

DEFENCE

APPENDICES

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Table 8.1: Budgeted Statement of Financial Performance⁽¹⁾

2003-04 Actual Result \$'000	2004-05 Budget Estimate \$'000	2004-05 Revised Estimate \$'000	Variation %	2005-06 Forward Estimate \$'000	2006-07 Forward Estimate \$'000	2007-08 Forward Estimate \$'000	
REVENUES							
14,639,217	Appropriations from Government	15,625,941	15,729,698	0.7	15,299,062	15,769,340	16,628,324
252,883	Sales of goods and services	245,670	262,789	7.0	261,074	265,923	271,173
143	Interest	-	-	-	-	-	-
185,159	Revenue from asset sales	230,980	206,480	(10.6)	40,000	40,000	40,000
16,552	Net gain on foreign exchange	-	-	-	-	-	-
579,828	Assets now recognised	-	600,000	-	100,000	65,000	35,000
156,211	Other	86,892	72,046	(17.1)	50,434	46,980	47,916
15,829,993	Total Revenues	16,189,483	16,871,013	4.2	15,750,570	16,187,243	17,022,413
EXPENSES							
6,827,421	Employees	6,710,346	6,677,700	(0.5)	6,824,772	7,110,227	7,438,010
5,302,089	Suppliers	6,109,274	6,028,823	(1.3)	5,878,121	6,000,275	6,455,405
7,183	Grants	1,250	9,266	641.3	1,275	1,301	1,327
2,799,405	Depreciation and amortisation	2,984,937	3,134,337	5.0	2,844,827	2,902,724	2,995,788
1,152,818	Write-down of assets	100,000	800,000	700.0	130,000	100,000	65,000
163,575	Value of assets sold	230,980	206,480	(10.6)	40,000	40,000	40,000
75,158	Other	-	-	-	-	-	-
16,327,649	Total Expenses	16,136,787	16,856,606	4.5	15,718,995	16,154,527	16,995,530
34,148	Borrowing cost expense	31,446	31,446	-	32,075	32,716	26,883
(531,804)	Net Operating Result	21,250	(17,039)	(180.2)	(500)	-	-
EQUITY INTEREST							
37,144,693	Accumulated surpluses at 1 July	36,335,083	36,612,889	(0.8)	38,297,280	38,399,260	38,510,830
36,612,889	Total Available for Appropriation	38,057,764	38,297,280	(0.6)	38,399,260	38,510,830	38,628,540
-	Change in accounting policy	-	-	-	-	-	-
-	Capital Withdrawal	-	-	-	-	-	-
36,612,889	Accumulated Surpluses as at 30 June	38,057,764	38,297,280	(0.6)	38,399,260	38,510,830	38,628,540

Note

1. Cross reference to Table 2.5 on p. 16.

Table 8.2: Budgeted Statement of Financial Position⁽¹⁾

2003-04 Actual Result \$'000	2004-05 Budget Estimate \$'000	2004-05 Revised Estimate \$'000	Variation %	2005-06 Forward Estimate \$'000	2006-07 Forward Estimate \$'000	2007-08 Forward Estimate \$'000
ASSETS						
Financial Assets						
237,809	(90,443)	87,584	196.8	87,584	87,584	87,584
777,044	1,061,322	824,799	-22.3	769,999	694,399	597,399
1,014,853	970,879	912,383	-6.0	857,283	781,983	684,983
Non Financial Assets						
10,059,528	8,923,728	9,879,536	10.7	9,830,668	9,774,816	9,716,175
35,743,501	36,258,966	36,098,918	(0.4)	37,211,919	38,493,164	40,023,017
299,103	85,847	254,313	196.2	234,129	213,235	191,632
26,010	19,047	26,010	36.6	26,010	26,010	26,010
4,464,895	3,836,895	4,519,866	17.8	4,583,100	4,798,249	4,929,061
689,681	718,548	689,681	(4.0)	689,681	689,681	689,681
51,282,718	49,843,031	51,468,324	3.3	52,575,507	53,995,155	55,575,576
52,297,571	50,813,910	52,380,707	3.1	53,432,790	54,777,138	56,260,559
LIABILITIES						
Debt						
367,943	317,570	354,336	11.6	339,856	324,436	308,076
367,943	317,570	354,336	11.6	339,856	324,436	308,076
Provisions and Payables						
3,907,316	1,955,018	2,104,151	7.6	2,044,994	1,956,925	1,843,980
1,017,313	1,200,066	1,017,313	(15.2)	1,017,313	1,017,313	1,017,313
407,723	373,729	407,723	9.1	407,723	407,723	407,723
5,332,352	3,528,813	3,529,187	0.0	3,470,030	3,381,961	3,269,016
5,700,295	3,846,383	3,883,523	1.0	3,809,886	3,706,397	3,577,092
46,597,276	46,967,527	48,497,184	3.3	49,622,904	51,070,741	52,683,467
EQUITY						
1,774,924	1,661,852	2,023,674	21.8	3,047,414	4,383,681	5,878,697
8,209,463	7,247,911	8,176,230	12.8	8,176,230	8,176,230	8,176,230
36,612,889	38,057,764	38,297,280	0.6	38,399,260	38,510,830	38,628,540
46,597,276	46,967,527	48,497,184	3.3	49,622,904	51,070,741	52,683,467
1,980,192	1,964,958	2,019,761	3.0	1,975,139	1,888,382	1,804,503
50,317,379	48,848,952	50,360,946	3.1	51,457,651	52,888,756	54,456,056
2,322,821	2,233,182	2,315,607	4.0	2,316,480	2,317,420	2,318,360
3,377,474	1,613,200	1,567,916	(3.0)	1,493,406	1,388,977	1,258,732

Note

1. Cross reference to Table 2.6 on p. 18.

Table 8.3: Budgeted Statement of Cash Flows

2003-04 Actual Result \$'000	2004-05 Budget Estimate \$'000	2004-05 Revised Estimate \$'000	Variation %	2005-06 Forward Estimate \$'000	2006-07 Forward Estimate \$'000	2007-08 Forward Estimate \$'000
OPERATING ACTIVITIES						
14,570,357	15,625,941	15,729,698	0.7	15,299,062	15,769,340	16,628,324
274,338	266,798	285,389	7.0	278,144	283,209	288,801
143	-	-	-	-	-	-
710,088	872,561	894,077	2.5	873,761	918,321	981,337
217,663	84,892	70,046	(17.5)	48,434	44,980	45,916
398,341	71,100	150,523	111.7	55,100	75,300	97,000
16,170,930	16,921,292	17,129,733	1.2	16,554,501	17,091,150	18,041,378
6,237,818	6,812,081	6,779,435	(0.5)	6,781,449	7,086,726	7,433,245
5,382,001	6,110,472	6,157,885	0.8	5,970,859	6,149,246	6,654,613
7,183	1,250	9,266	641.3	1,275	1,301	1,327
-	109,276	109,276	-	111,713	129,972	120,714
75,313	31,446	31,446	-	32,075	32,716	26,883
-	209,167	198,278	(5.2)	-	-	-
11,702,315	13,273,692	13,285,586	0.1	12,897,371	13,399,961	14,236,782
4,468,615	3,647,600	3,884,147	6.5	3,657,130	3,691,189	3,804,596
OPERATING ACTIVITIES						
INVESTING ACTIVITIES						
184,366	230,980	206,480	(10.6)	40,000	40,000	40,000
184,366	230,980	206,480	(10.6)	40,000	40,000	40,000
2,454,482	2,874,945	3,090,144	7.5	3,361,372	3,658,292	3,995,035
720,523	608,743	614,541	1.0	597,404	523,931	520,362
1,202,210	731,310	731,310	-	747,614	869,813	807,855
4,377,215	4,214,998	4,435,995	5.2	4,706,390	5,052,036	5,323,252
(4,192,849)	(3,984,018)	(4,229,515)	(6.2)	(4,666,390)	(5,012,036)	(5,283,252)
INVESTING ACTIVITIES						
FINANCING ACTIVITIES						
706,334	299,025	375,498	25.6	1,023,740	1,336,267	1,495,016
706,334	299,025	375,498	25.6	1,023,740	1,336,267	1,495,016
117,983	13,607	13,607	-	14,480	15,420	16,360
-	-	-	-	-	-	-
742,418	139,000	126,748	(8.8)	-	-	-
860,401	152,607	140,335	(8.0)	14,480	15,420	16,360
(154,067)	146,418	235,143	60.1	1,009,260	1,320,847	1,478,656
121,699	(190,000)	(150,225)	20.9	-	-	-
99,557	99,557	237,809	138.9	87,584	87,584	87,584
16,553	-	-	-	-	-	-
237,809	(90,443)	87,584	196.8	87,584	87,584	87,584
CASH AT 30 JUNE⁽¹⁾						

Note

1. Cross reference to Table 2.7 on p. 20.

Table 8.4: Capital Budget Statement

2003-04 Actual Result \$'000	2004-05 Budget Estimate \$'000	2004-05 Revised Estimate \$'000	Variation %	2005-06 Forward Estimate \$'000	2006-07 Forward Estimate \$'000	2007-08 Forward Estimate \$'000	
CAPITAL EXPENDITURE							
2,454,482	Purchase of specialist military equipment	2,874,945	3,090,144	7.5	3,361,372	3,658,292	3,995,035
720,523	Purchase of property, plant and equipment	608,743	614,541	1.0	597,404	523,931	520,362
3,175,005	Total Capital Payments	3,483,688	3,704,685	6.3	3,958,776	4,182,223	4,515,397
Funded from:							
706,334	Equity injection ⁽¹⁾	299,025	375,498	25.6	1,023,740	1,336,267	1,495,016
2,366,709	Operating receipts	3,092,683	3,237,207	4.7	2,895,036	2,805,956	2,980,381
101,962	Net Capital receipts ⁽²⁾	91,980	91,980	-	40,000	40,000	40,000
3,175,005	Total Capital Funding	3,483,688	3,704,685	6.3	3,958,776	4,182,223	4,515,397
CAPITAL RECEIPTS							
184,366	Proceeds from sale of specialist military equipment	230,980	206,480	(10.6)	40,000	40,000	40,000
-	Proceeds from sales of property, plant and equipment	-	-	-	-	-	-
-	- Other capital receipts	-	-	-	-	-	-
82,404	Less: Capital withdrawal	(139,000)	(114,500)	17.6	-	-	-
101,932	NET CAPITAL RECEIPTS⁽³⁾	91,980	91,980	-	40,000	40,000	40,000

Notes

1. Cross reference to Serial 2 in Table 2.1 on p. 11 and Serial 8 in Table 2.7 on p. 20.
2. Cross reference to Serial 5 in Table 2.1 on p. 11.
3. Cross reference to Table 3.6 at p. 46.

Table 8.5: Non-Financial Assets – Summary of Movement

Revised Budget Year 2004-05	Land	Buildings	Other IP&E	Specialist Military Equipment	Software	Other Intangibles	Heritage and cultural	Total
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Gross value								
Gross value as at 30 June 2004	2,735,137	10,231,702	7,902,428	53,607,244	299,881	156,871	26,010	74,933,263
Gross value - additions	-	220,939	391,884	3,082,131	-	1,718		3,704,685
Gross value - revaluations		(33,233)						(33,233)
Gross value - disposals	(80,970)	(117,608)	(118,270)	(39,934)				(356,782)
Gross value - write offs				(800,000)				(800,000)
Gross value - other movements				600,000				600,000
Gross value as at 30 June 2005	2,654,167	10,301,800	8,176,042	56,457,454	299,881	158,589	26,010	78,047,933
ACCUMULATED DEPRECIATION/AMORTISATION								
Accumulated depreciation/amortisation as at 30 June 2004	-	2,907,311	2,799,430	22,966,741	101,065	56,584	-	28,831,131
Depreciation/amortisation on assets held at the beginning of the year	-	221,617	349,466	2,516,746	18,486	28,022		3,134,337
Accumulated depreciation/amortisation on assets disposed through the year	-	52,497	63,641	34,164	-	-	-	150,302
Accumulated depreciation/amortisation as at 30 June 2005	-	3,076,431	3,085,255	25,449,323	119,551	84,606	-	31,815,166
Net Book Value 30 June	2,654,167	7,225,369	5,090,787	31,008,131	180,330	73,983	26,010	46,232,767

Table 8.6: Schedule of Budgeted Revenues and Expenses Administered on Behalf of Government

2003-04 Actual \$'000		2004-05 Budget Estimate \$'000	2004-05 Revised Estimate \$'000	Variation %	2005-06 Forward Estimate \$'000	2006-07 Forward Estimate \$'000	2007-08 Forward Estimate \$'000
Revenues Administered on Behalf of Government							
	Interest and						
232,971	Dividends	45,047	52,600	16.8	15,276	19,079	25,189
629,150	Other	603,389	674,405	11.8	686,475	686,475	686,475
	Total revenues administered on behalf of Government	648,436	727,005	12.1	701,751	705,554	711,664
Expenses Administered on Behalf of Government							
2,288,506	Military benefits	2,329,400	2,429,100	4.3	2,530,100	2,530,100	2,630,100
8,202	Subsidies	7,500	9,250	23.3	9,250	9,250	9,250
22,792	Other	-	-	-	-	-	-
	Total expenses administered on behalf of Government	2,336,900	2,438,350	4.3	2,539,350	2,539,350	2,639,350

Table 8.7: Schedule of Budgeted Assets and Liabilities Administered on Behalf of Government

2003-04 Actual \$'000		2004-05 Budget Estimate \$'000	2004-05 Revised Estimate \$'000	Variation %	2005-06 Forward Estimate \$'000	2006-07 Forward Estimate \$'000	2007-08 Forward Estimate \$'000
Assets Administered on Behalf of Government							
-	Cash	-	-	-	-	-	-
23,896	Receivables	10,000	14,369	43.7	4,369	4,369	4,369
1,258,883	Investments	1,258,883	1,258,883	-	1,258,883	1,258,883	1,258,883
85,044	Non-Financial Assets	74,016	90,000	21.6	95,000	100,000	105,000
Total assets administered on behalf of Government							
1,367,823		1,342,889	1,363,252	1.5	1,358,252	1,363,252	1,368,252
Liabilities Administered on Behalf of Government							
29,064,000	Military benefits	29,580,000	30,100,000	1.8	31,000,000	32,000,000	33,000,000
Total liabilities administered on behalf of Government							
29,064,000		29,580,000	30,100,000	1.8	31,000,000	32,000,000	33,000,000
Represented by:							
108,940	Current assets	10,000	14,369	43.7	14,369	14,369	14,369
1,258,883	Non-current assets	1,332,889	1,348,883	1.2	1,353,883	1,358,883	1,363,883
1,357,000	Current liabilities	-	-	-	-	-	-
27,707,000	Non-current liabilities	29,580,000	30,100,000	1.8	31,000,000	32,000,000	33,000,000

Table 8.8: Schedule of Budgeted Administered Cash Flows

2003-04 Actual		2004-05 Budget Estimate	2004-05 Revised Estimate	Variation	2005-06 Forward Estimate	2006-07 Forward Estimate	2007-08 Forward Estimate
\$'000		\$'000	\$'000	%	\$'000	\$'000	\$'000
OPERATING ACTIVITIES							
Cash Received							
	Cash from the Official						
1,343,734	Public Account	1,436,900	1,402,350	(2.4)	1,639,350	1,539,350	1,639,350
232,971	Interest and dividends	45,047	52,600	16.8	15,276	19,079	25,189
658,633	Other	618,389	689,405	11.5	696,475	686,475	686,475
2,235,338	Total Cash Received	2,100,336	2,144,355	2.1	2,351,101	2,244,904	2,351,014
Cash Used							
1,335,532	Military benefits	1,429,400	1,393,100	(2.5)	1,630,100	1,530,100	1,630,100
8,202	Subsidies	7,500	9,250	23.3	9,250	9,250	9,250
	Cash to the Official						
971,992	Public Account	663,436	742,005	11.8	711,751	705,554	711,664
-	Other	-	-	-	-	-	-
2,482,708	Total Cash Used	2,325,564	2,144,355	(7.8)	2,351,101	2,244,904	2,351,014
	Net cash from/(to)						
(80,388)	operating activities	-	-	-	-	-	-
	Net (decrease) / increase						
80,226	in cash held	-	-	-	-	-	-
	Cash at the beginning of						
162	the reporting period	-	-	-	-	-	-
	Cash at the end of the						
-	reporting period	-	-	-	-	-	-

NOTES TO THE BUDGETED FINANCIAL STATEMENTS

Note 1 – Key Accounting Policies

1.1 Budgeted Financial Statements Overview

Budgeted financial statements have been included to show the planned financial performance over the 2004-05 budget year, and each of the following forward years from 2005-06 to 2007-08.

Budgeted statements of financial performance, financial position and cash flows, and a budgeted capital statement, are provided to show the revenues, expenses, assets, liabilities and equity of Defence. These budgeted statements contain estimates prepared in accordance with the requirements of the Government's financial budgeting and reporting framework.

Budgeted financial estimates are provided for both *departmental* and *administered* financial items. *Departmental*, or controlled, financial statements are those statements which include revenues, expenses, assets and liabilities over which Defence has discretion, responsibility and authority. *Departmental* financial statements represent the financial performance of Defence in delivering its outcomes.

Administered financial estimates include revenues, expenses, assets and liabilities that Defence administers on behalf of the Government, but over which Defence does not have management control. These typically include military superannuation benefits.

1.2 Comparative figures and variations

In recognition of the budget development and scrutiny process, variations explained in the budgeted financial statements are between the budget and the revised estimate for 2004-05, unless otherwise noted. The actual result for 2003-04 is also included in these budgeted financial statements for comparative purposes and is based on the audited financial results as provided in the *Defence Annual Report 2003-04*.

1.3 Rounding

Unless otherwise stated, the convention used in these budgeted financial statements is to round amounts to the nearest \$'000. Totals are the sum of unrounded figures.

1.4 Budgeted Departmental Financial Statements and Schedule of Budgeted Administered Activity

Note that the term '*budgeted financial statements*' and '*statements*' are used interchangeably.

Under the Australian Government's accrual-based budgeting framework, and consistent with Australian Accounting Standards, transactions that agencies control (Departmental transactions) are separately budgeted for and reported, compared to transactions that agencies do not have control over (Administered transactions). This ensures that agencies are only held fully accountable for the transactions over which they have control.

- Departmental expenses include employee and supplier expenses and other administrative costs, which are incurred by Defence in providing its goods and services.
- Administered items are revenues, expenses, assets and liabilities that are managed by Defence on behalf of the Government according to set the Government directions and which Defence does not have management control. These include Military Superannuation contributions, payments received from the United Nations and foreign governments, bank interest and dividends paid by the Defence Housing Authority.

1.5 Appropriations in the accrual budgeting framework

Under the Australian Government's accrual budgeting framework, separate annual appropriations are provided for:

- departmental price of outcomes appropriations (representing the Government's funding for outcomes from agencies);
- departmental capital appropriations (representing investments by the Government for either additional equity in or loans to agencies);
- administered expense appropriations (representing estimated Administered expenses relating to an existing outcome, a new outcome or a Specific Purpose Payment to the states); and
- administered capital appropriations (represent increases in Administered equity through funding non-expense Administered payments).

Special appropriations fund the majority of payments from the Consolidated Revenue Fund (especially those that are entitlement driven or involve transfers to state and territory governments).

1.6 Basis of Accounting

The Budgeted statements have been prepared in accordance with:

- the Financial Management and Accountability Orders under the authority of section 63 of the *Financial Management and Accountability Act 1997*;
- Australian Accounting Standards (AAS) and Accounting Interpretations issued by the Australian Accounting Standards Board (AASB); and
- Consensus Views of the Urgent Issues Group.

The Budgeted Statements of Financial Performance and Financial Position have been prepared on an accrual basis and are in accordance with the historic cost convention, except for certain assets which, as noted (refer to items 1.15 and 1.16), are at valuation. Except where stated, no allowance is made for the effect of changing prices on the results or financial position.

Revenues and expenses are recognised in the Statement of Financial Performance when, and only when, the flow or consumption or loss of economic benefits has occurred and can be reliably measured.

Administered revenues, expenses, assets and liabilities and cash flows reported in the Schedules of Administered Item are accounted for on the same basis and using the same policies as for departmental items, except as otherwise stated.

1.7 Changes in Accounting Policy

The accounting policies used in the preparation of these budgeted financial statements are consistent with those used in the preparation of the *Portfolio Budget Statements 2004-05*.

1.8 Revenue

Revenues from Government

Departmental outputs appropriation for the year are recognised as revenue, except for certain amounts which relate to activities that are reciprocal in nature, in which case revenue is recognised only when it has been earned.

From 2002-03, Defence elected to operate on an 'as required' draw-down basis that has resulted in undrawn appropriations that will be reflected as a receivable. This receivable is available for draw-down to meet future obligations.

Other Revenue

Revenue from the delivery of goods and the rendering of services is recognised by reference to the stage of completion of contracts or other agreements to provide goods or services. The stage of completion is determined according to the proportion that costs incurred to date bear to the estimated total costs of the transaction. Revenue from disposal of non-current assets is recognised when control of the asset has passed to the buyer.

1.9 Transactions with Government

Equity Injection

Equity injection represents an additional contribution to Defence by the Government, which is over and above the revenue from the Government for the price of outcomes. Equity injections are used entirely to fund capital expenditure. The Finance Ministers' Orders require that amounts of appropriations designated as 'equity injections' are recognised directly in Contributed Equity as at 1 July or later date of effect of the appropriation.

1.10 Employee Benefits

Defence's workforce comprises two employment components: Australian Public Service (APS, ie civilians) and Australian Defence Force (ADF, ie military) personnel. Employee benefits for each workforce component are based on the relevant employment agreements and legislation.

Liabilities for services rendered by employees are recognised at the reporting date to the extent that they have not been settled.

Liabilities for wages and salaries (including non-monetary benefits), annual leave and sick leave are measured at their nominal amounts. Other employee benefits expected

to be settled within 12 months of the reporting date are also measured at their nominal amounts. The nominal amount is calculated with regard to the rates expected to be paid on settlement of the liability.

Leave

The liability for employee benefits includes provision for annual leave and long service leave. No provision has been made for sick leave as all sick leave is non-vesting and the average sick leave taken in future years by employees of Defence is estimated to be less than the annual entitlement for sick leave. The leave liabilities are calculated on the basis of employees' remuneration, including Defence's employer superannuation contribution rates to the extent that the leave is likely to be taken during service rather than paid out on termination.

The liability for long service leave is determined by reference to the work of an actuary. The estimate of the value of the liability takes into account attrition rates and pay increases through promotion and inflation.

The liability for annual leave for APS employees reflects the value of total annual leave entitlements of all such employees and is recognised at the nominal amount. All annual leave for APS employees is current. The liability in respect of annual leave for ADF personnel reflects an estimate of the total value of annual leave entitlements. The liability is recognised as the best estimate of the nominal amount required to settle the obligation as at the reporting date. All annual leave for ADF is current.

Superannuation

Permanently appointed APS employees and the department contribute to the Commonwealth Superannuation Scheme (CSS) or the Public Sector Superannuation Scheme (PSS). These schemes are defined benefit superannuation plans for APS employees. No liability is shown for APS superannuation in the Statement of Financial Position as the employer superannuation contributions by Defence fully extinguish the accruing liability, which is assumed by the Commonwealth, and is reported by the Department of Finance and Administration, with the administration being conducted by ComSuper. For APS employees who are not members of the CSS or PSS the Department makes an employer superannuation contribution to their nominated fund.

The Defence Force Retirement and Death Benefits Scheme (DFRDB) and the Military Superannuation Benefits Scheme (MSBS) are defined benefit superannuation plans for ADF members. ADF employer superannuation contributions, pension payments, DFRDB member contributions and the provision for unfunded superannuation are reflected in the Schedules of Administered Items

Military Workers' Compensation

The *Military Rehabilitation and Compensation Bill 2003* and the *Military Rehabilitation and Compensation (Consequential and Transitional Provisions) Bill 2003* passed by the Parliament on 1 April 2004, provide for the establishment of the new Military Rehabilitation and Compensation scheme. The new scheme significantly reforms the existing arrangement of two separate military compensation schemes under multiple

sources of legislation including the *Veterans' Entitlements Act 1986* and the *Safety Rehabilitation and Compensation Act 1988*. Effective from 1 July 2004, the Department of Veterans' Affairs is the single administrative body for all forms of ADF compensation under the old and the new schemes.

Employee Workplace Agreements

As a result of workplace agreements in place for Defence employees, a number of pay increases for both APS and ADF personnel are due to be paid in ensuing years. The current military agreement is for a period of 18 months from 6 May 2004 until 3 November 2006. The remaining pay rises are 2 per cent from 2 June 2005 and 1.5 per cent from 9 March 2006. The APS Certified Agreement expires on 31 December 2006. The remaining pay rises are 2 per cent from 2 June 2005 and 2 per cent from 12 January 2006. Remuneration for executives (being members of the Senior Executive Service or equivalent) is subject to individual agreements.

1.11 Asbestos-related Disease Exposure

An inter-departmental committee chaired by the Department of Finance and Administration commissioned an actuarial study on the nature and extent of the Australian Government's liability for Asbestos-Related Diseases. The Actuarial Assessment of the Australian Government Asbestos-Related Disease Exposure report, which was finalised in October 2003, involved collecting extensive data on individual Australian Government claims, modeling the various sources of claims and conducting interviews with various Australian Government agencies involved in managing the claims.

The provision is based on the best estimate of Defence's potential exposure, consistent with the requirement of AASB 1044, Provisions, Contingent Assets and Contingent Liabilities. In making the best estimate of the consideration required to settle the provision, the Actuary has applied independent expertise and has used existing historical data, as well as similar claims elsewhere. The estimate represents the present value of future compensation payments on both future reported claims and currently open claims, including defendant legal costs. In the financial statements, Defence is required to present the full liability as well as disclosing the asset.

1.12 Cash

Cash means notes and coins held, as well as any deposits held at call with a bank or financial institution. Changed cash management procedures during 2002-03 required Defence to adopt an 'as required' draw-down approach to appropriations. This has reduced the amount of cash held by Defence. Undrawn appropriation is represented as a receivable from the Commonwealth.

1.13 Acquisition of Assets

Assets are recorded at cost of acquisition except as stated below. The cost of acquisition includes the fair value of assets transferred in exchange and liabilities undertaken. With the exception of specialist military equipment, assets acquired at no cost or for nominal consideration are initially recognised as assets and revenues at

their fair value as at the date of acquisition, unless acquired as a consequence of restructuring of administrative arrangements. In the latter case, assets are initially recognised as contributions by owners at the amounts at which they were recognised in the transferor agency's accounts immediately prior to the restructuring.

1.14 Property, Plant and Equipment including Land, Buildings and Infrastructure

Asset Recognition Threshold

Purchases of property, plant and equipment are recognised initially at cost in the Budgeted Statement of Financial Position where they meet the capitalisation threshold. Individual items will be capitalised where the individual value is equal to or exceeds \$10,000. Grouped assets will be capitalised for items of homogenous nature within a single class where the individual item values equal or exceed \$2,000 and the class group value equals or exceeds \$50,000.

Asset valuation

From 1 July 2002, Commonwealth agencies and authorities are required to use the cost basis (for specialist military equipment and intangibles) or the fair value basis (for other, infrastructure, plant and equipment) to measure Property, Plant and Equipment. The shift from the deprival method of valuation to fair value occurred gradually over a three-year period. Fair value essentially reflects the current market value of an asset.

Revaluations

In accordance with Schedule 1 of the Financial Management and Accountability (Financial Statements 2003-2004) Orders and AASB 1041 Revaluation of Non-Current Assets, all non-current assets are valued on the fair value basis from 1 July 2002, with the exception of specialist military equipment, which is currently valued on the basis of historical costs.

Property, plant and equipment, except for assets under construction and specialist military equipment with values greater than established revaluation thresholds, are revalued progressively in successive three-year cycles. All current progressive revaluation cycles commenced on 1 July 2002 and will conclude by 30 June 2005.

Assets within each class acquired after the valuation of the asset type in the current revaluation cycle are reported at cost for the duration of the cycle unless significant changes in the value of the asset have occurred, in which case the asset will be subject to revaluation or indexation.

Assets under construction are not revalued but are accounted for at cost. In addition to reviewing expenditures from the point of rollout into service, assets under construction expenditures are now also considered on a whole-of-life basis.

All valuations are conducted by an independent qualified valuer.

Depreciation and Amortisation

Depreciable property, plant and equipment assets are written-off to their estimated residual values over their estimated useful lives to Defence using, in all cases, the

straight-line method of depreciation from the time they are first held ready for use. Leasehold improvements are amortised on a straight-line basis over the lesser of the estimated useful life of the improvements and the unexpired period of the lease.

Depreciation and amortisation rates (useful lives) and methods are reviewed at each reporting date and necessary adjustments are recognised in the current, or current and future reporting periods, as appropriate. Residual values are re-estimated for a change in prices only when assets are revalued.

Asset Disposals

The gain or loss on disposal of property, plant and equipment is determined as the difference between the carrying amount of the asset at the time of disposal and the proceeds of disposal.

New disclosure requirements from 2002-03 require the proceeds from asset sales to be separately disclosed from the net book value of assets sold. Therefore the gross position is disclosed in the Budgeted Statement of Financial Performance.

1.15 Inventory

Defence does not ordinarily hold inventory for sale. Sales recorded represent disposal of inventory, surplus to requirements, and minor fuel sales. Inventory has been brought to account at weighted average cost since 2001-02.

Costs incurred in bringing each item of inventory (primarily explosive ordnance and general stores) to its present location and condition, that are capable of being allocated on a reasonable basis, are assigned on a weighted average cost basis.

Previously, as historic cost was not available in all instances, inventory was brought to account at average cost, replacement cost or at last purchase price.

Inventory is considered obsolete based upon the nature of current inventory levels and expected usage of such assets in the achievement of Defence's Outcomes.

1.16 Investments

Investments held on behalf of the Commonwealth are included as administered assets and are brought to account as the value of the Commonwealth's share as at 30 June 1997 of the net assets of the entity, except where there has been a return of equity to the owner (the Government). This is a requirement of the Finance Ministers' Orders. Administered investments in controlled entities are not consolidated because their consolidation is relevant only at the whole-of-government level.

1.17 Taxation

Defence's activities are exempt from all forms of taxation except fringe benefits tax and the goods and services tax (GST). Defence is able to claim input credits for goods and services tax incorporated within the costs of assets and supplies purchased by Defence.

Revenues, expenses and assets are recognised net of GST except:

- where the amount of GST incurred is not recoverable from the Australian Taxation Office (in these circumstances GST is recognised as part of the cost of acquisition of the asset or part of the item of expense); and
- for receivables and payables (which are shown inclusive of GST in the Budgeted Statement of Financial Position).

1.18 Leases

A distinction is made between finance leases which effectively transfer from the lessor to the lessee substantially all the risks and benefits incidental to ownership of leased non-current assets and operating leases under which the lessor effectively retains substantially all such risks and benefits.

Where a non-current asset is acquired by means of a finance lease, the asset is capitalised at the present value of minimum lease payments at the inception of the lease and a liability recognised for the same amount. Leased assets are amortised over the period of the lease. Operating lease payments are expensed on a basis which is representative of the pattern of benefits derived from the leased assets.

1.19 Bad and Doubtful Debts

The provision for bad and doubtful debts is based on an analysis of the expected realisation of outstanding debts and write-off experience from prior years. Bad debts are written-off as they are identified. No provision is made for the Australian Government or Foreign Government debtors as they are deemed to be collectable.

1.20 Insurance

Defence has insured for key insurable risks through the Government's insurable risk-managed fund called Comcover. Workers compensation for civilians is insured through the Government's Comcare Australia. Defence meets the benefit costs for military compensation on an emerging cost basis.

1.21 Schedule of Budgeted Administered Activities

Administered revenues, expenses, assets, liabilities and cash flows are disclosed in the Schedules of Administered Items and related notes.

Except where otherwise stated below, administered items are accounted for on the same basis and using the same policies as for departmental items, including the application to the greatest extent possible of Australian Accounting Standards, Accounting Interpretations and Urgent Issues Group Consensus Views.

Administered appropriations received or receivable from the Official Public Account are not reported as administered revenues or assets respectively. Similarly, administered receipts transferred or transferable to the Official Public Account are not reported as administered expenses or payables. These transactions or balances are internal to the Administered entity.

Accounting policies that are relevant to administered activities only of Defence are disclosed below.

Administered Revenue

All administered revenues are revenues relating to the core operating activities performed by Defence on behalf of the Commonwealth. Administered revenues comprise Military Superannuation contributions, payments received from the United Nations and foreign governments, bank interest and dividends paid by the Defence Housing Authority.

Administered Expenses

All administered expenses are expenses relating to the core operating activities performed by Defence on behalf of the Commonwealth. Administered expenses comprise unfunded Military Superannuation benefits, ADF Housing Subsidies, ADF Retention Benefits and foreign exchange losses.

Administered Investments

Each Commonwealth department is required to show an Administered investment in each *Commonwealth Authority and Company (CAC) Act 1997* entity within their portfolio. These Administered investments should be valued at the Commonwealth's ownership interest in the net assets of those CAC entities, fixed at a notional acquisition date of 30 June 1997.

Military Retention Benefits

Certain categories of ADF personnel who are members of the Military Superannuation Benefits Scheme (MSBS) and have had 15 years of service receive Retention Benefits as an incentive for continued service. From 1 July 2002, Retention Benefit payments are recorded as prepayments instead of expenses. The change has been made to recognise the nature of these payments.

Military Superannuation

The Defence Force Retirement and Death Benefits Scheme (DFRDB) and the Military Superannuation Benefits Scheme (MSBS) are defined benefit superannuation plans for ADF members. ADF employer superannuation contribution revenue, pension and lump sum payments, the provision for unfunded DFRDB and MSBS superannuation and DFRDB member contribution revenue are reflected in the Schedules of Administered Items.

The DFRDB is a fully unfunded scheme but the MSBS is a partly funded scheme. MSBS member contributions are paid into the MSBS Fund that is controlled by the MSBS Board and are therefore not reflected in the Schedules of Administered Items. The Commonwealth on behalf of the MSBS Fund makes funded benefit payments to members of the scheme and the Commonwealth is reimbursed by the Fund for these payments.

The Australian Government Actuary (AGA) estimates the unfunded provisions and expected future cash flows as at 30 June each year. These estimates are reflected in the Schedules of Administered Items. The AGA completes a full review of the unfunded

liabilities (a Long Term Cost Report) every three years. The most recent Long Term Cost Report was completed as at 30 June 2002. ComSuper administers MSBS and DFRDB benefit payments on behalf of Defence. These payments are made using Defence Special Appropriations.

Note 2 – Budgeted Statement of Financial Performance - Variations in Estimates

This note provides explanations for the material variations between the 2004-05 revised budget and the 2004-05 budget estimates as published in the *Portfolio Budget Statements 2004-05* for Defence.

Departmental Statements

Budgeted Statement of Financial Performance

Appropriations from Government

The cost to the Government of Defence's outcomes directly equates to the full operating costs of inputs used by Defence during the year in delivering the outcomes. Defence's remaining funding requirements for the year are provided as new equity injection. Defence's budgeted cash flow statement shows how total cash received by Defence during the year is used to meet operating, investing and financing costs.

The cost of Defence's outcomes to the Government for 2004-05 is expected to increase by \$103.8m, predominantly due to new budget measures and a number of other technical adjustments including:

- the aggregate impact of a number of internal reallocations, including increased write-down expense (+\$100m), increased depreciation expense (+\$149.4m), reduced inventory consumption expense (-\$104.9m) and a reduction in the estimate for suppliers expense to reflect that the logistics support budget will be used to purchase new repairable items to replace current ones that have become uneconomical to repair (-\$120.0m) all fully offset in equity injection;
- revision of the price parameters used in the 2004-05 Budget reflecting movements in the non-farm gross domestic product deflator from 2.5 per cent to 3.3 per cent for 2004-05 (+\$85.1m);
- additional funding for implementation costs associated with the Australia-United States Free Trade Agreement (+\$5.5m);
- additional supplementation from the Government following a review of the costs arising from the property sale-and-leaseback program (+\$5.5m);
- continuation of funding for Operation Anode (+\$4.7m);
- supplementation for the implementation of recommendations of the Flood Inquiry into Australia's intelligence agencies (+\$0.7m);
- enhanced security for Australian diplomatic missions (-\$0.4m);
- reduced reimbursement for the 2003-04 costs associated with the commercialisation of the Defence Housing Authority (-\$1.5m);
- reduced reimbursement for the 2003-04 costs associated with the property sales disposal cost (-\$9.4m); and
- return of supplementation provided in the 2004-05 Budget as a result of a lower-than-expected increase in Comcover premiums (-\$11.7m).

Equity

The equity injection from the Government has increased by \$76.5m mainly due to the:

- an increase in foreign exchange supplementation reflecting the difference between current foreign exchange parameters and those on which the 2004-05 Budget was based (+\$75.1m);
- revision of the price parameters used in the 2004-05 Budget reflecting movements in the non-farm gross domestic product deflator from 2.5 per cent to 3.3 per cent for 2004-05 (+\$24.3m);
- funding for enhanced security for Australian diplomatic missions (+\$1.5m);
- supplementation for costs associated with the detention of illegal foreign fishers in Australia's northern waters (+\$0.1m); and
- internal re-allocations as outlined in Appropriations from Government, fully offsetting in nature (refer to first dot point on previous page) (-\$24.5m).

Sales of Goods and Services

The estimate for sales of goods and services has increased by \$17.1m from previous estimates due to:

- an internal reclassification from Other Revenue (+\$15.4m); and
- revision to the price parameters (+\$1.7m).

Other Revenue

The other revenue estimate has decreased by \$14.8m since the previous estimate due to:

- revision to the price parameters (+\$0.6m); and
- an internal reclassification from Other Revenue (-\$15.4m).

Revenue from the Sale of Assets

The estimate for Revenue from the Sale of Assets has decreased by \$24.5m as a result of the revised Property Sales Program.

Assets Recognised for the First Time

The Assets Recognised for the First Time estimate has increased by \$600.0m due to the expected outcome of stocktakes to be undertaken, including a large stocktake to occur at the Defence National Storage and Distribution Centre.

Employee Expenses

Employee expenses have decreased by \$32.6m from previous estimates mainly due to:

- revision to the price parameters (+\$45.9m);
- additional Operation Anode funding (+\$3.2m);
- supplementation for the implementation of recommendations of the Flood Inquiry into Australian intelligence agencies (+\$0.7m); and
- reallocation of funds to suppliers expenses to fund increases in the operating element of the capital program (-\$82.5m).

Suppliers Expenses

Suppliers expenses have decreased by \$80.5m from previous estimates mainly due to:

- reallocation of funds from employee expenses to fund increases in the operating element of the capital program (+\$82.5m);
- revision to the price parameters (+\$41.5m);
- rephasing of Operation Catalyst spending from 2003-04 (+\$14.6m);
- rephasing of Operation Anode spending from 2003-04 (+\$12.8m);
- additional supplementation from the Government following a review of the costs arising from the property sale-and-leaseback program (+\$5.5m);
- additional funding for implementation costs associated with the Australia-United States Free Trade Agreement (+\$5.5m);
- additional Operation Anode funding (+\$1.5m);
- enhanced security for Australian diplomatic missions (+\$0.4m);
- transfer of funding for the National Tidal Centre within the Bureau of Meteorology (-\$0.1m);
- return of supplementation provided in the 2004-05 Budget as a result of a lower-than-expected increase in Comcover premiums (-\$11.7m);
- revised Inventory Consumption estimate to better align with planned activity levels and continued valuation improvements (-\$104.9m);
- a reduction in the estimate for suppliers expense to reflect that some of the logistics support budget will be used to purchase new repairable items to replace current ones that have become uneconomical to repair (-\$120.0m); and
- a range of other variations (-\$8.1m).

Depreciation and Amortisation

Depreciation expense has increased by \$149.4m since the previous estimate due to the Government-endorsed accelerated withdrawal of the F-111 aircraft and two FFGs (HMAS *Adelaide* and *Canberra*).

Value of Assets Sold

The estimate for the Value of Assets Sold has decreased by \$24.5m as a result of the revised Property Sales Program.

Write-down of Assets

The write-down of Assets has increased by \$700m due to the expected outcome of planned stocktakes to be undertaken, including a large stocktake to occur at the Defence National Storage and Distribution Centre.

Budgeted Statement of Financial Position

Cash and Receivables

The \$178.0m increase in cash held from the previous budget estimate is due to:

- actual end of year result being \$138.3m higher than projected, primarily as a result of the 1 July 2004 payday monies being drawn down by Defence on 30 June 2004 (see p. 45 of the *2003-04 Defence Annual Report*, for further detail); and
- additional cash drawn from the Appropriation Receivable to reimburse the bank for the 27th pay (\$39.8m).

Receivables have decreased by \$236.5m from the previous budget estimate as a result of:

- refund of special appropriation *East Timor Act 1999-2000* (-\$0.2m);
- supplementation for costs associated with the commercialisation of Defence Housing Authority (Stamp duty & Land Tax) (-\$1.5m);
- reimbursement of property disposal costs (-\$9.4m);
- 2003-04 retrospective foreign exchange adjustment (-\$12.0m);
- Operation Anode (-\$12.8m);
- Operation Catalyst rephasing (-\$14.6m);
- additional draw-down from the receivable for the 27th pay (-\$39.8m);
- actual result for other receivables less than forecasted (-\$43.0m); and
- appropriation receivable at 1 July 2004 being less than the original budget (\$537.7m rather than \$640.9m) (-\$103.3m).

Infrastructure, Plant and Equipment

Infrastructure, Plant and Equipment has decreased by \$160.0m from previous estimates, as a result of:

- the actual 2003-04 closing position being \$130.0m less than estimated (see pp. 45-46 of the *2003-04 Defence Annual Report* for further detail);
- depreciation expense has increased by \$149.4m since the previous estimate due to the Government-endorsed accelerated withdrawal of the F-111 aircraft and two FFGs (HMAS *Adelaide* and *Canberra*);
- a increase in the estimate for specialist military equipment to reflect that some of the logistics support budget will be used to purchase new repairable items to replace current ones that have become uneconomical to repair (+\$120.0m);

- an increase in foreign exchange supplementation reflecting the difference between current foreign exchange parameters and those on which the 2004-05 Budget was based (+\$75.1m);
- revision to the price parameters (+\$24.3m); and
- increased write-down of Specialist Military Equipment above increased Assets Recognised for the First Time due to the expected outcome of planned stocktakes to be undertaken (-\$100m).

Inventories

Inventories has increased by \$683.0m from previous estimates, as a result of:

- the actual 2003-04 closing position being \$578.1m higher than estimated (see p. 47 of the *Defence Annual Report 2003-04* for further detail); and
- revised Inventory Consumption estimate to better align with planned activity levels and continued valuation improvements (+\$104.9m).

All other assets (Intangibles, Heritage and Cultural Assets and Other Non-Financial Assets) have changed since the previous estimate due to the actual 2003-04 closing position being different to the estimate at the time of the *Portfolio Budget Statements 2004-05* (see p 46 of the *Defence Annual Report 2003-04* for further detail).

Liabilities

Total Liabilities have increased by \$37.1m from previous estimates because the actual 2003-04 closing position for Lease Liabilities and Total Provisions and Payables were \$36.7m and \$0.4m greater, respectively, than the estimate at the time of the *Portfolio Budget Statements 2004-05* (see pp. 47-48 of the *Defence Annual Report 2003-04* for further detail).

Budgeted Statement of Cash Flows

In general, the explanation of variations in cash flows associated with operating items is included under the relevant statement of financial performance item above.

Reasons for other material variations elsewhere are outlined below.

Net GST Refund

Defence is registered as an Australian business and therefore is able to claim input tax credits from the Australian Taxation Office.

Proceeds from Sales of Property, Plant and Equipment

Proceeds from the sale of property, plant and equipment have decreased by \$24.5m from previous estimates, reflecting the revision of the 2004-05 property sales target.

Capital Withdrawal

Capital Withdrawal has decreased by \$12.3m from the previous estimate reflecting:

- revised property sales target for 2004-05 (-\$24.5m);
- final reconciliation of foreign exchange transactions from 2002-03 and 2003-04 (+\$12.1m); and

- return of special appropriation related to the *East Timor Act 1999-2000* (+\$0.2m).

Cash transferred from the Official Public Account

Cash transferred from the Official Public Account increased by \$79.4m from the previous estimate as a result of:

- increased draw-down from the appropriation receivable to fund the remainder of the 27th pay (+\$39.8m);
- rephasing of additional operations funding for Operations Anode and Catalyst (+\$27.4m);
- final reconciliation of foreign exchange transactions from 2002-03 and 2003-04 (+\$12.1m); and
- return of special appropriation related to the *East Timor Act 1999-2000* (+\$0.2m).

Cash transferred to the Official Public Account

Cash transferred from the Official Public Account decreased by \$10.9m from the previous estimate as a result of:

- reduced reimbursement of property disposal costs (-\$9.4m); and
- reduced reimbursement for costs associated with the commercialisation of Defence Housing Authority (Stamp duty & Land Tax) (-\$1.5m).

Administered Statements

Interest and Dividends

Interest and dividends has increased by \$7.6m from previous estimates, reflecting the revised estimate of dividends from the Defence Housing Authority.

Other Revenues

Other revenues administered on behalf of the Government have increased by \$71.0m from the previous estimate, reflecting the revised estimate of military superannuation contributions.

Expenses

Expenses administered on behalf of the Government will increase by \$101.5m from \$2,336.9m to \$2,438.4m, representing an increase of 4.3 per cent from the 2004-05 budget estimate. The variation arises from an actuarial review of military superannuation schemes.

Note 3 – Summary of Estimated Special Account Balances

Table 8.9: Summary of Estimated Special Account Balances⁽¹⁾⁽²⁾

	Opening Balance 2004-05 <i>2003-04</i>	Receipts 2004-05 <i>2003-04</i>	Payments 2004-05 <i>2003-04</i>	Adjustments 2004-05 <i>2003-04</i>	Closing Balance 2004-05 <i>2003-04</i>
	\$'000	\$'000	\$'000	\$'000	\$'000
Services for Other Governments and Non-Agency Bodies – <i>Financial Management and Accountability Act 1997⁽³⁾</i>	93,927 <i>72,068</i>	110,000 <i>113,771</i>	90,000 <i>87,945</i>	- <i>-3,967</i>	113,927 <i>93,927</i>
Defence Endowments – <i>Financial Management and Accountability Act 1997⁽⁴⁾</i>	266 <i>264</i>	45 <i>40</i>	35 <i>31</i>	- <i>-7</i>	276 <i>266</i>
Fedorczenko Legacy Fund – <i>Financial Management and Accountability Act 1997⁽⁴⁾</i>	151 <i>148</i>	2 <i>7</i>	5 <i>4</i>	- <i>0</i>	148 <i>151</i>
Other Trust Monies – <i>Financial Management and Accountability Act 1997⁽⁴⁾</i>	9,356 <i>10,885</i>	1,500 <i>1,478</i>	2,200 <i>2,147</i>	- <i>-860</i>	8,656 <i>9,356</i>
Young Endeavour Youth Program – <i>Financial Management and Accountability Act 1997⁽⁴⁾</i>	878 <i>2,035</i>	677 <i>772</i>	783 <i>1,934</i>	- <i>6</i>	772 <i>878</i>
Total Special Accounts	104,578 <i>85,401</i>	112,224 <i>116,068</i>	93,023 <i>92,062</i>	- <i>-4,828</i>	123,779 <i>104,578</i>

Notes

1. 2004-05 revised estimates in bold.
2. 2003-04 actual outcome in italics.
3. The Services for other Governments balance includes money relating to Comcare. As Defence does not have a Ministerial determination for Comcare, it cannot be disclosed separately in this note to the financial statements.
4. These are Departmental special accounts.

