

ASSESSMENT GUIDELINES

INTRODUCTION

- 1 In response to calls to clarify and strengthen the Commission's decision making process in this review, we developed interim assessment guidelines. We developed them in consultation with the Australian and State Treasuries and they were first published in the *Progress Report to Ministerial Council for Commonwealth-State Financial Relations, 2006*. Since then, a number of additions and amendments have been made.
- 2 The guidelines are forward looking and have provided structure, rigor and transparency to the process of making assessments. They did this by:
 - defining the sequence of decisions;
 - specifying what information is needed at each step;
 - establishing the quality of the information the Commission requires; and
 - providing guidance on how to modify assessments, depending on the quality of the information on which they are based.
- 3 We consider that the guidelines have assisted in:
 - achieving consistent and appropriate standards in the assessment of disabilities and the development of categories, consistent with the principles of fiscal equalisation; and
 - doing this in the simplest, most transparent way possible, leading to assessments with fewer moving parts.
- 4 In operation, the guidelines set a clear hurdle for both individual disability assessments and expense or revenue category assessments to pass before they are included in the calculation of relativities. We decided not to index the materiality thresholds set at the start of this review, although they could be indexed in the future, if required.
- 5 The guidelines have also formed a key part of the quality assurance process. They have allowed us to be confident that all relevant information has been used in making decisions. They have also allowed external parties to follow the decision processes used by the Commission and to form conclusions about whether due process has been observed.
- 6 We planned to follow an iterative process in building and finalising our assessments. We planned:
 - to apply prospective materiality thresholds to make preliminary decisions about category structures and disabilities using historical information;
 - to build the assessments using data relating to the assessment period for the review;
 - to confirm the reliability of methods, including through the use of external reviews of important assessments; and

- to confirm the materiality of all its category and disabilities assessments at the conclusion.

7 The final assessment guidelines we used to decide on the category structure for the assessments and how each assessment would be made for this review are set out in Box A-1.

Box A-1 Assessment guidelines

STRUCTURE GUIDELINES

- 1 The Commission proposes to structure expense and revenue categories starting with large aggregates and disaggregating only where that is expected to improve the equalisation outcome.
- 2 A function (expense or revenue item) will be considered for separate category assessment, if:
 - the service provided or revenue source is clearly a major State service or revenue source distinct from others;
 - it is affected by disabilities that are markedly different from those of other categories;
 - data used to estimate the average expense or revenue are satisfactory;
 - it is expected that satisfactory assessments of disabilities can be made; and
 - the category is expected to be material, which is defined as:
 - the average expense or revenue is greater than \$50 per capita; or
 - the assessment is likely to redistribute more than \$30 per capita for any State.

ASSESSMENT GUIDELINES

- 3 The Commission organises its work by making assessments for individual categories.
- 4 The Commission will include a disability in a category when:
 - A presumptive case for the disability is established, namely:
 - a sound conceptual basis for these differences exists; and
 - there is sufficient empirical evidence that differences exist between States in the levels of use and/or unit costs in providing services or in their capacities to raise revenues.
 - A reliable method has been devised that is:
 - conceptually rigorous (for example, it measures what is intended to be measured, is based on internal standards and is policy neutral);
 - implementable (the disability can be measured satisfactorily); and
 - where used, consistent with external review outcomes.
 - Data are available that are:
 - fit for purpose — they capture the influence the Commission is trying to measure and provide a valid measure of States' circumstances; and
 - of suitable quality — the collection process and sampling techniques are appropriate, the data are consistent across the States and over time and are not subject to large revisions.
 - Data will be adjusted where necessary to improve interstate comparability. The Commission will not make data adjustments unless they redistribute more than \$3 per capita for any State.
 - Where a case for including a disability in a category is established but the Commission is unable to make a suitable assessment of its impact, the options are:
 - to discount the impact that has been determined; or
 - to make no assessment.

The option chosen will reflect the specific circumstances of the assessment. It will depend on:

- the particular concerns about the assessment;
- the strength of the conceptual case for assessing the category or the disability;
- the reliability of the method and data;
- the sensitivity of the assessment to the data used, measured in terms of the likely impact on State revenue shares of an error in the data; and
- consistency with State circumstances.

When the assessment is to be discounted, a uniform set of discounts is used, with higher discounts being applied when there is less confidence in the outcome of the assessment or more uncertainty attaches to the information. The discounts are:

- 12.5 per cent, if there is not full confidence about the size of an effect because of a low level of uncertainty around the information on which it is based;
- 25 per cent, if there is a medium level of confidence about the size of an effect or a medium level of uncertainty about the information;
- 50 per cent, if an effect on States is known to be large and there is confidence about its direction and but there is limited confidence in the measurement of its size due to a high level of uncertainty in the information; and
- if there is little confidence in the direction of an effect or its size, no differential assessment would be made.

5 The Commission will include the disability in its final assessments if it is material.

- A disability assessment must redistribute more than \$10 per capita for any State in the reference period to be included in the calculation of relativities.
- Where a disability influences more than one revenue or expense category, the materiality test will be applied to the total impact it has on the redistribution of funds.
- The disability may not be assessed in a category, if the amount redistributed in that category is small.

6 A category assessment will be included in the final assessment if:

- the assessment cannot be made simpler without reducing its conceptual rigor and reliability;
- the Commission considers the methods are reliable and has confidence in the results;
- the results are consistent with the real world;
- where used, external review highlights that the approach is reasonable;
- the assessment is robust, that is, it is not unduly sensitive to the change in inputs;
- the average expense or revenue is greater than \$50 per capita or the category redistributes more than \$30 per capita for any State. Categories that do not meet one of these thresholds will either remain part of an aggregated category that has similar, often broader, disabilities or be treated EPC; and
- the effect on the distribution of the GST pool resulting from the use of disaggregated assessments instead of an aggregated assessment exceeds \$30 per capita for any one State. If the combined distributions of disaggregated assessments do not redistribute \$30 per capita more than the aggregated assessment, then the aggregated assessment will be used.