other party harmless against loss caused by a specific stated event.

A number of these indemnities are provided to organisations within the Crown's control. If these indemnities were to crystallise, the Crown would compensate the individual entity for the loss and there would likely be an adverse impact on core Crown expenses and core Crown net debt.

Party indemnified	**Instrument of indemnification**	**Actions indemnified**
Air New Zealand	Deed of indemnity issued 24 September 2001	Claims arising from acts of war and terrorism that cannot be met from insurance, up to a limit of US$1 billion in respect of any one claim.
Contact Energy Limited	The Crown and Contact Energy signed a number of documents to settle in full Contact's outstanding land rights and geothermal asset rights at Wairakei	The documents contained two reciprocal indemnities between the Crown and Contact to address the risk of certain losses to the respective parties' assets arising from the negligence or fault of the other party.
Earthquake Commission (EQC)	Section 16 of the Earthquake Commission Act 1993	As set out in the Earthquake Commission Act 1993, the Crown shall fund any deficiency in EQC's assets to cover its financial liabilities on such terms and conditions that the Minister of Finance determines. See risk page 73.

Party indemnified	**Instrument of indemnification**	**Actions indemnified**
Genesis Energy Limited	Deed between Genesis Power Limited and the Crown	The agreement sees the Crown compensate Genesis in the event that Genesis has less gas than it requires for the long-term supply of gas to cover Huntly power station's minimum needs.
	Genesis acquisition of Tekapo A & B power stations	Indemnity against any damage to bed of lakes and rivers subject to operating easements.
Housing New Zealand Corporation (HNZC)	The Crown has provided a warranty in respect of title to the assets transferred to Housing New Zealand Limited (HNZL)	The Crown indemnified HNZL against: • any breach of the warranty provided, and • any third party claims that are a result of acts or omissions prior to 1 November 1992. The Crown also indemnified the directors and officers of HNZL against any liability consequent upon the assets not complying with statutory requirements, provided it is taking steps to rectify any non-compliance.
Justices of the Peace, Community Magistrates and Disputes Tribunal Referees	Section 11CE of the District Courts Act 1947 Section 4F of the Justices of the Peace Act 1957 Section 58 of the Disputes Tribunal Act 1988	Damages or costs awarded against them as a result of them exceeding their jurisdiction, provided a High Court Judge certifies that they have exceeded their jurisdiction in good faith and ought to be indemnified.
Maui Contracts	Contracts in respect of which the Crown purchases gas from Maui mining companies and sells gas downstream to Contact Energy Limited, Vector Gas Limited and Methanex Waitara Valley Limited	The contracts provide for invoices to be re-opened in certain circumstances within two years of their issue date as a result of revisions to indices. These revisions may result in the Crown refunding monies or receiving monies from those parties.
Maui Partners	Confidentiality agreements with the Maui Partners in relation to the provision of gas reserves information	Any losses arising from a breach of the deed.
New Zealand Aluminium Smelter and Comalco	The Minister of Finance signed indemnities in November 2003 and February 2004 in respect of aluminium dross currently stored at another site in Invercargill	The indemnity relates to costs incurred in removing the dross and disposing of it at another site if required to do so by an appropriate authority.

Party indemnified	**Instrument of indemnification**	**Actions indemnified**
New Zealand Local Authorities	Section 9 of the Civil Defence Emergency Management Act 2002 Civil Defence Emergency Management Plan	The Guide to the National Civil Defence Emergency Management Plan ("the Guide") states that, with the approval of the Minister, the Government will reimburse local authorities, in whole or in part, for certain types of response and recovery costs incurred as a result of a local or national emergency. The Guide is approved and issued by the Director of Civil Defence Emergency Management.
New Zealand Railways Corporation	The Minister of Finance signed the indemnity on 1 September 2004	The directors of New Zealand Railways Corporation against all liabilities in connection with the Corporation taking ownership and/or responsibility for the national rail network and any associated assets and liabilities.
	Section 10 of the Finance Act 1990	Guarantees all loan and swap obligations of the New Zealand Railways Corporation.
Persons exercising investigating powers	Section 63 of the Corporations (Investigation and Management) Act 1989	Indemnifies the Financial Markets Authority (formerly Securities Commission), the Registrar and Deputy Registrar of Companies, members of advising committees within the Act, every statutory manager of a corporation, and persons appointed pursuant to sections 17 to 19 of the Act, in the exercise of investigating powers, has been exercised in bad faith.
Synfuels-Waitara Outfall Indemnity	1990 sale of the Synfuels plant and operations to New Zealand Liquid Fuels Investment Limited (NZLFI)	The Crown transferred to NZLFI the benefit and obligation of a Deed of Indemnity between the Crown and Borthwick-CWS Limited (and subsequent owners) in respect of the Waitara effluent transfer line which was laid across the Waitara meat processing plant site. The Crown has the benefit of a counter indemnity from NZLFI which has since been transferred to Methanex Motunui Limited.