

ATTACHMENT B



Australian Government

Commonwealth Grants Commission

2010 Review of State Revenue Sharing Relativities

**Progress report to
Ministerial Council for
Commonwealth-State Financial Relations, 2007**

Canberra

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REPORT

Progress Report to Ministerial Council for Commonwealth-State Financial Relations, 2007

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Australian Government
Commonwealth Grants Commission

Senator the Hon Richard Colbeck
Parliamentary Secretary to the
Minister for Finance and Administration
Parliament House
CANBERRA ACT 2600

Dear Parliamentary Secretary

As members of the Commonwealth Grants Commission appointed under the *Commonwealth Grants Commission Act 1973*, we have prepared this report on progress with work on the 2010 Methodology Review for the Ministerial Council on Commonwealth-State Financial Relations. Terms of reference asking that the review be done and that this progress report be produced were received from the then Parliamentary Secretary, Dr Sharman Stone, on 26 May 2005.

Yours sincerely

A handwritten signature in black ink, appearing to read 'A G Morris'.

A G Morris
Chairman

A handwritten signature in black ink, appearing to read 'R A Williams'.

R A Williams
Member

A handwritten signature in black ink, appearing to read 'G P Appleyard'.

G P Appleyard
Member

A handwritten signature in black ink, appearing to read 'J A Westacott'.

J A Westacott
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We are grateful for the ready co-operation extended to the Commission and its staff during this inquiry by Australian, State and Territory Treasury officers and by staff of the Australian Bureau of Statistics.

We also acknowledge the dedication and professionalism shown by the staff of the Commission during the period of the inquiry.

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OVERVIEW

The terms of reference for the 2010 Review ask the Commission to provide a progress report in 2007 covering its activities in 2006. Those terms of reference ask for responses to particular issues and these are provided in Chapters 3, 4 and 5, as described in Chapter 1.

PROGRESS DURING 2006

Assessment methods

The main focus of the Commission through 2006 was to decide on an appropriate level of disaggregation for both revenue and expenses and to initiate the process of building assessment methods using broader indicators.

This process is consistent with the Commission's view that the terms of reference call for horizontal fiscal equalisation (HFE) to be achieved with simpler, less disaggregated categories and using broader indicators of the inherent differences between the States.

During 2006, we used our clean-slate, top-down approach agreed last year and the interim assessment guidelines to develop a preliminary category structure of seven revenue categories and twelve expense categories. In doing this we were mindful of the need to balance a simpler structure against a structure which logically groups main areas of State activity to give appropriate weight to the inherent differences between the States and for which reliable indicators were available.

The interim structure we have adopted reflects close consultation with States — in particular, State concerns that our initial proposals were so aggregated that they would not enable differences between the States to be appropriately captured by the assessment methods.

Chapter 3 contains more detail of our activity during the year.

In undertaking this work, we found that we needed to make one change to the interim assessment guidelines to introduce a materiality guideline to assist in deciding whether a conceptually superior disaggregated assessment was materially different from the

assessment undertaken in a more aggregated way. The revised guidelines are in Attachment A of this report.

Data issues

Our work on assessment methods was accompanied by continuing effort to improve data quality. During 2006, with the assistance of the States and the ABS, we continued the programme for reviewing the reliability of the main data sets used in the assessments. The work done during 2006, which is outlined in Chapter 4, indicated that:

- some changes were required in methods and data sets used to calculate State shares of the GST pool for the 2007 Update; and
- Government Finance Statistics (GFS) data used in the adjusted budget are continuing to improve, although there is more work to be done.

We also introduced the protocol for improving the quality of State-provided data, as set out in the last report to the Ministerial Council. We believe that the protocol has led to a better understanding of the quality of the data we are using in the assessments and resulted in improvements in comparability in a number of areas. We intend to continue to apply the protocol, amended if required, for the 2008 Update and beyond. We will seek feedback from the States at the conclusion of the 2007 Update on their experience with the protocol.

We have concluded that we would generally prefer to use the GFS Government Purpose Classifications (GPCs) at the 2 and 3-digit level to define assessment categories and not to move expenses from one 2-digit GPC to another in deriving a category structure for use in the assessments. However, there are some instances where more robust equalisation can be achieved by bringing together similar expenses that are classified to different 2-digit GPCs and using 4-digit GPCs or State-provided data where it is necessary to better define categories that are affected by similar disabilities. We will do this when it enables a better identification and measurement of differences between States that affect the relative cost of providing services and if the data are reliable.

Principles and architecture for the 2010 Review

With the objective of producing recommendations that achieve equalisation, but in simpler ways than in the 2004 Review, we have begun the task of reviewing what 'achieving equalisation' means and how it should be implemented. We note that most, though not all, States favour minimal change, particularly in the objectives of horizontal fiscal equalisation. They support the continuation of the existing aim of equalising the financial capacity of States in a comprehensive way. However, some consider that the objectives should be reconsidered, for example, to encourage States to become more efficient. All support the implementation of equalisation through simpler approaches.

Most States value the stability and predictability of the GST revenue achieved through the use of a five-year averaging process. While an issue to consider in the review, they do not support changing the five-year averaging approach before 2010.

We plan to distribute a paper setting out our views on equalisation principles, pillars and their interpretation in May 2007. We propose to deal with issues relating to the implementation of these principles as they arise in the review.

Quality assurance

The implementation of the quality assurance plan the Commission adopted last year has seen:

- improvements to data quality as noted above;
- the use of external experts to provide specialised advice in the areas of land, roads and stamp duties data;
- the introduction of an external audit of our calculations and an enhanced checking process; and
- improvements in documentation and reporting to States.

WORK FOR 2007

During 2007, we will:

- in consultation with the States, develop assessment methods for the categories of expenses and revenue we have identified. A key element of that work will be the identification of suitable broad indicators of inherent differences between the States, which give the Commission confidence that equalisation will be achieved;
- again in consultation with the States, develop assessments for those inherent differences across the States, which impact on all expenses; for example, the scale of public administration; and
- establish the conceptual framework for equalisation by setting out our views on the equalisation principle, pillars and their interpretation.

CONSULTATION WITH THE STATES

In 2006, the Commission and its staff continued the close consultation with State Governments. These discussions covered issues relating to the structure and nature of assessments and data quality.

We consulted with Heads of Treasuries on the principles and architecture of equalisation.

The consultation was invaluable in helping the Commission in its work in 2006 and we propose to continue that consultation through the remainder of the review.

CHAPTER 1

INTRODUCTION

- 1 On 26 May 2005, the Commission received terms of reference (Box 1-1), which require it to:
 - report by 26 February 2010 on a review of the methods used to derive State ²¹² revenue sharing relativities; and
 - provide progress reports to the Ministerial Council for Commonwealth-State Financial Relations in 2006 and 2007.

2006 REPORT

- 2 In the 2006 Progress Report, the Commission laid the foundations for its approach to the 2010 Review. The Commission said that it intended to vigorously pursue both equalisation and simplification. It said that it believed that both objectives could both be achieved and that simplification would improve the reliability and robustness of the processes and acceptability of the outcomes. It noted that simplifying the way equalisation was implemented would involve fundamental changes to methods used to calculate the relativities.
- 3 The report set out the Commission's strategy and work programme developed in consultation with the Australian Treasury and the States. Essential features of the strategy include:
 - starting with a clean-slate when it comes to devising assessment methods;
 - adopting a top-down approach, where State revenues and expenses would be disaggregated into specific services and taxes only if it materially improves equalisation and can be done reliably;
 - establishing new assessment guidelines with stronger reliability and materiality criteria; and
 - introducing the new assessment methods in the 2010 Review Report.

²¹² In this report, the words State(s) include the Australian Capital Territory and the Northern Territory, unless the context indicates otherwise.

Box 1-1 Terms of reference for 2010 Review

1. Pursuant to sections 16, 16A and 16AA of the *Commonwealth Grants Commission Act 1973*, I hereby refer to the Commission for inquiry into and report upon, by 26 February 2010 at the latest, the question of per capita relativities which the Commission would regard as appropriate to apply after 2009-10 for the distribution of the combined pool of Goods and Services Tax (GST) revenue and Health Care Grants (HCGs) among the States, the Northern Territory and the Australian Capital Territory (the States).
2. The Commission should commence a work programme for responding to these terms of reference and consult with the States and the Australian Government in deciding the priorities for the work programme.
3. Having regard to the work progressed by HoTs after the 2004 Ministerial Council and providing that to do so is consistent with the principle of Horizontal Fiscal Equalisation, the Commission should simplify its assessments by:
 - (a) aggregating existing assessment categories, components and factors, in whole or in part;
 - (b) eliminating category assessments found unreliable because of unsatisfactory data or methodology; and
 - (c) applying a materiality threshold to current and future assessments.
4. Having regard to the work progressed by HoTs after the 2004 Ministerial Council and providing that to do so is consistent with the principle of Horizontal Fiscal Equalisation, the Commission should consider developing other ways to simplify its assessments, including by:
 - (a) addressing issues relating to quality and fitness for purpose of data used by the Commission, in particular by reducing the reliance on the use of 4 digit GFS data and examining the capacity of making effective use of 2 digit and 3 digit GFS data in the assessments;
 - (b) undertaking a programme of continuous improvement of assessments. This programme includes improvements to the quality and fitness for purpose of both data and methodology; and
 - (c) reviewing the scope for the use of more general indicators of revenue capacity and expenditure need.
5. The Commission should also consider:
 - (a) developing mechanisms to maintain simplification once achieved; and
 - (b) improving quality assurance processes.
6.
 - (a) The Commission will report to the Ministerial Council in 2006 on its conclusions in relation to paragraphs 3(b) and 3(c) and progress in relation to paragraphs 3(a), 4 and 5.
 - (b) The Commission will report to the Ministerial Council in 2007 on its conclusions in relation to paragraphs 3(a) and 4(a) and progress in relation to paragraphs 4(b), 4(c) and 5.
 - (c) The Commission will report to the Ministerial Council in 2006 and 2007 on any conclusions it has reached in relation to paragraphs 6(a) and 6(b) which, in the Commission's opinion, should be implemented in advance of its 2010 Report. In drawing any such conclusions, the Commission should apply the principle of Horizontal Fiscal Equalisation used for the 2004 Review.
 - (d) The Commission will report on the conclusions in relation to the remaining items in paragraphs 3, 4, and 5 as part of its 2010 Report.
7. The Ministerial Council will give further instruction to the Commission on transitional arrangements, if and as necessary.

Dr Sharman Stone
Parliamentary Secretary to the Minister for Finance and Administration

26 May 2005

- 4 The report also noted the Commission's intention to provide an opportunity in the review process for consideration to be given to different views of equalisation and how it might be implemented.

2007 REPORT

- 5 The conclusions the Commission reached last year have implications for this report. The Commission's clean-slate, top-down approach means that we have responded to the requirement in the terms of reference to report on aggregation of assessments and on the continuous improvement of assessments from a different perspective. Similarly, the decision (endorsed by the States) to introduce new assessment methods in 2010 reduces the need to report on method changes which could be introduced progressively.
- 6 This report outlines the Commission's progress in 2006, including:
- consultations on the principles and architecture of horizontal fiscal equalisation (Chapter 2);
 - preliminary conclusions on simpler assessments, including how State revenues and expenses should be disaggregated and broader indicators of revenue capacity and expense requirements developed (Chapter 3). This chapter also includes revised assessment guidelines and discusses proposed revision to the 2010 Review work plan to reflect our experience to date with the disaggregation approach;
 - preliminary conclusions relating to the quality and fitness for purpose of data reviewed during the year (Chapter 4). We provide a progress report on the implementation of the protocol agreed with States for improving the quality of State data and on the outcomes of the reviews of agreed data sets. We also report on the work undertaken with the Australian Bureau of Statistics (ABS) to improve the quality of GFS data; and
 - the implementation of its quality assurance plan and progress on other issues raised in the terms of reference (Chapter 5).
- 7 The report responds to the terms of reference which require the Commission to report its conclusions and progress on a range of matters in the following way.
- We have reported our conclusions on how assessments might be simplified by 'aggregating existing assessment categories, components and factors, in whole or in part' (clause 3a) in Chapter 3.
 - We have reported our conclusions on 'addressing issues relating to quality and fitness for purpose of data used by the Commission' (clause 4a) in Chapter 4.
 - We have discussed whether we can reduce our 'reliance on the use of 4-digit GFS data' and make 'effective use of 2-digit and 3-digit GFS data in the assessments' (also clause 4a) in Chapter 3.

- The results of the programme of continuous improvement to the quality and fitness for purpose of data (clause 4b), as set out in the 2006 Report to Ministerial Council, are covered in Chapter 4. This includes a report on where changes to methods were implemented in the 2007 Update in advance of the 2010 Review because of unsatisfactory data. The programme for 2007 is also set out.
- Our progress with 'reviewing the scope for the use of more general indicators of revenue capacity and expenditure need' in simplified assessments (clause 4c) is reported in Chapter 3.
- In Chapter 5, we have provided our response to clauses 5a and 5b on developing mechanisms to maintain simplification once achieved and how we have improved our quality assurance processes.
- Our conclusions on changes that should be implemented in advance of the 2010 Report (clause 6c) are provided in Chapter 2 in relation to whether the relativities should be made more contemporaneous and in Chapter 4 in relation to method changes required because of unsatisfactory data.

CHAPTER 2

IMPLEMENTING HORIZONTAL FISCAL EQUALISATION

INTRODUCTION

- 1 In its 2006 report to the Ministerial Council, the Commission said that, although the objective of achieving HFE is implicit in the terms of reference, it was important that different views of equalisation and how it might be implemented be considered in the review.
- 2 The Commission has initiated a process of considering these issues in consultation with the State and the Australian Heads of Treasuries (HoTs). This chapter reports on that process, the main issues raised and State views. It does not contain Commission positions or recommendations because the process of consultation has not concluded.
- 3 A preliminary discussion of equalisation principles was held during a conference with HoTs in November 2005. In March 2006, we released an issues paper (*Architecture of Horizontal Fiscal Equalisation: Principles and Interpretation*). This asked States for their views on the objectives of HFE, how it should be defined, and how we should interpret and apply the definition. We specifically sought comment on:
 - the implications for Commonwealth-State relations of a change to the objectives of HFE and how much direction was needed from government for such change;
 - whether the aim of equalisation should change from equalising all States to the same standard, to standards ‘not appreciably different from’ other States, and what this would mean in practice;
 - whether equalisation should be confined to merit goods or ‘core’ State services;
 - whether there should be additional pillars of equalisation, such as efficiency, and if so, how would they be implemented; and
 - whether the standard to which all States are equalised should be changed from an average of all States to one based on the most ‘efficient’ State, or some other benchmark?

- 4 The discussion paper also canvassed the issue of whether the assessments should be changed to better reflect State circumstances in the year they are applied. We released a further paper on this issue (Issues Paper 2006/04) in June 2006.
- 5 States responded with submissions and the Commission held a conference on 27 July 2006 to discuss the issues with HoTs.
- 6 There was considerable diversity in the views expressed by States.

ISSUES RAISED DURING THE CONSULTATION PROCESS

Objectives of HFE

- 7 While a number of States strongly supported a reconsideration of the objectives of HFE, others questioned the need for it. They argued that:
 - the terms of reference do not require it, but would have if this had been intended;
 - a review was not supported by States at the November 2005 HoTs conference; and
 - the Commission itself in the 2004 Review concluded that, in the absence of any specific direction, HFE should be based on the definition in place in June 1999 when the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* was signed.
- 8 **Complete or partial equalisation.** The majority of States supported a continuation of comprehensive equalisation. They argued that changing the current objective of providing all States with the same capacity to deliver services would lead to growing disadvantage and inequity between States. Some were concerned that adding new objectives could lead to conflicts and trade-offs between different objectives, inconsistencies in their application, increased complexity and greater need for judgment.
- 9 However, support for the current approach was not unanimous. A fundamental question was asked about what, or to what extent, we should equalise. One view was that equalisation should be limited to the 'core' services provided by States (health, education, and law and order). Another was that we should consider partial equalisation, to perhaps 80 per cent of the average. This approach was said to be akin to the 'safety net' philosophy that applies in Australia's welfare system. Many States strongly opposed a partial equalisation approach on the basis that it would result in Australians in different States being treated differently. All States agreed that further direction from governments would be required before partial equalisation approaches could be applied.
- 10 **Perfect or proximate equalisation.** There was considerable debate about the definition of equalisation, and particularly about whether it should aim to give all States the capacity to deliver the 'same' standard of services or a standard of services 'not appreciably different from' that of the other States. Some States asked whether the equalisation process should attempt to recognise all inherent differences between the States that impact on their fiscal capacities, or only the major inherent differences. One State said there was nothing sacrosanct

about the current definition of equalisation, and noted that it had changed in the past. For example, the reference to equalising to the ‘same’ standard is a relatively recent variant; earlier definitions were based on equalising to standards that were ‘not appreciably different from’ those in other States. Another State said the current definition had led to growth in the complexity of assessments. It argued a change in the definition was needed to help maintain the simplification achieved by the 2010 Review.

- 11 Several States noted that practical considerations, such as data availability and materiality, meant that it was not possible to equalise to the same standards.
- 12 One State said the Commission was not equalising to the ‘same’ standard. It said that the way capacity equalisation is applied means that lower standards are preserved in remote areas — even though there is no case on efficiency grounds for doing so, particularly as much of Australia’s wealth is tied to economic activities in these areas.
- 13 Opponents of change accepted that achieving exact equalisation was not practical, but said that was not a sufficient reason to change the objective away from seeking comprehensive and full equalisation. Some said that if any such change in the definition was intended to set an expectation that equalisation should only be partial, rather than full, it would be inconsistent with the terms of reference.
- 14 **Capacity or performance equalisation.** The States universally rejected the possibility that the objective of equalisation might be changed from the current aim of equalising their financial capacity to one of equalising performance. States argued such a change would be inconsistent with the untied nature of the GST grants and would erode State autonomy. Many also noted the difficulties that would be involved in setting and measuring performance standards.

New equalisation pillars

- 15 The objectives and definition of equalisation are reflected in three core principles or ‘pillars’ that were adopted by the Commission in its 2004 Review to guide its decisions. These pillars are:
 - capacity equalisation, which means that the aim is to give each State the same financial capacity to deliver services as other States;
 - equalising to internal standards, which means that the standards to which States are equalised are based on an average of what all States actually do; and
 - policy neutrality, which means that a State’s share of GST should not be directly affected by its own policies — rather, it is based on the presumption that each State applies the average policy of all States regarding service delivery and revenue raising.
- 16 Most States considered that the three current pillars were consistent with comprehensive fiscal equalisation and provided the fundamental bases for achieving it. They saw other pillars as secondary. However several said there was a need for additional pillars addressing

simplification, efficiency, removal of disincentives for economic development, and, possibly, robustness.

- 17 The case for a 'simplification' pillar was based on the requirement of the terms of reference to seek simplification and to maintain it after 2010. A 'robustness' pillar was supported on the basis that greater scrutiny of data used in assessments is required by the terms of reference.
- 18 The case for an 'efficiency' pillar was based on a range of views. Some thought that the Commission's methods should encourage States to achieve technical efficiencies in service provision and discourage waste, duplication and lack of coordination. Others thought allocative efficiency issues (the need to remove any disincentives for resources to move to more productive regions) were more important. Some argued that the equalisation standard should no longer be the all-State average, but that set by the most efficient State, the most efficient three States or some other external, efficient benchmark.
- 19 Other States argued that such a pillar was unnecessary because equalisation provides no impediment to efficiency. They noted that States benefited directly from any efficiency improvements they make and inefficient States (particularly smaller States that have less influence on the average standards) bear the cost of their inefficiencies.
- 20 A pillar on removal of disincentives for economic development was proposed as a complement to the policy neutrality pillar. The proponent of this potential pillar said that the Commission's current approaches do not remove the effects of 'second round' or dynamic influences on State revenue bases arising from differences between States in their policies on economic development. A related observation was made by another State when it argued that the assessment of location-based disabilities was not policy neutral because State policies could influence where people live.

Scope of equalisation

- 21 All States explicitly or implicitly supported a scope based on the general State government sector. Most said that equalisation should be based on a comprehensive coverage of this sector but, as noted earlier, there was support from one State for limiting it to 'core' services.
- 22 There was more diversity of opinion about including private and community goods in the scope of equalisation. Of those that commented, none supported a blanket extension of scope to assess community or private activities that overlap and affect State services. However, some supported consideration of the extent to which they affect the quantity of services States must provide.

Reflecting the impact of Indigenous populations

- 23 One State argued that the equalisation process was not the appropriate policy mechanism to deal with the impact that Indigenous populations had on State budgets. It considered that these issues were better dealt with through bilateral arrangements between the Australian

Government and the States affected¹. If that were to occur, the Commission would exclude Indigenous influences from its 2010 methods. Other States did not support such a position.

Broader indicators of revenue bases and expense disabilities

- 24 The terms of reference require us to consider using broader indicators of revenue bases and expense disabilities as part of the simplification process. Most States support a simpler, more aggregated approach to assessments that logically requires the use of broader indicators. Many, however, encouraged caution in their use on the basis that some broader indicators may not accurately measure the way State circumstances affect the quantity of services States must provide, the cost of those services or State revenue raising capacities.

Contemporaneity

- 25 The supplementary discussion paper on this topic noted that the relativities are currently based on historical data that precede the application year by between two and six years. As a result, if State circumstances change over that period, the relativities could be out of date by the time they were applied. This lag has led to criticisms of the Commission's recommendations because they do not reflect the changes in State economies quickly enough. The paper outlined options aimed at making the assessments better reflect the circumstances of the States in the years when the relativities are used to distribute GST revenue.
- 26 Some States see the current process of basing the relativities on an average of the circumstances in the five most recently completed years as providing the benefit of stability and predictability in the GST revenue they receive. Most States appear to value this over a more up-to-date assessment of their fiscal capacity because the growing significance of GST to their budgets meant there could be some stability in their aggregate revenues, notwithstanding the relative unpredictability of State own-source revenue. Some States supported further investigation of averaging over a shorter period, for example three years, as part of the 2010 Review process.
- 27 The options we proposed were not all mutually exclusive. Some could be implemented while still averaging assessments over five years. For example, the treatment of SPPs could be changed so that GST shares are calculated using actual SPP allocations in the year the GST is distributed, rather than historical SPP amounts. There was some support for further investigation of these ideas. Other States were less convinced, commenting that these options would both add complexity and achieve little, if any, improvement to contemporaneity.
- 28 Other than changing the averaging period, there was little support for other potential ways of improving the contemporaneity of the relativities. States generally considered they would increase the need for judgment, add complexity and reduce the reliability of the assessment process (and thereby reduce confidence in the recommended relativities).

¹ The State acknowledged that such an approach would require some additional changes, possibly with the States taking on some additional funding responsibilities.

- 29 One State argued that the current volatility in GST grants was as much a reflection of poor data and assessments and the effect of data revisions as it was of underlying changes in needs. It concluded that a sensible discussion on contemporaneity could not proceed until more reliable assessments using better data were built.
- 30 Because of the recent criticisms, we also asked States if there was interest in implementing any change in this area before the 2010 Review. There was unanimous support for maintaining the current methods including the process of basing relativities on five-year averages, at least until 2010. The terms of reference for the 2007 Update, agreed in consultation between the Commonwealth and the States after the HoTs meeting, retain the requirement to use a five-year average. The Commission intends to consider the issue of the appropriate balance between stability and contemporaneity as part of the 2010 Review.

THE WAY FORWARD

- 31 We consider that the issues raised during consultations fall into three main groups, each of which has to be considered differently.
- There are issues that are outside the Commission's terms of reference; for example, whether funding for Indigenous services should be removed from the scope of HFE. We made it clear during discussions with HoTs that we would not deal with such issues without further direction from governments.
 - There are issues of principle: including the objectives of HFE, whether equalisation should aim to achieve the 'same' standard or 'approximately the same' standard, whether something other than an all-State average should be used as the 'standard', and whether efficiency should be included as a pillar of equalisation. We will be considering issues in this group, based on our view of the terms of reference that require equalisation and simplification, the experience of equalisation, and the views of the HoTs. We see this process as a normal and important part of the review. It is integral to our coming to a position on appropriate relativities and it establishes the context for the development of assessment methods over the rest of the review period. As such, we consider it important that there be a clear presentation of how we propose to interpret and give effect to HFE in the 2010 Review.

We propose to distribute a paper setting out our views on principles in May 2007 after considering final State Submissions.

- There are issues of implementation that would normally be dealt with during the review, such as ways of achieving simplification, the use of broader indicators of disabilities, the treatment of locational disabilities and contemporaneity.

We propose to respond to these issues as they arise in the review process.

CHAPTER 3

PROGRESS ON SIMPLIFYING ASSESSMENTS

INTRODUCTION

- 1 The terms of reference for the 2010 Review ask us to simplify the assessments by:
 - aggregating existing groupings of State revenues and services into broader categories;
 - applying materiality thresholds; and
 - considering the use of broader indicators of revenue bases and expense disabilities.
- 2 In the 2006 report to the Ministerial Council, we said that we intended to devise the broader categories envisaged by the reference by applying a clean-slate, top-down approach to decide how total State expenses and revenues would be best disaggregated into categories for assessment purposes. The use of broader indicators of revenue bases and expense disabilities would be a natural corollary of adopting broader assessment categories. We said revised and strengthened assessment guidelines, which incorporated materiality thresholds and criteria for judging the reliability of data and methods, would be applied in implementing that approach.
- 3 This chapter explains the development of the approach we are taking to the preparation of broader assessments. It includes a report on our experience in using the interim assessment guidelines outlined in the 2006 report to Ministerial Council, preliminary conclusions on how we propose to use GFS data, and progress on the development of broader categories and indicators of revenue bases and expense disabilities. Possible changes to the work programme for the 2010 Review that better suit the iterative nature of the work are also discussed.

APPROACH TO DISAGGREGATION

- 4 Disaggregation starts with an initial disaggregation of revenue and expenses into a few large aggregates.
- 5 For each main aggregate, the Commission constructs assessments using appropriate indicators of State differences, which are most likely to be broader measures than in the past.

- 6 The Commission then considers whether the broad assessments capture the major influences that give rise to differences between States in revenue raising capacity or costs of providing services. If so, no further disaggregation is necessary. If not, the Commission considers a further disaggregation using the assessment guidelines.
- 7 We have used this approach in working towards an assessment structure for the 2010 Review. We have not yet finalised the structure but have made progress towards it. We have proposed disaggregating revenues and expenses (using our structure guidelines) only when we believed:
- a strong conceptual case exists;
 - satisfactory data are likely to be available to make the disaggregation; and
 - it is likely that material differences can be identified.
- 8 **Conceptual case.** In considering the conceptual case for disaggregating categories, we started by considering what major revenues States raised or services they provided. For example, we concluded that States provide services to people, to communities, to industries and for general government purposes. We then sought to identify more specific services, such as school education, hospital inpatient services and welfare. Similarly, we concluded that States tax particular activities, including through distinct taxes on payrolls, land, mining activities and motor vehicles.
- 9 We were guided by average State practice. However, consistent with the aim of achieving equalisation using simpler methods, State practice was interpreted broadly. For example, we considered State activities in the welfare and housing fields in terms of ‘States providing assistance to disadvantaged people’ rather than ‘States providing aged and family welfare services and public housing’.
- 10 We have also interpreted the types of costs to be included in a category more broadly. We intend to distribute expenses such as depreciation, superannuation and possibly debt charges to the functions or categories to which they relate. For example, we are considering depreciation on school buildings and superannuation expenses for teachers to be schools education costs.
- 11 Next we considered whether the activities included within a broad aggregate were affected by similar disabilities. For example, we concluded the disabilities affecting all school education costs are similar and that the effects of these disabilities can be assessed in one category. However, because State expenses on water, sewerage and protection of the environment are affected by quite different disabilities from those affecting welfare services, we considered that a clear case for disaggregation had been made. Many judgments of this nature were required.
- 12 In using disabilities to guide decisions on category structure, we mainly considered influences specific to particular services, such as the target or client population (those using the service), rather than disabilities that affect costs in most services, such as head office scale, wage levels and location¹.

¹ A separate stream of work will consider the conceptual case for assessing those influences and how they might be measured. If the cases are proven, the influences would be applied to all relevant categories.

- 13 In choosing appropriate measures of the disabilities, we recognised that we should seek broader indicators of disability, commensurate with the more aggregated approach. In developing these broader measures, we sought to measure only those drivers or revenue bases that are conceptually justified. In cases where cost drivers or revenue bases could be measured using several different indicators, we generally chose the more policy-neutral one.
- 14 **Satisfactory data.** We have also had regard to the need for satisfactory expense or revenue data in considering the establishment of expense or revenue categories. As suggested by the terms of reference, we began by defining expense assessment categories on the basis of the GPCs at the 2-digit level, with some 2-digit GPCs combined. However, there were cases where 3 and 4-digit GPCs were needed because activities affected by different disabilities were included in the same 2 and 3-digit GPC classifications. In a small number of cases, we found that activities affected by different disabilities were included in a 4-digit GPC.
- 15 We therefore have accepted that in defining assessment categories, expenses may be moved from one 2-digit classification to another and 4-digit GPCs or State-provided data may be used if the Commission is convinced:
- it improves equalisation — meaning it enables a better identification and measurement of differences between States that affect the relative cost of providing services; and
 - the data are reliable — as far as possible this should be supported by external advice.
- 16 The GPC is based on an international classification and is not specifically designed for the purpose of supporting horizontal fiscal equalisation. Nonetheless, we will continue to use GPC data, and at a much higher level of aggregation than in the past. The GFS Taxes classification does not present similar concerns. Three-digit codes can be used to define revenue categories.
- 17 In addition to requiring reliable data on expenses and revenue, we need to be able to measure disabilities. The availability of simple disability measures can influence decisions on disaggregation. If broad, reliable and transparent measures of disabilities cannot be found, one option is to disaggregate further so that appropriate measures become available. In some cases there is a choice to be made between the complexity of disability measures and the number of categories to be assessed.
- 18 **Materiality.** In reaching our initial disaggregation we have ensured that each category is both significant in size and that, based on our experience, differences between the States in each category will lead to a significant difference in assessed expenses or revenue capacity. If we need to consider further disaggregation we will also require that such a disaggregation will itself make a material difference to the overall distribution of the pool.

CONSULTATIONS IN 2006

- 19 *Issues Paper 2006/02 Approach to Disaggregation*, released in March 2006, outlined the Commission's proposed approach to developing a category structure for the 2010 Review. The

Commission initially disaggregated State expenses into four categories — education, health, law and order and other services. It noted that a possible disaggregation of State revenues might be into taxes based on economic rent or corporate profits; personal income or wages; wealth; and the value of other taxable transactions.

- 20 State responses contained a wide range of views on the appropriateness of the Commission's proposed disaggregation, but supported the general approach. One State argued that the starting point for disaggregation should be one category of total expenses and one for total revenues. It suggested total expenses might then be disaggregated into social, economic and environment services, and capital costs not elsewhere assessed. Another State suggested basing expense categories on 2-digit level GPCs, while another proposed up to 27 expense categories and 9 revenue categories.
- 21 Staff discussion papers *CGC 2006/06 Disaggregating Expenses* and *CGC 2006/07 Disaggregating Revenues* were released in August 2006 and discussed with State Treasury officers in September 2006. They proposed six expense categories (education, health and welfare, law and order, transport, services to industry and other services) and explored three broad approaches to disaggregating revenues:
- a single assessment using a simple aggregate, or global, measure of economic activity;
 - a single category using multiple indicators of the main revenue bases taxed by States; and
 - five categories with a measure of the revenue base States tax in each category.
- 22 State submissions on the Commission staff proposals were received in September and October 2006. After considering the State views, the Commission issued *Discussion Paper CGC 2006/11 Initial Views on Assessment Structure and Approaches* in December 2006. It outlines our current views on assessment categories and approaches for the 2010 Review and how we have reached those views.

PROGRESS WITH DISAGGREGATION

The proposed category structure

- 23 The views of the States and further staff research convinced us that some further disaggregation beyond six categories was required on the expense side of the budget to achieve equalisation. For example, we concluded that the disabilities affecting schools education costs differed in a material way from those affecting post-secondary education costs. In particular, we concluded that the age groups to which the services were delivered, the use made by those age groups of the services and the unit cost of delivering them were quite different. Similarly, we concluded that the disabilities affecting the functions included in the health and welfare category were too disparate, and too many, to include in one assessment. The main users of hospital inpatient services and the unit costs of delivering them differed markedly from those of community health services, housing and welfare services and other community services,

such as water subsidies. The same was true for users and unit costs relating to the provision of roads and other transport services.

- 24 On the revenue side, we agreed with the States that a single assessment using a simple aggregate or global measure of economic activity would be unlikely to adequately recognise differences in State capacities to raise revenues. We also noted their opposition to a single category assessment using multiple indicators of the main revenue bases taxed by States. We have decided that seven categories should allow State capacities to be properly measured, provided suitable policy neutral broad measures of the revenue bases are found.
- 25 The assessment categories shown in Tables 3-1 and 3-2 represent the disaggregation of State revenues and expenses on which further work will be based. The tables also show the total and average per capita State revenues and expenses in 2004-05 for each proposed category.

Table 3-1 Proposed revenue categories

Category	Revenue in 2004-05	
	\$m	\$pc
Payroll tax	11 996	594
Land tax ^(a)	3 720	184
Mining revenue	2 429	120
Stamp duty on conveyances	9 595	475
Insurance tax	2 754	136
Motor vehicle taxes	5 414	268
Miscellaneous revenue ^(b)	21 717	1 075
TOTAL	57 625	2 852

(a) Includes revenue from land tax and other revenues based on land values, such as metropolitan improvement levies and contributions to fire services.

(b) Includes gambling revenue, contributions from trading enterprises and other revenues and revenues from the business taxes that are being phased out (financial transaction taxes and stamp duty on marketable securities), charges for the use of services, and fines.

Source: 2004-05 ABS GFS data.

Table 3-2 Proposed expense categories

Category	Expenses in 2004-05	
	\$m	\$pc
School education	29 413	1 455
Post-secondary education	4 598	227
Admitted patients	19 762	978
Community and other health services	11 391	564
Welfare and general government housing services	12 316	609
Services to communities	3 646	180
Justice services ^(a)	7 746	383
Public safety	4 137	205
Services to industry	5 935	294
Roads	6 029	298
Other transport	5 249	260
Other services	14 622	723
TOTAL	124 844	6 177

(a) Includes 40 per cent of police expenses. The other 60 per cent of police expenses are in Public safety.

Source: 2004-05 ABS GFS data.

Broader indicators of revenue bases

26 In the staff discussion paper *Disaggregating revenue*, Commission staff proposed not allowing for exemptions, thresholds or progressive tax rates because it would make the assessments simpler, more reliable and improve policy neutrality. Many States opposed that proposal. They said it was vital that the assessments reflected the common policies of the States to exempt small business from payroll tax and apply progressive tax rates in stamp duty on

conveyances and land tax, even if there were differences among the States in the precise levels or rates applied.

- 27 Having regard to our intention to interpret 'what States do' broadly, we propose to divide the measures of potential revenue bases into taxable and non-taxable parts **by** reference to the type of exemptions and thresholds applied by all States, providing reliable data are available and that doing so would have a material effect on the GST distribution and would not be unduly complex. The levels of any exemptions or thresholds reflected in the assessments would be based on the average of the levels applied by the States. In this way agricultural land would be excluded from the measure of the revenue base for land tax and small businesses would be excluded from the payroll tax base.
- 28 The way each State structures a tax to apply to particular groups of transactions or taxpayers within the taxable part of the revenue base appears to be a matter of its policy and subject to variability across States. Against this background, **once** the taxable parts of revenue bases are defined, we propose to use a single average effective tax rate for each year to capture other matters of tax design and effort. Thus, the average effect of progressive tax rates would be reflected in the assessments.
- 29 In considering indicators of revenue bases, we:
 - sought indicators that are policy neutral measures of the revenue bases;
 - aimed to simplify the amount and depth of data required for revenue assessments, and to reduce the number of 'moving parts' in the assessments.
- 30 On the basis of current information, we propose to use the indicators set out in Table 3-3 as a basis for further work on designing assessments. That work will include examining the reliability and robustness of data and method.

Table 3-3 Proposed indicators of revenue bases

New category	Proposed indicators
Payroll tax	Compensation of employees (excluding government administration, health and education). Weights may be used to reflect the concentration of small firms that fall below the average tax-free threshold in each industry.
Land tax	The policy neutrality of land values is being examined. If necessary, alternative broad indicators will be sought.
Mining royalty revenue	Gross value of production or total factor income or gross operating surpluses.
Stamp duty on conveyances	Secured housing finance loan commitments with appropriate State weights, plus investment financing in housing are being examined as possible revenue bases. A simplified version of the existing method is also a possibility.
Insurance taxes	Total insurance premiums from all sources.
Motor vehicles registration and transfer fees	New vehicle sales and vehicles on register. Weights may be used to reflect the common higher taxes on heavy vehicles.
Miscellaneous revenue	Population.

Broader measures of cost drivers

- 31 We have divided the work on cost drivers into two:
- those that relate to a specific service or group of services, such as differences between States in population and economic characteristics that determine the quantity of services provided²; and
 - those that have similar effects on the costs of most services, such as the cost of minimum head office services, the cost of inputs and the effect of population location on the cost of delivering services.
- 32 While some work has commenced on the second group (specifically location-specific disabilities as reported below), more has been done on the first because they are more relevant to decisions on category structure.
- 33 We have concluded, with the agreement of the States, that outcome measures (such as literacy and numeracy rates and mortality rates) are unsuitable broad measures because they are not policy neutral and fail to capture influences known to affect States' cost of providing services.
- 34 We have also concluded that capturing the main influences that cause differences between States in the cost of providing an average level of services often requires more than one indicator, such as the size of the population group to which services are provided. This is mainly because there are material differences:
- in the use of services by groups of people within the population or in the cost of providing a unit of service to them; and
 - between the States in the size of those groups as a proportion of the total population.

² Some of these influences may also affect the costs of providing some services. Service-specific cost weights may be used to take those effects into account.

- 35 State submissions acknowledged that the use of multiple indicators, or of a principal indicator with adjustments (through use and cost weights), may be necessary in many assessments. However, States have differing views on the extent to which such indicators should be used.
- 36 We believe it will be necessary to use multiple measures to capture relevant differences between States. Our preference is to find one use indicator, such as relevant population or enrolments for school education services, and to identify any major adjustments required to recognise differences between the States outside their control that result in different levels of expense to deliver the same level of services. We recognise that a measure of the relevant population without adjustment may not recognise all the main drivers of State expense needs and that a more direct measure, such as enrolments, may not be policy neutral without adjustment. The challenge is to find the simplest, reliable way of measuring State needs.
- 37 Table 3-4 summarises our current positions on possible indicators of category specific or quantity of service disabilities. Some of these indicators are in very early stages of development and require more work to ensure they reflect the main influences on expenses.

Progress with the development of socio-demographic composition disabilities

- 38 In May 2006, staff discussion paper *CGC 2006/01 Socio-demographic composition* was circulated to the States. The proposals in that paper, as revised in the light of State comments received through submissions and a staff conference, have formed the basis of our approach to the category-specific indicators outlined earlier.
- 39 Consistent with agreements between Commission staff and State Treasury officers, work is proceeding on some specific measurement issues, including how to better measure the effects Indigenous people have on the cost of providing services; whether there is better evidence of the effect on the cost of providing services to people who do not speak English well or who are from different cultural backgrounds; and whether interstate differences in household size and cost of living should be taken into account in measuring the effect of people with low income on the use and cost of services.
- 40 It is planned that a staff discussion paper on these issues will be circulated to States in May 2007.

Table 3-4 Proposed indicators of broader quantity of service disabilities^(a)

Category	Proposed assessment approach
School education	<p>A broad indicator of population aged 4 to 17 with adjustments for:</p> <ul style="list-style-type: none"> • differences in retention rates (if material); • differences in the per unit costs to the States of government and non-government students; • differences in the cost of providing services to students who are Indigenous, who are from low socio-economic backgrounds, or who live in sparsely populated areas; and • above average use of ACT services by New South Wales residents.
Post-secondary education	<p>A broad indicator of population aged 15 to 59 with adjustments for:</p> <ul style="list-style-type: none"> • differences in the use of services by employment status, location and Indigeneity; • differences in the cost of providing services to students who are Indigenous, or who live in sparsely populated areas; and • above average use of ACT services by New South Wales residents.
Admitted patients	<p>A broad indicator of total population; with adjustments for differences in intensity and cost of use by:</p> <ul style="list-style-type: none"> • different age groups; • Indigenous people; and • people living in different parts of the State.
Community and other health services	<p>Two approaches are being considered. The first recognises that differences in expense requirements stem from differences in:</p> <ul style="list-style-type: none"> • health needs; • cost of providing services in remote areas; and • access to non-government providers. <p>The second postulates that differences in expense requirements stem from differences in access to services, measured by reference to differences in:</p> <ul style="list-style-type: none"> • number of service sites; • cost per site; and • access to non-government providers.
Welfare and general government housing services	<p>A broad indicator of total population with adjustments for differences in the intensity of use by, and cost of providing services to:</p> <ul style="list-style-type: none"> • low income people; • Indigenous people; • people in different age groups; and • people living in different parts of the State.
Services to communities	<p>A weighted combination of indicators of the:</p> <ul style="list-style-type: none"> • impact of the physical environment on the need for water and sanitation subsidies; • impact of distance from the grid on the need for electricity subsidies; and • special community service needs of discrete Indigenous communities.

Table 3-4 Proposed indicators of broader quantity of service disabilities^(a) (cont'd)

Category	Proposed assessment approach
Justice services	A broad indicator of total population with adjustments for differences in the intensity of use by, and cost in providing services to: <ul style="list-style-type: none"> • young males; • Indigenous people; and • those living in different parts of the State.
Public safety	A broad indicator of total population, unadjusted, that is, equal per capita (EPC) unless States suggest reliable ways of making conceptually sound adjustments for location.
Services to industry	Broad indicators of the size of the regulation and administrative tasks, discounted substantially to reflect the policy-determined nature of industry development expenses.
Roads	Options being examined include broad indicators of the size of task based on the size and use of a synthetic or simplified road network or proxy measures (such as fuel consumption or population weighted distances).
Other transport	Options being examined include total population with adjustments for differences in the intensity of use by, and cost in providing services to: <ul style="list-style-type: none"> • rural and urban populations in centres of differing sizes and densities; and • concession card holders.
Other services	Total population.
User charges	Classified to other revenue or some mixture of these.

(a) This table summarises the current views on potential broad indicators of the quantity of service provided. The progress made in considering alternative indicators varies across the categories.

The table does not include indicators that reflect general influences on the costs of services, such as those currently captured by administrative scale, input costs, dispersion and isolation factors. If the conceptual case for those influences is proven, they would be assessed in addition to the quantity of service disabilities measured by the indicators in this table.

Progress with the development of location disabilities

- 41 In May 2006, *Staff discussion paper CGC 2006/02 Location-based disabilities* was circulated to the States. The paper presented alternative broad approaches for the assessment of location-based disabilities. The Commission staff preferred approach was to develop simpler, broader assessments. The alternative was to simplify the current range of assessments.
- 42 The States expressed concern at the possibility that broader measures may not accurately reflect the costs faced by States due to the many different ways location affected State costs.
- 43 Work is proceeding on the development of assessments and a further staff discussion paper is planned for circulation to States in May 2007.

REVIEWING THE ASSESSMENT GUIDELINES

- 44 The 2006 Report to the Ministerial Council set out the interim assessment guidelines to be used in developing the category structure and the category assessments. The report said we

would evaluate and, if necessary, revise the guidelines on the basis of our experience in applying them during the year. Any revised guidelines would be provided in this report.

45 In general, we consider that the guidelines have worked well and are well understood by the parties. They have enabled the Commission, in consultation with States, to develop proposals on category structure and assessments that are consistent with the aim of the 2010 Review terms of reference; that is, achieving equalisation using simpler assessments than those of the 2004 Review.

46 However, earlier in 2006, the Commission concluded that it needed an additional materiality threshold to guide decisions on the appropriate level of disaggregation of revenue and expenses. Such a threshold was proposed in *Issues Paper CGC 2006/02 Approach to Disaggregation*, which said:

The difference between the aggregated and the disaggregated assessments would itself need to be material to justify accepting the more disaggregated assessment. The Commission is proposing that an aggregated category would be disaggregated only if the effect on the distribution of the GST pool resulting from the use of the disaggregated assessment instead of the aggregated assessment exceeds \$30 per capita for any one State.

47 In response, Western Australia, South Australia, Tasmania and the ACT expressed concerns that the threshold may be too large. Since assessments have not yet been developed, we think it is too early to make a final decision on the appropriate size of the threshold.

48 Overall, the only change to the interim guidelines that we currently think is required is to include the additional materiality threshold. We have done so. The revised assessment guidelines are shown in Attachment A. We propose to keep these guidelines, including the size of the materiality thresholds, under review as we develop the assessments for the 2010 Review. We will consult with States if the experience gained in applying the guidelines suggests further revisions are necessary.

REVISED WORK PROGRAMME

49 Following the completion of the work programme for 2006 (summarised in Table 3-5), the Commission proposed changes to the programme for the remainder of the review that would better support the top-down approach to developing assessments. We said that we envisaged two main streams of work being done over the next two years and that they would come together in the draft report in 2009.

- We intend to assess disabilities that influence many expense categories, such as scale and location, once, and then apply them to all relevant expense categories. The review process will need to establish the ongoing case for these disabilities to be recognised and how they should be assessed. That process will be progressed through disability-specific staff-level meetings or working parties, and through State submissions.
- We propose to handle the iterative assessment of expense and revenue categories in a similar fashion. We envisage working parties or staff-level meetings and State

submissions, leading to specific proposals being placed before the Commission to modify current proposals on the assessment structure and the way assessments will be made. Because of the different issues associated with each category, we expect the rates of progress to vary across categories. Nevertheless, we envisage at least one complete iteration with the States, covering all expense and revenue items, during the course of 2007 and another during 2008.

Table 3-5 2010 Review work programme, 2006

Date	
March	<i>Commission discussion paper 2006/02 Approach to disaggregation</i> released. <i>Commission discussion paper 2006/03 Architecture of HFE</i> released.
April	Data Working Party met to discuss data quality issues. Data requests sent to States on: <ul style="list-style-type: none"> • Native title, Land rights, Services to Indigenous communities expenses — comparability of data, verification and classification; • what States do re non-financial assets; and • content and comparability of data on national parks visitors, conveyance exemptions and isolation. State responses to discussion paper on disaggregation received.
May	State responses on Native title, Land rights, Services to Indigenous communities expenses, non-financial assets. <i>Staff discussion paper 2006/01-S Socio-demographic composition</i> released. <i>Staff discussion paper 2006/02-S Location-based disabilities</i> released.
June	Staff consultations on Socio-demographic composition and Location disabilities. <i>Commission discussion paper 2006/04 Contemporaneity</i> released. State responses to discussion papers on Architecture of HFE and Contemporaneity received. State responses on proposed definition of arterial roads received.
July	<i>Staff discussion paper 2006/03-S Roads data project — defining arterial roads</i> released. HoTs conference on principles and architecture of HFE. Staff papers to States on ‘what States do’ and its implications for the disaggregation of Education, Health, Law and order, Other expenses and Revenue received.
August	<i>Staff discussion paper 2006/08-S State responses to defining arterial roads</i> released. <i>Staff discussion paper 2006/06-S Disaggregating expenses</i> released. <i>Staff discussion paper 2006/07-S Disaggregating revenue</i> released.
September	Staff consultations with States on ‘what States do’ and disaggregation. Data Working Party consultations with States on definition of arterial roads. <i>Staff discussion paper 2006/09-S Proposed approach to defining arterial roads</i> released.
November	Chairman’s meeting with HoTs to discuss work programme.
December	<i>Commission discussion paper 2006/11 Initial views on assessment structure and approaches</i> released. <i>Staff information paper 2006/12-S, December 2006 Report to the Data Working Party</i> released. <i>Commission information paper 2006/13 Revised Assessment Guidelines</i> released. Optional State comments on principles and architecture of HFE received.

- 50 We also said that States may wish to lodge a more general submission on issues that they consider important to the review process and that these submissions should be lodged by mid-2007. From the Commission's point of view, it will be important that State submissions proactively present State views, rather than merely react to staff proposals. Where States advocate a change, we would want their submissions to articulate the conceptual case for that change and the practical implications of the change, including on the simplification agenda.
- 51 We noted that we value structured workplace discussions as a way of enabling each State to present its case on the issues it sees as important and of gathering information to help us test our preliminary views from people responsible for delivering services. We said that we saw merit in bringing those discussions forward, if possible, so they can better support the iterative nature of this review.
- 52 While broadly supportive of the proposed work programme, HoTs expressed some concerns about the distribution of the workload. We will review the proposed programme in the light of views we have received from HoTs on how their concerns might be overcome.

CONCLUSIONS

We have:

- proposed that further work on the development of assessments be based on 7 revenue categories and 12 expense categories;
- accepted that while we would prefer to use only 2 or 3-digit GPC classifications in defining assessment categories, there are some cases where other approaches are likely to be necessary to improve equalisation;
- proposed the development of broader measures of revenue bases through the identification of taxable parts of each base and the application of the average effective tax rate to that;
- proposed the development of broader measures of 'quantity' or 'use' cost drivers through the identification of one indicator, plus adjustments to recognise material differences in the use of services made by groups of people within the population or in the cost of providing a unit of service to them;
- made a minor amendment to the assessment guidelines (Attachment A) to include an additional materiality guideline to guide decisions on the appropriate level of disaggregation of revenue and expenses;
- decided that further staff discussion papers on the development of assessments and the measurement of disability factors will be circulated in May 2007; and
- proposed changes to the work programme to better support the top-down approach to developing assessments. We will circulate a revised work programme after considering State views.

CHAPTER 4

PROGRESS ON IMPROVING DATA

INTRODUCTION

- 1 As discussed in the 2006 Progress Report to Ministerial Council, the Commission's recommendations depend heavily on the available data and how they are used. For governments to have confidence in the recommendations, the data need to be robust, reliable, comparable and up to date. For those reasons, the Commission and the States agreed:
 - to implement a protocol aimed at improving the quality of State data used in assessments;
 - to review nominated data sets as part of a programme of continuous improvement of data used in the assessments; and
 - to work with ABS to improve the quality of GFS data.
- 2 A process was also agreed for implementing any changes to data and methods before the 2010 Review, should the Commission discover unsuitable data used in the assessments. That protocol would, where possible, see alternate data sets used before alternate methods were used in the update process. This was the exception to the 'package approach' to the 2010 Review in which we proposed to introduce all the new data and methods at the one time in the 2010 Review Report.
- 3 This chapter provides a progress report on these strategies. Most of the information was sent to members of the Commission's Data Working Party¹ in December 2006 (*Staff Information Paper CGC 2006/12-S, December 2006 Report to the Data Working Party*).

¹ The working party established by the Commission in 2005 comprises Commission, State Treasury and ABS staff.

PROTOCOL FOR IMPROVING THE QUALITY OF STATE DATA

Background

- 4 A protocol for improving the quality of data provided by States was developed by the Data Working Party and adopted by the Commission in 2005. It was described in the 2006 Report to Ministerial Council and is summarised in Table 8. The protocol reflects our belief that the ultimate responsibility for State-provided data rests with the States, but also recognises our responsibility to accurately specify our requirements and check data provided to us.

Table 4-9 Protocol for improving quality of State-provided data

Stage in process	Responsibility	Protocol
Data specification	Commission, with assistance of States	Improve data requests by: <ul style="list-style-type: none"> • circulating draft data request annually for comment; • clarifying definitions; and • earlier specification of data needs.
Data collection	States	Improve quality of data collected by: <ul style="list-style-type: none"> • adhering to specifications^(a); • performing basic checks of data; • explaining large variations where required^(b); • provision of timely data; and • provision of disclosure statement which includes: <ul style="list-style-type: none"> – name of the data set, source and date of collection; – the State's purpose for collecting the information; – whether they conform to the specification (and if not, how); – known problems with the data; – explanations for large variations; and – whether they have been checked by the agency and represent the best available data.
Verification after provision	Commission	Evaluate data quality by: <ul style="list-style-type: none"> • checking the changes in the data over time and differences between States; • checking disclosure statements for consistency of approach and making adjustments as required; and • confirming adjusted data with States and providing feedback for the following year; <p>With agreement of the working party, improve quality of data set by:</p> <ul style="list-style-type: none"> • including it in the schedule for examining data sets; or • for data sets with serious problems, audit data at source (no data sets have been identified at this stage).

(a) Adhere as closely as possible to the specifications and document divergences from them.

(b) The level of variation requiring explanation is left to the discretion of Treasuries.

Progress

5 The protocol was used in the 2007 Update. It was applied comprehensively for State data requests and, with appropriate modification², for requests of Australian Government agencies. The protocol had limited utility for ABS data since the ABS collects data for a wider audience and its data are well supported by documentation that enables their quality to be assessed.

² For example, draft data requests were not circulated to Commonwealth agencies.

- 6 For the 2007 Update, the Commission revised its data request format and content, consistent with the protocol. A set of standard questions was included in each data request to obtain information on the quality of the data States and other agencies provide. State responses to the data disclosure questions helped Commission staff to better understand the fitness for purpose of the data they are using, and in some cases to raise further questions with data providers about issues or problems that may exist with the data.
- 7 From the Commission's perspective, the protocol has generally worked well. The Commission intends to seek feedback from the States at the conclusion of the 2007 Update on their experience with the 2007 Update data requests, the data disclosure questions, and the protocol more generally. We will continue to use the protocol, amended if required, for the 2008 Update and beyond.

OUTCOME OF REVIEWS OF AGREED DATA SETS

- 7 During 2005, the Commission and States established guidelines for dealing with unsatisfactory data in existing assessments. Those guidelines were described in the 2006 Progress Report to Ministerial Council and are summarised in Box 4-1. The Commission and the States also agreed on a programme for reviewing the reliability of the main data sets used in the assessments (Attachment B).

Stamp duty on conveyances

- 8 A review of data provided by each State on the number and value of transactions subject to Stamp Duty on Conveyances, and which are used to measure the revenue base for that tax, indicated the data were generally comparable, with the exception of details of transactions that are exempt from the duty. To help improve the comparability of the data, we agreed with the States that the definition should be changed to make it clear that the data should exclude the main groups of transactions that are exempt from duty in most States.
- 9 This action is consistent with the guidelines for dealing with unsatisfactory data agreed to last year and set out in Box 4-1. Examination of the data provided for the 2007 Update indicates that they are more comparable across States than those for previous updates. These data revisions had a significant impact on the distribution of the pool in the 2007 Update.

Box 4-1 Guidelines for dealing with unsatisfactory data in existing assessments

If investigations indicate that data used in existing assessments are unsatisfactory, the Commission will need to decide what changes should be made in the assessments used in the updates. The response we decide upon will need to reflect the circumstances of the assessment in which the data are used.

Specifically:

- where the assessment is unlikely to be material, it will not be pursued;
- where the data are fit for purpose and can be improved with reasonable effort, we will do so;
- where it is not practical to improve the data quality, alternative data and/or methods will be sought in the first possible update, subject to consultation with States during that update;
- where this is not possible, an assessment could be made using the original data in a way consistent with their quality (for example, a conservative assessment could be made or an adjustment to the data made to compensate for their deficiencies); and
- where suitable data are not available and a judgment cannot be made with sufficient confidence, an equal per capita assessment or, if there are limited differences between States in their policies on the range and standard of services provided, an actual per capita assessment would be adopted.

Court appearances

- 10 The 2004 Review methods rest on State-supplied criminal court appearance data, disaggregated by age, sex and Indigeneity. Because the States collect data using different definitions and classifications, it is not possible to obtain data from the States on a consistent basis at the level of disaggregation required. This raised concerns about the comparability of State data and led the Commission to use alternate estimates of court workloads based on a combination of ABS and State-supplied data in the 2006 Update.
- 11 During the year and in consultation with the States, the ABS and the Productivity Commission, we searched for a single source of comparable data that provided the details required by the existing methods. Neither the ABS nor the Productivity Commission data on court workloads are disaggregated in the manner we require. As a result, suitable data are not available from a single source. Obtaining such data is a long-term project.
- 12 We decided to continue to use the approach developed in the 2006 Update for the 2007 Update because age and Indigenous status have large effects on the propensity of people to appear in courts and therefore on the relative costs of providing court services. However, States were asked to provide their data on the basis of the definitions used in relevant ABS and Productivity Commission collections. All but one State was able to comply, although a number were unable to disaggregate their data by Indigeneity.
- 13 There has been an improvement in the comparability of these data but further improvements are unlikely to be possible without changes to the way States record court activity.
- 14 Our focus in 2007 will be on data needs for the 2010 Review methods. Subject to final decisions on disaggregation, that might involve the development of a new comparable data set on court workloads.

National parks

- 15 The number of visitors to national parks currently plays an important role in the assessment of expenses in the National parks and wildlife services category. Staff investigations and consultation with the States during the year revealed that visitor numbers provided by the States are not comparable because they are compiled using different methods. Those investigations also suggest that other potential data sets that might indicate park use, such as population and tourist numbers, while more comparable, are inappropriate measures of national park use.
- 16 As a result, we have decided to continue to use the visitor number data as the basis of the assessment. To reduce the effect of the data deficiencies on the GST distribution, we discounted interstate differences in visitor numbers by 50 per cent for the 2007 Update and will freeze the allowance at the discounted level in future updates unless better data become available. This conservative use of the data is consistent with the guidelines for dealing with unsatisfactory data.

Roads

- 17 Since 2004, the interstate comparability of data on State managed roads, particularly the lane length of arterial roads, has been a concern. Differences in how States defined State arterial roads mean their data are not comparable and raise concerns about the policy neutrality of what is being reported. Because of those concerns, the Commission froze the road length and use disabilities at the 2004 Review levels (which were based on 2001 Austroads data) in the 2005 and 2006 Updates rather than updating them with more recent data. We initiated a Roads Data Project in 2005 with the aim of improving arterial road length data.
- 18 Commission staff sought to prepare a clarified definition of State arterial roads that removed much of the potential for differences in interpretation and would lead to more comparable data being supplied by State road authorities. Even so, there would remain residual concerns about policy neutrality. The proposed definition and State comments on it were summarised in *Staff Discussion Paper 2006/09-S Measuring the Length of State Arterial Roads*, which was circulated in September 2006.
- 19 At a meeting of the Roads Data Working Party on 8 September 2006 an alternative method for preparing comparable and policy-neutral road length data was proposed by Queensland. The discussions agreed that an alternative approach, based on using mapping databases, was worthy of further consideration. We have engaged a consultant to examine that approach.

Native title, land rights and services to Indigenous communities data

- 20 In each year, the Commission collects data directly from States on their expenses related to native title and land rights legislation, and services to Indigenous communities, because data are either not available in GFS or are of poor quality. The Data Working Party suggested that the Commission consider the comparability of the data collected from the States.

- 21 In 2006, the States assisted Commission staff to develop a clearer definition of the items to be included in the annual data requests to improve comparability. Data quality questions were included in the request.
- 22 We have received 2007 Update data returns from all States. The States have certified that the data are the best available, are usually sourced from cost-centres and comply with the specifications set out in the data request.
- 23 Our examination of the information provided by States indicated the data collected under the new specifications are fit for purpose, reliable and comparable across States. We concluded they are suitable for continued use in updates.

Isolation data

- 24 As part of each update, those States assessed to have isolation disabilities (the five smaller States) provide updated data. In the last two updates, some States argued for an expanded range and size of isolation related disabilities.
- 25 At the beginning of 2006, Commission staff asked States for information on the scope and methods of compilation of the data they provide on isolation-affected costs. States noted the difficulties they have in extracting relevant data from their financial systems.
- 26 The annual data request was subsequently redrafted to clarify, but not broaden, the range of isolation-affected costs States were asked to measure. Each State was also asked for its views on the quality of the data it provided. The responses indicated that isolation data are not fully reliable because:
 - States seem to be supplying data selectively;
 - data on freight costs appear particularly poor; and
 - States have difficulty in identifying much of the relevant data in their accounting records.
- 27 Consistent with the guidelines for dealing with unsatisfactory data, we have decided that:
 - for the 2007, 2008 and 2009 Updates, all labour related and freight-related isolation costs would be based on the 2006 assessments updated by CPI;
 - the existing cost relativities between States would be preserved; and
 - as the data will not be used, States would not be asked to provide data on isolation costs for future updates.

Population issues

- 28 As agreed by the Data Working Party, Commission staff have continued to work with the ABS to better understand the effects of its population estimates on relativities. Information on recent variations in processes adopted by the ABS in preparing population data, especially processes related to data from the 2006 Census, indicate there will be changes in the data that will affect the results of future updates and the 2010 Review. For example, we note the following developments:

- The estimates of State population as at 30 December 2006, to be released by the ABS in July 2007, will be based on data from the 2006 Census and new methods for estimating Net Overseas Migration. This is likely to result in changes to each State's share of the Australian population and consequently its share of the GST.
- The ABS Post Enumeration Survey for the 2006 Census (the survey designed to estimate the net under-count in the census) was conducted in remote areas for the first time. This may result in future population estimates that are based on the results of the 2006 Census indicating an increase in remote area population, especially remote area Indigenous population, because counting people in remote areas is generally more difficult than in non-remote areas.
- The ABS will produce an evaluation of the quality of the Indigenous counts in the 2006 Census when the data are first released in mid-2007. If this indicates that significant under-counting continues to be an issue for some States, we will consider the significance of its impact on the distribution of GST revenue and whether it is necessary to adjust the detailed population data.
- The ABS has overcome some issues with its estimated resident population data series. In the interests of simplicity and reliability, we will consider using those data in the 2010 Review instead of the mean resident population which are currently used as the basis of our assessments. The estimated resident population data are more readily available because they are the most commonly used population figures and their use would have an immaterial effect on the relativities.

Use of employment, earnings, benefits and trade union membership (EEBTUM) data

- 29 In its 2005 report to the HoTs review of the implementation of equalisation, the ABS suggested that the EEBTUM data may provide a more comparable basis for estimating interstate differences in wage levels than the data currently obtained from the Survey of Education and Training (SET).
- 30 We have examined the EEBTUM data and concluded that while it provides much of the information required, it is not as comprehensive as the SET data which provides a clearer picture of underlying relative wages between the States. Nevertheless, we have used the EEBTUM data as a 'reality check' for the 2007 Update.
- 31 The EEBTUM data may provide useful information in an update context in years between the publication of SET data. Because the EEBTUM data have only been published for one year the Commission has not been able to be definitive on this issue and will consider it again in the 2008 Update.

Issues to be examined in 2007

- 32 The Data Working Party programme for 2007 has the Commission and the States progressing work on:
- matters not finalised during 2006, such as roads and GFS data;

- data for socio-demographic composition, location, scale and other disabilities;
- capital assessments, including the need for special physical environment disabilities;
- improving the comparability of urban transit data; and
- special data collections.

33 We will consult the Data Working Party on whether these remain the priorities for 2007, given the approach we are taking to the development of assessments.

IMPROVING GOVERNMENT FINANCE STATISTICS DATA

34 In 2006, the States, the ABS and the Commission continued to work together to improve the quality of GFS data used in assessments. We have now implemented all outcomes of our review of GFS issues raised by the 2005 ABS report to the HoTs' review of the implementation of equalisation.

35 The final change introduced is the use of GFS expense data for the ACT for the 2007 Update, rather than the data supplied by the ACT. The ACT-supplied data had municipal expenses removed. We have made this change because including municipal transactions does not have a material impact on the relativities and we have no independent way of confirming the reliability of the data provided by the ACT. We would reconsider this decision if the ACT Government and the ABS could agree on a set of ACT 'State' data that was considered sufficiently comparable with that of the States.

36 In addition, there have been a number of developments outlined below which are leading to improvements in the quality of the GFS data, especially for the more recent years.

- In May 2006, the ABS circulated a GFS quality improvement paper that identified a number of strategies that would be implemented to improve the quality of the GFS data, including that at lower levels of disaggregation. The paper sought comments on the proposals. The Commission was supportive of the ABS approach and said that, in particular, it attached a high priority to obtaining comparable GPC data for the States for the five years of an assessment period (2001-02 to 2005-06 for the 2007 Update).
- During the year, several States reviewed the GPCs assigned to their expense data for a number of years and submitted the revised data to ABS. The ABS is working to include these revisions in its time series. While these revisions improve the comparability of the data for recent years, it has introduced discontinuities in the time series for some States.
- Commission staff identified a number of areas where data do not appear to be comparable across States or over time. The ABS, the States and the Commission will work on improving those areas in 2007.

CONCLUSIONS FROM WORK ON IMPROVING DATA

- 37 The Commission considers that work with and by the States in 2006 has seen an improvement in the quality of data used by the Commission. However, problem areas still remain and data quality will continue to be a factor shaping the assessment methods developed in 2010.
- 38 The Commission understands that State administrative statistical systems do not produce comparable data. States collect such data for their own purposes, using different definitions and classifications. For them, it is not important that the same data be collected on the same basis as in other States. In fact, there can be good policy-related reasons for differences. However, as a result, data series derived without modification from State sources are rarely suitable for our purposes.
- 39 Unless considerable efforts are made to develop data sets required to independently measure interstate differences of relevance to State fiscal capacities, these problems will remain. The need to agree on a minimum number of such collections supports the emphasis in the terms of reference on simplification and reducing the number of assessments. Once assessment methods for the 2010 Review have been decided, the data sets we require can be identified and improved.

CHAPTER 5

PROGRESS ON OTHER ISSUES

INTRODUCTION

- 1 As required by the terms of reference for the 2010 Review, this chapter reports progress on:
 - developing mechanisms to maintain simplification; and
 - improving quality assurance.

MAINTAINING SIMPLIFICATION

- 2 In the 2006 Progress Report to the Ministerial Council, the Commission acknowledged the importance of maintaining simplification once it is achieved. However, consideration of specific strategies for achieving that aim is premature at this point because:
 - we are in the early stages of developing simpler assessments for the 2010 Review;
 - we have agreed with the HoTs that, except where method changes are necessary to overcome data deficiencies, all method changes would be introduced in the 2010 Review report;
 - until more progress is made on the 2010 Review, it is difficult to predict what may be necessary after it is completed.
- 3 At this stage, we think it possible that new guidelines governing the changes that may be made in updates could simplify the update process. In a further review of methods, the use of the assessment guidelines developed for this review, especially the aspects of them relating to reliability and materiality, could help to maintain simpler assessments. We also note the view of one State that a change in the definition of equalisation so that it requires less precision could help to avoid the trend to greater complexity that has occurred in the past. We will give further consideration to this issue as the review progresses.

QUALITY ASSURANCE

Background

- 4 The terms of reference for the 2010 Review ask the Commission to consider improving quality assurance (QA) processes. They also require us to report to the Ministerial Council in 2006 and 2007 on progress. This section presents our second progress report.
- 5 The Commission's QA processes are ultimately aimed at ensuring the accuracy of the relativities calculated by the Commission each year. As part of this aim, we place importance on building confidence among our stakeholders in our work. We seek to do this by providing a clear understanding of how we have determined the relativities each year, why they may have changed from previous years, and the quality controls we have used to assure their accuracy.
- 6 As a major step in responding to the terms of reference, a QA Strategic Plan was completed in 2006 following consultation with States and the Australian Government. The plan is published on the Commission's website (www.cgc.gov.au).
- 7 We engaged external consultants to help prepare the plan. They undertook a comprehensive examination of our workflow, the existing QA processes and a risk assessment to identify gaps in these. That work showed that our existing processes were sound and reasonably comprehensive. Those existing processes included:
 - formal assessment guidelines;
 - detailed documentation of current assessment methods and findings (through update reports, working papers, and the assessment system simulator provided to States), and processes to seek feedback on these from stakeholders;
 - published work programmes and consultation processes for engaging stakeholders;
 - internal process documentation covering most aspects of our work from recording of Commission decisions to construction of assessment workbooks, and means of checking and recording compliance with these; and
 - internal checking processes for input data and the calculation of relativities.
- 8 Nevertheless, we saw a need for improvement to address gaps in coverage and provide stakeholders with information on our QA processes and their application. Progress on implementing new or changed processes is outlined below.

Improvements to data quality

- 9 The reliability of our assessments is affected by both the soundness of the methods we have developed and the quality of the data used in those methods. The QA plan has formalised a process for continued work to improve data quality.
- 10 During 2006, we have implemented findings from the Data Working Party by:
 - conducting a programme to review problem data sets; and

- implementing a protocol for obtaining data quality information as part of the annual data collection process from States and others (see Chapter 4).

11 However, the role of the Commission is not one of a data collection agency. We do not have the capacity to systematically audit all data. Primary responsibility for data quality still resides with our data providers, which in many cases are States.

Greater use of external expertise

- 12 The Commission's work is sometimes criticised for its complexity and related to this, the inability of stakeholders to understand how conclusions were reached. In some areas, we do not always possess detailed subject matter expertise on some issues. These issues are generally relevant to developing new assessments for the 2010 Review.
- 13 We are at an early stage in the development of assessments and we have consulted the States about suitable experts to assist in a range of areas, including the measurement of location-based disabilities, use of broader indicators or alternative approaches to assessing disabilities, assessing roads disabilities, and examining State tax regimes.

Identification of an issues programme

- 14 Some stakeholders thought we could improve the information we provided to them on the issues that the Commission is considering or planning to consider to enable better input and workload planning by States. We have kept States regularly informed of both our update and review work programme. We have also aimed to give States a clear understanding of the strategy driving our activities. We would welcome further feedback from States on further improvements that may be necessary in this area.

External audit of calculations and enhanced checking processes

- 15 To provide greater assurance about the calculations we perform to calculate the relativities, we have commenced an annual programme of engaging external auditors to check a sample of calculations. The audit covers approximately 20 per cent of calculations each year. The first audit has been completed and no errors were found. Improvements to the presentation of workbooks were recommended.
- 16 To dovetail with the external checking process, we have also re-designed our internal checking programme and have added additional checking processes, such as completely re-building a sample of category assessments each year to validate calculations.
- 17 More broadly, we have been reviewing our internal process documentation to ensure the obligations and responsibilities of staff are clear. We have also reviewed sign-off and compliance processes to enhance audit trails, accountability and personal responsibilities.

Improved documentation and reporting

- 18 We have continued to improve the structure, content and style of our publications. The *Report on revenue sharing relativities* and *Relative fiscal capacity of the States* volumes underwent

significant revision in 2006, including adoption of a revised terminology. We have also begun revision of the structure and content of all working papers, with another tranche to be completed in 2007. The working paper revisions are aimed at providing more pertinent information for States and to better balance the size of these with the need for detailed explanation of methods.

- 19 In 2007, we will again seek feedback from States on improvements that are made to our published material, including to our website.

ATTACHMENT A

REVISED INTERIM ASSESSMENT GUIDELINES

INTRODUCTION

- 1 The guidelines provide structure, rigor and transparency to the process of making assessments. They do this by:
 - defining the sequence of decisions;
 - specifying what information is needed at each step; and
 - establishing the quality of the information the Commission requires.
- 2 The guidelines assist 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.
- 3 In operation, the guidelines set a clear hurdle that both individual disability assessments and expense or revenue category assessments have to pass before they are included in the calculation of relativities. The guidelines contain materiality thresholds that will be indexed as required.
- 4 The guidelines also form a key part of the quality assurance process. They allow the Commission to be confident that all relevant information has been used in making preliminary decisions, and allow external parties to follow the decision processes used by the Commission.
- 5 The Commission plans to follow an iterative process in building and finalising its assessments. It will:
 - apply prospective materiality thresholds to make preliminary decisions about category structures and disabilities using historical information;
 - build the assessments using data relating to the assessment period for the review;

- confirm the reliability of methods, including through the use of external reviews of important assessments; and
- confirm the materiality of all its category and disabilities assessments at the conclusion.

STRUCTURE GUIDELINES

- 6 The Commission proposes to structure expense and revenue categories starting with large aggregates and disaggregating only where that is expected to improve the HFE outcome.
- 7 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

- 8 The Commission organises its work by making assessments for individual categories.
- 9 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;

- 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 small 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 needs to 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.

10 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.

11 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 equal per capita; 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.

ATTACHMENT B

SCHEDULE FOR EXAMINING DATA SETS

1 Table B-1 summarises the work programme for examining data sets developed by the Data Working Party. It lists the data sets to be examined, the work proposed and when the outcomes from the work will be reported, or commenced.

Table B-1 Schedule for examining data sets

Assessment/Data set	Work to be done	When
GFS GPC — 4-digit and other issues	Respond to concerns of ABS: (v) continue improving data for updates; (vi) preliminary response to ABS report; (vii) revise scope and structure of adjusted budget; and (viii) if necessary, improve quality of required GPCs with assistance from States and ABS.	Updates, Minco Report 2006, Minco Report 2007, March 2007, and 2010 Review
Disaggregation of AIHW Inpatient and Census data	(iv) preliminary response on 'unintended effects'; (v) examine volatility of data; and (vi) identify main drivers of the costs of providing inpatient services.	Minco Report 2006, Minco Report 2007 and June 2009
Land valuation data	Improve interstate comparability of valuation data on non-principal places of residence. Continue usual audit of commercial and industrial land values by the Australian Valuation Office.	Update and Minco Reports 2006
Roads data	Improve interstate comparability of road length and use data with the assistance of the States.	Update and Minco Reports 2006
Business Register data	Consider interstate comparability of data and, if necessary, look for alternate source or new method.	Minco Report 2006
Mining data	Investigate comparability of data and suitability of new data framework being developed by ABS.	Minco Report 2007
Population	Continue to work with ABS to improve reliability of estimates by improving the <i>Indigenous Enumeration Strategy</i> and understand the effects of this on population estimates. Consider adjusting Census tables to account for non-Indigenous under-enumeration when category structure is determined.	Minco Report 2007 and on-going Minco Report 2007

Assessment/Data set	Work to be done	When
National Health Survey	Investigate ABS concern and proposed alternate sources of information.	Minco Report 2007
Stamp duty on conveyances	Improve specification and check comparability across States.	Minco Report 2007
Native title, land rights and services to Indigenous communities expense	Improve specification and check comparability across States.	Minco Report 2007
National parks data (visitors, biodiversity)	Work with States to attempt to achieve greater comparability in visitor numbers. Investigate if recent biodiversity data are available.	Minco Report 2007
Court appearances	Check basis of collection in each State and comparability across States.	2008 Update
Isolation (freight, labour related costs)	Investigate how these assessments can be made more reliable, based on data from more States.	Commence 2006 for 2008 Update
Socio-demographic composition disabilities	Investigate how these assessments can be simplified, made more reliable, based on data from more than one State, and assessed in more aggregated ways.	Commence 2005
Urban influences, vandalism	Investigate how these assessments can be made more reliable and based on data from more than one State.	Commence 2005
Survey of Education and Training data	Consider the use of the EEBTUM data and whether adjustments made deal adequately with risks posed by small sample sizes for small States.	Commence 2005
Education, Health, Law and Order	Review how States are providing services and assessment frameworks in preparation for decisions on data requirements for 2010 Review.	Commence 2005
Dispersion indexes	Expand sample data used to derive them.	Commence 2006
Scale	Consider whether the assessment could be materially improved through the collection of more data.	Commence 2006
Capital assessments	Review how States are providing services and assessment frameworks in preparation for decisions on data requirements for 2010 Review.	Commence 2006
Special data collections	Consider requirements in consultation with States.	Commence 2007 for collection in 2008 or 2009
Urban transit data	Improve comparability of data on which assessment is based (subsidies, component weights, fleet characteristics) or change method.	Commence 2007
Climate, natural hazards	Consider whether future work is likely to yield materially better results.	Commence 2007
Data for other specific assessments	Consider how these data sets might be improved as part of the review process after a decision has been taken on whether the categories/factors/influences will continue to be assessed separately.	Commence post-2007

Source: Data Working Party, Report to Commonwealth Grants Commission, *Dealing with Unsatisfactory Data*, September 2005.