NSW Commission of Audit
Final Report

Government Expenditure

4 May 2012

Table of Contents

Acknowledgement

The work of the Commission of Audit on this Report has been conducted by an Advisory Board chaired by David Gonski AC and a small secretariat led by Kerry Schott. The secretariat staff included Louis Kastoun and Michael Abrahams from Treasury, Nigel Bailey from KPMG, Peter Connelly from Premier and Cabinet (for a short time), and Kathryn Olsen in support and as office manager.

The secretariat was assisted by several consultants on specific issues. Boston Consulting Group provided case studies of devolution (see Appendix 6) and Third Horizon and KPMG assisted with the chapter on electricity utilities (Chapter 8). In all the areas covered the secretariat had access to reports prepared for agencies, and in particular those prepared for the Department of Finance and Services and Treasury. Some chapters especially benefited from particular agency expertise. Agencies made time to comment, fully and frankly, and the Commission of Audit found this input invaluable. The way in which significant reforms are being embraced by the public service bodes well for the future.

The Advisory Board had extensive experience and specialist knowledge. Their work and subsequent comments have been extremely helpful to the secretariat.

With such a large topic, and such a small work group it is inevitable that we have made mistakes. The important thing to note is the directions for expenditure that the Commission of Audit has indicated. We are confident that any errors we have made do not change the broad directions that we are signalling. We hope that the NSW Government and the public service find this report, and the earlier Interim Report, helpful.

Part I: Overview

1. Introduction

The Commission of Audit believes that NSW is at a turning point. For many years financial management in NSW has been confusing, lacking in transparency and below the standards expected of efficient and effective government. This situation is not sustainable. The interim and final reports of the Commission have considered the current predicament and provide directions for how NSW can achieve outstanding services over time within the limits of its financial resources.

1.1 Key expenditure themes

In relation to expenditure the NSW Public Service has felt under siege since 2005-06. At that time the State budget began deteriorating significantly and continued to do so, given the growth in expenditure which is well in excess of the growth in revenue. In response the Government established the Commission of Audit to review and benchmark current operating and capital expenditure. The objective of the Commission has been to identify opportunities to deliver improved services to the people of NSW in a more efficient and cost effective manner and to provide a sustainable budget position going forward. The benchmarking with other jurisdictions has demonstrated that there are significant areas for improvement in delivery and cost of services.

This report sets out broad principles and directions for expenditure in the context of the Government"s policies, key strategies and priorities as summarised in the key themes below. It also provides recommendations for change. A number of the recommendations can be fast tracked and implemented over the next year while others will require investment over a number of years.

The implementation of these recommendations will require a coordinated and disciplined approach across government together with a clear communication program. In undertaking this review the Commission has been impressed by the capability, enthusiasm and willingness of many in the public service to embrace and recommend change to improve service delivery.

Six key themes emerged as the Report progressed:

- **Devolution**

  The devolution of authority and accountability, specifically in the areas of education and health, means expenditure (and power) must move from the centre to more local units. The capabilities of both people and systems need to be significantly improved along with a clearer understanding of the respective responsibilities of central and local roles and how to move from here to there. The experience of front line public servants needs to inform the development and delivery of government policy.

- **Partnerships, outsourcing**

  Partnerships, outsourcing and divestments are an increasing part of modern government and service delivery. Where groups outside government can deliver better services at lower cost and with greater innovation than government then that should be expedited. The contracted not for profit providers of the government‟s human and social services need to be recognised as partners with the public service in implementing government programs. In areas like social housing, out of home care for children, and disability services, the not for profit sector is actively exploring new partnerships with government and the private sector. And this partnership activity is growing. This should be encouraged.

  It is also evident that many relatively routine tasks, like cleaning and maintenance, are more cost effective when done by private enterprise who specialise in these roles. While outsourcing has been used by government for some time there are still many areas of government that have not fully embraced outsourcing. There are also some opportunities for divestments where sale value exceeds properly calculated retention value.

- **Workforce flexibility**

  Greater workforce flexibility allows modern work practices to be implemented. This is not happening sufficiently because of a perceived or real restriction in workplace practices. The outcome is a frustration to those wanting to do their best and having to work around needless hierarchy and bureaucracy. This is observable throughout the public service and it impedes talent and new ideas which undoubtedly exist within the service. The Commission notes how impressed it has been by the talent, capacity for hard work and forward thinking it has seen displayed by so many public servants.

- **Transparent and evidence based decisions**

  More transparent and evidence based decisions around programs is essential. For programs and schemes, especially those that have been in place for many years, it is worth reviewing whether or not they are achieving what was intended. This comment applies across the public sector to both small and large programs.

  The matrix by which program effectiveness is measured need to be significantly improved to ensure that the full long term costs and benefits are incorporated in the calculation of public benefits from programs. Where benchmarks have been available they have been used to compare costs and performance standards.

- **Collaboration and coordination**

  Collaboration and coordination across government can improve outcomes significantly. This is the case for some important services and also for internal activities that require coordination and consistent standards across the sector. Modern governance arrangements should also harness cross sectoral partnerships between the public, private and community sectors. The Commission also notes that better collaboration and coordination between the Commonwealth and State Governments would improve outcomes. Attention is typically focussed on the taxation behaviours of each of these governments but the overlap of expenditure responsibilities can be better managed. A similar comment also applies to the local / state government relationship.

- **Budget constraint**

  Finally, there is a severe budget constraint and government must prioritise its activities. Government should not do things that others can do more effectively, and what government does must be done efficiently. Expectations about services that can be delivered within the existing budget must be managed.

Within the above six key themes the recommendations focus on the issues that the Commission hopes will assist the significant reforms that are underway. The Commission has:

- examined service delivery issues
- evaluated existing performance levels
- identified improvements
- produced recommendations.

The direction of these recommendations is set out in the next section.

The report includes chapters on Government services and covers government policy; present structure and expenditure; available benchmarking compared to other jurisdictions; case studies of other models of delivery; and specific recommendations to provide improved and more sustainable services.

1.2 Broad direction of recommendations

The recommendations are discussed by theme in this section. These recommendations are also set out in each chapter as they arise and the discussion leading up to the recommendation provides the context and reasoning. A full set of the 132 recommendations, showing the cluster responsibility, timeframe for implementation, and theme are in Chapter 16.

Theme: Devolution

The majority of recommendations around the devolution of services in Health and Education concern communication and consultation, capability requirements, budgets and financial reporting, and increased expenditure on systems and staff capability. Local units, whether they are schools, hospitals or TAFE Institutes, will need to be responsive to the needs of their local areas. It is quite urgent that local budgets be well understood and managed as the funding model changes to an activity base (in Health), to individual entitlements (in TAFE), and to a local school base (in Education).

The Commission is generally of the view that devolution should not increase expenditure in aggregate though capabilities and systems will need attention at the start. Expenditure in local units should however increase and be offset by reductions at the centre. These are exciting reforms that offer a new era for TAFE, more power and responsibility to school principals, and more community and clinician input and responsibility within Health.

The devolution of services will be challenging. It must be clearly understood by both the centre and local units what their roles and responsibilities are, and what they are not. (Recommendations: 8,14,22,27,35,36,37.)

The financial and management systems needed must be put in place along with the necessary IT and other support. This is easier to suggest than to do but it is a critical factor for success. (Recommendations: 15,18,19,25,29,45.) It is also essential that training is provided for those responsible at local levels. (Recommendations: 12,17,23,38,39.) Building up capability for more local responsibility also needs to be supplemented by capability at the centre around strategy and monitoring and assistance.

And case studies show that communication and consultation are the area most critical for success, and the one most frequently overlooked. (Recommendations: 9,13,28.)

Theme: Partnerships and outsourcing

The recommendations around partnerships are intended to encourage growth of service delivery by non-government organisations where these provide better outcomes than government. More understanding of each other by both government and non-government organisations is called for along with smarter contracts. A staged approach is endorsed in social housing and in areas like disabilities, where individualised funding is growing in importance and people can increasingly choose the type of service and provider they wish.

Outsourcing is well entrenched in government but the Commission has noted several agencies where it should be further examined – electricity utilities, Roads and Maritime Services, Sydney Water, Railcorp and Corrective Services. This is not a matter that should be decided on the basis of „private vs. public" ideology but rather on what is the best value for money option for service delivery. (Recommendations: 7,52,53,55,59,63,67,86.)

Various other options including franchising, divestment and public private partnerships are also discussed for certain services. (Recommendations: 68,76,81,82,83,118,119.)

The increasing importance of partnerships is occurring along with improving knowledge within both government and the non-government organisations about how to manage contracts and similar arrangements between them. There is much to learn on both sides. A staged approach may be needed for capacity building. (Recommendations: 40,41,43,44.)

Productivity will also increase if coordination and partnership within government improved. This includes better partnership between entities providing different services within a cluster, as well as services being delivered by different entities across clusters. (Recommendations: 21,108,115.)

Theme: Workforce flexibility

A lack of workforce flexibility was observed in various areas of the public service including Education, Health, Police, and Transport and in the government owned electricity industry. Several recommendations are made that are intended to increase staff responsiveness and responsibility, and over time increase pride in doing a good job. Rigid rules can hamper effective service delivery.

Workforce flexibility was addressed in the Commission of Audit"s Interim Report that covered Management in the NSW Government. The issue has also emerged in this Expenditure Report because a lack of flexibility is adding to expenses and inhibiting better service delivery. Better ways of doing things can be blocked by agreed rules between government and unions which are included in industrial agreements and awards. There is nothing unusual about this but what is not typical is the difficulty in changing the situation even when it could improve the position of both the staff and the community they serve. To change industrial agreements it is important to be clear about what is to be achieved by doing so and what the benefits will be. Some recommendations suggest planning ahead (Recommendation: 30.), comparing costs with other jurisdictions (Recommendation: 33.), and considering how to manage staff more effectively. (Recommendations: 31,34,111.) Potential reforms to workforce arrangements are covered. (Recommendations: 47,51,60,61,106.) Capability improvements are a constant comment throughout the report and do get covered in this theme as well as elsewhere (Recommendation: 101). Safety rules and arrangements within Railcorp are extraordinarily complex and cumbersome to the point where they may be counterproductive. The Commission does recommend benchmarking with other industries (such as airlines) where safety at work is also the highest priority. (Recommendation: 58.)

Theme: Transparent and evidence based decisions

Transparent and evidence based decisions obviously allow scrutiny and assessment. It is impossible to spend money wisely without such consideration by the government, the public service and the community. The reviews recommended by the Commission cover both services delivered to business and the community as well as internal activities like corporate and shared services and procurement. There is room for significant improvements in these latter areas.

Clear reporting and plain English are needed. It is only by doing so that community involvement and better understanding can be achieved. (Recommendations: 3,26,48,50,77,78,79,87,89,90,92,93,126.)

Benchmarking also becomes possible and improvements can be suggested. This is basic for better management of service delivery. Knowing your performance compares with others doing similar work can be a great lesson. (Recommendations: 16,32,65,70,71,72,73,84,85,91,112,113,114,116,117,120, 121,124,128,129,130,131,132.)

Information sharing is important internally so that staff know what changes are expected, what they will deliver (in terms of better services) and how such change will effect them. (Recommendations: 103,107.)

Theme: Collaboration

More collaboration and coordination across agencies is needed to address some matters – and to encourage new ideas. The Commission supports the trial of Social Benefits Bonds. These bonds involve an investor providing up front funds to a provider (a non-government organisation, say) to deliver services that, if successful, reduce future costs to government. Part of the government savings are used to provide a payment on the bond in line with the outcomes achieved. (Recommendation: 49.) Another innovation the Commission supports is a Family Recovery Unit. The Unit uses resources from various agencies to provide intensive support for multiple and complex need families. These families experience a high proportion of government attention that is mainly devoted to managing the symptoms (poor school attendance, domestic violence, alcohol and drug abuse, petty crime etc.) rather than addressing the solutions. (Recommendation: 46.)

The Commission endorses the new Transport for NSW structure which ensures cooperation across different transport modes – something that has not happened with great success in the past. Similarly the Commission encourages continuing coordination of programs between the Family and Community Services cluster, Education and Corrective Services. The high proportion of people in custody who are indigenous and/or have experienced mental illness is an issue that cannot be tackled by the Justice cluster acting alone. (Recommendations:42,54.)

Corporate and shared services within government are in the midst of a significant reform program. Collaboration and coordination is essential in these activities which provide the back up support for government service delivery. It is a reform that has been discussed for many years and is only now being implemented to improve government productivity. Experience in this sector will be needed as well as resources for capability training and systems. (Recommendations: 104,105,109.)

Attention also needs to be paid to programs so that the information required by each agency, or by central agencies is coordinated. (Recommendation: 127.)

Procurement services are in a situation where out dated approaches and ill-informed mandatory use of government contracts are detracting from best practice. This needs to change as existing contracts expire. (Recommendation: 110.) The Commission has also noted that injury management within government can be improved. (Recommendation: 123.)

Across the sector the Commission noted a number of areas where collaboration and coordination may improve delivery. These include arrangements with local councils about road maintenance (Recommendation:

64), coordination of funds management (Recommendation: 99.), one- stop-shops for government services (Recommendation: 66.) and several other matters. (Recommendations: 69,97,100,102.)

Theme: Budget Constraint

Finally, given the infrastructure needs in general government and in non-commercial Public Trading Enterprises, the Commission has recommended that the budget must be in surplus by $500-900 million a year. This would enable capital expenditure requirements to be met and ensure that debt in the general government and non-commercial PTE sector is controlled and sustainable. (Recommendations: 4,5,6.)

To meet this expenditure target both priorities and efficiency are important. The government of the day sets the priorities and the Commission has noted several areas where the budget can be better managed. These include:

- checking that expenditure is focused on government priorities (Recommendations: 1,2.)
- that reporting of non-commercial PTEs is more transparent (Recommendation: 3.)
- that upfront expenditure is accommodated when it would produce later savings (Recommendation: 20.)
- that various programs across the public service be reviewed for effectiveness.

Many internal changes around insurance, more centralised funds management, better corporate and shared service delivery, and improved procurement practices would leave more resources for other services.

The Health budget needs even more than its usual close attention before the commencement of the National Health Reform Agreement in 2014-15. The Commission made a number of recommendations concerning Health and noted that maintenance expenditure in that area did need an increase. (Recommendations: 10,11,24.)

Compared to other jurisdictions, planning for Transport and other long term infrastructure requirements has been inadequate. Transport for NSW and others are addressing this matter but it is an important matter for the budget in the long term. (Recommendation: 56.)

Various ways in which the budget position can be improved were set out in the Lambert Report of 2011. In this report the Commission has recommended the privatisation of state owned electricity utilities though this should be managed without undue haste. (Recommendations: 74,75.)

A more commercial outcome for Railcorp and the water utilities is also supported. (Recommendation: 88.)

Of considerable concern to the Commission was the deterioration in the WorkCover Scheme. This fund is now about $4 billion in deficit despite premiums being 20-60% above that in other states. The disadvantage to NSW business is clear without significantly better outcomes for injured workers. Significant changes are recommended. (Recommendations: 94,95,96,98.)

The Commission also recommended that concessional arrangements be reviewed – something that has not been done for sometime. (Recommendation: 125.) There are also savings to be made in self-insurance (Recommendation: 122.), and by increasing rail fares modestly once performance is better. (Recommendation: 57.) It is also noted that the contingency for natural disasters should be held by Treasury and that arrangements with Roads and Maritime Services to handle natural disasters should be reviewed. (Recommendation: 62.)

1.3 The Interim Report

In its previous Interim Report on Management, the Commission of Audit concluded that reforms needed to begin now. The time had come to stop analysing what to do and just do it. The recommendations in the Schott Interim Report called for action on four fronts:

- fixing the structures of Government
- managing finances
- managing people
- managing assets.

The problems were consistent and related to poor management practices at a basic level. Many dedicated people have been working to deliver services by navigating through and around cumbersome structures and unnecessary barriers. They have made do with poor data, unclear reporting lines and ineffective systems. These people are keen to be part of the solution.

It is very pleasing for the Commission to report that implementation of the recommendations in that Interim Report is underway. The Directors General of each of the nine clusters, led by the Department of Premier and Cabinet and the Public Service Commission, are monitoring progress. These management reforms are critical to achieving policy outcomes and a broader reform agenda that is well underway.

1.4 Terms of reference

Preface

The Commission of Audit delivers a long standing commitment by the Government to review the current fiscal situation of the State of NSW and to establish a framework for future reform. The Audit is to be delivered in two stages:

1. Financial Audit (the Lambert Review), comprising:
    a. Review of State Finances
    b. State Financial Strategy
2. Expenditure and Management Audit.

Background

The Commission of Audit reports to the Treasurer. The Financial Audit (Lambert Review) was completed before the 2011-12 Budget and informed that budget and the second stage Expenditure and Management Audit. An interim report of the Expenditure and Management Audit was issued in February 2012. This covered Management and this Final Report addresses expenditure.

Governance of Commission of Audit

An Advisory Board of Commissioners, directed by a Chairman, has provided advice to the CEO of the Commission of Audit on both the Stage 2 Interim Report (Management) and the Final Report Expenditure Audit.

The Commissioners on the Advisory Board were chosen on the basis of their management and professional background with expertise in areas including public service delivery, community services, regional issues, performance management and auditing. The CEO is responsible for the stage 2 Expenditure and Management Audit, the Interim Report in February 2012 and the Final Report due in April 2012.

The Advisory Board is:

David Gonski AC Chairman

Chris Eccles (ex officio)

Phil Gaetjens (ex officio)

Belinda Hutchinson AM

Sue Page AM

Kerry Schott (ex officio)

Peter Shergold AC

Richard Spencer

Gerard Sutton AO.

Dr Schott is also the CEO of the Commission of Audit, and is an ex officio member of the Advisory Board. Chris Eccles and Phil Gaetjens are also ex officio members of the Advisory Board and are Director General of the Department of Premier and Cabinet and the Secretary of the Treasury respectively.

Financial Audit (The Lambert Review)

The first stage Financial Audit was convened by Acting Treasury Secretary Michael Lambert and included:

- a comprehensive review of the State‟s finances
- development of a State Financial Strategy.

The Stage 1 Financial Audit was to identify and report on issues including:

a. the state of the NSW balance sheet, including on budget and off budget assets and liabilities
b. the long-term sustainability of the NSW Budget position, including its underlying cost and revenue drivers
c. weaknesses in financial controls and financial risk management frameworks
d. wasted expenditure that has built up over 14 years of Labor including program and infrastructure costs overruns and areas of less effective programs and infrastructure provision
e. opportunities to strengthen the NSW financial position.

The Financial Audit is supported by a secretariat within Treasury. It was completed prior to the 2011-12 budget and prior to the commencement of the Stage 2 work on the Expenditure and Management Audit. The Financial Audit informed the second stage work.

Expenditure and Management Audit

The Expenditure and Management Audit examines public sector management and service delivery issues through case studies which illuminate specific and systemic weaknesses in management and expenditure. It aims to identify reform opportunities and appropriate performance objectives for public sector management and service delivery.

Terms of reference for the Expenditure and Management Audit were:

a. a review of all costs and performance of State Government services to global benchmarks
b. measures to drive better performance through increased accountability and transparency in financial reporting.

The Expenditure and Management Audit will deliver against these Terms of Reference and support the implementation of the NSW State Plan by:

1. Examining public sector management and service delivery issues, including procurement, corporate services and asset management and identify potential improvements to productivity, service quality, and public value across the public sector.
2. Evaluating the effectiveness of existing performance metrics and options for greater transparency and accountability through improved public reporting.
3. Using benchmarking data (against public, private, not for profit, interstate; international comparisons) to identify objectives for performance improvement and analyse the reasons for any significant divergence from these objectives in NSW.
4. Producing recommendations to generate long term systemic reform.

The Expenditure and Management Audit may take up matters arising from the Financial Audit.

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2. Expenditure by the NSW Government

Key points:

- The allocation of expenditure is changing to reflect the policy and priorities of the new NSW Government. Expenditures to increase the focus on customers and to devolve control and responsibility to more local and community levels will drive much of this change.
- About half of the current expenditure in general government is allocated to health and education. The highest growth areas over the past decade have been social security and welfare and environmental protection and natural resources. Employee costs are the largest costs component (49%) in general government.
- Capital expenditure has mainly been directed at electricity, roads and rail, education and social housing. Capital expenditure over the last decade was high, partly because of the Commonwealth stimulus.
- Current expenditure growth has exceeded revenue growth over the last decade contributing to, budget deficits. Capital expenditure growth has been even higher. As the Lambert Report noted the budget position deteriorated significantly since 2005-06 and state debt has increased.
- For sustainable current expenditure, revenue must exceed expenditure. Budget deficits should be avoided.
- For sustainable capital expenditure the increase in net debt should not exceed the growth in Gross State Product (GSP). The high level of debt at present in general government and non-commercial Public Trading Enterprise (PTEs) should be decreased over time.
- The aggregate level of capital expenditure appears to be adequate – though this does not mean it was spent in the right place or done efficiently.

2.1 Introduction

A new government has different policies and priorities to the government it replaced. This is particularly evident when the previous government has been in power for a long time. The new Liberal National Party Government has replaced a Labor Government that was in power for 16 years. Policies and priorities have changed.

In this context the Commission has identified five basic questions concerning NSW Government expenditure. These are:

1. Does the expenditure reflect government policy and priorities?
2. Is the proportion of expenditure being devoted to infrastructure and maintenance adequate?
3. Is the expenditure sustainable?
4. Is the current and capital expenditure efficient?
5. Is the expenditure on particular policies delivering the required and expected outcomes?

Examining expenditure at an aggregate level across government gives general answers to the first three of these questions. The question of whether or not expenditure is efficient is addressed for specific areas throughout this Final Report.

2.2 Government policy and priorities

The policy of the incoming government is set around five strategies to:

- rebuild the economy
- return quality services
- renovate infrastructure
- strengthen local environment and communities
- restore accountability to government.

Behind these five strategies are a number of specific goals – thirty two in total. Many of these have direct expenditure implications. They also suggest a change in priorities and a different way of delivering services.

The number one priority is to rebuild the economy, restore economic growth in NSW and make it the most attractive place in Australia to do business. There are six goals set to achieve this outcome:

- improve the performance of the NSW economy
- rebuild state finances
- drive economic growth in regional NSW
- increase the competitiveness of doing business in NSW
- place downward pressure on the cost of living
- strengthen the NSW skill base.

To meet these goals, a number of policies were announced in the government"s first budget. In terms of rebuilding the economy and rebuilding the state finances, the following measures will impact expenditure:

- steps to improve the competiveness of doing business in NSW
- placing downward pressure on the cost of living
- strengthening the skill base.

Returning quality services envisages a focus on the five areas of transport, health, family and community services, education, and police and justice.

The particular focus within transport is on improving public transport. This involves an integrated transport system that puts customer needs first, together with the delivery of strategic infrastructure. In health both prevention and world class clinical services and effective infrastructure are the goals. There is a significant local emphasis so that communities and health care providers are given a strong and direct voice in improved patient care. A major devolution of responsibility to local health divisions is envisaged.

For family and community services the intention is to break the cycle of disadvantage and increase opportunities for people with a disability. Strong collaboration with the non-government sector is expected to promote more choice and quality services.

In education, the focus is on learning outcomes. Service delivery in both schools and TAFE is intended to be more localised at the individual school and TAFE institute level. This is intended to give communities more involvement in education at their local levels.

For police and justice the aims are to prevent and reduce crime and re-offending and to improve confidence in the justice system. Key infrastructure and resources required to tackle anti-social behaviour, including alcohol related crime are planned. Again there is an emphasis on community engagement, prevention and early intervention strategies.

The infrastructure focus is on investment in critical infrastructure based on long term planning. Rail freight and roads are in need of upgrade. The important requirement to move freight efficiently to and from ports is noted along with increased port capacity needs. Planning is also a focus in the context of developing liveable cities and towns and close collaboration with local councils and communities is sought.

It is noted that drinking water supplies in many regional towns are not up to the quality standards that are reached in Sydney, the Illawarra and the Hunter. A program is to be delivered to address this shortcoming.

The fourth strategy is intended to strengthen our local environment and communities. Considerable decision making powers are to be returned to local communities. They will have more control over planning issues, tackling graffiti, quality of the built and natural environment, preparation for floods and fire and other emergencies, volunteering and recreational and cultural activities.

The final strategy is to restore accountability to government. This involves changes to the planning system, more available government information and transparency, involving the community in decisions about government policy, services and projects.

It is clear that the Liberal National Party Government is intent on being customer focussed. Devolving control and responsibilities to more local and community levels is an important part of that approach. This is evident in the proposed changes to health and education service delivery. It is also present in the new approach to planning and proposed changes in disability services.

Along with this change is a determination to rebuild the NSW Government"s financial position and to ensure that adequate infrastructure is provided for both freight and public transport. Changes in expenditure and its allocations will reflect these policies and priorities.

2.3 Previous Expenditure Allocations

2.3.1 Background

The financial year 2010-11 marks the last year of the previous Labor Government. The expenditure allocations in that year, and the decade before, are evidence of previous policies and priorities. This expenditure is the base from which change will occur.

Table 2.1: Aggregate NSW Government Expenditure, 2010-11

$ billion	**General Government**	**Public trading enterprises**	**Public financial enterprises**
Current expenditure	56	20	4
Capital expenditure	8	9	0
Total	64	29	4

As table 2.1 sets out, government expenditure is divided between the general government sector and public enterprises. In the general government sector the proportion of expenditure on capital was 14% compared to 31% in the public trading enterprise sector. The higher proportion of capital expenditure in public trading enterprises, such as water and electricity utilities, ports and forestry, is not surprising given that these entities are capital intensive in their operations.

Goods and services delivered in the general government sector are pure public goods (law and order), merit goods (education, welfare services, environmental services and health) or of a regulatory nature (food safety). These goods and services are generally provided at no charge to the user.

Public trading and financial enterprises typically provide services which are partly or wholly funded by user charges. Public financial enterprises include NSW Treasury Corporation which raises and manages debt for the government. Public trading enterprises include water, energy and port services which are wholly funded by user charges. Non-commercial public trading enterprises (such as transport and public housing) rely heavily upon the general government budget for funding. Their user charges do not fully cover costs.

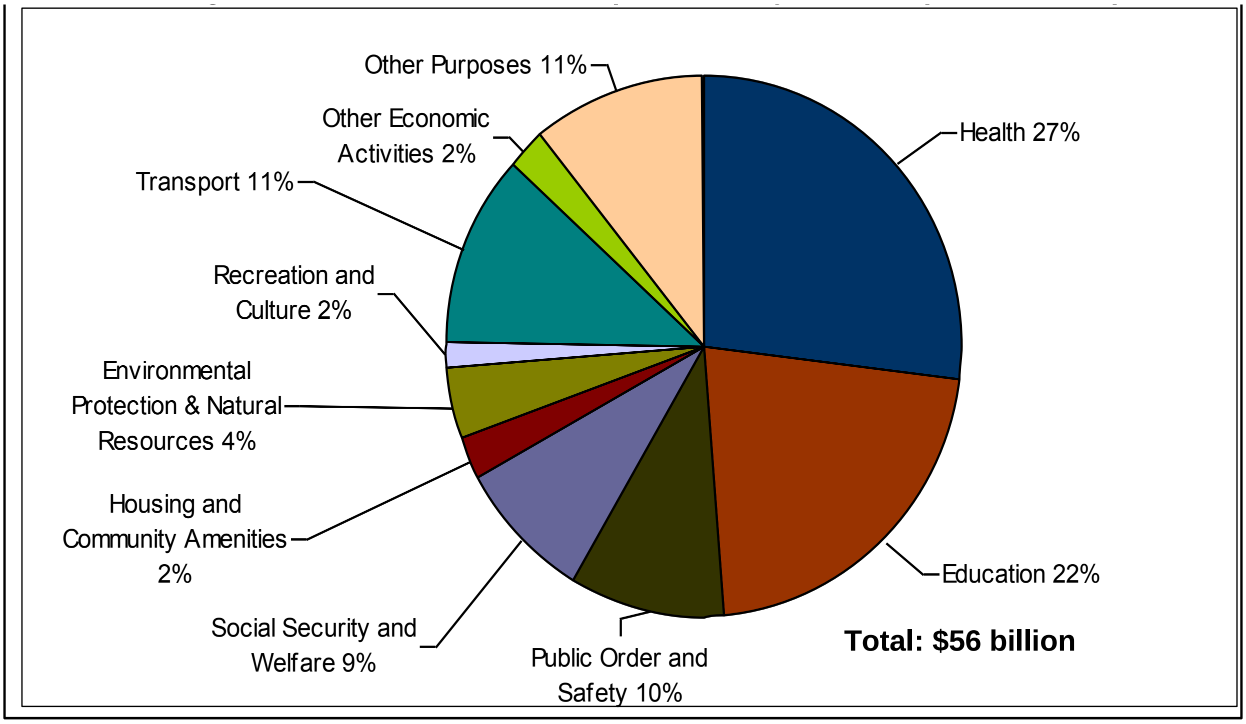
Over time the previous government increased its total expenditure and shifted its expenditure allocation toward capital. Current expenditure in the general government sector grew by 6.2% per year on average over the last decade, while capital expenditure grew by 9.8%. The shift to capital expenditure was even stronger in the public trading enterprises. In that sector current expenses grew at 3.1% per annum over the last decade and capital expenditure grew by 12% per annum.

For the incoming government the aggregate change in the allocation between current and capital expenditure will be driven by specific policy areas. These matters are commented on later.

2.3.2 Current expenditure

Current expenditure in general government is dominated by the activities of two agencies, Health and Education. Together, they spent almost half (49%) of the $56 billion in 2010-11. Chapters 3 and 4 examine policy and the recent expenditure in these agencies in more detail.

Figure 2.1: General government current expenditure 2010-11 (excluding stimulus)

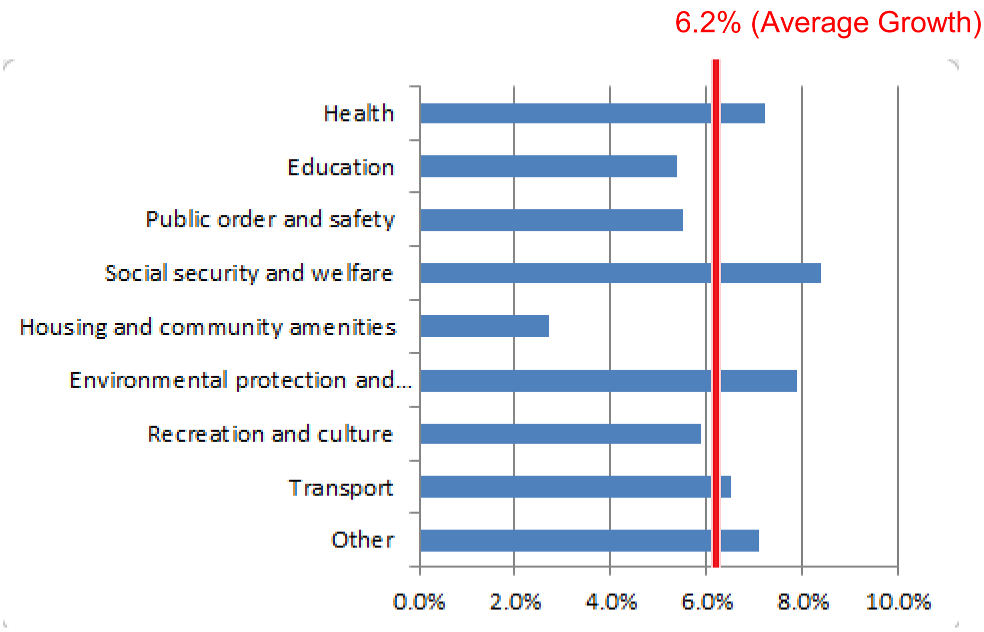


Over the last decade Health current expenditure has almost doubled. It has increased by 7.2% per annum on average to over $15 billion per annum. Drivers of this increase have been expanded services to meet population growth and ageing, improved medical technology and increasing community expectations.

Current expenditure on education over the last decade has increased by 5.5% a year, on average. It is now over $12 billion a year. This expenditure growth has been mainly driven by population growth.

Health and Education current expenditure are given significant attention because of their size in the general government budget. However the Commission was surprised to find that, over the last decade several other areas have grown faster. In particular social security and welfare expenditure has grown by 8.4% a year and environmental protection and natural resources expenditure has grown by 7.9% a year on average. The growth of current expenditure in various areas over the last decade is shown in figure 2.2.

Figure 2.2: Current expenditure, annual average growth 2000-01 to 2010-11, general Government by function

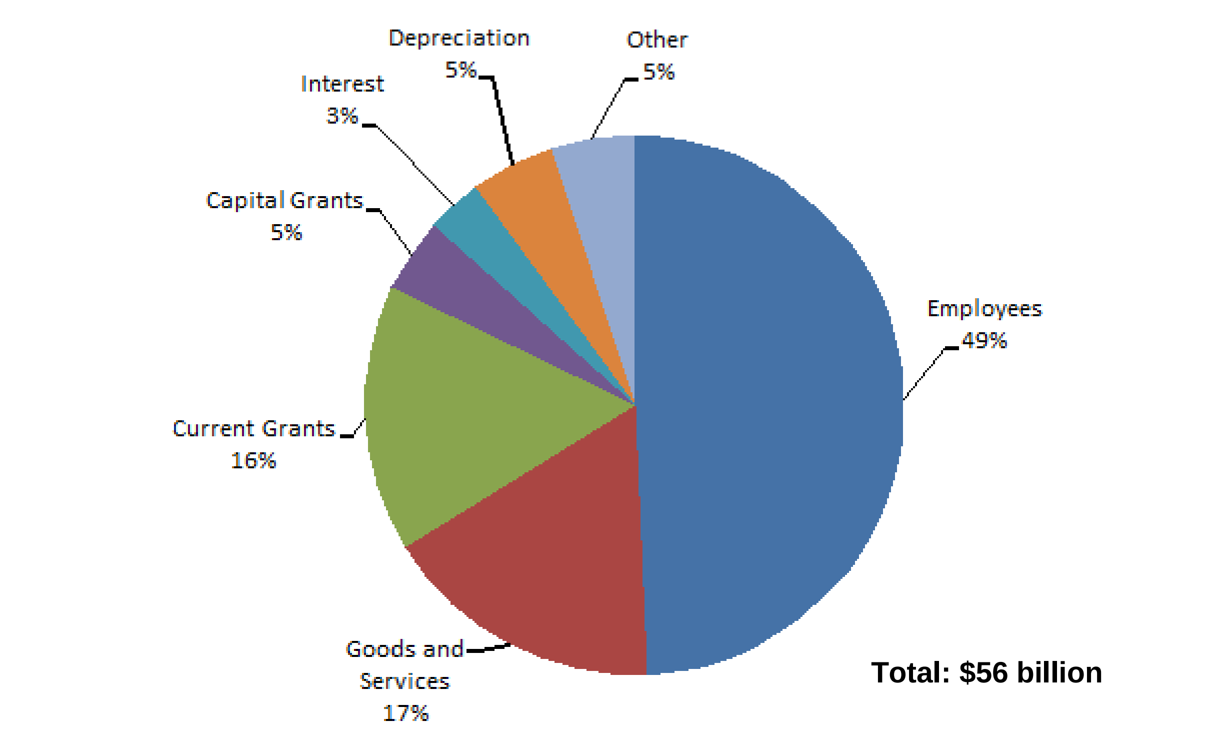


The above average growth of 8.4% per annum in Social security and welfare has been mainly driven by an increase in child care and protection, and in disability services. Many of these services are increasingly being delivered through non-government organisations (NGOs). Since 2007-08, aggregate expenditure growth in grants to NGOs has increased by 12% annually. The major driver of the relative high expenditure increase over the decade in the environmental area of 7.9% has been grants, particularly aimed at water and energy conservation to reduce greenhouse gas emissions.

Service delivery in general government is labour intensive. Growth in employee-related expenses are a major contributor to the cost of services unless labour cost increases are offset by productivity gains. As the Interim Report on Management makes clear the productivity gains are not likely to have been significant.

As Figure 2.3 shows, labour costs were 49%, or $27.5 billion, of general government expenditure in 2010-11.

Figure 2.3: General government current expenditure by type 2010-11



Employee expenses are not only the largest component of total expenses; they have grown on average by 6.5% a year over the last decade. This is due to increases in wages, the number of employees and a tendency for grade composition to move upwards. As the Financial Audit noted, these employee cost increases exceed those in the NSW private sector.

As a percentage of gross state product (GSP), current expenditure by the general government in NSW is around 12.3%. The Commonwealth stimulus spending sent this proportion up over 13%, but since the stimulus the ratio has been trending back to its longer term average.

In comparison to other states this ratio appears to be reasonable. There is a wide range in the current expenditure to GSP ratios across the states. In Victoria the long term average is just below 13%, Queensland"s ratio ranges from 15% to over 19%. The experience in Western Australia reflects the mining boom and is astonishing. Since 2005-06 the current expenditure to GSP ratio in Western Australia has decreased from around 12% to 10.5%. General government current expenditure has risen over the same period from $14 billion to $23 billion. The GSP has grown from $119 billion in 2005-06 to $217 billion in 2010-11!

Changes in the allocation of current expenditure, in line with policy and priorities is likely to reflect:

- measures to strengthen the skill base of the economy, including expenditure to improve the capability of the public service
- current expenditure to move service delivery closer to local and community levels, and to improve real time communication about services
- strengthening arrangements with NGOs
- a focus on early intervention for the most vulnerable and a person centred approach
- attention to keeping people healthy (prevention) and not in hospital
- an emphasis on medium and long term planning, for example the work of Infrastructure NSW.

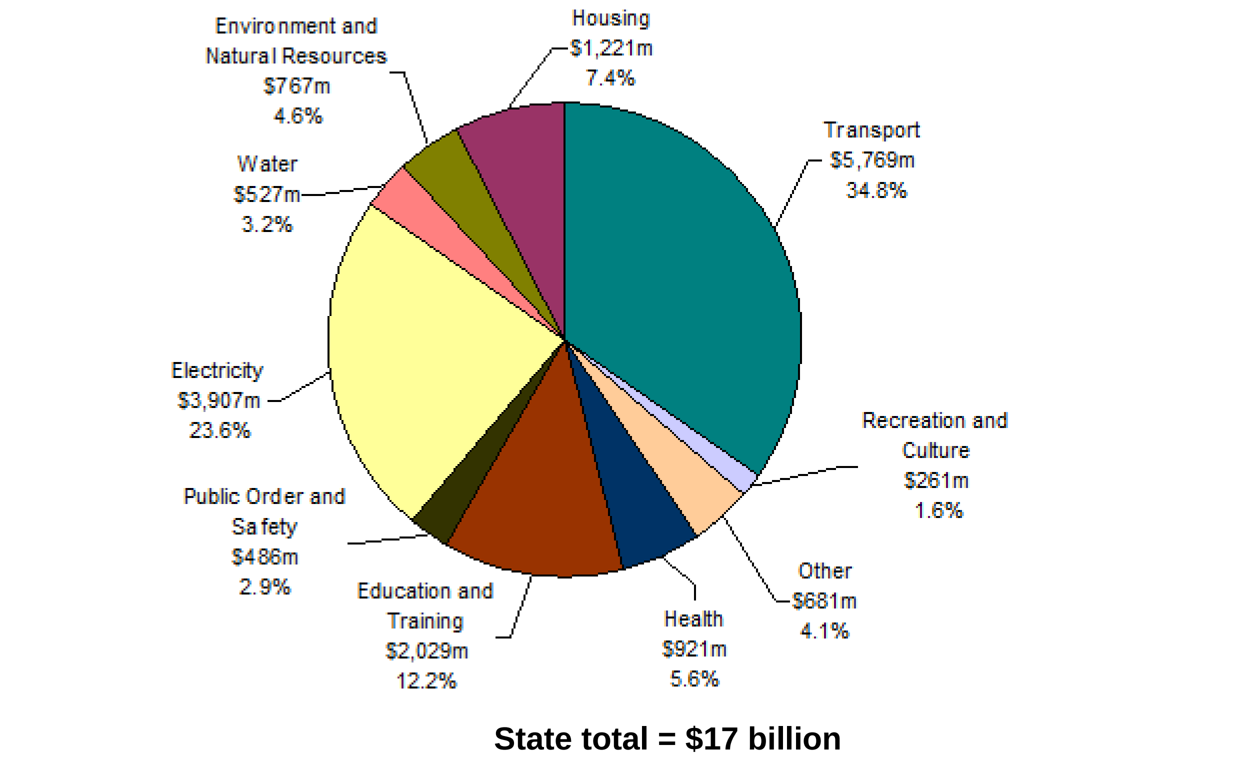
Overall aggregate expenditure is not likely to increase substantially and for reasons set out in section 2.5 it needs to be constrained.

Recommendation: The Commission recommends that each year Treasury review the allocation of general government current expenditure to check that it is reflecting government policy and priorities, namely improving the capability of the public service, devolution of service delivery to more local levels, strengthening non-government organisation (NGO) arrangements, focussing on early intervention, keeping people healthy (prevention) and out of hospital, and improving medium to long term planning.

2.3.3 Capital expenditure

Capital expenditure for the total government in 2010-11 of $17 billion was mainly directed to transport, electricity, education and housing. This is shown in figure 2.4 below.

Figure 2.4: Total State capital expenditure, 2010-11

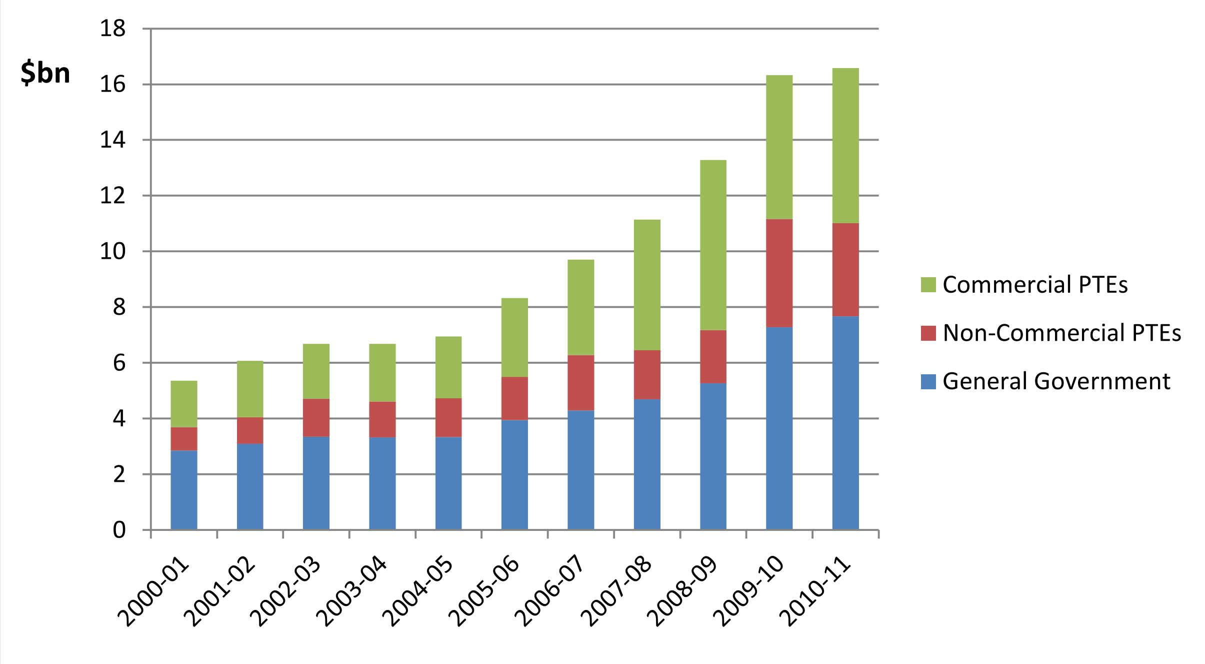


In general government the capital expenditure allocation principally went to roads ($2.8 billion), education and training ($2 billion including $1.2 billion of Commonwealth stimulus), and $918 million to health.

In public trading enterprises, the $9 billion in capital expenditure was divided between commercial enterprises ($5.6 billion) and non-commercial enterprises ($3.4 billion). The main allocations went to electricity ($3.4 billion), rail ($2.1 billion), social housing ($1.1 billion including $538 million in Commonwealth stimulus) and $900 million on water infrastructure.

As noted previously, capital expenditure grew significantly under the last government, particularly from 2005-06. This is shown in figure 2.5. Average annual growth over the last decade was about 12% but after 2005-06 the average growth was 17.6%.

Figure 2.5: Total annual capital expenditure



When the present allocation of capital expenditure changes to meet government policies and priorities, there is likely to be:

- a relative increase in capital expenditure on IT systems and communication to enable devolution of services and customer focus
- more focus on public transport and coordination between different transport modes
- attention to critical infrastructure including rail freight and port connections
- further road upgrades
- relative increase in IT systems to improve financial reporting and management of people and physical assets.

Recommendation: The Commission recommends that each year Treasury review the allocation of capital expenditure to check that it is reflecting government policy and priorities, namely an increase in IT spending to enable devolution, a focus on transport, critical infrastructure including freight and port connections, further road upgrades, and an increase in IT systems to improve financial reporting and management of people and physical assets.

2.4 Adequate capital expenditure

Whether or not expenditure on infrastructure and maintenance is sufficient is better answered within specific areas. Is public transport infrastructure adequate? Is road maintenance sufficient? Are there enough schools and hospitals and are they located where the population needs them?

At an aggregate level an independent review of state finances in Victoria in 2011[a] presented a methodology to consider the sustainable level of infrastructure investment. The approach is an economic analysis over a medium term. The analysis considers the infrastructure spending necessary to maintain and enhance the delivery of services to the community. Their approach is explained in Appendix 2 (which has been taken directly from their review) and this appendix also sets out our analysis for New South Wales.

The analysis assumes the drivers of capital expenditure are population growth, community expectations (or an enhancement factor), technological change and investment needed for the replacement of depreciated capital stock. (See Appendix 2 for more details). On that basis it appears that at present in NSW the level of aggregate capital expenditure (in general government) has been above the medium term trend required. However by 2014-15, the end of the budget period, the planned capital spend falls below the required medium trend. This trend figure goes up over time and ranges from about $5.4 billion in 2010-11 to $6.8 billion in 2014-15.

There is no evidence in this analysis to suggest that the aggregate capital spend in general government has been too low. Whether it has been spent on appropriate projects is another question for later chapters.

The earlier Lambert Report also concluded that there was no evidence of underspending on infrastructure in NSW, based on expenditure trends and in comparison with other jurisdictions. While both the Commission and the Lambert Report share this conclusion about the aggregate expenditure, it is important to note:

- adequate aggregate expenditure does not mean that the expenditure has been made in the right place or done efficiently
- asset registers and related condition reports for government assets are not comprehensive.

These are issues that are properly dealt with at the area level and not at this aggregate level.

In the public trading enterprise sector of government there has also been significant capital growth since 2005-06 as discussed in section 2.3.3. In the commercial PTE

[a] Victorian Government 2011, Independent Review of State Finances, Interim Report, April.

segment this expenditure is closely examined and analysed by regulators and the relevant corporations. The Commission is confident that this expenditure is adequate.

The non-commercial PTE segment benefited from Commonwealth stimulus funding in social housing. The other main component of non-commercial PTEs is transport (mainly rail). These areas are addressed later. Because non-commercial PTEs rely on general government, through both current and capital grants, their performance should be assessed as thoroughly as that of general government agencies. The Budget papers do not show that this occurs.

Recommendation: The Commission recommends that the reporting of Public Trading Enterprises (PTEs) in the Budget splits out non-commercial PTEs so that their increasing capital expenditure and debt, and reliance on general government is not hidden through their aggregation with commercial PTEs.

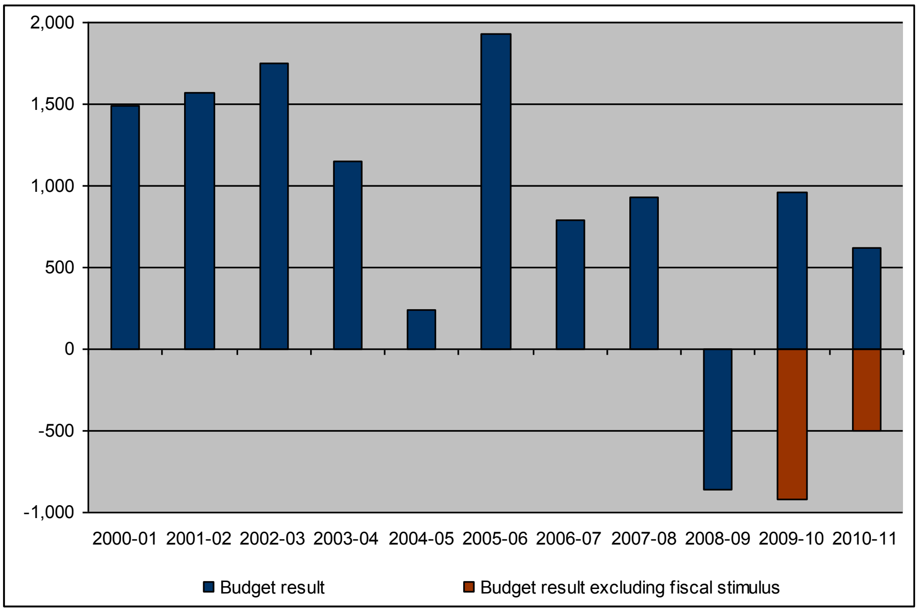
2.5 Sustainable expenditure

Without sustainable expenditure there cannot be ongoing and continuous delivery of goods and services. A failure to continuously provide health services, childcare and protection, education, public transport, power, water, sewerage and other basic services would be calamitous. Indeed recent events in Europe illustrate public reaction to the withdrawal of public services and benefits where expenditure is no longer sustainable.

2.5.1 Current expenditure

The present NSW Government has inherited a budget position that was not sustainable. The deterioration in the Budget result was documented in the Financial Audit. Figure 2.6 illustrates the point dramatically. By 2008-09 a run of annual budget surpluses in the general government turned to a budget deficit once fiscal stimulus is excluded. The Financial Audit noted that the budget deterioration was largely due to current expenditure growing faster than revenue.

Figure 2.6: General government operating result: 2000-01 to 2010-11 ($ million)



Over the last decade current expenditure has increased by 6.2% a year (excluding Commonwealth stimulus). Revenue growth has been less at 5.6% a year on average.

Borrowing to fund a deficit in current expenditure is only sensible in very limited circumstances, such as a short term drop in revenue. Borrowing on an ongoing basis to fund current expenditure, whose main component is wages, is a sure step toward financial crisis.

Measures have now been taken in the most recent budget to address this deterioration. Sustainable current expenditure can only be achieved when general government current expenditure does not exceed revenue.

Recommendation: The Commission recommends that the general government operating result (generally called the Budget result) should be managed to avoid a deficit in order to achieve sustainable current expenditure.

2.5.2 Capital expenditure

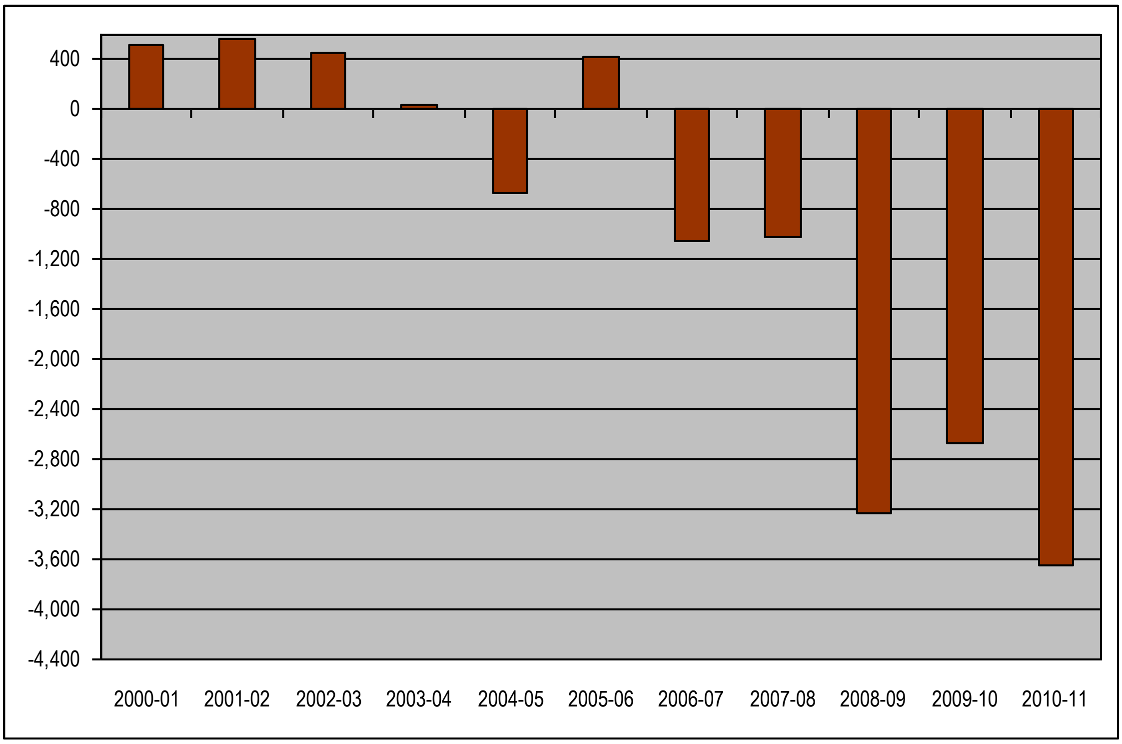
Borrowing to fund capital expenditure is appropriate but there are constraints that must be met. These constraints are different for commercial public trading enterprises and for general government and non-commercial public trading enterprises.

In the case of commercial public trading enterprises, the constraint is similar to that of any corporation. The funding of capital expenditure can be met by retained earnings or by borrowing. The best mix between these two sources of funds should be determined by the optimal capital structure of the commercial public trading enterprises. Over the longer term, the debt position must be stable and cash flows must be sufficient to fund operations, debt and a reasonable return on equity both now and in the future.

In the case of general government and non-commercial public trading enterprises the constraint is severe. Capital expenditure in these sectors does not earn a commercial rate of return and in many cases its return on a cash basis is zero. Its funding necessarily comes from government budget revenue to either fund the capital directly or to support debt finance. For example a new school will provide a service but it does not earn revenue. Of course this capital expenditure is appropriate. The Budget must therefore set continuing funds aside from current operations to fund this capital expenditure over time. When capital expenditure and debt are both continuously increasing there is a risk that the position will become unsustainable.

As the Commission noted earlier the general government budget was in deficit in 2008-09 and then in surplus only because of the Commonwealth stimulus. Insufficient funds were being set aside out of current expenditure to finance capital expenditure directly or to fund the debt supporting it. As a consequence borrowing and debt increased. The Lambert Report noted that the deterioration in the net borrowing requirement by the government is the most significant fiscal challenge. The net borrowing requirement shows the net demand for funds to cover any budget deficit and the capital program.

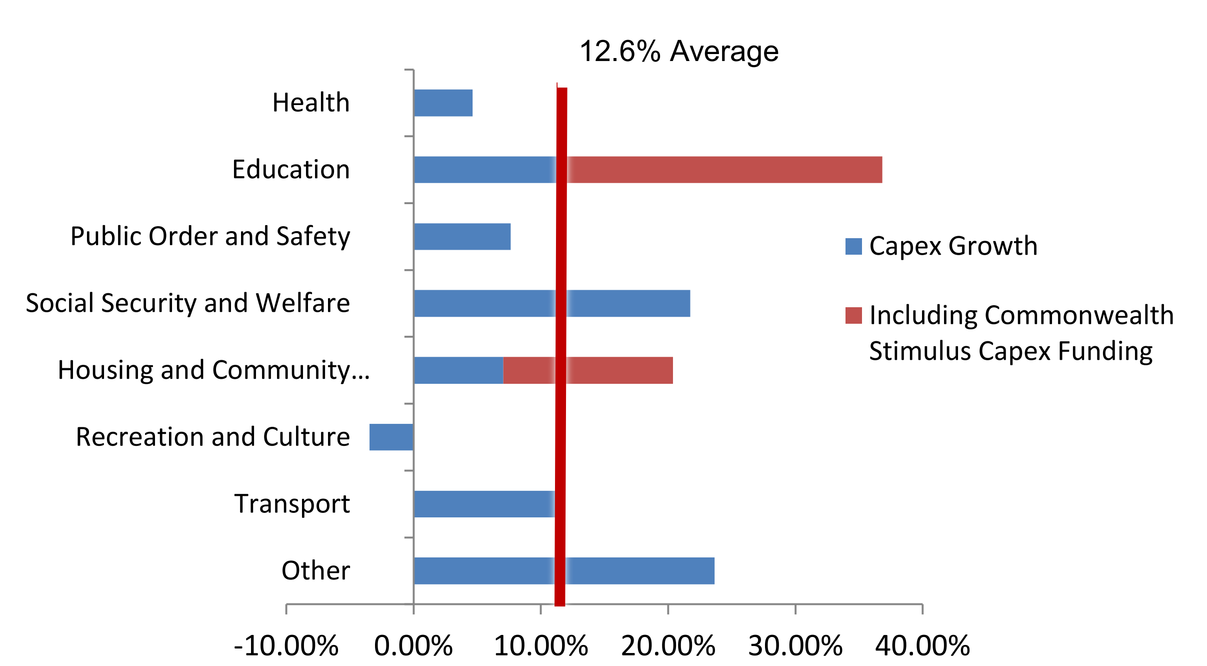
Figure 2.7: Net lending results 2000-01 to 2010-11



As this figure 2.7 shows the deterioration escalated after 2005-06 as capital expenditure increased in both general government and non-commercial public trading enterprises. Capital expenditure in these categories is shown in Figure 2.5 earlier. From 2005-06 to 2010-11 the non-commercial capital expenditure almost doubled.

The growth over the last decade in non-commercial capital expenditure was concentrated in several areas. With the Commonwealth stimulus, education growth was an extraordinary 36.8% a year, and housing and community amenities was 20.4% a year. The other major growth area for capital expenditure was social security and welfare at 21.7% per annum. Excluding the stimulus, annual average growth was 9.4% and with stimulus 12.6%. This is shown in figure 2.9 below.

Figure 2.8: Capital expenditure growth: general government and non-commercial PTEs



Note: The Health capital expenditure growth average of 5% excludes Private Partnership Projects, and with these added, the average rate is 7.5%.

Sustainable capital expenditure is the big challenge. As argued earlier sufficient funds must be put aside each year from the general government budget to finance the capital expenditure in general government and in non-commercial public trading enterprises. This amount, an „infrastructure funding amount", would pay for capital projects directly or meet the ongoing borrowing costs and stabilise the debt. The size of the amount set aside can be lessened through asset sales. In recent years, asset sales have been devoted to unfunded superannuation liabilities. To the extent that this occurs there is less available for infrastructure.

The funding task is set out in table 2.3 below. For an aggregate of general government and non-commercial public trading enterprises, the funding of capital expenditure depends on either:

- a cash surplus in the Budget
- borrowing.

Table 2.3: Funding capital expenditure, (General government and non-commercial PTEs)

$billion	2010-11	2011-12	2012-13	2013-14	2014-15
Capital expenditure	**10.1**	**9.6**	**9.6**	**10.1**	**8.5**
Source of funds					
Operating balance, general government	1.3	(0.2)	(0.3)	(0)	(0.2)
(exclude depreciation)	2.8	3.0	3.2	3.5	3.6
EBITDA, non-commercial PTEs	0.7	2.4	3.2	3.4	3.3
Asset sales	0.3	0.6	0.7	0.4	0.4
Shortfall (implied borrowing)	5.0	3.8	2.8	2.8	1.4
	10.1	**9.6**	**9.6**	**10.1**	**8.5**

Source: Half yearly Budget Review, December 2011 (except for the shortfall figure)

By the end of the budget period these figures suggest that $8.5 billion in capital expenditure will be met by a cash operating surplus, that is excluding depreciation, of:

- $3.6 billion in general government
- $3.3 billion in non-commercial PTEs
- $0.4 billion in asset sales
- an implied new net borrowing requirement of $1.4 billion.

There are several things of interest in this table:

- The implied new net borrowing requirement is decreasing across the budget period. This is because capital expenditure growth, according to the budget, is restrained and the operating deficit has been reduced.
- A decrease in this implied new borrowing across the budget period means that debt is increasing but at a slower rate.
- The positive earnings result for non-commercial PTEs includes grants from general government of about $4-6 billion per year. These entities (mainly Railcorp and Housing) are budget dependent.
- Asset sales are assumed to be modest. Should these increase, as expected, the new borrowing requirement would be less on the assumption that the value of the sales exceed retention values.

To achieve sustainability, the government is committed to meet various measures set out in the *Fiscal Responsibility Act 2005.* As the Treasurer reported in June 2011, these measures were generally not met by the previous government after 2005-06.

Of particular concern for the sustainability of capital expenditure is the increasing net debt. The target is to keep net debt in general government as a percentage of GSP at 0.9%. At this ratio, debt could increase in line with GSP growth. The net debt GSP ratio is presently at 2.3%, having risen continuously since 2005-06. The June 2011 Budget has begun the important task of stabilising the debt through both operating expenditure measures and lower capital expenditure growth.

The Commission strongly supports the policy to stabilise the general government net debt as a per cent of GSP and over the longer term to decrease that ratio.

The target of 0.9% for the net debt to GSP ratio does not seem to have much reason or analysis supporting it.

Recommendation: The Commission recommends that Treasury review the target measure of 0.9% of GSP for general government net debt to GSP and explain the reason for the chosen target. In this review they should consider both general government and the reliance of the non-commercial PTE sector on general government.

To assist in funding capital expenditure in general government and non-commercial PTEs an amount should be set aside from general government operations – an infrastructure funding amount. This budget surplus would fund capital directly and support debt finance. An amount between $500-900 million would assist in decreasing net debt over time and begin to improve the budgetary position. The amount of budget surplus that is desirable will depend on the capital expenditure required and the level of new borrowing that is considered prudent. The aggregated operating surplus ($500-900 million) is likely to decrease net debt gradually over time. The important strategy is to get net debt funding down as a percentage of GSP and to continue that trend.

Recommendation: The Commission recommends that to achieve sustainability the budget operating result should aim to run a surplus each year for an infrastructure fund amount of around $500-900 million to fund general government and non-commercial infrastructure.

2.6 Conclusions

The incoming government has different policies and priorities and these will be reflected in changing expenditure allocations. An immediate task is to halt the deteriorating budget position and to do this several measures must be taken. These include:

- The budget result must aim to be an operating surplus.
- While net debt continues to increase the budget surplus target should be around $500-900 million per year.
- With the changes recommended in the Interim Report this level of budget surplus should be a consequence of better management, information and controls. The quantity and quality of services need not be impacted.
- Once net debt is at a low ratio to GSP, say around 0.9%, it could then grow at the GSP annual trend rate.
- Asset sales are an important way to fund infrastructure and are likely to make a larger contribution than presently reported in the Budget. The Budget follows accounting rules that do not allow likely sales to be included until they are effectively contracted.
- The contribution to the Budget that non-commercial PTEs make, both negative and positive, is not clear in the Budget papers at present. They are reported in aggregate with the commercial PTEs and this masks their reliance on general government and their significant and increasing debt which is also reliant on general government support.

Part II: Service Delivery

3. Health

Key points:

- NSW Health is undergoing two major reforms – a move to activity based funding, and a devolution of responsibility and decision making to local levels.
- Both reforms require upgraded information and management systems and a change of culture. The Ministry for Health must become an enabler and not a ‟do-er„; and local hospitals and others must accept increased responsibility and locally based budgets.
- NSW Health ranks well within Australia, and globally, on performance criteria of hospital staff per total population, available beds and medical indicators such as life expectancy and infant mortality.
- Current expenditure in NSW Health appears to be adequate at present but demand is increasing with population growth and ageing, technological improvements and rising expectations. Health costs are increasing with demand.
- There appears to be a maintenance backlog and a need for extra capital expenditure in this area. Facilities are run down.
- For reforms to work a number of recommendations are made relating to increased training around community and clinician engagement at Local Health District (LHD) levels, better budgeting and improved local administration, and systems. These matters will require resources and related expenditure.

3.1 Government Policy

Health is facing its most challenging reform for some decades. The reform is driven by two fundamental changes:

- activity based funding (ABF)
- devolution of decision making and responsibility to more local levels.

The NSW Government‟s policy principles are to achieve:

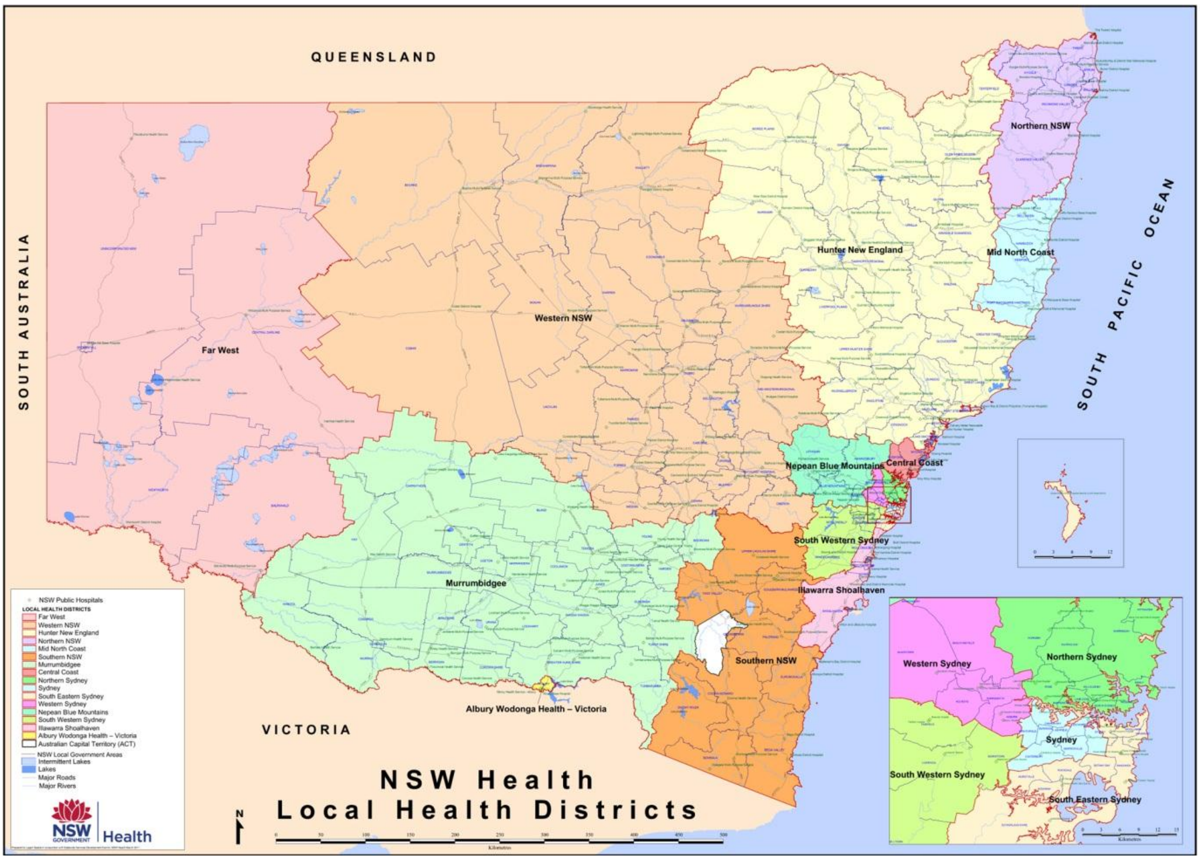
- equitable access to timely, quality, health care
- rights for individuals to make choices based on realistic expectations of the health system
- an allocation of resources to where they can do most good
- open governance and accountability of performance
- greater patient involvement in decision‟s about their own health care

- greater community and clinician involvement in planning and delivery.

3.1.1. Devolution

The principal change is the devolution of decisions and accountability to Local Health Districts (LHDs). Fifteen LHDs and two specialty networks (the Sydney Children"s Hospitals Network and the Forensic Mental Health Network) have been established. Each LHD or specialty network is governed by a Board that is responsible for leading, directing and monitoring the activities of their services. Figure 3.1 shows the LHDs across the state

Figure 3.1: Local Health Districts across the state



There are nine hospitals in NSW with over 500 beds. These are all in the Metropolitan LHDs. There are 14 hospitals with 200-500 beds. These are set out in Table 3.1.

Table 3.1: Hospitals with 200 to 500 beds

LHD	Hospital >200 beds	Hospital >500 beds
Central Coast	Gosford Wyong	–
Illawarra	Wollongong	–
Nepean Blue Mountains	-	Nepean
Northern Sydney	Hornsby	Royal North Shore
South Eastern Sydney	Sutherland	Prince of Wales St. George
South Western Sydney	Bankstown/Lidcombe Campbelltown	Liverpool
Sydney	–	Concord Royal Prince Alfred
Western Sydney	Blacktown	Westmead
Far West	–	–
Hunter New England	Tamworth	John Hunter
Mid North Coast	Coffs Harbour	–
Murrumbidgee	Wagga Wagga	–
Northern NSW	Lismore Tweed	–
Southern NSW	–	–
Western NSW	Orange/Bloomfield	–

The number of hospitals within less than 50 beds is 127. These are in regional and rural areas of the state. There are 23 hospitals with 50-100 beds and 17 with 100-200 beds.

Through its Board and management, each LHD must determine how it will deliver services set out in a Service Agreement with the Ministry of Health. The annual agreement specifies the services to be funded by the Ministry. LHDs can provide these services directly or purchase services from Affiliated Health Organisations and other non-government organisations.

LHD Board members are appointed by the Minister. The Board is chosen to have a mix of skills including medical expertise, financial and risk management, and local community and clinician representation. Responsibility for control and management of the day-to-day operation and performance of the LHD or specialty network is vested in a Chief Executive who is accountable to the Board.

The devolution of greater responsibility to LHDs has led to consequential changes at the centre. The previous Department has been replaced by the Ministry of Health. The Ministry has taken a step back from day-to-day operational issues (which are devolved) and is focusing on its core roles of:

- advising on policy, legislation and governance
- planning for future capacity and workforce needs
- securing the resources the system needs from the State and Federal Government, and distributing those resources fairly
- negotiating Service Agreements with LHDs, monitoring progress against the agreements, and intervening if performance does not meet specific standards
- stimulating system-wide initiatives that improve quality and efficiency based on the need for a critical mass of expertise or economies of scale
- ensuring clinicians are actively engaged in service planning, management and formulating budget priorities
- performing regulatory duties (for example to protect public health and to licence private providers).

The roles of other organisations that form part of NSW Health have also been adjusted as the:

- Clinical Excellence Commission takes the lead in policy and strategy on system-wide improvements to clinical quality and safety
- Agency for Clinical Innovation has the central role in designing and implementing new models of care and improved patient pathways. Its focus includes programs that can prevent hospitalisation Health Education and Training Institute is responsible for undergraduate clinical placements, vocational education and training, management and leadership development, and post-graduate clinical education
- Bureau of Health Information is responsible for producing health performance information to assist patient choice and contribute to public debate.

Shared services are organised into:

- HealthShare NSW, which provides linen, food, payroll, warehousing, procurement and other shared services to public hospitals and health services
- Health Infrastructure, which continues to plan and deliver capital projects worth over $10 million
- Pathology Services where a business case is currently being considered to form a statewide entity
- eHealth which is leading the NSW Health information strategy.

This arrangement of shared services may need changing as the division of responsibilities between the Ministry and LHDs evolves. Shared services are discussed in a separate chapter later in this Report but in other areas of the public service more outsourcing of these functions is being examined.

Recommendation: The Commission recommends that HealthShare NSW should investigate whether some of its functions would be more effectively provided through outsourced arrangements.

The decision to plan and deliver capital projects over $10 million in size through the Ministry is a starting position. Over time the size of the capital projects delivered at the LHD level, rather than the Ministry level, may need to be increased for efficient outcomes. Such a step may also reflect increasing capabilities at the LHD level.

Recommendation: The Commission recommends that Health Infrastructure consider what level of capital project delivery should be done centrally, by the Ministry, and what should be the responsibility of the new LHDs.

A new Performance Framework has been set up for each LHD. This Framework sets financial and operational targets and includes a performance review. Benchmarking will be introduced in the next iteration of the Performance Framework, due to begin in 2012-13. A new national performance and accountability framework is also being established under the National Health Reforms. Under this national framework, new consistent standards and reporting arrangements will be introduced. These will provide information at the national, state and local levels about the performance of the health system.

3.1.2. Activity Based Funding

A large proportion of LHD funding will be allocated using an Activity Based Funding (ABF) model. LHD Service Agreements will include a price and volume figure for services that are covered by ABF. The pricing will involve an independently-determined national efficient price, a state price and a state funding model. The national efficient price will determine the Commonwealth contribution to ABF. Some regional and rural public hospitals, and other agreed services, will be block funded. This block of funding reflects the higher costs associated with delivering services in these areas.

ABF is due to commence on 1 July 2012 for admitted acute services, emergency department services and some outpatient services. On 1 July 2013, ABF will be used for other non-admitted services, mental health and subacute services.

Implementation of both ABF and devolution requires, amongst other things, better information and management. As part of this improvement a new Strategic Management Reporting Tool has been implemented and has been rolled out for all LHDs and the Ministry. It is a web based system that consolidates financial data to deliver consistent financial reporting. It should enable an efficient and streamlined budget, financial and payroll information to flow between LHDs and the Ministry. A new information system is underway to support the implementation of ABF. The information contained in these systems needs to transparently demonstrate how funding from the Commonwealth and State Governments is being made available to LHDs.

Risks

There are of course significant risks when major changes are introduced. The Ministry will need to monitor progress carefully while letting the LHDs and their local business units take the responsibility intended. Mistakes are inevitable.

There may be a role for the Health Efficiency Improvement Taskforce (HEIT) to assist with the change implementation. HEIT is a high-level interagency committee that assists with strategies and implementation. There may also be a role for the Public Service Commission to provide assistance on matters of public sector management.

Recommendation: The Commission recommends that Health discusses its reform progress (and difficulties) with the Directors General of the central agencies (including the Health Efficiency Improvement Taskforce and the Public Service Commission) at least annually; and seek their assistance when this is judged helpful.

3.2 The current situation

3.2.1. Performance

The NSW public health system is large and complex. NSW Health operates in about 430 locations across NSW, including 235 hospitals, 500 community, family and children's health centres and 220 ambulance stations. A range of other services are also provided including mental health, dental, allied health, public health, aboriginal health and multicultural health services.

The public health system is very active and becoming more so. In 2010-11:

- around 2.5 million people presented at an emergency department
- around 200,000 people were admitted for planned surgical procedures
- there were around 19 million occasions of service for non-admitted patients
- and on an average day, there were around 17,500 inpatients in hospitals across the state.

All the main indicators for health service activity show that demand has been increasing. This trend is expected to continue, particularly as the population grows and ages. Increasing activity in the public health system is also being driven by a growing chronic disease burden, rapid technological advances, and increasing community expectations.

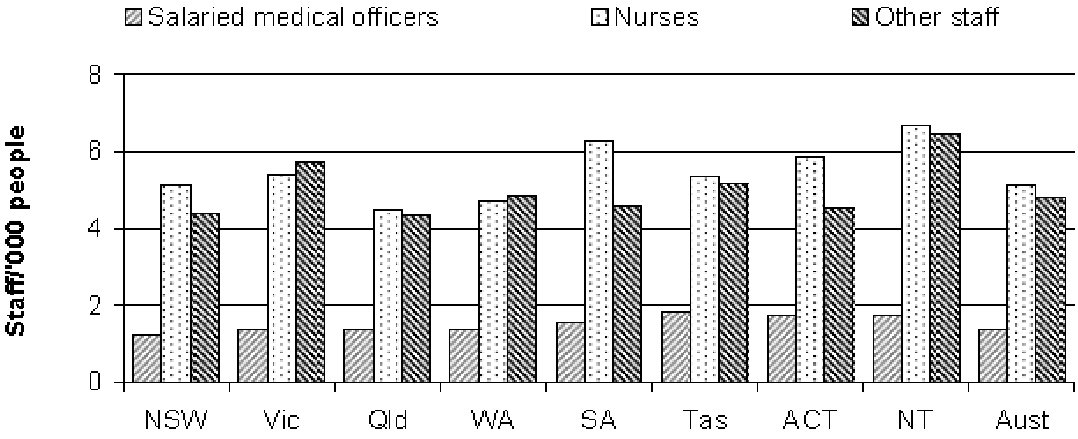
Despite the challenges posed by its size, complexity and growth, the Commission notes that NSW public health system deserves recognition as a strong and responsive system with a dedicated workforce who provide an excellent standard of care. Peter Garling SC, in the recent Special Commission of Inquiry into Acute Care Services in NSW Public Hospitals, found that „NSW still has one of the better public health care systems in the developed world‟.

Commissioner Garling found that doctors, nurses and clinical staff in NSW hospitals are well-trained, skilled, caring and dedicated. Patient satisfaction surveys support this conclusion. These surveys show that patients‟ experiences in NSW public hospitals are generally positive, and broadly consistent with the level of satisfaction experienced in public hospitals in other States and Territories. Data from the Productivity Commission about patient satisfaction with experience in emergency departments, also supports this view.

Productivity Commission data also shows that the level of service provided in NSW public hospitals is broadly consistent with the level provided in other states. For example, staffing numbers per thousand head of population are broadly similar between the States and Territories. The proportion of salaried medical officers and other non-nursing staff in NSW was slightly below the national average in 2009-10, as shown in Figure 6.1. However, NSW Health has a higher proportion of Visiting

Medical Officers (VMOs) compared to other States, which is not captured in Figure 3.2.

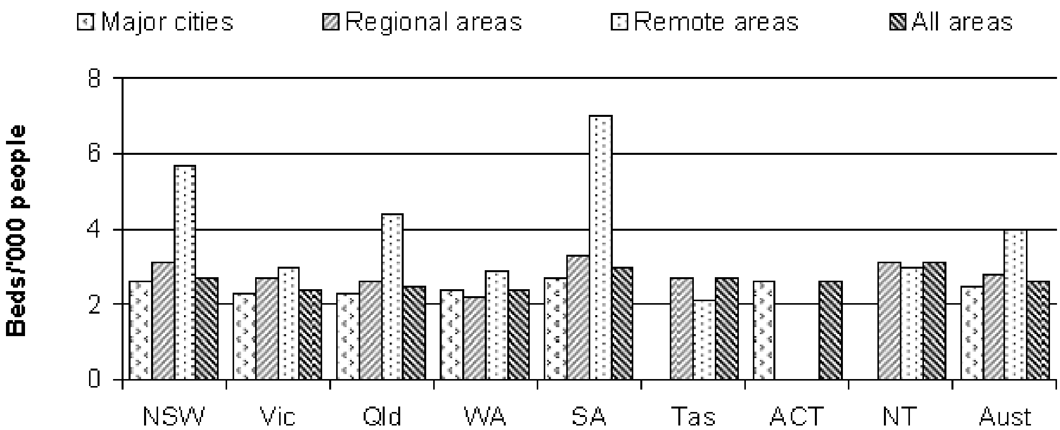
Figure 3.2: Average full-time equivalent staff per 1000 people, public hospitals, 2009-10



Source: Productivity Commission Report on Government Services 2012

The number of available public hospital beds per 1000 head of population in NSW is also broadly similar to the number in the other States and Territories (NSW has 2.7 public hospital beds per 1000 head of population compared to 2.5 in other states). The number of available beds in NSW was slightly above the national average in 2009-10, as shown in Figure 3.3. This reflects NSW"s larger share of public hospitals relative to private hospitals.

Figure 3.3: Available public hospital beds per 1000 people, 2009-10.



Source: Productivity Commission Report on Government Services 2012

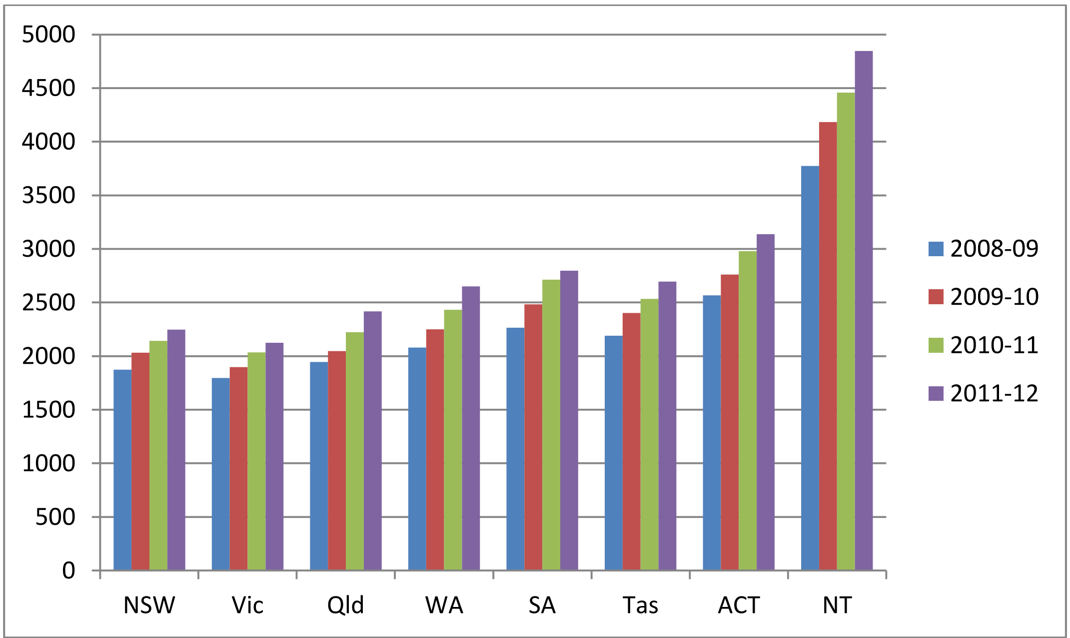
The Australian health system, in general, is above average among developed countries. This is demonstrated in data from the Organisation for Economic Cooperation and Development (OECD) that ranks Australia above the OECD average in terms of total health spending per capita. Australia also compares well on life expectancy, infant mortality and has one of the lowest smoking rates for adults among OECD countries.

3.2.2. Current expenditure

Health employs about 100,000 staff[b], has assets with a replacement value of around $18 billion, and an annual operating budget of over $16 billion per year. This $16 billion operating budget represents 27% of the total general government budget for 2011-12.

Current funding for public health services in NSW appears to be adequate, relative to the rest of Australia. See Figure 3.4.

Figure 3.4: Health current budget per head of population ($)



Source: State and territory budget papers

Nevertheless growth in demand for services and rising public expectations mean that NSW Health faces a significant challenge. Providing an appropriate level of timely, quality and suitably-located healthcare services is not always a good fit with finite resources. Given these pressures any productivity improvements that can be made should be made.

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[b] On a „full-time equivalent" basis.

The Commission notes that Health has largely kept pace with demand in recent years partly due to additional funding from the Commonwealth Government since 2008. The Commonwealth contribution to NSW Health is capped for the next two years and specific growth funding commences under the National Health Reform Agreement in 2014-15. This means that a further State contribution to growing Health costs may be needed in 2012-13 and 2013-14 and Treasury and Health must monitor this matter.

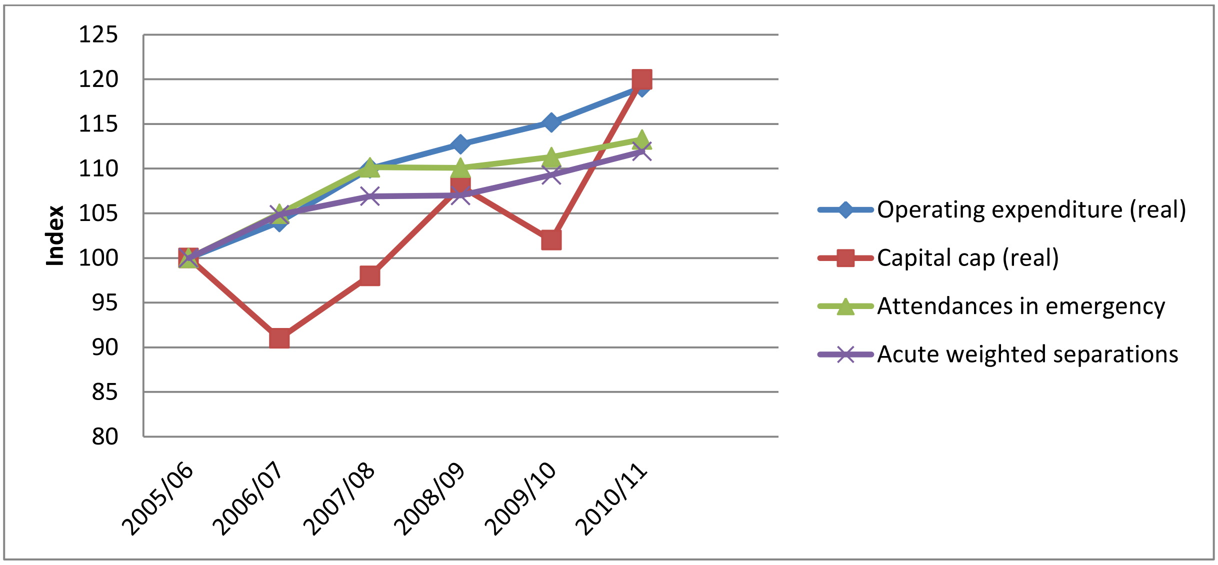
Recommendation: The Commission recommends that Treasury and NSW Health identify clearly what specific funding measures are required to meet the Health budget between now and the commencement of specific growth funding under the National Health Reform Agreement in 2014-15.

3.2.3. Capital expenditure

Good quality facilities and equipment contribute to the quality and safety of care. Health facilities and equipment must have the capacity to cope with increasing demand and changes in the way services are delivered. While, as noted above, the current expenditure profile is adequate, many would argue that NSW is not keeping pace with its capital expenditure.

Figure 3.5 illustrates this, showing the steady increase in emergency department attendances, acute weighted hospital separations and real operating expenditure between 2005-06 and 2010-11. In the same period, the capital limit that Treasury places on NSW Health has fallen in real terms and then increased. This capital funding increase in recent years in response to ad-hoc enhancements for priority projects or funding received from the Commonwealth Government, for example under the Health and Hospitals Fund and national partnerships. However, such increases have only been temporary top-ups and, in some cases, have been made in exchange for a reduction in the cap in future years. The Commission notes, however, that escalation is included in the capital planning limit from 2014-15. A steady capital expenditure budget would be easier to manage.

Figure 3.5: NSW Health Service and Funding Trends (2005-06 to 2010-11)



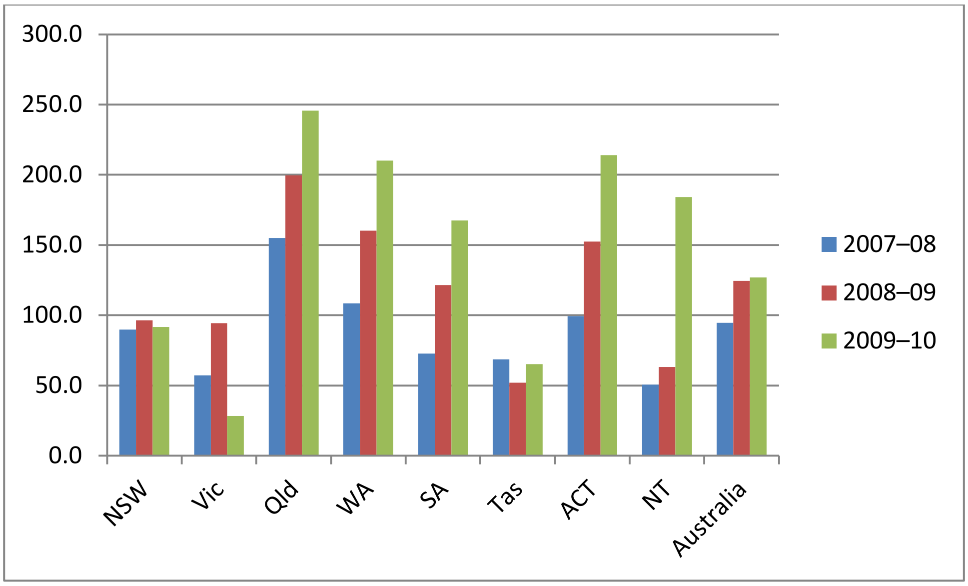
Source: 2010-11 NSW Ministry for Health Annual Report, AIHW Australia Hospital Statistics Report Series, NSW Budget Paper No 3

The Commission suggests that spending on health facilities has not been keeping pace with community expectations about the standard of facilities. Patients and family members regularly compliment the care they receive from NSW Health, but many also criticise the facilities the care is provided in. Stories of cramped operating theatres, leaking roofs and faulty equipment are not uncommon. This is perhaps unsurprising given the age of the NSW Health asset portfolio. Only two in 10 health facilities are less than 40 years old. Older facilities are less flexible and tend not to meet current functional requirements. It should be noted however, that NSW Health"s larger facilities. including the major hospitals, tend to be newer or to have had more recent upgrades.

In 2011-12, the health capital budget is 13.5% of general government sector infrastructure investment. The growth in health capital expenditure has been relatively low. Over the last ten years to 2010-11, the health capital budget grew by about 5% a year (or 7.5% a year once the value of Private Partnership Projects for Orange/Bloomfield, Mater and Forensic hospitals are included). This compares to the average annual growth in capital expenditure by general government agencies and non-commercial PTEs of 9.4%, excluding Commonwealth stimulus capital expenditure funding.

NSW Health"s capital budget is low compared to most of the other states. For example, between 2007-08 and 2009-10, NSW Health"s average capital spend was $93 per capita while the national average was $116 per capita. These figures are presented in Figure 3.6. The Commission notes that a comparison of the rates of capital expenditure in different States needs to consider a range of factors, including past expenditure trends, the age of existing facilities and population growth.

Figure 3.6: States" and Territories" capital expenditure per capita in Health. 2007-08 to 2009-10



Source: Australian Institute of Health and Welfare

Note: Low capital expenditure in Victoria in 2009-10 may be due to treatment of PPPs.

On balance the Commission notes that the level of capital expenditure in the health sector, while significant, may not be sufficient. NSW Health"s capital expenditure budget was $921 million in 2011-12. A strategic review of capital investment, being conducted by the Ministry of Health, the Department of Premier and Cabinet and Treasury, will recommend the level of capital investment needed to maintain a sustainable system and modernise the asset base. NSW Health considers this level to be in the order of $1.3 billion to $1.6 billion a year, escalated annually. The appropriate level of capital budget should also be informed by future service and hospital reconfigurations that lead to a safer and more appropriate mix of services in each LHD.

A sampling study has also suggested that there is around $74 million of backlog maintenance across NSW Health, and around $80 million a year is required to replace major electrical and mechanical plant. The accuracy of this estimate is limited by the absence of good systems to track maintenance requirements and expenditure.

The 2011-12 capital budget for NSW Health includes funding for new and upgraded hospitals and other health services, including works at Liverpool, Royal North Shore and Port Macquarie Hospitals, as well as the development of seven cancer care centres. The capital budget also funds major items of medical equipment, for example PET and CT scanners, information and communication technology (ICT) and ambulance infrastructure. Major ICT programs include Electronic Medical

Records, Electronic Medications Management, and a Clinical Information System for Intensive Care Units.

There are concerns that maintenance expenditure is frequently diverted to plug gaps in funding for service delivery. While reported levels of maintenance expenditure meet benchmark levels, a review found varying levels of asset condition, functionality and compliance with regulatory requirements. For example, LHD scores for the condition of their capital infrastructure, equipment and technology ranged from 60% to 85%. The target for asset condition is 80%. Meeting this target means that all preventative maintenance is compliant with relevant codes and standards, and corrective maintenance is conducted to ensure the fabric and non-preventative maintenance assets are maintained in a condition correlated with fair wear and tear for their age.

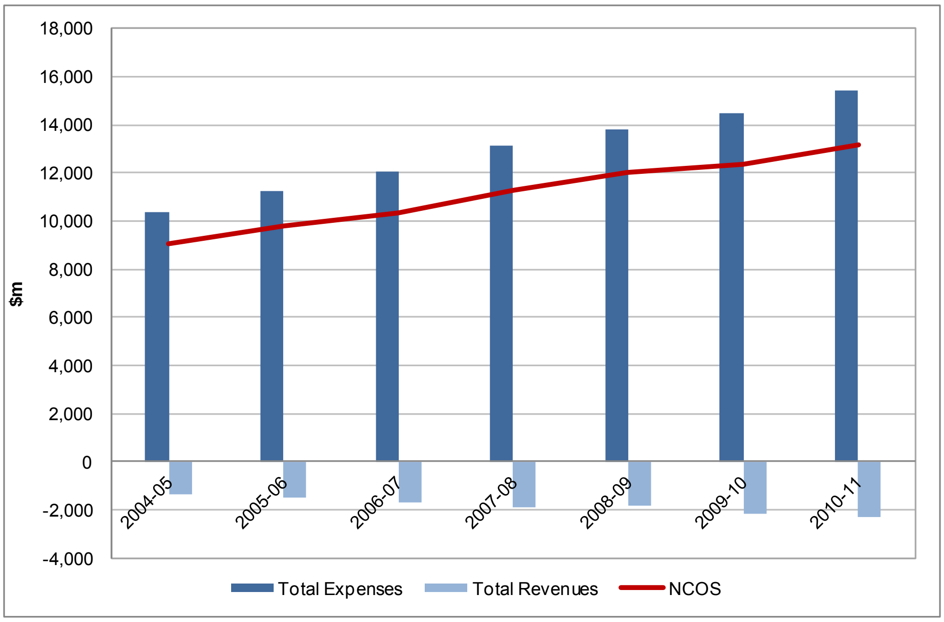
As commented in the Interim Report, Health is not alone in the less than satisfactory level of maintenance it conducts. But as a result, facilities become run down, and require upgrade sooner than would otherwise be the case. This approach is expedient but is inefficient in the longer term.

Recommendation: The Commission recommends that the Ministry for Health and Treasury examine the Health capital budget with a view to increasing it so that each Local Health District is able to meet maintenance standards and so that new facilities can be added when supported by business case assessments.

3.2.4. Increasing cost and demand

NSW Health is a large and growing cost for government. In 2011-12, total expenditure is budgeted to be $16.4 billion. As shown in Figure 3.7, the health budget has been increasing steadily. In 1995-96, current expenditure in health made up 19% of total expenditure in general government. This proportion is now 27%.

Figure 3.7: NSW Health: Current expenditure 2004-05 to 2010-11



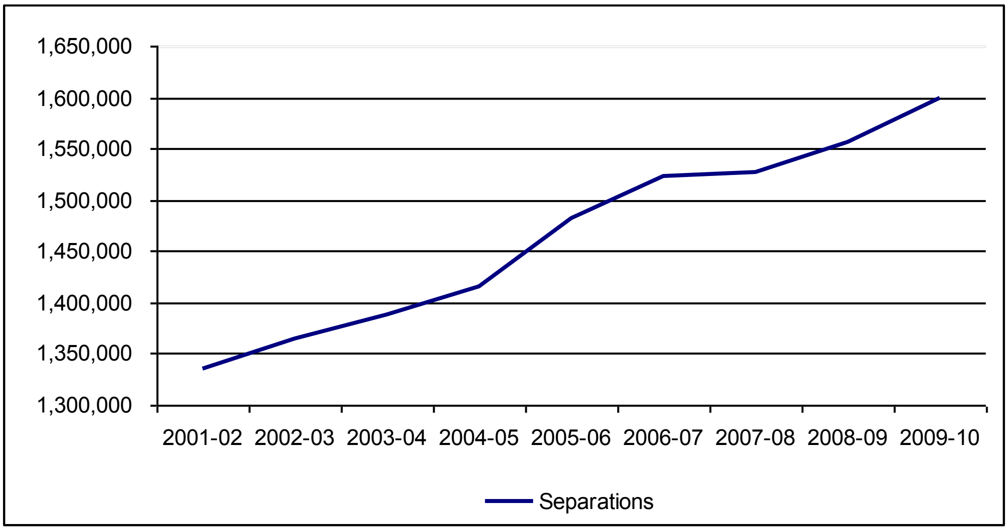
Source: NSW Treasury FIS data

A similar trend of increasing costs has been experienced in the other States and the increase in health expenditure is forecast to continue. The 2011-12 NSW Budget forecast growth in costs to be 6.2% a year over the next 40 years. Health is expected to make the largest contribution to current expense growth in general government over that period.

Health"s spending has been within Treasury"s tolerance limits for the past few years. As noted earlier it must be recognised that Health has met funding limits as set by the budget because of the funding that has been made available through various Commonwealth agreements since 2008 and because of Health"s efforts to improve efficiency. Further, the continual increase in costs does place Health under particular pressure to find savings. It also places importance on ensuring that expenditure is allocated to the most effective and appropriate services; that is, on the services that deliver the best health outcomes for the state.

Much of the growth in expenditure in recent years can be explained by increases in demand for services. Figure 3.8 shows that hospital separations increased significantly between 2001-02 and 2009-10. A hospital separation is when a patient leaves hospital because of death, discharge or sign-out against medical advice. During the nine years to 2009-10, the number of separations rose by approximately 260,000 an annual growth rate of 2.3%.

Figure 3.8: Total separations, 2001-02 to 2009-10



Source: NSW Health

Total bed days also increased over this decade by 1.1% each year. The lower rate of growth in bed days, compared to separations, is a result of a trend towards shorter stays in hospital and a higher rate of same day admissions. This suggests an increased efficiency in the treatment of patients, as well as the adoption of new technologies and models of care that reduce the time in hospital and allow for less invasive treatment on a same day basis.

Emergency department presentations have experienced a large increase since 2004-05. Over the period 2004-05 to 2010-11, the annual growth was 4.4% compared to 2.7% over the last decade. The key reasons for the high growth in emergency attendance since 2005 appear to be:

- a reduction in access to General Practitioners
- changes in patient preferences for Emergency Departments rather than General Practitioners
- higher demand from the under 25 years and over 65 years age groups.

Projections indicate that the share of aged in the population will grow. This also adds to cost pressure as the cost of treating patients increases with age. Older patients are more likely to develop co-morbidities and require hospital admission. Older patients also tend to have longer stays in hospital. The average length of stay in hospital is four days, but for people over 75 it is nine days. The ratio of people aged 65 and over to those between 15 and 64 (the „aged dependency ratio") is expected to nearly double from 21% in 2011 to 41% in 2051. More immediately, with the first „baby boomers" born 65 years ago and now moving into traditional retirement age, we are now at the beginning of an 18-year period of accelerated growth in the aged dependency ratio.

Non-demographic factors also appear to be driving activity as new treatments become available, and as more patients use emergency departments rather than other services, such as General Practitioners. Around 20% of presentations at Emergency Departments could be dealt with in a primary care setting if the right sorts of service were available. For example, people might visit an Emergency Department because of a lack of after-hours General Practitioners or because of a lack of local General Practitioners who bulk bill, particularly in the case of young people and older people. Other people might be more appropriately treated in another kind of primary care service, for example, a service providing support for patients to manage chronic illness, but such services do not necessarily exist in a comprehensive way.

Growth in health expenditure is also being driven by increasing unit costs for the delivery of health services. The cost per case mix-adjusted separation has increased in a relatively uniform manner, and significantly around Australia. There are various factors causing increasing unit costs. Staff costs have grown as a greater proportion of staff are employed in higher skill areas. The trend towards shorter stays in hospital means that the patients in hospital tend to have higher care needs. This influences costs.

Technology may also be a contributor to increased unit costs. Overall spending can increase, even if unit costs decline. This occurs when improvements in a treatment expand its use. New technologies can have beneficial flow-on effects in other areas of spending. For example, rates and duration of hospitalisation may reduce, or the aged may be able to remain in their own homes and thereby reduce aged care costs.

In a now dated study, the Productivity Commission found that technology contributed around one-third of the increase in real health expenditure across Australia in the decade to 2003. That Productivity Commission report also demonstrated that while some technologies contributed to rising unit costs, and others to falling unit costs, on balance unit costs were rising. The decisive factor was the expansion of treatment associated with new technologies.

3.3 Making better expenditure decisions

Various reviews have identified a number of obstacles to making the best budget decisions in NSW Health. These include:

- a lack of information
- limits to Health"s capacity to use the information
- inappropriate incentives
- a lack of strategic direction to guide expenditure choices.

A 2011 audit emphasised problems with inadequate information systems. The audit noted variations in cost attribution and a general absence of common standards in the costing and finance environments. As a result of these shortcomings, benchmarking and working out the reason for trends in key areas was not possible in 2011.

A number of other problems have been identified including that:

- there are increased expectations, among clinicians and the community, about the level of service. The only brake on the provision of service appears to be the actual capacity of the resources in the system
- there are tensions between clinicians and management arising from the clinical focus of the former and the budget focus of the latter, which are not always easily reconciled
- budgets do not clearly link activity and funding, and the process of devolving budgets to cost centres takes too long or does not happen at all
- some cost centre managers (who may be doctors, nurses or administration staff) lack skills and capabilities to manage budgets. Finance managers in health services have also not had appropriate managerial prominence.

These and other factors have led to unpaid accounts that are months old, local business with unpaid invoices from their local hospital, visiting surgeons remaining unpaid for long periods, and staff chasing up matters that should never have happened in the first place.

3.3.1. Consultation and engagement

Increased clinician and community involvement in local hospital decisions could lead to better expenditure decisions. Those close to the patient are best equipped to make decisions about that patient"s health care. The Special Commission of Inquiry (Garland) cited the importance of face to face discussion so that appropriate decisions are made.

Whether better expenditure decisions occur, depends, in part, on the extent to which consultation is effective and based on evidence. The Commission of Audit noted that the Health Education and Training Institute is developing training for clinical leadership which may improve the capacity to consult and to use available evidence.

The Council of LHD Chairs, and the NSW Health Senior Executive Forum, provide forums for sharing ideas. There may be opportunities for the Public Service Commission and the Health Education and Training Institute to provide training in effective engagement strategies. It is a critical factor for success.

Recommendation: The Commission recommends that the Ministry for Health set up training for Local Health District Boards and their senior management in effective engagement with clinicians and the community.

The consultation should be „real‟. A number of stakeholders consulted by the Commission of Audit cited examples where they were advised of a change, rather than asked for their views; or consultation simply did not occur (despite, in some cases, statements to the contrary). If stakeholders believe that management is only paying lip-service to consultation, the intention of the government reforms, to empower clinicians and the community through greater involvement in decision-making, will be undermined.

In view of the importance of consultation it seems appropriate for the Ministry to monitor consultation and how it is practically working.

Recommendation: The Commission recommends that the Ministry of Health set up a system to monitor LHDs consultation obligations and advise on how consultation may be improved. This system could be embedded in the existing Performance Framework for LHDs.

3.3.2. Improving financial management

Better expenditure decisions must involve better financial management and performance information. For example, the financial information system improvements should ensure that those responsible for budgets have the information they need to exercise that responsibility. Thus a Nurse Unit Manager, who is responsible for managing the budget for a particular ward, must have access to information to do this on a monthly basis. Previously, budgets for some LHDs have not been devolved to the cost centre level. This makes it difficult, even accidental, to operate within budget. Doctors, nurses and other clinicians generally want to be cost effective, but this is impossible if they do not know how much things cost and what the limits on expenditure are.

Better information will of course assist LHDs to manage budgets at their level. The four-year forecast of funding and savings targets, provided by NSW Treasury, must filter down to the cost-centre level. A degree of certainty about the future (combined with an understanding that these forecasts may change somewhat through the annual Budget process) would assist LHDs (and the cost centres within them) to make better expenditure decisions.

Recommendation: The Commission recommends that LHDs devolve both annual budgets and four-year budget forecasts to the cost-centre level, having assured themselves that financial and management systems, including accountability frameworks, are appropriate at that cost centre level.

The Ministry has identified that LHDs need to increase their financial management capability and is rolling out training. LHDs should also consider whether they possess the capacity to gather and use the information available to inform decisions. In the past, some efficiency saving targets were achieved in the short term through the removal of finance and administration staff. LHDs need to boost their financial capabilities if they are to perform their new roles well. This will free up clinical staff who are currently distracted by these support functions and who should be focused on frontline service delivery.

Similarly, the Ministry"s financial and economic capabilities may need to be enhanced to deal with the new level of monitoring and reporting that is required by Activity Based Funding. The Ministry will also need to ensure it has the capacity to shift to its new role of being a purchaser of services from LHDs. This includes ensuring that Service Agreements with LHDs evolve towards being formal purchasing agreements and are signed by both LHDs and the Ministry within a defined timeframe each year.

Recommendation: The Commission recommends that LHDs and the Ministry ensure they have adequate financial and administration support to undertake their new roles in managing a budget at both the Ministry level and cost centre level.

3.3.3. Performance reporting and benchmarking

National Health Reforms include national performance reporting. The National Health Reforms also include Activity Based Funding, and hospitals will need to classify, count and cost each activity they perform. This information is not held (or even known) at present for some LHDs. Once this information is collected, it will be possible to compare the cost of each activity between hospitals, LHDs and States.

Health does not currently have the systems to conduct a detailed comparison of the cost of a given service between different hospitals and LHDs. Work is currently underway to determine the systems that are required to do these comparisons. This will be crucial to driving improvements where a service is more expensive than the same service elsewhere.

Recommendation: The Commission recommends that the Ministry prioritises the implementation of systems to allow the cost of services in different hospitals to be compared.

3.3.4. Accountability, responsibility and productivity

Productivity improvements depend on people being responsible for managing budgets and also being accountable for them. The accountability arrangements need to be understood at all levels. First members of LHD Boards need to understand and have the expertise to perform their roles. The Ministry is offering governance training to Board Members to assist with this. Board Chairs will have guidelines that include assistance with performance reviews of Board members and whole-of-Board evaluations.

Second, and perhaps the bigger challenge, is for the new arrangements to be understood beneath the Board and senior management level. The Ministry and LHDs have made efforts to ensure that these arrangements are communicated and understood. These efforts should continue.

Recommendation: The Commission recommends that the Ministry and LHDs continue to communicate and educate their workforce on their accountability, responsibility and governance arrangements under the new reforms.

The way in which people are made accountable needs to be clear. The Performance Framework for LHDs outlines the process by which the Ministry intervenes in a LHD in response to unsatisfactory performance. At this stage the process appears to be somewhat subjective and the Ministry might consider ways to apply more objectivity.

Improving efficiency depends, in part, on the options available to those who are accountable. For example, LHD Chief Executives are accountable for delivering health services within their budget. However, the Chief Executives" flexibility will be limited by various statewide policies agreements. Such agreements, about ICT standards, working arrangements or equipment types,often contain requirements that limit the ability of managers to manage. This is sensible for some matters but ideally must be limited to those issues where such inflexibility provides more benefit than cost. Over time policies and agreements should be modified by the relevant body to better suit the new devolved system.

Recommendation: The Commission recommends that the Ministry identify and, where appropriate, modify statewide policies and agreements that limit the options available to LHD Chief Executives to deliver high quality services within their LHD budget.

eHealth is a particular focus. Systems implemented under the banner of eHealth include electronic medical records and electronic medications management. These can improve both clinical outcomes and productivity.

Savings that may be achieved through eHealth require consistent ICT systems; though the Commission of Audit notes that inconsistent „cottage industries" in ICT continue to proliferate. ICT is an area where there may be some tension between devolution and the need for statewide and national standards and consistency. The Ministry has already stated that a priority for eHealth NSW is to redesign ICT governance so that there are clear statewide plans and an appropriate balance with local initiatives.

Recommendation: The Commission recommends that the Ministry"s new ICT strategy should balance local and statewide initiatives and set very clear standards for ICT statewide. Consultation is required and a set of ICT operating rules established.

As already noted the reforms require greater clinician and community involvement in service planning. Ideas about delivering better outcomes and efficiency may need help to become applied. For example, the Commission has been told that the automated trolleys (or transcars) that will be used to deliver food, linen and other supplies around Royal North Shore Hospital are expected to deliver recurrent savings but require an initial capital investment. Strangely, it is unlikely that transcars would be used at Royal North Shore if they were not being funded under the Public Private Partnership for the redevelopment of the hospital. Where anomalies of this kind occur the matter should be taken up at more senior levels.

There is also a clear role for the Agency for Clinical Innovation in identifying and assisting with changes to clinical practices that result in more effective use of health funds. This is discussed further below.

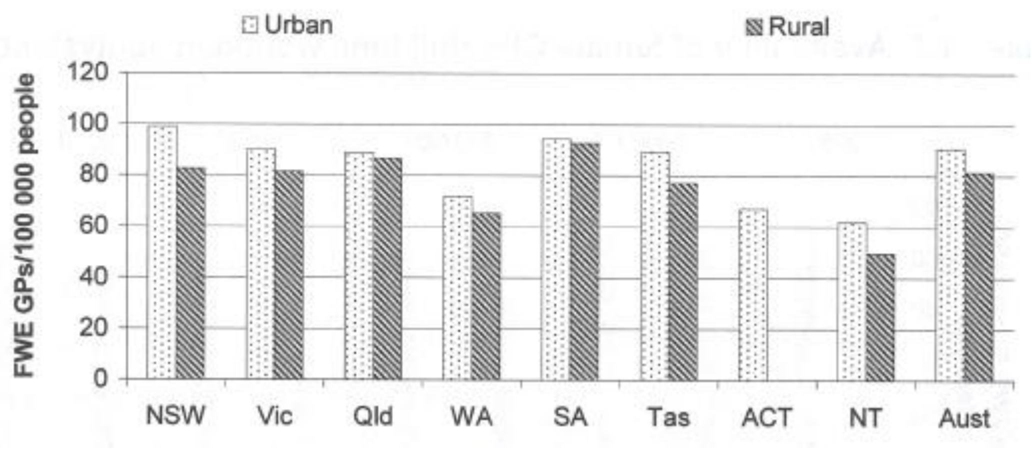
Recommendation: The Commission recommends that the Ministry and Treasury investigate why innovations that could save money, but which may need some upfront funds, are not being delivered.

Networking between smaller and larger hospitals, and the sharing of clinical expertise (and clinicians themselves) across an area, is of considerable benefit. It seems likely that partnerships will persist between LHDs that previously formed part of the same Area Health Service, at least for the time being. These partnerships may however, erode over time. The Council of LHD Chairs and the NSW Health Senior Executive Forum would be appropriate forums for considering ways to prevent this from happening, and to foster new partnerships.

The National Health Reforms also create opportunities for LHDs to cooperate with primary health care and residential aged care, which are regulated at the Commonwealth level. Such relationships are likely to be beneficial to LHDs. For example, partnerships with primary care, through the new Medicare Locals, may lead to strategies to avoid unnecessary attendances at emergency departments.

For example LHDs might pursue strategies to improve access to GPs. Rising emergency department attendances are often blamed on inadequate numbers of GPs. That said, the data suggests that NSW has a relatively high number of GPs compared to the other States and Territories, even in rural areas (see Figure 3.9). Improving access to GPs might therefore need to focus on other issues, such as the cost of GPs to patients relative to Emergency Departments.

Figure 3.9 Availability of GPs, full time workload equivalent, 2009-10



There may also be opportunities for partnerships with the private health system and residential aged care. One idea suggested to the Commission is that residential aged care facilities could provide a type of short-stay transition care for elderly people who are ready to be discharged from hospital but not quite ready to return home, and to provide additional respite beds. There may also be scope to work with the Commonwealth Government to increase the capacity of residential aged care facilities to care for medically unwell residents to help avoid unnecessary hospital admissions. LHDs should work to identify partnership opportunities that have the potential to make a more effective use of existing resources. Where necessary, the Ministry should provide assistance to remove impediments to creating such partnerships.

Recommendation: The Commission recommends that LHDs investigate ways to establish partnerships with other parts of the health system, including between hospitals and local GPs, and between hospitals and residential aged care. The Commission recommends that the Agency for Clinical Innovation work with LHDs to help establish these partnerships.

Both the Agency for Clinical Innovation (ACI) and the Clinical Excellence Commission (CEC) recommend changes to clinical practices that result in more effective use of health funds. There are opportunities for significant reductions in costs, for the same clinical outcomes, by making such changes. For example, there is a big variation in the cost of different prostheses, though there may not be a performance variation that warrants using the more costly items all the time.

The key issue in ensuring the success of any recommendations from the CEC and ACI is the identification and implementation of changes needs to happen in very close consultation with clinicians, particularly at the local level. The ACI and CEC should therefore ensure they have appropriate and effective avenues in place to consult, through LHDs or relevant networks, with those clinicians likely to be affected by their recommendations.

Recommendation: The Commission recommends that the Clinical Excellence Commission (CEC) and Agency for Clinical Innovation (ACI) work with LHDs to establish a framework for effective engagement with clinicians in the development and implementation of CEC and ACI recommendations. This role for the CEC and ACI should also be reflected in their Service Compacts with the Ministry of Health.

Good workforce morale is crucial to the success of reform. Almost all of the stakeholders consulted by the Commission said that morale was low. Workforce morale has been eroded by various factors, including:

- a lack of influence by clinicians over decisions that affect them
- continual restructures
- a lack of clarity about responsibilities and accountabilities
- a breakdown in communication between clinicians and management
- micro-management of operational issues by the past Department of Health.

Devolution itself can help address the morale issues. To do so, the LHDs must undertake real consultation with staff and the community. The Ministry must also be serious about stepping back from operational issues. Giving into the temptation to intervene in LHDs when it is not warranted will seriously undermine the intention of devolution:

- The LHDs should pay attention to staff satisfaction. It is their responsibility. The Commission noted that Hunter New England LHD has a number of strategies to improve its workplace culture. These are embedded in their Service Agreement and have helped to create a positive culture in that LHD. It is no surprise to the Commission that Hunter New England Area Health Service was a high performer in terms of financial and clinical indicators

- At this early stage, LHDs should focus on investing in managers at various levels with the capability to implement the new roles, responsibilities and accountabilities. Doing this should, of itself, have a positive impact on morale by reducing the confusion that can occur during a restructure.

Recommendation: The Commission recommends that LHDs, with the assistance of the Ministry and the Health Education and Training Institute (HETI) focus on building up their management and leadership capabilities. The Public Service Commission should, with HETI, review progress and assist where possible.

3.3.5. Maintaining and improving facilities

The community expects high quality health facilities. The current level of capital investment does appear to be inadequate when compared to other states. The average annual capital allocation for Health over the four years of the forward estimates is $1.2 billion. In the six years beyond 2014-15, capital allocations for Health are currently budgeted at an average of $860 million a year. This decrease is related to the completion of large redevelopment projects at Liverpool Hospital and Royal North Shore Hospital and additional Health and Hospital Fund projects to be constructed over the forward estimates that are largely funded by the Commonwealth.

As noted earlier, NSW Health has proposed, as part of a strategic review of its capital program, that capital investment of $1.3-1.6 billion a year, escalated annually, is needed to maintain a sustainable system and modernise the asset base. This includes funding for:

- major works
- minor works (many of which have been deferred in recent years due to the need to progress major works and ICT projects)
- ICT projects
- local initiatives (locally funded projects above $250,000)
- routine repairs, maintenance and renewals.

Health"s proposal for a sustainable level of capital investment is derived by applying index factors to the replacement value of existing assets. Whether this is appropriate needs to be considered in the context of any hospital and service reconfigurations proposed by LHDs, which is discussed further in Section 3.3.6.

The new LHDs are completing new HealthCare Services Plans and Asset Strategic Plans during 2012. There will be some reprioritisation of NSW Health"s total capital program as a result. Health"s prioritisation of capital projects must clearly demonstrate how individual projects, and the capital program and a whole, will contribute to state-wide and local needs.

The articulation of capital investment priorities should also identify possible sources of funds. These include NSW Budget funding, special Commonwealth grants, like the recent Health and Hospitals Fund grants, the sale of surplus land and buildings, and Special Purpose and Trust Funds. The Ministry and Treasury should investigate ways to increase access to each of these sources of funds. This may include removing disincentives to dispose of surplus land and buildings, and identifying impediments to the use of Special Purpose and Trust Funds. The Commission notes, that Special Purpose and Trust Funds largely comprise donations and bequests which must be used for the specific purpose for which they were made. Further, the incentive to identify alternative funding sources is constrained by the annual cap on capital expenditure by Health.

Recommendation: The Commission recommends that the Ministry for Health articulate its capital investment priorities. The Ministry for Health and Treasury should then investigate ways to increase funding for capital works from all potential sources, and make adjustments to the capital expenditure limit to ensure there is no disincentive in using non-government funding sources.

3.3.6. Managing expectations

Health has been through multiple reforms and restructures. Every restructure causes disruption. LHDs, the Ministry and the Government need to be realistic about the time required to make improvements. There needs to be a change management plan that allows reforms to bed down for several years before drawing any conclusions about them.

For example, there are still three years to go in the program for National Health Reform. This implementation program needs to be completed and NSW Health given time to adjust before clear benefits can be expected. A Council of Australian Governments review of National Health reform is also intended to be conducted in 2015-16.

Recommendation: The Commission recommends that the Ministry articulate the timetable for implementing reform to the health system and commit itself to allowing the system adequate time to adjust before benefits are expected. The current round of reforms should be allowed to bed down for around five years or more.

There are growing expectations about the level of service the Health system can and will provide. These expectations can be a significant driver of costs. For example, where:

- patients, or their families, expect to be kept in hospital longer than necessary
- people expect to be treated in emergency departments for complaints that are more appropriately treated by a general practitioner
- some clinicians and patients expect to have access to the most up to date and expensive technology, rather than less expensive but proven and effective technology
- a small community expects to receive services locally that are more appropriately provided in larger, though more distant, facilities.

Given that individuals should be able to make choices based on realistic expectations, the Ministry should consider how to engage with the community about this matter. This should include consideration of the level of service that NSW Health can appropriately provide, as well as the roles of the remaining parts of the health system, including the private health system, primary care and aged care.

Targets and key performance indicators influence the level of service that NSW Health provides. LHDs have limited flexibility in the way they manage demand for certain services due to these targets. For example, elective surgery requirements can affect how emergency admissions are dealt with. Existing targets and KPIs should therefore be part of any consideration of the appropriate level of service to be provided in the public hospital system.

The level of service provided by the public and private health systems should also be given particular consideration. NSW has a lower level of private hospital beds than other states. Around 26.5% of hospital beds in NSW are private beds. In contract, Victoria the proportion is 35.5% and in Queensland the proportion is 37%. This raises questions about the relative proportion of services that should be provided in the NSW public hospital system, compared to the private system.

Whether hospitals are public or private, the Government has signalled its intention to increase the focus on out of hospital services. Upstream services can offer earlier intervention in community settings so that the need for hospitalisation does not arise or can be managed in a planned way, rather than by urgent admission. Early intervention might also involve working more closely with other NSW Government agencies, for example the Department of Family and Community Services.

Out of hospital services may not increase without more funding. Arguably, the Commonwealth Government should make a contribution to such investment, given that it has a greater responsibility for out of hospital healthcare. An articulation of appropriate service levels needs to filter down to the LHD level and better communication of LHD"s service plans would help. It may also assist the community to understand the limits to the public health system if it better understands what is currently provided. While (as noted) patient surveys tend to demonstrate that patients are happy with the care they receive, broader community sentiment appears to be that the system is inadequate. Better information on NSW Health"s performance will be available as a result of the reforms and this information needs to be communicated effectively – by both clinicians and management – to the community.

Also at the LHD level, the appropriate level of service should be defined with reference to the Government"s intention to achieve more patient centred health care. This approach has been shown to improve quality and safety, as well as decrease costs.

Recommendation: The Commission recommends that Government and LHDs define and communicate the level of service that Health can appropriately provide and what is provided at present within the community. This should include consideration of the appropriate level of out of hospital care, the role of the private health sector, primary health and aged care, and interactions with other parts of the Government such as the Department of Family and Community.

A key issue is that LHD"s service planning needs to deal with is the configuration of hospitals and services. There are potential risks to patient safety and quality of care arising from the present hospital configuration around the State. Compared to other States, NSW has a higher proportion of small facilities, a higher level of hospital beds per capita and a larger number of intensive care unit and emergency department facilities. The current location and type of facilities reflects historical decisions rather than an assessment of the best current configuration for a safe health system.

A critical responsibility of LHDs is the delineation of roles of hospitals and other health facilities in their Clinical Services Plans within statewide planning frameworks. The Commission of Audit supports this direction. Any reconfiguration should be initiated at the local level. Benefits may be achieved through re-configuring hospitals and services but many stakeholders have strong expectations about the services that their local hospital will provide. The community needs to understand and support any changes if the benefits are to be realised. It also needs to be recognised that re-configurations will not necessarily lead to significant cost savings. Safety and quality of healthcare are the primary rationale.

Recommendation: The Commission recommends that LHDs pursue service and hospital reconfigurations that lead to more appropriate and safer mix of services in their LHD.

Decentralisation has been done before. Four case studies have been chosen to show the sort of changes that will be required. The Commission has selected these case studies to illustrate the lessons that have been learned by other states who have experienced devolution. See Appendix 6.

Recommendation: The Commission recommends that the Ministry for Health select case studies of experience with devolution and use those case studies to assist in their transition to devolution. The case studies may be from another jurisdiction, outside the public sector or an entirely different business. Moving beyond the familiar may make the lessons of experience clearer.

4. Education and training

Key points:

- Without devolution school principals have very limited capacity to make decisions on the allocation of resources for the benefit of their school. TAFE Institute Directors have relatively more flexibility but this needs to increase to allow Institutes to respond to local needs.
- There is considerable scope in NSW to reallocate expenditure in education and training to improve outcomes, through greater devolution of resource allocation decisions to principals and TAFE Institute Directors. This can occur within existing expenditure budgets.
- Better resource allocation and improved education and training outcomes can be achieved by:

  (i) removing centrally imposed constraints over resource allocation and investment decisions within schools and TAFE

  (ii) a reallocation of existing resources away from centralised administration and supervision in the Department of Education to individual schools and TAFE Institutes.
- Achieving a greater return on expenditure through devolution will require additional investment in building staff capability and systems. Investment in new systems is already happening.

4.1 Government policy

There is a general policy push by the NSW Government towards a strong customer focus and community involvement. There will be a devolution of decisions about service delivery closer to the point where those services are being delivered. Education is at the forefront of this policy shift in NSW. It will be a considerable challenge as at present education and training are highly centralised and bureaucratic. Furthermore these significant changes will need to be achieved without any significant increase in expenditure.

There are two policy goals of the NSW Government that are of direct relevance to the Department of Education. These are to:

- strengthen the NSW skill base
- improve education and learning outcomes for all students.

The Department of Education and Communities is supporting these policy goals with the following major reform directions:

- „Smart and Skilled": a suite of reform measures to strengthen vocational education and training in NSW

- „Local Schools, Local Decisions": giving greater control over school decisions to principals, teachers and school communities.

Improving the performance of the NSW economy relies in the medium to longer term on the education and skills of the NSW people. In addition the Office of Communities has the goal of making it easier for people to be involved in their communities. The goal of involving the community in decision making about government policy, services and projects is also obviously relevant.

While NSW Government has already introduced some measures to decentralise the VET sector in NSW, it is also related to changes in funding arrangements by the Commonwealth Government. About 25% of TAFE funding is provided by the Commonwealth Government.

The changes for vocational education and training include:

- a move to entitlement based funding – the Council of Australian Governments (COAG), has agreed in principle to introduce greater entitlement funding to the VET sector
- increased transparency in the Vocational Education and Training (VET) sector, through MySkills online which will provide information about training institutes and colleges, a unique student identifier and reporting of total VET effort.

The federal government has also offered to expand the availability of income contingent loans (VET FEE-HELP) for higher level diploma and advanced diploma qualifications. This is in return for the states agreeing to change the funding of their VET systems to an entitlement or demand driven system.

The Commonwealth announced in March 2012 that state governments which agree to introduce an entitlement to training for anyone of working age without a certificate III or higher qualification will receive Commonwealth funding to support:

- the introduction of the entitlement funding
- access to VET FEE HELP.

The policy direction of Commonwealth funding has moved from funding courses, to demand driven, entitlement based funding. This approach is based on the choices of training participants. There is also an expectation among state governments that the Commonwealth will increase the proportion of its VET funding that is allocated on a fully contestable basis and there have been recent announcements to this effect.

COAG has agreed to a new national agreement on skills and workforce development that include:

- a demand driven training system with access to training for all working age Australians
- being more responsive to the needs of industry and building pathways between schools, VET and higher education
- a high quality training system
- greater transparency in reporting of training outcomes and the role of the public provider
- stable funding
- jurisdictional flexibility in design and implementation but where appropriate reforms will be nationally consistent.

Recently, the federal government has also used its role in the funding of school education to introduce greater transparency, autonomy and choice into the school system. This includes the following elements.

- NAPLAN, the National Assessment Program – Literary and Numeracy, which commenced in Australian schools in 2008. Every year, all students in Years 3, 5, 7 and 9 are assessed on the same days using national tests in reading, writing, language conventions (spelling, grammar and punctuation) and numeracy. This report provides detailed information on the achievement of students on national literacy and numeracy tests.
- The My School website, which provides a profile of each school, including information on students, the resourcing of the school and student outcomes, including:
    - school financial information, with directly comparable details of recurrent income and capital expenditure for all government and non-government schools
    - annual results of the NAPLAN – allowing users to now follow trends in school performance over time.
- The Empowering Local Schools initiative – with an aim of empowering participating schools to make decisions at a local level, so as to better support the needs of students and the school community.

Under the Empowering Local Schools program, the federal government will provide $480 million over seven years, with participating schools receiving a start-up grant of between $40,000 and $50,000 to assist them to manage their increased decision-making responsibilities. Participating schools will also be able to access training and professional development opportunities.

The increased transparency and reporting of school performance, supports school principals as they move to greater autonomy over school resources, and are empowered to command the human and physical resources that can affect student performance. This is entirely consistent with the policy of the NSW Government.

4.2 Present arrangements and expenditure

4.2.1 Technical and Further Education (TAFE)

TAFE is the dominant provider of vocational education and training in NSW. More than 550,000 people attend a TAFE Institute each year. Around 300,000 students are supported through government funding. There are four metropolitan TAFE Institutes – Sydney, South Western Sydney, Northern Sydney and Western Sydney. There are two regional TAFEs, Hunter and the Illawarra, and four country TAFE Institutes – New England, Western, Riverina and North Coast. Between these ten TAFE Institutes there are 130 campuses.

Each state independently operates its own TAFE institutes, under state based legislation and state determined policy priorities. The Commonwealth and State Governments together develop national training priorities and standards.

- There are private providers in the VET market as well as TAFE Institutes. Both public and private providers receive income from government funding and private tuition fees.
- Government funding was about 65% of revenue for TAFEs. The remaining revenue is evenly split between fee-for-service and funding by enterprises and employers. TAFE commercial revenues have been significantly affected by a decline in student enrolments in the last two years.
- In contrast, fee-for-service contributed 56% of funding for private providers, with a further 20% contributed by enterprises and employers and 12% from government funding.

Government funded training commencements have been declining in NSW since 2006. By contrast, commencements have been increasing in Victoria. Nevertheless it is understood that completion rates in NSW remain higher.

This is against a background of the NSW TAFE public provider market share in NSW being proportionately larger than in Victoria. In real terms, government investment in TAFE NSW has been declining. The 2010-11 allocation to TAFE NSW of $1.1 billion is now $141 million less than that in 1996-97 in real terms.

In NSW total TAFE expenditure was around $2 billion in 2010-11. The operations and expenditure of TAFEs have been reviewed many times in recent years and the conclusions of these reviews have been similar. These cost efficiency and expenditure focussed reviews have recommended two improvements:

- increasing accountability and authority at the TAFE Institute level, with less central imposition
- a continued focus on teacher productivity.

Given the policy emphasis on the devolution of services to more local levels, the first of these areas for improvement is particularly important. The Commission is aware of reports which suggest that savings of around $160-170 million may be possible for TAFE through improved asset utilisation and greater local autonomy over financial management and staffing. Savings from improved asset management could also yield a one-off benefit of up to $150 million. The reforms will take some time, say two or three years. Each TAFE Institute would face increased accountability and authority. There would be a central pricing and purchasing approach, and agreed targets, including:

- Institute budget would not be set for one year, as at present, but over four years, and retained earnings from one year could be carried across to the next year
- asset management and utilisation would be improved. The potential for savings here is significant but hard to quantify. At present Institutes do not receive benefits from asset utilisation improvements and there is no incentive for Institutes to manage this well or to focus on cost reductions in this area
- the proportion of commercial revenue should be increased, adding the margin on fee for service to the Institute budget. The fee for service revenue in TAFE has increased as a share of revenue but is lower than that in Victoria. Institutes need to be able to pursue opportunities for commercial revenue and to retain a greater proportion of that revenue for reinvestment within their Institute
- the Commission is aware of an Institute which was unable to join a focussed international marketing initiative, along with the regional university they work with. There is simply not enough flexibility for the Institutes and too much central control to allow such opportunities to be pursued easily or in a timely manner
- corporate and shared service functions can be simplified. When compared to other jurisdictions NSW TAFE is relatively lean. However at a regional level some costs appear to be subsidising school costs. For the benefit of both TAFE and schools the shared service cost, while managed centrally for efficiency, should be transparent and properly allocated. This involves the Department of Education and TAFE Institutes being very clear about what is being managed centrally, and at what cost, and what is being done in the Institute.

The processes for the approval of capital works in TAFE need to be streamlined and more attuned to the needs of TAFE Institutes. Currently, all TAFE Institutes must submit proposals for capital works to the Asset Directorate in the Department of Education and Communities. The Directorate approves funding after assessing proposals across all Institutes. The Directorate is also responsible for assessing capital works across schools.

It can take up to four years for TAFE capital works to be approved. Approval of TAFE capital works involves the Institute, the TAFE Commission, and the Asset Directorate in the Department and Public Works. This applies to the refurbishment of existing buildings, as well as the construction of new facilities. To state the obvious, this process can be rationalised and made more responsive to the needs of TAFE Institutes. Institutes should be allowed to undertake their own capital works up to a set, reasonable monetary threshold from a central fund for capital works. TAFE Institutes should also be allowed to source private contractors for capital works under this limit.

Recommendation: The Commission recommends that:

- TAFE Institute budgets be extended beyond one year and out to four years, and that retained earnings may be carried forward for use in the next year
- the commercial „fee for service‟ courses be increased and that Institutes be given the authority (and accountability) to pursue opportunities in a responsible manner
- that the cost of corporate and shared services be identified and borne by the party (schools and TAFE) using that service.

Teacher productivity within TAFE Institutes is driven by both course mix and teacher utilisation. Not surprisingly the metro and Hunter TAFE Institutes () are generally measured as more productive than those based in the country. However in comparison to Victoria and Queensland, NSW TAFE teachers have lower face to face hours. The number of teaching weeks is less and the average hours of teaching during the week are also less.

Work conditions are reflected in agreements and awards. If extra teaching hours, along with an appropriate balance between preparation and teaching are negotiated the aim would be to achieve an extra three hours per week on average of workload. There are $30-60 million in potential savings a year. Furthermore if NSW operated at Victorian working levels the potential savings are estimated at $85 million.

Recommendation: The Commission recommends that the TAFE sector adopt and prepare a long term strategy to achieve improved productivity, including more face to face hours for TAFE teachers and more flexible employment arrangements.

The present organisational structure of TAFE is not conducive to these types of reform. In NSW there is no doubt about the control from the centre. The NSW TAFE Commission is a body corporate established by legislation with the power to maintain

„TAFE establishments‟. Operational responsibilities are devolved to TAFE Institutes but the affairs of the Commission are managed and controlled by the Director General of the Department of Education who is also the Managing Director of TAFE.

TAFE purchases training from TAFE Institutes on behalf of the NSW Government. The aim is to ensure that both national and NSW training targets are achieved and expected future skill needs are met.

The elements of the purchasing agreement reflect central objectives:

- **Planning** – the Deputy Director General TAFE purchases training in industry areas following research, review and consultation.
- **Pricing** – the price paid for training is based on an analysis of costs and recognises that high level qualifications, particular industry areas and some student cohorts require greater expenditure than others.
- **Performance** – measures and targets in the agreement are reviewed annually.
- **Governance and Accountability** – the Deputy Director General TAFE monitors activity and expenditure biannually to ensure that accountability requirements are met and evaluates the Institute‟s success in meeting targets and financial budgets.

If purchased training is not delivered, sanctions are implemented. Institutes return funding and/or delivery hours which are then offered to other Institutes. It is clear under this arrangement that individual TAFE Institutes have virtually no incentive to do other than meet the requirement of the Purchasing Agreement over the one year budget period.

This high degree of centralisation in NSW TAFE partly reflects government objectives to ensure that NSW has the right mix of workforce skills to meet the needs of the NSW economy into the future. In planning future investment in TAFE courses, TAFE uses independent forecasts of changes in the structure of the NSW economy and what skills will be in demand in the future.

These forecasts show that over the next ten years the greatest growth in employment in NSW will be in the skilled services of healthcare, professional and technical services and construction. This will see increased demand for professionals, managers, technicians and trades. The NSW workforce currently lacks the skills required to meet this growth including that:

- some 45% of the NSW population does not have a post-school qualification and almost half of these are below functional levels of literacy. The proportion of government-funded commencing students studying at a diploma level and above is below Victoria and the national average

- forecasts indicate a shortfall of high-level qualifications in NSW that will impede future growth. To overcome the shortfall in diploma and advanced diploma qualifications alone, current government-funded commencements would have to increase from 11% in 2009 to 25% by 2015.

4.2.2 Schools

About $10 billion in current expenditure was devoted to schools in 2010-11. This expenditure has grown by 5.4% a year over the last decade. About 68% of current expenditure is allocated to employees, mainly teachers.

The number of people employed in primary and secondary school at 30 June 2011 was about 92,000 (73,196 FTEs). These staff were allocated as follows:

- 54,984 classroom teachers (44,408 FTEs)
- 9,529 assistant principals and head teachers (8,972 FTEs)
- 3,859 principals and deputy principals (3,798 FTEs)
- 23,879 administrative and other teaching staff (15,819 FTEs).

The staff are spread across ten Regional Directorates, comprising 2,208 schools:

- 1,613 primary schools
- 398 secondary schools
- 113 schools for specific purposes
- 67 central/community schools
- 17 infant schools.

The cost of school based salaries is around $6 billion.

A major challenge is to improve teacher productivity and efficient workforce management. The ageing workforce is another issue, as 43% of school staff are over 50 years of age and 18% of school based staff have over 28 years of service. There is likely to be significant staff turnover during the next five to 15 years, which demands good workforce management as the change occurs.

Recent reviews have identified areas where management could be improved. These areas are:

- staff numbers
- leave arrangements
- performance.

The number of teachers in NSW schools is based on school enrolments and the allocation of teachers is managed from the centre. The cost of „over establishment" teaching staff has been estimated at $120 million a year. This includes 378 „nominated transfer" staff who are not filling a vacant position. Teachers can be on alternate duties for some reasons or not teaching due to poor health or injury. The Commission is aware of some cases where schools were allocated staff from this list only to find that the allocated teachers are poor performers or they take significant leave in an inappropriate manner. This causes considerable cost to the school and its students.

The Commission understands that the Department of Education has put in place strategies to address „over establishment" staff and these are being implemented.

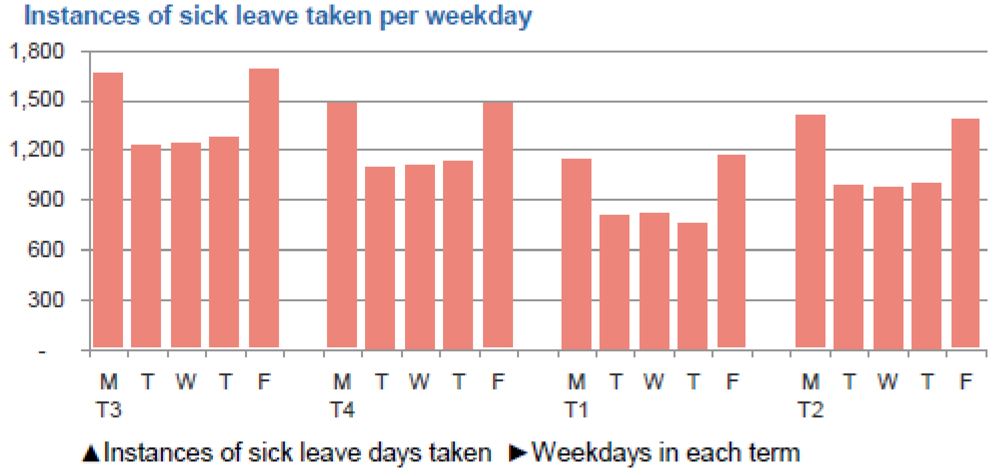
Recommendation: The Commission recommends that the Department of Education and Communities continue to actively manage any remaining over-establishment staff and especially provide assistance and if necessary exits for poor performers to keep the number of staff on this list to a minimum.

There is ample evidence of poor management of sick leave and long service leave entitlements. This is not always a matter that the centre can handle better than principals at a school level. Principals need incentives to address the issue such as being able to keep at least some of the savings.

Sick leave rates in NSW vary with seniority, and by region. More senior teachers in NSW have high average sick leave, over nine days a year, compared to the public service, more junior teachers and also relatively higher than head teachers, assistant principals and school principals.

Across the state, the Hunter/Central and North Coast have the highest rates of sick leave, about nine days of sick leave a year. Department of Education records indicate a higher number of sick days taken on Mondays and Fridays compared to other days of the week. The Commission is of course supportive of appropriate sick leave but the evidence suggests that some abuse of the system is present.

Figure 4.1: Patter of sick leave



The Award allows High School Principals to require a teacher, head teacher or Deputy Principal to cover for an absent colleague. Analysis indicates that schools avoid using this fall back provision, with principals employing casual staff rather than using the coverage provisions available under the Award. A later procurement chapter notes the heavy use of the Contingent Workforce Contract (C100) by Education.

Recommendation: The Commission recommends that:

- The Department alert principals about any staff whose sick leave behaviour appears to be atypical. Principals should then undertake an investigation of sick leave in their school, to determine whether some individuals may be abusing their entitlement.
- Principals implement measures to require the use of coverage provisions in the Award prior to temporary or casual staff being employed to cover for short term absences. Enforcement of this provision should be made by the school and related savings should stay with the school.

Provisions for Long Service Leave in the Award are more generous than in other states and the broader public service. NSW teachers accumulate a year of long service leave with three years less service than general Department of Education staff, and over five years less service that teaching staff in Victoria and Queensland.

Long service leave in NSW is drawn down for relatively short periods. There are two distinct peaks in long service leave days taken – four days and 11 days.

- The four day peak appears to coincide with a week where a public holiday occurred.
- The 11 day peak may be related to the Department"s approach that requires long service leave less than 10 days to be funded from the school budget, while leave over 10 days is funded centrally.

Recommendation: The Commission recommends that the Department of Education and Communities review the cost of long service leave entitlements for NSW teachers, compared to other jurisdictions and examine options for reducing the cost of long service leave entitlements over the long term. For example, Teachers may prefer more pay rather than generous long service leave entitlements, and a negotiated settlement may be better for both teachers and the Education budget.

Underperformance by some teachers in NSW schools is managed under the Teacher Improvement Program (TIP). This is a specific 10 week program that aims to improve the teacher"s performance to an efficient level. If this is not possible the member of staff is stood down and leaves. TIP involves only around 0.5% of staff each year. The TIP is tightly managed and approximately half of those on the program return to efficient performance and half are exited at the end of the 10 weeks.

Increasing the number of people whose performance is reviewed to something closer to 5% rather than 0.5%, is likely to result in better teachers. The cost to pupils and the poor outcomes caused by poor teachers must be recognised and managed.

Current department policies also provide for former teachers who have been occupying administrative or management positions to be found a teaching position if their non-teaching position becomes excess or redundant. The Department"s policies should be changed to improve management"s flexibility to deal with such staff, particularly if they have not taught for a number of years and there is a concern about their teaching performance, or a suitable teaching position cannot be found.

Recommendation: The Commission recommends that the Department of Education and Communities, in consultation with the Public Service Commission, should implement measures to improve the management of poor performing teachers.

4.3 Future changes in arrangements and education

4.3.1 The future TAFE System

NSW is well behind the reform path of other jurisdictions. This is not necessarily a great disadvantage as NSW is able to learn from the experiences of others. But change in NSW does need to occur urgently. Over the next few years:

- the external environment for VET will change rapidly to a more competitive model where all Commonwealth funding is likely to become contestable and entitlement based
- some states have already made significant changes to the structure and governance of their TAFE providers, with some having moved to create independent entities The aim is for these entities to achieve the levels of flexibility and competitiveness seen as essential to operate in this environment
- in future, NSW TAFE must be far more flexible and responsive to changing circumstances if it is to participate in an increasingly competitive training market
- competition from private registered training organisations, both within NSW and across state borders, will intensify
- these factors support NSW TAFE needing a more devolved and flexible structure.

In these circumstances, the cost structure of TAFE and its ability to raise commercial revenues must be put on a basis to compete more directly with private providers. This will require TAFE institutes to have more information and considerably more control over both their costs and sources of income. In an increasingly competitive market:

- TAFE Institutes should not have to bear the hidden cost of corporate overheads in the education bureaucracy that are not borne by private providers
- TAFE Institutes should be provided with a detailed breakdown of the corporate and administrative overheads charged to their budget by Education, including for shared corporate services
- the components of the corporate charge and any other charges for central administration should be fully disclosed to TAFE Institutes to eliminate duplication and reduce the scope for overcharging of services
- there should be greater clarity on any cross-subsidisation between commercial and non-commercial services, between core and non-core activities and between Institutes.

TAFE Institutes will also need to ensure that their courses are correctly priced to cover both recurrent and capital costs. In an increasingly competitive market, commercial course offerings will also need to be priced to recover an element of capital costs, as well as recurrent costs of course provision.

Several reviews have canvassed two broad approaches for providing TAFE with greater autonomy. These are:

- changes to the legal and legislative structure supporting TAFE Institutes, to provide them with legal and structural separation from the centre
- maintenance of existing governance arrangements and greater operational autonomy and flexibility within the existing arrangements.

In Victoria, TAFE autonomy had been progressively increased over a decade prior to deregulation of VET funding. TAFE Institutes in Victoria are separate legal entities to the Department of Education and Training. On the other hand South Australia TAFE remains an entity within the Department of Education and Training, but with greater managerial autonomy.

In any model where TAFE is required to compete on broadly similar terms to private providers, Institute Directors will need greater autonomy to make decisions based on changing conditions in their local markets.

Under a decentralised TAFE model:

- the centre should continue to be responsible for ensuring state wide skills needs are met through decisions on total investment in TAFE and allocation of TAFE subsidies to particular courses
- the centre should recognise that private trainer providers also have a role in the delivery of state wide skills needs
- corporate shared services and a common enterprise agreement should remain with the centre, with the charging for corporate services being fully transparent
- TAFE institutes should be responsible for financial management and staffing decisions, including the ability to negotiate specific conditions to attract specialist staff and entering into commercial decisions.

Where central planning of skill needs occurs, Institutes should nevertheless be able to not provide course hours where the course content is not relevant to local skill needs. This would require agreement with the TAFE Commission.

Providing TAFE with greater autonomy in order to be able to compete involves two main considerations:

- the importance of legal autonomy for TAFE, as compared to greater managerial autonomy
- how to manage the provision of greater autonomy for TAFE with its accountability as a public institution for the expenditure of public money.

Clear guidelines for TAFE are needed about accountabilities for expenditure in a market that will become increasingly competitive for government funding.

Recommendation: The Commission recommends that legal autonomy for TAFE be considered as a matter of priority, in particular:

- TAFE Institutes be established as separate corporate entities, reporting to the TAFE Commission, which would retain responsibility for overall coordination of TAFE policy
- the government provide TAFE Institute Directors with greater autonomy over the management of TAFE Institutes, including for financial and staff management
- TAFE Institute Directors be given greater autonomy over the hiring and remuneration of staff, to acquire necessary management and training capabilities required in a competitive VET market.

A report commissioned by Skills Victoria in 2011 noted that:

- the move to a demand driven system for VET services has the potential to generate tension between the appropriate autonomy TAFE needs to compete, and its accountability for public expenditure
- the devolved model involves the taking of some risk
- tension between the devolved management of TAFEs and concerns about performance and accountability are evident and seem to increase as commercial activities develop in response to competitive market requirements
- there is an increasing mismatch between the aspiration of devolved management, with appropriate accountability, and limits to TAFE autonomy, such as central directions on financial controls and restrictions on some management decision.

The report outlined two options to address these issues:

- greater clarity about the oversight of TAFE by the Minister – particularly when the Minister can intervene on issues of under performance
- allow TAFEs to operate as government business enterprises after satisfying an eligibility criteria, for example size, financial strength, preferably under corporations law.

With a deregulated and decentralised model, achieving increased participation in the VET sector depends on the price of training, or the degree of subsidy, and national skill requirements. But it also depends on the training preference of students and employers, in particular:

- increasing participation requires students and employers being able to choose the training courses and training provider they desire
- allowing greater choice requires greater information for students and employers, on which to make decisions
- allowing greater choice also requires a change in the way that government subsidies are allocated to training courses – away from central allocations to institutions, and toward subsidies following the choices of training participants.

Allowing funding to follow the choices of participants requires measures to manage changes in the demand for courses, consistent with overall funding allocations and state wide skills needs. Such measures can include:

- ensuring a consistent approach to pricing, or subsidies, across courses. Prices and subsidies should be targeted at those courses achieving specific public policy objectives and skill needs – courses not fitting this category should have lower subsidies and higher prices
- ensuring that demand driven or entitlement funding is directed at courses that will meet future skill needs. Courses that are not essential for future skill requirements may not need to be included in an entitlement based funding model.

Deregulation of funding allocations and increased choice raises challenges for the delivery of national training needs at a national and state wide level. This includes:

- national and state VET policy makers will still need to monitor the choices of training users against forecast skill needs for NSW
- achievement of broad skill objectives may be affected by greater choice, particularly if there is inadequate information.

Ensuring a smooth transition to a deregulated market requires a clear articulation of both policy objectives and the instruments needed to achieve those objectives.

The core objective of policy is to meet the future skills needs of the state and appropriate regulation will be required.

The policy instruments are:

- regulation of the cost of training courses to ensure they remain accessible to the general population – through both subsidies and price regulation
- public provision of VET services that provide the training services needed but not provided by the private sector

A summary of the policy objectives and policy instruments in a deregulated VET market is outlined in the following table.

Table 4.1: VET Policy objectives and investment

VET Policy Objectives	VET Policy Instruments
User choice by students and employers	Entitlement based funding
Address under investment in skills training to meet state wide training needs	Government subsidies
Alignment of user choice and state wide needs	Information to market participants
Reflect private benefits of training in course costs	Appropriate pricing
Access and equity for disadvantaged groups	Explicit Community Service Obligation (CSO) payment
Efficiency in course delivery	Regulatory environment that ensures competitive neutrality

The NSW Government has already implemented a number of measures to position NSW TAFE Institutes for a deregulated funding environment. These include:

- financial and governance changes to allow Institutes to rationalise assets – this will not take effect until 2012-13 and the mechanisms to achieve it would form part of wider VET reforms
- providing TAFE Institutes with greater autonomy to choose providers of ancillary TAFE services (such as child care in Institutes)
- amendment to the TAFE Act in 2011 to allow TAFE to employ its own staff.

Recommendation: The Commission recommends that:

- demand management tools be used to ensure that the cost of a demand driven or entitlement based funding model is consistent with TAFE funding allocations
- demand management tools, along with communication and information programs, be actively used to ensure that entitlement based funding models are consistent with future state wide skill requirements.

4.3.2 The future decentralised school system

Following consultation the Premier and Minister for Education, recently announced that significant decisions would move from the Department to school level. This change is in line with government policy and follows both recent consultation and an earlier pilot study.

The consultation paper, *Local Schools, Local Decisions* outlined the reasons for providing greater autonomy for schools, and how greater autonomy could be achieved. The consultation paper noted that:

- the NSW public school education system is very centralised
- the NSW government is committed to giving greater control over school decision making to principals, teachers and communities
- supporting school based innovation and decision making tends to provide schools that perform better
- schools should be able to control a greater proportion of their budget and have more flexibility to respond to the ideas of parents, teachers and support staff
- the current approach to staffing is driven by a „one size fits all" formula that does not take into account the individual circumstances of each school.

Under a decentralised model the following responsibilities are devolved to a school:

- the local community may have a formalised role in providing direction and guidance on school operations, through local school councils or boards
- school budgets, while determined and allocated centrally, provide a high degree of autonomy to schools as to how the budget may be expended, to improve the learning environment for students
- schools are provided with the flexibility to determine their own staffing arrangements and mix of staff according the learning needs of their local community
- schools have greater influence over the utilisation of physical assets within the school premises.

In a decentralised model, the following functions would remain with the centre:

- salary and conditions, usually under a single enterprise bargaining agreement, including the management of extended long service leave and sick leave
- the position of principal
- centralised employment and payment of teaching staff
- major capital works and infrastructure
- ICT infrastructure and networking.

Generally, the non-government school system operates on a decentralised structure in Australia, while government schools in most states, including NSW operate on a centralised structure. Subsidiarity in the Catholic school system provides schools with greater independence from central administration than government schools, except for the planning of new schools and some resource allocation. Independent schools are largely autonomous entities, with some restrictions on funding allocations and reporting requirements.

In Catholic and Independent schools:

- decisions on the use of non-staff resources, targeted programs and allocation of funding for the specific needs of a community are generally made a school level, rather than by the centre
- decisions on staff resources are primarily school based, with some involvement of the central administration. In government schools there is generally heavy involvement by the centre
- for state wide services, such as cleaning and maintenance, there is mix of both central control and school based decisions, based on the level of expenditure.

A two year pilot of school based management in 47 NSW schools has recently been completed and reviewed. The main conclusions of the review were that:

- principals in the pilot study were positive about the benefits of school based management
- all principals agreed that the pilot had led to improvements at their school
- principals reported that they achieved:
    - improvements in literacy and numeracy for targeted students
    - increased school engagement and educational outcomes for students
    - better student welfare support
    - increased support opportunities for staff
    - enhanced quality of teaching and learning
    - improved management of the school.
- principals valued and utilised greater responsibility, authority and decision making and accepted the additional accountability that went with the responsibility to make autonomous decisions.

Principals highlighted several constraints to improving school performance under the current centralised structure, including:

- staffing is the critical variable for achieving outcomes and most wanted more flexibility
- needing more flexibility around budget decision making to implement programs suited to their school
- that school based management required reliable, accurate and timely data and that current central office financial management systems were inadequate for providing this information.

The review also noted a number of pre-requisites for decentralisation. A clear delineation of responsibility between the centre and the schools was essential, as was the appropriate skill mix in schools to implement school based management. The five requests were:

- clear communication to principals and schools about the authority that has been devolved to them, and what was not
- correct staffing and budget information at the school level – the current department information systems will need significant development to meet this requirement
- school based management requires principals with leadership and management skills as well as increased capacity for financial management
- significant cultural and organisational challenges to implementing school based management in NSW include industrial concerns about its impact on the union and some principals.

The school based management pilot in NSW and the introduction of school based management in Western Australia has also allowed for greater collaboration and combining of resources between schools in the same community. School based management has allowed principals to allocate financial resources to activities which draw on staff from other schools in the area, to the benefit of students and the local community.

In both Victoria and Western Australia, introduction of school based management has been assisted by school councils that are a formal element of local school governance. The councils comprise both community and school representatives and provide an established forum for local community participation in setting the direction of school management. A formal role for local school councils allows the principal to set a direction for the school with local community support and also gives the local community ownership of the school"s role in the community.

It is not clear that a move to greater autonomy would be associated with a significant change in expenditure in aggregate. However, there is likely to be a reallocation of existing funding from the centre to schools as functions are decentralised. While the centre retains a core role in maintaining standards under a decentralised model, autonomy should not only result in a decentralisation of decision making and accountability but also a decentralisation of financial resources.

Recommendation: The Commission recommends that the Department of Education and Communities at the cost centre clearly sets out the roles and functions to be done by the centre and by schools. This should identify resources (including staff no longer needed) and the additional resources needed at the school level. The aggregate budget will be generally stable but expenditure decreases at the centre and increases at a school level.

Studies of school autonomy and leadership, while positive in their assessment of impacts on student outcomes, are also cautious about the leadership capabilities of principals. For this reason, profiling and scheduling of the devolution to NSW schools may be required in advance of leadership capabilities being improved.

The publication of school by school performance results through NAPLAN will in the future allow the performance of autonomous and centralised schools in Australia to be compared, to assess any material difference in student outcomes.

Recommendation: The Commission recommends that:

- NSW Government proceed with greater autonomy in NSW schools, particularly in relation to staffing and financial management
- as part of the implementation of greater school autonomy, detailed consultation and profiling of schools be undertaken to identify those schools where greater autonomy can be provided in the near term
- for other schools, the government invest in leadership development and training for schools, in advance of providing greater autonomy
- a structured program of school leadership and support be developed for both current and future school principals.

Decentralisation has been done before. Four case studies have been chosen to show the sort of changes that will be required. The Commission has selected these case studies to illustrate the lessons that have been learned by other states who have experienced devolution. (See appendix 6)

Recommendation: The Commission recommends that the Department of Education and Communities select case studies of experience with devolution and use those case studies to assist in their transition to devolution. The case studies may be from another jurisdiction, outside the public sector or an entirely different business. Moving beyond the familiar may make the lessons of experience clearer.

5. Family and Community Services

Key points:

- Over the last four years expenditure growth on family and community services has exceeded 8% a year. This is higher than the general government average of 6.5% a year, making this one of the fastest expenditure growth areas for government.
- Whilst this growth has extended the scope and capacity of services, projected increases in demand will continue.
- Any wholesale improvements to the efficiency, effectiveness and capacity of the service system are undermined by the limited transparency on programs and expenditures in this area. This information gap should continue to be addressed as a matter of priority.
- Greater outsourcing to the non-government sector can increase both effectiveness and innovation in service provision. It is an approach that is developing, particularly in out-of-home care and social housing.
- It is important that any further outsourcing is conducted in an informed manner – and supported through close engagement and partnerships with the sector as well as improved contracting arrangements.
- Individualised funding packages impart a client-centric model of care intending to lead to better alignment of services and client outcomes. Rolling out this approach in NSW fits well with government policy to move closer to customers.

5.1 Overview

The Government"s family and community services priorities centre on supporting and improving the lives of vulnerable people in NSW and reducing the impact of disadvantage. People who need assistance are not necessarily in this position for all of their lives. Vulnerable population groups that may need government support for some period include young people, children and families, seniors, Aboriginal people and Torres Straight Islanders, people with a disability and their families and carers, and people who are homeless or in housing need.

The *NSW 2021* priorities for Family and Community Services encapsulate:

- **Child wellbeing** – increased focus on prevention and early intervention; reducing the rate of children and young people reported at the risk of harm; reducing the number of children and young people in out-of-home care
- **Homelessness** – reducing the rate and number of people who are homeless

- **Disability services**:
    - creating person-centred services, through increased use of individualised funding arrangements
    - increased participation by people with disabilities, including in employment, further education and out-of-home activities (for people with profound and severe disabilities).

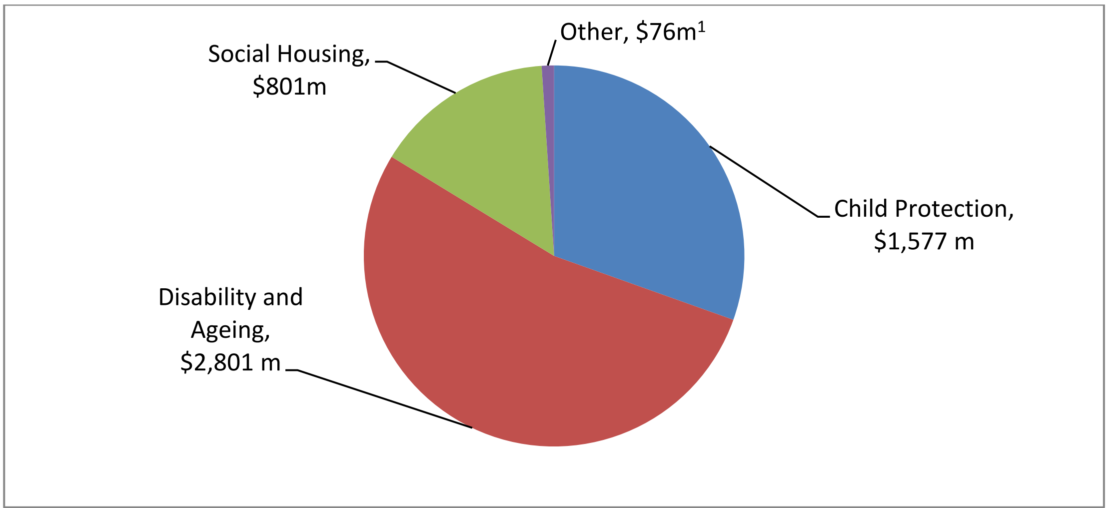
Services in this area are provided by the Department of Family and Community Services (FACS) in partnership with non-government organisations (NGOs) and other government agencies, for certain programs. The FACS cluster brings together:

- **Aboriginal Housing Office** – making sure that Aboriginal people have access to affordable housing
- **Ageing, Disability and Home Care (ADHC)** – delivering community support and specialist care services for older people, people with a disability and their families and carers
- **Community Services** – keeping children safe and providing support to vulnerable families.
- **Housing NSW** – helping to house people in need
- **Office for Women's Policy** – promoting opportunities and equality for women in NSW
- **Businesslink** – providing the cluster with corporate and shared services.

NSW expenditure on family and community services will total more than $5.2 billion in 2011-12, around 8.7% of general government expenditure. In recent years, this has been one of the fastest growing areas of general government expenditure, with average expenditure growth exceeding 8% per annum over the four years to 2011-12. The general government sector average was 6.5%. Part of the expenditure growth for family and community services reflects key initiatives especially in disability services. The scope and capacity of services have been extended through three programs:

- The *Keep Them Safe: A shared approach to child wellbeing* policy – $750 million between 2009-10 to 2013-14
- The *Stronger Together* direction for disability services – $1.3 billion between 2006-07 to 2010-11
- Phase two of *Stronger Together ('Stronger Together 2')* – $2 billion between 2011-12 to 2015-16.

Figure 5.1: Breakdown of the Department of Family and Community Services expenditure by service areas, 2011-12



1. Includes a component of corporate and shared services expenditure

The recent growth rate in family and community services expenditure is not sustainable on budgetary grounds. At the same time FACS faces further demand growth across a number of key service lines:

- **disability services** – expected increases in the disability population and the ageing of informal carers, leading to growing demand
- **child protection services** – the number of children and young people in out-of-home-care has historically increased at around 5% a year (although recent reforms have started to reduce the rate of entries into care)
- **social housing and rental assistance** – increasing with population growth, housing affordability challenges, and escalating leasing costs in the private rental market.

The tension between increasing demand and a budget constraint will be an ongoing challenge. Better results for currently available resources is the immediate target and a strong reform agenda is required. Within that context, it is encouraging that FACS is now focusing on:

- a shift from the historic program focus to client outcomes: clients will have more say in the way services are designed and, where possible, they will have control of the way services are provided
- prevention and early intervention: working with individuals and families as soon as possible so that small problems don"t develop into larger ones and to provide them with the skills to help themselves
- increased leverage of community capacity: FACs has an agenda to increase the use of NGOs to deliver services

- performance orientated delivery system: better understanding the needs of clients and an emphasis on evaluating results through setting, monitoring and analysing service and programs outcomes.

These directions should be continued as a matter of priority. Building on these, the following sections discuss reforms across the following key areas:

- non-government organisation (NGO) service delivery
- out of home care
- social housing
- person-centric service delivery
- boarding houses
- multiple and complex needs families.

5.2 NGO service delivery

The NGO sector comprises charities, associations, cooperatives and not for profit companies. The size of NGOs in the sector varies considerably – from small local, single service organisations to large, national, church based organisations.

Almost half of all FACS" service delivery is done through NGOs. In 2010-11, FACS funded around 2,500 NGOs (at a cost of around $2 billion) for the delivery of services in the areas of disability, children"s services and social housing. It is understood that the aggregate expenditure growth of NGOs has been12% a year since 2007-08, almost double the government sector expenditure growth of 6.5%. This increase has been across most FACS divisions and programs.

Reforms around disability (*Stronger Together 2*), out of home care and social housing will government shift more of its services into the NGO sector, with a significant increase in funding in the sector. The sustainability of this shift will in part depend on:

- the government"s ability to achieve a reduction in the services it directly provides
- the capacity of the NGO sector to deliver the growth required and on transforming the way services are provided.

Greater outsourcing to and investment in NGOs will result in substantial jobs growth for that sector, accompanied with the need for increased skills and other resources. Transitioning some of the skills and capability within government to the sector may partially assist. A significant work program of sector capacity building is already underway across FACS to assist NGOs to respond to these changes.

An important facet of NGO capacity building will be the leveraging of social capital that is not always available to government agencies and business. This includes volunteers and the ability to mobilise communities on local issues. Community participation can be mobilised for shared community benefit, and can generate revenue from private sector sources to supplement government funding. The transfer of government service delivery to NGOs comes with a responsibility to access social capital from the community wherever possible to support the delivery of services.

NGOs may also have better local knowledge and more flexible and innovative service arrangements. Their expertise may be more relevant to the task and can sometimes provide services more cost effectively than government. NGO contracting by FACS should be open to both not-for-profit and for-profit organisations who have these attributes.

Fostering NGO partnerships

Increasingly government is looking to the NGO sector for the delivery of family and community services. This is occurring as those services become more complex and individualised to specific needs. While this closer engagement, and inter-dependency, between the two sectors would be expected to lead to a closer partnership, this has not always been the case. Each sector has competing demands from different stakeholders, particularly around access to government resources.

The Commission understands that there is a close alliance and partnership between Ageing, Disability and Home Care and National Disability Services. This partnership aims to deliver industry support and set the NGO sector up to deliver person centric services. A whole-of-government partnership approach does not however prevail and it is limited to just this one part of the sector. Nonetheless, it has influenced work being undertaken between FACS and the NGO sector out of home care.

These partnership approaches may signal a new way of working. Nevertheless these come after a period of tension between the government and the not for profit sector. Despite the best efforts of both sides to forge a true partnership in the development and implementation of social policy, achieving this goal has been difficult and often disappointing and dispiriting.

In the last two years, a new relationship approach between the Western Australian government and the not for profit sector has seen a concerted effort by both sides to create a partnership that leaves behind old battles. The Western Australian Partnership Forum, comprising government and the sector has been created with the intention of forging a collaborative relationship on the design and implementation of social policy initiatives.

Given past experiences, participants in the Forum were at first cautious as to why this forum would be any different to previous efforts. However, the feedback from both government and the not for profit sectors to the Commission is positive. The Forum does look encouraging as a new approach to reinvigorating the relationship between the two sectors.

An outline of the features of the Forum is provided in the following case study.

Case study: The Western Australian Partnership Forum

The Forum was established by the Western Australian Government in 2010 as the focus of its relationship with the public and not for profit community sectors. The stated mission of the Forum is to improve outcomes for all Western Australians through a genuine partnership in the policy, planning and delivery of community services.

Two key early tasks for the Forum were:

- to determine the actual cost of services and how the government and community sector would respond to any decision of Fair Work Australia to adjust award rates of pay in the sector
- implementation of reforms to government contracting of services from the community sector, including standardised contracting arrangements across government, and less onerous reporting requirements.

The Commission has met with representatives of both government and the community sector to discuss the operation of the Forum, particularly in relation to these two tasks. While there will always be areas of disagreement, the overwhelming response to the Forum has been positive from both government and the community sectors. This is in large part due to a strong commitment from both parties for the Forum to operate as an active two-way partnership and not just another consultative forum that fails to deliver change and results.

The characteristics of the Forum that provide this commitment were:

- a high level of ownership, participation and continuity in key members of the Forum, including the Premier and the Director General of his department, other Directors General and community sector leaders. Continuous participation by members was important in generating trust and commitment to the Forum as a functional partnership
- the Forum being established with a set of agreed behaviours, as well as principles, covering consultation, transparency and engagement of citizens in the planning, design and delivery of community services, that engendered trust and confidence in the partnership
- a shared goal of delivering results and bringing issues to a final conclusion
- an independent chair, Peter Shergold AC, from outside both the community sector and the Western Australian government
- exchanges and secondment of staff between government and the sector, that developed a shared understanding of the constraints under which each sector operated
- ensuring compliance with the principles and behaviours by all participants.

Recent developments have led to a new stage of reform to contracting arrangements between the Western Australian Government and community service providers. These developments include:

- the decision of Fair Work Australia (FWA) to award significant pay rises for workers in the social and community services sector, which will increase the cost of service provision
- a renewed emphasis on individualised funding approaches, discussed further below
- the need for simpler, more transparent contracting arrangements that reflect the true value of services provided by the community not for profit sector.

The Western Australian government and the sector have been working through these challenges in the Partnership Forum. The Forum has a strong level of commitment from both sectors to active and constructive participation in the forum and the delivery of concrete results.

Instrumental to the success of the Forum and an effective partnership between the two sectors was the Western Australian Government"s early commitment to additional funding in anticipation of the Fair Work Australia decision. This was an important act of good faith on behalf the government to work in partnership with the sector. The basis of service provision through community providers should be about who is best placed to meet the needs of those in support – not simply cost factors alone.

The Commission believes the approach to the delivery of services through the community sector, including the concept of a partnership forum can also work in NSW.

Recommendation: The Commission recommends that the NSW government reach agreement with not for profit community organisations on the establishment of a community partnership forum along the lines of that in Western Australia. The Forum should establish its own set of principles and behaviours and require a high level of continuous participation and commitment from both government and not for profit members.

Improved contracting

Historically, contracting arrangements between government and NGOs have tended towards block or grant-funding agreements. Under these arrangements grants were made based on the numbers of people assisted or the quantity of services to be provided. Such arrangements have been less than ideal as reflected in:

- a major variability in unit prices and costs across NGOs – in many circumstances, prices do not accurately reflect the cost of services
- issues with transparency on how funding is used – anecdotally, some NGOs have received funding for specific clients no longer accessing services which then has been spent on other clients
- contracts have been onerous, prescriptive and restrictive to the extent of specifying both inputs and outputs for service delivery – specification of outcomes is far more appropriate
- significant „red tape" for NGOs – arising through administration of multiple contracts and contract types across government for similar services
- reflecting the above, relatively little emphasis on performance and results achieved from the delivery of services.

The grant funding design does not appear to serve the interests of NGOs, government or the clients who ultimately receive services. The Commission understands that both Victoria and Western Australia are moving away from NGO block grant funding and transitioning to performance or output based contracts. The Commission is of the view that NSW must adopt a similar approach and we understand this reform is underway.

Recommendation: The Commission recommends that the NSW government transition to a performance-based contracting model for all services provided by the NGO sector. This model should provide strong assurance around the quality, effectiveness and efficiency of services provided by the sector but give flexibility in how funding is spent.

The NSW government and NGOs should ensure that the performance-based design embodies several principles:

- a partnership exists between NGOs and government – the contractual relationship should be collaborative and non-adversarial
- the focus should be on client outcomes and whether these are being effectively met – the contract should „open the door" for greater flexibility and

innovation in service delivery so that people have more control over the services they receive

- service delivery must be as cost efficient as possible and administrative arrangements must also be minimised. Inefficiencies have cost implications for both NGOs and government
- the effectiveness and efficiency dimensions should be transparent through appropriate performance management frameworks within contracts.

Contracting reform has been occurring within FACS. For example, new NGO-provided respite care places under *Stronger Together 2* have been introduced through performance contracts. The new arrangements are around 30% less costly than respite places provided under the older block-funded arrangements. However, the new arrangements are not, and should not be, simply about cost efficiencies per se. They are also intended to introduce a greater level of transparency on performance, including client outcomes.

The Commission understands that existing contracting arrangements for NGO-provided out-of-home care (OOHC) placements have also been flawed in a number of areas. Of concern, OOHC contracting was dispersed across FACS (Community Services) and appeared to be undertaken in an ad hoc manner. This led to significant variations across similar contracts, particularly around price, and provided limited transparency. A revised contracting model is being introduced to achieve consistency in approach and unit pricing, to ensure focus on performance and to provide better funding certainty and transparency and reduce the administrative burden for NGOs.

Building on these recent directions, existing block or grant funded NGO service arrangements across government should be phased out. With agencies and the NGO sector moving to performance based agreements as soon as practicable – either through retrospective negotiation or as current agreements expire.

There is at least one further dimension to better contracting. The appropriate commercial and contract management acumen across government and the NGOs is needed. The NGO sector must build its capability and so too must FACS.

Recommendation: The Commission recommends that the Department of Family and Community Services increase its commercial and contract management capabilities to allow it to effectively undertake its significant contracting function and become an effective purchaser of services

The contracting of NGOs across government is quite inconsistent in its approach. There are different forms of contracts, tenders, performance measures and different ways to do financial acquittals. This contributes to unnecessary “red tape” and administrative burden for NGOs.

A joint agency working group, comprising FACS, Health, central agencies and other agencies which have a significant reliance on NGOs, should investigate and examine approaches. The aim would be to get a consistent approach that minimises administrative work for NGOs and which also allows agencies to have clear performance based contracts. The NGOs should be involved in this consideration.

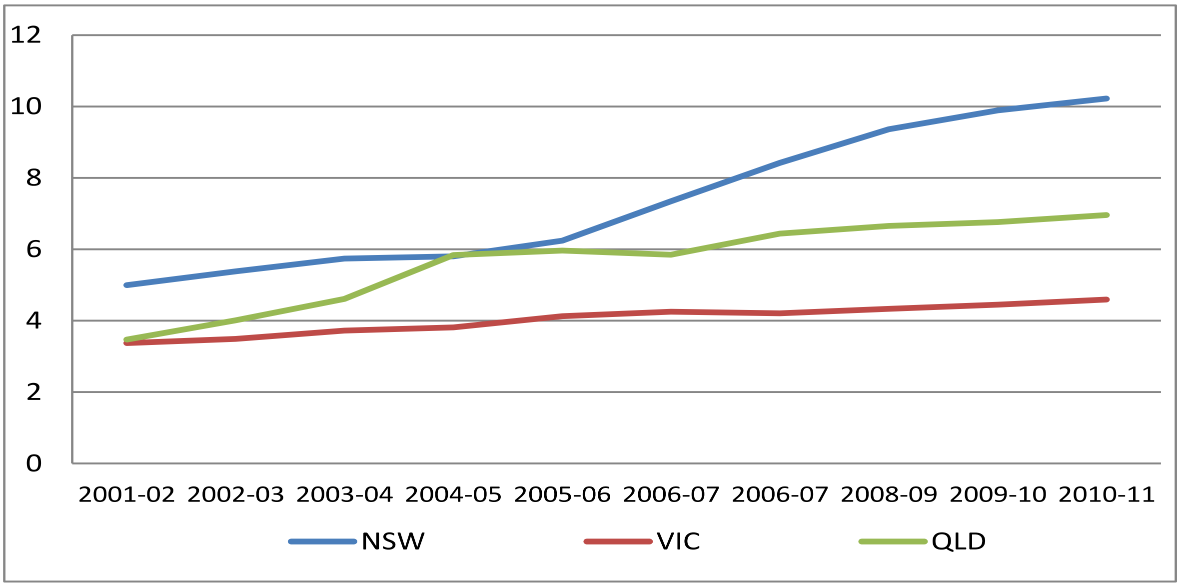
5.3 Out of home care

In each Australian state, out of home care (OOHC) represents the predominant form of protection for children who are in need of care and protection. The program provides alternative accommodation for children and young people who are unable to live with their parents. Service providers may also provide aspects of parental responsibility for children. The arrangements can include foster care, placements with relatives, and residential care.

Annual expenditure in NSW on OOHC is around $700 million a year. In June 2011, there were around 16,800 children aged 0-17 in OOHC in NSW, compared to 5,678 in Victoria and 7,602 in Queensland. Of those 16,800 children in NSW, 13,600 were cared for by the FACS. The remaining 3,200 were placed in the care of NGOs. In addition to those 16,800 children, there were another 1,150 children as at June 2011 who were placed in other statutory and non-statutory OOHC arrangements including children transitioning to adoptive or birth parents and children living in homelessness, disability and juvenile justice facilities.

The chart below shows that in 2004-05, the rate of children in OOHC in NSW was the same as in Queensland and around 50% higher than in Victoria. By 2010-11, the NSW rate of children in OOHC was almost 50% higher than in Queensland and double that in Victoria.

Chart 5.1: Children in OOCH – rate per 1000 children aged 0-17 years



Source: Report on Government Services 2012 – Productivity Commission

The sharp rise in NSW numbers in OOHC occurred in 2006-07. That year, the number of children in OOHC in NSW increased by 20%, compared to a 7% increase the year earlier.

This increase in the rate of children in OOHC in NSW reflects both an increase in the number of notifications in NSW, as well as the longer duration of children in OOHC in NSW compared to other states.

The reason why NSW has so many children in OOHC compared to Victoria and Queensland is mainly because of differences in recording when a child is placed in OOHC. There is a three stage process across jurisdictions before a child is placed in care. In NSW the recording of the child occurs early in the pathway even though they may not proceed through all stages.

The decision making pathway in OOHC is:

1. **Notifications**: Once government receives information that a child is potentially at risk, the information is assessed against a threshold of risk, which determines whether the information is reported as a notification. NSW has a lower notification threshold than other states and this increased recorded notification. However since January 2010, NSW has changed its notifications threshold to a „Risk of Significant Harm‟. This has decreased the notifications recorded. A notification may be dealt with by an investigation, or through the provision of advice or referral to other services.

2. **Investigations**: Investigations are the process by which the relevant government agency obtains more detailed information about a child who is the subject of a notification. The agency will make an assessment about the harm or degree of harm to the child and their protective needs. A child is sighted in all jurisdictions during the investigations stage.

3. **Substantiation**: This refers to notifications and investigations where there was reasonable cause to believe that the child had been, was being, or was likely to be, abused, neglected or otherwise harmed. Substantiations may also include cases where there is no suitable caregiver, such as children who have been abandoned or whose parents are deceased. Substantiation leads to intervention to protect the child that can include: referral to other services, supervision and support, an application to court and a placement in OOHC.

Previous analysis undertaken for FACS indicates this increase in the rate of children in OOHC reflected long term trends and policy changes, including:

- long term trends observed elsewhere, such as increasing complexity of cases and public awareness
- changes to income support payments that provided greater financial incentive for relatives to care for children at risk
- an increase in the number of caseworkers.

Most recent data shows that over the last six to seven years, the growth in the number of children in OOHC in NSW has fallen substantially:

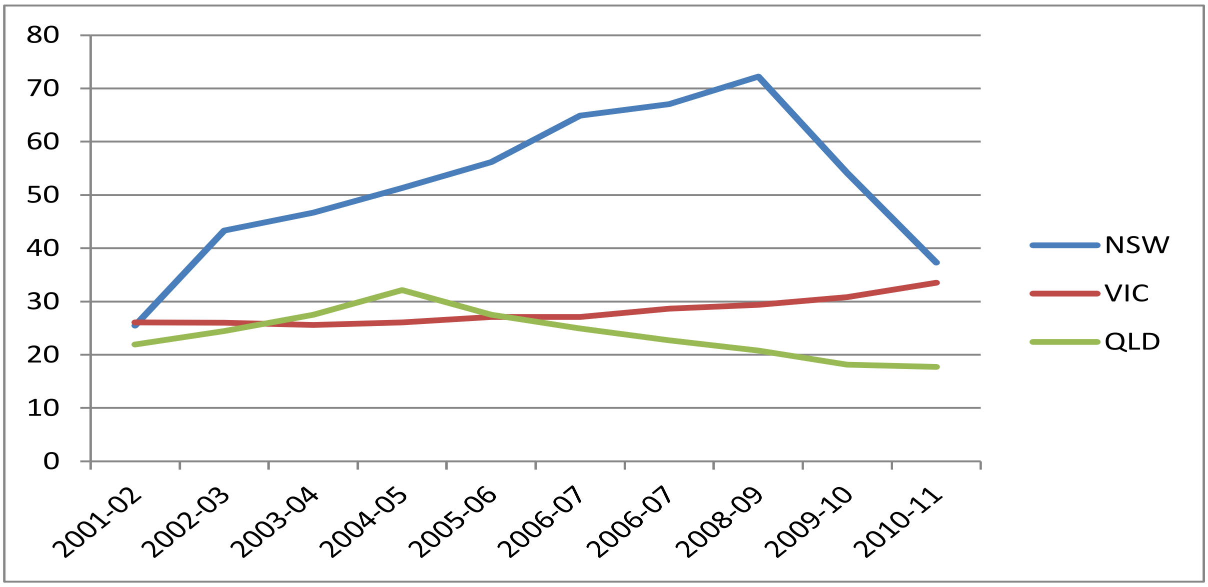
- from a peak growth rate of 20% a year in 2006-07, the number of children in OOHC grew by 3.5% in 2010-11
- children admitted in OOHC in NSW (per child population) fell from a peak of 2.8% in 2008-09 to 2% in 2010-11 – around the same level as in 2004-05.

Differences in policy and measurement between states make it difficult to draw definitive conclusions as to the reasons for the divergence between OOHC rates across states. However, the policy in NSW of having a relatively lower notification threshold compared to other states until 2010, combined with a longer than average duration in care appears to influenced the reported NSW data.

The figure below shows that in 2001-02, the rate of notifications in NSW was around the same as in Victoria and Queensland. The dramatic increase in notifications was not matched by a commensurate increase in substantiations. While the rate of notifications relative to population almost trebled between 2001-02 and 2008-09, the rate of substantiations doubled during that period. The proportion of finalised child care protection investigations that were substantiated fell from around 40% in 2005-06 to around 30% in 2009-10. This indicates that some proportion of the additional notifications did not result in ongoing care in OOHC.

By 2008-09, the rate in NSW was double that in the other states and by 2010-11, the rate had fallen dramatically to around the level of Victoria. This turnaround coincided with NSW changing its threshold for notification to a report that is assessed as being above the Risk of Significant Harm.

Figure 5.2: Children in notifications – rate per 1000 children 0-17 years



Source: Report on Government Services 2012 – Productivity Commission

The change in the rate of notifications also appears to have flowed through to a reduction in OOHC substantiations in NSW.

Despite the recent falls in the rate of notifications and substantiations, the overall rate of children in OOHC in NSW remains significantly higher than comparable states. This may reflect the higher duration rates for OOHC in NSW. In NSW, 71% of children in OOHC have been in a continuous placement for more than two years, compared to around 60% in Victoria and 64% in Queensland.

The increase in the numbers of children in OOHC in NSW is also reflected in a dramatic rise in costs. Between 2004-05 and 2008-09, annual expenditure on OOHC in NSW almost doubled from $304 million to $589 million. By 2010-11, expenditure on OOHC was around $700 million.

Future provision of out of home care

The slowdown in the rate of growth in children in OOHC in the last two years should, overtime, lead to a decline in the number of children in care relative to the population. The rate of growth in OOHC population should also decline.

In July 2011 the NSW Government established the Ministerial Advisory Group on Transition of OOHC Service Provision in NSW to NGOs. This Advisory Group has published plans for increased involvement of in the care of children and young people. Currently the NGO sector is looking after about 15% of the total number of children and young people in statutory Foster Care and statutory Relative/Kinship care

The Stage 1: OOHC Transition Plan provides details on the transition of children and young people in care to the non-government sector. Initial estimates suggest that:

- all children and young people entering statutory Foster Care and statutory Relative/Kinship Care for the first time to be placed and case managed by the non-government sector
- all non-Aboriginal children and young people placed in statutory Foster Care and statutory Relative/Kinship care placements managed by the Department and their carers to transfer to the non-government sector within five years
- all Aboriginal children and young people placed in statutory Foster Care and statutory Relative/ Kinship care placements managed by the Department and their carers to transfer to the Aboriginal non-government sector within ten years.

The OOHC Transition Implementation Framework provides for:

- a state-wide governance group to drive monitor and report to the Minister on the transition

- regional implementation groups to drive, monitor and report on the progress of the transition in each of the Department"s seven regions
- an increased focus on preservation and restoration through greater collaboration with the non-government sector.

The Commission supports this transition and the governance arrangements put in place to ensure the plan is implemented.

5.4 Social housing

Social housing is primarily affordable, long-term rental housing for people on low to moderate incomes, with a housing need. The NSW social housing system supports more than 300,000 people, with housing provided through Housing NSW, the Aboriginal Housing Office and non-government community housing providers (CHPs). Around 87%, or 134,033, of the social housing stock in NSW is government-owned.

NSW is starting to move away from the traditional government-provided public housing model. An increasing proportion of social housing is being managed by CHPs – around 26,082 properties, including around 1,500 dwellings for crisis accommodation, are currently managed or owned and managed by CHPs. Thirty two of the largest providers, primarily housing associations, manage 98% of the general non-government organisation owned and managed housing stock. This outsourcing trend follows similar directions in other Australian States and Territories, as well as internationally such as in the US and the UK.

In the UK for example, there are over 2,000 not-for-profit groups, known as „Housing Associations", which have largely replaced Councils as the providers of low-cost social housing. Housing Associations now provide the bulk of the social housing in the UK, managing around 1.7 million homes. Their growth has been facilitated through progressive stock transfers from Councils and significant funding contributions by government. Housing Associations have been able to utilise their operating surpluses to maintain existing homes and to finance acquisition of new dwellings. Existing stock has been used to leverage borrowings.

In Australia, the comparative advantage of CHPs arises through their not-for-profit status. They have the opportunity to leverage this across a number of areas:

- their tenants have access to Commonwealth Rent Assistance as well as exemptions to GST and other taxes – this provides additional income and reduces both operating and capital costs
- CHP tenants include a mix of low and moderate to higher income tenants. This approach serves to subsidise the costs of housing low income tenants and provides an income that supports the servicing of debt incurred by those providers leveraging new housing supply. It also supports a better social mix in housing developments
- institutional investors or banks may lend on more favourable terms as part of their social contribution.

The CHPs will continue to require the support of Government in terms of:

- housing stock transfers from government. The transfer of management provides a rental income stream whilst complete title transfers provide both a rental income stream and the opportunity to borrow against those assets
- ongoing grant funding. This includes subsidies for providers leasing properties from the private market and capital grants that in combination with a provider"s own debt / equity is used to deliver new housing supply.

NSW has undertaken property management transfers to CHPs since 1996 and more recently, title transfers to facilitate the growth of the community housing sector, as follows:

- Property management transfers involve the transfer of tenanted public housing properties to a non-government housing provider. Since 2003-4 over 6,424 properties have been transferred from public to community housing management
- Title transfers: this involves transferring ownership of social housing assets to CHPs. It is expected that providers will leverage finance off the assets to purchase or build additional affordable housing. 3,099 properties have had their title transferred to date.

In 2009, NSW committed to transferring title to 6,019 dwellings to CHPs through competitive tender. The sector already manages around 5,000 of these dwellings. The Commission understands that these transfers are part of the State"s commitment under the National Affordable Housing Agreement to grow the community housing sector to up to 35% of social housing stock nationally by July 2014.

Titles to 3,099 dwellings have been vested with the community housing sector, Title transfers to a further 2,920 properties have not yet been undertaken. The transfers have occurred for nil consideration. It is estimated the dwellings have a combined value of around $2 billion. CHPs are responsible for all lifecycle maintenance and tenancy management for properties they own. As part of the transfer the sector has committed to deliver 1,200 new social and affordable housing properties over ten years. This will be financed by leveraging the housing assets against borrowings.

There have been suggestions that more stock transfers in the short term could support a rapid growth of the community housing sector and its asset base. The CHPs would leverage these assets for further stock growth. The aim would be to grow the sector to the point where it provides a legitimate alternative to direct government provision as the main form of social housing – as in the UK.

However, the Commission believes that growth of the sector should occur gradually over time, with decisions around further stock transfers, beyond the currently committed 6,019 dwellings, needing to be well informed. The Commission recognises that pockets of community housing provision in Australia are innovative and efficient. But there are a number of parameters that need to be considered.

Capacity and capability vary significantly across CHPs and the pool itself is relatively small at present. There are around 135 long term housing providers in NSW and just over 900 providers across Australia. In NSW, the majority of stock transfers have been to the larger high-performing registered Class 1 and 2 providers, of which there are 26. The largest provider has a portfolio of around 4,000 properties. Other state jurisdictions are also relying on this pool of providers for their sector growth aspirations. There is a risk of saturating the sector with stock transfers and grant funding in a way that is difficult for the sector to manage.

Building the requisite capacity, capability and scale into the sector will take time – this has been the experience in the UK. In this context, FACS has put systems in place, including a NSW based statutory regulatory system, to support a growth of the sector. It is encouraging that the Commonwealth and the States are already working with the sector on these aspects, including the implementation of a national regulatory framework for CHPs.

In addition to capacity building, there are a number of governance and financial aspects requiring clarification, such as:

- establishing ways to maintain transparency around performance and client outcomes
- establishing frameworks to safeguard the proportion of dwellings available to low income/high needs tenants as social housing. The CHP income model also relies on moderate to higher income tenants that pay higher rents under the banner of affordable housing
- the cost to government under the outsourced model - as well as asset transfers ongoing subsidies will probably be required
- validating the benefits and efficiencies available to government
- how to achieve a reduction in the size of government providers in parallel to the growth of community housing – this must occur for cost benefits to government to be realised.

The Commission reinforces its view that greater outsourcing to NGO sector should represent the future direction for social and community services. But this must be undertaken in an informed manner. In the case of social housing, outsourcing must be staged to enable capacity building in the CHPs. The matters relating to governance and the financial impacts also need to be worked through by FACS in conjunction with the central agencies

Recommendation: The Commission recommends that the growth of the NSW Community Housing Sector should be conducted in a staged approach to enable capacity building of the Community Housing Sector and greater clarity around matters relating to governance and cost.

The sector is likely to require some time to absorb existing stock transfers in NSW and in other jurisdictions.

With this in mind, further stock transfers in NSW should be informed by an evaluation of what is achieved with the current round of transfers. This will require an evaluation framework that clarifies the:

- progress of the sector‟s capability and capacity growth
- success in delivering client outcomes
- progress in the delivery of the additional social and affordable dwellings as committed to by the CHPs
- ongoing costs and benefits to government.

Recommendation: The Commission recommends that the decisions by Government to transfer further social housing stock to the Community Housing Sector, over and above the 6,019 dwellings currently committed, should be undertaken in an informed manner. To achieve this, Family and Community Services should implement an evaluation framework to clarify the achievements of Community Housing Providers with the current round of stock transfers.

5.5 Individualised funding

Historically, human services have developed through planning processes responding to the needs of broad population groups. These programs have assumed in a relatively homogeneous demographic. The primary funding and planning relationship has been between government and service providers. This arrangement has meant that people receiving services have not had a direct role in determining what those services are and how they are delivered.

This „one size fits all" approach runs the risk of over servicing, providing wrong services or limiting a person"s ability to match services according to their individual preferences or needs. It is possible to improve the alignment of services and impart a client-centric model of care through individualised funding, also known as Person Centred Planning. This allocates a portable package of funding or budget to an individual or their carers based on the individual"s assessed level of need. Clients are given control over the services purchased with this funding. They are empowered to make decisions around the services they receive and from whom they receive them. This allows people to have regard to their individual needs, preferences and their goals. One area where this has been adopted in a number of jurisdictions is in the area of support for the disabled.

Choice through individualised funding can act as a mechanism to improve the quality of support and reduce ineffective interventions and inefficiencies. Experience elsewhere, both in Australia and abroad suggests there is scope for higher quality care and improved health and well-being outcomes as a result.

Whilst not the main objective, it appears that individualised funding can also provide efficiencies and savings which can relieve some of the pressure on the service system. An independent analysis of international applications of individualised funding found decreases of between 7% and 50% in the costs to serve individuals within programs. In the context of NSW expenditure on direct disability services alone – which is in excess $1.5 billion and rapidly increasing – the potential savings through the use of individualised funding could be quite considerable.

Individual funding is a radical departure from the old program-based service delivery models. Its successful implementation requires a number of issues to be resolved, including:

- establishing new service system entry points
- how to assess individuals" needs
- how to determine the individual funding packages amounts and how they are to be linked to need
- the form of individual funding packages and who holds or manages the funding and undertakes the planning with the client

- the scope of supports included and excluded in individual packages
- what are the efficient prices for the services
- how will outcomes be monitored and what is the government"s role in terms of ensuring the quality of services.

These issues, although complex, are not insurmountable. For example, Western Australia has successfully implemented individualised funding for the bulk of its disability services.

Case study: Individualised funding – the Western Australian experience

In 2011, 70% of funding for disability services in Western Australia was delivered through community providers with 80% of this funding now allocated to individualised funding approaches. This compares to the situation in NSW where less than 10% of disability services are provided through individualised funding.

The high level of individualised funding in WA reflects a process of ongoing reforms over a 20 year period. Commencing in the late 1980s, the funding arrangements for non-government organisations was moved from block funding to an individualised funding approach.

Key elements of this transition included a:

- staged approach to reform that allowed both service providers and individuals to adjust to the new funding arrangements. Service providers had a greater level of certainty over funding, based on choice rather than block grants. Individuals had increased control over and discretion over both the source and quality of the services provided
- close relationship between the government and service providers. The creation of the Partnership Forum has assisted with most recent reforms
- shift in assessing the performance of individualised funding from an input focus (type of service demanded) to an outcomes approach (improvement in the wellbeing of the individual)
- greater emphasis, over time, on transparent service provision and on the actual cost. This is being applied across the entire disability sector in reforms being progressed by the Partnership Forum
- change in the nature of services provided in response to greater individual choice, particularly in accommodation services.

In NSW, individualised funding packages are currently being trialled under the *Stronger Together 2* reform. *NSW 2021* has also set targets to increase the percentage of users who access individualised funding arrangements, with:

- 10% of disability service users accessing individualised funding arrangements by July 2014
- 100% of disability service users being able to access individualised funding arrangements by July 2019.

There is scope for NSW to be innovative in this area by identifying other opportunities across government where individualised funding could be piloted.

Recommendation: The Commission recommends that NSW agencies investigate other opportunities to pilot individualised funding, including across health services and services for the ageing.

5.6 Boarding housing reform

FACS, through Ageing Disability and Home Care (ADHC), is responsible for the licensing and monitoring of boarding houses that accommodate two or more people with a disability who require supervision and social habitation. The small number of licensed boarding houses, about 30, forms part of all boarding homes in NSW that numbered 465 at the 2006 Census.

The boarding house industry in NSW faces a number of issues including:

- limited protection and support for vulnerable people living in this accommodation
- difficulties in enforcing standards to protect the safety and wellbeing of residents
- insufficient co-ordination among monitoring and enforcement bodies
- limited incentives for operators to improve standards, or to enter the industry.

Closures in the licensed part of the industry over the past decade have also had implications for government. People with a disability and those with a mental illness have had to be rehoused.

The Commission understands that a reform proposal for the whole boarding house industry is being developed. Considerations will include:

- the preferred form of a registration system for all boarding houses
- a principles-based approach to occupancy rights and responsibilities for residents and proprietors
- minimum accommodation and operational standards
- the appropriate roles for service providers and regulators.

5.7 Intensive support for multiple and complex needs families

In most communities there are families with multiple and complex problems that impact more than one member. Problems include poor parenting, poor educational outcomes, child protection risks, drug and alcohol abuse, poor mental health, poor housing, debt, domestic violence and unemployment.

Example: A Family with multiple and complex needs

X and Y are a young couple with three small children. One of their children has severe disabilities.

The family was living in a unit in an area where ongoing violence, anti-social behaviour and crime are common. The condition of their home unit was poor and was severely affecting the health of the children.

The family was engaged with the Brighter Futures program and had a number of other needs identified that impeded their ability to provide a safe and nurturing environment for the children.

Multiple and complex needs families tend to have interactions with multiple government agencies. Typically they are known to Health and Education, Police, Juvenile Justice and FACS. Within FACS these families may receive support from multiple service lines such as housing, disability services and community services.

Despite the wide range of services provided to such families, their outcomes remain poor. And although these families are a small proportion of the government overall client base, they are disproportionately costly and complicated to serve well. Direct costs of supporting these clients run into hundreds of thousands of dollars per year. Indirect costs are more difficult to quantify but can include the impact of social disruption or costs associated with interventions by Police and Juvenile Justice. The costs increase over time as disadvantage is entrenched through generations.

Difficulties in supporting families with multiple and complex needs arise through:

- fragmentation in service delivery
- service systems that are program orientated and assume a „one-size fits all" approach
- difficulties for client in accessing and navigating the system as there are multiple „doors" or service systems and each with their own requirements and criteria.

Part of the problem is the „silos" that exist across agencies. Moreover, demarcations in policies, programs and budgets have often complicated attempts to get multiple agencies „around the table" to prioritise and deal with high/complex needs clients. Supported families can have suboptimal services and outcomes because of a lack of coordination between supporting agencies and because services do not always account for wider problems faced by family members.

Emerging evidence suggests that families with multiple and complex needs benefit most when support is facilitated through intensive case management. This approach takes a holistic view of the problems faced by family members; and responds with an integrated services approach to targeting each of the family members.

The UK has been trialling family orientated intensive support programs for some years. Their program model has the following characteristics:

1. There is an effective case coordinator or manager. These are highly experienced professionals that can provide leadership and extensive attention to families. The case coordinator or manager is able to navigate the service system and broker the necessary specialist support on a priority basis and with authority.
2. There is a family focused approach. The focus includes a comprehensive assessment of the needs of all family members and a multi-disciplinary team that supports the family members accordingly. This ensures that needs of the family are identified and the right support determined.
3. An intensive and flexible but family focused response is made. Government services are phased and managed to address the multiple family issues. A performance management framework is set out to measure the outcomes for the family, rather than whether an intervention was delivered or not.

There has been overwhelming evidence of improved client outcomes. For example, one particular study looked at a sample of 3,675 families who had received intensive support services since 2006. The study concluded that among the families, there was a:

- 58% reduction in anti-social behaviour
- 53% reduction in truancy
- 57% reduction in domestic violence
- 34% reduction in child protection issues.

Other studies also found that intensive support programs had contributed to reductions in substance abuse and improved parenting outcomes. „Parent(s) felt calmer/less anxious/hopeful/more confident/safer/less angry, developed parenting skills, communicated more, fought less and family life and relationships improved". Children also felt less anxious, happier and safer. In many cases, the programs were able to preserve family units and prevented the need for children to enter the out of home care system.

The benefits extended beyond the improved client outcomes. One researcher found that for every £1 spent on these programs, around £2 was saved in costs largely as a result of preventing the need for more profound and costly interventions. The social benefits are even greater, with analyses showing that for every £1 invested the likely social value created can range between £3 to £6.

The Commission notes that work is underway within FACS to establish and resource a more integrated and coordinated management of high needs clients. FACS has undertaken an analysis of clients to determine families who are currently using high levels of government support services. FACS has also undertaken analysis of current programs/initiatives and resources across departments for delivery of integrated services to families who may be frequently encountered f and those with multiple and complex needs. This work has included testing options to improve service responses through a number of initiatives such as the Clients with Complex and Multiple Needs Panels, and the Family Case Management service.

These are positive initiatives by FACS and go some way to removing silos across its service lines. However, the Commission is concerned that FACS may still be somewhat limited in its ability to persuade or compel other agencies to participate or coordinate (with some priority) services that extend beyond its boundaries.

Effective intensive case management for this client group ultimately requires a whole-of-government commitment and response – one that is able to unite the relevant agencies and overcome service system boundaries and program limitations. This should be driven through an authoritative central agency such as the Department of Premier and Cabinet, ideally supported by a dedicated Minister and Cabinet Sub-Committee.

The Commission believes that there is merit in trialling a centrally hosted Family Recovery Unit. Placing such a unit in Department of Premier and Cabinet would ensure that senior attention is paid to the unit. Such a unit is able to provide intensive support programs and direct case management for multiple and complex needs families – similar to the program approaches in the UK. How the Family Recovery Unit will operate requires further scoping but should have regard to the following parameters:

- the Unit should target the 100 or so highest risk multiple and complex needs families
- the Unit should be trialled for a period of two years
- the Unit could be funded from both new allocation and from the transfer of an appropriate level of resources from government agencies who interact or provide services to these families

- suitably experienced family case managers should be seconded to the Unit from other government agencies or the NGO sector
- case managers should be empowered to make decisions, be able to navigate through service systems, and have authority to broker the necessary specialist support on a priority basis
- needs of all participating family members should be identified and supported through multidisciplinary teams using a wide range of professional expertise, including from the NGO sector, over a sustained period of time
- agencies such as FACS, Health, Education, Police and Juvenile Justice should work closely with the Unit and prioritise support to it
- outcome-centred performance measures and targets should be established for each family prior to the commencement of the support program
- cost information should be accurately captured to inform a better understanding of this area.

Recommendation: The Commission recommends that the NSW Government trial a centralised Family Recovery Unit (hosted by the Department of Premier and Cabinet) which is able to provide intensive support programs for multiple and complex needs families.

6. Justice: Police, Corrective Services and Juvenile Justice

Key points:

- Expenditure across the NSW justice system exceeds $6 billion a year. At present there are major reforms in progress in this cluster. The Police Death and Disability Scheme has been replaced with a more viable arrangement. Two prisons have been closed and programs are targeting a reduction in recidivism.
- The cost of policing and corrective services in NSW at present is higher than in other jurisdictions. NSW has the largest police force in Australia. Greater workforce flexibility would assist both the management of the police force and corrective services.
- The inmate population across NSW correctional facilities is almost double that of the other states. The number of inmates in minimum security centres is particularly concerning. Custodial sentences for low level offences have negative consequences. For example the risk of recidivism increases, imprisonment is costly and custody is not the correct remedy for many offences.
- Prison facilities are becoming the default setting for those with mental health problems. This is not appropriate and must be addressed.
- In NSW, the number of juveniles in detention is more than double that of other states. Almost half are on remand. The increased emphasis on diversionary punishments for juvenile crime is a positive direction but remains a „post the event" response.
- Whole-of-government preventative and early intervention approaches are required to tackle juvenile crime. This is in line with government policy.
- Over the last five years, Corrective Services NSW has, on average, overrun its budget by approximately $80 million a year. Measures have been taken to address this issue.
- Further outsourcing of prison facilities, as well as inmate transportation and court escort services should be investigated.

6.1 Government policy and priorities

The NSW Government has three policy goals:

- prevent and reduce the level of crime
- prevent and reduce the level of re-offending
- improve community confidence in the justice system.

The first policy goal to reduce the level of crime is particularly focused on domestic violence and alcohol related assaults. The Government also has a target of reducing personal crime by 10% and reducing property crime by 15% by 2016. Returning police officers to the frontline and targeting crime hotspots and repeat offenders are central to the strategy. Greater community involvement in local crime prevention is a priority.

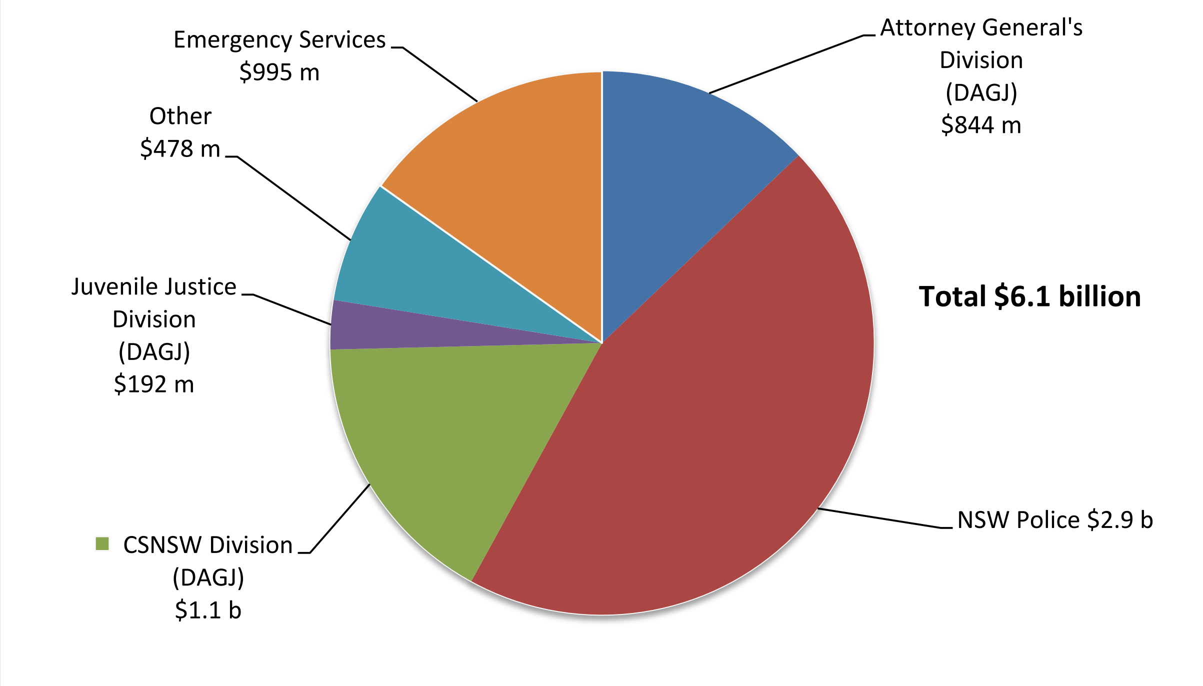
The second of the policy goals is to reduce reoffending. A 5% reduction in recidivism has been targeted by 2016. The underlying causes of juvenile crime are to be addressed through early intervention and more appropriate non-custodial approaches. It is intended to divert people with mental health problems away from the criminal justice system and towards the health services they need. There will be a renewed focus on increasing completion rates for key treatments and intervention programs of those held in custody.

The third policy goal seeks to improve community confidence in the justice system. There is concern about delays in the court system and firm targets have been set for the efficiency of the courts in finalising matters. Ninety per cent of Local Court matters are to be dealt with within six months, 75% of pending civil matters in the District Court are to be completed within 12 months. Further resources are diverted to victim and community support services.

The Attorney General and Justice Cluster (Justice cluster) comprises police, the courts, corrective services, juvenile justice and emergency services agencies. The Department of Attorney General and Justice is the principal department and is responsible for setting the overall policy direction of the cluster. The Commission is pleased to note the progress being made across the cluster to coordinate agency activities with the aim of better service delivery outcomes.

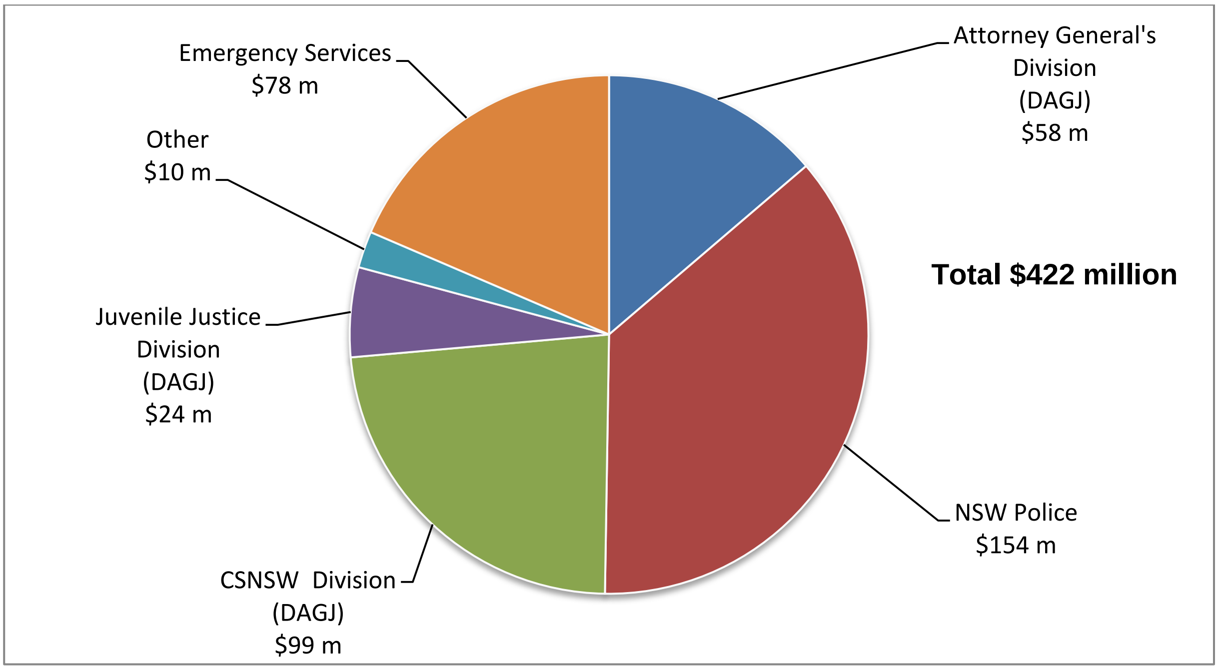
In 2010-11, current expenditure in this cluster totalled $6.1 billion. See Figure 6.1. Labour was the largest item of current expenditure in the cluster. There are about 38,000 FTE staff and of those 19,000 are in Police. Police is by far the biggest agency within the cluster. Its current expenditure was $2.9 billion in 2010-11. Total expenditure for the Department of Attorney General and Justice (DGAJ) was over $2.1billion across its three divisions of Corrective Services ($1.1 billion), Attorney General"s ($844 million) and Juvenile Justice ($192 million). Emergency Services includes the State Emergency Service, Rural Fire Service and Fire and Rescue with collective operating expenditure of $995 million.

Figure 6.1: Current expenditure in the Attorney General and Justice Cluster, 2010-11



Capital expenditure across the cluster was $422 million in 2010-11, as illustrated in Figure 6.2 below.

Figure 6.2: Capital expenditure in the Attorney General and Justice Cluster, 2010-11



The focus of this chapter is the NSW Police Force, Corrective Services NSW and Juvenile Justice.

6.2 The NSW Police Force

6.2.1 Overview

The NSW Police Force has 80 Local Area Commands and operates from 426 police stations which deliver policing services to the community. Specialist commands complement the general duties operational capability, covering land, sea and air operations.

The Police Force has a major role in ensuring the safety of the community. Its mission, as set out in the *Police Act* 1990, is to work with the community to reduce violence, crime and fear. The Police Force also supports the community by responding to incidents, emergencies and public events. Key performance objectives include:

- **Reducing rates of crime:** Frontline policing targets crime hotspots and repeat offenders. The Commission notes that NSW crime levels across key indicators have been falling or remain stable.
- **Public safety:** Police are focused on reducing levels of poor driving, antisocial behaviour and the community"s perception and fear of crime. Police"s 2010-11 performance data indicates that the number of injury crashes, fatal crashes and charges for exceeding prescribed concentration of alcohol whilst driving fell to their lowest levels in five years. The level of community concern around crime and antisocial behaviour also appears to be falling.
- **Increased community confidence in police:** this includes prompt, professional responses to crime and safety issues and catering to community expectations. Performance data indicates that community satisfaction and confidence in the NSW Police Force has steadily increased in recent years. An important measure of police performance is their responsiveness to urgent calls. These are calls where there is an imminent threat to life or property. The target is to arrive at 80% of urgent duty jobs within 12 minutes. In 2010-11, the Force responded to around 114,000 urgent response calls and 79.5% of those calls were attended to within the target time.

  Emergency management capability is critical in minimising the effects of an emergency on the community. Police have a vital role in this regard, with responsibility for coordinating all multi-agency responses in emergency situations. This year, and last, the NSW Police Force has effectively responded to devastating floods across much of the state.

6.2.2 Death and Disability Scheme

In December 2011, the NSW Government announced the cessation of the NSW Police Death and Disability Scheme. The replacement scheme will see the purchase of commercial insurance which will continue to provide lump sum benefits for death and total and permanent disabilities. An income protection benefit will be paid to replace the lump sum benefits for partial and permanent disability benefits, and it will also provide salary top-up payments for officers receiving workers" compensation weekly benefits.

The replacement of the former scheme is an important reform for Police. The Auditor General (*Managing Injured Police Officers 2008*) emphasised that this former scheme encouraged injured officers to leave the NSW Police Force rather than seek rehabilitation. Extended sick leave was taken and large lump sum payouts made available with little incentive for injured officers to return to work. This had significant implications for police productivity and performance and hindered community safety.

The scheme commenced in 2006 with a budget of $69 million. By 2011, the Scheme was costing the Government $288 million and was well on the way to being equivalent to 50% of the Police annual wages expenditure. The scheme has also had implications for NSW Police workers" compensation costs which have risen considerably. This is discussed in Chapter 14.

The new scheme focuses on returning the 800 officers currently on long term sick leave back to work, and rehabilitating officers who would otherwise leave the Police Force for medical reasons. The Commission is supportive of this reform direction.

6.2.3 Efficiency and resource allocation

Expenditure

NSW has the largest police force in Australia with 4,200 more police staff than Victoria. This is shown in Table 6.1. The proportion of operational, or frontline, police officers is lower in NSW than Victoria and Queensland.

Table 6.1: Police staff numbers 2010-11

	NSW	Vic	Qld	WA
Total FTEs	19,266	15,063	14,739	7,648
Operational	88%	93%	90%	85%
Non-Operational	12%	7%	10%	15%

Productivity Commission data shows the cost of delivering police services on a per capita basis is higher in NSW relative to Victoria and Queensland.

Table 6.2: Current expenditure per capita on police services (2010-11)

	NSW	Vic	Qld	WA	Average all jurisdictions)
Current expenditure on police services per person	$393	$347	$385	$472	$395

In 2010-11, the NSW Government spent approximately $2.9 billion on police services. This was $900 million (40%) more than Victoria, $1.1 billion (61%) more than Queensland and $1.7 billion (142%) more than Western Australia.

When the average cost is applied to the cost of 100 police FTE, the relative cost in NSW is $2 million higher than in Victoria and $2.9 million higher than in Queensland.

Table 6.3: Current expenditure per 100 police staff

	NSW	VIC	QLD	WA
Current expenditure per 100 FTE	$14.8 million	$12.8 million	$11.9 million	$14.3 million
How much more does NSW spend per 100 FTE?		$2 million (15%)	$2.9 million (25%)	$0.5 million (4%)

Cost differences may partly reflect differences in service provision between states. For example, the role of NSW Police in regulating some industries, such as the security industry and taking responsibility for prisoner transports is generally not undertaken to the same extent in other states.

As the Productivity Commission notes, high expenditure per person is not a direct reflection of inefficiency. It may reflect aspects of the service or characteristics of the policing environment such as more effective policing or more challenging crime and safety situations. Similarly, low expenditure per person may reflect more desirable efficiency outcomes or lower quality, (less intensive policing or less challenging crime and safety situations.

Work practices

The key management issue does not appear to be the overall level of resources. Rather it is the most efficient use of existing resources. Currently, the efficient allocation of police in response to reported events is made more difficult by:

- a command structure that may not promote the most efficient allocation of policing resources across boundaries
- limited flexibility for local area commanders to deploy resources according to when they are needed most
- resource allocation that is focussed more on maintaining the existing distribution of strength rather than on where resources are needed.

The basic organisational unit is the Local Area Command (LAC). This provides a good localised focus on policing operations, with effective supports available for HR and other corporate services functions from headquarters and other support commands. Notwithstanding this, a recent audit of the NSW Police highlighted a number of problems with the LAC structure that limits the capacity of Local Area Commanders to deploy resources to their most efficient use. The current LAC structure is criticised by the Audit report which argues that:

- the structure is rigid with possibly too many LACs. In practice this significantly limits the flexible allocation of resources as priorities change
- the LAC configuration is not conducive to the provision of local community policing – the audit states that in many respects the Police have lost their concept of community service delivery and are not flexible to changes in demand
- LACs are top heavy with each LAC having both management and administrators – resources that would be better allocated to frontline policing.

It should be noted that the NSW Police Force does not agree with these assessments and points out that it has invested significant resources in recent years to improve victim support and community engagement.

The NSW Police Force also notes that the current management structure of LACs is partly a result of Royal Commission recommendations on the need for increased supervision and civilian involvement at a local level to promote corruption resistance.

Nonetheless, the Commission understands that the NSW Police Force is currently reviewing its operational structure, including the number of LACs. Given that the size of these commands varies considerably from between 68 to 300 officers, some amalgamations would appear to be sensible. However, such reforms should be undertaken with the objective of increasing flexibility in the allocation of resources whilst also maintaining and building on the advantages of the LAC model.

The Lambert Report has also recognised that the number of sworn officers to be employed by NSW Police is determined through a target officer number known as „police authorised strength". The total authorised strength has in turn been allocated to individual LACs and both „actual" and „authorised" police numbers are reported each month.

The 1997 Royal Commission into the NSW Police Service recommended that the concept of an authorised strength number be abolished. The Commission in relation to this issue stated:

> "There be no return to the concept of authorised strength or any similar notion and the Police Commissioner be given the authority and flexibility to determine matters of staffing structure and deployment to meet current needs and resources."[c]

In the Interim Report, the Commission addressed the issue of input controls and recommended that workforce management policies, such as staff ratios, should not be included in industrial agreements. The Commission of Audit endorses the findings of the 1997 Royal Commission.

Rostering arrangements in the NSW Police Force have also been of concern. A 2007 Audit Office report found that police rosters do not deliver flexibility and can pose difficulties for officers with young children or other family responsibilities. General duties officers can, for example, work a block of four 12 hour shifts, with four days on and four days off. This practice:

- delays follow up action and risks a loss in continuity
- increases fatigue and is not in the interest of officers in terms of health and safety
- negatively impacts victim support.

The Police Force advises that it has actively pursued a range of rostering improvements including the introduction of an intelligence based rostering system, and improved training and support for Commanders.

The NSW Police Force is also actively pursuing reforms to the command structure with a view to returning police to the frontline and increase flexibility in their allocations within the Command boundaries.

There has been a public commitment to try and ensure that actual police operational strength at LACs is at a minimum of 90%.

The Police Force is also reviewing its workforce planning and allocation policies to promote the matching of staff numbers to workloads by recognising that the daily

[c] Royal Commission into the NSW Police Service Final Report, May 1997, Volume 2, p. 242.

activities across LACs can vary and shifts should reflect this. Having more officers on hand in periods of high activity allows police to respond more effectively. For example, general duties officers can be on duty daily, working shifts of between six to 12 hours per day and starting and finishing at different times. Flexible rostering is also likely to improve levels of service provision, officer health and safety, and overall productivity, as staffing will better reflect incident activity.

Recommendation: The Commission recommends that the NSW Police Force adopt revised workforce allocation practices that allow resourcing at the Local Area Command level to be more flexible and efficient and better attuned to community needs. In particular, the authorised strength concept should be replaced by outcome measures that allow more flexibility in the NSW Police Force.

6.3 Corrective Services

6.3.1 Overview

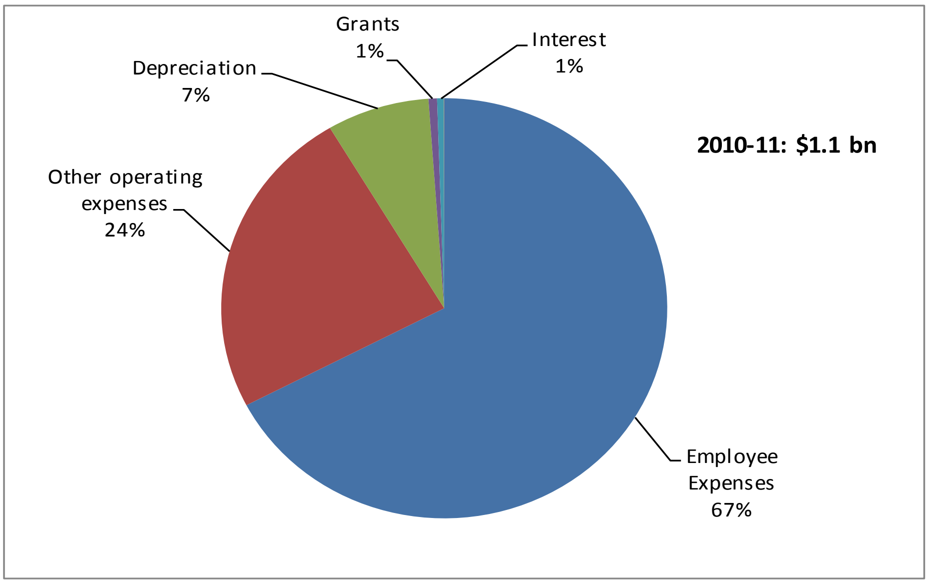
Corrective Services is responsible for managing the largest correctional system in Australia. In June 2011 there were 36 correctional centres in NSW, compared to 13 in Victoria, 14 in Queensland and 13 in Western Australia. (See Appendix 1).

Recent major reforms for Corrective Services have centred on:

- better management of overtime, excess employees and leave which will help control expenses
- outsourcing and decommissioning of correctional centres. The operation of the Parklea correctional centre was outsourced in November 2009. The Kirkconnell Correctional Centre, as well as the heritage listed goals at Berrima and Parramatta, were recently closed.

Corrective Services had current expenditure of $1.1 billion in 2010-11 and $99 million in capital expenditure. NSW has almost doubled the corrective services expenditure of all state jurisdictions. Queensland ($584m), Victoria ($545m) and Western Australia ($491m) are far less.

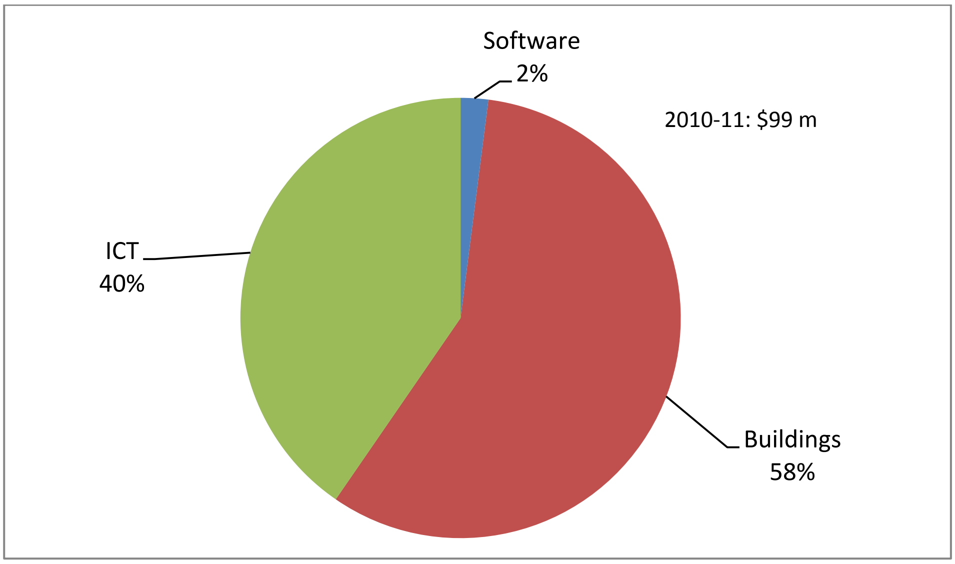
Figure 6.3: Corrective Services NSW: 2010-11 Current Expenditure



The current expenditure in Corrective Services has grown at 7.3% a year on average over the past decade, compared to general government growth of 6.2% per annum. This growth is not sustainable.

Capital expenditure growth in corrective services has also been high at 13.3% a year. In 2010-11, capital expenditure was $99 million. As the profile shows below, this has mainly been spent on new correctional facilities (buildings) and investment in information technology and communications (ICT).

Figure 6.4: Corrective Services NSW: 2010-11 capital expenditure ($99 million)



The following table provides a snapshot of Corrective Services performance against budget. On average, the agency has been 9.2% above budget over the past 5 years. An average budget overrun of $81 million per year is not acceptable.

Table 6.4: Corrective Services budget performance 2005-06 to 2010-11

$million	2006-07	2007-08	2008-09	2009-10	2010-11	5 Year average
Budget	764	833	876	910	936	864
Actual	815	883	961	1011	1053	945
Surplus/(Deficit)	(51)	(50)	(85)	(102)	(116)	(81)
Overspend	6.70%	6.00%	9.70%	11.20%	12.40%	9.20%

The tables below provide an overview of the operating expenditure across jurisdictions for both open and secure prisons. In 2010-11, NSW spent far more on corrective services than any other jurisdiction. In fact, current expenditure was higher than Victoria for open prisons by $210 million (525%) and $102 million (26%) more for secure prisons.

Table 6.5: Daily average prison population: Open (minimum security) prisons 2010-11

	Operating Expenditure	Prison Population
NSW	$248 million	3,648
Victoria	$40 million	513
Queensland	$36 million	515
WA	$98 million	970

Table 6.6: Daily Average Prison Population: Secure (maximum security) Prisons 2010-11

	Operating expenditure	Prison population
NSW	$493 million	6,446
Victoria	$391 million	4,073
Queensland	$344 million	5,022
WA	$314 million	3,663

Costs per prisoner are reported annually by the Productivity Commission and are set out below.

Table 6.7: Operating and capital expenditure rates per prisoner

Net opex ($ per prisoner per day)	NSW	VIC	QLD	WA
Open plus Periodic Detention	182.28	211.83	191.44	277.85
Secure	209.49	263.08	187.49	235.04
All	199.46	257.35	187.89	244.00
Capex ($per day per prisoner)	NSW	VIC	QLD	WA
Total capital cost	76.55	68.27	100.83	45.95
Total	NSW	VIC	QLD	WA
Net operating and capital expenditure ($ per prisoner per day)	276.01	325.62	288.70	289.95

The relatively high prison population in NSW lowers the cost per prisoner when compared to other jurisdictions. This is because a high proportion of costs are fixed.

6.3.2 NSW prisoner population

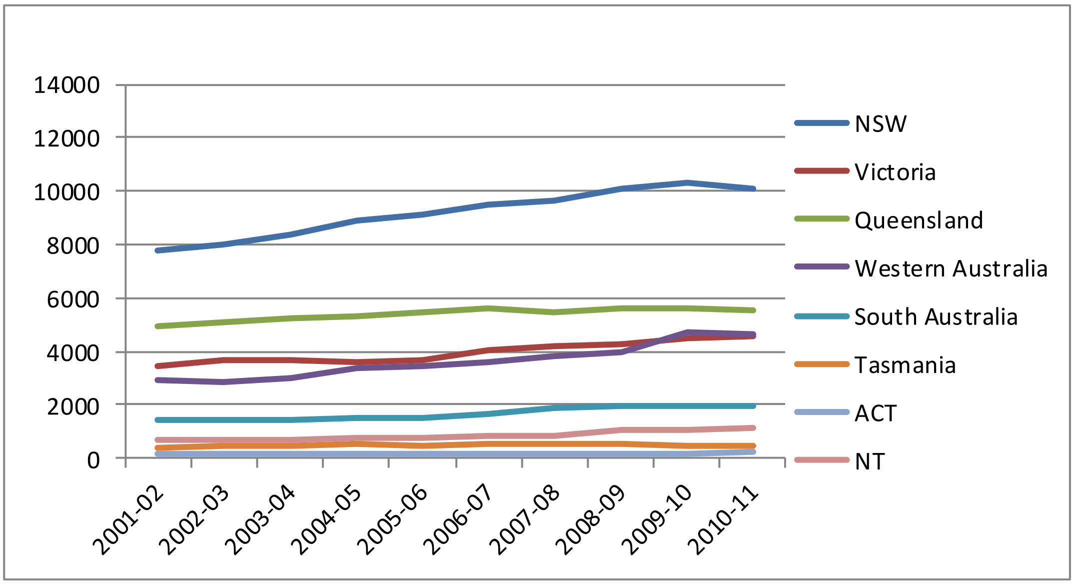
The average daily prisoner population in NSW was 10,094 in 2010-11, compared to 4,586 in Victoria, 5,537 in Queensland and 4,633 in Western Australia.

Table 6.8: Average daily prisoner population: 2010-11

	NSW	VIC	QLD	WA
Total prisoners	10,094	4,586	5,537	4,633
Open	3,648	513	515	970
	36%	11%	9%	21%
Secure	6,446	4,073	5,022	3,663
	64%	89%	91%	79%

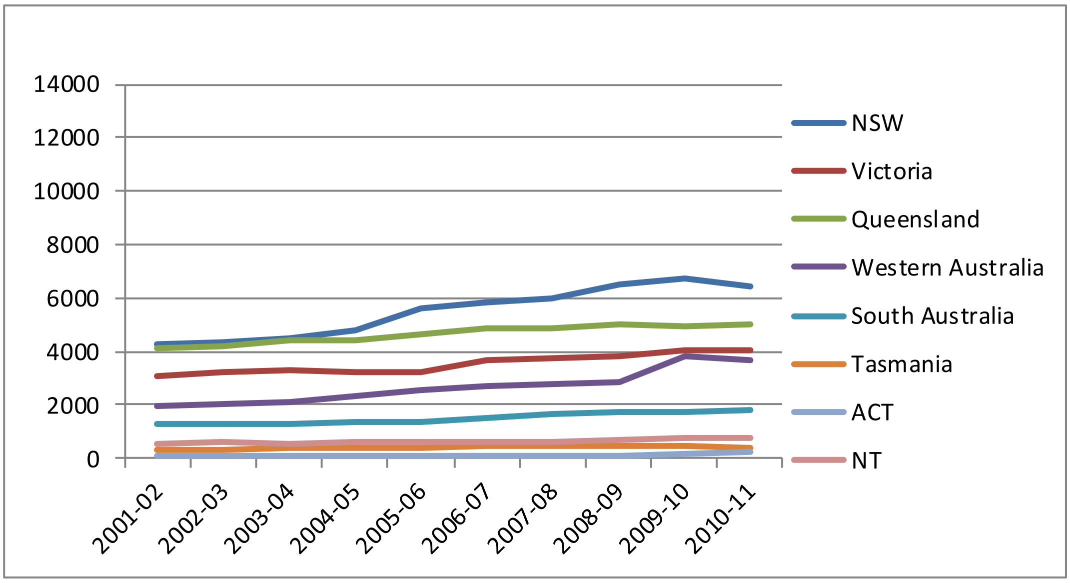
The NSW prison population has steadily increased over the past decade, peaking in April 2010 with 10,482 inmates.

Figure 6.5: Historic average total daily prison population



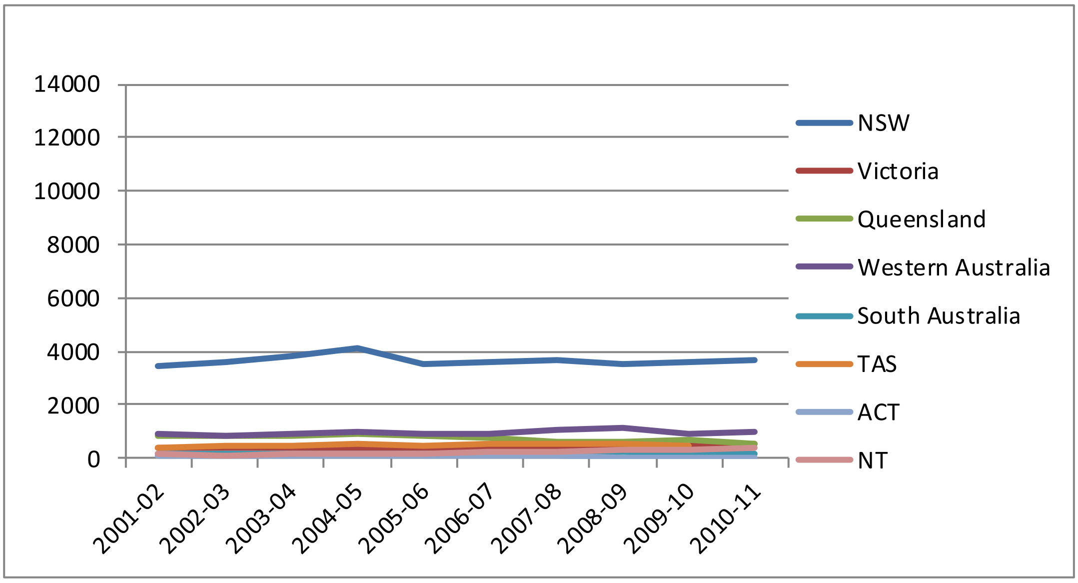
The growth in average daily prisoner numbers has been steeper in NSW over the last decade when compared to other jurisdictions. The Commission notes that this trend has reversed in the last 12 months, with average daily rates reducing by 258 (2.5%) in NSW between 2010 and 2011. This is mainly due to greater use of non-custodial sentencing options. As Figure 6.6 illustrates below, prisoners in secure prisons have increased significantly since 2004-05 and far more steeply than in other Australian jurisdictions.

Figure 6.6: Historic average daily prison population – secure prisons



The number of prisoners in open prisons, low security custody, across NSW is also surprisingly high compared to other jurisdictions. Approximately 36% of NSW prisoners are in open prisons, compared to 11% in Victoria, 9% in Queensland and 21% in Western Australia.

Figure 6.7: Average daily prison population – Open prisons



Prisoners in NSW correctional facilities can be generally characterised by:

- nine out of ten prisoners are male
- the ratio of male to female prisoners appears to be similar across jurisdictions and has been stable over the last decade.
- between one in three and two in three prisoners has been diagnosed with a mental illness at some time in their life
- around one in five prisoners (22%) are from indigenous backgrounds. Both Queensland and Western Australia are higher than NSW at 30% and 38% respectively
- more than one in two prisoners has previously been incarcerated in NSW
- three out of five prisoners are aged between 18 and 34 years of age.

Identifying a single cause of higher than average imprisonment rates is not simple. It cannot be explained by crime rates alone – the level of crime in NSW is no worse than other jurisdictions. Other factors, such as more effective policing, could be at play. The Commission believes that the operation of the criminal justice system, recidivism and mental illness are also contributing factors.

The Criminal Justice System

Corrective Services have no control over inmate population numbers. This is influenced by a number of variables such as arrest rates by police, bail conditions, court delays and sentencing policies. Historically, mandatory sentencing and stronger bail laws have significantly increased the average daily prison population and led to increased expenditure on prison facilities. Relative to other jurisdictions, the largest disparity is the inmate population within NSW minimum security prisons. These prisons accommodate perpetrators of low-level offences. In NSW, the inmate population in these prisons is more than seven times higher than the Victorian and Queensland equivalents (see table 6.8). There appears to be a greater tendency to „lock" people up in NSW for low-level offences.

In December 2010, the NSW Bureau of Crime Statistics and Research (BOCSAR) examined the influence of sentencing practice and other factors on the difference between NSW and Victoria in their imprisonment rates. The study found that NSW, compared to Victoria:

- has a higher court appearance rate (3,168 per 100,000 versus 2,542 per 100,000 population)
- convicts a higher proportion of those appearing in court (85.7% v 79.0%)
- imprisons a significantly higher proportion of those convicted (7.5% compared to 5.4%) the remand rate is 2.5 times higher per 100,000 population.

To emphasise the magnitude of the problem, for every 100,000 people in the adult population, NSW is imprisoning 179 people compared to 105 people in Victoria. The imprisonment rate in NSW is 70% higher than Victoria.. This places significant pressure on the NSW corrective system.

On average, it costs about $182 per day to keep a person in full time custody in an open prison. Alternatively it costs about $25 per day per offender for a community supervision order. In 2009-10, a range of community supervision orders were used as sentencing mechanisms. These included home detention and drug court orders (Restricted Movement), community service and fine default (Reparation) and parole and bonds (Supervision). Eighty one per cent of community corrections orders were successfully completed.

The community expects a tough stance on crime. However, incarceration for relatively low level offences makes no sense. It is costly and the custody environment can negatively impact inmates, leading to increased risk of recidivism and higher-level offences.

A priority action for *NSW 2021* is to expand the options available to courts and police to reduce repeat traffic offenders. An Interdepartmental Working Group convened by the justice cluster has identified that a large number of people are being incarcerated or placed on supervised orders for driving licence offences. This has a significant cost while having little effect on re-offending rates as many of these people continue to drive out of necessity. It is understood that the working group is developing a range of options to reduce repeat traffic offenders, without compromising community safety. The aim is to substantially reduce the cost of detaining and supervising them.

From 1 October 2010, periodic detention ceased to be a sentencing option in NSW and a new community sentencing option called an Intensive Correction Order (ICO) became available. An ICO is a non-custodial sentence of imprisonment of up to two years that is served in the community. Offenders can be subject to a range of stringent conditions including 24 hour monitoring, regular community service and a combination of tailored educational, rehabilitative and other activities. The offender may also be directed to submit to regular tests for drug and alcohol consumption.

The ICO has been available in Queensland and Victoria in less intensive forms. It is directed at addressing some of the documented shortcomings of periodic detention, giving offenders the opportunity to turn their lives around through addressing factors associated with their offence. At the same time, the community is safeguarded through the intensive monitoring and supervision of offenders by Corrective Services.

The NSW Sentencing Council is to report annually on the use of the new orders and will review their operation after five years. In addition, the Bureau of Crime Statistics and Research in NSW will be asked to measure the effectiveness of the order in reducing re-offending.

At the time of writing, there was limited cost information available on ICOs and how successful they have been in reducing re-offending. However, the recent reduction in average daily prisoner numbers is partly attributable to the increased use of ICOs. It is clear that this new ICO policy may be an important contributor to stemming unsustainable growth in the NSW prison population. Its success needs to be carefully monitored.

Recidivism

Recidivism rates indicate the extent to which people who have had contact with the criminal justice system are rearrested, reconvicted or return to community corrections.

NSW has one of the highest rates of recidivism with 43% of released prisoners being re-incarcerated within two years. This recidivism rate is around 5% above the national average. Recidivism rates in NSW have remained relatively static and do not appear to be improving. This is also the case with other jurisdictions.

A key factor in the high recidivism rates may be the higher number of people in NSW who are incarcerated for minor offences. Those who would not have been incarcerated for minor offences in other states are gaoled in NSW, then convicted of offences after release.

Table 6.9: Percentage of prisoners released who returned to prison (under sentence within two years)

	NSW	VIC	QLD	WA	SA	Tas	ACT	NT	Aust
2006-07	43.8	36.2	28.7	43.3	32.8	37.1	n.a.	44.6	38.2
2007-08	43.0	35.6	33.6	42.3	33.2	36.0	n.a.	44.8	38.9
2008-09	42.9	33.9	37.9	44.7	32.2	36.4	n.a.	47.3	40.0
2009-10	42.4	33.7	33.5	45.3	30.2	31.7	n.a.	47.9	38.5
2010-11	43.1	36.9	35.2	44.2	29.8	36.2	n.a.	47.1	39.7

As noted earlier, *NSW 2021* has set a goal to reduce recidivism in NSW by 5% within 10 years. Some of the proposed actions to support this objective include:

- establishing dedicated metropolitan drug treatment facilities focused on treatment and rehabilitation and keeping drugs out of prison
- increasing the effectiveness of numeracy and literacy programs provided to inmates
- encouraging greater use of non-custodial punishment and diversionary programs for less serious offences
- reducing juvenile re-offending through improved early intervention and post-release support.

Corrective Services also delivers a suite of rehabilitation/reoffender programs for both offenders held in custody and offenders on community based orders. The largest focal area targets alcohol, drug and other addictions with 10 different programs and a total of 5,776 participants in 2010-11. The next largest focal area is aggression and violence with six different programs and had 1,233 participants in 2010-11. Other programs promote offender health, community engagement and readiness to reintegrate into the community. A number of programs are also specifically tailored towards female, Aboriginal and young offenders and sexual offenders.

Table 6.10: Compendium of offender management programs (2010-11)

Category	Number of different programs
Aggression and violence	6
Alcohol, drugs and addictions	10
Community engagement	4
Health promotion	1
Readiness	6
Sexual offending	9
Women offenders	3
Young offender programs	5
Two Ways Together Framework (Indigenous focus)	3
Total	47

Given the continuing high levels of recidivism in NSW, the effectiveness of these programs should be reviewed. Programs should be consolidated and less effective programs dropped or changed. Expenditure should be targeted on the more successful programs. Improving the effectiveness of offender management programs in this manner should contribute positively towards reduced recidivism.

Recommendation: The Commission recommends that the Department of Attorney General and Justice should evaluate the effectiveness of offender management programs with a view to consolidating and rationalising less effective programs and investing in the more successful ones.

The Commission also notes that the NSW Government is developing Social Benefit Bond trials in the areas of out of home care in child protection (OOHC) and recidivism in the criminal justice system. Social Benefits Bonds are a new financial instrument that pays a return to private investors based on the achievement of agreed social outcomes. These are an innovation which has both the potential to improve outcomes in social programs and to introduce private funding.

Under a Social Benefit Bond, an investor provides upfront funds to a partner NGO) to provide services that will, if successful, reduce future costs to government. Part of the government savings are used to repay this investment and provide a reward payment commensurate with the outcomes achieved.

Recidivism and OOHC have been selected as the focus of a trial. There are clear measurable social outcomes in these areas which have the potential to result in longer term savings to Government. In the case of recidivism, this is achieved through reducing the reoffending rate through programs such as post-release support.

Social benefit bonds are also being pilot tested in the UK in the area of prisoner rehabilitation. The intake into the Peterborough program in 2010 was encouraging and they await the long term evaluation of the program.

As well as improved client and social outcomes, Social Benefit Bonds can:

- increase private sector funding for prevention and early intervention programs
- be a catalyst to develop the „social finance" sector
- harness the innovation capacity of both investors and NGO service providers
- improve the evidence base and focus on measurement for social programs.

A successful trial of the Social Benefits Bonds here and in the UK may offer a more innovative approach to address the high rates of recidivism in NSW.

Recommendation: The Commission recommends that the trial of the Social Benefits Bonds be monitored and after three years evaluated for progress to date.

Mental illness

One in five Australians experiences a mental illness at some stage in their lives. Mental illness is most common, including substance use disorder, among 18 to 24 year olds (27%).

The high incidence of mental illness in the community has implications for corrective services. "Much of the increase in the prison numbers of the last decade can be related to untreated mental health needs often associated with illegal use of drugs as a form of self-medication. Eventual intervention of the criminal justice system is the result of this course of action."[d]

In NSW, 54% of women in prison and 39% of men in prison have at some point in their lives been medically diagnosed as having a „psychiatric problem" and many have attempted suicide.[e] The frequency of mental illness amongst inmates is far higher than that of the general population and is likely to be much higher than currently reported.

The Commonwealth has the primary policy responsibility for funding mental health.

Historically, their limited funding for mental health services has meant that prison facilities have become the default service provider for those in need of mental health treatment. In some cases, when mentally ill people appear before the courts, the magistrate or judge has limited referral options. There are hopeful signs that the Commonwealth is elevating policy priority around mental health and will step up to its responsibilities in this area.

There is some support to assist mentally ill inmates. For example, the Stateside Mental Health Directorate in Justice Health provides comprehensive mental health care to offenders, young people and formal forensic patients in a range of settings. Referral to specialised mental health services is arranged through Justice Health centres.

The Court Liaison Service also provides mentally ill offenders with court-based diversion options from the criminal justice system towards treatment in mental health facilities. One example is the Biryani Cottage at Malabar. This provides an alternative to custody and treatment for female offenders with mental health disorders or mild intellectual disabilities who also have problems with abuse of alcohol or drugs.

On 2 June 2011, the NSW Mental Health Taskforce was launched. The taskforce has advised on the creation of the new NSW Mental Health Commission which is now in the process of being established. The Commission is to ensure that there is

[d] The Honourable Justice Murray Kellam AO "Mental Health Issues in Parole" (May 2006)

[e] Lambert – 15-11

quarantined and accountable funding for mental health expenditure, and that resources are focused where they are needed most and through the most appropriate models of care. It is vital that the NSW Mental Health Taskforce and the NSW Mental Health Commission include a suitable level of focus on mental health issues impacting corrective services.

Greater investment is also needed in prevention and early intervention programs by Health and Community Services to ensure that individuals with mental health issues, receive the support they need well before they offend and end up in the prison system.

Treating mental illness and related issues in the younger population is particularly important given its early intervention potential, including preventing crime and homelessness, and because of its higher prevalence in this group. There should be ongoing engagement with Commonwealth around the funding required to support increased mental health services and investment in proactive strategies.

Recommendation: The Commission recommends that:

- the NSW Mental Health Taskforce and the subsequent NSW Mental Health Commission should include a suitable level of focus on mental health issues that impact corrective services
- greater investment be made in prevention and early intervention programs to ensure that individuals with mental health problems receive the support they need well before they offend and end up in the prison system
- the NSW Government should continue to engaged the Commonwealth Government on the matter of funding for increased mental health services.

6.3.3 Increasing efficiency

Workforce practices

Corrective Services is a labour intensive organisation. Prison staffing requirements are embedded in industrial awards. This means in practice that expenditure growth is driven largely by prison capacity, rather than by changes in prison population. In a prison with a 400 prisoner capacity, approximately 80% of operating costs will be incurred as fixed costs when the first prisoner is taken into custody. The marginal cost of additional inmates is very low.

Employee related expenditure (around $730 million in 2010-11) has almost doubled over the last decade ($381 million in 2000-01). It is expected that this growth will slow somewhat given the recent closures of the Kirkconnell, Berrima and Parramatta Correctional Centres. Better management of overtime, excess employees and leave will also help control expenses. Historically, excess employee numbers, overtime payments and other leave payments have been well above public sector benchmarks. In 2011, an independent review found that, on average, custodial staff within Corrective services took 63 days leave and worked 177 shifts per year. This includes an average of 23 days sick leave and workers compensation leave, compared to a NSW public sector average of 8 days.

The privatisation of Parklea Correctional Centre in November 2009, the closures of the Kirkconnell, Berrima and Parramatta centres and other workplace reforms should serve to lower employee related expenditure. The Commission has been advised that approximately 360 related voluntary redundancies were accepted in late 2011.

The Crown Employees (Corrective Services NSW – Safe Staffing Levels) Award took effect from 24 November 2009 for three years, requiring each correctional centre operated by Corrective Services to have a management plan identifying staff establishment, maximum inmate numbers and classifications.

The Commission is concerned that the current award structure may impose inflexible input controls that inhibit the ability of Corrective Services to proactively manage staffing levels according to actual need. Of particular note, a continuation of the recent trend of reduced daily average prison numbers means that Corrective Services will require greater flexibility to manage its prison resources. This needs to be addressed when the current Award is due for review in November 2012.

Recommendation: The Commission recommends that negotiations around the next Corrective Services Industrial Agreement should ensure that provisions that effect staffing deployment and levels do not impact better and more effective service provision.

Outsourcing Corrective Services

There are currently eight privately run correctional facilities across Australia. New South Wales, Queensland and Victoria each have two and both Western Australia and South Australia have one.

The outsourced facilities in NSW are Junee (medium security) and Parklea (maximum security). Junee has been operated by GEO Australia since it opened in April 1993. GEO Australia took over the operations of Parklea in November 2009.

NSW has the highest number and percentage of prisoners in government run facilities (8600 or 85%), followed by Queensland (4200 or 79%), Western Australia (3650 or 76%) and Victoria (3050 or 67%).

Table 6.11: Prisoners in government operated facilities

NSW	VIC	QLD	WA
8600	3054	4197	3642
85%	67%	76%	79%

Where evidence suggests that the private sector can effectively run prisons more efficiently whilst achieving policy objectives. The average daily cost of private prisons in the UK and USA are estimated to be 10-35% below that of government operated prisons.

Outsourced arrangements for corrective services can deliver considerable savings for government without diminution of outcomes. Building on the successes of the Junee and Parklea correctional centres, the Commission believes that further opportunities to outsource NSW correctional facilities should be investigated and implemented where feasible.

Recommendation: The Commission recommends that the Government should explore further opportunities to outsource correctional facilities with appropriate governance and performance frameworks.

Outsourcing prisoner transport and court escort services

Expenditure on prisoner transportation and court escort services in NSW has historically been greater than $50 million a year and remains the highest across jurisdictions, followed by Western Australia (~$23 million), Queensland (~$11 million) and Victoria (~$10 million).

Prisoner transportation and court escort services in NSW are currently delivered by Corrective Services and NSW Police. In NSW there are around 134,000 inmate movements each year. Victoria and Western Australia have outsourced their transportation arrangements.

Victoria outsourced prisoner transport more than a decade ago and costs have been stable at around $10 million a year. The work is managed through performance based agreements with the private sector. The recently renewed five year contract covers 50,000 inmate movements each year, a new charging system, enhanced information technology systems and investment in a new fleet of vehicles.

Western Australia privatised prisoner transport and custodial services in 2000, entering into a five year contract with two, three year options. The agreement covers around 32,000 inmate movements each year. The intention was to create an improved and integrated service that released police and justice-based staff from the non-core activities of court security and prisoner transportation. The contractor is required to provide in-court security and court custody services in both metropolitan and regional courts, as well as the transport and escort of people in custody throughout WA.

The disparity in the cost of prisoner transportation in NSW compared to Victoria and Western Australia is partly because of geography and higher inmate numbers. The cost disparity also reflects the higher costs of the insourced model. The use of Police to deliver inmate movements diverts important police resources from the frontline, particularly in regional areas. The Commission has had comments about the strain on Police in regional areas caused by their transport duties displacing their police presence. There are potential benefits in outsourcing prisoner transport and escort services in NSW. This warrants further investigation.

Recommendation: The Commission recommends that the Department of Attorney General and Justice examine the potential to outsource prisoner transportation and escort services in NSW and provide options for government"s consideration.

6.4 Juvenile Justice

6.4.1 Overview

Juvenile Justice NSW, a division of the Department of Attorney General and Justice, is responsible for the supervision and case management of young people on a range of legal and administrative orders, and for the provision of a wide range of services intended to reduce and prevent crime. Juvenile Justice NSW also supervises and cares for young offenders in both the community and in detention centres, and provides youth justice conferences for young offenders referred by police or the courts.

There are nine juvenile justice centres, 36 juvenile justice community service centres, 3 regional offices and 18 youth justice conference centres throughout NSW. In 2010-11, current expenditure on juvenile justice services was $192 million, with a further $24 million for capital expenditure.

The majority of young people who come into contact with the system do not become clients of statutory juvenile justice agencies. Instead, they are diverted through a range of mechanisms including contact with police, who have the authority to issue warnings, formal cautions and infringements notices for minor offences, and the courts, which can issue non-supervised orders for minor offences.

Juvenile diversion is defined as juveniles who would otherwise be taken to court, but who are diverted by police. The term diverted also includes diversions of offenders away from the courts by way of community conference; diversionary conference; formal cautioning by police; family conferences; and other diversionary programs including drug assessment/treatment. Offenders who would not normally be sent to court for the offence detected and are treated by the police in a less formal manner (for example, issued warnings or infringement notices) are excluded.

The Productivity Commission reports that comparable and extensive national data to illustrate the nature or level of diversion undertaken by Australian jurisdictions is still under development. Table 6.12 below is indicative that NSW has steadily increased diversions over the last five years and performs well relative to other jurisdictions.

Table 6.12: Percentage of juvenile diversions as a proportion of juvenile offenders

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
2007	49	40	48	47	52	71	43	39
2008	48	41	49	47	49	67	49	42
2009	51	40	47	47	52	61	47	41
2010	57	39	47	47	52	58	42	42
2011	57	33	44	49	51	60	38	49

Nevertheless NSW still has a higher number of young offenders held in juvenile justice centres, with an average daily number in custody in 2010-11 of almost 400 young offenders. By comparison, the average daily number of young offenders held in custody in Victoria (86), Queensland (133) and Western Australia (156) is less than half the number in NSW.

In NSW, almost half of the young people in custody were on remand awaiting trial. Only 20% of this group go on to receive custodial sentences. Juvenile Justice is particularly concerned that a large number of juveniles are held on remand by police for offences that would that would not typically impose a custodial sentence. The vast majority (49%) of young offenders being held on remand are between the ages of 16 and 17 years and an almost equivalent proportion (48%) are under the age of 16 years of age. Young offenders in contact with Juvenile Justice NSW are typically male (81%).

The Commission is particularly concerned by the over representation of Indigenous young people in both remand/custody and community-based supervision orders. In NSW, there were 184 indigenous young people in detention in 2010-11 (daily average) compared to 207 non-indigenous young offenders. It is understood that Juvenile Justice NSW has now implemented an Aboriginal Strategic Plan 2011-2013 to ensure a coordinated approach to addressing the over-representation of Aboriginal young people in the juvenile justice system. The effectiveness of the plan should be closely monitored.

Existing actions to reduce the number of young offenders in custody

The experience of juvenile custody, even for short periods when on remand, can have a blighting impact on the lives and future prospects of a young offender. The experience is often followed up with recidivism and may spiral to future incarceration as an adult in prisons. It is universally accepted that juvenile custody should be avoided and taken only as the last resort.

Many juveniles who come before the courts have no stable accommodation and cannot return to their homes because of family breakdown or safety or neglect risks. A high proportion of young offenders who are charged therefore fail to meet accommodation conditions for bail and so are remanded in custody.

The Commission understands that there has been some effort to reduce the number of young people held on remand – mainly by helping courts to speed up bail hearings and assist young people to meet their bail conditions. It is somewhat encouraging that the average length of detention of young offenders held on remand decreased from a high of 13.2 days in 2008-09 to 9.5 days in 2010-11. There is however, significant room for improvement.

In addition, the Waratah Pre-Release Unit located at Reiby Juvenile Justice Centre was opened in December 2010 with the aim of preparing young offenders for their release from detention and improving their chances of successful reintegration into the community. This initiative targets a reduction in recidivism.

In recent years, there has also been a particularly strong push towards youth justice conferencing. This approach brings the young offender face to face with the victim, and the victim"s support group, to hear about the harm caused and to take responsibility for their actions. Together, the people at the conference agree on a suitable outcome, including an apology, reasonable reparation to the victim and steps to reintegrate the young offender back into the community.

When a young person is arrested, the police are responsible for determining whether a young offender is eligible for a caution or a youth justice conference. The Office of the Director of Public Prosecutions and the courts may also recommend a young offender go through youth justice conferencing, rather than court. Consideration is given to the young person"s willingness to participate in the conference, the seriousness of the offense, the degree of violence involved, the harm caused to any victim, the young offender"s previous offending history and the number of times the child has been cautioned or participated in a youth justice conference, as well as any other appropriate matters.

The benefits of Youth Justice Conferences extend beyond the diversion of young offenders away from the court system and potential custody. Research evidence suggests that that both victims and offenders find the conference process satisfying and rewarding. Moreover, there is considerable public support for restorative justice initiatives. This approach could also potentially be more successful in reducing the level of recidivism amongst young offenders – however this aspect requires further validation.

The Commission understands that Juvenile Justice is working to further improve Youth Justice Conferencing outcomes across the state, including increased conferencing capacity. Work is also underway to assess the relative cost of a conference and a Children"s Court appearance, so a cost effectiveness comparison can be made.

Table 6.13 outlines a number of programs that provide assistance to juvenile offenders. There is however limited information available about their relative success. It would be prudent for these programs to be evaluated and funding re-channelled or increased for the more successful programs.

Table 6.13: Overview of programs that might reduce the number of young people in custody

Program	Overview
Youth Drug Court	The Youth Drug and Alcohol Court of New South Wales is a harm minimisation program administered through the Children"s Court of New South Wales. It specialises in criminal offences in which a child over 14 but under 18 years of age has an addiction to illicit drugs or alcohol. Interventions are targeted towards entrenched, recidivist young offenders where offending is closely linked to significant drug and/or alcohol abuse
Community Funding Program	Facilitates referrals for young people to appropriate services and establishes case plan for young offenders
Bail Intervention	Provides support for young people with problems seeking bail or those remanded in custody
Youth Conduct Orders	Children and young people charged with, pleading guilty or found guilty of antisocial behaviour offenses
Bail Assistance Line – NSW	Police are to use the Bail Assistance Line after a young person has been apprehended
Child Wellbeing Unit	Provides a central contact point for staff in Juvenile Justice, Housing and Ageing, Disability and Home Care who are concerned about a child or young person at risk of harm

Juvenile offenders typically face multiple and complex problems relating to:

- drug and alcohol
- mental health issues
- social influences (such as growing up in areas of disadvantage) and peer pressure
- family issues – may be part of a disadvantaged family; subjected to poor parenting; or face child protection issues
- poor educational outcomes
- homelessness.

These social, health and family problems influence the actions and behaviours of juvenile offenders. The Commission believes that in dealing with juvenile crime, responses should avoid increased law and order options and police powers. Rather, appropriate responses to juvenile crime must focus on the underlying causes of juvenile offending, looking at:

- how these minors and their family lives are breaking down
- what is leading them into trouble
- how government agencies and the community can interact with them at a much earlier stage and try to fix the problems before they escalate.

Where juveniles continue to get into trouble, there should be a continued focus on the use of divisionary punishments where appropriate to avoid custody as far as possible.

The focus on prevention and early intervention should also be increased, primarily through dedicated whole-of-government programs. These should address the underlying causes of juvenile crime amongst individuals and in local communities. However as discussed in Chapter 6, government programs and supports for individuals and families with multiple and complex needs have not always been effective given the fragmentation in service delivery, a lack of coordination and continuity between supporting agencies, service systems that assume a „one-size fits all approach, and difficulties for clients in navigating the system.

Whilst it is easy to assume that the Department of Attorney General and Justice has the policy responsibility for juvenile justice, it is clear that this is an area where other parts of government and the community must be actively involved. Well before becoming known to Juvenile Justice and Police, many juvenile offenders will have had prior interaction with Health, Education, Family and Community Services and the NGO sector. These agencies and organisations have a major role with the early identification of client issues and subsequent targeted prevention and early intervention strategies. Tackling juvenile crime requires a concentrated whole-of-government commitment and response – one where the relevant agencies are united and are prepared to look past their service system boundaries.

Recommendation: The Commission recommends that the Government, through the Department of Premier and Cabinet, should examine measures to promote a concentrated and whole-of-government approach to dealing with juvenile crime.

6.4.2 Transportation of juvenile offenders

Transportation of young offenders is currently shared by NSW Police and Juvenile Justice. The current Memorandum of Understanding between Juvenile Justice and NSW Police states that police will undertake the first transport of young offenders in their custody to a Juvenile Justice Centre and then Juvenile Justice will undertake any subsequent movement to court or between centres.

In 2008, the two parties further agreed to an arrangement of cost recovery for services, supervision and transport of juveniles in instances where NSW Police undertake duties that would normally be undertaken by Juvenile Justice.

The recently completed audit of NSW Police has however recommended that the Juvenile Justice immediately take responsibility for all juvenile escorts..

This would have significant benefits for Police but there are flow on costs for Juvenile Justice. One solution to minimise the cost of transportation is to improve the use of audio visual technology. At present this is used in only about a third of hearings. Magistrates have control over whether this technology is used and it has so far had mixed uptake. Outsourcing the transportation of young offenders provides another option.

Recommendation: The Commission recommends that for the same reasons outlined for Corrective Services outsourcing should be considered and potentially bundled in the same tender process for the transport of juvenile offenders.

Part III: Business and Community

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7. Transport

Key points:

- Government policy is giving a high priority to transport, both passenger and freight.
- There is significant structural reform in progress with *Transport for NSW* having the central coordinator, planning and strategy role. *Transport for NSW* will establish performance contracts with operating entities, including RailCorp and Roads and Maritime Services and allocate funding within the cluster.
- Reforms include addressing the efficiency of the operators. There is considerable scope to increase efficiency across RailCorp and Roads and Maritime Services through greater outsourcing and changes to existing work practices.
- As efficiency at Railcorp improves, the share of fares in cost recovery should increase.
- Ferries are being franchised. This is expected to deliver better services.
- Transport is capital intensive and many changes, including efficiency gains will take some time as they depend on capital programs being delivered.
- The involvement of the Commonwealth in national transport strategies is welcome. The priority for NSW is in the Port Botany, Moorebank and M5 infrastructure areas.

7.1 Government policy

The NSW Government has transport of passengers amongst its most important policy priorities. The *NSW 2021* Plan emphasises the interests of the travelling public and calls for an integrated transport system. It is envisaged that Transport for NSW, the new transport authority, will deliver strategic infrastructure projects and better coordinate different modes of transport. On the passenger side a number of important goals are specified:

- a reduction in travel times
- growing the patronage on public transport by making it an attractive choice
- improving the customer experience with transport services
- improving road safety.

To reduce travel times, two targets have been set for the Minister. The first is to improve the efficiency of the road network during peak times in Sydney"s road corridors. The second target is to minimise public transport waiting times. This means on-time running and increased frequency.

Patronage is to increase by meeting reliability targets. Buses, ferries and trains have had run on-time targets for some time but this has been given added weight in policy. The goal of increasing patronage on public transport will be measured by looking at the share of commuter trips that public transport accounts for. These shares have been targeted for large increases of between 15-80% by 2016. The government clearly wants to see improved customer satisfaction. Real time travel information is to be provided. Increased walking and cycling is also being encouraged.

Each year in NSW there are about 400 fatalities and 24,000 injuries on our roads. Safer roads, upgrades to black spots, enforced speed limits, safer vehicles and driver responsibility are the focus to improve this outcome.

The efficient movement and handling of freight is one of the major contributors to national productivity. This is of particular importance in NSW where 75% of all interstate road freight uses NSW roads and half of Australia"s road freight. Port Botany and Port Kembla receive 38% of Australia"s imports and NSW account for 15% of Australian exports. It is not widely recognised that the Port of Newcastle is at present the largest coal exporter in the world.

The NSW Government released a long term Transport Master Plan in February 2012. This is a discussion paper for the community and, as well as noting progress to date, it sets out the challenges for Sydney and Regional NSW in freight transport and funding.

The government in its development of a Freight Strategy aims to:

- increase the productivity of existing transport assets
- develop new strategic freight infrastructure
- increase end-to-end supply chain efficiency in freight transport
- minimise the negative effects of freight transport on the community
- complement urban growth strategies.

The NSW Freight strategy is intended to align with national strategies for freight and ports as well as integrate with land use plans and State Infrastructure Strategies. The Commission"s Interim Report recommended that Infrastructure NSW address the coordination of these planning matters.

7.2 Structural reform

A number of significant reforms are being implemented within Transport. *Transport for NSW* has been established to be the integrated transport authority, and to head the Transport cluster within government. *Transport for NSW* is to drive customer focus and a coordinated approach to the planning and operation of the State‟s transport system.

Major reforms in transport have been attempted before and it is widely recognised that change is needed. This time it does appear that significant progress will be made. Responsibilities are being clearly allocated and the transport cluster is beginning to act as a strategic and coherent group for the first time in a decade.

The responsibilities of Transport for NSW cover:

- transport coordination
- policy and planning
- transport services
- infrastructure
- freight
- Marine pollution response.

The operation of services is the responsibility of other entities under performance contracts with Transport for NSW. It is difficult to overstate the importance of this restructure. Transport for NSW can take a broad view of the effective transport system needed to benefit the community and the economy. And operations are the clear responsibility of the operating entities.

The core business of Transport for NSW is:

- the allocation of funding for road, rail, buses, taxis, ferries, cycling, community transport services and freight
- moving people and freight efficiently with licenced public transport drivers and accredited operators
- developing regulators and policy to meet community requirements.

Railcorp, State Transit Authority, Roads and Maritime Services are among the operating agencies within Transport for NSW. Their focus is operations, that is service delivery to customers. The corporate and shared services functions they once performed are moving to the centre (Transport for NSW). Historically these operational areas have also focussed on strategy and planning and coordination beyond their particular transport mode was a challenge. Powerful „silos‟ developed and agreement about coordination and strategy was difficult. This shortcoming made an integrated transport system more of a dream that a reality.

Transport for NSW

The Transport Administration Amendment Act 2010 formalised the new structural reform. The structure of Transport for NSW is set out below.

Figure 7.1: the Structure of Transport for NSW

Divisions

- Customer Experience
- Freight and Regional Development
- Planning and Programs
- Transport Projects
- Policy and Regulation
- Transport Services

Performance contracts

- Railcorp
- Sydney Ferries
- State Transit Authority
- Roads and Maritime Service
- Transport Construction Authority
- Country Rail Infrastructure Authority
- Private Busses

As this structural reform progresses Transport for NSW has an opportunity to put in place the spans of control that best suit its functions. Spans of control differ depending on the business, but better practice suggests that a span of control of no more than 10 direct reports should be the aim. The current spans of control across entities within the Transport cluster, as with other entities in the NSW public sector, are not in line with better practice. The Commission is advised that progress is already underway within Roads and Maritime Services.

7.3 The business of Transport

Transport is a large business. In 2010-11 there were 300 million rail passenger journeys, 14 million ferry passengers, and 200 million Sydney metro bus trips. Transport for NSW was involved in 22.7 million licencing and registration related transactions. The summary income statement and balance sheet for the consolidated transport group are in Tables 7.1A and 7.1B.

Table 7.1A: Transport for NSW Income Statement, 2010-11

Revenue	$ million
Government contribution	8,603
Passenger service	1,009
Toll etag	139
Other	947
Total revenue	**10,698**
Expenses	**$ million**
Labour	2,538
Other operating	2,476
Total operating	4,914
Depreciation	1,887
Finance costs	177
Grants	497
Other expenses	823
Total expenses	**8,399**
Gains/(Loss)	(237)
Surplus/(Loss)	2,062

Table 7.1B: Transport for NSW Balance Sheet 30 June, 2011

Assets	$ million
Property, plant and equipment	91,405
Other	2,924
Total assets	**94,329**
Liabilities	**$ million**
Debt	2,389
Employee benefits	2,070
Payables	1,395
Other	1,327
Total liabilities	**7,181**
Net Assets	**87,147**

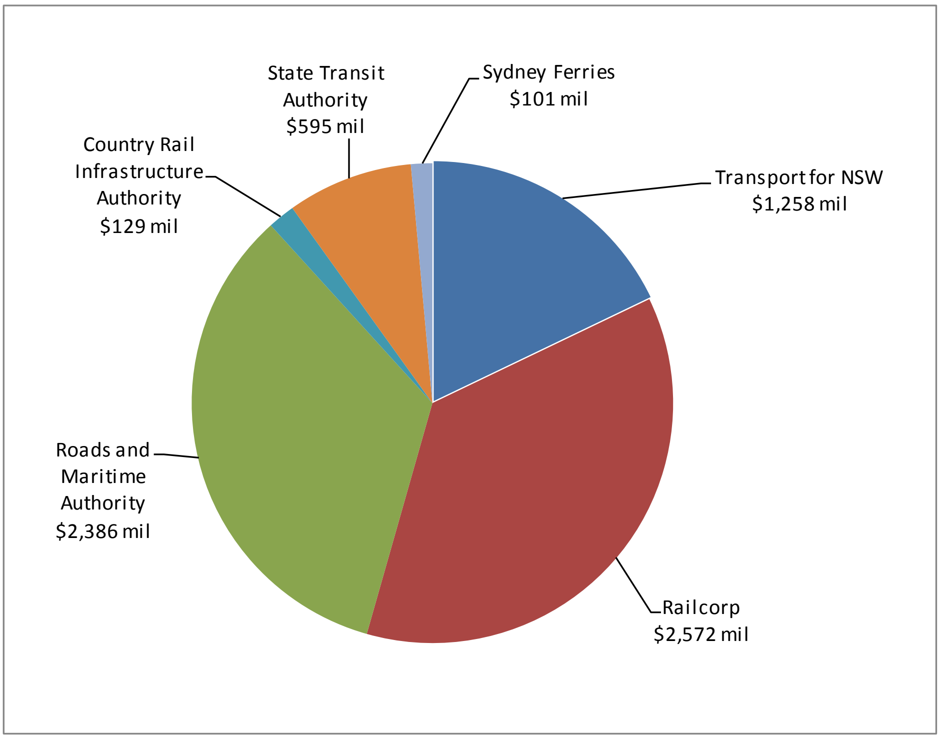
There are a number of interesting features in these summary accounts.

- The $91 billion in physical assets are largely roads ($59 billion), rail ($24 billion) and rolling stock ($2.7 billion). Transport is the most capital intensive service in the general government sector.
- The government contribution to revenue is significant at 80%. Conversely cost recovery from users is relatively low, at about 9% of revenue.
- Depreciation of about $1.9 billion compares to capital expenditure, including purchases of property, plant and equipment and intangibles, of $4.6 billion in 2010-11.

- Debt of $2.4 billion is associated with finance costs of $177 million.
- The employee liability is over $2 billion. About half of this liability is related to unfunded defined benefit superannuation liabilities. Many of the 28,000 staff are long time employees and members of defined benefits schemes which no longer accept new members.

Current expenditure in Transport is mainly devoted to Railcorp and the Roads and Maritime Authority. This is shown in Figure 7.2 which is based on 2011-12 budget figures.

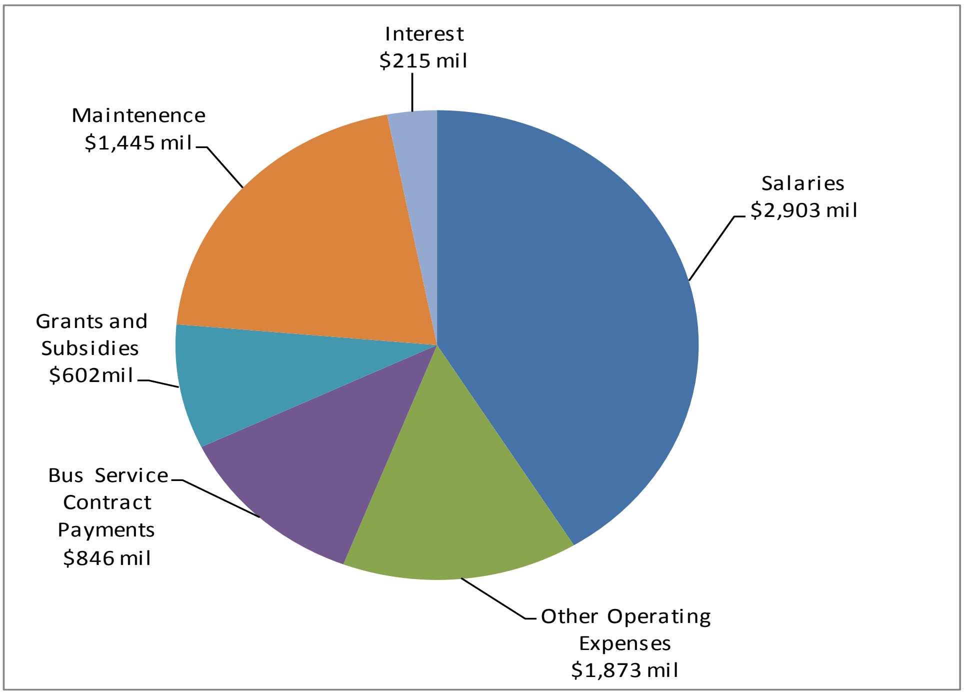
Figure 7.2: Transport: Current expenditure, 2011-12 [1]



Source: NSW Treasury
1. Excludes current grants to NSW agencies for capital purposes and also depreciation.

As Figure 7.3 illustrates, current expenditure is largely allocated to labour costs, maintenance, and bus contracts.

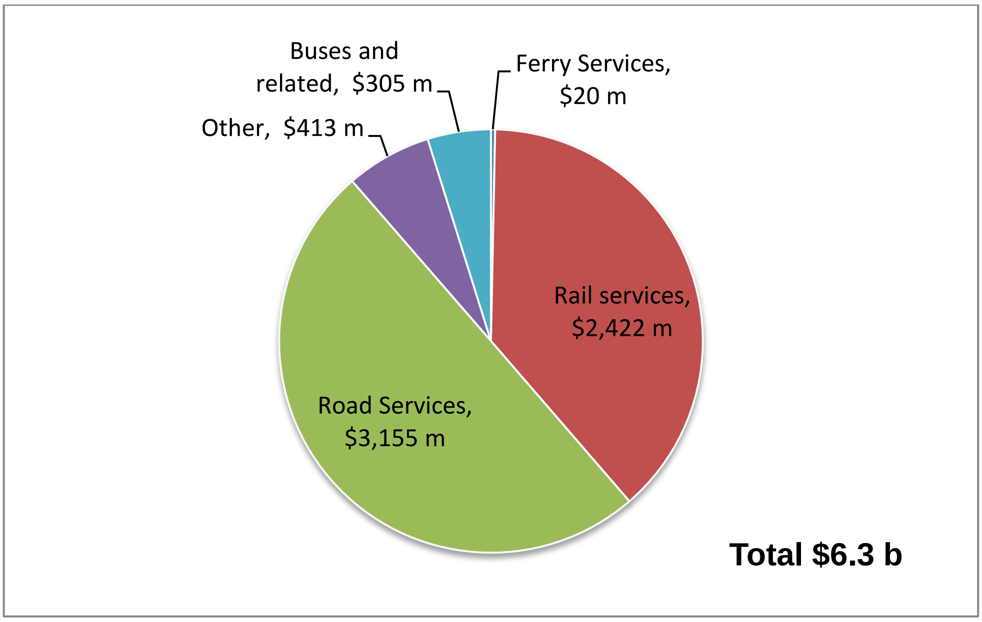
Figure 7.3: Transport: Current expenditure by type, 2011-12 [1]



Source: NSW Treasury
1. Excludes current grants to NSW agencies for capital purposes and depreciation

Being a capital intensive business it is the allocation of capital expenditure that is perhaps the most important concern. Transport for NSW is now in a position to strategically assess these important and long term decisions. It can recommend the allocation of capital across different transport modes and ensure that maintenance and renewal investment is receiving an adequate allocation. The capital expenditure allocation in the 2011-12 budget is set out in Figure 7.4.

Figure 7.4: Transport: Capital expenditure, 2011-12 $b



This division of expenditure is not surprising given that roads account for $59 billion of the total $91 billion in Transport physical assets. Rail and rolling stock physical assets together are about $27 billion.

Over the last decade, and particularly since 2005-06, there have been frequent changes in planning and direction, largely driven by political changes. In an ideal world long term capital programs mesh with long term plans and these do not change from one year to the next. The Commission observes that Victoria appears to have had the best approach to planning, and longer term capital programs. This has allowed them to avoid the significant costs of stopping and starting major capital programs. The cancellation of the Sydney Metro resulted in unrecoverable costs of $350 million prior to the last election.

Recommendation: The Commission recommends that strong support be given to Transport for NSW and Infrastructure NSW to enable long lasting transport plans to be developed and implemented in stages over future decades. Treasury, the Department of Premier and Cabinet and the Department of Planning all have important support roles in this work.

Transport is pursuing a systemic program to improve efficiency. It is aiming to realise savings in current expenditure well in excess of $1 billion. This is a significant task and is being done at the same time as the capacity and quality of the transport system is being upgraded.

The Commission understands that part of the suite of efficiency reforms includes a Corporate and Shared Services Reform Program which focuses on centralisation, standardisation and removal of duplication in IT, administrative and back office functions across the Transport cluster. This is the type of reform that requires expenditure up front to save significant amounts later. The Commission strongly supports this reform as discussed in the Interim Report. This report recommends elsewhere that Treasury ensures that sufficient funds are allocated for IT systems to assist with this type of transformation.

Operational reforms will be the most visible to the customer. The Commission notes that progress is occurring. Service standards have become less of an issue as reliability steadily improves. On time running is comparable or better than services in other Australian jurisdictions.

Table 7.2: Comparison of on time running across major cities

On time running	**Sydney**	**Melbourne**	**Brisbane**	**Perth**
Trains services	~96%	~88%	~94%	~95%
Buses services	~96%	~94%	~96%	~85%
Ferry services	~98%	N/A	N/A	N/A

Source: NSW Treasury

As services improve, and as current cost expenditures reduce, user charges (fares) as a percentage of expenses should increase. At present the combined cost recovery for RailCorp, State Transit Authority and Sydney Ferries through fares is only 26.8%. Cost recovery for other Australian cities appears to range between 25% to 45%.

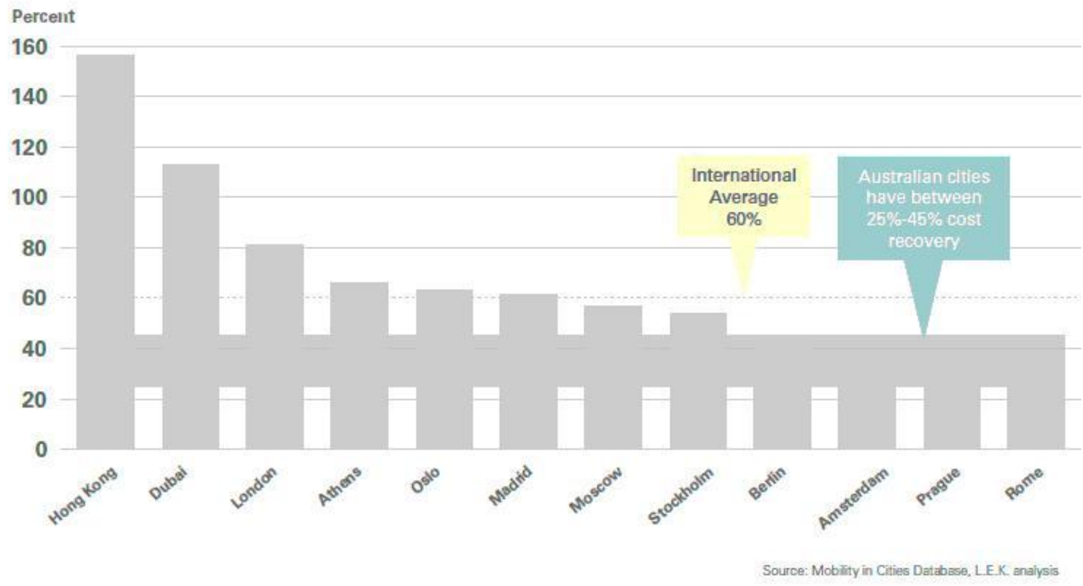
Table 7.3: Fares as a percentage of cost recovery

Agency	**Farebox $ mil**	**Expenses $mil**	**Cost recovery %**
RailCorp	746,673	3,460,815	22.1
State Transit Authority	288,000	624,952	33.5
Sydney Ferries	40,556	120,980	46.1
Total	**1,075,229**	**4,206,747**	**26.8**

Source: NSW Treasury

International cost-recovery is about 60%. Hong Kong is an interesting case of a densely populated urban city, a profitable rail operation, a modern rail system and property value uplift mechanism for the rail operator as the system grows. Cityrail can learn from this city (and others) but its historical legacy including past inadequate capital expenditure means it is not likely to reach these full cost recovery levels in the foreseeable future.

Figure 7.3: International comparisons of fares as percentage of cost recovery



What proportion of costs should be recovered from users, and what proportion from the government budget is the question. IPART have recommended that users of Railcorp should pay about 30% of costs but this ratio could be achieved by both reducing costs and increasing fares. Given practice elsewhere in Australia a cost recovery from Railcorp users of around 30% is not unreasonable.

Recommendation: The Commission recommends that the proportion of expenses met from the Railcorp fare box increase to over 30%. This would be achieved by a mix of cost savings and modest fare increases until the ratio of 30% is reached. Fares should then increase by CPI each year.

7.4 Railcorp

Railcorp employs about 15,000 people in two core businesses, Cityrail and CountryLink. The Railcorp CEO reports to the Director General of Transport for NSW Railcorp has three main functions:

- passenger rail services
- rail infrastructure management
- provision of access to the rail network for about 19 third party operators including freight operators.

The financials for Railcorp are set out below.

Table 7.4A: Railcorp
Income Statement, 2010-11

Revenue	$ million
Government contribution	2,509
Passenger services	703
Non passenger	310
Other	1
Total revenue	**3,523**
Expenses	**$ million**
Labour	1,426
Other operating	1,244
Total operating	2,668
Depreciation	815
Finance costs	17
Total expenses	**3,501**
Surplus/(Loss)	**22**

Table 7.4B: Railcorp
Balance Sheet, 30 June, 2011

Assets	$ million
Property, plant and equipment	24,465
Other	549
Total assets	**25,014**
Liabilities	**$ million**
Borrowing	715
Provisions	975
Other	542
Total liabilities	**2,232**
Net assets	**22,782**

There are a number of interesting features in these summary financials:

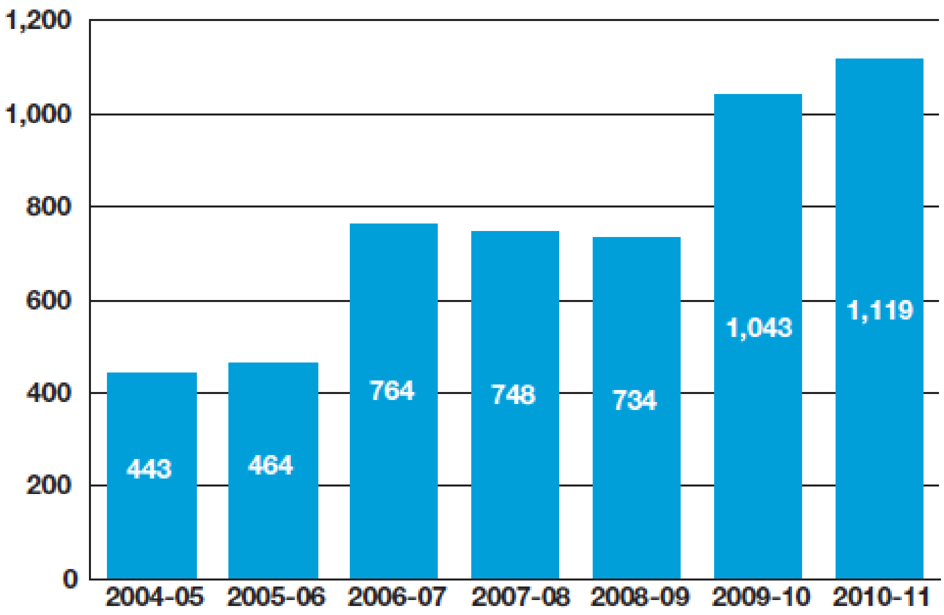
- the capital intensive nature of RailCorp is clear with physical assets valued at over $24 billion
- the government contribution of $2.5 billion is 71% of RailCorp revenue. Conversely service charges are about 27% of revenue. This government contribution includes $873 million for capital expenditure
- labour is 53% of operating expenses

- borrowing and finance leases of $715 million are associated with $17 million in finance costs
- provisions of $975 million are partly related to unfunded defined benefits superannuation schemes of $290 million. RailCorp has 7,530 members in these old schemes, almost half of its workforce.

Capital expenditure at RailCorp has increased to over $1 billion in recent years. See Figure 7.5.

Figure 7.5: Historic RailCorp Capital Expenditure

$ million



Major capital programs underway at present include:

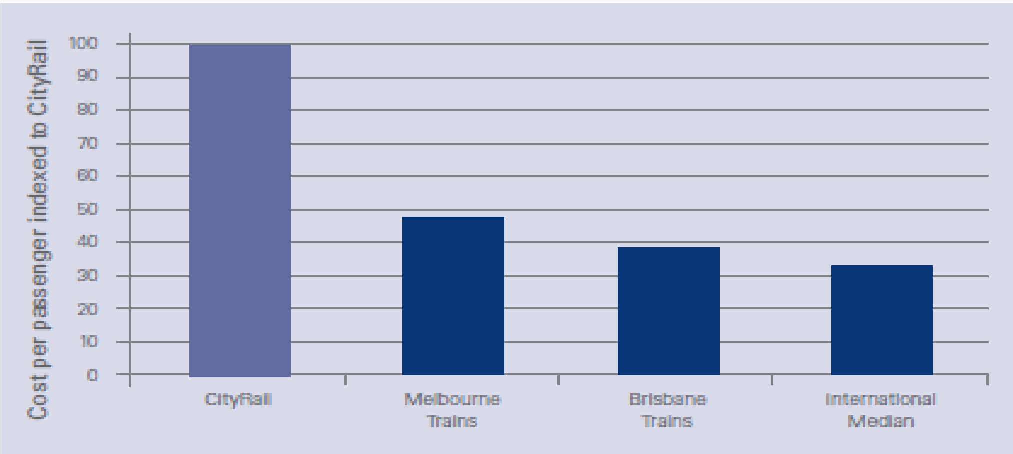
- Clearways – to remove bottlenecks and junctions in the suburban network in order to reduce congestion and delays.
- Oscar rolling stock – this includes 221 new double deck carriages for Cityrail.122 carriages have been delivered, 74 will be delivered by mid-2012, and a further 25 in March 2013.
- Waratah rolling stock – the first eight car set went into service in July 2011. Over the next two years 626 new carriages will replace the existing fleet. Related staff training and capital expenditure is occurring.
- Novorail Alliance is working on 17 projects including junction and signalling upgrade, traction supply upgrades, stabling yards etc.

- South West Rail – construction of over 11km of new twin track from Glenfield to Leppington in the South West growth sector. This involved stations, carparks, stabling and bus interchanges.
- South Sydney Freight Line – a 36km bi-directional track from Macarthur to Sefton for freight traffic is being built by the Australian Rail Track Corporation (ARTC). This will improve rail freight efficiency on the major north south corridor of Brisbane-Sydney-Melbourne.

Improving inefficiency at RailCorp is the goal but what is less well understood is the difficulties and costs involved in improving its operations. Previous independent benchmarking (LEK, 2008) found that RailCorp"s operating costs were some $600 million a year higher than comparators. The problem is that efficient rail systems, such as in Hong Kong, run with a single type of rail car on a purpose build system. RailCorp has seven types of rail cars and these run on a system built up over many years, without the investments and upgrades needed for a modern efficient railway. Capital programs underway will assist in getting the efficiencies required.

It is nevertheless striking that the cost of Sydney CityRail services, on a per passenger basis, appear to be more than double that of Melbourne and Brisbane train services. This gives some feel to what the size of the current inefficiencies may be. But achieving these efficiencies will be difficult and in some cases will depend on initial expenditure.

Figure 7.6: Comparison of CityRail costs on a per passenger basis[1]



Source: Infrastructure Partnerships Australia
1. Based on 2009-10 cost data

RailCorp"s operating expenses have grown markedly, averaging 9% growth a year over the last few years. Within that expenditure growth, total employee expenses (about 60% of RailCorp"s current cost base) have risen by about 8.6% year-on-year. The total workforce in 2010-11 was 15,271 employees, compared with 13,266 in 2005-06. Why there has been an increase of more than 15% over this period is not clear to the Commission. It is understood that RailCorp"s 2011-12 budget includes a further increase of approximately 360 employees.

Transport for NSW are developing and implementing a reform plan which will transition RailCorp to close to benchmark costs per passenger over the next four years. A number of specific reform opportunities are being examined and the Commission notes several.

RailCorp has a strong focus on system engineering and safety. The Commission agrees that the integrity and safety of the rail network should be a priority. However, there are concerns that the engineering and safety focus translates into unnecessary or overly complex requirements/standards. This can result in an organisation which is not only larger than it needs to be, but also one that is not responsive and possibly less safe. The cumbersome structures cause confused accountabilities.

RailCorp"s safety and engineering operations should be reviewed and benchmarked against other railways and where possible, other safety/engineering critical industries such as the airline industry. This should include an investigation of:

- areas of unnecessary complexity and cost, what drives these, and how they might be addressed more appropriately without detriment to safety
- whether RailCorp"s engineering and safety capability is at the appropriate size and scale
- measures that can increase the clarity and accountability for safety and engineering standards across the organisation.

Recommendation: The Commission recommends that RailCorp"s safety and engineering operations be reviewed and benchmarked to identify areas of unnecessary complexity and cost which are of limited or no safety benefit. Measures that lead to better transparency and accountability for safety and operating standards should be identified and implemented while maintaining or improving safety outcomes.

Around half of RailCorp"s maintenance requirements are met through outsourced arrangements:

- 45% of infrastructure maintenance is outsourced (for example, through the Novo Alliance)
- major periodic rolling stock maintenance is fully outsourced – this is around 75% of rolling stock maintenance expenditure.

Half of RailCorp‟s maintenance requirements continue to be done in-house. Routine maintenance of rolling stock (around $90 million per annum) is mostly in-house. Together about 2,100 full time staff are employed on these activities. However, routine maintenance of the newer rolling stock, such as the Waratah train sets, are outsourced for warranty purposes. As newer train sets are introduced, this will reduce demand for in-house maintenance.

Cleaning trains and stations costs around $70 million a year. Only 10% of RailCorp‟s cleaning activities are outsourced. The remainder is provided internally through a workforce of some 890 full time equivalent staff.

Recommendation: The Commission recommends that RailCorp investigate whether additional outsourcing of maintenance and cleaning activities is more efficient than current in house arrangements. If so, more outsourcing should be implemented.

It is understood that RailCorp employs around 1,150 train guards at an estimated cost of $90 million a year. This is in addition to the 1,600 train drivers which also comprises RailCorp‟s train crewing. Benchmarking has highlighted the significant cost attached to existing NSW practices around station staffing and train crewing.

Guards are used on trains to, amongst other things, facilitate the movement of passengers in and out of trains. Most railways have dispensed with the need for train guards. In Victoria for instance, the Melbourne rail operator Connex has moved to one-person operated (or driver only) trains without detriment to safety. Connex‟s train crewing costs are almost half that of CityRail.

The practice of one-person operated trains should be investigated for implementation in NSW. Implementation would require a significant upfront investment as rail cars may need to be changed and technology must be installed to ensure that safety standards are maintained. Nevertheless the benefits are likely to outweigh the costs.

Recommendation: The Commission recommends that, as part of its reforms, RailCorp consider the feasibility of implementing one-person (driver only) operated trains and if feasible identify how long the move to such a system would take. The modifications and expenditure required to do so should be identified.

Benchmarking has also highlighted that CityRail‟s railway station costs are significantly higher than efficient best practice. This has been partly attributed to the cost of staffing certain stations across the network which have limited passenger movements.

RailCorp owns 303 railway stations across the network. 138 of these stations have less than 1,500 passenger movements per day. Of these low use stations there are about 80 that are now unattended stations.

There may be some potential to extend the number of unattended railway stations. Best practice for unattended stations is less than 2,000 passenger movements per day. In Victoria, it is understood that Connex applies this threshold and has double the number of unattended stations compared to CityRail. Connex only has slightly lower passenger densities across its stations compared to Cityrail.

Technology, such as CCTV, electronic indicator boards and customer help points, make it possible to extend the number of unattended stations without detriment to customer service or safety.

Recommendation: The Commission recommends that the Government consider the feasibility of expanding the number of unattended stations across the NSW railway network, having regard to best practice.

7.5 Roads and Maritime Services

Road and Maritime Services (RMS) is an amalgamation of the former Roads and Traffic Authority (RTA) and the Maritime Authority of NSW. In 2011-12, RMS‟s current expenditure will be around $2.4 billion with a further $3.1 billion allocated for capital and infrastructure. RMS has over 7,850 staff.

Summary financials of the former RTA in 2010-11 are set out below.

Table 7.5A: RTA
Income Statement 2010-11

Revenue	$ million
Government contribution	4,240
Sales	430
Other	328
Total revenue	**4,998**
Expenses	**$ million**
Labour	587
Other operating	452
Total operating	1,039
Depreciation	849
Finance costs	89
Grants	373
Other	621
Total expenses	**2,972**
Gains/(Loss)	(104)
Surplus/(Loss)	**1,922**

Table 7.5B: RTA
Balance Sheet 30 June, 2011

Assets	$ million
Property, plant and equipment	63,398
Other	620
Total assets	**64,018**
Liabilities	**$ million**
Borrowing	1,203
Provisions	912
Other	1,223
Total liabilities	**3,338**
Net assets	**60,680**

The main features of this summary are:

- the high proportion of revenue is NSW and Commonwealth government contributions, 85%
- labour is 56% of operating costs
- the capital base of $63 billion includes private sector provided infrastructure of $665 million, being various Sydney motorways
- depreciation of $849 million is related to an asset base of $63 billion. In 2010-11 capital purchases were $2.5 billion

- provisions of $912 million include $618 million related to unfunded defined benefits superannuation.

As noted earlier RMS is in the process of reducing unnecessary organisational layers and strengthened the line of sight for managers around outcomes. This reform is expected to be complete by 2012. RMS has also reduced its dependency on contractors, with contractor numbers this year falling from 698 to 448 (a 36% reduction). These actions will reduce RMS" operating costs.

Benchmarking with other jurisdictions is difficult because the data is not necessarily comparable. Different road authorities include different functions and each jurisdiction has different road systems, climate and freight challenges. What data there is suggests that the former RTA, in comparison to its counterparts in Victoria, Queensland and Western Australia:

- had around 30% more full time staff relative to the size of the road network and relative to the number of registered vehicles
- spent more on road maintenance than other jurisdictions, though road quality is not superior
- had around 30% more registries relative to population size and relative to land area.

Local factors could be contributing to these differences. Nevertheless, the disparity between the former RTA and the other jurisdictions suggests that it may be useful for the roads operation of RMS to benchmark itself against other jurisdictions and understand the differences.

Following the recent widespread floods it is timely to note that the RMS budget carries a significant risk associated with natural disasters. This risk relates to both state and non-state roads. The expenditure required to cover the repairs of roads following disasters is highly variable. Around $72 million was expended in 2009-10, around to $152 million in 2010-11 and now in in 2011-12, the severe flooding across much of the state is likely to increase this cost to well over $200 million. The Commission found that reimbursement arrangements in place between Treasury and RMS are complicated and do not appear to be entirely reasonable. It would seem to be more sensible for a contingency against state disasters to be held by Treasury (in the Treasurer"s Advance) than for the road contingency to be partly covered by RMS.

Recommendation: The Commission recommends that Treasury and RMS simplify the funding arrangements that apply following natural disasters and put in place a system that does not leave RMS carrying an unreasonable burden on its budget. Non state road costs should also be examined.

Road maintenance was of particular interest to the Commission. RMS spends over $900 million per annum on the maintenance of road pavements, bridges and roadsides. Road maintenance budgets are facing pressure caused by an increasing freight task (higher axle loads) and accelerated wear and damage particularly under (currently) wet road conditions. A further $300 million a year was estimated to be required to sustain the road network. This does not include flood impacts which are likely to exceed $200 million.

Road quality in NSW, at 91% (based on Austroad"s „Smooth travel Exposure") is on par with Victoria (91%) but below Queensland (94%) and WA (99%). The maintenance spend per lane kilometre in NSW appears to be higher than in other jurisdictions. See Table 7.6.

Table 7.6: Maintenance spend per lane km measured against road quality.

	WA	VIC	QLD	NSW
Roads managed (lane km)	52,659	50,510	71,353	80,348
Estimated maintenance spend ($,000/lane km)	5	4.5	6	7
Road quality measure (%)[1]	99	91	94	91

Source: Third Horizon Consulting Partners, 2010

1. 2009-10 data based on Austroads" Smooth Travel Exposure http://algin.net/austroads/site/Index.asp?id=33)

A major reason for the difference is the freight task. For NSW roads this task is higher than other jurisdictions. About 75% of all interstate road freight passes over NSW roads and half of all Australian road freight. Other factors are likely to include the age of assets, climate and terrain. NSW has a higher number of road bridges including, older timber bridges, and these increase maintenance costs. A close investigation of road maintenance practices and costs is also needed to fully understand the differences between NSW and other jurisdictions.

One further difference in maintenance is the degree of outsourced provision. In Western Australia, the private sector is involved in road maintenance for the entire network. In Victoria, road maintenance has been contestable since 2000. The Victorian State Government has retained an off-budget road maintenance arm (VicRoads Road Services) which competes for work with the private sector on the open market.

In NSW, RMS uses a mix of delivery mechanisms for road maintenance, including:

- a single outsourced Performance Specified Maintenance Contract in northern Sydney (19% of the maintenance work)
- other smaller maintenance contracts with the private sector (1% of the maintenance work)
- Road Maintenance Council Contracts with 78 Councils to maintain around half of the State"s rural roads (17% of the maintenance work)
- an internal Road and Maritimes Services day labour workforce (Road and Fleet Services) operating across the remainder of both metropolitan and rural areas (63% of the maintenance work).

Within the council maintenance contracts and the network maintained by the internal entity Road and Fleet Services, there is a proportion of activities which is subcontracted to private firms. Road and Fleet Services maintains the vast majority of the state"s road network, including the metropolitan areas (with the exception of northern Sydney) through an alliancing arrangement with RMS. Road and Fleet Services employs a workforce of around 2,000 staff across regional offices and depots in NSW. By virtue of this scale and spread, Road and Fleet Services has considerable operational experience and capacity in planning, costing and scheduling road maintenance works.

The big question is whether Road and Fleet Services are more efficient than the alternatives of outsourcing and contracting out. At present RMS lacks comprehensive cost and other benchmarking data around its road maintenance activities and is working to address this deficiency. This benchmarking data is not yet comprehensive and this limits a full assessment of Road and Fleet Services" efficiency. It is noted that Road and Fleet Services has successfully competed for maintenance work with non- RMS clients. This is perhaps a measure of Road and Fleet Services" cost efficiency relative to other providers. However, how Road and Fleet Services could be more efficient than private sector contractors, given it has potentially more costly work practices and overheads needs to be clarified.

In any event, the Government has previously signalled its intent to examine the potential for road maintenance contestability. This prompted two independent reviews. The first review identified scope to progressively rollout up to four network maintenance contracts within the greater metropolitan area: in south Sydney, western Sydney, the Illawarra and the Hunter.

The second review attempted to benchmark the cost structures of the outsourced maintenance contract in northern Sydney against the RFS delivery model. This was intended to be the start of a wider examination of the potential efficiencies through outsourcing. The Commission notes that this exercise was inconclusive given limitations with the data. In particular, the current northern Sydney contract tends towards lump sum payments and offers limited visibility on unit costs.

The Commission believes the time has come to act and that a true validation of the benefits of road maintenance outsourcing must ultimately occur through an initial outsourced contract – starting in the metropolitan south Sydney. RMS advise that this area is the best suited for an initial contract given its higher network density which could correspond to higher efficiency yields.

This initial outsource contract should then be used inform the progressive rollout of road maintenance contestability across other areas of the state, if the benefits of doing so exceed costs.

Recommendation: The Commission recommends that the Roads and Maritime Services Authority bring forward a proposal to conduct a competitive tender for the road maintenance of the Southern Sydney road network.

It is recognised that considerable scoping and planning will be required to release road maintenance in southern Sydney to a contestable market. There are three crucial matters that need to be addressed as part of that process:

- **Determining the appropriate contract form and term** – a timetable should be set for this to be achieved (say within 6 months) to enable the timely competitive tender for the road maintenance of the Southern Sydney road network.
- **Benchmarking of current costs** – further work should be done to increase transparency of the costs of the current maintenance models and establish a framework to enable a comparison of costs under an outsourced model.
- **Determining an appropriate structure and scale for Roads and Fleet Services (RFS)** – options should be presented to government on the appropriate structure and scale for the Road and Fleet Services.

There is considerable scope to improve efficiency of road maintenance outside the greater metropolitan area. As noted earlier 78 Councils currently maintain around half of the State"s rural roads and regional highways through Road Maintenance Council Contracts (RMCCs). The RMCCs are “single invitation” arrangements put in place with councils in 2000.

A review in 2008 highlighted a number of concerns with the operation of the RMCCs, namely:

- administrative inefficiencies for RMS in managing a large number (78) of relatively small contracts. The contracts also place significant administrative burden on Councils
- potential economies of scales and aggregation benefits are not being leveraged by RMS or the Councils
- high variability in the overheard rates being applied by Councils
- there are capacity/capability constraints with some Councils which impacts on the standard of maintenance delivered (RMS has subsequently being assisting some of these councils)
- a number of councils are managing less than 100km which is inefficient.

The Commission understands that RMS will seek to address these through the next round of state road maintenance contracts, scheduled to commence in July 2012. However, concerns relating to the last two points (capacity/capability and scale) may continue to be problematic.

An independent review has recommended that operation of Council road maintenance contracts could be significantly enhanced by:

- transitioning the current Council road maintenance contracts to relational or alliance contract forms
- for road maintenance purposes, „bundlinga" number of adjacent Councils under singular road maintenance contracts to enable pooling of capacity/capability and increased scale (where some councils maintain relatively small lengths of road).

As well as broadening capacity, capability and scale across Councils, the Commission sees this potential approach as beneficial for both Councils and RMS in other ways, notably:

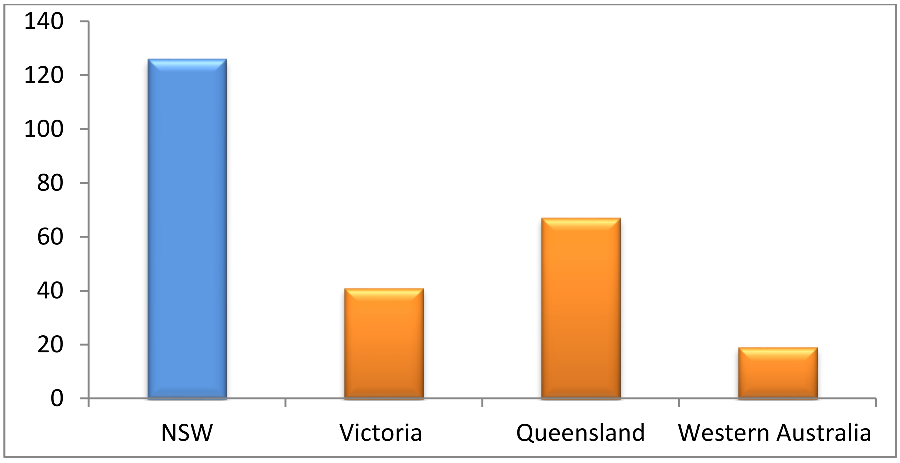
- a reduction in the administrative burden across RMS and Councils
- greater funding certainty for Councils
- enhanced general road network understanding
- it lays the foundation for a more structured and aggregated approach to subcontracting undertaken at the Council level.

Recommendation: The Commission recommends that the Roads and Maritime Services Authority, working with Councils, investigate and report back to Government on the potential opportunities to enhance the operation Road Maintenance Council Contracts (RMCC), including:

- transitioning the current RMCCs to relational or alliance contract forms
- for road maintenance purposes, „bundling" a number of adjacent Councils under single road maintenance contracts to enable pooling of capacity/capability and increase scale across Councils.

The Commission was also very interested in Motor registries. In NSW, there are 126 motor registries compared with 19 driver and vehicle centres in Western Australia, 41 VicRoads customer service centres, and 67 transport customer service centres in Queensland. Even after factoring demographic and geographic differences, NSW overall has a higher number of registries relative to land mass and population served than other jurisdictions. See Figure 7.7. Separate to the motor registries, there are a further 31 maritime offices across the State.

Figure 7.7: Number of Motor Registries or Driver/Vehicle Customer Service Centres per jurisdiction.



The comparison across jurisdictions can be complicated through differing licensing, registration requirements and inclusion of other functions which drive transaction volumes and influence the need for registries. For example, the maximum licence tenure in NSW is five years. Other jurisdictions offer 10 year licences which essentially halve the number of related face to face transactions at their registry equivalents. Under the auspices of the Government Access Program, 21 rural motor registries also provide agent services for other State Government agencies. Additional services such as firearms, boat, and security licensing functions are also in a number of NSW registries.

Notwithstanding some of these variables, a relatively large number of dedicated registries and maritime offices has higher operating costs and presents an outmoded approach to servicing customers. Other jurisdictions sustain a lower count by offering customers a mix of online and call centre services and use of agents – such as Australia Post, and shire offices and police stations – which are able to complete various licensing and registration transactions. Similarly, other jurisdictions use their motor registry equivalents to offer agent services on behalf of other departments in lightly-populated rural areas. For example, under the Queensland Government Agent Program nine transport customer service centres in rural areas offer transactional services for other government agencies. This ensures broader accessibility for customers.

RMS offers customers the option to complete registration renewals and transfers, notice of disposal, and address changes online. As noted, there are also some agent arrangements with other government entities in regional areas. Take up of online transactions by RMS customers has steadily increased and may continue to grow if other transactions are potentially made available online. The Commission is informed that RMS has a strategy in place to move towards online transactions where possible. This is changing demand within motor registries and should prompt a closer examination of the operation and footprint of the State‟s motor registry network. Over the next four years RMS will focus on changes to its computer systems and business processes to increase the rate of online transactions amongst other things.

The Commission understands that work is underway to re-establish selected motor registries and Fair Trading centres as 17 whole-of-government „one-stop-shops‟ in an initial phase. Whilst the strategy has merit, it should also include customer channel strategies that can reduce the need for “face to face” transactions and government shopfronts. This could include greater use of the internet and digital technology. The channel strategies should be coupled with measures that can also support a reduced footprint or more efficient structures and operations across motor registries and maritime offices. Measures may include:

- greater use of agent-based arrangements, similar to other jurisdictions
- more transactions types moved to online channels
- integration of functions across registries and Maritime‟s offices
- longer licence tenure to remove the need or reduce the frequency of visits to registries and offices. Removing the driver testing function from certain registries and creating dedicated driver testing centres or hubs.

These measures would serve to increase convenience and choice for customers.

Recommendation: The Commission recommends that to assist in managing reforms of motor registries appropriate benchmarking of the cost per face-to-face RMS registry transaction be compared to online transactions. Such a benchmarking exercise could include data from Australia Post and other major transaction based operations.

The Commission also notes that with the technology now available and used by many Police, a paper-based approach to vehicle registration is unnecessary. A computer check of number plates can confirm whether or not a vehicle is registered. This raises the question of the costs of paper-based vehicle registration. The Commission understands that Western Australia is using a less paper-based approach and that NSW Police are currently considering its suitability for NSW.

Recommendation: The Commission recommends that the proposed “one-stop-shop” strategy for services should accommodate a range of channels that reduce the need for “face-to-face” transactions when customers interact with government. The number of motor registry and maritime offices should reduce, though service, convenience and choice for customers should improve. As part of these improvements RMS should examine the registration system used in Western Australia.

7.6 Buses

In 2010-11 the NSW Government spent about $1.2 billion on bus services. Total patronage on Metropolitan Bus Service Contracts was nearly 199 million people; 45 million of that total was carried by private contractors. In the outer metropolitan area, patronage was 15 million and over 10 million of that was carried by private contractors.

In 2010-11 there were 253 new buses and 114 articulated buses added to the fleet to meet growth. In addition, 198 new buses replaced older vehicles. CCTV and duress alarms were upgraded on existing buses.

Bus services in metropolitan Sydney are delivered through 15 contract regions. The current contracts were introduced in 2005 for a seven year term (with a one year extension now applied) at a cost of around $900 million a year. Four contract regions are operated by State Transit Authority and the remainder by 14 private bus operators. Several regions are operated by a group of operators under a management company arrangement.

The Auditor General in 2010 noted that four years after the signing of the contracts, no performance management regime was in place, with the result that:

- poor performance and poor service are not being addressed through the contract provisions
- bus services may be more costly than they need to be.

The Auditor General noted that there were variations in service levels between public and private operators; services were not always reliable; and the contracts were negotiated directly with existing operators rather than tendered. It was suggested that a competitive tender may have allowed decreased cost to be passed on to customers.

An independent review prepared for Treasury in 2010 recommended that the renewal of the bus contracts in 2012 be restructured. The report found that:

- the cost of the bus contracts (per service kilometre) in NSW ($6.25) was higher than in Perth ($5.89), Brisbane ($4.61) and Melbourne ($4.55)
- existing contracts award operators for outcomes over which they have little control (for example, patronage) and are not well aligned to the objective of improving operating efficiency
- opportunities exist to rationalise spare buses and redeploy the excess to improve utilisation
- average dead running times (where buses run empty to the commencement or from completion of a route) times in Sydney were higher than for other cities where data was available.

The Commission understands that *Transport for NSW* is developing performance based contracts to underpin the next generation of Metropolitan Bus Service contracts to commence later this year. This is welcomed.

Recommendation: The Commission recommends that Transport for NSW‟s new performance-based Metropolitan Bus Contacts demonstrate cost efficiencies over the existing contracts where possible, target a reduction in dead running, ensure sufficient flexibility to accommodate long term development of bus services and establish appropriate Key Performance Indicators along with a reward/sanctions framework that is monitored.

7.7 Franchising services

In May-2011 a significant reform of Sydney Ferries commenced. Franchising existing services, and expanding and improving them was envisaged. The government will retain control of the fare structure and routes. A franchise process has commenced and at the time of writing three short listed parties were preparing offers. The private operator will be in place by the end of 2012.

The performance of Sydney Ferries has shown some improvement in 2010-11. On time running was 98.5%, service reliability was 99.9% and vessel reliability 96.5%. In 2010-11 patronage was 14,502 million, the highest level recorded.

While the community enjoys ferries as a transport mode the Commission notes that the recently franchised Manly service has been especially popular. Commuters have commented on the improved service (coffee, daily papers etc.) and the phone text notifications of any running time changes. This is a promising precedent for the more fully franchised operation.

In time there is also considerable scope to apply the franchise model to RailCorp if this makes commercial sense and improves services. Franchised rail models have been successfully implemented elsewhere, including Victoria. The Commission believes that there should be a concerted effort to increase"s RailCorp"s efficiency, followed by due consideration of possible franchising options. The Government"s experience with franchising Sydney Ferries would also serve to inform decisions around RailCorp options.

A recent study reviewed rail franchising in the UK, Sweden and Victoria. It noted that under a franchise model government has an enforceable contract with clear expectations and outcomes, and financial sanctions for poor or part performance.

Recommendation: The Commission recommends that Transport for NSW investigates the possibility of franchising passenger rail services in NSW to ascertain whether such a move would improve commercial outcomes and service. If the franchise options appear to offer benefits a staged process of trial and possible implementation should be established.

7.8 Infrastructure and freight

From a funding perspective, the 2012-13 Budget commits $27.7 billion to 2014-15 on transport infrastructure – around 40% of the state‟s total infrastructure spend over this period. This investment fits within the broader transport capital plan under development by Transport for NSW which will have a forecast investment of around $52 billion over 10 years.

Port activity is increasing significantly. A major expansion at Port Botany has recently been completed. This port handles over one-third of Australia‟s container cargo and is likely to hit a planning approval capacity limit in 2017-18. By 2030 throughput is likely to be 7.5 million Tonne Equivalent Units (TEUs). This fact, along with its anticipated long term lease to the private sector, means that work is well underway to address the movement of freight from and to the port, and from and to a terminal that links with rail and road freight modes.

The complex but specific issues being addressed include:

- the role and availability of Moorebank as an intermodal inland terminal
- the expansion and upgrade of the M5
- improved rail operations between the port and Moorebank
- reconsideration of the planning approval cap on Port Botany throughput
- interfaces with Kingsford Smith Airport.

With this considerable work underway the Commission is reluctant to do more than applaud the efforts. It is clear that the transport precinct of Port Botany, Kingsford Smith Airport and the M5 must get priority attention. This is not simply a NSW issue; it is of great importance to Australia.

Recommendation: The Commission recommends that high priority continues to be given to the requirements emerging for Port Botany, Moorebank and the M5 expansion.

The Commission notes the freight rail upgrade on the South Sydney freight line by the Australian Rail Track Corporation (ARTC). For decades freight trains on the north-south corridor have had their pathways constrained by the priority given to passengers on the network. This is an appropriate priority but with growth in both freight and passenger movements over recent decades it has become extremely costly for rail freight in this corridor. Waiting times for a pathway can be five to eight hours. Passenger and freight lines must be separated through the Sydney urban network. The north side of the city requires an upgrade to allow for this freight traffic separation from passenger.

A national land freight strategy is being developed by Infrastructure Australia and a discussion paper was issued in February 2011. The importance of this strategy to NSW is quite direct. The vast majority of freight movements in NSW are road-based. It is understood that NSW roads carry around 67 billion tonne-kilometres of freight each year. Road freight movements between Victoria and Queensland are connected via NSW roads. This has major implications for the NSW road network in terms of traffic volumes and wear-and-tear which leads to higher road maintenance costs.

As it is doing with rail freight, the Commonwealth should support similar reforms for road freight. This should include a national framework that sets safety standards for road freight movements funding for key National road corridors, and funding for connectivity around ports.

It is very pleasing to see a national approach to road freight being developed and a national land freight network. As the map shows NSW is a key link.

Figure 7.8: A national land freight network

The national focus on rail as a national network from the 1990s has improved rail freight productivity markedly over the last decade. This should be the aim for a national road freight network.

At a conceptual level a national land freight network has been accepted. Discussion and consultation is now commencing on:

- the specific roads and port connection that will offer access as part of the network, and in particular those in urban areas
- whether road freight should be user pay and tolled, if so how
- whether axle loads can be increased to B-triples and if so what would be the productivity impact
- importantly, what safety regimes would be in place.

This strategic direction appears to be well worth exploring, particularly for NSW. That said protection for the community from freight diseconomies is vital and a recent tragic trucking accident highlights the importance of robust regulation for road freight transport and safety. It is understood that the Council of Australian Governments (COAG) are expecting a report on the national land freight strategy late in 2012.

This is a matter that Infrastructure NSW and Transport for NSW will no doubt be closely involved with.

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8 Electricity

Key points:

- There is evidence that the NSW electricity businesses are inefficient in comparison to others. This has contributed to prices increasing faster than in other jurisdictions.
- To improve efficiency reforms should be sequenced to get benefits early where possible.
- The Government is pursuing the privatisation of the Eraring, Delta West, Delta Coastal and Macquarie Generation generators which are valued at over $3 billion.
- Structural reforms to the three distribution network businesses are underway. They are to be merged into a single State owned corporate structure with Ausgrid, Endeavour Energy and Essential Energy to provide operational services as subsidiaries. The new model is aimed to achieve cost reductions of around $400 million a year.
- The case for privatisation of the network assets is strong but it should not be done in haste. Careful assessment of how to achieve the best outcome for the state of NSW is necessary and a sale strategy needs to be developed.

8.1 Government policy

At the highest level there are five policy goals that are of direct relevance to the electricity sector. These are to:

1. Improve the performance of the NSW economy – encourage private investment in NSW by reducing the cost of doing business through lower electricity prices and a more efficient public service.
2. Rebuild state finances – maintain the state"s AAA credit rating and ensure expenditure growth is less than or equal to revenue growth.
3. Place downward pressure on the cost of living – contain electricity costs through efficient energy use by supporting households and businesses to reduce their energy consumption.
4. Invest in critical infrastructure – ensure that sufficient generation and network capacity is built to meet forecast demand whilst funding major capital investments to other key strategic infrastructure such as rail freight, public transport, local councils and regional centres.
5. Protect our natural environment – promote energy security through a more diverse energy mix, reducing coal dependence, increasing energy efficiency and moving to lower emission energy sources.

In response to the recent steep increases to electricity prices, the NSW government has given a commitment to rein in spending in the sector. Targeted policy responses have included:

- Establishing a Special Commission of Inquiry into the former Government"s electricity transactions. This Tamberlin Inquiry also reviewed options to promote competitive electricity prices and to ensure reliability of supply.
- Establishing a Task Force to undertake a detailed cost-benefit analysis for rationalising the three existing networks with a view to maximising cost and efficiency savings. In March 2012 the Minister for Resources and Energy announced a major restructure of the electricity businesses by merging the three distribution networks into a single state owned corporate structure to reduce waste and duplication and generate savings from economies of scale.
- Implementing a new dividends policy. The Government is committed to capping dividends at forecast levels and will require electricity company directors to personally certify that dividend payments place no additional pressures on prices or reliability.
- Opposing the carbon tax unless householders are fully compensated by the Commonwealth Government. Federal Treasury modelling indicates a carbon price of $30 a tonne will increase annual household bills by $863 from 1 July 2012 if there are no fuel tax concessions. These concessions are some form of Federal financial support to reduce the impact of a carbon tax on fuel prices.
- On 15 May 2011, the NSW Government announced a freeze on non-frontline staff recruitment in NSW electricity network companies. The freeze applies to Ausgrid, Endeavour Energy and Essential Energy. Network spending has been identified as a main driver of price increases.
- In April 2011 the Government also unveiled a three point plan to try to ease the impact of proposed power price rises announced by IPART through:
    1. the introduction of rebates of up to $250 for low income earners (funded by savings through distribution network restructuring) and a review of the electricity network licence conditions to halt any over-spending which may be forcing up power prices
    2. seeking compensation from the Federal Government to offset the price rises caused by the Commonwealth"s Renewable Energy Target
    3. requiring Boards to report on employment numbers and costs as part of their quarterly reporting to the Shareholding Ministers.

Sustainable energy policies and associated schemes also contribute to electricity prices as the costs of these are recovered from customers. These policies and schemes currently include:

- the NSW Climate Change Fund (CCF)

- the NSW Solar Bonus Scheme (SBS)
- the Commonwealth Expanded Renewable Energy Target (RET)
- the NSW Greenhouse Gas Reduction Scheme (GGAS)
- the NSW Energy Savings Scheme (ESS)

If a carbon tax is introduced by the Commonwealth Government, the state based schemes should be reviewed.

8.2 Industry structure

8.2.1 Structure and ownership

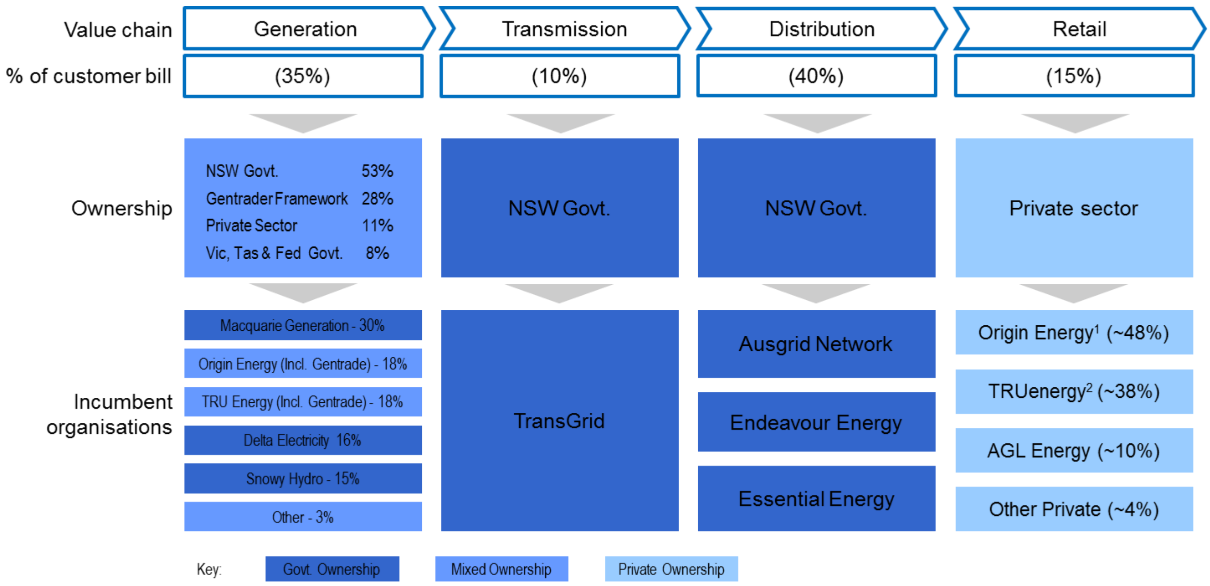
The electricity industry is split into generation, transmission, distribution and retail sectors. The retail sector is the only element within the NSW electricity sector to be fully privatised. This occurred in March 2011. In those transactions:

- The retailing arms of Country Energy and Integral Energy, along with the Generation Trading Agreement (Gentrader Agreement) for Eraring power station, were acquired by Origin Energy.
- The retailing arm of EnergyAustralia, the Gentrader Agreement for Delta Electricity"s Mt Piper and Wallerawang power stations, and development sites at Mt Piper and Marulan were acquired by TRUenergy.

In a second round of bidding no bids were received for Macquarie Generation"s power stations (Bayswater and Liddell); or for Delta Electricity"s coastal power stations (Vales Point and Munmorah). These assets remain in Government hands, along with four power station development sites.

Almost all network and most generation assets are government owned.

Figure 8.1: Illustrative industry structure and ownership



1. Origin Energy acquired both retail arms of Country Energy and Integral Energy Australia on 1 March 2011.
2. TRUenergy acquired the retail arm of Energy Australia on 1 March 2011.

8.2.2 Generation

Wholesale generation assets within NSW are mainly government owned. About 81% of generation capacity is owned and/or operated by the NSW Government. About

53% is wholly owned and operated and 28% has operations contracted out under long-term Gentrader arrangements. A further 8% is owned by other Australian governments. At present 11% of NSW wholesale generation capacity is privately owned.

Table 8.1: NSW generation capacity

Generator	Sites	Total capacity (MW)	Ownership
Macquarie Generation	Bayswater; Liddell; Hunter Valley	4,839	Macquarie Generation (NSW Government)
Delta Electricity	Vales Point B; Munmorah; Colongra; others	2,648	Delta Electricity (NSW Government)
Snowy Hydro	Blowering; Upper Tumut; Tumut; Guthega	2,466	Snowy Hydro (NSW Government 58%; Vic Government 29%; Australian Government 13%)
TRUenergy	Mount Piper; Wallerawang	2,400	Delta Electricity (NSW Government) Contracted to TRUenergy
Origin Energy	Eraring; Shoalhaven	2,322	Eraring Energy (NSW Government) Contracted to Origin Energy
Origin Energy	Uranquinty; Cullerin Range	670	Origin Energy
TRUenergy	Tallawarra	422	TRUenergy (CLP Group)
Infigen Energy	Capital; Woodlawn	182	Infigen Energy
Marubeni Australia Power Services	Smithfield Energy Facility	160	Marubeni Corporation
Redbank Energy	Redbank	145	Redbank Energy
EDL Group	Appin; Tower; Lucas Heights	108	EDL Group
Earing Energy	Brown Mountain; Burrinjuck; others	98	Eraring Energy (NSW Government)
AGL Hydro	Copeton; Burrendong; Wyangala; others	74	AGL Energy
Essential	Broken Hill Gas Turbine	50	Essential Energy (NSW

Generator	Sites	Total capacity (MW)	Ownership
Energy			Government)
Acciona Energy	Gunning	47	Acciona Energy
Infratil Energy Australia	Hunter; Awaba	30	Infratil

Source: AER State of the Market 2011

The summary profit and loss and balance sheet statements for the three generation companies that are owned by the NSW Government (excluding Essential Energy"s generation assets) are set out below. Macquarie Generation is the largest of the three. The combined generating capacity across its Bayswater and Liddell plants is 4,640 megawatts (MW). In 2010-11 its physical asset base was about $3.2 billion and its profit after tax was $124 million.

Table 8.2A: **Macquarie Generation** Profit and Loss (2010-11)

Revenue	**$m**
Total revenue	1,018
Operating expenditure	(608)
EBITDA	410
Depreciation & amortisation	(169)
Interest expense	(65)
Tax expense	(52)
Profit after tax	124

Table 8.2B: **Macquarie Generation** Balance sheet 30 June, 2011

Assets	**$m**
Property, plant and equipment	3,214
Other assets	819
Total assets	4,033
Liabilities	
Debt	823
Other liabilities	1,347
Total liabilities	2,170
Net assets	1,863

Delta Generation has capacity to generate around 5,000 MW. Its Mount Piper and Wallerawang plants are subject to Gentrader contracts with TRUenergy and have a combined generating capacity of 2,400 MW. Delta"s, Vales Point and other smaller plants have a combined generating capacity of around 2,600 MW. The physical assets of Delta Generation are valued at $833 million. Its revenue in 2010-11 was $1,109 million, however Delta made a loss of about $200 million, largely due to one off asset value impairments of around $387 million.

Table 8.3A: **Delta**
Profit and Loss (2010-11)

Revenue	$m
Total revenue	1,109
Operating expenditure	(1,191)
EBITDA	(82)
Depreciation & amortisation	(103)
Interest expense	(96)
Tax expense	81
Profit after tax	(200)

Table 8.3B: **Delta**
Balance sheet 30 June, 2011

Assets	$m
Property, plant and equipment	833
Other assets	1,336
Total assets	2,169
Liabilities	
Debt	850
Other liabilities	808
Total liabilities	1,658
Net assets	511

Snowy Hydro is owned by three governments, NSW, Victoria and the Commonwealth. NSW is the majority shareholder at 58%. The scheme has core plants located at Murray 1 and 2, Blowering, Tumut and Guthega. Around 2,500 MW is located in NSW.

Table 8.4A: **Snowy Hydro**
Profit and Loss (2010-11)*

Revenue	$m
Total revenue	958
Operating expenditure	(233)
EBITDA	725
Depreciation & amortisation	(60)
Interest expense	(24)
Tax expense	(181)
Profit after tax	460

Table 8.4B: **Snowy Hydro**
Balance sheet 30 June, 2011*

Assets	$m
Property, plant and equipment	1,778
Other assets	645
Total assets	2,423
Liabilities	
Debt	221
Other Liabilities	246
Total liabilities	467
Net assets	1956

* for the parent entity Snowy Hydro Limited which undertakes the Snowy Hydro-electric scheme and other business activities.

8.2.3 Transmission

TransGrid manages the high voltage transmission network sometimes referred to as the „towers and lines" business. TransGrid"s network comprises 12,656 kilometres of high voltage transmission line and underground cables. One of the distribution businesses, Ausgrid, also operates a small Transmission network of 962 kilometres of transmission lines and associated substations.

TransGrid"s physical assets were valued at $5.4 billion and its profit after tax was $167 million in 2010-11.

Table 8.5A: **TransGrid**
Profit and Loss (2010-11)

Revenue	$m
Total revenue	758
Operating expenditure	(145)
EBITDA	613
Depreciation & amortisation	(218)
Interest expense	(152)
Tax expense	(76)
Profit after tax	167

Table 8.5B: **TransGrid**
Balance sheet 30 June, 2011

Assets	$m
Property, plant and equipment	5,390
Other assets	792
Total assets	6,182
Liabilities	
Debt	2,271
Other liabilities	1,452
Total liabilities	3,723
Net assets	2,459

8.2.4 Distribution

Ausgrid, Endeavour Energy and Essential Energy deliver electricity from the transmission networks to consumers on their respective distribution networks (the „poles and wires" businesses). A high level breakdown of the key characteristics of each of these three network businesses is set out in Table 8.6.

Table 8.6: Key characteristics of the NSW distributors

Network characteristic	Ausgrid	Endeavour	Essential
Regulatory asset base ($b)	9,716	4,690	5,066
Distribution customers (total)	1,619,988	877,340	801,913
Maximum demand (MW)	6,072	4,002	2,238
Energy distributed (GWh)	30,691	17,502	12,053
Employees (FTE number)	5,941	2,714	4,573
Contractors (FTE number)	792	84	545
FY 10 /11 capital works program ($m)	1,578	420	748
Sub transmission system (km)	3,662	3,463	11,391
High voltage overhead (km)	10,195	11,326	145,835
High voltage underground (km)	7,384	3,718	2,011
Low voltage overhead (km)	20,834	8,871	66,523
Low voltage underground (km)	6,673	6,794	4,810
Total (km) excl. transmission	**48,748**	**34,172**	**230,570**

Source: Network Performance Reports 2010/2011 - as of 30th June 2011 and AERs PTRM models.

Ausgrid is the former network business of EnergyAustralia. It distributes electricity to Sydney, the Central Coast and the Hunter region across a distribution network that includes over 48,000 kilometres and over 1.6 million customers. Ausgrid"s physical assets were valued at almost $10 billion and its profit after tax was $175 million in 2010-11.

Table 8.7A: Ausgrid
Profit and Loss (2010-11)

Revenue	$m
Total revenue	2,636
Operating expenditure	(1,493)
EBITDA	1,143
Depreciation & amortisation	(374)
Interest expense	(470)
Tax expense	(124)
Profit after tax	175

Table 8.7B: Ausgrid
Balance sheet 30 June, 2011

Assets	$m
Property, plant and equipment	9,950
Other assets	1,320
Total assets	11,270
Liabilities	
Debt	6,792
Other liabilities	2,549
Total liabilities	9,341
Net assets	1,929

Endeavour Energy is the former network business of Integral Energy. It distributes electricity to Sydney‟s Greater West, Blue Mountains, Illawarra and Southern Highlands across a distribution network that is over 34,000 circuit kilometres and 877,000 customers. Endeavour Energy‟s physical assets were valued at almost $4.7 billion and its profit after tax was $203 million in 2010-11.

Table 8.8A: **Endeavour**
Profit and Loss (2010-11)

Revenue	$m
Total revenue	1,282
Operating expenditure	(629)
EBITDA	653
Depreciation & amortisation	(165)
Interest expense	(193)
Tax expense	(92)
Profit after tax	203

Table 8.8B: **Endeavour**
Balance sheet 30 June, 2011

Assets	$m
Property, plant and equipment	4,712
Other assets	447
Total assets	5,159
Liabilities	
Debt	2,617
Other liabilities	1,308
Total liabilities	3,925
Net assets	1,234

Essential Energy represents the former network business of Country Energy. It distributes electricity to much of the state‟s rural and regional areas and has the largest distribution network of the three distributors. Essential Energy‟s network spans around 230,000 kilometres across the Northern, North Coast, Southern, South East, and Far West areas of the state. Essential Energy‟s electricity distribution customer base, of just over 800,000 customers, is the smallest of the three. Essential

Energy"s physical assets are valued at $6.3 billion and its profit after tax was $43 million in 2010-11.

Table 8.9A: **Essential**
Profit and Loss (2010-11)

Revenue	**$m**
Total revenue	1,474
Operating expenditure	(820)
EBITDA	654
Depreciation & amortisation	(307)
Interest expense	(288)
Tax expense	(16)
Profit after tax	43

Table 8.9B: **Essential**
Balance sheet 30 June, 2011

Assets	**$m**
Property, plant and equipment	6,279
Other assets	439
Total assets	6,718
Liabilities	
Debt	3,641
Other liabilities	1,258
Total liabilities	4,899
Net assets	1,819

8.2.5 Retail

At present customers in NSW are free to choose a standard supply contract offered by one of the three standard retailers: Energy Australia (owned by TRUenergy), and Integral Energy and Country Energy (owned by Origin Energy). These three retailers were previously associated with the distribution networks. Alternatively customers can opt for a negotiated contract with any of the licensed electricity retailers in NSW.

8.2.6 Regulatory bodies

Regulation in NSW is broadly similar to that in other states and territories. There are three tiers of regulation throughout Australia covering:

- generation
- transmission and distribution networks
- retail.

The National Electricity Market (NEM) provides a single uniform marketplace for the trading of wholesale electricity across all Australian states and territories except Western Australia and the Northern Territory. The NEM is facilitated by the interconnectors between the transmission networks in each state and is the world"s longest interconnected power system.

The Australian Energy Market Commission (AEMC) is the rule maker and developer for the nation"s electricity markets. It makes and amends the rules regarding the regulation of the generation, transmission and distribution businesses connected to the NEM.

The Australian Energy Regulator (AER) is responsible for regulating the energy transmission and distribution network businesses on the NEM, and for determining the prices these businesses can charge for use of their networks. These prices inform the network charges component of consumer energy bills. The AER is guided by the National Electricity Rules, which are set by the AEMC, and government-imposed network operator licence conditions, that include such matters as service quality standards.

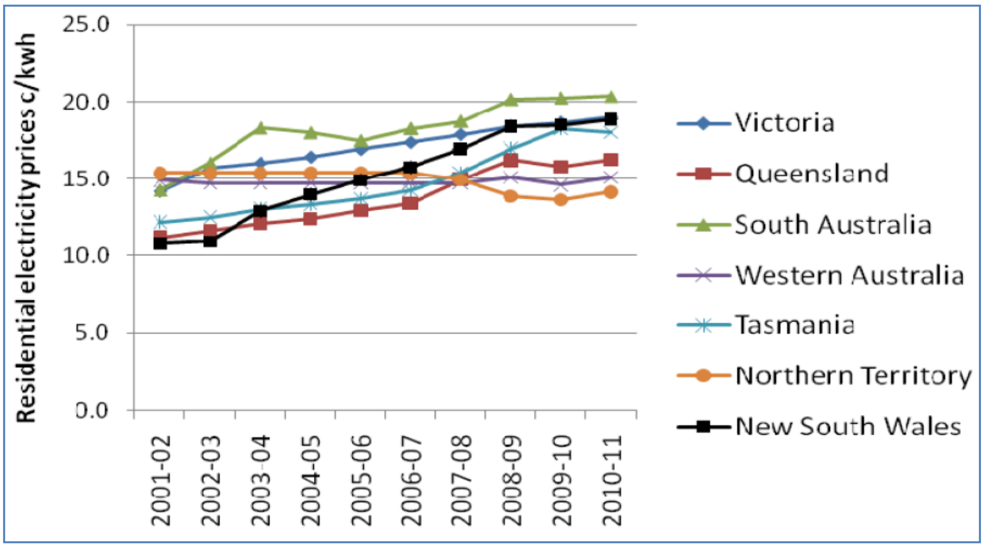
The Independent Pricing and Regulatory Tribunal (IPART) regulates the prices charged to NSW consumers under standard electricity contracts available through TRUenergy and Origin Energy.

8.3 Current situation

8.3.1 Escalating prices

Historically NSW has had cheap electricity relative to other jurisdictions. Recently NSW prices have increased more rapidly and are now higher than the national average. See Table 8.2. The situation is expected to worsen as the trend of above-average price rises in NSW continues. Victoria and South Australia, which are fully privatised, are expected to have lower price increases than those jurisdictions where the public sector dominates.

Figure 8.2: Comparison of electricity prices by jurisdiction (c/kwh)



Source: NSW Electricity Network and Prices Inquiry, December 2010 – page 10

In December 2010, the NSW Electricity Network and Prices Inquiry highlighted that prices have increased by about 43% in NSW between June 2007 and June 2010.Prices were expected to rise by about that much again over the following three years. The Report warned that under current arrangements it was possible that prices for some customers could increase by up to 27% in July 2011 alone.

These findings are consistent with those of other studies. The Australian Energy Market Commission (AEMC) estimated that retail electricity prices in NSW on average would increase by 39 % between 1 July 2010 and 30 June 2013. This is the second highest increase of any state or territory. Only Western Australia is higher at 45%. It is important to recognise that this level of increase is not uniform across all NSW retailers. The cumulative increase for Endeavour Energy over this period is only 20% which is amongst the lowest recorded in the AEMC study.

The AEMC analysis also highlighted that prices have increased most rapidly where public ownership dominates, although Endeavour Energy appears to be one exception in this regard. Prices are generally increasing at more modest rates where the private sector dominates. The private sector responds more efficiently to incentives to be efficient. The regulatory framework maintains the incentives for investors and allows appropriate gain sharing with customers. More competitive markets impose discipline and prompt efficiency, though regulation is needed in this industry because customers require protection where markets are not fully effective and retain some monopoly characteristics.

Table 8.10: Retail electricity price increases: Forecast 1 July 2010 to 30 June 2013

State	Nominal increase	Ownership
Western Australia	45%	Majority public
New South Wales	39%	Majority public
Queensland	32%	Majority public
South Australia	31%	Private
Victoria	27%	Private
Australia-wide	30%	n/a

Source: AEMC Retail electricity price forecasts

Based on its final determination for customers in NSW who have not entered into contracts, electricity prices will increase substantially in all Standard Retailers:

(%, nominal)* 2010/11	2010/11	2011/12	2012/13	Cumulative total increase
Ausgrid Formerly EnergyAustralia	10	11	11	36
Endeavour Energy Formerly Integral Energy	7	10	2	20
Essential Energy Formerly Country Energy	13	13	11	42

Source: IPART 2010, Fact Sheet, Regulated electricity retail tariffs for 1 July 2010 to 30 June 2013 – Final Report.

The key drivers of the NSW electricity price rises are network charges (which reflect a high cost base and efforts to gain a return on the $1.4 billion network overspend in the last regulatory period) and sustainable energy schemes. Other factors such as investments in smart grid technologies and declining productivity have the potential to drive network charges higher.

8.3.2 Network expenditure

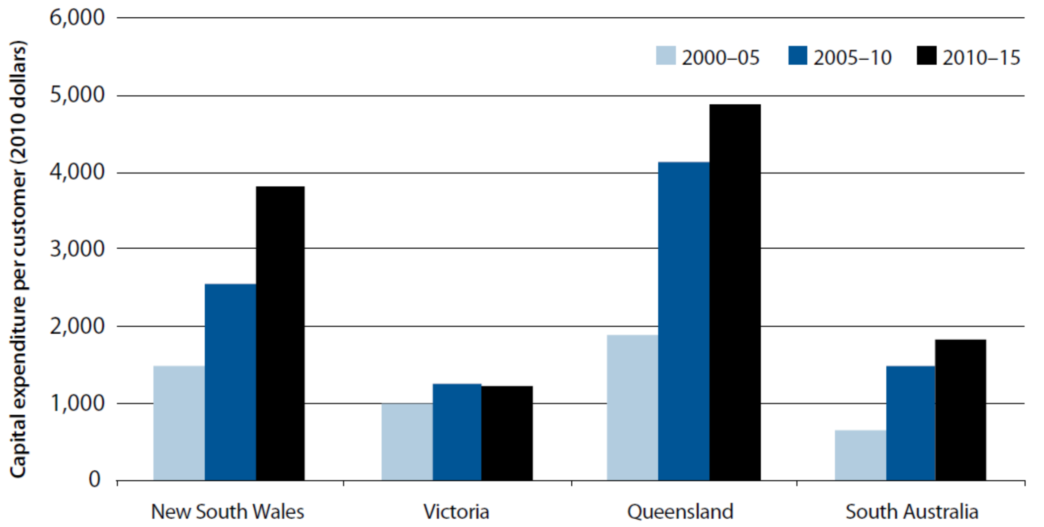
The biggest driver of price increases in the last decade NSW has been network costs. These account for about 50% of the total cost of electricity and they have been increasing rapidly.

Total annual capital expenditure has grown from about $1 billion in 2004-05 to a forecast of over $3 billion in 2013-14. Operating expenditure is expected to double over the same time period, from about $0.8 billion to $1.6 billion.

Capital expenditure

Since FY2000-01 NSW"s network capital expenditure has escalated rapidly and far more than in the predominately privatised jurisdictions. This can be seen in Figure 8.3 below.

Figure 8.3: Real capital expenditure per capita.



Source: Energy Users Association of Australia 2010, *Issues for the MCE: presentation to SCO meeting #59*.

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In his review in 2011, Professor Ross Garnaut raised the issue of this divergence, stating that:

„While there are likely to be genuine differences between the states that explain some of these divergences, it is unlikely that these differences explain the majority of them."

Growth of capital expenditure is made up of growth in the following main components:

- replacement of ageing assets
- investment in new assets to service growth in customer numbers and increased demand for electricity, especially during peak demand
- asset investment to improve reliability and flexibility for network operations which minimises the number of customers impacted by unforeseen outages.

Appendix 11 sets out where capital expenditure savings may be made.

Operating expenditure

Growth in operating expenditure is driven by:

- escalation in real wages, salaries and entitlements
- increases in staff numbers driven by increased workload on approved work programs
- greater focus on risk management practices, with associated costs, following natural disasters such as bushfires
- declining productivity.

Appendix 11 sets out where operating expenditure savings may be made.

Comparative expenditure performance

A recent comparison of capital and operating expenditure by the AER[f] indicates that both capital expenditure (capex) and operating expenditure (opex) has been higher in NSW than in Victoria, but less than in Queensland on most measures. This benchmark comparison compared expenditure over the size of the regulated asset base, line length and customers numbers.

Comparing capital expenditure efficiency between Distribution Network Service Providers (DNSPs) is fraught with difficulty. It is necessary to define relevant ratios (e.g. capex/RAB, capex/ line length or capex/customer) and also to explore the utilisation drivers of these ratios (e.g. customers/line length, load profile) as the benchmarking study does. But this still leaves the problems of misleading point in time comparison as capex spending for each DNSP may be quite volatile one period to the next. The risk is that high capex ratios are primarily reflective of „catch up renewal‟, rather than ineffective investment in incremental capacity.

[f] Victorian electricity distribution network service providers - Distribution determination 2011–2015 (Final decision – Appendices)

Nevertheless, the benchmarking study cites Nuttall Consulting evidence that capital expenditure at the DNSPs in South Australia is more efficient than that at the DNSPs in Victoria and NSW which are in turn more efficient than those in Queensland.

Recommendation: The Commission recommends that capital expenditure efficiency for incremental capacity in electricity networks be systematically benchmarked, commencing in 2012 as a part of the network reform. In particular, attention should be on whether replacement rather than maintenance of existing assets is efficient.

The operating expenditure comparison from the same benchmarking study notes that:

- NSW distribution and transmission business operating expenditure is generally higher than the average across four states and is typically at the higher end of the range
- Essential Energy has the highest operating expenditure on most measures and significantly higher than both Ausgrid and Endeavour Energy
- on a number of measures, operating expenditure by Essential Energy (compared to customers per line length) is the highest business in all four states, and
- distribution and transmission businesses in Victoria are generally the lowest of the businesses across the four states.

8.3.3 Sustainable Energy Schemes

Sustainable energy schemes such as the Solar Bonus Scheme (SBS) are likely to be contributing to the current price increases. Other schemes, such as the Commonwealth‟s renewable energy target scheme, which will increase bills by 6%, or approximately $75 per household, if the NSW government complies with the Commonwealth sustainable energy targets, will also have an impact. It is important to ensure that all such schemes are implemented in the most cost efficient way and reviewed when national carbon prices are introduced.

Recommendation: The Commission recommends that the various state based environmental schemes aimed at encouraging renewable energy and sustainability be evaluated and those that are not achieving their objectives be closed down or modified.

The Commission notes that the Commonwealth Government‟s Energy White Paper has also concluded that green schemes, not aligned with the Carbon Tax regime, whether they are State or Federal, should be progressively reviewed.

The costs of sustainable energy schemes are included in retail tariffs after their recovery is approved by the relevant regulators. Participants in the National Energy Market (NEM) incur costs associated with the NSW Government‟s Greenhouse Gas Reduction Scheme (GGAS) and Energy Savings Scheme (ESS) as well as the Commonwealth Government‟s Renewable Energy Target (RET). Recovery of these costs is regulated by IPART which assesses the costs of the schemes and determines allowances for cost recovery by electricity retailers.

NSW distribution businesses incur costs associated with the NSW Government‟s SBS. The distributors are reimbursed for these costs by the Climate Change Fund (CCF). The distributors are also required to make contributions to the CCF. Those contributions are regulated by the Australian Energy Regulator (AER) using cost pass-through mechanisms. The AER has no role in assessing the costs of the schemes but ensures that the distribution businesses do not over-recover the costs. Based on current pricing determinations, these costs are expected to grow from 4% of the retail price in 2010-11 to about 7% in 2012-13. This does not account for all of the possible increases in costs for some schemes such as the SBS and RET which means the proportion of the retail price is likely to be even greater.

8.3.4 Investments in Smart Grid Technology

NSW is considering the potential rollout of smart meters which are currently being trialled. Smart metering is potentially an important way to reduce peak load demands, but the investment required for such a program is significant and experience in Victoria is cautionary.

The Victorian Government approved an Advanced Metering Infrastructure Project in 2006. An Auditor-General review in 2009 found uncertainty in the economic benefits, identified significant implementation risks, and noted that the benefits to consumers were not clear. Safety concerns have also been raised around their use given a spate of related fires in Melbourne. It is not clear whether this is due to faulty installation or a problem with the meters themselves.

In June 2010 the former Energy Australia was awarded $100 million in Federal Government funding for a demonstration-scale smart grid to be rolled out across fives sites in Newcastle, Sydney and the Hunter. About 50,000 smart meters will be deployed and customers will be offered a number of pricing options. This large pilot will help to provide a basis for decisions on the use of smart grids and meters in NSW.

Smart meters do have the potential to defer requirements for new capital expenditure to meet peak demand if customers receive truly cost reflective and competitive prices. In the long term, however, load peaks and network investment requirements could be driven by change in the load profiles of wind and solar generation. The network structure and location of wind and solar energy sources may become more important. The real question is whether the regulatory certainty is yet in place to drive efficient long term low emission generation.

To ensure that investment decisions being made today are consistent with the need for efficiency improvements and the longer term aspiration to potentially sell the assets, each major investment should be re-evaluated with that in mind.

This is of particular relevance for smart metering and grids where Victoria"s experience in the Advanced Metering Infrastructure Project has called into question the overall benefits. Other investment strategies to minimise peak load demand will be applicable in this respect.

Recommendation: The Commission recommends that the NSW Government re-evaluates the decision-making process and business cases for major investments and projects of state significance based on the likely market scenarios, timeframes for economic payback and the evolving regulatory environment. Business cases should also be supported by Gateway reviews.

8.3.5 Productivity

An assessment by IPART indicated that the distributors have seen a decline in productivity over the past decade. IPART recognised the limitations on productivity estimates and describes it as simply being helpful in informing analysis. Key recommendations from IPART"s review, to increase productivity were to:

- improve competition and flexibility in the utilities input/output markets
- enhance the authority and autonomy of the State Owned Corporations
- clarify commercial and public policy objectives

Three electricity generators (Delta Electricity, Eraring Energy and Macquarie Generation) were reviewed, as was TransGrid, and the three electricity distribution businesses (excluding their retail arms).

Generation – Total factor productivity did not change significantly between 2000/01 to 2008/09. The analysis of other performance indicators suggested that their performance was largely comparable to that of other similar coal-fired generators.

Transmission – Total factor productivity at TransGrid declined between 1997-98 and 2008-09, mainly due to substantially increased capital expenditure on its transmission network. Capital productivity declined, and labour productivity increased significantly. TransGrid outsources most of its capital projects and a number of its operating activities. This appears to have helped it contain the growth in its labour inputs.

Distribution – Total factor productivity at the distribution network service providers declined between 2001-02 and 2008-09. The providers undertook major capital works programs, which continue, and which caused declines in their total factor productivity and capital productivity. Labour productivity at each of the distribution network service providers also declined. Among other things, they employed more workers to manage their capital programs and to prepare for the ageing of their workforces.

Common major influences on productivity were cited and include: significant capital investment, government policy requirements and higher standards for service provision, and changes in output caused by supply disruptions.

8.3.6 Previous market reforms

The development of a competitive, efficient national electricity market has long been the aim of both Commonwealth and State governments. Various inquiries have made explicit recommendations in favour of selling state-owned assets on the basis of efficiency and more competitive markets. Victoria and South Australia have fully privatised, in 1997 and 2001 respectively, and demonstrated clear benefits from doing so.

The case for privatisation is not new. It was a key recommendation of a 1991 Industry Commission Inquiry into energy generation and distribution. The Commission cited the formidable barriers to achieving full competition and recommended the sale of publicly-owned generation assets „to remove on-going constraints associated with public ownership‟, and „to permit faster rationalisation of management and work practices‟.

In 1995 the Competition Policies Agreement formalised a process of reform across the states to undertake structural reforms to separate contestable retail and generation businesses from natural monopoly network assets. Steps were to be taken toward the development of a contestable NEM. Progress towards the NEM continued throughout the 1990s and 2000s, with the development of national regulatory and management institutions to oversee its development and function.

Privatisation was put firmly back on the reform agenda in 2007 when the Energy Reform Implementation Group (ERIG) – appointed by Council of Australian Governments (COAG) to provide advice on energy sector reform – made privatisation of electricity assets across the NEM its key recommendation. ERIG quantified that privatisation – and associated regulatory reform – would increase real GDP by about $400 million a year (in 2007 dollars) and reduce retail prices by 2%.

Later that year, these findings were reinforced by the Owen Inquiry into electricity supply, which found the New South Wales government would have to borrow more, raise taxes or reprioritise other expenditure to meet the $15 billion capital expenditure required in its electricity businesses over the next 10 to 15 years (Owen, 2007). More recently, the OECD has added its voice to calls for privatisation in the electricity sector, including in its 2010 *Review of regulatory reform in Australia* (OECD, 2010).

The studies and inquiries discussed above have all agreed that regulation alone is a less effective prompt for efficiency than regulation coupled with the market discipline associated with private sector ownership.

The NSW Government has responded to the various studies by making changes to address comparative inefficiency in the NSW electricity industry. As noted these include announcing an efficiency transformation or restructure of the distribution businesses and a freeze on non-frontline staff recruitment.

While these steps are important the problem of the large investments required in the network assets over the next few years remains. The NSW Government will have to fund these investments if the network businesses remain in public ownership. This requirement may both „crowd out‟ other investment projects and jeopardise the State‟s longer-term financial position and credit rating. If the utilities facing these issues were in private, rather than public ownership, the size of the investment would be lessened by the significant efficiencies and savings that are possible outside restrictive work practices and with focus and good management.

8.3.7 Current structural reforms

In May 2011, the NSW Government established a Task Force comprising a number of government agencies supported by a Panel of industry and commercial experts. The Task Force undertook an options analysis across the three existing networks with a view to maximising cost and efficiency savings.

Over a six month period the Task Force assessed the resulting options against a number of criteria including their potential impact on employment in regional communities and their relative ability to guarantee the reliable, safe and secure supply of electricity. The study examined a variety of potential operating structures to extract synergy benefits, including:

- merging the three businesses into two and/or reapportioning them
- establishing a holding company (HoldCo) to own and operate the NSW Distribution Network and take overarching control of the three subsidiaries, the existing distribution companies
- resetting geographic boundaries of distribution network service providers.

In March 2012 the Minister for Resources and Energy announced a major restructure of the electricity businesses by merging the three distribution networks into a single corporate structure to reduce waste and duplication and generate savings from economies of scale. A new State Owned Corporation (SOC) will be created to own and operate the electricity distribution network. Three subsidiary businesses – Ausgrid, Endeavour Energy and Essential Energy – will provide operational services to the SOC under their current brands. The new model aims to:

- reduce the duplication of corporate services and overheads
- standardise IT and network management
- deliver economies of scale in purchasing (i.e. make savings by buying in bulk).

The focus will be on streamlining executive management and some corporate support functions, rather than frontline jobs or services.

The Task Force expects the reform to deliver in excess of $400 million in efficiency savings over four years. This saving will be used to fund electricity bill rebates for low income households and families. These reforms will also place downward pressure on electricity prices in future years.

Recommendation: The Commission recommends that the Board and CEO of the new electricity Holding Company ensure that a robust baseline is agreed so that benefits realisation can be planned and measured within an implementation program.

8.3.8 The case for further privatisation

There is evidence that the privatisation of electricity assets will cause downward pressure on electricity prices, through the creation of a competitive and efficient electricity market on a fully commercial footing. The experience in both Victoria and South Australia is that privatisation creates a market which supplements regulatory oversight. Good regulation should provide returns to investors who innovate and take calculated risks, alongside improved outcomes for customers.

There are other benefits that would be derived from divestment, including:

- the private sector is more able to tackle the inefficient work practices in the industry
- releases capital for pressing investment needs in other areas of the NSW State
- the State"s longer-term financial position would improve significantly by removing exposure to electricity market risk and removing investment requirements.

Estimated sales proceeds

Asset valuations undertaken by Infrastructure Partnerships Australia show that sales proceeds could realise between $29 billion and $34 billion for NSW taxpayers. The higher value multiple imply that a purchaser can extract value by retaining the benefits of outperforming the regulatory benchmarks.

Asset	RAB[1]	Low value (A$b)	High value (A$b)[2]
Distribution			
Ausgrid	11	12	15
Endeavour Energy	6	6	7
Essential Energy	5	5	6
Subtotal	**22**	**23**	**28**
Transmission			
TransGrid	5	6	7
Subtotal	**5**	**6**	**7**
Total	**27**	**29**	**35**

1 - Regulated Asset Base (RAB) values as at 1 July 2011, based on Australian Energy Regulator (AER) roll forward RABs from the final decisions in 2009.
2 - The low and high multiple values (1.1-1.3x) are consistent with relevant trading and transaction comparisons.

Recent gas and electricity network company transaction values shows the low and high multiples used in the valuation of NSW electricity distribution assets are consistent.

Regulated Asset Transactions	Year	EV ($m)	RABx
Northumbrian Water (UK)	**2011**	**7,481**	**1.30x**
WA gas networks	**2011**	**1,019**	**1.20x**
Multinet Gas	**2011**	**200**	**1.13x**
NSW gas networks	**2010**	**114**	**1.14x**
Average			**1.19x**

Infrastructure Partnerships Australia estimated that full privatisation of the two main remaining state owned and operated generation assets could realise between $3 billion and $6 billion for NSW taxpayers.

Generation assets	EBITDA ($m)	Low ($bn)	High ($bn)	Metric
Macquarie Generation	491	2.4	4.9	5-10x EBITDA
Delta Electricity	159	0.793	1.6	5-10x EBITDA
Total	**836**	**3.3**	**6.5**	**5-10x EBITDA**

The recent generation company transactions below show the multiples of EBITDA.

Generator Transactions	Year	EV (A$m)	EBITDAx
Transfield Services Infra Fund	2011	813	8.1x
Loy Yang A	2007	n/a	12.6x
Loy Yang B	2006	n/a	10.6x
Average			**10.4x**

Consideration of Snowy Hydro

Snowy Hydro Limited is an electricity generation, electricity retailing, and bulk water management public utility corporation. It owns, manages, and maintains the Snowy Mountains Hydro-electric Scheme which consists of nine hydro-electric power stations and sixteen large dams connected by 145 kilometres of tunnels and 80 kilometres of aqueducts located mainly in the Kosciuszko National Park. At a capacity of 2466 MW, Snowy Hydro is the third largest generator in NSW. It has three owners with NSW Government as the largest shareholder with 58%. The Victorian Government and Commonwealth Government own 29% and 13% respectively.

In December 2005, the NSW Government announced its intent to sell its share in Snowy Hydro, expecting to yield $1 billion, and in February 2006 the Commonwealth and Victorian governments also announced their intentions to sell. Over 200,000 people pre-registered to purchase but in June 2006, the Federal Government announced that it would no longer sell its 13% stake in the project, effectively forcing the sale to be aborted. The aborted sale followed strong opposition from the public, including government MPs and prominent Australians.

But the electricity sector and financial landscape has shifted since 2006. With continuing price rises, and an expectation that this trend will continue, the increasing demand for investment in other areas of NSW and the desire to improve the State"s longer-term financial position, the inclination for such a sale may be changing.

Recommendation: The Commission recommends that the options and appetite to divest the public ownership of Snowy Hydro Limited be reviewed.

Public attitude to privatisation

Research shows that a majority of the public have a positive attitude to private ownership of the state"s electricity assets. In February 2008 research was conducted by Auspoll (on behalf of Infrastructure Partnerships Australia) to explore issues around the privatisation of the electricity industry in New South Wales.

This research found 72% of NSW residents are prepared to accept power from private sources as long as they are guaranteed constant, affordable and environmentally responsible privately run power. The majority of these people (67%) believed the source did not matter and 5% preferred a private source. This majority applies across gender, age, location and voting intention

Conversely, only one out of every four NSW residents (25%) believed it was important that the power industry is run by the government.

8.3.9 Gentrader operating restrictions

In 2011 the NSW government commissioned the Honourable Brian Tamberlin QC to conduct a special commission of inquiry into the recent electricity transactions. The inquiry found that the Gentrader transactions entered into by the former NSW Government were a „sub optimal solution", but that the best option (sale and/or long term lease of the generation assets) was not available at the time. Specifically the inquiry stated that:

- „When considered individually, the bid price for each of the Delta and Eraring bundle was less than the retention value of each bundle."

- „The gentrader agreements are necessarily more complex than a sale or lease of the generators. The gentrader agreement requires a high degree of cooperation between the (state owned) generator and the gentrader to make the relationship work effectively, which gives rise to an unquantifiable risk of disputes and litigation‟.

It is the Commission‟s view that the Gentrader arrangements fail to deliver competition or create downward pressure on energy prices. The current position leaves a confused and opaque structure, with some generators subject to Gentrader contracts, while others are not. This remains a significant barrier to supply side competition. The current structure also means that government retains exposure to more than half of the states generating capacity.

The Gentrader agreements have burdened NSW taxpayers with significant risks relating to the electricity market, coal supply and the costs of operating and maintaining generators. The Commission agrees with the recommendation of the Tamberlin Inquiry, in that the NSW Government should offer for sale or long term lease all the remaining state owned generators, including those subject to Gentrader agreements.

8.3.10 Achieving a desired sale outcome

Planning is necessary to ensure that privatisation achieves its purposes. There should be a:

- clear statement of objectives of which sale price maximization is likely to be only one. Others might focus on more competitors in the industry to keep prices down and on reliable supply inter alia
- sale of assets after initial cost reductions and efficiency improvements so that these can be recognised in the sale price
- timetable for execution, which is reasonably expeditious, though not at the risk of flawed delivery.

A truly competitive sale is likely to be informed by a detailed scoping of the potential scale, focus and speed of realisation. A sale proves involves „selling the plan‟ some of which may have been achieved, at the same time as selling the assets. It is not possible to orchestrate a tender in a very short timeframe and it will be necessary to define what immediate improvements can be identified and delivered.

It is worthwhile considering what exactly will be privatised. Many private sector investors may have no interest in the corporate functions that will be performed by the corporate area of the new state owned HoldCo since they are likely to have access to these services already. They will however have an interest in the people and assets of the proposed three operating subsidiaries of HoldCo.

Any proposals to restructure and /or improve efficiency or service performance of the companies will impact their attractiveness to potential investors. In advance of making substantial, and possibly permanent, structural changes, it is prudent to assess the various options and possible timescales against the possible market value.

Furthermore, the private sector has a wealth of experience in extracting value from assets as demonstrated both nationally and internationally, and it should be recognised and accepted that some aspects of the transformation are best undertaken by the private sector upon privatisation of the assets. Therefore, it is necessary for NSW Government to have a clear view of the scope and scale of longer term opportunities in order to extract the best price from the market.

Recommendation: The Commission recommends that the government undertakes a study that considers the scope and implementation strategy for privatisation.

The scoping study should address:

- Structure
- Improvements
- Electoral Authority
- Likely market interest and price
- Timing
- Sale structure
- Consultation with community interest groups.

Understanding the regulatory backdrop

Any reforms made in the regulation of the sector may impact the planned efficiency improvements, the operating model changes and also the investor appetite for operating assets in the emerging environment.

Changes to reduce any capital expenditure bias will, for example, reduce investor certainty of adding investments to the Regulated Asset Base.

Recommendation: The Commission recommends that Treasury should assess any likely regulatory reforms in electricity and evaluate their impact on each possible sale scenario.

9. Water

Key points:

- Government policy balances public health, delivery standards, and water security with commercial objectives. There is a particular focus to improve water quality in regional towns in NSW served by small council owned utilities.
- Over time the Operating Licences of the government owned utilities have grown to be complex and cumbersome. Items have been added and very few subtracted. Some requirements in the licence are not based on solid evidence or analysis.
- Competition is developing in the urban water industry. The sale of Sydney Desalination Plant Pty Ltd (SDP), and its lease of the desalination plant, will add competition to the bulk water sector. More maintenance could be outsourced if the economics supported such a move. Similarly the operations and maintenance of the wastewater treatment plants could be outsourced if there was value to be added. Retail (billing) could be opened to competition, although billing systems may need to change away from a property based to a customer cased system.
- Each of the utilities, except SDP, has a value impaired asset base. Profits are overstated by low depreciation estimates. Insufficient cashflow is being clearly recognized for asset renewals. The regulator should address this matter.
- The standards set by the Dam Safety Committee appear to be achieving small risk reductions for major costs. This needs examination.
- The pricing of rural water entitlements by IPART has given windfall gains to some traders. This has been caused by the wide gap between (regulated) general security entitlement prices and market entitlement prices.
- Several regional towns served by small local utilities have had drinking water standards that do not meet accepted public health guidelines. To the extent this has not been corrected it needs immediate attention and assistance to those local entities.
- The Office of Water should consider moving its operational activities to State Water and focus on its regulatory functions.
- IPART determinations should be subject to a merit based review of its decisions.

9.1 Government policy

The water policy of the NSW Government addresses:

- drinking water quality

- delivery standards generally
- security of the water supply.

There is also a focus on affordability and the cost of services delivered. Costs that are at efficient levels assist with a competitive economic performance for NSW and a better cost of living outcome. It is recognised that lower costs to consumers need to be balanced with commercial outcomes.

The commercial policies that have been set for the government owned water utilities include meeting a specified rate of return by June 2015, and maintaining a stand-alone investment grade credit rating. Each utility is required to perform in a commercially efficient way.

There is also a focus on the quality of drinking water in regional NSW. The water supplied in some towns is not always meeting specified public health guidelines. A specific goal has been set to achieve 99% compliance in all non-metropolitan water utilities, including small council owned utilities.

The single feature that dominates the Australian water industry is climate variability. Droughts and flooding rains are certain but their severity and timing are not. This is the challenge for both urban and rural water utilities and their customers. Over the last decade significant changes have occurred in both the urban and rural water sectors. Nevertheless to meet government policy objectives there are further changes required.

9.2 Urban water

9.2.1. Background

There are four major urban water utilities in NSW are:

- Sydney Water Corporation
- Hunter Water Corporation
- Sydney Catchment Authority
- Sydney Desalination Plant Pty Ltd (SDP).

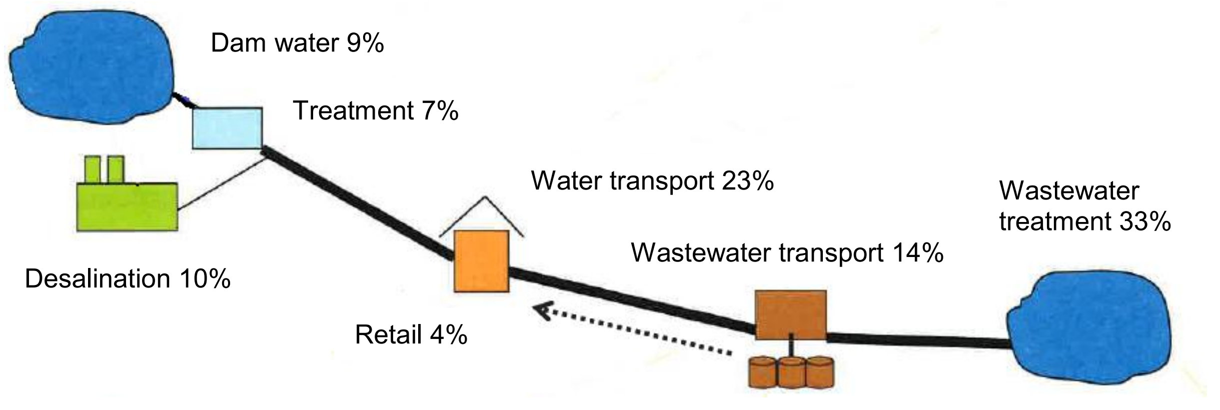
Together these four entities provide water services to the Illawarra, the Blue Mountains, Sydney and the Hunter. The Central Coast is serviced by local water utilities owned by the councils of Gosford and Wyong. The functions of the Gosford/Wyong Councils‟ Water Authority are in the process of being transferred to the newly created Central Coast Water Corporation.

Hunter Water and Sydney Water are State Owned Corporations. The Sydney Catchment Authority is a statutory body established through the *Sydney Water Catchment Management Act 1998*. SDP is a fully owned subsidiary of Sydney Water. It is expected that its equity will be owned by the private sector and its assets will be leased from the government by June 2012. The basic functions of each of these utilities is for:

- Sydney Water – to provide water and wastewater services to the people of Sydney, the Illawarra and the Blue Mountains
- Sydney Catchment Authority – to store and deliver bulk water to Sydney Water, Wingecarribee and Shoalhaven councils, and several smaller customers
- Hunter Water – to store and deliver bulk water and provide water and wastewater services to the Hunter region
- SDP – to provide desalinated water, treated to drinking water quality to Sydney Water and other customers if it wishes.

The basic structure of urban water operations is evident in the following diagram that shows the cost components of a typical Sydney Water bill, based on 200 kilolitres of drinking water supplied a year.

Figure 9.1: Urban water operations – cost components of a typical $1,100 bill in 2011-12



The percentage values represent cost components across the value chain of a typical $1,100 bill

Bulk water is supplied by the Sydney Catchment Authority and SDP. When fully operational SDP meets about 15% of total water demand.

Bulk water is treated to water quality specifications set by NSW Health based on national guidelines. In Sydney and the Illawarra the four major treatment plants are owned and operated by private sector companies. These are Build Own Operate arrangements entered into in the mid-1990s. Several smaller treatment plants are owned and operated by Sydney Water.

After treatment, water is transported to homes and businesses. For Sydney Water, about 72% of supply is residential and 28% non-residential. Wastewater is then transported from customers to 16 sewerage treatment plants and following treatment is reused and/or discharged to rivers and ocean. The level of treatment depends on where the discharge is occurring and on environmental requirements set to minimise environmental damage. Treated waste water is also reused by homes and industry in various recycled water schemes. There are four large recycled water plants: Port Kembla, Rouse Hill, St Marys and Rosehill. The latter is a public private partnership. Every year about 180,000 wet tonnes of biosolids are transported for broad acre agriculture use under regulated conditions, and about 50 billion litres of recycled water is produced.

What is notable about the split of costs in Figure 9.2 is the high proportion relating to the transport of water and wastewater of 37%. This reflects the fact that water/wastewater is a capital intensive business with a large network of assets. Sydney Water has a network of 21,000 km of water pipes and 24,000 km of wastewater pipes. There are also substantial pumping costs to move water and wastewater uphill.

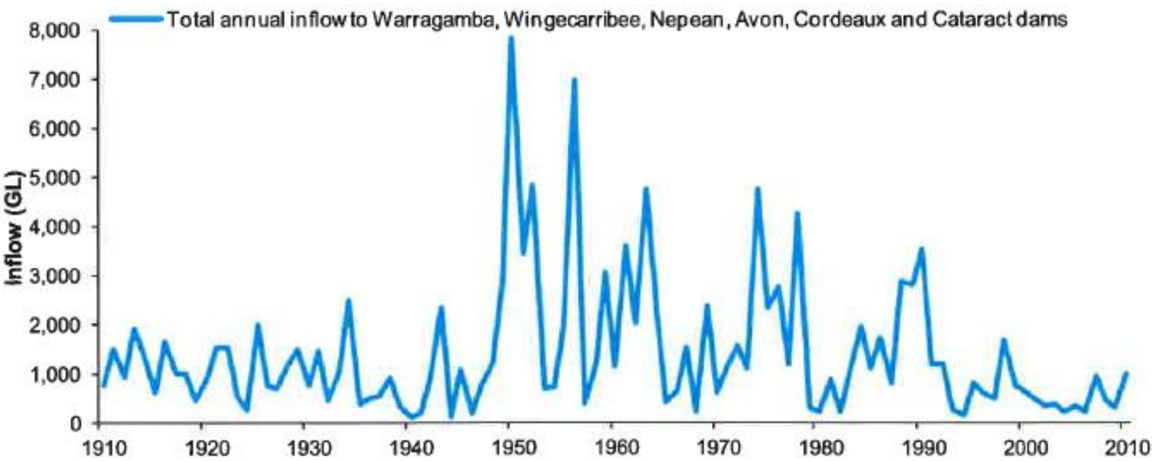
The supply chain for Hunter Water is similar but has several notable differences, as it:

- is vertically integrated and provides its own bulk water supply
- is a smaller scale operation, serving 549,000 people compared to Sydney Water"s 4.6 million. To do so it has 4,900km of water pipes and 4,700km of wastewater pipes (compared to 21,000 and 24,000 respectively in Sydney Water)
- has a mix of customers at Hunter Water of about 65% residential compared to 72% at Sydney Water.

Sydney Catchment Authority (SCA) activities include the management of storage dams and catchment areas, and the supply of raw water. They manage 21 storage dams with a total storage capacity of around 2,500 billion litres. By far the largest storage is Warragamba Dam which is about 80% of the total storage. When all storages are full, the capacity represents about four to five years of Sydney Water"s supply. By global standards this amount of capacity is high. This relatively large capacity is needed because of the extreme variance in catchment rainfall and runoff. Variability is not an issue in many other places outside Australia.

With increasing population and more extreme weather events, possibly associated with climate change, SDP provides additional water supply security. As noted the rainfall in the Sydney Catchment is extremely variable and the desalination plant runs under operating rules that have been set to complement this rainfall variance.

Figure 9.2: Dam inflows from 1910 to 2010



Source: Sydney Catchment Authority
[1] Inflows to the storages estimated by SCA using gauging data prior to the construction of the dams and mass balancing at the storages under various assumptions.

When storages are above 80% the desalination plant will not provide water to Sydney Water, and when storages are below 70% the plant will run at its full capacity of about 90 billion litres per year.

9.2.2. Effectiveness and efficiency

The two main drivers of expenditure in the urban water utilities are the standards set for service delivery, and the cost and effectiveness of implementation. Standards are set by regulators but they are also influenced by government policy which is reflected in the Operating Licence for the utilities. An Operating Licence spells out requirements for service delivery for each utility. For Sydney Water and Hunter Water the level of detail in their Operating Licence has increased over time as requirements have been added and very few removed. The Operating Licences are now extraordinarily prescriptive. For Sydney Water the Operating Licence runs over 90 pages plus a similar number of pages that set out reporting requirements.

Operating Licences cover:

- drinking water quality requirements
- water pressure and continuity standards
- requirements to set prices in line with regulations
- wastewater overflow standards
- customers rights and obligations

At present Operating Licences also include requirements concerning:

- response times for water main breaks
- water leakage targets across the network
- targeted reductions in water demand per capita per day
- targeted reductions in potable water use at wastewater treatments plants
- construction of Priority Sewerage Programs in specified villages
- targeted recycled water supply volumes
- asset management requirements
- environmental management systems and reports against environmental performance indicators
- water efficiency programs, for both residential and other customers
- connections being available on request to any property, subject to conditions of safety, reliability and financial variability
- recycled water and stormwater quality
- reporting obligations.

These requirements have assisted in making the relevant cities water efficient. But they have also contributed to increased utility costs. The targets set in the licences have not paid sufficient attention to benefit/cost trade-offs. There has on occasion been a lack of information to do this analysis, but this is no longer the case.

Recommendation: The Commission recommends that IPART review the Operating Licences of the water utilities with the aim of producing a more simplified less cumbersome Licence that maintains water quality and appropriate delivery standards.

Independent audits of the Operating Licence are conducted by IPART. For both Hunter Water and Sydney Water compliance has steadily improved to full compliance. On the more important requirements about drinking water quality, water pressure and continuity, wastewater overflows, and customer rights and obligations there is obviously no question about the need to meet such standards. Both Sydney Water and Hunter Water met the 2004 Australian Drinking Water Guidelines.

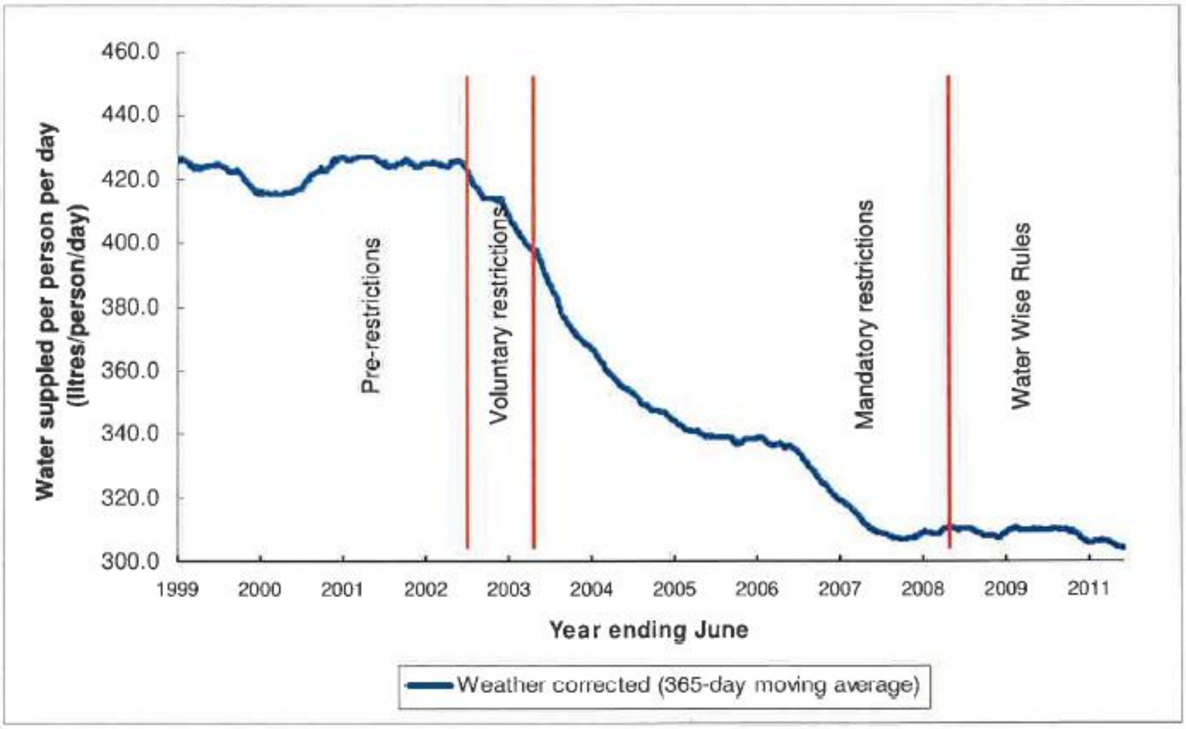
The water pressure targets permit a set number of failures a year, measured as the number of properties affected by low water pressure. Significant improvements have been achieved at Sydney Water and Hunter Water over the last decade. Continuity standards relate to the number of properties affected by planned and unplanned water supply interruptions, and by sewage overflows and discharges. These standards have also been met by the utilities.

The utilities have also been set a target about the amount of leakage permitted in their network. For Sydney Water the amount of water leakage must not exceed 105 megalitres a day. This level of performance is equivalent to about 8% of the water supplied not being accounted for. By global standards this is very low. The level of leakage in major cities is usually closer to 20% or more.

The cost of repairing leaks, which are typically hidden below ground, can exceed the long term marginal costs of supply, which is just above $2 per kilolitre at present. It makes economic sense to repair leaks up to this long term marginal cost of supply or the „economic level of leakage‟. But going beyond that standard is of questionable benefit to customers. The current leakage target is linked to the economic level of leakage. Leaks are addressed up to a cost per kilolitre that is the long run marginal cost of water.

The Operating Licence target for the volume of water supplied per person per day is a further requirement. This particular target has had scant regard to economics and measures pursued to meet this target have been well over the long run marginal cost of water. The total water demand by Sydney Water customers is in Figure 9.3.

Figure 9.3: Water demand



This decline in demand reflects the specific steps taken under the Metropolitan Water Plan, reflected in the Operating Licence, to balance water supply and demand. The 2003 restrictions were accompanied by rebates and services to encourage the fitting of water efficient appliances. Business took steps to improve the use of water in their processes including more efficient cooling towers, more water reuse for non-drinking purposes, and addressing internal leaks. Targets for lower water demand and for recycled water volumes were reflected in the Operating Licence. An outcome of these measures was an extraordinary decline in drinking water demand at Sydney Water, from about 630 billion litres a year in the late 1990s to about 500 billion litres at present. Recycled water supply was targeted to be 70 billion litres a year by 2015. By 2010-2011 Sydney Water was producing more than 50 billion litres of recycled water for environmental, industrial and residential non-drinking use. Other suppliers, including councils, were also producing recycled water.

The important issue is whether standards in the Operating Licences are being set at an appropriate level. There are significant costs in achieving these standards and the correct balance between benefits and costs needs to be struck.

The targets set for water demand per customer, and for the volume of recycled water to be supplied, were not well costed at the time. There is now more information available to inform the policies. Recycled water schemes vary in total cost per kilolitre supplied. Much of this cost can be in the cost of transporting. Cost effective schemes (including recycled water from the Port Kembla) are less than the long run marginal cost of water and are easy to support. Many other schemes, including the Rouse Hill Recycled Water Scheme, cost 2 or 3 times the marginal cost of water and are of questionable value to customers. There are less costly methods of supply.

An Operating Licence requirement to provide sewerage services to distant villages, at a cost that is spread across all water users in Sydney, is popular for that village. But when this service cost is extreme, over $80,000 a lot, and septic tanks or other localised alternatives have been performing satisfactorily without environmental costs, it is not efficient. Service provision is important for customers but the cost / benefit ratio must be considered.

Recommendation: The Commission recommends that IPART review the Operating Licences of water utilities and recommend a change to standards and other requirements that do not meet cost/benefit criteria.

It is the Commission"s view that there are two positive contributing factors to operating efficiency in the urban water industry. These are the independence of the price regulator, and competition. The pricing methodology used for Hunter Water, Sydney Water, Sydney Catchment Authority and SDP is intended to set full cost recovery prices for costs that are efficient. There is no mechanism that allows political considerations to directly influence pricing. The only way this can happen is through policy reflected in the Operating Licence. Where independent price regulation is not in place prices are frequently less than full cost recovery and their increases are related to the political cycle. The consequences of partial cost recovery are subsidies, large catch-up future price rises, and delayed maintenance and capital expenditure.

Because IPART is required, under legislation, to set prices that cover efficient costs there is considerable attention paid by the regulator to the cost base. At each price determination the utility is thoroughly reviewed by independent parties to ensure that their intended costs of operation and capital are efficient. This process does provide a level of rigour not present in other NSW State Owned Corporations and Authorities which are not subject to economic regulation.

However under the IPART Act the objectives set for IPART are not clear and over time the weight that the Tribunal has placed on commercial outcomes in comparison to consumer price reductions has varied. While IPART has focussed on efficient operations and efficient capital spending they have paid less attention to what an optimal capital structure would be for each utility. This has in turn led to little focus on the cost of borrowing and the return on equity, and insufficient focus on the significantly impaired asset values. Possibly because of this lack of attention to capital structure, State Water is at risk of financial non-viability with a credit rating below investment grade. Sydney Water while not yet in such dire straits, has an increasing debt position which must be allowed to stabilise though appropriate price determinations.

Recommendation: The Commission recommends that the Department of Premier and Cabinet, Treasury and IPART examine the *IPART Act* with the intention of improving IPART‟s regulation by making its objectives clear. As the water industry becomes more competitive with more private sector involvement it is also timely to consider the introduction of an Appeal or Review mechanism.

The prices charged for water and wastewater by various entities are set out in Table 9.1. Those utilities with more connections tend to have lower prices because of economies of scale. In Sydney and the Hunter in 2010-11, prices increased by about 7%. It is notable that price increases for all urban water utilities have been high (and well above inflation) reflecting recent high capital expenditure towards the end of the recent drought. The movements in price have also been uneven. Although Sydney Water is among the higher priced group, the charges for a typical household are generally not dissimilar across Australian cities.

Table 9.1: Urban water utilities – water and wastewater charges, 2009-10

100,000 + Properties connected	**$/p.a.**		**50,000 - 100,000 + Properties connected**	**$/p.a.**
Sydney Water	985		Logan	1017
Water Corp (Perth)	918		Cairns	1047
Yarra Valley Water (Melbourne)	918		Townsville	632
South East Water (Melbourne)	882		Gosford	832
SA Water (Adelaide)	855		Coliban Water	778
Brisbane	836		Gippsland Water	1049
City West Water (Melbourne)	946		Ipswich	1118
Gold Coast	1115		Central Highlands Water	951
Hunter Water	832		Wyong	821
ACTEW	967		Goulbourn Valley Water	654
Barwon Water	778			
Range of increase in 2009-10: 6-16%			Range of increase in 2009-10: 6-21%	
Average increase: 11%			Average increase: 12%	

The benefits of an independent and rigorous pricing regulator are clear. However, a regulator performs at its best when its decisions are subject to scrutiny through an appropriate merits-based review as part of a transparent appeals process. Unlike the regulated energy sector, where parties can appeal decisions by the Australian Energy Regulator (AER), IPART‟s decisions are not subject to review. Stakeholders are not able to have any concerns with the determination, methodology and other issues heard. Not only does this cause disquiet among stakeholders it creates an environment where the market perceives regulatory risk within the NSW economy. The Commission is aware that Moody‟s, the Credit Ratings Agency, has rated IPART as an A rating for their regulatory work, well below the AAA rating that it has given the UK‟s Office of Water regulator (Ofwat).

Recommendation: The Commission recommends that IPART be subject to merit based reviews of its decisions and that work commence on the various options to achieve this outcome.

Economic theory suggests that competition aids efficiency in particular circumstances. In the water industry, because of its monopoly characteristics, competition is always accompanied by regulation. There are opportunities for competition, and more is emerging in NSW under the *Water Industry Competition Act* (WICA). Within urban utilities the large networks of water and sewerage pipes would be inefficient to replicate. As in other industries however, access regimes can be established for competitors to use these networks. Sydney Water‟s networks have access regimes in place and IPART‟s role in ensuring that these regimes will encourage competition is critical. Under access regimes a new entrant pays the access owner for use of their network in transporting their water / wastewater, from and to a set destination(s).

Recommendation: The Commission recommends that IPART ensures that the access regimes for water and wastewater encourage competition and new entrants, while ensuring that the access owner receives a commercial return on their assets.

Both the bulk water suppliers for Sydney and the Illawarra, the SCA and SDP are able to supply bulk water to any customers wishing to purchase at their regulated prices. As noted earlier SDP is expected to be privately owned in the near future, with a long term lease of the desalination plant, and is being encouraged, under WICA, to supply water to other customers. New entrants purchasing water from the SCA need treatment facilities and, under the network access regime, this service can be added at an agreed price.

The larger water treatment plants in Sydney and the Illawarra are privately owned and operated. The competitive tenders for the BOOT contracts for water filtration plants in Sydney in the mid-1990s lowered treatment costs. More recently the small wastewater plants being used by the private sector have suggested more cost effective ways of managing new developments and providing services to small village communities. The recycled water plant at St Marys is also efficiently operated and maintained by the private sector and as noted earlier, the Rosehill recycled water plant is a public private partnership that followed a competitive tender.

This experience suggests that the urban water utilities should examine whether or not to extend the competitive tendering option to the operations, maintenance and lease/ownership of new and existing water and wastewater treatment plants, and recycled water plants. This approach has proved successful and could be expanded. Where options are identified that lower costs and risks to the utilities, these should be implemented.

Recommendation: The Commission recommends that Sydney Water and Hunter Water examine options to extend the competitive tender of operations, maintenance and lease/ownership of new and existing water treatment and wastewater treatment and recycled water plants. A public private partnership approach should also be considered as part of this analysis.

Treatment plants are contestable assets in the sense of being capable of outsourcing or franchising. Where the private sector can operate these plants more efficiently they should do so.

Retail competition (billing) is also a contestable activity. The UK regulator has recently been investigating the introduction of competition in this area. The Commission understands that retail competition has been introduced recently in Scotland. IPART and the utilities should keep abreast of the UK developments around retail competition. If these suggest further efficiencies in retail they should be examined. One possible barrier to retail competition in Australia is the fact that water utilities bill on a property basis. They also have rights to recover bad debts when property is sold which keeps bad debts very low. Electricity and gas utilities bill on a person/tenant basis. This means the billing systems of energy utilities do not fully match those of the water utilities.

To encourage retail competition it is worth examining whether water utility billing systems could be changed to a person rather that a property basis. This would open up the possibility of retailers in others areas using their systems to bill for water. Whether or not this is worthwhile does need investigation. Such a move would be best made when billing systems are being replaced or renewed. Preparation for a new billing system is underway at Sydney Water at present. The Commission understands that retailing for Sydney Water and Hunter Water appears to be a low margin operation which may count against any change.

Recommendation: The Commission recommends that Sydney Water and Hunter Water investigate the option of moving their billing system from a property base to a person base, similar to that for energy customers.

The SCA and SDP have water supply responsibilities. While the aggregate demand–supply balance is adequate at present, the Commission notes that there are two areas that appear to be less resilient. These are the Illawarra and the Blue Mountains. Both rely on small dams – Avon Dam with Nepean Dam transfers in the Illawarra, and Cascades Dam and the Fish River Dam in the Blue Mountains. With population growth, especially in the Illawarra region, there is a need for the Sydney Catchment Authority to address the issues of local resilience over the medium term. In the last drought the Port Kembla Recycled Water Plant substituted about 17% of drinking water supply in the Illawarra. Without this action the Illawarra could have faced draconian water restrictions and some industries may not have been able to get water supply. In the Blue Mountains supply for both residential and electricity generation purposes was uncomfortably tight. Over time added population growth will add to these pressures.

Recommendation: The Commission recommends that the Sydney Catchment Authority review future water supply for specific parts of Sydney and the Illawarra where resilience of supply may not be sufficient.

The SCA has noted a need to upgrade the Upper Canal. This canal transfers water from the coastal dams and the Shoalhaven, to a major water treatment plant at Prospect. The Upper Canal is an aged asset with urban encroachment well advanced to its borders. This upgrade is necessary to both protect water quality and to allow the volume of water transferred to meet both current design capacity and planned expansions.

There is also an issue around reliability of supply in the Hunter. During the last drought storages fell by about 60% in 18 months. Grahamstown Dam is a wide, shallow storage and prone to extreme evaporation. Over short periods storages can fall dramatically. This situation led to a decision to construct Tillegra Dam, a decision which was subsequently reversed on environmental grounds. Hunter Water owns about 90% of the area to be impacted by that proposed dam and at a cost of about $400 million it was less than half the cost of a desalination plant.

At some point in the future the difficult decision about the most appropriate option to expand Hunter Water‟s supply must be confronted. The Commission notes that the Department of Finance and Services is currently leading the development of a Lower Hunter Water Plan, which will set out strategies to secure the water supply for the area. Planning before another drought occurs is to be commended.

Recommendation: The Commission recommends that the Department of Finance and Services and the Department of Planning set out strategies for community consideration about the long run security of water supply in the lower Hunter.

9.2.3. Efficient costs and investment returns

The summary profit and loss and balance sheets for Sydney Water are set out below in Tables 9.2A and 9.3B.

Table 9.2A: Profit and Loss
Sydney Water (2010-11)

$ million

Revenue	
Regulated	2,189
Non-regulated	119
Total revenue	2,308
Operating expenditure	1,257
EBITDA	1,051
Depreciation	194
Asset charges	23
Interest expense	384
Tax expense	152
Profit after tax	274

Table 9.2B: Balance sheet
Sydney Water June 30, 2011

$ million

Assets	
Property, plant and equipment	13,174
Other assets	675
Total assets	13,849
Liabilities	
Debt	6019
Other liabilities	1970
Total liabilities	7989
Net Assets	5860

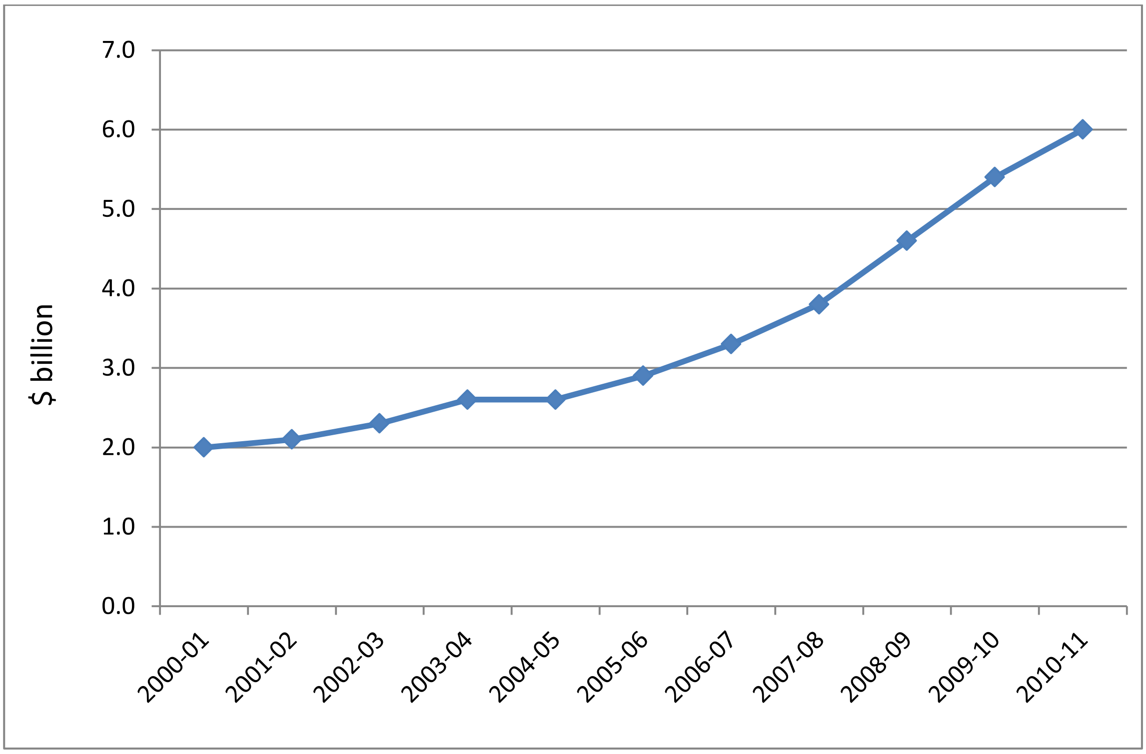
There are several items worth noting about Sydney Water"s financials.

- most revenue is regulated and IPART determines water and wastewater charges every four years
- key components of operating expenses are bulk water costs and labour. There are about 2,970 employees, down from 3676 in 2001
- depreciation is based on the IPART determined Regulated Asset Base. This is about half the Modern Engineering Equivalent Replacement Asset (MEERA) Value. Depreciation is thus understated in an economic sense (by more than half), and the profit result is overstated
- the value of property, plant and equipment and the level of debt is notable. The value of property, plant and equipment at MEERA value is $32 billion for Sydney Water. The regulated asset base is about $13 billion.

Over time, as new capital expenditure occurs, the impaired asset value approaches the MEERA value or the depreciated optimised replacement value. The consequence is that the requirement for maintenance and renewal capital expenditure is underestimated by the depreciation figure in the accounts. The value of assets in the balance sheet is based on allowed cash flows and reflect only half the replacement value. When this underestimate of depreciation and replacement capital expenditure is considered, it adds about an extra 1.5% a year to prices.

Capital expenditure at Sydney Water has recently exceeded $1 billion a year as recycled water plants and the desalination plant were constructed and completed. Capital expenditure has now returned to more usual levels of $600-700 million a year. Considerable debt has built up as the past capital projects have been funded. See Figure 9.4. Managing financial variability in the future with this high debt level will require continuing attention to cash flows, and those related to efficiencies in operations and capital delivery in particular.

Figure 9.4: Debt: Sydney Water



The Funds From Operations (FFO) interest cover ratio has declined from 2.4 in 2008-09 to 1.9 in 2010-11 as debt has increased. This trend is of concern and financial costs, as well as operating and capital costs require close attention.

As well as being reviewed regularly by IPART the operating costs have recently been independently reviewed for Treasury. For Sydney Water various saving opportunities were identified:

- better productivity in maintenance through improved work practices
- better management of service contracts
- more efficient council road restoration
- improved inventory management
- asset planning process efficiencies
- a review of management structure and spans of control
- extend shared services and administration efficiencies.

Together these and other initiatives were estimated to lower costs by over $50 million a year. A program to implement these initiatives is underway and Sydney Water has committed to $139 million in real savings over the period to 2015-16. The main challenge for cost reductions is in maintenance. About half of this work is contracted out and the rest is done internally. While significant efficiencies have been made in recent years further progress is dependent on changes in work practices and culture.

Further outsourcing is an obvious option but it is initially costly and partially prohibitive because of existing employment conditions relating to leave, superannuation and redundancy provisions. These matters are gradually being addressed. In the meantime better management of task allocations, overtime and inventory is achieving improvements.

Recommendation: The Commission recommends that Sydney Water investigate further ways to improve productivity in its maintenance work. This review should examine existing outsourced contracts, work practices internally and how more maintenance work can be outsourced if that is the most cost effective option.

The summary profit and loss and balance sheets for Hunter Water are set out below in Tables 9.3A and 9.4B.

Table 9.3A: Profit and Loss
Hunter Water (2010-11)
$ million

Revenue	
Regulated	222
Non-regulated	39
Total revenue	261
Operating expenditure	107
EBITDA	154
Depreciation	33
Asset charges	2
Interest expense	57
Other	28
Tax expense	10
Profit after tax	24

Table 9.3B: Balance Sheet
Hunter Water, 30 June 2011
$ million

Assets	
Property, plant and equipment	3,474
Other assets	62
Total assets	3536
Liabilities	
Debt	816
Other liabilities	669
Total liabilities	1485
Net assets	2051

Hunter Water revenues are also regulated, though 16% of its revenue is earned from engineering consulting work conducted outside Hunter Water. The main operating cost is labour. There are about 480 employees. As with Sydney Water the regulated asset base, on which depreciation is calculated, is less than half of the MEERA value or depreciated optimised replacement value. The profit is overstated and depreciation, in an economic sense, is understated. The time it will take for regulated asset base value at Hunter Water to approach MEERA value is well over fifty years. This gap between the depreciated replacement value of assets and the regulated asset base is a device that keeps profits below their commercial level. It reduced equity returns to government. Perhaps more importantly, it fails to allow sufficient funds to be clearly set aside for asset renewals and replacements. This matter has been commented on in similar terms by the Auditor General over at least the 2002 to 2007 period.

Recommendation: The Commission recommends that IPART examines the gap between its regulated asset base (RAB) value and MEERA or depreciated optimised replacement values, and takes steps to have the RAB value approach the MEERA or depreciated optimised replacement values over a shorter time frame that is currently the case.

For Hunter Water the cost savings identified to IPART amounted to $36 million a year by 2015-16. Their independent review identified a further $1.4-2.4 million a year savings through better procurement outcomes and fleet management. Overall the Commission is of the opinion that Hunter Water is efficient and are in pursuit of cost reductions.

The summary financials for the Sydney Catchment Authority are set out below:

Table 9.4A: SCA, Profit and Loss
2010-11
$ million

Revenue	
Water sales	191
Other	3
Total revenue	194
Operating costs	86
EBITDA	108
Depreciation	23
Interest expense	34
Tax expense	16
Profit after tax	37

Table 9.4B: SCA, Balance sheet
30 June 2011
$ million

Assets	
Property, plant and equipment	133
Other assets	46
Total assets	1376
Liabilities	
Debt	475
Other liabilities	188
Total liabilities	663
Net assets	713

The main features of the SCA financials are:

- capital expenditure of $27 million in 2010-11 is less than usual and as noted above there is a major project pending for the Upper Canal, possibly in stages
- SCA"s main revenue source is regulated charges from Sydney Water that are passed through to their customers.

The summary financials for SDP are set out below:

Table 9.5A: SDP, Profit and Loss
2010-11
$ million

Revenue	
Water sales	203
Other	0
Total revenue	203
Operating costs	67
EBITDA	134
Depreciation	29
Interest expense	90
Tax expense	4
Profit after tax	9

Table 9.5B: SDP, Balance sheet
30 June 2011
$ million

Assets	
Property, plant and equipment	1284
Other assets	26
Total assets	1310
Liabilities	
Debt	1094
Other liabilities	95
Total liabilities	1189
Net assets	121

There are several noteworthy features about the financials for SDP:

- the pipeline asset from Kurnell to Erskineville is not included
- this now has been transferred from Sydney Water to SDP
- about half the operating costs are for renewable energy. Reverse osmosis is an energy intensive technology
- assets have been largely financed by debt. Its future capital requirements are relatively minor.

An independent goal for the government is that its utilities earn a commercial rate of return. For the urban water utilities their commercial performance is set out in Table 9.6.

Table 9.6 Commercial Performance Indicators, 2010-11

	Sydney Water	Hunter Water	SCA	SDP
Debt/Assets	43%	23%	34%	83%
Debt/(Equity plus Debt)	51%	28%	39%	90%
EDITDA interest cover	2.7	2.7	3.3	1.6
FFO interest cover	1.9	2.1	2.6	1.5
Dividends/PAT	84%	141%	84%	n.a
EBIT/RAB*	6.3%	4.2%	6.8%	8.1%
EBITDA/RAB*	7.9%	4.4%	8.5%	10.4%
Credit rating	BBB	BBB	BBB+	n.a

*RAB is Regulated Asset Base

With the exception of SDP, the urban utilities have had their assets impaired through value adjustments linked to their regulated cash flows. When this is taken into account their rates of return (EBIT/RAB or EBITDA/RAB) look decidedly better than they would if the ratios were to MEERA value.

The gearing in SDP is not intended to be a long term position. The sale of this company, which will hold a long-term lease of the desalination plant, will trigger a capital restructure. Sydney Water debt will be repaid and the private sector will be able to gear SDP appropriately.

The dividend payout ratio for all the utilities is high and the shareholders need to consider ongoing financial sustainability when dividends are agreed. This is particularly the case when interest cover ratios are declining rapidly, as at Sydney Water. While the utilities are not highly geared their current cashflows will not support further gearing. This is a matter that both IPART and the shareholders must recognise.

Recommendation: The Commission recommends that the three urban utilities, Sydney Water, Hunter Water, and the Sydney Catchment Authority continue to improve their commercial outcomes and that IPART and the shareholders put in place a strategy that will move the utilities to a more commercial capital structure.

9.3 Rural water

In non-metropolitan NSW, water services are delivered by local councils, State Water, the Office of Water and Essential Energy. This rural part of the NSW water industry is important for agriculture, rural industry, country towns and environmental management.

9.3.1. State water

State Water Corporation is the main rural bulk water supplier. It delivers water to licenced users on the fourteen regulated river systems in NSW. It also manages and releases environmental flows on these regulated rivers that stretch for 7,000 km. Over the last two decades State Water delivered about 4,600 billion litres each year. In the recent drought these deliveries fell by 76% to 1,100 billion litres a year.

State Water manages 20 dams and 280 weirs and related infrastructure. These provide bulk water for town supplies, industry, irrigation, stock and domestic use, riparian and environmental flows. Water usage is monitored and customers are billed. The regulatory framework for State Water is set out below.

State Water regulatory framework

IPART – sets prices to cover costs and reviews the Operating Licence. In 2014 price regulation will move to the Australian Competition and Consumer Commission (ACCC).

NSW Treasury – sets requirements for tax equivalent payments, dividends and an annual Statement of Corporate Intent (SCI) that covers a rolling five year period.

NSW Office of Water –sets the policy for water resource management. Accountable for Water Sharing Plans that share regulated river water between users and the environment.

State Water"s large operating footprint is managed using sophisticated IT control systems that enable remote monitoring, operation and control of assets. These systems have reduced water losses and improved the efficiency of operations and asset management.

The main customers of State Water are irrigators, industry, government (for environmental flows) and local council utilities for town water supplies. Revenue collection is based on perpetual water licences that entitle some unit share of available water in the relevant valley. Licences can be transferred. There is a fixed charge on licences and a usage charge on water extraction. Licences can be high security, for town water supplies, and general security, for some types of agriculture.

The summary financials for State Water are set out below.

Table 9.7A State Water, Profit and loss 2010-11
$ million

Revenue	
Sales	102
Other	34
Total revenue	136
Operating costs	93
EBITDA	43
Depreciation	10
Asset charges	1
Interest expense	5
Tax expense	7
Profit after tax	20

Table 9.7B: State Water, Balance Sheet 30 June 2011
$ million

Assets	
Property, plant and equipment	627
Other assets	54
Total assets	681
Liabilities	
Debt	151
Other liabilities	
Total liabilities	312
Net assets	369

Since the creation of State Water in 2004 there has been a focus on operational efficiency. Operating costs have decreased by 20% and staff numbers from 329 to 309. The corporation continues to seek improvements and a recent consulting report for Treasury suggested further savings through labour, procurement, location and travel efficiencies. These changes amount to annual savings of $7million a year and at least half will take over one year to implement. The Commission notes that several of these initiatives are well underway and efficiencies through better office locations are implemented.

In terms of capital efficiencies it is notable that State Water, along with all the other NSW water utilities, has a significantly impaired asset value. The MEERA value of State Water"s assets is about $2.5 billion though the regulated asset base is about $650 million. Previous sections have commented on the impact of this asset impairment, notably low equity return and insufficient funding for asset renewals and replacement.

Recommendation: The Commission recommends that the regulator of State Water examines its regulated asset base and its MEERA asset base value and consider how to bring the two more closely together over a reasonable period of time.

State Water is currently halfway through a major capital program of dam safety upgrades which has a total cost of around $400 million. This dam safety work is being driven by standards established by the Government"s Dam Safety Committee, under the *Dam Safety Act 1978*. This Act requires dams to be designed to accommodate the Probable Maximum Flood. The current spend is to ensure that dams can withstand a one in 700 year flood. To meet the Act"s requirements, very small reductions in risk are being achieved at a disproportionate cost that is not consistent with safety cost/benefit trade-offs in other industries. There is potentially a second stage of dam safety upgrade expenditure which may be required depending on the standards set by the Dam Safety Committee and the results of further investigation by State Water.

Recommendation: The Commission recommends that an independent review be conducted of the standards set by the Dam Safety Committee following a thorough risk and cost benefit assessment.

The Office of Water plays an important regulatory role for State Water. The Office of Water prepares water sharing plans for regulated rivers and issues Water Licences to customers. These specify the unit share, in millions of litres, that can be extracted from the available water. The high security licences have increased priority over general security licences, for example for agriculture.

Every year the Office of Water determines how much water is available. Essential supply is reserved first and remaining water is then allocated to water users as a percentage of their entitlement. This is known as an Available Water Determination (AWD) and customers are told each month of their AWD. The customers can then trade or use their water allocated volume. They must pay State Water a usage payment for both high security and general security water.

The prices charged for an annual entitlement and a usage charge are determined by IPART. The cost base of State Water is mainly fixed but the charges it is allowed by IPART are mainly variable. These charges are not set at levels that enable a commercial return. This puts State Water at considerable risk as a business, especially in drought, and has caused its debt funding to increase to uncomfortable levels. An independent report for Treasury in June 2010 noted that State Water"s credit rating was at risk of falling below investment grade if interest rates were to increase or if extracted water volumes were to be low. A drought, accompanied by higher interest rates would threaten financial viability.

Recommendation: The Commission recommends that State Water and its present and future regulator examine its capital structure and propose changes that would leave State Water financially viable.

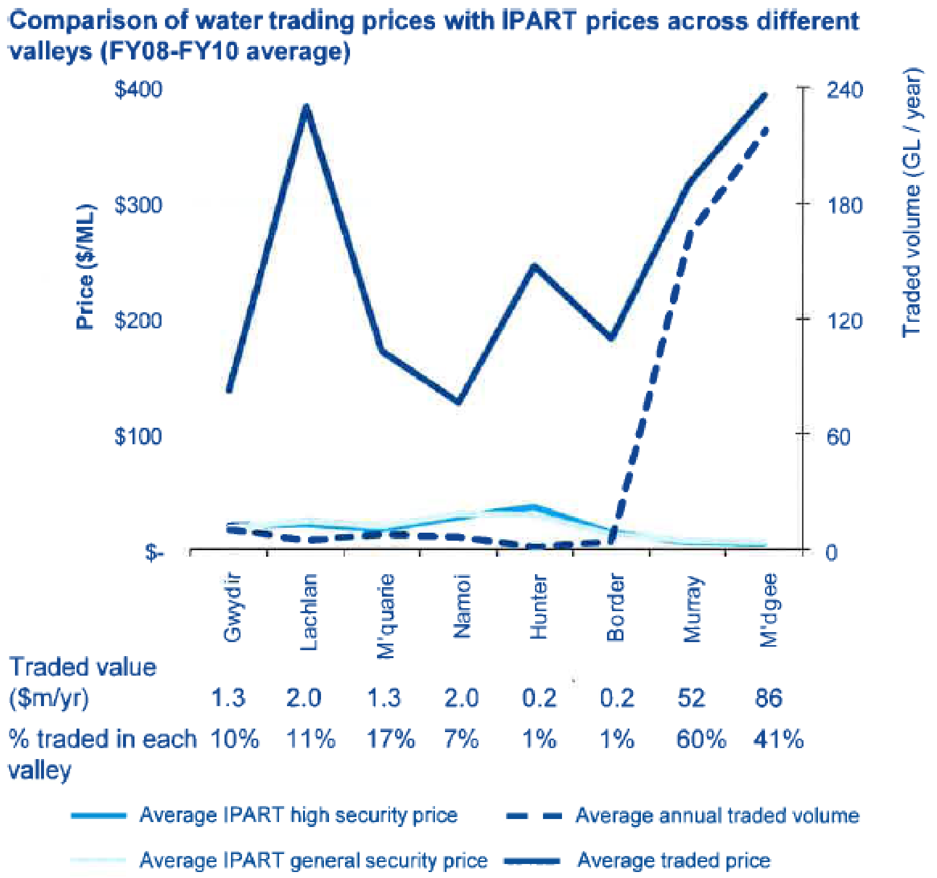
The regulatory pricing regime currently used for State Water will change when the ACCC takes over IPART"s role in 2014. The new regulatory pricing regime to be used by the ACCC in its regulation of State Water is largely in place. In July 2011, the ACCC released the document – *Pricing principles for price approvals and* *determinations under the Water Charge (infrastructure) Rules 2010* – which applies to all bulk water supplies in the Murray Darling Basin. State Water will be subject to these pricing principles.

One element of the new pricing principles is an annual review process whereby water charges can be updates annually to reflect updated demand forecasts used in determining charges. At least in theory, the intention of this is to provide State Water with greater revenue stability.

The ACCC is likely to consider State Water"s capital structure to be a matter for its shareholder.

There are a number of other features in the current approach by IPART which require revisiting. First prices have been set well below customer"s willingness to pay. This is shown in Figure 9.5 below. The prices paid for water that is traded on the market are significantly above IPART prices in valleys. The difference is more marked in the south of NSW.

Figure 9.5: IPART prices and traded water prices 2007-08 to 2009-10 average.



Availability of water is the issue, not price. The Commission notes that water usage is controlled in other states through a supply cap and/or by a regulated tiered pricing structure. In NSW customers have traded about 32% of delivered water for a return of about $430 million over the last three years. This outcome, in light of the IPART determination, does not seem appropriate.

High security water prices are rightly set by IPART to be above general security prices. However because licence holders do not get their full entitlement, because of over allocations, the actual prices of general security water have frequently exceeded high security water.

9.3.2. Local councils

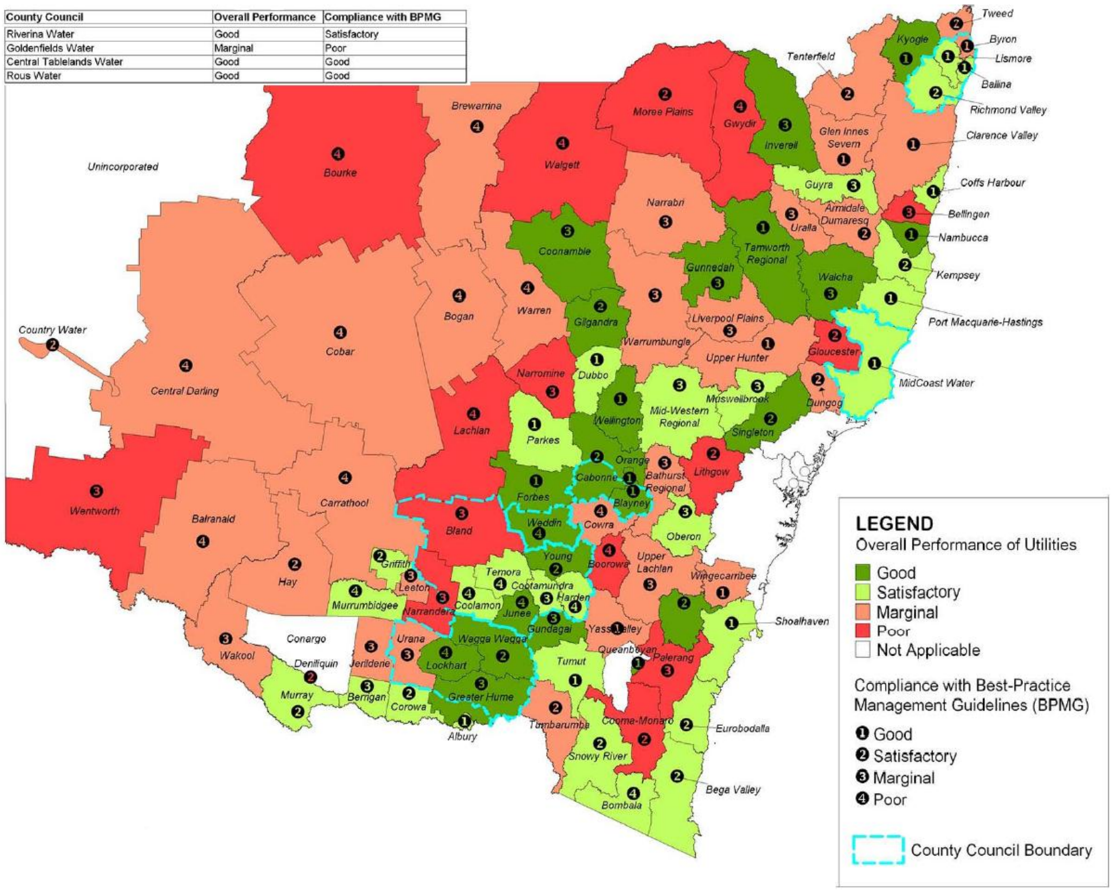
There are 104 local water utilities. Unlike the urban utilities, and Gosford and Wyong, these water utilities are not regulated by IPART. They determine their own prices, in accordance with government guidelines and their management of water and sewerage is also based on guidelines. These require best practice and if demonstrated the utility is able to pay their council a dividend, and be eligible for financial assistance towards the capital cost of an infrastructure backlog.

The total revenue of these utilities was around $ 900 million in 2010-11. Collectively they are the largest water and wastewater services supplies outside Sydney and Melbourne. The NSW Government is responsible for overseeing their performance under the *Water Management Act 2000* and the *Local Government Act 1993*. The local utilities task is to:

> provide appropriate, affordable and cost-effective water supply and sewerage services in urban areas of non-metropolitan NSW which meet community needs, protect public health and the environment and make best use of regional resources.

An independent inquiry in 2008, the Armstrong and Gellatly Inquiry, found that performance was mixed. Of particular concern was the failure of 17 local water utilities to meet the microbiological water quality requirements set in the 2004 Australian Drinking Water Guidelines. There had been 22 boil water alerts in the 25 months prior to June 2008. That said, the performance of most local utilities was either good or satisfactory. This is shown in Figure 9.6.

Figure 9.6: Performance of local water utilities, 2008 Inquiry



More recent data for 2009-10 suggests that issues with water quality continue, especially in the smaller local utilities. Compliance on *e coli* testing for water quality showed only 89% compliance, meaning that 2004 Australian Water Guidelines are not being met. This is a risk for public health. Sewage treatment and disposal is also not compliant in around 15% of local utilities. Again the problem is evident in smaller utilities.

To address the poor performance of some utilities seven recommendations were made in 2008. In summary these involved:

- an aggregation of local water utilities
- structural changes across regional groups
- better regulation, and improved pricing
- simplified reporting and regulatory roles within government
- mandatory adoption of consumer protection through a body, such as the Energy and Water Ombudsman
- various ways to manage and mitigate current and future skills shortages.

The Commission notes that current government policy specifically focuses on improved water quality in non-metropolitan areas. For public health outcomes this is critical. The Commission has been informed that there has been some improvement.

Recommendation: The Commission recommends that the Office of Water regularly reports to the government in some detail on progress made in each of the rural and regional water utilities to improve performance. Where local utilities are not compliant with drinking water standards, the actions being taken to remedy the situation and over what timeline, should be specified.

9.3.3. Essential Energy

For completeness the Commission notes that this State Owned Corporation is, as its name suggests, mainly an energy distributor. It does however supply water to Broken Hill, Menindee, Sunset Strip and Silverton. It also provides wastewater services in Broken Hill. The water business is not a natural fit for Essential Energy and they might consider an alternative arrangement.

9.3.4. Office of Water

The Office of Water conducts regulatory activities and provides policy advice. As noted its regulatory activities include licencing, natural resource management and compliance enforcement. The Office of Water is involved also in extensive operational activities. These are activities involving unregulated rivers, groundwater, hydrometers, and the Murray Darling Basin Authority salt interception scheme.

The Commission notes that the management of unregulated rivers by one group in government, and regulated rivers by another, leads to duplication of operations staff and less than holistic water management of river levels, ground water and aquifers. There is also unnecessary duplication of hydrometrics networks around assets operated by the Office of Water.

A separation of operational and regulatory activities is being encouraged by the Commonwealth Government under the National Water Initiative. If this policy were to be pursued by the Office of Water the operational activities listed above would move to State Water. These matters are core business for State Water and moving these activities from the Office of Water would both avoid duplication and potentially improve regulation.

Recommendation: The Commission recommends that the government consider moving the operational activities of the Office of Water to State Water. The regulatory roles of the Office of Water should be reviewed and made clear.

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10. Workers' Compensation

Key points:

- Workplace injuries deeply affect people and their families and is encouraging that over the last decade, there has been an almost 30% reduction in serious workplace injuries in NSW.
- Despite this reduction in injury rates, the financial position of the NSW WorkCover Scheme has deteriorated rapidly. There are increasing scheme operating deficits and increasing net liabilities.
- Premiums payable by employers are above those in Queensland and Victoria by 20-60%. This places NSW business at a considerable disadvantage, and is a heavy cost to employers.
- The NSW WorkCover scheme on current parameters is unsustainable and requires urgent action in a number of key areas.
- In particular return to work outcomes should be improved. The rate of injuries can decrease further, damages arrangements should be improved, medical costs managed better, and benefits for longer term injuries require reform to move in line with other states.

10.1 Overview

Work-related injuries can impose significant impacts and costs on injured workers, their families, business, the community and the economy as a whole. The impact of a workplace injury on an injured worker is immeasurable and can go beyond the physical pain of the injury itself. They and their families may be impacted financially, emotionally and psychologically as they contend with changed life circumstances. One objective of the workers" compensation system is to provide an injured worker with an adequate and fair level of medical and financial assistance.

Encouraging timely recovery and a return to work must also be an overarching objective of the system. Prolonged absence from the workforce has an adverse effect on the physical and mental health of injured workers. Research shows that employment prospects are severely impacted, and the effect increases, the longer a work absence continues. Providing the right incentives, and removing any disincentives, to return to work is of paramount importance.

The workers" compensation system must meet these objectives in a sustainable manner. This means balancing the cost of the scheme for business, and the economy as a whole with the cost of benefits provided to injured workers.

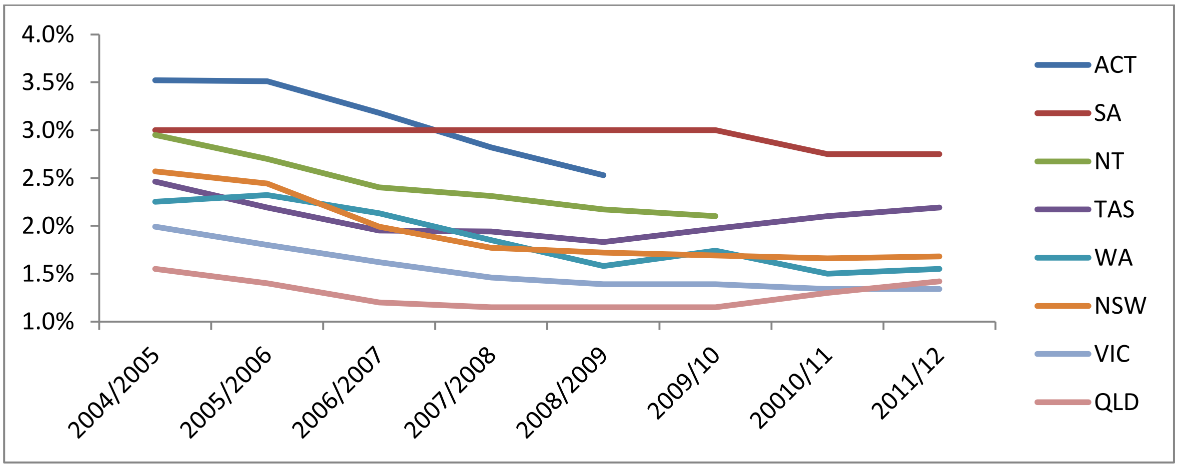
The total economic cost of workplace injury was most recently estimated at 4.8% of Gross Domestic Product. In current values, this equates to around $20 billion of the NSW Gross State Product.

The cost of compensating workplace injury is ultimately borne by employers through premium payments. The target premium collection rate for the NSW WorkCover Scheme in 2011-12 is 1.68% of wages. This target collection rate is:

- less than the 1.73% of wages rate required to cover the expected cost of claims for the year based on risk free investment returns
- marginally higher than the break even rate of 1.61% of wages, based on long term expected investment returns.

Since 2005, there has been a cumulative 33% reduction in average premium rates. The resulting savings for employers is now around $1 billion per annum. Despite these reductions, premiums in NSW remain higher than those in Victoria, Queensland and Western Australia. This seriously affects NSW business competitiveness against other jurisdictions.

Chart 10.1: Average premium rates as a percentage of payroll [(a)] [(b)]



Source: WorkCover Authority

(a) Variances in premium rates across jurisdictions can be influenced by differences in industry mix across states, the level of Government subsidies, returns from the management of scheme fund assets, the cost bases of the scheme operators, the level of entitlements across the various schemes.

(b) ACT and Northern Territory have private insurance and calculate an average premium rate in retrospect based on actuarial calculated results at year-end. Western Australia and Tasmania also use private insurers and set average recommended premium rates.

After adjusting for factors such as differential industry mix, claim excesses and whether journey and recess claims are covered, Victoria and Queensland premium rates are between 20 and 60% lower than in NSW, depending on the industry.

Table 10.1: Industry premium rates as a percentage of payroll, NSW and other States[(a)]

						% Difference to NSW (to nearest 10%)		
WIC	Description	NSW	VIC	QLD	SA	VIC	QLD	SA
861300	Nursing homes	5.06%	4.01%	2.70%	9.30%	-20.00%	-50.00%	80.00%
573000	Cafes and restaurants	2.64%	1.80%	1.19%	3.56%	-30.00%	-50.00%	30.00%
411300	Non-residential building construction	3.93%	2.67%	2.67%	3.49%	-30.00%	-30.00%	-10.00%
411100	House construction	5.04%	2.17%	2.64%	3.09%	-60.00%	-40.00%	-40.00%
547000	Clubs (hospitality)	3.12%	2.17%	1.67%	3.15%	-30.00%	-50.00%	0.00%
6110XX	Road freight transport	6.49%	5.07%	4.41%	8.96%	-20.00%	-30.00%	40.00%
783400	Computer consultancy services	0.24%	0.50%	0.18%	0.81%	110.00%	-20.00%	240.00%
843100	Higher education	0.61%	0.56%	0.61%	0.98%	-10.00%	0.00%	60.00%
421010	Demolition	10.57%		8.69%	5.80%		-20.00%	-50.00%
7866XX	Cleaning services	7.54%	4.40%	2.84%	8.72%	-40.00%	-60.00%	20.00%
12200	Combined grain growing sheep and cattle farming	7.15%	3.14%	3.80%	4.34%	-60.00%	-50.00%	-40.00%

Source: PricewaterhouseCoopers, 2011

(a) Standardised for Industry Mix, Claim Excess and Journey Cover

Further deterioration in the claims experience in NSW is likely to increase premiums unless steps are taken to address the causes of the deterioration. Understanding the underlying causes of the pressure on premiums, that are already relatively high, is fundamental.

The NSW workers compensation system is regulated through a comprehensive legislative framework which is discussed in Appendix 8 along with a summary of the main features of the workers" compensation system.

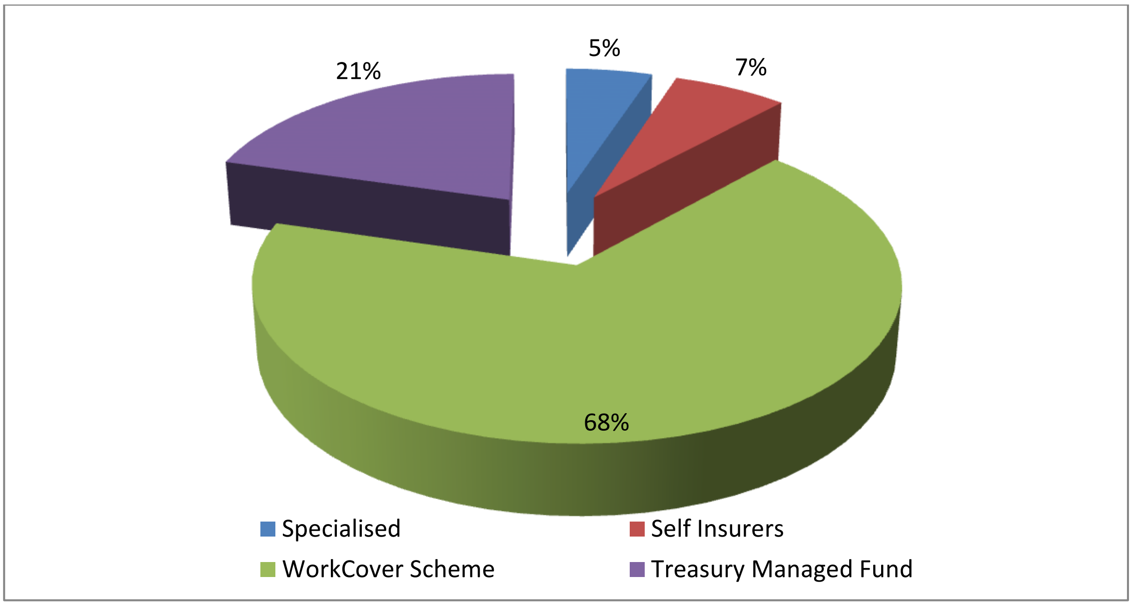
In the event of a work related injury or disease, a workers" compensation insurance policy ensures that an employer is covered for the costs of all benefits due to the injured worker. Compensation may include:

- weekly incapacity payments in lieu of lost income of up to 12 months post retiring age
- medical, hospital and allied health costs for indefinite period of cover
- lump sums for permanent impairment and pain and suffering
- rehabilitation assistance
- employer and employee legal expenses
- death compensation including funeral costs, lump sum and dependency payments
- limited access to negligence based damages under common law (Work Injury Damages)
- commutation of statutory entitlements to a lump sum.

There are four ways an employer can insure. These are through the WorkCover Scheme, self-insurance, a specialised insurer or the NSW government entity

Treasury Managed Fund. The distribution of claims between these four mechanisms is set out below. The importance of the WorkCover Scheme outside the public sector is obvious.

Chart 10.2: Distribution of major claims by insurance type 2010-11



Source: WorkCover Authority

Under the WorkCover Scheme, the NSW government as insurer is responsible for underwriting risk, funds management and premium setting. Private sector agents are under contract to collect premiums, conduct case management and debt management.

Workplace injury trends

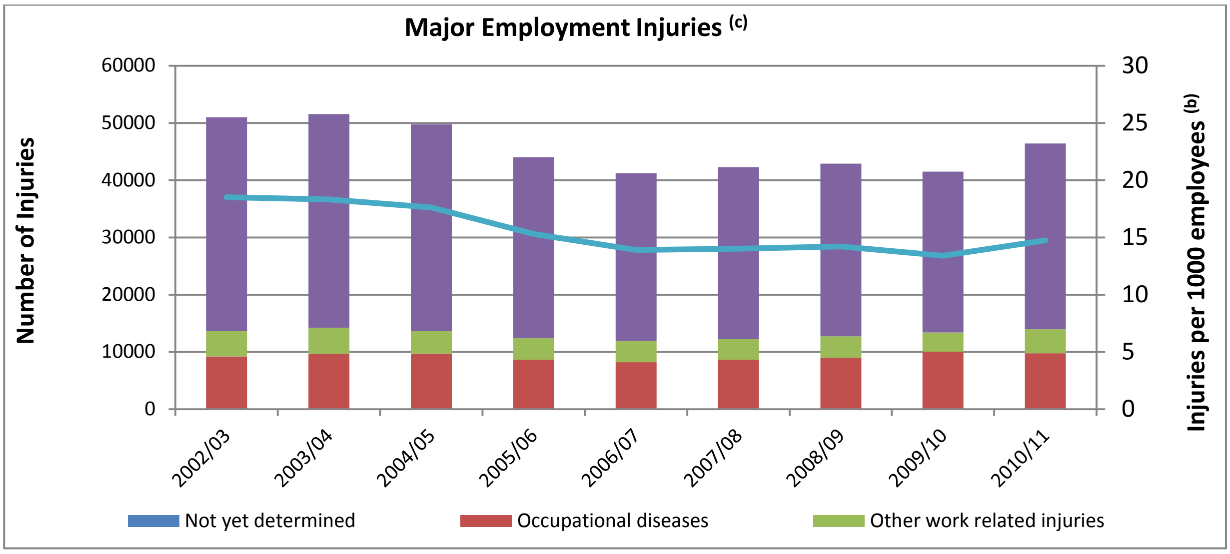
It is encouraging that workplace injury levels have declined steadily since the current workers" compensation regime commenced in 1987. The number of major injuries is down from around 55,000 in 2000-01 to around 41,000 in 2009-10. Over this same period, the NSW workforce grew by some 690,000 employees.

Key drivers of the injury reductions are:

- changes in workforce composition, particularly a proportionate shift from blue collar industries to lower risk service industries
- generally improved occupational health and safety (OHS) regulation and workplace safety performance
- increased public awareness and improved attitudes.

There has been only one period in the last decade where injury rates did not significantly reduce – the period from 2006-07 when claim rates essentially plateaued.

Chart 10.3: Major claim numbers 2000-01 to 20010-11[(a)]



Source: WorkCover Authority

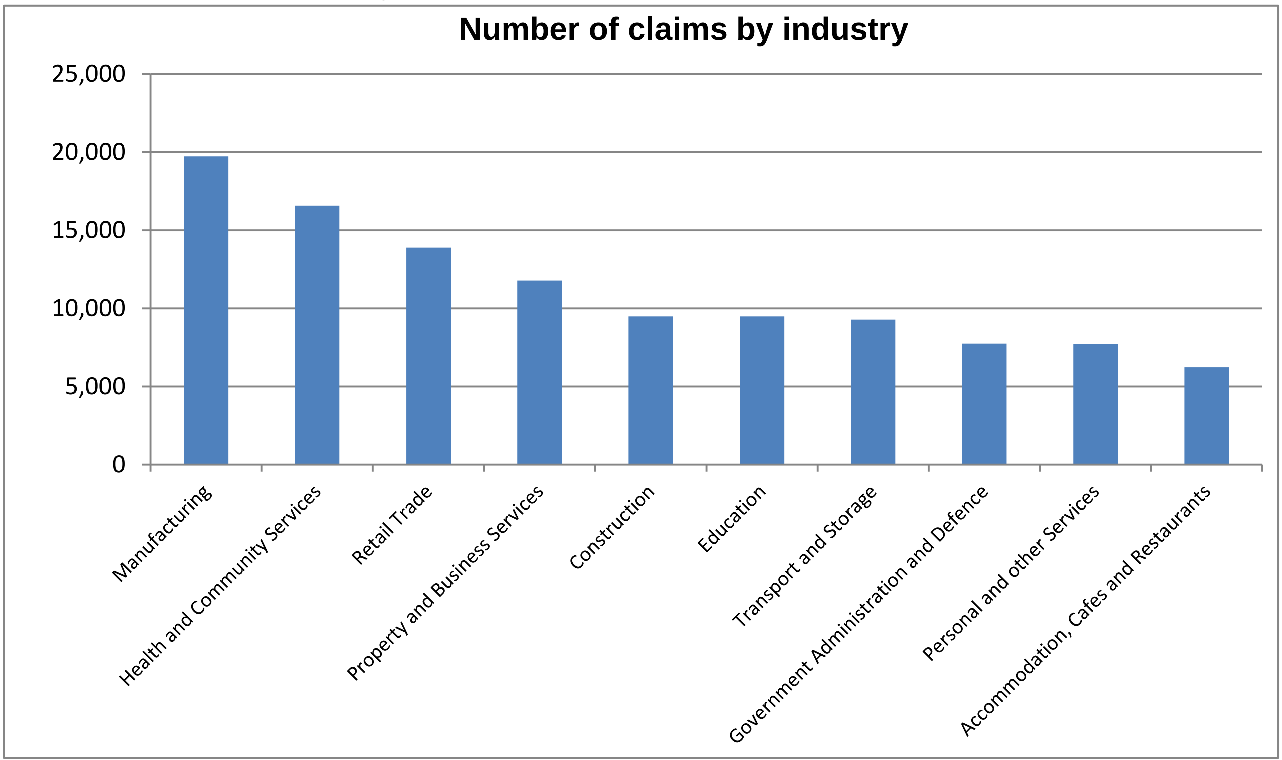
(a) 2010-11 claims and workforce data is not fully mature and may be subject to change.

(b) Incidence rate: measures the number major claims of per 1,000 employees.

(c) Major employment injury is defined as a compensation claim resulting in death or permanent disability or five or more days incapacitated for work.

„Sprains and strains" were the most common injuries in 2010-11. They accounted for 48% of all claims. The Commission notes that mental and psychosocial injury types have also been on the increase in recent years, particularly in the public sector. From an industry perspective, the manufacturing and property/construction sectors generate the most claims.

Chart 10.4: Industries with highest claim numbers in 2010-11



Source: WorkCover Authority

10.2 The WorkCover Insurance Scheme

The injury rate in the WorkCover Scheme has been stable for the past three years. The rate declined for around ten years before this time.

Table 10.2: Change in the number of claims: WorkCover Scheme

Year ended 30 June	**Number of claims**										
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Total claims	109,047	97,812	96,478	98,694	98,988	90,992	89,033	89,807	84,356	82,128	83,532
Claim frequency rate[(a)]	0.98	0.9	0.89	0.81	0.77	0.69	0.66	0.63	0.61	0.6	0.6

Source: New South Wales Workers Compensation data and WorkCover Authority (unaudited). The number of accepted claims per $million in wages (inflation adjusted to current values).

Despite the decrease in claims, the underwriting result has deteriorated rapidly since 2007-08. This is evident through larger operating deficits and an increasing net liability. The ratio of assets to liabilities (the „funding ratio") has declined significantly.

Table 10.3: Financial position of the NSW WorkCover Scheme

Year ended 30 June ($mil)	**2007**	**2008**	**2009**	**2010**	**2011**
Scheme operating result surplus/(deficit)	727	(187)	(2,107)	(101)	(780)
Net assets/(liabilities)	812	625	(1,482)	(1,583)	(2,363)
Funding ratio (85%) [(a)]	107%	104%	89%	89%	85%

Source: NSW Auditor-General"s Report Volume Five 2011

(a) The scheme"s target asset to liability ratio is between 90 and 110 %.

Appendix 9 sets out in more detail the scheme"s financial performance.

The underwriting result at 30 June 2011 showed net liabilities of around $2.4 billion, an increase of $780 million on the previous year. By October 2011, another increase in the deficit was evident. Based on June 2011 forecasts, the scheme is not expected to return to surplus until after 2020. This stands in stark contrast to the period of consistent underwriting surpluses between 2002 and 2008. The Commission understands that by December 2011, the deficit in the scheme had increased further with net liabilities rising from $2.4 billion in June to around $4.1 billion in December.

The deterioration in the scheme"s financial position is attributed to a number of factors. These are explained in Appendix 9 and several are outside the government"s control. First, the forecast value of outstanding claims liability has increased as yields from Commonwealth Government securities have declined.

Second, the WorkCover Investment Fund, which backs the scheme"s liabilities, was significantly impacted by the Global Financial Crisis (GFC). Whilst investment performance has subsequently improved, investment returns are unlikely to offset the deterioration in claims experience in the medium term.

Discount rates on bond yields and investment returns are not matters that the NSW Government can influence. However some of the cost pressures facing the scheme can more directly be influenced. These affect the total cost of benefits which makes up 80% of the scheme costs.

The scheme is facing cost pressures to benefits in four key areas:

- increasing duration of benefits

- increasing cost of weekly payments
- increasing Work Injury Damages (Common Law) claims
- increasing medical payments.

Looking at these in turn:

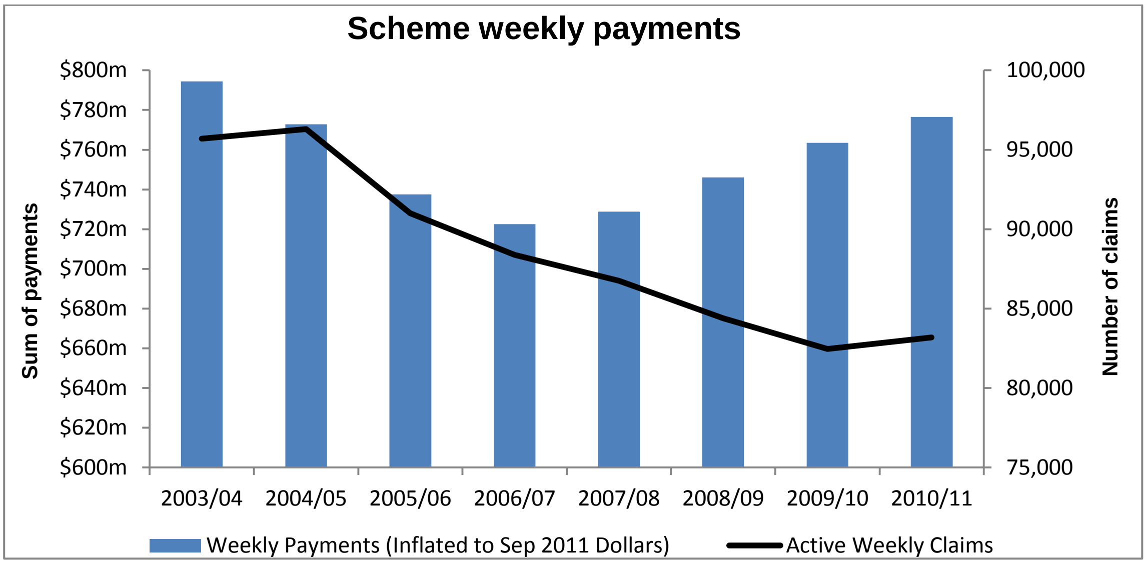
1. Duration of Benefits: NSW is a long tail benefits regime, with most benefits available to an injured worker indefinitely, or until the injury resolves. The average duration of a claim in NSW is around eight years with a wide range of duration around that average. The longest running claims remain active for over 60 years.

Other jurisdictions, including Queensland and Victoria have benefits regimes that are of a much shorter claim duration than NSW. After a particular time on those schemes, injured workers" entitlements can expire and in the absence of compensation payments they must seek assistance elsewhere, including Medicare, unemployment benefits or welfare payments. This effectively releases the state benefits regime from long term claims and transfers a proportion of work injury cost to the Commonwealth. This is one reason why systems in Queensland and Victoria have lower premiums.

2. Weekly Benefits: The primary determinant of scheme costs is return to work performance. More specifically, this means the number and duration of claims that receive weekly incapacity payments. Weekly benefits account for approximately 40% of the scheme"s gross cost. The utilisation of many other benefits is also highly correlated with a claim continuing on weekly benefits, for example medical costs.

Chart 10.5 depicts the change in weekly payment experience. Although the number of claims that receive weekly payments each year has trended downwards (black line), the total cost of weekly payments has increased sharply since 2006-07.

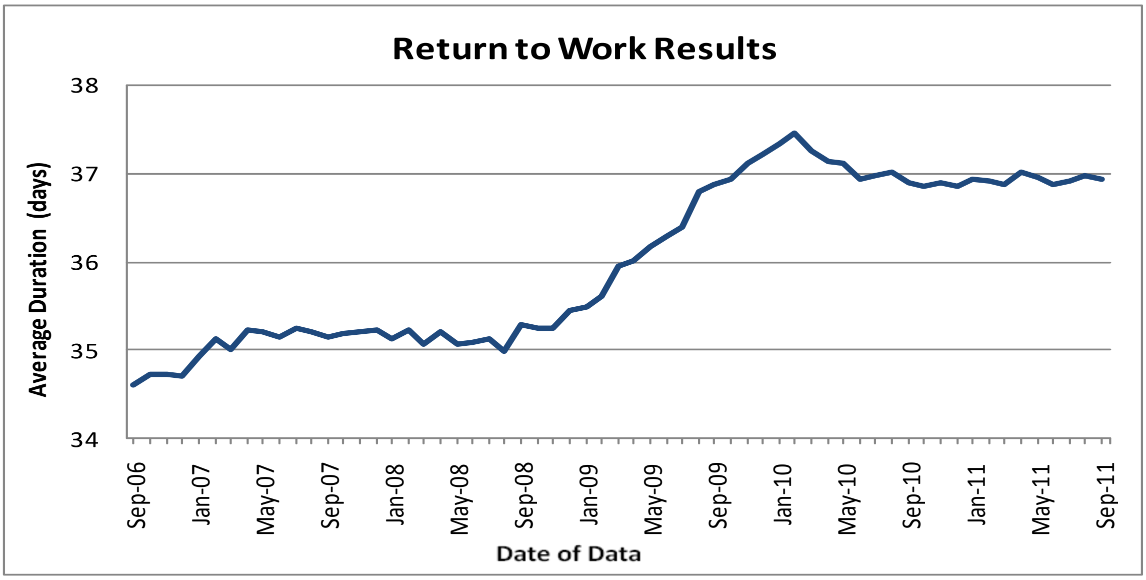
Chart 10.5: Weekly payment claims and total cost



Source: WorkCover Authority

The reason for this discrepancy is that claims are receiving payments for longer. Chart 10.6 below illustrates this clearly. Note in particular the two day increase in the average duration since 2008.

Chart 10.6: Weekly payment average duration [(a)]



Source: WorkCover Authority

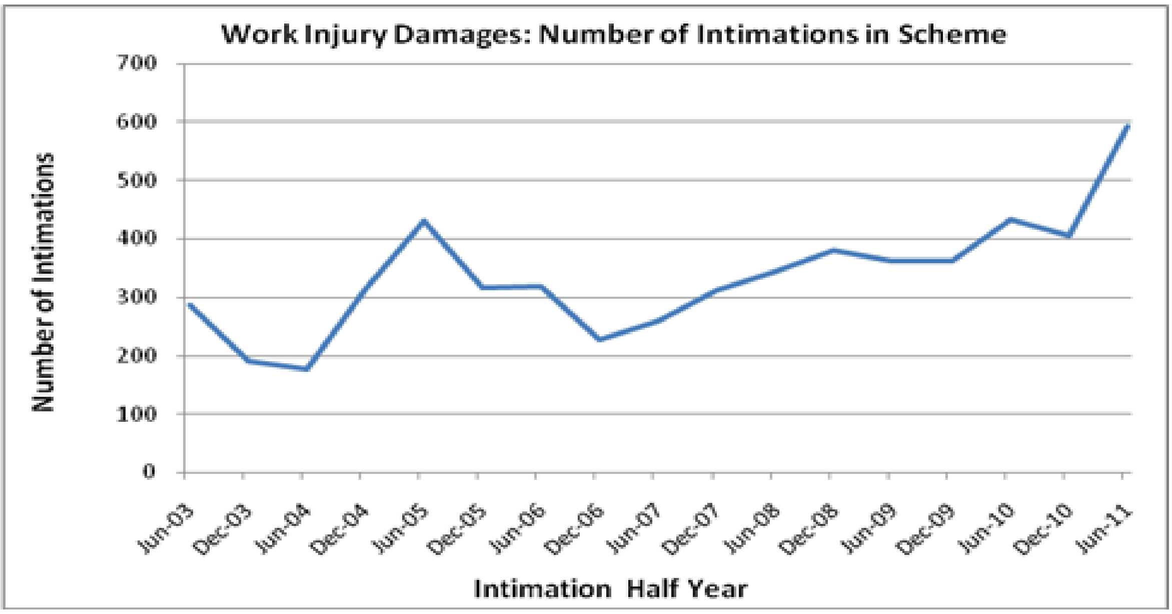
(a) average amount of lost work time during the first 26 weeks of a claim under the WorkCover Scheme.

Although weekly payments form the largest pool of the claims liability and are the primary determinant of total cost, they are not the strongest contributor to the deterioration in performance since 2008.

3. Work Injury Damages (Common Law) Claims: The cumulative deterioration in Work Injury Damages liability over the last three years was $934 million, making it the fastest growing scheme liability. Such claims involve an injured worker suing their employer for economic damages at common law.

Work Injury Damages claims cost significantly more than a statutory benefits claim. Further, the number of claimants electing to pursue Work Injury Damages is increasing. As a proportion of total liabilities, Work Injury Damages liability has almost doubled in less than three years, from 6.3% in December 2008 to over 12% in June 2011.

Chart 10.7: Work Injury Damages intimations under the NSW WorkCover Scheme



Source: WorkCover Authority

This increase in Work Injury Damages claims is not related to an increasing number of serious injuries. To be able to make a common law Work Injury Damages claim, several criteria must be met in law. The legislated criteria include:

- the work injury is a result of employer negligence
- the injured worker must have at least a 15% whole person impairment
- a claim can only commence at least six months after the worker gave notice of the injury to the employer

- Court proceedings cannot be commenced more than three years after the date on which the injury was received, except with the leave of the Court.

These criteria were introduced in 2001 and were intended to limit common law claims to severe injuries and to limit the damages available to economic loss – with separate statutory non-economic loss lump sums.

Various loopholes in the legislation have emerged and have been exploited. In practice:

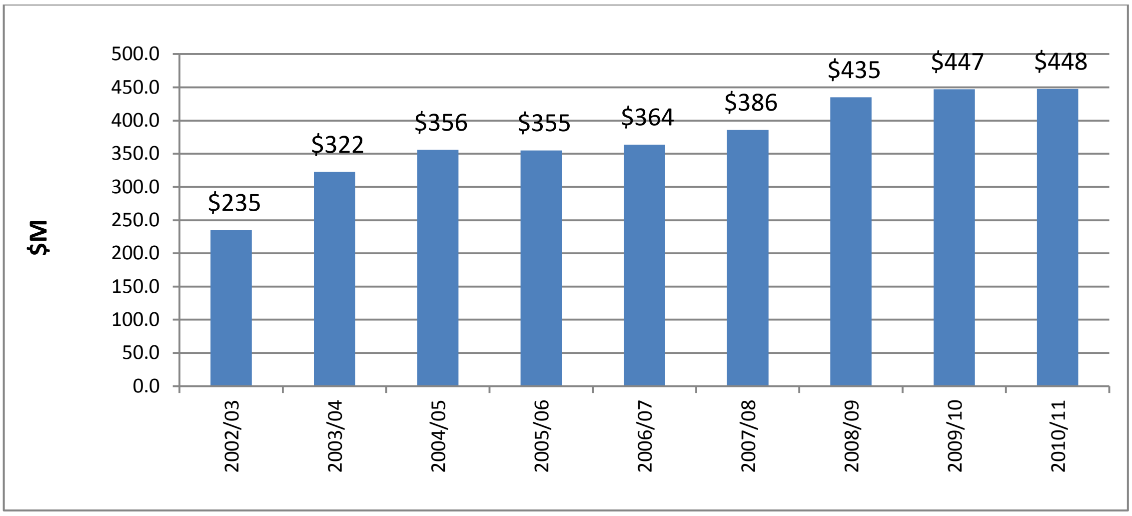
- negligence of the employer is rarely tested or adequately demonstrated
- claims are made many years "out of time„ and the Court accepts these claims in nearly all instances
- inappropriate strategies are used to satisfy the impairment threshold.

This is not to say that all Work Injury Damages are inappropriate. It is however clear that the pursuit of claims is on the increase and the intent to constrain common law claims as part of the 2001 reforms is failing.

4. Medical Costs: Medical payments for injured workers have almost doubled between 2002-03 and 2010-11, with a compound annual growth rate of 8.4%. This increase has been higher than inflation, and has outstripped the growth in costs in private health insurance, which is approximately 4% a year.

As a result, gross outstanding medical claims liabilities have increased by around $1.8 billion to around $3.0 billion in the last five years. Medical liabilities now represent 25% of the scheme"s liabilities. In the context of decreasing total incidents, this is a startling outcome.

Chart 10.8: Medical payments by the NSW WorkCover Scheme 2002-03 to 2010-11



Source: WorkCover Authority

10.3 Addressing the cost drivers

The emergence of cost pressures, associated with rising weekly payments, Workplace Injury Damages claims and medical costs, raise significant concern about the scheme‟s financial sustainability at current premium levels.

The Commission is of the view that a number of actions are required - and with some urgency – to address the four underlying drivers of the scheme‟s cost pressures. This amounts to reducing injuries, improving case management and return to work outcomes, addressing the increase in Work Injury Damages, controlling and managing increasing medical costs, and refining the current benefits regime.

The Commission considers that any reforms must, in addition to addressing financial sustainability, encouraging timely recovery and return to work, also balance the adequacy and fairness of benefits.

10.3.1 Reducing injuries and improving return to work

In ten years, NSW has reduced serious workplace injuries by almost 30%. The injury rate has now largely "flat-lined", with over 40,000 serious injuries occurring each year. Nevertheless, the incidence rate of serious injuries in NSW is higher than in South Australia, the Northern Territory, Western Australia and Victoria. Further effort is required to reduce the NSW injury rate.

Western Australia and South Australia continue to have one less serious incident per 1,000 employees than NSW. This is in spite of the fact that both these states have significant ‟blue collar„ industries which exhibit higher workplace risk.

Table 10.4: Incidence rates (claims per 1,000 employees) and percentage improvement of serious [(a)] compensated injury claims by jurisdiction

Year ended 30 June	Incidence rates					
	Improvement (%)[(b)]	**2010 Projected**	**2009**	**2008**	**2007**	**Base period**
SA	38.8	11.2	11.4	12.4	14.6	18.3
NSW	28.7	12.2	12.4	12.6	12.6	17.1
VIC[(c)]	28.3	8.1	8.6	9.0	9.5	11.3
QLD	16.9	13.8	15.0	16.3	15.9	16.6
TAS	12.3	13.7	14.8	14.7	15.7	16.2
WA	12.0	11.0	11.7	12.3	12.3	12.5
NT	9.7	11.2	11.0	12.1	11.4	12.4
ACT	-7.0	12.2	11.9	11.5	11.6	11.4

Source: Safe Work Australia Comparative Performance Monitoring Report, 13th Edition, October 2011

(a) Includes accepted workers" compensation claims for temporary incapacity involving one or more weeks compensation plus all claims for fatality and permanent incapacity.

(b) Percentage improvement from base period (2000-01 to 2002-03) to 2009-10 projected.

(c) It should be noted that Victoria"s claim rate is not directly comparable to NSW, due to scheme design and definitional differences.

The average cost per workplace injury claim is currently around $28,000. Reducing the injury rate to levels comparable with Western Australia and South Australia, i.e. one less serious claim per 1,000 workers, would result in around 8,500 fewer claims per year in NSW with annual cost savings of up to $230 million. The broader economic benefits for the community are much greater. WorkCover"s activities to manage and prevent injury are set out in Appendix 10.

Early return to work to suitable duties is important for both the injured worker"s wellbeing and also in containing claims costs. Changes to the arrangements with agents who manage claims are likely to assist. Every one day improvement in return to work outcomes saves $16.5 million and reduces claims liabilities by about $56 million per annum.

The Commission understands that WorkCover is currently reviewing the formula for remunerating Scheme Agents. The purpose of this review is to improve scheme performance. Existing remuneration arrangements do not encourage Scheme Agents to improve case management and this is required to address deteriorating performance.

A proposal is being developed which makes additional remuneration available to Scheme Agents if current performance deterioration is addressed. Further remuneration is also available for Scheme Agents if they improve the liabilities associated with their particular portfolios. New arrangements are expected to be in place later in 2012. A further, more comprehensive review of Scheme Agent remuneration is expected later in 2012, for commencement in 2013.

At least one Scheme Agent considers the current remuneration arrangements to be unviable and as a result the Agent‟s attention to case management is not what it should be. It is recognised that the remuneration arrangements need to be affordable for the Scheme. But at the same time, Scheme Agents need to earn reasonable returns to encourage more active case management. This would drive sustainable Scheme outcomes.

Recommendation: The Commission recommends that the Government should request the WorkCover Authority to consider a number of reform options to improve injury management and return to work outcomes under the WorkCover Scheme. WorkCover should liaise with other jurisdictions and consider directions taken elsewhere. The objective is to reduce the cost of weekly payments and in due course lead to lower employer premiums. Reform options should be presented to Government for consideration and should cover:

- the introduction of a specialist return to work inspectorate
- revised Scheme Agent remuneration structures to create better incentives for improvements in active case management
- enhanced incentives, or penalties, to encourage employers to offer suitable duties or not terminate the employment of workers who have made a claim
- changes to work capacity certification, that is arrangements whereby an injured person‟s capacity to do work is medically assessed, documented and used to support a return to work plan
- introduction of specialist claims management providers
- introduction of a work capacity test as a condition for receiving long term partial incapacity, i.e. weekly top-up payments – similar to the one used in Victoria and South Australia
- changing the step-down in weekly benefit levels – the point in time when the weekly payment an injured worker receives changes to a lower rate.

10.3.2 Addressing the increase in lump sum payments

The rising number of new Work Injury Damages claims in recent years, and associated changes in the profile of statutory permanent impairment lump sum claims, suggests that a lump sum culture is re-emerging within the scheme. This was last evident before 2001 and was addressed through significant changes to the scheme at that time.

The Commission considers it imperative that action is taken to contain emerging Work Injury Damages cost pressures. A major driver of the adverse experience is the legislative „loop holes" that are now being unreasonably exploited to establish and maximise claims. The Auditor-General has recently commented that the increased trend in claims is an indication "that workers and their advisors are becoming more familiar with the rules for particular benefit entitlements, and are behaving so as to maximise their claims„.

A number of issues with the current framework around Work Injury Damages are summarised in Appendix 12 along with potential lines of reform and action that should be prioritised for further investigation. In summary, the statute of limitations is ineffective in many instances, as:

- negligence by employers is not always proven
- the impairment threshold has become porous
- economic loss tests are ineffective
- there are financial incentives for solicitors to pursue claims that are not in the interests of the injured worker.

The Commission does not consider that major changes, as in 2001, are required. Rather, the need is to restore the original intent of the Work Injury Damages arrangements. This can be done by tightening definitions and constraining practice (see Table 1, Appendix 11). Some of the concerns associated with Work Injury Damages Claims are set out in the following case study.

Case study: Work Injury Damages claim

In January 2011, a Work Injury Damages claim for an injury – fractured ankle succeeded and was settled. The claim commenced more than ten years after the date of the injury in 1996 despite a statute of limitations of three years.

A Medical Assessor approved by the Workers Compensation Commission found that the impairment was 10% in April 2009. The threshold for accessing damages is 15%.

There are several firms of solicitors who persist in achieving the 15% whole person impairment threshold. They follow a practice known as „patch working". Multiple assessments against multiple bodily systems are made for the original and alleged consequent secondary impairments. The process is set out in the table below.

Table 10.5: History of „whole person impairment" assessments for the claimant in the case study

Date	Doctor	Body part or system	Assessed Whole Person Impairment (WPI)	Description
April 2007	1	Lumbar spine, left ankle	14%	Assessed by applicant solicitor"s preferred specialist. Threshold of 15% not achieved.
May 2007	2	Back, left ankle, sexual dysfunction	14%	Further assessment attempted to find additional impairments and achieve the 15% threshold. In this case, a claim for sexual dysfunction. Assessed by the applicant solicitor"s preferred doctor on the basis of the claimant"s use of anti-depressants which "may contribute" to sexual dysfunction. Fifteen per cent threshold not achieved.
July 2007	3	Back, left ankle, scarring of ankle, left leg	20%	Additional assessment seeking additional impairment rating – in this case, scarring. The Scheme Agent does not accept assessment based on deficiencies in the process.
Jan 2008	4	Lumbar spine, left ankle, scarring	11%	Report from another of the applicant solicitor"s preferred doctors – this had been submitted in December 2007 but did not include a whole person impairment assessment. Claim rejected again due to the failure to satisfy the necessary 15% whole person impairment threshold.
March	2	Back, sexual	17%	Scarring is added by applicant solicitor"s

Date	Doctor	Body part or system	Assessed Whole Person Impairment (WPI)	Description
2009		organs, left leg		preferred provider who has previously assessed the worker.
April 2009	5	Sexual dysfunction	15%	Another applicant solicitor"s preferred provider assesses 15% impairment based solely on sexual dysfunction. The Scheme Agent rejects the claim for sexual dysfunction based on this report.
April 2009	6	Lumbar spine, left lower extremity	10%	A binding medical assessment was issued following the lodgement of a dispute and request for the issue of a medical assessment by the Workers Compensation Commission.
May 2009	7	Digestive system	6%	Immediately following the Workers" Compensation Commission ruling, applicant solicitor refers the worker to another of their preferred doctors in order to include a new body system and increase the impairment total. The impairment is assessed based on the worker"s report of constipation and bloating due to opioid pain medication.
May 2009	8	Scarring	4%	Scarring, which has previously been rejected by the Scheme Agent, is reassessed by a different applicant solicitor preferred doctor. In June 2009, this report and the one above are submitted to the Scheme Agent, along with the report which has already been rejected.
Nov 2009	9	Digestive system	5%	An independent medical report is obtained by Scheme Agent in relation to the claim for permanent impairment of the digestive system. This is sought from an approved assessor who is also an Approved Medical Specialist for the Workers" Compensation Commission. Doctor assessed 5% impairment based on the opioid pain medication leading to constipation. The conclusion drawn was that worker was likely to reach the required 15% if any appeal was sought and the Agent settled the claim.

Recommendation: The Commission recommends that the WorkCover Authority should bring forward for Government‟s consideration a number of legislative and procedural reforms that better manage the rising incidence of Work Injury Damages claims. The proposed reforms for Work Injury Damages Claims should serve to address the following concerns:

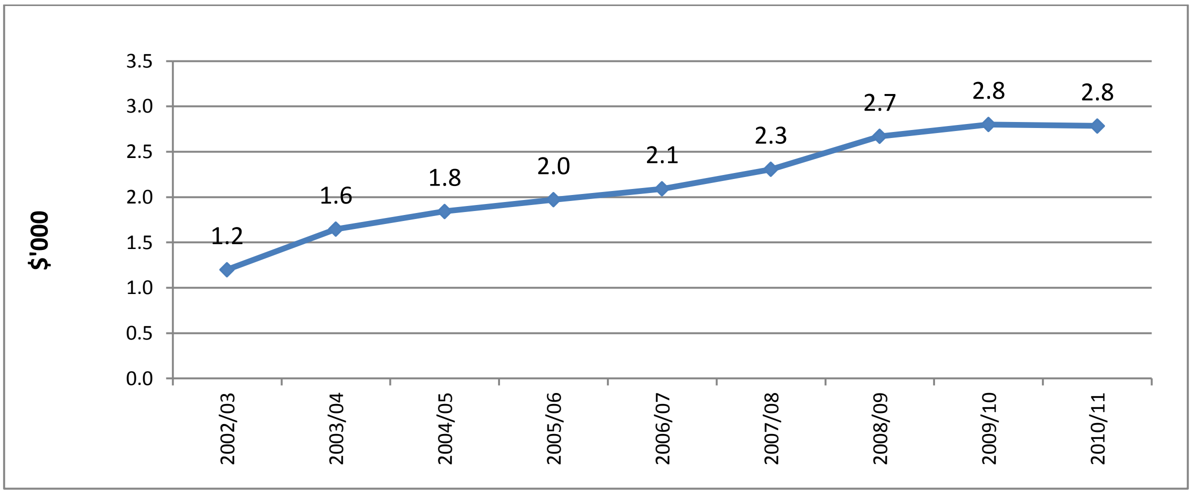
- the current ineffective statute of limitations
- ineffective testing of negligence by the Court and others
- increasingly porous impairment threshold
- ineffective testing of economic loss
- incentives for legal providers and claimants to pursue damages at the expense of recovery and returning to work.

10.3.3 Addressing medical costs

As mentioned earlier, another cost pressure has been increasing medical costs since 2006. Injured workers in NSW are rightly entitled to all reasonable medical, allied health and rehabilitation assistance. The worker retains an entitlement to these services for life provided they are required as a result of the workplace injury. The Commission notes that the system supports person-centric care and generally provides high levels of treatment support for workers.

Medical payments continue to increase as a proportion of total scheme costs. They now represent 25% of claim liabilities, up from 15% in June 2006. The size of the liability and long term period of coverage makes the scheme highly sensitive to relatively small fluctuations in medical cost.

Chart 10.9: Increase in average medical payments per active claim since 2002-03



Source: WorkCover Authority

Part of the growth in the scheme"s medical costs reflects:

- inflation
- increases in the number of medical claims, the number of services provided and a shift towards more expensive types of treatment
- increasing levels of elective surgery, for example surgery several years post injury, with a cascading impact on associated treatments such as diagnostics and private hospitalisation.

Medical and associated benefits are payable for the life of the worker or until the workplace injury is fully resolved. In practice, there is no limit on the total amount that may be expended on medical costs. The injured worker may choose their treating doctor and rehabilitation provider. The Scheme Agent or insurer will approve and pay these expenses after determining they are reasonably necessary.

The subjective nature of the „reasonably necessary" definition presents a number of issues for scheme administration. The definition has been interpreted broadly, resulting in a much wider range of medical and allied health services being covered by NSW workers compensation than would be covered under Medicare or workers compensation jurisdictions with a more specific definition of reasonableness as, for example, in Victoria.

The financial burden placed on the scheme as a result of over-servicing and inappropriate treatment is difficult to gauge without rigorous assessment by injury or service type. However, a case study on hand surgery by WorkCover led to savings of 39% through subsequent application of more stringent treatment standards leading to a reduction in over-servicing.

Case study: The high cost of hand injuries

Hand surgery was identified by the WorkCover Authority as a key area where unnecessary and excessive levels of treatment were occurring. Anecdotal evidence indicated that a common practice was for private hand surgery clinics to identify patients in hospital emergency waiting rooms and transport them directly to the private clinic for treatment.

A panel of hand surgeons were convened to provide expert advice about requests for surgery and invoicing. Consequently they developed billing guidelines for hand surgery, including items never to be used and items requiring clinical justification. These were gazetted in January 2010.

In the first nine months of the initiative:

- hand surgery payments reduced by 39% (saving over $4 million)
- proscribed hand surgery types declined by 70%
- payments for hand surgery codes requiring clinical justification declined by 54%.

Recovery action is underway of about $2.5 million for services found to be inappropriately billed. Two surgeons have also been referred to the Healthcare Complaints Commission on grounds of professional misconduct.

The Commission notes other concerns and practices which may be leading to inappropriate use of the scheme:

- **overcharging**: whilst WorkCover has a schedule of fees for a range of treatment items, this is not exhaustive and lacks guidance in several significant areas such as pharmacy, private hospital services and attendant care
- **excessive fees**: for example, up-coding to more expensive items or duplicated payments
- **medical certification, i.e. determining fitness for work**: this is currently the role of the nominated treating doctor. There is a concern that this is sometimes not done accurately or consistently which can hinder return to work outcomes.

The following case study illustrates some of these concerns.

Case study: Excessive and inappropriate fees

A recent review of WorkCover data has shown a large number of payments against item numbers for spinal fusion for the treatment of scoliosis. Scoliosis is a developmental deformity and it is unusual to see these item numbers used so frequently in the workers compensation environment.

The item numbers in the AMA List of medical services and fees have a price differential of approximately $3,000 for spinal fusion for scoliosis and a standard spinal fusion.

WorkCover is in the process of writing to the surgeons involved with the intention of recovering over $500,000 identified as paid incorrectly.

Reviewing specialist, surgical and hospital invoices is a complex and specialised task that is beyond the capability of most claim managers. The absence of supporting tools and procedures also introduces uncertainty and the risk of disputation.

Recommendation: The Commission recommends that the WorkCover Authority should:

- prepare for Government‟s consideration, a business case for introducing a regulation making power that would allow for specific determinations of what constitutes reasonable treatment and associated schedules of rates
- undertake further analyses across service types, commencing with the largest medical treatment types by cost to the scheme, to identify the extent of over-servicing and establish more thorough clinical guidelines
- enhance procedures and systems for early identification of aberrant provider behaviour and conduct targeted compliance interventions
- consider contracting a specialist organisation to negotiate highly complex fee schedules, e.g. private hospital fee schedules
- consider contracting a specialist third party to perform compliance reviews and invoice processing e.g. surgical and private hospital
- investigate and report to Government on alternate medical certification avenues that better enable an early return to work.

WorkCover is largely reliant on Scheme Agents to:

- determine whether the type and number of treatments a claimant is undergoing are reasonable
- identify instances of overcharging and duplicate billing
- report and rectify the problem.

Reforms to the incentive structures should be made to drive increased vigilance by Scheme Agents.

Current legislation also restricts WorkCover"s powers to enforce treatment schedules, recover costs from providers who have charged excessively, and to penalise and suspend or exclude non-compliant providers from participating in the scheme.

The WorkCover Authority therefore requires greater priority assistance from the Health Care Complaints Commission and the NSW Medical Council to investigate improper practice and to have sanctions imposed with some urgency where necessary.

Recommendation: The Commission recommends that the WorkCover Authority should consult with the Health Care Complaints Commission and make a joint submission to the Government on improved and coordinated arrangements for investigating and responding to allegations of over-servicing and poor clinical practice.

As a stronger alternative, consideration could be given to empowering WorkCover to:

- exclude providers from offering services within the scheme, on grounds of repeated non-compliance with the conditions of service
- recover costs from medical providers who have charged excessively or incorrectly.

10.3.4 The benefits regime

As mentioned previously, around 80% of scheme liabilities are driven by claim costs. Consequently, the strongest determinant of scheme costs is the benefit regime.

It is acknowledged that the NSW workers" compensation benefits regime has not been comprehensively reviewed for over ten years. There are clear differences in the level of compensation provided across jurisdictions which impacts the premiums charged. Some of the major points of difference are:

- **liability restrictions:** for example, in NSW, injuries sustained travelling to and from work are compensable, whereas in several other states, including

Victoria, they are not covered. In addition, claim excess arrangements provide different levels of incentive to report claims

- **duration of entitlement:** NSW is a long tail scheme, which means most benefits are available indefinitely. Other states, for example Queensland and Tasmania, are short tail – and finalise claims after a fixed periods of time regardless of whether the injury has fully resolved
- **thresholds:** in most cases, NSW makes a statutory lump sum available where there is any measurable whole person impairment. Other jurisdictions, including Victoria, have higher impairment thresholds that must be met before a lump sum is paid. For example, around 70% of the people who receive a statutory lump sum in NSW would not receive one in Victoria. The amount payable also differs across jurisdictions
- **weekly incapacity payment entitlements:** vary considerably between jurisdictions, in respect of the length of time they are available, payment size and the point in time when a „step-down„ occurs. For example, in comparison with NSW, the Victorian weekly payment model:
    - has its initial „step down„ at 13 weeks duration, rather than 26 weeks
    - reduces the payment entitlement following the step down at 13 weeks to 80% of the workers pre-injury earnings, whereas in NSW, the step down rate is a statutory amount which has no relationship to the worker"s pre-injury earnings
    - applies a „work capacity test" at 130 weeks duration, whereby a worker with a partial capacity to work must have achieved an actual return to employment in excess of 15 hours per week in order to continue in receipt of payments, with some exceptions apply, whereas in NSW, partially incapacitated workers can receive payments until retiring age
    - calculates the base entitlement amount based on actual earnings in the 12 month period prior to injury and varies in its treatment of superannuation contributions. NSW has a more complex approach which varies depending on the industrial instrument the worker is employed under.

The most certain means of addressing the scheme"s emerging cost pressures would be to significantly modify the scheme"s benefit structure. This is controversial and care must be taken to be fair with the changes. However, the long term sustainability of the WorkCover Scheme is ultimately at risk - and it is this which is being balanced against benefit provisions. If NSW continues to provide benefits that are significantly above those in other state jurisdictions the increased cost of the NSW scheme impacts NSW business and decreases growth and employment in the state.

Several of the recommendations and potential lines of reform pertaining to Work Injury Damages and medical costs would involve reforming workers‟ compensation benefits design. The table in Appendix 12 describes a range of additional issues and potential lines of reform for addressing them.

The Commission emphasises that individual options for reform should be considered as part of a package. Individual changes may not achieve the desired outcome if other elements of the benefit structure, supporting guidelines, operating protocols or broader system design do not reinforce and support the intent of individual proposed changes.

Further and just as importantly the Commission considers that any complementary suite of reforms must, in addition to addressing financial sustainability, encourage timely recovery and return to work, address benefit adequacy and equity issues.

Recommendation: The Commission recommends that a comprehensive review of the NSW workers‟ compensation benefits regime should be undertaken. The review should seek to identify reforms to workers‟ compensation benefits that bring them more in line with other states, and balance the need to lower premiums and assist workers recover and return to work.

With regard to the above recommendation, specific consideration may be given to the options identified in the table to Appendix 12.

10.3.5 Funds management

The WorkCover Insurance Fund (WCIF) assets are currently valued at around $12 billion and provide backing for the WorkCover Scheme‟s claims liabilities. The Fund‟s investment income supplements annual employer premiums in meeting the cost of claims each year.

The management of the WCIF appears structured and disciplined:

- there is clear separation within WorkCover around the management of the scheme and the WCIF
- separate divisions are responsible for the management of the scheme and management of the WCIF
- a separate Investment Board oversees the WCIF. The Investment Board is an advisory Board and sets the investment policies of the WCIF and reports to the Minister
- the Investment Board has set a risk-based investment strategy for the WCIF. This means that the Investment Board considers the liability profile of the scheme when setting the investment strategy

- the WCIF‟s asset allocation is formerly reviewed twice a year, coinciding with the release of the six-monthly actuarial valuation undertaken by the scheme‟s actuary
- an independent asset consultant (Mercer) undertakes asset liability analysis where the asset allocation of the WCIF is compared against scheme liabilities.

The WCIF asset allocation has been structured around the Board‟s stated risk tolerance relative to the percentage change in the value of the liabilities of the scheme, due to changes in interest rates. As at 30 September 2011, the fund had a 44% exposure to growth assets and a 56% exposure to defensive assets. A breakdown of the fund‟s allocation across asset classes is provided in the following table.

Table 10.6: Strategic asset allocation(a) of the WorkCover Investment Fund at 30 September 2011

Asset class	Asset allocation (%)	Asset Allocation ($m)(b)
Australian Equities	11.0	1,316
International Equities(b)	16.0	1,914
Australian Unlisted Property	6.0	718
Australian Fixed Interest	17.0	2,034
Australian Inflation-linked bond	37.0	4,426
Investment Grade Credit	6.0	718
Australian Infrastructure Debt	3.0	359
Commodities	2.0	239
Cash	2.0	239
Total	**100.0**	**11,963**

Source: WorkCover Authority

(a) Actual allocations are within +/- 2.5% from the asset allocation above.

(b) Developed international equities currency exposure was 10% hedged as at 30 September 2011. International Equities consist of 13% developed international equities and 3% emerging market equities.

The level of the fund‟s investment in equities is notable. Equities, both Australian and international, represent around 27% or around $3.2 billion of the fund‟s total investment. By contrast, most general insurers typically only invest around 3% to 4%

in equities. Their risk exposure mainly relates to short term claims. The „long-tail" liability of the WorkCover Scheme, particularly in NSW, dictates a different fund allocation.

The current level of investment in equities is intended to match the scheme"s „long-tail" liabilities. The average life of claims under the scheme is around eight years. Investment in equities provides a long term return suited to match this liability profile and to assist in meeting long term weekly payments.

A comparison of workers compensation investment funds in other jurisdictions suggests that the WCIF has a relatively conservative level of investment in growth assets such as equities, as illustrated in the table below.

Table 10.7: Asset allocations of workers compensation investment funds in other jurisdictions as at 30 June 2011

Asset class (%)	**NSW**	**SA**	**QLD**	**VIC**
Cash	2.0	2.0	24.0	4.0
Fixed Interest (incl. ILBs)	55.0	31.0	16.0	25.0
Investment Grade Credit	6.0			
Alternative Income		5.0		
Property	6.0	7.5	10.0	7.0
Australian Equities	11.0	16.5	17.0	11.0
International Equities	16.0	18.0	23.0	36.0
Commodities	2.0			
Infrastructure Debt	2.0			
Infrastructure Equity			5.0	6.0
Diversified Alternatives			5.0	8.0
CPI +[(a)]		20.0		
Private Equity				3.0
Growth Asset Allocation (%)	**43**	**67**	**60**	**71**

Source: WorkCover Authority

(a) CPI + asset class (or real return focused growth assets) are assets with broad equity or property characteristics, where the return is expected to have a high correlation with inflation. The benchmark is based on market benchmarks, where available. We are assuming this allocation is considered „growth".

There has been some variability in the WCIF performance since its inception on 1 July 2005, particularly during the global financial crisis (GFC) which had implications for most large investment funds. The value of the WCIF declined by some $1.2 billion in 2008-09 but has recovered in the years post the GFC.

Table 10.8: Movement in the value the WorkCover Investment Fund (a)

Year ended 30 June ($bil)	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
	8.9	10.6	10.9	9.7	10.9	11.8

Source: WorkCover Authority

(a) The WCIF commenced on 1 July 2005 and was valued at $7.5 billion at that point.

The WCIF has generally outperformed its Asset Benchmark. In some years, the fund"s returns have also exceeded the Liability Proxy. This would suggest that the fund"s performance on the whole has been relatively sound.

Table 10.9: Comparison of WorkCover Investment Fund returns against the Asset Benchmark and Liability Proxy

Year ended 30 June (%)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012 YTD***
WCIF return	13.5	-0.6	-7.9	11	8	1.6
Asset Benchmark[(a)]	12.8	-1.5	-9.5	11.3	7.6	1.5
Relative[(b)]	**0.8**	**0.9**	**1.6**	**-0.3**	**0.5**	**0.1**
Liability Proxy[(c)]	2.4	4.5	17.4	8	4.7	4.9
Relative[(d)]	**11.1**	**-5.1**	**-25.3**	**3**	**3.3**	**-3.3**

Source: WorkCover Authority

*To 31 October 2011

(a) Asset benchmark is a weighted series of market benchmarks aligned to the asset allocation of the WCIF.

(b) WCIF performance relative to the asset benchmark (for example, a positive figure indicates WCIF outperformed its asset benchmark).

(c) The liability proxy return is an approximation to the effect on the Fund"s claims liabilities of market nominal government bond interest rates.

(d) WCIF performance relative to the Liability Proxy (for example, a positive figure indicates WCIF outperformed its liabilities as estimated by the Liability Proxy).

The current global economic uncertainty could however have further implications for the fund. In particular, declining Government bond yields, the current European sovereign debt crisis and continued global deleveraging will add further volatility to fund‟s value and investment returns

Notwithstanding what appears to be sound performance and management of the WCIF, the Commission notes that the WCIF is not subjected to independent performance reviews. It is recognised that the WCIF‟s asset consultant, who undertakes asset liability analysis, is external and independent. However, given the size and significance of the fund, it may be prudent for Government to undertake periodic independent reviews of the WCIF to holistically validate the fund‟s ongoing performance, investment strategies, and management and governance approaches.

There are also synergies through the possible consolidation of the WCIF with other investment funds across the compensation authorities, specifically the Dust Diseases Board and Lifetime Care and Support Authority.

The Dust Diseases Board and Lifetime Care and Support Authority currently have separate funds valued at around $680 million and $1.5 billion respectively. Funds management is not part of core business for these entities. This may have implications for the performance of the funds.

Continued separate management also creates unnecessary duplication. Under the existing Compensation Authorities Staff Division (CASD) structure, there are five Boards governing the existing authorities and/or the funds they administer. Several of these Boards have subcommittees.

The Commission notes that the Dust Diseases Board and Lifetime Care and Support Authority are currently developing service level agreements with WorkCover around the provision of investment management through WorkCover‟s Investment Division.

Joint management of the WorkCover Investment Fund and the Dust Diseases Board and Lifetime Care and Support Authority funds would potentially provide:

- lower cost of fund management
- improved leverage in investment markets
- higher degrees of expertise in asset/risk management for the Dust Diseases Board and the Lifetime Care and Support Authority, including the matching of short/long term liabilities to investment profile.

There are a number of options for the joint management of the funds. For example, a single Board with an Investment Sub-Committee and an Audit Committee amongst others could be created which holds compensation authority funds together within a single governance structure.

In determining the best option, it is vital that transparency is maintained. Each entity should continue to have independent line of site on their portion of funds and how they are being managed.

Recommendation: The Commission recommends that the WorkCover Authority, the Dust Diseases Board and the Life Time Care and Support Authority should jointly develop, for Government"s consideration, options that allow their respective investment funds to be managed jointly in separate funds under a consolidated entity. Periodic independent reviews should also be undertaken to validate the ongoing performance, investment strategies and management of the funds.

The Commission notes that the consolidation of funds and financial assets management considered here can be extended beyond the Compensation Authorities to include a broader consolidation across other parts of the government.

10.3.6 WorkCover efficiency

The WorkCover Authority has been through a period of transition in recent years. In 2009, the staff of WorkCover, the Sporting Injuries Committee, the Motor Accidents Authority, the Lifetime Care and Support Authority, and the Workers Compensation (Dust Diseases) Board were brought together. This has enabled a reduction in overheads across the entities. Shared services for IT, human resources, finance and internal audit functions have been introduced.

In 2010, WorkCover established a new organisational structure. A number of reforms were identified to assist effectiveness and efficiency, including the need for a consolidated business strategy including:

- the establishment of a strong performance management framework
- a focus on prevention
- embedding a commercial culture in workers compensation insurance management.

The Commission considers that there are three other proposed reforms which require further detailed investigation. These are a change to governance, an improvement in capability of staff and a centralised IT system for workers compensation claim and policy management.

Governance model

WorkCover NSW currently operates under an authority model, which reflects the regulatory functions that WorkCover must perform. At the same time, WorkCover has a separate but complementary workers" compensation insurance business to manage. This requires WorkCover to have a degree of flexibility to make commercial decisions and to manage the insurance business commercially.

Some have suggested that the current authority model for WorkCover is not conducive to the optimal commercial management of the insurance business, citing:

- WorkCover should adopt a more commercial approach in a number of areas
- potential tension between Parliamentary accountability and commercial decision making, for example setting premiums for employers
- a perceived culture of compliance and resistance to change based on the belief that the business is entirely regulatory.

The Commission is aware of discussions to potentially convert WorkCover into a State Owned Corporation (SOC). The Motor Accidents Authority (MAA) and the Lifetime Care Authority (LCA) would also be part of the new SOC through a consolidation of legislative frameworks.

The Commission considers that putting the Compensation Authorities and the Dust Diseases Board together, but in separate divisions, has merit.

The Commission is not convinced that a SOC model is the appropriate operating structure for the merged entities. In particular, the SOC model is generally applied to entities with both commercial and profit objectives – the aim being to run the entity like a corporation, pay tax, carry debt and provide a return on investments to its shareholders. WorkCover and the other Compensation Authorities, whilst needing to be more commercial, do not, and should not, have an underlying profit objective. Scheme investments are not Government funded – they are funded through employer premiums. Any scheme surpluses are generally returned to the system through reduced scheme liabilities and lower employer premiums. It is also unclear to the Commission as to how the significant regulatory role would be accommodated within the SOC model.

Certain SOC type objectives are however relevant, for example:

- ensuring that entity has alignment between its liabilities and financial assets
- keeping user charges (i.e. premiums) low and having regard to the constraints posed by the entity"s liabilities and assets
- a suitably experienced and empowered governing Board that is able to bring knowledge of insurance, risk and funds management and able to balance the policy and social obligations against commercial imperatives.

It may be possible for these and other business objectives to be achieved through changes to the existing Authority operating structure or by say unifying the entities as a Compensation Commission.

The proposed Compensation Commission should be based on legislation that partly reflects the disciplines in the *SOC Act* as well as the non-profit nature of the compensation entities. The governing Board should be selected by the Minister and the Treasurer. In turn, the Board appoints the CEO who has delegation to appoint staff. Ideally, the proposed Commission"s workforce should also be covered by Fair Work Australia as occurs with SOCs at present. This step seems reasonable given that the revenues of the compensation entities are from the private sector and it is largely that sector which is being served.

The Commission formed the view that Government"s further consideration of the issue must be informed by an evaluation of alternative operating structures and a supporting cost benefit analysis. However, Appendix 13 suggests a high-level governance model that could be applied at present to an appropriately determined operating structure.

The critical issue here is that the WorkCover Scheme faces a number of cost pressures which are causing rapidly increasing Scheme deficits. Whatever structure is chosen must not lose focus on this issue. The immediate challenge is to stabilise the Scheme and return it to a path of sustainability. This must be achieved while reasonably balancing the needs of injured workers and optimising workers" compensation premiums to increase the competitiveness of the NSW economy.

As noted earlier, the NSW government as insurer is responsible for underwriting risk, funds management and premium setting under the NSW WorkCover Scheme. By contrast, Western Australia has successfully adopted a full commercial underwriting model for their workers" compensation arrangements. At present the Commission considers that moving NSW workers" compensation to a commercially underwritten model is not an option given the instability of the Scheme. In the longer term this structure becomes an option that could be considered by the Government.

Recommendation: The Commission recommends that the Compensation Authorities, working closely with Central Agencies, should examine options and provide recommendations to Government on approaches to merge the Compensation Authorities and achieve a greater commercial focus. This should be supported by a concise Charter and Statement of Business Intent which sets out expectations, objectives and targets for the merged Authorities. This structure may change once the scheme is stabilised.

Improved WorkCover capability

The Interim Report by the Commission has highlighted an underlying need for improved workforce and IT systems capability across the NSW public sector and the WorkCover Authority is no exception.

Recommendation: The Commission recommends that WorkCover should expand the Authority‟s staff capability and should discuss and implement this measure with the Public Service Commission.

IT systems

WorkCover has decentralised IT systems for the management of workers compensation claims and policies. This design requires agents and insurers to collect data via their separate and disparate front end claim and policy management systems. Data is extracted from these systems monthly and submitted to WorkCover in a standardised format and then manipulated by WorkCover to monitor and manage system performance.

This design impedes effective workers compensation system management due to:

- **time lags** – caused by periodic submission process and validation lag times
- **data quality issues** – caused by the complexity of data handling and manipulation processes and reliance on disparate insurer front-line systems
- **opportunity costs** – for example, from relying on multiple agents/ insurers to conduct tasks which a different IT design would allow to be performed centrally. These include the generation of policy renewal letters, statistical case estimation for claims and a range of medical service screening functions.

These issues could potentially be overcome through better interfacing module/s between the IT systems of WorkCover and the Scheme Agents. The quality of WorkCover‟s data would also be greatly enhanced if it was able to have „real time‟ access to individual Scheme Agent worker‟s compensation data. Other options could include more comprehensive live data feeds from the Scheme Agents. Various options should be investigated, and if feasible, implemented as part of the WorkCover-Scheme Agent contracting arrangements.

Recommendation: The Commission recommends that WorkCover should investigate options to improve the data interfacing between itself and its Scheme Agents. This should include options to access more comprehensive live data feeds from its Scheme Agents or gaining real time access to their workers" compensation data systems.

Part IV: Internal Efficiencies

11. Corporate and shared services

Key points:

- The expenditure on corporate and shared services was about $3.2 billion per year in 2010-11, excluding SOCs.
- There are great opportunities to improve the quality of services in each cluster and also to make significant savings. Across government (excluding SOCs) the savings target could be $500 million a year or above. To achieve these savings, a strong and capable commitment by senior management will be needed including a recognition that savings mean less staff and this means redeployment where possible and redundancies.
- A major reform program to consolidate and improve corporate and shared services commenced in 2006. Implementation has been at a glacial rate. The confidence within the public sector to manage the changes required is low and there is some doubt that savings will be made.
- In general systems and processes are fragmented and out dated, and there are worrying capability gaps. Expenditure on staff training as well as upgrades to systems is required.
- There are benchmarks available for corporate and shared services and efforts should focus on lifting performance towards these benchmarks and checking that benefits are being realised.

11.1 Introduction

Corporate and shared services (CSS) are the „back office" that provide the essential support for service delivery. Their role complements front line staff and contractors. Corporate services is more strategic and is part of, or should be part of, senior management within the agency. Shared services on the other hand are transaction focussed and do not need to be done by the agency directly though they are the responsibility of that agency. For example, financial strategy needs to be close to the Director General of a cluster whereas running a payroll can be undertaken by a shared service provider who may be outside the public sector.

There are eleven functions included in CSS within government. They are:

1. Finance
2. Human Resources management
3. Industrial relations
4. Occupational health and safety
5. Information technology and communications

6. Contract management and procurement
7. Governance and risk
8. Executive services
9. Records and knowledge management
10. Property, facilities and fleet management
11. Asset management

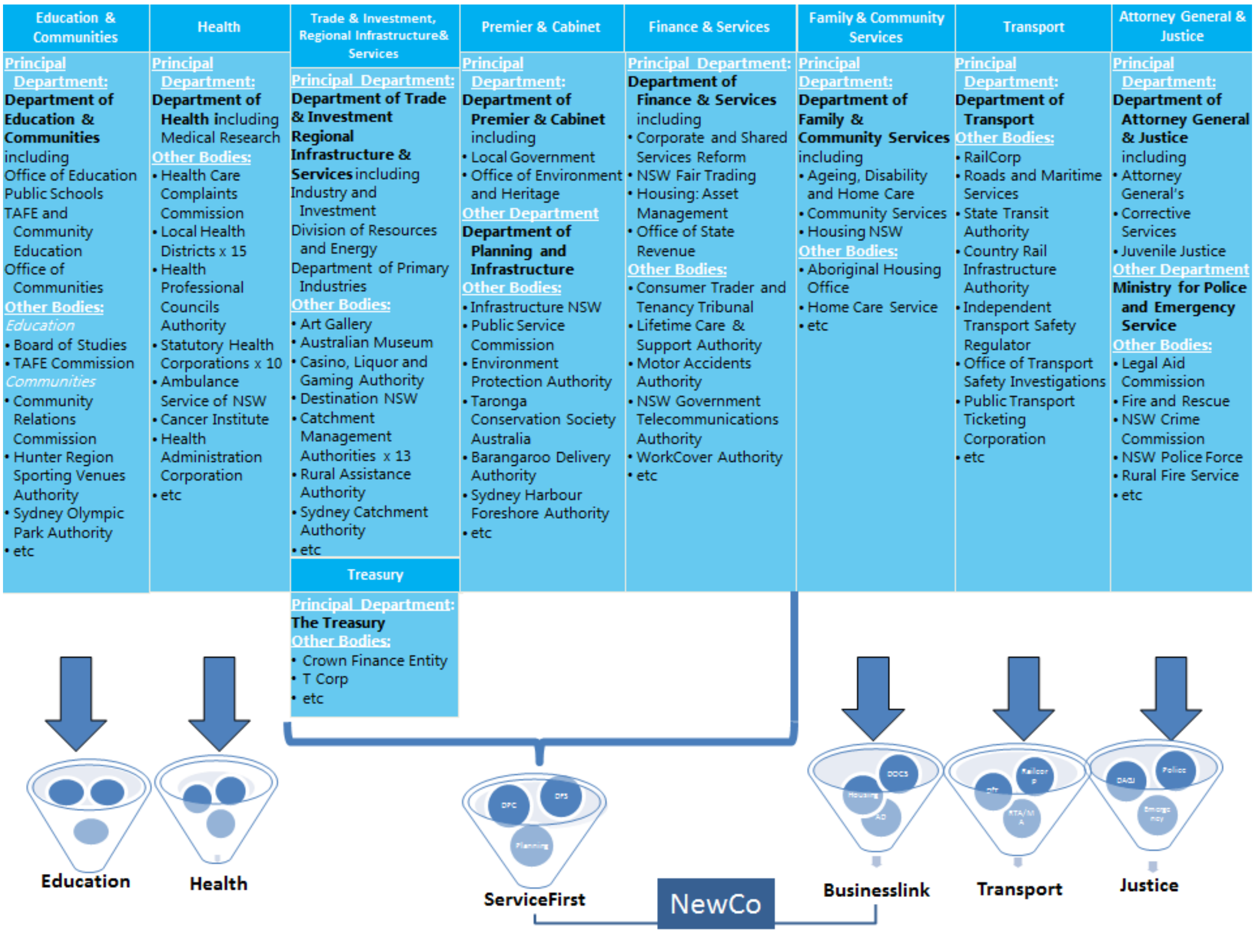
It is difficult to estimate the precise expenditure on Corporate and Shared Services despite numerous reviews of the area. The Commission has seen estimates that range from $2.3 billion to $3.2 billion in 2010-11.

11.2 The current situation

11.2.1 The policy

Under current policy, the corporate function is to be consolidated within each cluster. Shared services are to be consolidated within agreed shared service providers. The responsibility for corporate services is vested primarily with the principal department, although certain limited services unique to an agency are to be retained locally. A proposed strategy envisages a reduction in the number of shared services providers and the setting up of a new company (NewCo) that initially will pick up the clients of existing CSS providers, BusinessLink and ServiceFirst. Newco also has a wider role in procuring and managing outsourced services for clusters across the sector.

Figure 11.1: The consolidation of shared services providers.



The plan for consolidation will provide guidance on matters such as governance, funding and pricing models, benchmarking and performance management. Decisions about how the plan is applied are to be made at a cluster and department level to best meet specific circumstances. The proposed approach has not yet been finalised and approved.

11.2.2 The actual situation

The current shared service provider arrangements for the NSW public sector are:

- two well-established internal shared service providers supporting large clusters:
  - Health
  - Education and Communities
- two internal shared service providers being established for:
  - the Transport cluster
  - the Attorney General and Justice cluster
- two shared service providers that support several clusters or agencies:
  - Service First
  - BusinessLink.

The two biggest clusters – Health and Education and Communities – are the most mature in consolidating shared services and providing more effective delivery. However, they are not best practice and require substantial investment for technology upgrades and process redesign.

Neither ServiceFirst nor BusinessLink currently meet customer expectations across a number of vital functions. Neither is truly integrated and in many instances the level of service is poor. Nine years after its establishment, BusinessLink is now in the process of integrating its three SAP systems. ServiceFirst has three legacy systems, inherited from its predecessor units. More important, its staff morale is low and customer satisfaction is poor. Clients of Service First are united in their frustration and dissatisfaction with the service provided. To be fair to the shared service providers they have been starved of funds and have not been able to modernise.

To address the particular problems in Businesslink and ServiceFirst it is proposed to create a new single service provider for their clients. This NewCo will provide a „greenfield" site and clients and functions will be migrated onto new or modified systems which are consistent with the NSW Government CSS Standards. Once existing clients are transitioned, it is intended to migrate new clients, like the Trade and Investment, Regional Infrastructure and Services cluster, and the Office of Environment and Heritage to this new entity. This is a very important reform step and is discussed further below.

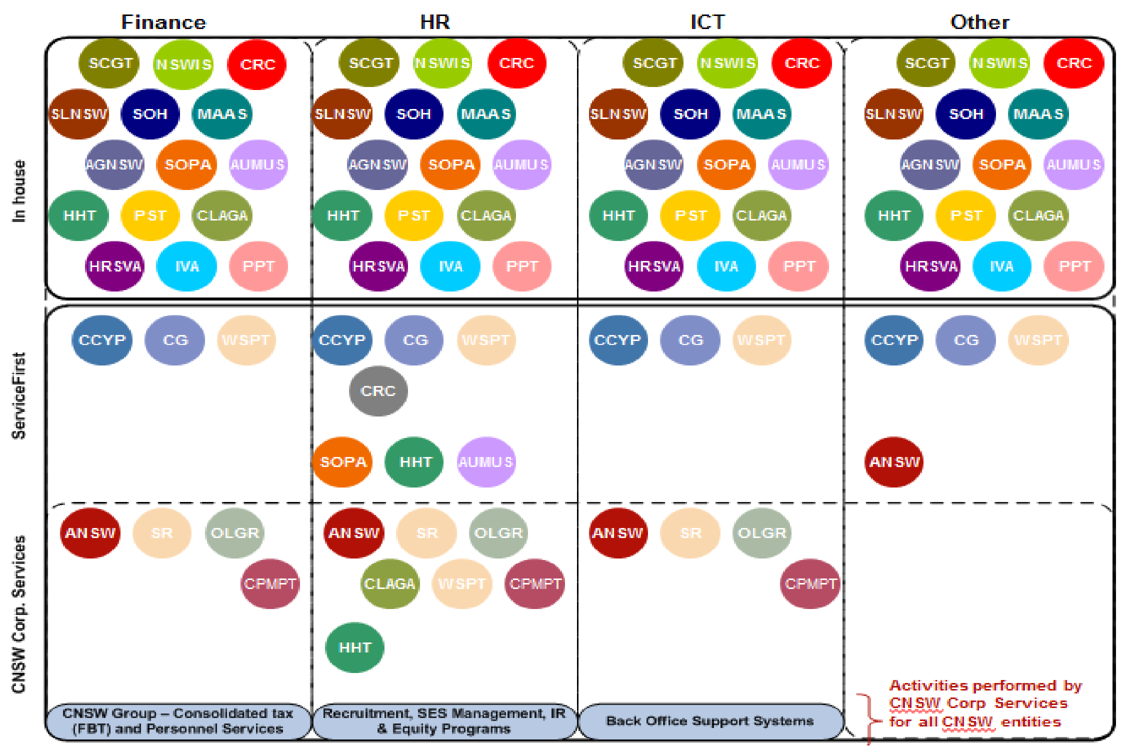
Newco is intended to directly provide shared services as well as purchase, and manage outsourced shared services on a market competitive basis. It is able to respond to increased maturity in the outsourcing market. Agencies increasingly have less desire to own their shared services operations, but want a reliable hassle-free service – payments made on time without errors, ICT desktops that work effectively, and electronic time-sheets that are easy to use.

Generally clusters continue to operate with multiple systems, inconsistent processes and disparate standards. The business needs of the cluster and agencies are not always well met by their corporate or shared services. Most clusters are not yet integrated in a practical sense. Most Directors General are not able to, for example:

- access aggregated data on the cluster"s financial position
- receive and review important information about the workforce, such as sick leave rates
- communicate with all staff on a single email system.

The chaos relating to multiple systems is evident in the former Communities NSW cluster. In 2010 this cluster, with around 3,000 staff, was supported by an astonishing 15 corporate service providers, ServiceFirst and 15 in-house shared service providers. Altogether, it relied on 76 different corporate systems. This is shown in Figure 12.2 where each circle in the diagram represents a system related to finance, human resources, ICT or some other area.

Figure 11.2: Corporate systems in the former Communities NSW cluster, 2010



This multitude of largely unrelated systems is not unusual. The Transport cluster for example, has 130 separate systems.

The poor support provided to front line workers is evident in all areas of transactional shared services: finances (e.g. invoice payments), HR (e.g. payroll processing), OH&S (e.g. claims processing), ICT (e.g. helpdesk support), records (e.g. archiving), property and facilities management (e.g. office leasing) and asset management (e.g. maintenance).

Corporate services should have a strategic focus and provide advice on driving business improvements and on risk management. As well as attention to compliance with standards, controls and policy their value add comes from high level strategic advice to the Director General and CEO of departments and agencies.

Within the CSS units there is a large amount of operational information about the business. Thoughtful analysis of such data can offer surprising improvements in both service and value. At present there is insufficient strategic analysis of this type at the cluster level, let alone effective comparisons between clusters.

11.2.3 The risks of change

Reform of CSS has been examined within the NSW Government for at least five years. Progress has been extraordinarily slow and the Commission has noted nine reasons, some real and some imagined. The first barrier to change has been managing staff. Reform in this area will involve streamlining processes and using more effective systems which will result in significant staff reductions over time. Managing this is always difficult. Nevertheless change in the back office is inevitable in recent public and private sector experience. Consultation and communication directly with employees and through their union is essential. Change must be carefully managed within the agreed policy and industrial frameworks

A change management strategy is needed that spells out the implementation steps, tracks progress and creates effective communications. Detailed job descriptions for the new CSS unit are essential along with KPIs so that appropriate training can be provided and appropriate staff kept on to do the job.

Second within some clusters there are many smaller entities, some statutorily independent from the Principal Department. Some of these entities may have concerns about inclusion in a centralised CSS unit and this can cause corporate structure complications. However, purely transactional functions should be included in the cluster CSS unit and any functions that must be retained in the entity must be justified. A good communications strategy in the cluster would address many of these concerns.

One compelling reason for the glacial pace of the CSS reform has been that of staff capability. There has been insufficient investment in skills and training and the capability gap needs to be addressed urgently. The CSS reforms have the potential to create more effective career paths for corporate and shared services staff. The reforms also provide staff with up to date systems on which to work. Investment in modern systems, staff capabilities and some external expertise is essential to successful implementation of CSS reforms.

A not dissimilar issue has been a lack of investment to upgrade and standardise technology. This investment is needed and a case study below demonstrates one government funding model that worked. The basic point is that to make savings and improve service quality in CSS there is expenditure required up front. The Commission notes that much of this expenditure is on IT systems and there is a lack of confidence in the sector about this type of procurement in particular. The development of the NSW ICT Strategy and greater engagement of external expertise will assist.

Implementing new systems is an area where lessons can be learnt from others and more knowledge sharing across clusters and agencies and private sector firms that have faced similar challenges will assist. It is also evident that some agencies consider their level of service could get worse with any CSS reform. Some of these agencies may be paying for a Rolls Royce service when a Holden will adequately meet their business needs.

Some expect the service will be negative and they fear that by moving to a shared provider, it will get worse. This reflects a lack of confidence in the ability of CSS units to improve. It suggests that leadership support from the most senior people is critical along with good communication and change management approaches. Users then get a clear understanding of how services will be better and they will be able to monitor improvements, and have any disputes resolved.

Related to this concern is a fear that the new CSS unit in their cluster may not understand their particular department or entity, and hence not service them well. Addressing this issue gets down to communications and a understanding of where their entity fits into the cluster and what CSS does and can do for them.

The varying degrees of CSS reform progress across agencies, and the lack of a standardised approach is an added challenge. The central agencies must monitor progress of Principal Departments with their CSS reform and offer assistance and knowledge sharing. Similarly the rate of change will vary across departments within a cluster. The transition is phased and all need to understand their place in that implementation.

Finally reform is occurring as other initiatives are underway. These need to be factored into the CSS reform planning so that the order of change is appropriate.

Recommendation: The Commission recommends that the CSS reforms in each cluster include detailed plans that when implemented mitigate against the risks associated with change management, workforce capabilities, required staff reductions and technology that needs upgrading and/or is non-standard.

The Commission recommends that the importance of communication and change management in the CSS reform be recognised in the preparation of a detailed communication plan for Directors General, CEOs, staff, agencies and to cover progress reporting to central agencies.

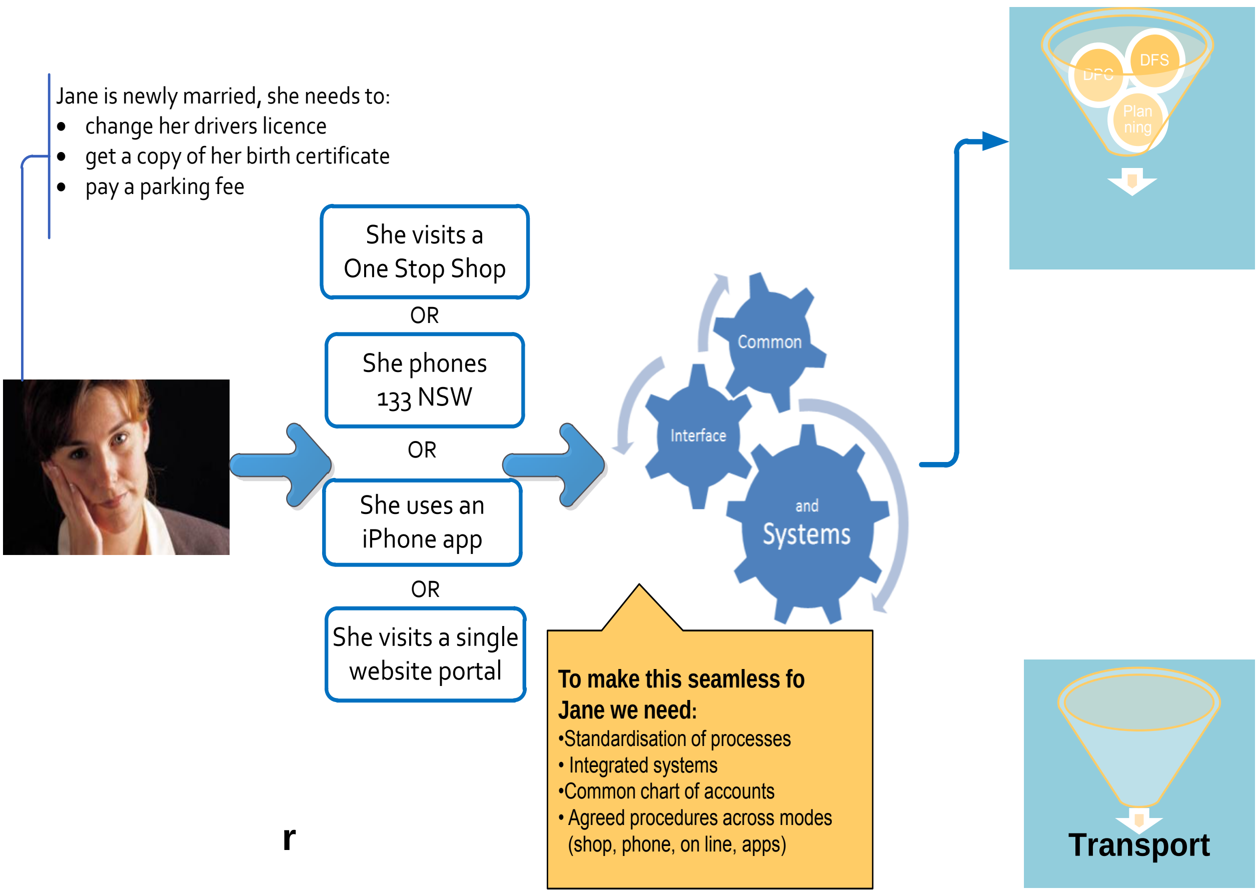
It is worth noting that some shared service functions in government are excellent. For example the insurance services offered to the sector by SI Corp and the Treasury Managed Fund (TMF) are first rate. They have saved significant expenditure over the years and provide good service to agencies. It can be done!

11.3 The case for change

There are two reasons to reform CSS in government. To improve service and reduce costs. The experiences of public and private organisations with efficient CSS show that the experience of internal customers improves. Amalgamating disparate units offers consistent policies across an agency and cluster and modern technology and better ways of doing business. Done properly, better processes and systems lighten the administrative burden on front office staff. They provide better information to decision makers such as Chief Financial Officers, heads of HR and Directors General. This includes the potential to link resource data, such as expenditure and FTEs per program, with program outputs and outcomes. Financial controls can be tighter and electronic risk management processes instituted, which also enables more appropriate levels of delegations and devolved decision-making. CSS consolidation can also benefit some CSS staff, through broader-scope jobs and better career paths.

Of more importance CSS also supports external customers. „One stop shops" or integrated service centres, depend on integrated back office systems, as shown in the example below.

Figure 11.3: Improving service delivery



Source: DPC.

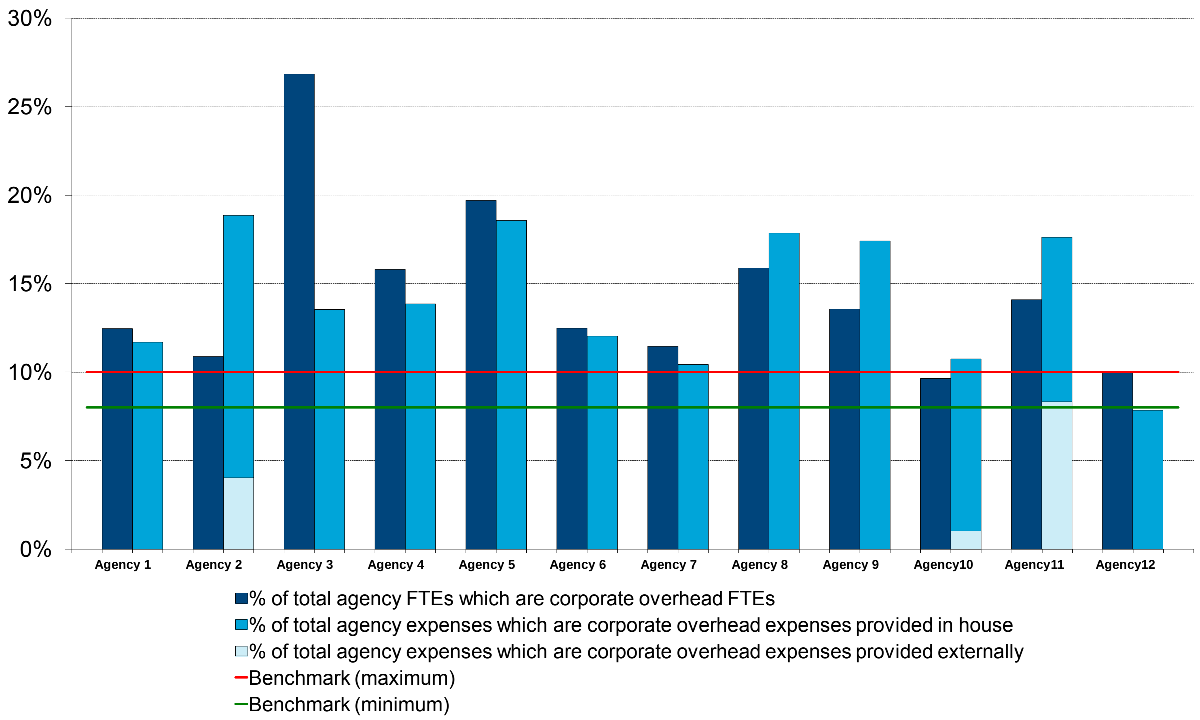
The savings that are possible are significant across both the corporate and shared services streams. A global review by Hackett in 2009 of 193 public and private organisations showed that 71% planned to reduce costs by over 20%. The actual reforms showed that 61% achieved over 20%. If such a cost savings could be reached with these reforms the annual saving would be around $500-600 million.

Over the last two years, the corporate overheads analysis of agencies in most clusters, except Health, Education and Attorney General and Justice, shows opportunities for considerable savings. These could be redirected to front line services such as schools, trains and Police. If all clusters were to meet the 10% benchmark ratio of corporate overhead staff to total staff, then estimated savings in general government would be over $500 million a year. If an 8% ratio is achieved, the annual savings are estimated to be $1 billion a year.

The Commission notes that various agencies did meet or were close to their target in 2008-09 and/or 2009-10.

In figure 11.5 the corporate overhead FTEs (light blue bars) and corporate overhead expenses (dark blue bars) above the maximum or minimum benchmark levels (red and green lines) must be reduced to benchmark levels. The FTEs and expenses above the benchmark levels represent the opportunity for potential savings. These can only be achieved if investment in the right system is made, and the staff have the right skills and capabilities. It is further noted that the largest opportunity is within each cluster/agency in terms of their corporate services, rather than their shared services.

Figure 11.5: Comparison of corporate overheads ratios
Arranged in ascending order of agency FTEs (ranging from 1,100 to 18,700)



Source: Department of Premier and Cabinet.

There are challenges to meet these benchmarks. To do so requires:

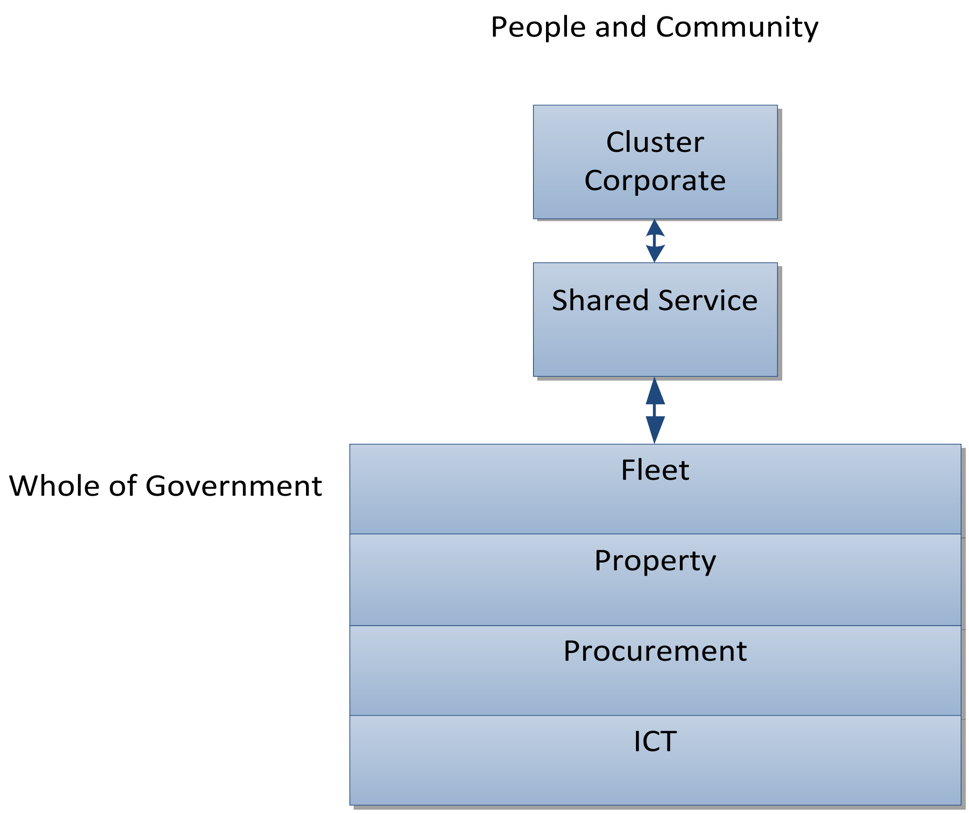
- the right level of staffing and the right capabilities
- expenditure on common or inter-operable systems and technology
- removing shadow corporate overhead structures within departments
- effective governance of corporate services within and between departments, and their shared service provider – through Service Level Agreements delineating clear roles, transparent pricing
- consolidating transaction services into shared service providers
- reforming shared service providers to increase their efficiency
- changing processes to standardise and streamline operations.

11.4 Making the change

11.4.1 Structure

The first step is being clear about how CSS operations will be structured. The proposal is to move to four in-house providers in the Education, Health, Justice and Transport clusters. It is also examining the feasibility of a new multi-tenanted service provider, NewCo that will take over the clients of Businesslink and ServiceFirst in a staged manner. Once that is completed the clients of the Trade and Investment, Regional Infrastructure and Services cluster will also migrate to NewCo together with other new clients. It is important that NewCo is also able to purchase and manage outsourced services on behalf of other agencies. The end state is set out in Appendix 15. The general model is set out in figure 11.6 below. Each cluster maintains corporate services in the Principal Department for high level advice and strategy input. Shared Services (being mainly transactional) are functionally separate but linked with corporate services. Across the whole of government should sit a common approach to ICT infrastructure and whole of government services that include fleet, property, procurement, and office services. These services are provided by the Department of Finance and Services.

Figure 11.6: Corporate and Shared Services operating model



11.4.2 Consolidation

A key rule of thumb in CSS operations is that economies of scale are one important factor in cost reduction. Numerous shared service examples support this proposition. For example:

- Barclay"s Finance and Reporting Shared Service Centre supports 148,000 FTE
- General Electric"s single provider supports 240,000 payroll employees
- Carrefour"s shared services provider delivers finance, procurement and ICT services to 490,000 employees
- the Australian Defence Force"s single service provider provides finance, HR, procurement and base and facilities management services to 100,000 FTE.

The Commission is of the view that, given the poor track record within the NSW public sector to date, targets should not be too ambitious. Managing this change in the clusters will be a challenge. The Education and Communities cluster and the Health cluster are of a scale where they service around 90,000 FTEs each. While achieving this scale in the other clusters may be something to aim for over the longer term, the Commission is of a view that it would be risky given the current high level of fragmentation. At this stage moving to shared service providers that serve between 30,000- 40,000 should bring major benefits. This is a practical target and one that the sector appears capable of implementing.

Recommendation: The Commission recommends the following Corporate and Shared Services strategies for the short-medium term:

- The **Health** and **Education and Communities** clusters should continue to improve their single providers.
- The clients of **ServiceFirst** and **BusinessLink** be moved to a new shared service provider (NewCo). This new service provider is to be gradually populated with systems and functions in a way that brings efficient service. The plan to transition certain clusters and agencies, such as TIRIS and the Office of Environment and Heritage, to this vehicle by 2015 should proceed.
- The **Transport** cluster should continue to consolidate its shared services in-house and upgrade its systems. This will take at least a year. Consideration should then be given to using different sourcing strategies and amalgamation with other NSW Government shared service providers, including working with the NewCo on outsourcing certain functions.
- The **Attorney General and Justice** cluster should continue with its plan to merge its shared services, based on Fire and Rescue NSW"s systems. The Police Force should remain separate until the merger is complete, then should be amalgamated into it.
- The Government must ensure that there is adequate investment in these transformations and that it is expertly managed.
- The **Department of Finance and Services** should monitor the progress and benefits of the various CSS programs across the sector and report on progress (or otherwise) to Ministers in a robust and transparent way.

The Commission is concerned that the governance arrangements for these in-house shared service providers may not be sufficiently commercially-focused or have the benefit of independent expertise. The shared service providers at present do not have commercially-focused governance structures and many have oversight boards of public servants that lack expertise in this industry. The in-house providers should be set up as a separate body, with an advising or oversighting board. This could enable the cluster to appoint people with industry experience in the CSS sector to assist with the change. The important element is to provide a commercial focus and independent expertise in the industry.

Recommendation: The Commission recommends that the Directors General of the Health, Education and Communities, Attorney General and Justice and Transport clusters consider establishing a skills based board to oversight the provision of shared services within their cluster to drive a more commercial approach. Consideration should be given to whether the current governance structures are appropriate or whether a more commercial driven approach which better leverages independent expertise from the shared service industry may advance the introduction of more effective shared service arrangements.

The establishment of NewCo presents a particular challenge and provides a great opportunity. At present Businesslink serves the Family and Community services cluster. ServiceFirst serves the Premier and Cabinet (in part), Treasury, Finance and Services clusters and will eventually serve the Trade and Investment, Regional Infrastructure and Services cluster.

The emphasis on consolidation is worthwhile for the benefits of scale that can be achieved. However, the main focus must be on the efficiency of the particular service provided. What is being delivered by the back office must meet front office / agency requirements and do so efficiently. The Commission notes that one reason for the slow pace in the consolidation of Corporate and Shared Service is concern at agency levels that the reform may not deliver the services required. While there is widespread acceptance that Corporate and Shared Service can be delivered in a far better way there is also concern that bigger may not actually be better.

Three case studies raise the change management issues that have not yet been addressed, and the risks that must be managed in changing.

Case study: StateFleet

In 2009-10, the NSW Government"s combined fleet was about 28,000 vehicles. This excludes specialised vehicles such as buses, fire engines, ambulances and vehicles in State Owned Corporations (SOCs). About 72% of the fleet was used by Health, Police, Emergency Services, Human Services and Transport. Operating costs were $283 million. This included about $156 million for lease payments, $58 million for fuel and $21 million for maintenance. StateFleet acquires 8,000-9,000 new vehicles each year.

All government agencies, excluding SOCs, must use StateFleet, unless exempted by Treasury. Police, Emergency Services and the Ambulance Service manage their own fleets. RailCorp uses an external third party for fleet management. The Queensland Government is the closest operational model to that in NSW. They have central management of 18,000 vehicles under operational leases. NSW appears to have more vehicles per FTE than Queensland through direct comparisons are difficult.

The Victorian Government is more decentralised. It uses a finance lease system, where residual risk resides with the agencies. The Western Australian and Commonwealth Governments both outsource their fleet management. In 2009, the Western Australian Government began reducing their motor vehicle fleet by 10%.

Treasury advise that, for every 1,000 vehicles removed from the NSW Government fleet, annual savings would amount to $10 million recurrent and $5 million capital expenditure.

Improving fleet management in NSW

The Commission is of the view that the key to savings is good management of fleet vehicles by each agency. While Western Australia"s 10% fleet reduction is not necessarily unreasonable, the real issue is to identify vehicles being underutilised and to reduce the number of vehicles. The majority of government-owned vehicles are not used in a share pool model and tend to be provided to specific people. This is not efficient and can lead to front line staff not having access to a vehicle when needed.

The first step is to improve the information available to agency fleet managers. This is essential to inform policy and governance. Information means monitoring and reporting what the fleet is doing and where it is being over and under-utilised.

The Commission is of the view that more efficient fleet management requires first, better information about the use of fleet vehicles, and second better management through vehicle pools. To do these two things requires a commitment to change and efficiency at the cluster/agency level. When implemented the size of the fleet is likely to decline substantially and utilisation should improve and be more evenly distributed.

Recommendation: The Commission recommends that the Department of Finance and Services should work with cluster Directors General to:

- make clear that fleet policy is understood and complied with. Fleet cars should be pool managed and not exist for individual operational requirements
- install and activate GPS in government vehicles, after consultation with employees and their unions, to improve employee safety and vehicle utilisation
- introduce vehicle pools within a cluster, and across all agencies in the same geographic region, to improve utilisation and dispose of any surplus vehicles
- standardise vehicles within specific agencies/clusters.

Case study: Purchasing cards

In 2010, approximately 2.7 million cheques were drawn by NSW Government agencies. The costs associated with purchasing goods and services vary with the type of transaction. Total transaction costs are higher than they should be.

At present about 85% of transactions (3.1 million) in agencies are low value/high volume. Payments are less than $3,000. These transactions are numerous but represent only 5% of total expenditure.

Traditional purchase-to-pay processes, where purchase orders are raised and invoices submitted, can be replaced by more efficient payment channels. These include PCards, and electronic funds transfer (EFT). Using PCards or purchase cards would save $15-50 per transaction. Their use also minimises fraud and misuse risks. PCards have set restrictions, such as a limit on the maximum allowable transaction value, the total monthly spend and/or the type of merchant.

The NSW Government has a low use of PCards compared to other States. In 2009-10, it made about 390,000 transactions using PCards. The Western Australian Government and the Queensland Government both made well over double that number.

Using PCards and/or EFT across the NSW public sector could save at least $127 million over six years:

- $97 million through the wider use of PCards for purchasing low value items
- $26 million through replacing cheques with EFT
- $3 million in increased rebates paid by the card-issuing bank related to increased PCard expenditure.

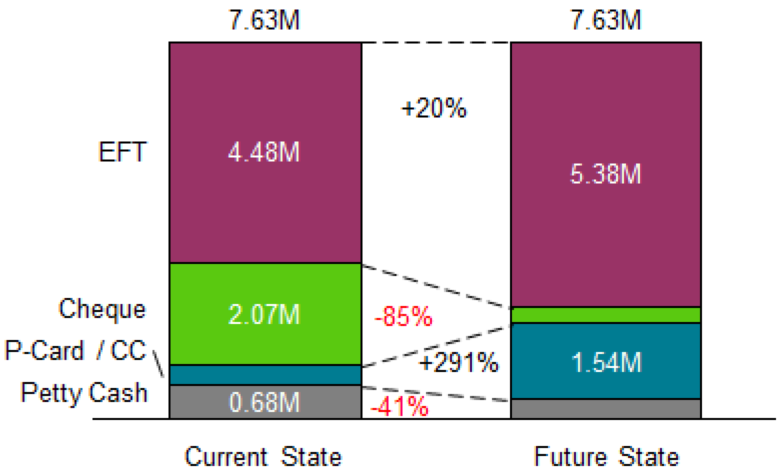
The Government has currently issued directions to staff.

- requiring PCards use for all applicable transactions less than $3,000
- for transactions that are not eligible for PCards staff should use an electronic payment methods such as EFT.

The Government is considering setting targets for the use of PCards and EFT for each Principal Department. This will require departments to underpin strong governance, including clear accountabilities for card holders and using electronic methods (such as transaction limits) to detect fraud or misuse.

The Commission strongly supports the recent move to PCards and EFT transactions. The extent of change is depicted in Figure 11.7 below.

Figure 11.7: Projected volume change in transaction method mix.



The benefits these major moves in transaction types will however only be fully realised when the costs of the more expensive ways of transacting are removed from Corporate and Shared Service. This means that as PCards and EFT are introduced staff will need training on their use and be encouraged to move away from purchase orders and cheques. This change will not be easy for some people. In addition those Corporate and Shared Service staff who currently work in accounts payable and manage the more expensive purchase orders/invoice transactions will be in positions that have become redundant. Those positions in Corporate and Shared Service need to be identified, declared redundant and the relevant staff redeployed or allowed to leave.

Recommendation: The Commission recommends that the recent move to PCards be accompanied by a benefits realisation program in each cluster. This should identify the changes in the type and numbers of transactions occurring and the positions that are redundant because of the change.

There have been two high profile examples of failure of CSS reform programs within Australian State governments. The Western Australian and Queensland Governments have both experienced severe problems with the implementation of their CSS consolidation programs.

Case study: CSS consolidation in Western Australia and Queensland

The Queensland Government decided to transition to a shared services model in 2002. It established three major shared services providers: one each for Health, Education and Training; and a Shared Service Agency for the remaining 80,000 FTE in 17 entities. All IT services were to be delivered by one whole-of-government IT provider (CorpTech). Following negative reviews, the Queensland Government abandoned the single centralised IT provider policy. It overhauled CorpTech and merged it with the Shared Service Agency. Payroll services are being devolved from CorpTech to Queensland Health and the Department of Education and Training.

The Western Australian Government introduced shared corporate services in 2003, with the objective of reducing costs. In 2005, it established three shared services providers: one each for Health, Education and Training and an Office of Shared Services for all other employees. Like Queensland, its strategy included implementing a whole-of-government IT solution. In 2011, the Economic Regulation Authority recommended that the Office of Shared Services be decommissioned and responsibility for corporate services be returned to agencies.

The first lesson to be drawn from the Queensland and Western Australian experiences are not to attempt a „one-size-fits-all" IT approach. Second, these experiences show the dangers of attempting to consolidate too far and too fast. The Queensland and Western Australia Governments each created a single shared services provider to service all general Government agencies other than Health and Education and Training. In NSW, the current plan is an initial reduction to five providers supporting all clusters, after the transition of Businesslink and ServiceFirst client to the single NewCo provider.

Finally, in Queensland and Western Australia, the departmental reform initiatives were not coordinated with central reform initiatives. In NSW, there is intended to be a strong central program and cross-sector coordination. Greater flexibility is also envisaged, to account for individual clusters" characteristics, needs, structures and organisational arrangements. The *Blueprint* aims to guide sector-wide consistency, while acknowledging the uniqueness and complexity of individual departments.

11.4.3 Outsourcing and partnerships

There has been recent consideration of whether further benefits can be gained through different sourcing strategies involving the private sector. Options include:

- selective outsourcing, where some of a cluster"s shared services functions are separately contracted to external providers. The other functions would be continued in house by the cluster"s shared service provider

- a commercial public:private partnership provider model, where risks and benefits are shared between an external shared service provider and the Government, for one or more clusters
- full outsource, where an external provider is contracted to provide the full range of shared services for a cluster or group of clusters. This is not usually implemented unless systems and processes are very mature. It is not considered a realistic option for the NSW Government at this time.

The first option, selective outsourcing, already occurs. For example fleet maintenance is outsourced in most agencies. Functions which are most often considered candidates for early outsourcing include payroll, desktop IT support, fleet management and facilities management. Coles recently outsourced their payroll function and the experience is relevant. Their payroll is as complex as the payroll in most clusters.

Case study: Coles Group's outsourcing of payroll

Between 2004 and 2006, the Coles Group started strategically streamlining its payroll function across its businesses. At the time the group included supermarkets, liquor stores, Officeworks, Kmart, Target and Harris Technology. About 167,000 people were employed in over 3,000 locations.

Coles operated four payroll systems involving multiple databases and interfaces with legacy computer systems. It was difficult to gain accurate information about the workforce. The business had out-dated and unsupported technology that required replacement or upgrade, and significant manual processes.

The Coles Group decided to outsource its payroll function in order to:

- use external expertise, after a number of incomplete internal attempts
- avoid incremental „band-aid" investments, often $25-$30 million at a time
- rapidly uptake „best practice" HR processes
- lower costs of doing business
- achieve a standardised system platform on preferred software.

Following a tender process, EDS was engaged to handle the payroll function. The handover process took about three years. It started with a year of planning and stabilising before transition. Roll out was progressive, with extensive planning and risk mitigation strategies in place. This was the largest business process outsource in Australia.

The Coles Group has found that technology was an enabler but not necessarily a solution. There were a number of organisational challenges, including:

- a covert resistance to change
- geographically dispersed businesses which were historically run as separate silos
- multiple complex union agreements
- multiple time and attendance systems
- no previous experience with outsourcing
- need to avoid disrupting day-to-day operations and strategic initiatives.

The outcome exceeded the initial savings goal of 10%, primarily from staff reductions. It also achieved the planned service improvement outcomes, such as freeing up operational staff"s time from manual administrative processes, and investment in new technology. The outsourced organisation now processes 6.9 million pays each year, on a single SAP system. For the first time, the Coles Group was able to get a single view of its entire workforce.

Outsourcing can provide solid benefits and reduce risks, but success depends on:

- keeping a firm focus on the benefits and outcomes, and not getting caught up in the process, especially not getting distracted by the IT and technology issues
- clear governance through contractual arrangements, which provide reward and penalty incentives and clearly assign specific accountabilities (avoiding the „blame game")
- communicating the benefits to participating organisations and providing them with incentives to fully participate.

A second option of public/private partnerships, has been used in the United Kingdom and in particular in their Health system. This case study is at Appendix 16

Both outsourcing and partnerships force a shift away from weak governance arrangements, usually through an oversight committee structure and Service Level Agreements, to a proper commercial governance model, based on clear accountabilities and contractual rewards and penalties.

Moving to selective outsourcing appears an easier option than developing a private : public partnership model. The level of maturity at present in the NSW Government suggests a cautious approach toward partnerships. Timing, sequencing and the bundling of functions are key considerations in working out a strategic pathway for reform. This could be done in a way that does not stop partnership at a later date.

Commercial partnerships should certainly be explored, but only in relation to shared service providers which have reached a maturity not yet evident. In the short/medium term, opportunities for outsourcing of specific functions should be considered. The

NewCo approach offers the opportunity to build a capability within government to outsource specific services.

Recommendation: The Commission recommends that:

- the Director General of the Department of Finance and Services explore the benefits and risks of outsourcing of specific functions (e.g. payroll) to the new vehicle servicing the clients of ServiceFirst and BusinessLink.
- the Director General of the other clusters examine whether or not they wish to join the outsourced model for any specific services in that vehicle.

11.5 Expenditure

Significant expenditure is required in the short and medium term with significant benefits in the longer term. For example, the business case for the reform of CSS in the Transport cluster shows that a capital investment of $151 million is required over the period 2012-16 and that the reforms will generate recurrent financial savings of $100 million annually from 2017 onwards. The business case has a Benefit-Cost Ratio in the order of 4.5.

While the long-term benefits of investment in technology are broadly accepted, the short and medium term investment required to reap these benefits has not been secured. One way in which the funding of this expenditure can be considered is shown in the merger of Centrelink, Medicare and the Department of Human Services. The expected savings arising from that CSS reform program were invested back in the department"s ICT systems over a number of years, as agreed with the Department of Finance and Deregulation (See Appendix 17).

Across the NSW Government, the level of investment required needs to be determined but could be in the order of $850 million over the forward estimates. The Commission understands that Treasury holds an ICT re-investment pool which is partly funding this investment, with around $110 million of CSS-related IT projects funded to date.

Recommendation: The Commission recommends that:

- the Department of Finance and Services develop an estimate of the investment required across the sector for the CSS reform programs across the clusters
- Treasury provision a central pool for clusters" investment in CSS reform programs
- Clusters monitor and check that benefits are being realised and take steps to ensure this outcome which in turn would cover their investment in the reform program.

12. Procurement

Key points:

- Procurement services in the NSW Government have begun reforms to address the dated, complex and uncoordinated processes that exist.
- The use of whole of government contracts is mandated far more than in other jurisdictions and is not likely to be offering value for money in all cases.
- There are 5,754 customers outside government making use of government contracts. This is in need of review.
- Clusters and agencies should pay more attention to their total procurement spend and a data system is now in place to assist the Department of Finance and Services in providing this information to agencies.
- Procurement capability needs improvement across capital, ICT and more basic goods and services.
- Public private partnerships can work well but some changes are needed to the current model. More non-core activities should be included on the private sector side where they add value and the risk transfer and allocations must be appropriate, especially in toll roads.

12.1 Procurement of goods and services

12.1.1 Present procurement practice

Several recent reviews of the procurement of goods and services by the NSW Government have noted an array of dated, complex and uncoordinated processes. At present agencies buy goods and services through both whole of government contracts and agency specific contracts. Agencies, except State Owned Corporations, are required to use whole of government contracts where they are available, though this requirement is not consistently followed.

Currently, whole of government procurement is managed by the State Contracts Control Board and its operational arm NSW Procurement, Department of Finance and Services. The Board operates under the *Public Sector Employment and Management Act 2002.*

Treasury estimate that about $13 billion is spent each year by general government on goods and services, excluding capital expenditure. This includes about $9.5 billion directly spent on goods and services (17% of the budget) and other goods and services expenditure currently held in other categories. Of this $13 billion spend, the whole of government contracts conducted by the Board account for $3.8 billion.

The top ten Board contracts in 2010-11 are set out in table 12.1. These are all whole of government contracts.

Table 12.1: Top ten Board contracts

	Total contract value ($m)	**Spend in 2010-11 ($m)**
Motor Vehicle Acquisition	$2,728	$531
Contingent Workforce	$2,338	$478
Supply of Electricity - Large Sites (Government)	$1,964	$305
Fuel and associated products (Bulk Fuel only)	$1,291	$138
Government Telecommunications Agreement	$929	$346
Disposal of Motor Vehicles	$841	$6
Travel Management Services	$566	$58
Food Services	$537	$78
Supply of Card Fuel & Associated Services	$501	$91
Personal Computers	$500	$105

Agency based procurement is substantial and tends to be focussed on purchases that are agency specific. In the case of the Ministry of Health, its focus is on medical equipment and supplies. In the Department of Education and Communities, telecommunications and computers are now major items. In 2007-08 aggregate spend on these two items in Education was about $37 million. Since then it has been well over $110 million a year reflecting the technological changes in these areas.

Not surprisingly the main agencies acting on their own behalf in procurement of goods and services are Health, Education and Transport. Approximately 80% of government spend is covered by Health, Education and Transport. The top five contract spends in Health and Education in 2010-11 are shown in table 12.2.

Table 12.2: Top Five Contracts in Health and Education

Health	**Spend $m 2010-11**
Pharmaceuticals	$92
Clinical Protective Apparel	$32
Endo Surgical & Single Use Staples	$32
Medical Industrial Gases Home O_2	$29
Clinical IV Administration	$23

Education	Spend $m 2010-11
Government Telecommunications	$90
Contingent Workforce *	$66
PCs and Notebooks	$37
Electrical and Gas Appliances	$24
Retail Supply of Electricity	$22

*Note this is a whole of government Board contract.

The NSW Government is committed to significant savings in its procurement of goods and services over the four year budget period. The commitment in saving is over $1billion across the four years 2011-12 to 2014-15:

2011-12	2012-13	2013-14	2014-15
$72m	$199m	$331m	$413m

For 2011-12 the target of $72 million appears to be achievable through more efficient purchasing, in particular by NSW Procurement (in Finance and Services) and the Education, Health and Transport clusters. To reach the larger target savings in later years there are basically only two options. Buy less and be more efficient and effective in procurement.

12.1.2 Efficient and effective procurement

There are a number of matters that could make procurement more efficient and less costly. These include:

- ensuring that the procurement strategy is value for money
- allowing outside government access to contracts only when this adds value
- increasing procurement and contract management capability across the sector.

Procurement strategy

There has been a view that whole of government contracts and procurement provide better value. It is now recognised that whole of government contracts may be best value for homogenous commodity purchases. For other goods and services, value for money is often more effectively achieved through more localised agency and intra agency based contracts. These can be managed more closely to user needs and typically involve purchasing items and services that are more complex than simple commodities.

In NSW, as noted earlier, about $3.8 billion per year is spent on whole of government contracts for goods and services. This amounts to about 30% centralised procurement. This level of whole of government contracting is high in comparison to other jurisdictions.

A recent study by Deloitte noted that in Victoria about $1.5 billion is spent through whole of government contracts (about 15% of their total expenditure on goods and services). In Queensland the level of centralisation is similar at about 18%. Queensland, like NSW, mandate the use of whole of government state contracts. Victoria mandates the use of only certain contracts – fuel, travel, vehicles, media and advertising.

Recommendation: The Commission recommends that the mandatory requirements to use whole of government contracts be applied only to those that clearly provide value for money for both the specific goods and the related services. Over time as contracts expire, the mandatory requirement to use whole of government contracts should be restricted to those that add value for money.

Further efficiency in procurement can be gained by agencies both using the most favourable contracts available and ensuring that using these contracts is the best way to get the goods or services required. An examination of the whole of government) Contingent Workforce contract, illustrates these points.

First this contract (known as C100) allows agencies to hire staff. It excludes medical officers and nurses, group home care staff and contractors. The largest cluster users in 2010-11 are shown in the table below.

Table 12.3: Uses of the Contingent Workforce Contract, 2010-11

	$m	Share
Transport	$105	22%
Education	$71	15%
Finance and Services	$63	13%
Family and Community Services	$59	12%
TIRIS	$54	11%
Attorney General and Justice	$49	10%
Health	$41	9%
Premier and Cabinet	$25	5%
Treasury	$2	1%
Other	$12	2%
Total	**$481m**	**100%**

Each of the major users of this contract should examine whether this large annual spend on temporary contract staff is the best way to manage their workforce. The Commission notes that the types of jobs hired on this contract are mainly IT and data base related/support (about 49%) and use of a contingent workforce in these areas may well be optimal. On the other hand the Commission notes that administrative hires account for 16% of the contingent workforce contract. This gives some credibility to anecdotal comments suggesting that this contract may have been used to circumvent staff freezes and restrictions. The Commission noted in its Interim Report that the Roads and Traffic Authority (RTA) employed about 690 contractors as “skill hires”. This group made up 9% of their workforce and costs $94 million per year. Further, 37% of these contractors have been engaged for over two years and as such could hardly be describes as contingent. The Commission understands this matter is being addressed.

Recommendation: The Commission recommends that Transport, Education, and other heavy users of the Contingent Workforce Contract (C100) examine whether clusters who are their annual spend on contingent labour and temporary contract staff: is value for money and the best way to manage their workforce.

Notably there is leakage from whole of government contracts. For example on this Contingent Workforce Contract agencies are also using vendors outside the contract. Recent analysis showed that suppliers not on the contract were providing 7.8% of the spend on contingent labour and recruitment. These suppliers could either be added to the contract, at agreed rates, or agencies alerted that their purchasing was more costly than it needed to be.

This behaviour simply suggests that a review by both the Department of Finance and Services (NSW Procurement) and agencies of their procurement would lead to more efficient outcomes. The two basic questions are whether the goods and services are being provided at least cost, and whether the specific procurement is the best way of obtaining the goods and services. Least cost is not always desirable if it impacts negatively on the quality of service being supplied under the engagement. Leakage from whole of government contracts suggests that agencies consider they do better elsewhere, and the use of some contracts (like the Contingent Workforce contract) may not always be the best way to meet agency requirements.

Recommendation: The Commission recommends that the Department of Finance and Services provides agencies with information about their major expenditure on contracts at least annually and if possible more regularly. Agencies should then review this data and consider whether this procurement was the best way to meet their requirements and if so was the procurement value for money. Any lessons should be noted for future implementation by agencies and if relevant Finance and Services.

The Commission has noticed a number of instances where the procurement strategy has been narrowly defined. The outcome in that narrow defined field may be optimal; but when the indirect costs across wider areas are considered the procurement strategy seems poor.

An example is printer supplies sourced only from the manufacturer – at lowest cost. However delivery is not frequent and the convenience of closer and timely supplies is not available. This leads either to inventories being kept to avoid disruptions (at some cost) or work being delayed (at some cost). These delivery service matters should be properly analysed as part of the tender so that the most efficient procurement decisions are made.

Recommendation: The Commission recommends that all procurement strategies examine both the direct cost of procuring goods and services and also the indirect costs of their ongoing delivery and service.

Outside use of contracts

A curious feature of NSW government contracts is the ability for „Eligible Customers" so defined, to use such contracts. In all there are 5,754 „Eligible customers" using NSW State Government contracts. These Eligible Customers include local governments, charities, trade unions, universities, and government related entities from other jurisdictions.

The relevant questions are:

1. Does the NSW Government consider that all these Eligible Customers should be using government contracts?
2. Do these additional customers add value to the contract? The Commission understands that only in a few contracts will their volume help pricing. Generally eligible customers are not big users and as such they benefit more from the contracts than Government benefit from their inclusion.
3. Do these customers contribute a sufficient management fee to cover the cost of their service?

Further examination is required to confirm whether additional customers add value but the Commission is doubtful that this is generally the case. Local governments are active users of the fuel contract and additional volume may lead to a better overall price. On other contracts such an outcome is more unlikely. In the case of electricity contracting diseconomies of scale through a whole of government approach are evident. The public sector is a substantial electricity user across a substantial number of sites. The very size of this electricity demand and the number of sites to be serviced limits the possible bidders. In order to make the tender competitive the government electricity contracts are divided into three contracts; one for large sites, one for small sites and one for non-government users. This has opened up the competition but it also highlights the large number of non-government users of NSW state contracts. In the case of power the government is now running a separate contract for the Eligible Customers.

It is salutary that no other jurisdiction appears to be as generous with its Eligible Customers category. In Queensland Not for Profits are eligible. In Victoria there is no centralised procurement available for Eligible Customers though agencies can endorse other organisations to use their contracts. Such endorsements tend to be with NGOs or firms that the agency is working with in partnership. This endorsement saves the agency money. The ACT tends to use NSW State Contracts. Tasmania and South Australia have no cross jurisdictional contracts though some of their agencies and local councils use NSW State Contracts. NSW Councils vary in their behaviour, some are very active and others are not, though most use the State motor vehicle and fuel contracts. The Commonwealth permits the use of NSW state contracts only where the Commonwealth does not have a contract for that good or service.

The Commission can see no reason why the NSW Government should be making its procurement services available to trade unions and the Labour Council of NSW. The same comment applies to various relatively wealthy private schools and to charities with business operations. Similarly universities and health insurers are large enough to stand alone without NSW Government assistance on procurement.

Recommendation: The Commission recommends that both the Eligible Customer definition, and the fees they pay to use NSW Government contracts, should be reviewed by the Department of Finance and Services. The Victorian and Queensland approach should be considered, along with other alternatives to narrow the number of Eligible Customers. Options should go to the Government for consideration along with any recommended changes to fees paid by Eligible Customers.

Procurement capability

The capability across the public sector in procurement is variable. A review of the NSW procurement functions in Finance and Services (by Ernst & Young) in 2009 highlighted four areas for particular improvement. These centred around:

- procurement strategy
- management of demand within agencies
- management of suppliers
- information management and reporting.

Steps have been taken to address these matters though it is recognised that time is needed to improve the information management and reporting.

The State Contract Control Board has recently introduced a revised procurement accreditation system. The reasons for this step are:

- to formally recognise that most procurement of goods and services occurs within clusters/agencies and not through the Board or NSW Procurement
- to encourage clusters/agencies to train their procurement staff so that this function is operated efficiently.

Agencies may be accredited to undertake agency specific procurement or whole of government contracts. Agency specific purchasing is up to some set value and without any reference to the Board. The whole of government contracts managed by agencies allow others to use the contracts. The agency becomes a lead agency. Under accreditation an agency is assessed independently on six criteria and its capability is rated on a scale of seven. On that basis the agency is then permitted to purchase goods and services up to a maximum contract value, between $250,000 and $30 million plus. Agencies must submit annual procurement plans, and must confirm compliance annually.

Both NSW Procurement and the Ministry for Health have been assessed and accredited. Both found the process helpful in identifying strengths and weaknesses and where improvements can be made.

Ongoing improvements in capability will be monitored by NSW Procurement who will now play a more enabling role for other operational agencies. Assistance will be provided where required.

Recommendation: The Commission recommends that the Department of Finance and Services, in partnership with the Public Service Commission, continue to improve the procurement capabilities of the NSW public sector**.**

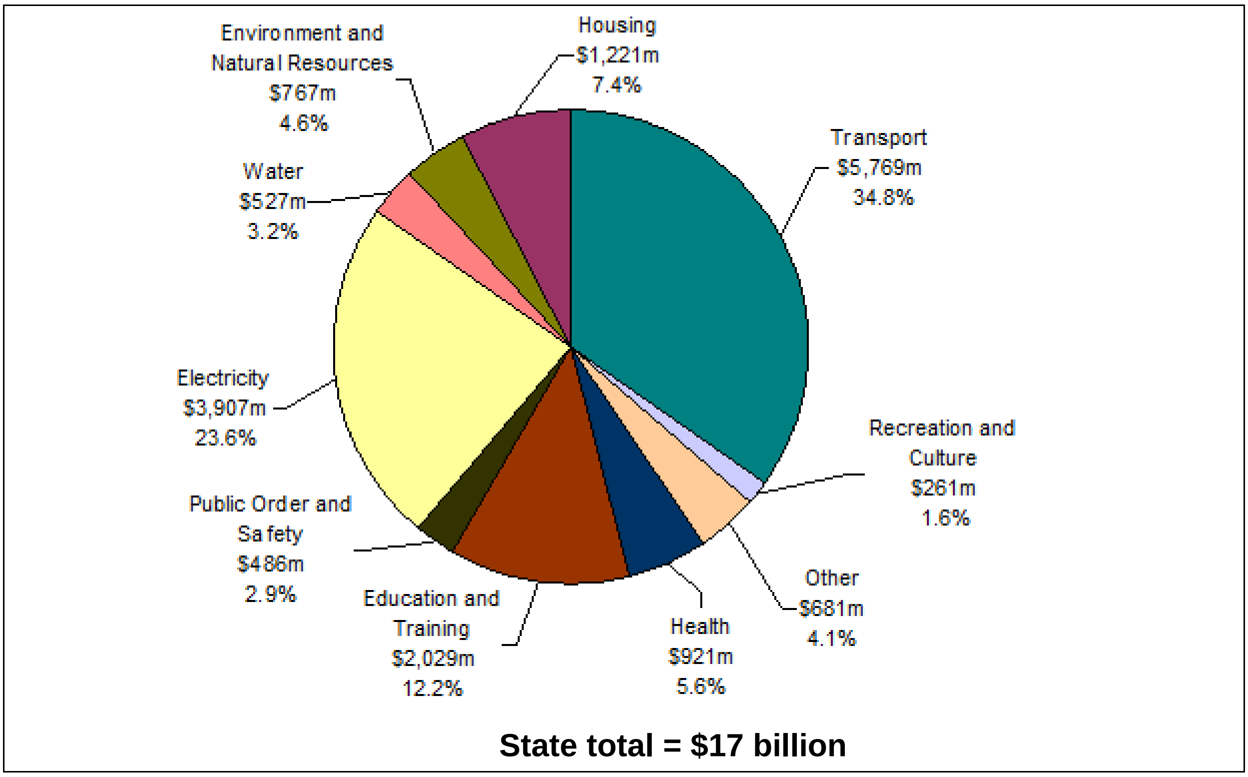
12.2 Capital procurement

12.2.1 Present procurement practice

In the general government sector about $8 billion per annum is spent on capital projects, both renewals and new capital. In 2010-11 most of this was devoted to roads, ($2.8 billion) education and training, ($2 billion including $1.1 billion stimulus) and health ($921 million). In the PTE sector, $9 billion of capital expenditure was divided between electricity ($3.9 billion), rail ($2.1 billion), social housing ($1.2 billion including $538 million in stimulus) and $900 million on water.[9]

An earlier figure in Chapter 2 showed this allocation.

Figure 12.1: Total state capital expenditure, 2010-11



Major capital spending agencies, excluding State Owned Corporations, are accredited to conduct capital procurement in their own right. This includes electricity, rail, social housing, and capital procurement in the large water utilities and roads. Those areas in the public sector that are not generally capital intensive tend to rely on Public Works (situated in the Department of Finance and Services) for assistance in their procurement. Their expertise is used by education, justice and smaller water utilities.

[9] This is composed of $527 million capital expenditure allocated to water and a remaining $373 million allocated within Environment and Natural Resources.

In the specialised area of Public Private Partnerships (PFPs) the expertise of a unit within Treasury is used. Over the last decade this unit has been involved in public private partnerships for both economic infrastructure (toll roads) and social infrastructure (schools, hospitals and rail cars). Their processes conform closely to national guidelines developed by Infrastructure Australia on the basis of earlier guidelines agreed between NSW and Victoria.

12.2.2 Efficient procurement

Issues in capital procurement are similar in the private and public sectors. These are:

- a shortage of skilled resources
- inadequate scoping
- use of inappropriate delivery methods
- poor risk allocation
- unrealistic time and costs objectives

Over the lifetime of a project, from conception to completion, these issues can contribute to significant cost overruns, delays and disputes.

About 44% of contracts were late and 10% exceeded budget across the agencies of education, health, corrective services and others. The year 2010-11 was somewhat exceptional for education in that time delays were larger than usual, related to the major increase in wet weather from the breaking of the La Niña weather pattern.

It is notable that the standard government design and construct contracts have been 4.2% over budget in 2010-11 compared with around 12% in earlier years. Delays have dropped from 49% of projects to 32%. This data does indicate considerable improvement.

The skill shortage in the public sector concerns project and contract management skills in particular. The concentration of expertise in public works and in capital intensive agencies and PTEs alleviates the problem, to some extent but these skills do need to be shared across the sector.

In public sector capital projects the most common flaw is poor scoping. When a project commences that is not properly scoped it can add 20% to the cost. In a construction survey done by the Australian Contractors Association about 26% of the large projects (over $1 billion) were $200 million or more over budget because of inadequate scoping.

The reason why inadequate scoping occurs include:

- preparation does not reflect the real time needed to conduct preliminary testing, designs, compare alternatives etc.
- a lack of understanding about what the users of the new capital project want and need for their work
- poor consultation, including with professional users like Judges and clinicians
- a lack of understanding by those consulted that there is a cut off time after which views cannot be incorporated, except at a huge cost
- projects being announced by Ministers for a political reason before a proper costing and scoping has been done.

These issues are systemic and also partly reflect a lack of project management skills which leads to inadequate scoping.

Needless to say choosing the most appropriate contracts for the project depend on knowing what the project is. For straightforward projects, like building a school on flat serviced land, a „design and construct‟ contract or similar lump sum contract would be typically preferred. These are contracts where a fixed price is quoted and the contractor takes the risk of not meeting the quote. About half of capital projects are contracted this way. Value for money is achieved in „design and construct‟ contracts where the risks are identifiable and can be reasonably quantified. Unknown risks and outcomes are not. Where there is a greater element of risk in the project more robust attention is given to design and engineering at the start, to scope, and to operations and maintenance after construction. To meet the requirements of the project varying different contracts are used including:

- design, build, operate
- design, construct, maintain
- build, own, operate and possibly transfer (BOO or BOOT)
- engineer, procure, construct, maintain
- alliance.

The particular contract choice should reflect the management of the risk around the particular project. A survey in 2011 of organisations involved in major construction, infrastructure, energy and resource projects in Australia found that risk identification and management was improving. There was a more detailed and sustained focus on risk. Lessons from the past were being heeded. Nevertheless about half the respondents felt that the risk allocation was inappropriate. Respondents suggest that clients shift risk to contractors because they have the power to do – even though the contractors are not able to manage that risk and it often should remain with the client or be allocated elsewhere.

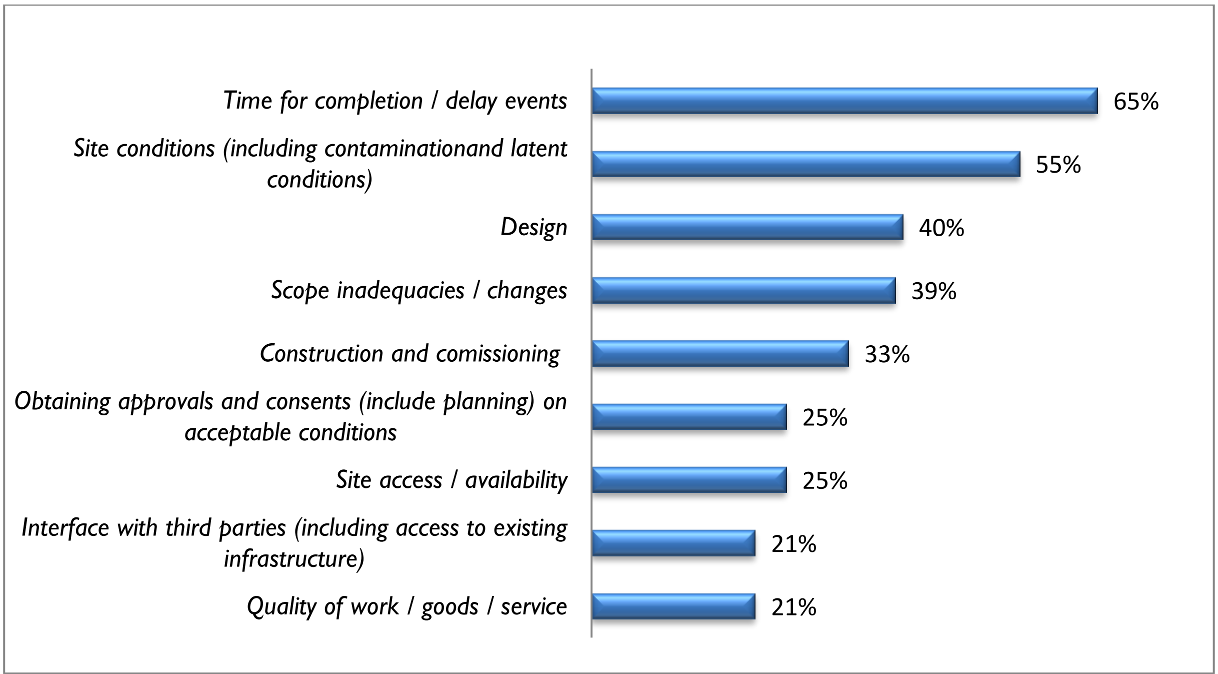
This is an important point for public sector procurement. Government as a client has the power to shift risks and sometimes does so inappropriately. This raises the cost of the project and also means the risk is not best managed. Scope inadequacies and planning risks are typically best managed by government in whole or in part in its capital procurement. The Commission has been advised informally that because of the frequent scope changes in rail projects contractors include a hidden contingency in their tender bids that cost can be as high as 50%. This is an increase in cost caused by inadequate scoping and a failure to carry the risk where it is best managed.

This commentary should be considered in the context of the Commission of Audit Interim Report. In the Interim Report we drew attention to various areas within asset management and planning that needed improvement. „Tick and flick" asset management plans invariably lead to poorly scoped capital projects and substantial cost and time overruns.

Recommendation: The Commission recommends that the procurement staff in agencies review and consider the detailed scope of their capital projects before committing to a contract. The way the project fits into the asset management plans should also be identified.

Key projects risks are set out in the figure below.

Figure 12.2: Key risks in projects



The risks that tend to be allocated inappropriately are timing / delays, scope inadequacies and design.

Alliance contracts have been discussed in chapter 5 of the Interim Report. They involve partnering with the private sector and can work well where risk is difficult to identify and quantify or cost. They have been well used for renewals and refurbishments of brown field assets where it is difficult to ascertain exactly what will be needed to do the job – for example in trunk sewer main renewals where operations must continue throughout the work and it is difficult to identify the extent of required renewals at the start of the project.

It is essential however that experienced managers represent the government throughout the project. Inexperience with alliance contracts has led to excessive margins for the private contractors at the expense of the government. The agreed total outturn cost (TOC) can be 35-45% higher than a well costed business case. In these circumstances an experienced client would not set off on an alliance partnership without revising the TOC to a more acceptable estimated outcome.

Recommendation: The Commission recommends that a review of risk and allocation by an experienced outside party, for projects over $20 million, be conducted.

Procurement in the specialised public private partnerships (PFPs) area is of interest. A report in 2009 of Australian PFPs found that this type of procurement is more likely to come in on budget and on time than other forms of purchasing. Of the $4.9 billion of PFP projects examined the net cost overrun was only $58 million. The net cost overrun for traditional project procurement of $4.5 billion was $673 million. In addition 24% of traditional projects are delivered late with an average delay of 56% of allowed project construction time. For PFPs the average delay on construction was only 2.6% of allowed time. The reason for the better PFP outcome is the relatively long period of time spent on scoping the project and the attention to detail that private financiers bring to the project.

However PFP projects have not always delivered optimal value for money. In social infrastructure, like schools and hospitals, the private sector usually provides more efficient non-core operations than the public sector. This covers non-core activities like private provision of cleaning, maintenance, gardening, facilities management, laundry and catering. Unfortunately in the recent past the NSW Government has not realised savings in these non-core service areas because of constraints placed on the private sector provider. For example, in recent health PFPs in New South Wales an agreement between the government and the public sector Health Services Union (HSU) constrained flexibility. This agreement appears to have been partly motivated by union demarcation issues, the HSU covers public sector workers and would have lost members to a union that covers private sector employees.

Under the Government/HSU agreement particular areas were constrained:

- Terms and condition of employment:
    - employees in the PFP project company remained covered by the HSU
    - the public sector awards and applicable workplace policies continued in the project company within the PFP
    - the project company was not able to offer higher pay (for changed work practices, for example)
- Selection of health staff members:
    - the project company could only select health staff members from existing employees providing support services
    - those not selected were redeployed by the Department of Health
    - any future restructuring had to be done in accordance with NSW Health public sector workplace policies and industrial instruments
- Management:
    - right to terminate health staff members
        - the project company had to submit a termination recommendation
        - Health has ultimate discretion on whether to terminate on recommendation by the project company
        - if recommendations not accepted by NSW Health, then the staff members are to be redeployed.

These restrictions led to less efficiency in such areas as facilities and maintenance, ground management, cleaning, catering, laundry, portering/wards person etc.

Recommendation: The Commission recommends that in PPPs optimal value for money is sought by allowing the private sector to conduct non-core activities where their provision of these activities is more cost efficient than public sector provision.

There has also been an issue around the tendering of some toll road PPPs. To win the tender consortium have relied on aggressive traffic forecasts. These have been well above government forecasts supplied to tenderers. Once the project has been won and the actual traffic is observed, it ends up being substantially less than the aggressive forecast. In the Cross City Tunnel and Lane Cove Tunnel projects in NSW the consortium equity partners lost their money and the consortium was sold at a loss. While the government had no financial risk it did preside over an outcome that it should have known was heading for a financial disaster. This has also recently occurred in Brisbane.

A further issue has been a requirement for upfront fees to be paid to government with tolls set in relation to that fee. An alternative that is customer focussed would be to tender on the lowest toll rates.

PPPs have become tarnished in the public sector arena as a result of these debacles. The tendering model for the toll roads should be modified so that the winner is not a consortium that is rewarded for aggressive traffic forecasts. One approach would be to constrain the bids to be based on the government traffic forecast with a gain/loss share mechanism between government and equity built around that agreed traffic volume. There would be other alternative ways to address the issue. Fundamentally the toll road owner is not the party to best handle traffic volume risk on their own.

Recommendation: The Commission recommends that Infrastructure NSW and Treasury should investigate options to optimise risk transfer arrangements for future toll road Public Private Partnerships (PPPs), with a view to ensuring that associated infrastructure remains off the State"s balance sheet and encourages private sector participation. In particular, the risk allocation in tenders for toll road PPPs be reconsidered so that the entire traffic volume risk is appropriately allocated and that toll costs are kept as low as possible for customers.

12.3 ICT Procurement

12.3.1 The present situation

The present approach to ICT procurement is to buy and own and predominately manage ICT in-house. This is now a very dated approach to ICT procurement and one that is not efficient with the changes in technology and service availability that has occurred.

The ICT procurement spend in 2009-10 of $993 million is set out in table 12.5. Total ICT expenditure each year in general government is around $2 billion, including staff costs.

Table 12.5: ICT Procurement expenditure

Projects and Services	$319m	Projects, services
Telco	$238m	Data and internet, fixed voice, mobile, other
End User Infrastructure	$193m	Desktop, laptop, printers other
Software	$159m	Enterprise apps, desktop o/s, integration apps, other
Midrange Servers	$84m	App servers, servers, other
Total	$993m	

12.3.2 Efficient ICT procurement

A recent review suggested that over $100 million a year in savings could be made assuming that the current approach to ICT continued. This saving was concentrated in three areas:

- projects and services
- desktops, laptops and printers etc.
- telcommunications (voice and data)

The spend on projects and services is not as focussed on service delivery as better practice would dictate. This is evident through a low ratio of spend on front line service delivery as compared to back office functions. The aim is usually to spend about 40% on back office and 60% on frontline services or businesses. In the government at present the spend ratio is 55% back office and only 45% frontline. This may be indicative of a gap between the front line service delivery areas and the

IT providers. This gap is a common problem in IT and leads to technical rather than „business" solutions.

Recommendation: The Commission recommends that before IT projects commence the technical providers are made fully aware of both what the business needs (and does not need) and the available budget. The project should be business led not technically led.

The IT projects being undertaken are not being aggregated even where possible. This means the knowledge of a particular vendor is not re-used to get gains across agencies. „One project-one vendor" tends to be the norm and insufficient leverage is being gained from the lessons learned the first time around.

There is also a tendency to use fixed price contracts even when the early stages of design are not sorted out. As with capital projects this means that excessive risk is being priced into the contracts instead of being identified and costed and managed properly.

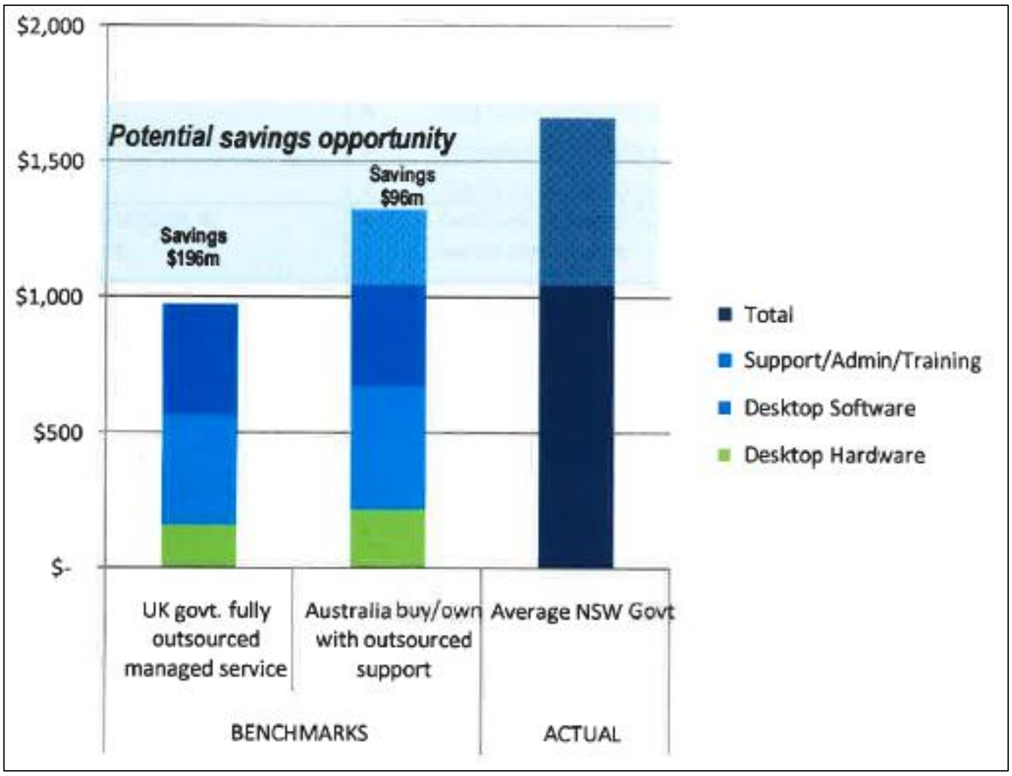
To address these shortcomings it has been suggested that vendors can be aggregated especially for back office functions like records, reporting and Enterprise Resource Programs. Agency specific solutions must include standards across agencies and the re-use of vendor expertise should be pursued. In short the procurement needs to be managed for the government, and not for a single project in a single service area. Obviously design work should be completed before any move to use fixed price contracts are contemplated.

Recommendation: The Commission recommends that IT projects be carefully scoped and that no budget be set until a firm costing can be made after the design phase.

The purchase of desktops and laptops at present is almost all capital purchase based and purchasing has been scattered so that volume discounts have not been maximized. The Commission notes a price difference of more than 30% for the same desktop from the same vendor in different agencies. A large amount of the spend is above benchmark specification bands.

A benchmark for desktop costs suggests that there are potential savings of between $96 and $196 million in this area. The situation with desktop benchmarks is shown in the figure below. The Commission notes that the UK benchmark needs to take into consideration the significant volume differences between NSW and the UK. This may impact pricing.

Figure 12.3: Desktop cost and support analysis



To make these savings the current state of procurement for desktops and their service support needs to change. The type of changes envisaged are a move to a managed service provider panel and a shift away from the buy/own model to a lease, pay-as-you-go model. The number of hardware vendors should be cut and software should not be acquired separately but as part of the managed service bundle. The changes needed are set out below in Table 12.7.

Table 12.7: Potential changes to desktop purchasing

	Current state	Future state
Contract	SCCB 2007 panel contract	Managed service provider panel. Noting that there may always need to be a hardware contract for front line services and smaller regional agencies/offices that do not yet have sufficient connection speeds
Commercial Basis	Capex – buy/own	Opex – lease, pay-as-you-go
Hardware	47 EUI vendors being used by agencies across WoG	Suggest 3-5 vendors
Software	Purchased in addition to hardware	Part of the managed desktop service bundle (except for agency specific software)
Support	Purchased in addition to hardware and software – predominately by Govt shared service provider	Part of the managed desktop service bundle (vendor could be managed by a Govt SSP)
Total potential savings		**$96-$196m p.a**

Addressing these issues is not difficult. Agencies should be allowed to purchase the best specification possible on any given day at the best market benchmark prices. And agencies should be curtailed in „spec-ing up" their purchases and adding unnecessary extras.

The government purchase of mobile and fixed line voice rates is in line with the best practice and no further savings on these services is expected. Current rates are comparable to best in market, however there are still opportunities to improve the product offering bought from Telcos. For example, free calls between same telco mobiles. In the short term mobile broadband and mobile data however need to be aggregated across government for purchasing. Almost all agencies are on the wrong cap plans and are spending too much for too little use. These rarely matched „cap plans" should be eliminated now and services benchmarked to better market prices. An aggregated government mobile and fixed broadband purchase would be better value than individual agency based agreement.

12.3.3 Future development of ICT for better services at less cost

The ICT cost base could be reduced further, at acceptable risk, by moving over the next three years or so to more commercial procurement and a more mature environment that offers better services. The implementation of such a move over time should be considered and planned.

12.4 Comment

Procurement is an important back office support for clusters. It also has a strategic role that should be front line and operating at a high level of exposure to leadership across Government. It drive"s performance improvement. Whether it is concerned with goods and services, capital or ICT procurement there is basic information that the service delivery areas must have to assess whether the procurement is meeting their needs. The basic information is:

- the procurement in your cluster, agency business unit on specific items
- the areas that have requested that procurement and the support case supporting that request
- the capability and experience of the people doing the procurement
- the procurement cost
- how the services/goods that have been procured fit in with cluster, agency, business unit plans and priorities
- is the procurement being driven by customer requirements or some less important factor.

13. Public sector insurance and Workers' Compensation

Key points:

- The NSW Treasury Managed Fund (TMF) insurance scheme has considerable coverage, cost and administration benefits for government.
- All NSW government agencies and entities should utilise the TMF scheme for their insurance requirements.
- Public sector injury and workers‟ compensation trends improved between 2005 to 2008. Recent years have been adversely impacted by the Police Death and Disability Scheme.
- The emergence of stress-related injury claims in the public sector is also of concern.

13.1 Overview

The NSW Treasury Managed Fund commenced on 1 July 1989 and covers a number of insurable liability and property risks of state government agencies. This includes workers compensation arrangements for around 90% of the state‟s public sector workers.

The NSW Self Insurance Corporation (SICorp) manages the TMF, including underwriting, funds management and premium setting. Private sector agents are contracted under the workers‟ compensation portfolio of the TMF to provide claims and case management.

Public sector agencies insured through the TMF pay premiums, called contributions to SICorp. Contributions are based on claims history adjusted for the size of the agency and a benchmark rate derived from comparison with WorkCover or like agencies in other states. Budget sector agencies receive funding from NSW Treasury based on the benchmark rate. Agencies performing well can receive surplus funding and underperforming agencies will receive deficit funding with the balance to be sourced from their annual budget allocation. This is an incentive for budget agencies to manage their performance.

The TMF scheme is designed to financially reward agencies that manage risk and to penalise those that do not. Hindsight premium refunds or penalties are calculated for TMF member agencies three and five years after the start of the relevant fund year. Whereas the deposit premium charges is based on the previous two years claims experience, the hindsight is adjusted according to the actual experience for the fund year. The cost of hindsight penalties are generally met from within agencies‟ own funding sources. This provides an incentive for agencies to actively manage workplace safety and focus on early return to work for injured workers.

There are a number of NSW government agencies and entities that are not TMF member agencies. Agencies such as Housing NSW have private sector underwriting arrangements and agencies including Railcorp have their own self-insurance arrangements that also cover workers‟ compensation.

However, it is not clear to the Commission why non-TMF agencies have alternate insurance arrangements. The Commission is advised that arrangements through the TMF scheme have numerous benefits for agencies and government, including:

- flexibility and co-operation in its dealings
- all-encompassing cover, (ground up, no excess and unlimited) which is wider than that available in the commercial markets. Coverage is provided within a single contract and agencies do not require additional budget support if a loss occurs
- premium rates that do not support a profit motive or return on capital requirements of insurers – premiums match estimated cost of claims
- emphasis on risk management to prevent and/or manage loss – as opposed to pricing as the main risk management strategy. Agencies are thus given incentives to manage their risks
- aggregating the Government‟s insurance requirements under one umbrella cover. This provides economies of scale in both claims management and risk transfer to the reinsurance market thereby providing opportunities for reducing premiums payable to reinsurers. It is also cheaper to buy reinsurance as a group compared to buying as individual agencies
- administration savings to agencies, for example tendering, statutory charges, brokerage and commissions. SICorp incurs such costs singularly compared to what it may cost agencies individually
- there is greater transparency of risk and transparency of claims cost to Government.

Whereas the commercial market is subject to premium volatility due to commercial market cycles, a key benefit in participation in the TMF is in the premium calculation methodology. TMF premiums are principally calculated on a direct analysis and projection of agencies‟ individual claims experience.

Sydney Water began transitioning its insurance arrangements to the TMF scheme in 2005 and it has achieved significant savings in premiums. Sydney Waters‟ low claims experience has enabled premium stability to be achieved, resulting in consistent annual savings of $12 million when compared with a commercial market placement.

Given the considerable benefits, the Commission believes that all NSW government agencies and entities should utilise the TMF scheme for their insurance requirements. Non-TMF agencies and entities should work with SICorp to transition their insurance across to the TMF scheme as their current arrangements expire. The following agencies and entities, in addition to RailCorp and Housing NSW have been identified as having insurance arrangements outside of the TMF:

- Newcastle Port Corporation
- State Transit Authority
- Sydney Catchment Authority
- Sydney Ferries
- Sydney Ports Corporation
- Transgrid (currently in discussions with SICorp)
- Wine Grapes Marketing Board
- Several medical councils, including the Podiatry Council, Psychologists Council Pharmacy Council, Dental Council and the Physiotherapists Council.

Recommendation: The Commission recommends that NSW Government agencies and entities with insurance arrangements outside of the Treasury Managed Fund (TMF) should work with SICorp to transition their insurance across to the TMF scheme as their current insurance arrangements expire.

13.2 Workers' Compensation

The NSW public sector has implemented a number of strategies over the last decade or so to reduce the incidence, severity and cost of workplace injury through implementation of a number of workplace safety strategies. These have included: *Taking Safety Seriously* in 1999 and 2002; and *2005-08 Working Together: Public Sector and Workplace Health and Safety and Injury Management Strategy* (*Working Together*). The *Working Together* strategy has now entered its second phase (2010-12).

Collectively, these strategies have focused on reducing the frequency and severity of public sector workplace injuries and improving injury management and return to work outcomes for injured workers. Measures within the strategies have centred on:

- increasing awareness and establishing transparency and accountability for workplace safety performance at all levels within agencies
- better and more responsive case management to improve return to work including improving response times for notifications of incidents, setting targets in CEO performance agreements around injury management and establishing targets around return to work performance.

The strategies have had some success. Of particular note, a review of *Working Together* by the Auditor-General in March 2010 found that, during its implementation period (2005-2008), public sector agencies had achieved a reduction in the impact of workplace injuries as follows:

- there were 5,041 less injuries
- the number of claims remained steady at around 21,000 despite an increase in the number of public sector employees
- the average cost of claims reduced by 25%, from approximately $24,000 down to around $18,000
- $108 million (adjusted for CPI) was saved through reduced cost of premiums
- $213 million (for 2004-05) of cumulative savings was made through reduced cost of claims.

Whist these improvements have been encouraging, it would appear that the momentum gained in the first phase of *Working Together* has not been sustained. Since 2008, the number of workers" compensation claims has steadily increased. The net ultimate average cost of claims also rose from $17,319 in 2007-08 to $21,806 in 2010-11. This has eroded the gains (reductions in the number of claims and average cost per claim) achieved between 2005-2008. The Police Death and Disability Scheme, discussed later in this chapter, was a significant factor in this.

Table 13.1 Change in the number of Workers" Compensation claims under the TMF scheme

Financial accident year	TMF Scheme							
	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Ultimate number of TMF Workers' Compensation claims projected	23,260	21,753	21,597	21,872	22,171	22,279	23,072	24,373

Source: TMF Scheme Actuary Valuation December 2010 (PricewaterhouseCoopers)

In the context of the public sector, increases in the number of workers" compensation claims and the costs of claims lead to an increase in the premiums paid by government agencies. There are also other costs for agencies associated with down-time, backfilling for injured workers and case management. Increased premiums and other associated costs of claims serve to divert agency funding away from essential government services.

In 2011-12, workers" compensation premiums for TMF member agencies collectively increased by $168 million or 31% over the previous year. In 2010-11, there was a $91.5 million increase in the total Workers" Compensation premiums paid.

Table 13.2 Total Workers" Compensation premiums paid by NSW government agencies under the TMF scheme

Year ended 30 June ($ million)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012(a)**
TMF Workers' Compensation premiums	392.5	424.8	431.2	484.9	507.1	441.9	451.8	437.1	454.7	546.2	714.4

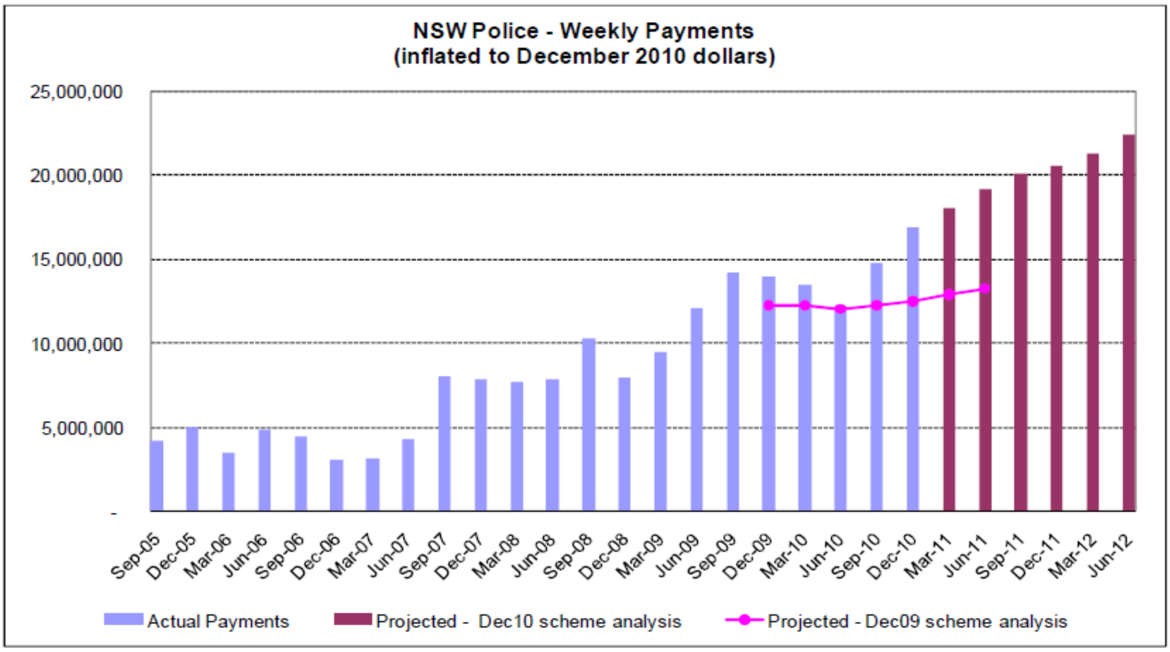
Source: SICorp (a) Budgeted for 2011-12

The Commission notes that deteriorating NSW Police Workers‟ Compensation experience was the primary contributor to this increase, accounting for over $116.5 million (69%) of the total premium increase for the entire TMF portfolio. Police workers‟ compensation premiums have risen from $55 million in 2005-06 to $270 million in 2011-12. This dramatic rise has been attributed to the impact of Police Death and Disability (D&D) scheme, specifically:

- the increased number of Police officers pursuing a D&D benefit
- a consequential increase in the duration of claims remaining on weekly benefit payments.

NSW Police has a number of arrangements in place to compensate workers in the event of workplace injury or death, namely workers‟ compensation, the D&D Scheme and weekly top up arrangements. The interaction of these three schemes creates a strong disincentive to return to work and hence have an adverse financial impact on the Police and TMF. This is evidenced by the clear deterioration in Police claims experience just prior to and following the introduction of the D&D Scheme. Weekly payments for example more than tripled from around $5 million in 2005 to over $15 million per quarter in December 2010.

Chart 13.1 Change in the cost of weekly payments associated with NSW Police workers‟ compensation claims.



Source: TMF Scheme Actuary Valuation December 2010 (PricewaterhouseCoopers)

In July 2011, the independent TMF Scheme actuary predicted that if the D&D Scheme was not reformed, and incapacity payment duration rates not curbed, the eventual size of a D&D claim may be much closer to $600,000 than the $450,000 which is assumed currently.

Case study: Police Death and Disability Scheme

The Police Death and Disability (D&D) scheme was established under the *Crown Employees (Police Officers Death and Disability) Award 2005* to provide benefits in the event of on-or-off-duty injuries resulting in death or disabilities.

The cost of the Police D&D scheme rose rapidly from $69 million in 2005-06 to $288 million in 2010-11, far exceeding its budget. The scheme"s cost was intended to be 5.4% (with 3.6% employer contribution) of Police"s wages cost but has been running at over 28% in 2010-11. As a result, the Government had contributed over $500 million more than its 3.6% contribution ceiling over the past six years.

The flow-on impact on workers" compensation had also led to substantial increases in the Police Force"s premium, largely as a result of deteriorating return to work outcomes after injury.

The Auditor General"s Report (*Managing Injured Police 2008*) noted that the structure of the *Death and Disability Award 2005* acted as an incentive for early separation. Officers accessed large lump sum payments after taking extended sick leave at full pay. The overall combined benefits provided little incentive for officers to return to work. The adverse impact on police productivity, performance and culture was significant.

Only 1% of officers left NSW Police through retirement in 2009-10, with 55% exiting for medical reasons. This compares with 14% retiring and 9% medical exits in Queensland.

As noted in chapter 6, the rapidly increasing and unsustainable cost of the D&D Scheme has prompted reform. A new scheme will see the purchase of commercial insurance which will continue to provide lump sum benefits for death and total and permanent disabilities. An income protection benefit will be paid to replace the lump sum benefits for partial and permanent disability benefits, and it will also provide salary top-up payments for officers receiving workers" compensation weekly benefits. The new arrangements focus on helping injured police officers return to work, which will in turn reduce costs in the long run.

It is important to note that the eventual impact of the D&D Scheme on Police workers compensation performance is uncertain. The recent increase in the number of D&D

applications is likely to have been impacted by speculation about changes to the D&D Scheme. It is unclear whether the increase in claim numbers reflects a speeding up of claims that would have eventually been lodged, or a genuine deterioration in Police injury experience.

NSW Health, which is another agency with large workers compensation costs, had previously made significant inroads in its injury management performance. This contributed to reductions in its premiums between 2006-07 and 2008-09. The Commission understands that this was achieved through greater devolution of accountability for work safety and injury management performance within NSW Health, and by proper investment in its injury case management capabilities.

However, NSW Health has recently experienced a rise in the cost of weekly payments, driven by an increase in the number of claimants receiving weekly incapacity payments. This deterioration has also impacted premiums, with around $12 million of the $168 million increase in TMF premiums in 2011-12 attributable to NSW Health. It is noted this is not an agency wide trend but particular to certain areas of Health.

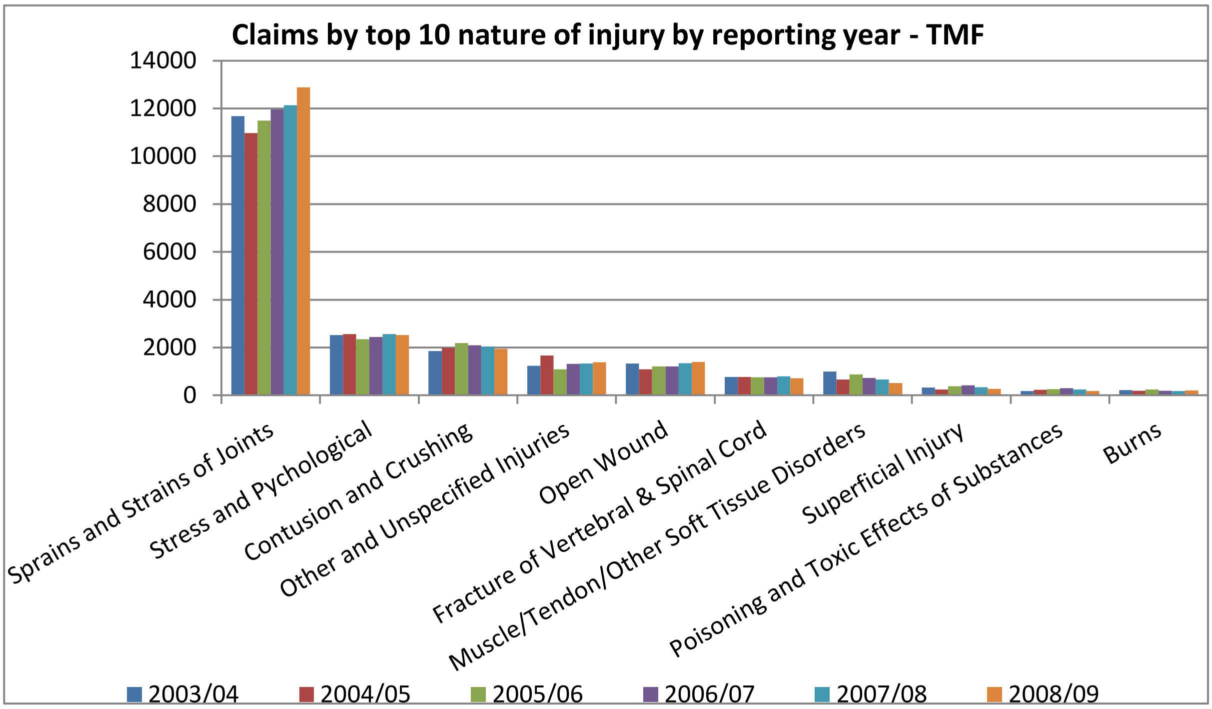
Advice from TMF Claims Agents and NSW Health staff indicate the following factors may have contributed to the recent deterioration:

- behavioural factors – with potential restructuring leading to workers being more willing to lodge a claim and delay their return to work. Anecdotally, some workers believe they will not be made redundant if they have an open workers compensation claim
- the ageing health work force – anecdotally ageing workforce is more likely to make a claim and achieving return to work outcomes can take longer
- staffing shortages impacting return to work support
- difficulties finding suitable duties in smaller or regional branches.

The December 2010 actuarial valuation of the TMF workers‟ compensation scheme also suggests emerging upward trends across the scheme associated with medical costs and Common Law claims (Workplace Injury Damages). The Workplace Injury Damages experience of the TMF in 2010 was similar to the WorkCover Scheme, with an increase in the number of claims commencing Workplace Injury Damages action and an increase in payments.

A major contributor to the cost of claims is the type of injury incurred. The most commonly occurring injuries in the public sector continue to be sprains and strains.

Chart 13.2 Top 10 claim types under the TMF Workers" Compensation scheme



Of concern is the prevalence of stress-related claims within the public sector. This does not appear to be particular to NSW as all states are affected by stress claims in the public sector. Within the TMF scheme, there are around 2,500 to 3,000 stress related claims made each year and around 18% of all open claims are for stress.

Stress related injuries, or psychological claims, may emerge from incidents whilst on front line duty, for example post-traumatic stress. Alternatively they could stem through work environment issues, for example workplace culture, harassment, bullying, grievances or workload.

Stress related injuries often require long periods time for away work for rehabilitation and their cost is significant, with the net ultimate average cost of a stress claim ($46,430 in 2010-11) being more than double that of a non-stress claim ($21,806 in 2010-11).

To some degree, stress related injuries can be avoided or their impacts significantly minimised through good employee support frameworks and strong managerial commitment and action. For example with post-traumatic stress, early identification of potential problems and effective counselling and case management frameworks can minimise impacts and subsequent claims. With regard to workplace stress, managerial vigilance and immediate action to address grievances, cultural issues and other problems can also correlate to lower incidences of claims.

The case study on the Ambulance Service of NSW later in this section demonstrates the benefits of early resolution on workplace grievances and complaints through empowering and training managers.

Addressing the recent trend

The recent rise in the number and cost of public sector workers‟ compensation claims is concerning. However, the Commission notes that a number of actions have already been taken to address this adverse trend.

In 2010, the second phase (2010-12) of *Working Together* was released. The second phase serves to establish even greater accountability for Chief Executives and Senior Management for workplace safety and injury management performance by embedding responsibilities and performance measures in executive performance contracts. There is also an emphasis on increased transparency of performance, for example establishment of KPIs, performance reporting to the Minister, focus on performance in executive meetings, setting performance targets in corporate plans.

The second phase of *Working Together* also establishes greater clarity on the roles and responsibilities of agencies, central agencies, the WorkCover Authority, SICorp and agents.

In this regard, it is important that agencies have an appropriate number of injury case managers that can support injured workers return to work. Effective case management is the major influence on return to work outcomes. However, concerns have been brought to the Commission‟s attention that, anecdotally, some agencies have either an inadequate number of qualified case managers or they have too many. In the case of the latter, this is potentially leading to confused accountabilities and hence interference and duplication with the regard to claims management function performed by TMF Claims Agents. This impacts the case management experience for injured workers and creates additional and unnecessary administrative cost.

Recommendation: The Commission recommends that WorkCover and SICorp should jointly prepare instructions to all agencies, to be issued either as a Treasurer‟s Direction or Premier‟s Memorandum, clarifying the following:

- the injury case management function that is to be performed within agencies and how this complements and differs from the function performed by the TMF Claims Agents
- the appropriate qualifications that agency injury case managers are required to hold
- the optimal number of case managers that should be employed by agencies by applying relevant benchmarks.

In January 2011, SICorp also awarded new Scheme Agent contracts. The new contracts have revised incentive structures that are intended to drive a greater focus on case management and return to work for injured workers.

If implemented, a number of the Commission"s recommendations for the WorkCover Scheme discussed in Chapter 10, around Common Law claims, medical costs and the benefits framework, would also positively impact the public sector scheme"s financial position. As well as more targeted and ultimately better outcomes for workers, the eventual cost savings from these reforms would allow agencies to re-direct funding to other essential services. This would see benefits distributed to the wider community.

Finally, this chapter ends with the following case study on the *Healthy Workplace Strategies* implemented by the Ambulance Service of NSW. The case study is an example of good practice that exists in the NSW public service. The principles of *Healthy Workplace Strategies* are universal and can be applied broadly because they promote good people management and reinforce the value of supporting staff in the workplace.

Case Study: Ambulance Service of NSW's *Healthy Workplace Strategies*

A 2008 Parliamentary enquiry highlighted bullying and harassment as a key issue within the Ambulance Service of NSW and a lengthy process for handling grievances and complaints within the organisation had exacerbated many of these situations.

The challenge for Ambulance was how to effectively address these issues and initiate a more positive organisational culture. Staff consultations also indicated a lack of awareness and knowledge in dealing with workplace concerns.

The *Healthy Workplace Strategies Program* (HWS) commenced in 2008 and four key priority areas were identified:

- improve the workplace environment
- help staff members resolve workplace issues
- simplify policies and procedures for managing workplace concerns
- promote early resolution of workplace conflict at a local level to avoid, if possible, the alienating and divisive consequences of such issues.

The program recognised that employee wellbeing is strongly linked to the effective management of workplace conflict and grievances. Change management programs were developed and involved a range of strategies that supported staff and importantly, their managers. These included:

- Respectful Workplace Training for all staff
- an easy to read Raising Workplace Concerns Policy which clarified specific staff responsibilities, incorporated into the Respectful Workplace Training as the first step and included step by step flowcharts which are displayed in all workplaces
- developing Our Values which is displayed in all workplaces, included in all position descriptions and performance development plans
- encouraging management to include „staff relationships" as a regular agenda item in meetings
- Grievance Contact Officer Program
- accredited mediator services
- a Grievance Management DVD.

In recognition of paramedics" preference to utilise internal staff support services, the existing Peer Support Program and Chaplaincy Program were also strengthened to provide additional support.

The Raising Workplace Concerns policy, procedures and flowcharts represent a new approach to managing workplace concerns confidentially and effectively. They provide staff with a simple and clearly documented process, so they can confidently raise concerns. The responsibilities of all staff are clearly defined, so any issues that arise can be resolved at the appropriate level.

In addition to identifying the key role of managers in contributing to a positive workplace culture, Ambulance recognised the common gap between policy and management practice and established the Ambulance Management Qualification (AMQ). This is a 12 day accredited in-house management program and includes skills based training on managing grievances and workplace concerns. Since 2008, over 600 staff have commenced the program with over 300 staff now having received the Certificate IV Frontline Management.

A 2011 independent survey of the AMQ indicated the awareness of managers handling workplace concerns and grievances has increased. Seventy nine per cent of AMQ participants surveyed agreed that the AMQ improved their knowledge in handling workplace concerns and/or grievances. Similarly, 84% of AMQ participants agreed the AMQ reaffirmed their responsibility to monitor the wellbeing of their staff.

Since 2006-07, Ambulance has seen a 70% reduction in the average cost of psychological claims, equating to savings of around $13.4 million to 2010-11.

When the workforce is well supported, improvements in service delivery and client outcomes can also occur. From early on in the HWS program, employees have reported flow-on benefits to patient care. This was supported by a 65% reduction in behaviour and human performance patient complaints.

The progress made by Ambulance to date was recognised externally. In September 2011, Ambulance won the TMF Risk Leadership Award for its *Healthy Workplace Strategies Program*. In November 2011, Ambulance won the Australian Human Resources Institute (AHRI) Rob Goffee Award for Talent Management for the Ambulance Management Qualification.

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14. Concessions

Key points:

- The NSW Government provides various concessions, in the form of discounts, subsidies, rebates, waivers and exemptions. These are granted across a range of government goods and services.
- The government also allows some certain concessional treatment on a number of state duties and taxes.
- Concessions and concessional tax arrangements have a combined cost of around $6.8 billion a year. Demographic changes will see the cost of concessions increase into the future as the proportion of aged people increases.
- While this is an area of considerable cost to the state, there is no identifiable framework to prioritise, set and evaluate commitments in this area. This needs to be addressed.
- Existing concessional arrangements across government have grown organically. Some may be poorly targeted, ineffective or no longer a priority. Existing arrangements should therefore be reviewed.

14.1 Overview

Concessions involve the provision of goods and services to certain users at a lower fee than that charged to the wider community. Concessions are intended to assist certain members of the community and are provided In the form of a discount, subsidy, rebate, waiver or an exemption on the usual fee.

Eligibility for concessional treatment is typically on the basis of low income, age, special needs or disadvantage in the case of individuals. In the case of organisations or institutions the basis for a concession is typically status/category. For example, organisations can be charitable, not for profit, religious or government.

NSW government concessions are concentrated in the areas of education, social security and welfare and are provided to eligible pensioners, older citizens and school students. The largest concessions relate to transport, water and energy charges, and to the School Student Transport Scheme.

Table 14.1 outlines the annual cost of concessions granted across the five function areas where concessions are available. The cost of these concessions has steadily increased over the past three financial years and is now estimated at around $1.8 billion for 2011-12.

Table 14.1: Concessions by function

Concessions by function ($m)	2008-09	2009-10	2010-11	2011-12
Education Including TAFE fee concession and School Student Transport Scheme	594	600	612	626
Health Including Ambulance service for pensioners, Outpatient Pharmaceutical Scheme and Life Support Energy Rebates Scheme	174	184	187	195
Social security and welfare Including public transport concessions, Community Transport Scheme and community interpreting and translation service	442	490	496	498
Housing and community amenities Including local council rates, water rates and energy concessions.	295	345	364	424
Recreation and culture Including free or discounted entry to National Parks and vessel registration concession	8	10	11	12
Agriculture, forestry, fishing and hunting Including recreational fishing fee concession	4	4	4	4
Total	**1,517**	**1,633**	**1,674**	**1,759**

The government also allows concessional treatment on a number of state duties and taxes. These „tax expenditures" are provided in the form of exemptions, lower tax rates, rebates, deductions and deferrals in the time to pay tax liabilities. Tax expenditures amount to around $5 billion in forgone state revenue each year.

Table 14.2: Concessional tax treatment by type

Tax expenditures by type ($m)	2008-09	2009-10	2010-11	2011-12
Transfer Duty	1,075	846	1,218	803
General and Life Insurance Duty	723	801	861	901
Mortgage Duty	123	86	143	130
Marketable Securities Duty	116	108	97	105
Payroll Tax	1,004	1,102	1,124	1,174
Land Tax	570	592	605	623
Taxes on Motor Vehicles	344	405	433	456
Parking Space Levy	23	46	48	51
Gambling and Betting Taxes	530	579	654	770
Total	**4,508**	**4,565**	**5,183**	**5,013**

Table 14.3: Concessional tax treatment by function

Tax expenditures by function ($m)	2008-09	2009-10	2010-11	2011-12
General public services	217	226	238	247
Public order and safety	5	5	6	6
Education	159	166	167	175
Health	525	533	547	571
Social security and welfare	484	621	666	692
Housing and community amenities	670	597	610	399
Recreation and culture	538	587	662	778
Agriculture, forestry, fishing and hunting	405	418	431	445
Transport and communications	36	71	77	81
Other economic affairs	1,464	1,337	1,760	1,609
Other purposes	5	4	19	10
Total	**4,508**	**4,565**	**5,183**	**5,013**

The Commission has observed that the distinction between „tax expenditures" and „concessions" is sometimes blurred. The term concession is used widely across government, even when the concessional treatment sometimes relates to „tax expenditure". For example, eligible pension card holders are entitled to an exemption on their driver"s licence fee and vehicle weight tax. These are widely perceived to be concessions, and described as such on the Roads and Maritime Authority website, yet the associated forgone revenue is reflected as tax expenditure.

Putting aside these definitional complexities, the level of concessional treatment provided across NSW government, through tax expenditures and concessions, represents around $6.8 billion a year. On the concessions side, the rapidly ageing population and the forecast increase in the general population will see a growth in eligibility. This is expected to significantly increase the cost of concessions into the future.

Case Study: Rising cost of concessions for motor vehicle registration and weight tax

A review of the former Roads and Traffic Authority (RTA) in 2010 highlighted the escalating cost of the concessional arrangements for motor vehicle registration and weight tax.

NSW residents holding a pensioner concession card are exempt from paying an annual vehicle registration fee or weight tax on their vehicles. In most other states, pensioner concession card holders typically pay around $90 to $130 per annum towards the cost of registration and/or weight tax.

The concessional arrangements for motor vehicle registration and weight tax currently costs NSW around $200 million in forgone revenue. It is estimated that the ageing population and other demographic or population changes will increase the pool of eligible recipients by an additional 65,000 people annually, excluding reductions due to attrition. This will increase costs, or revenue forgone, by a further $11 million each year.

14.2 Making concessions more effective and efficient

Setting a framework

Given that concessional arrangements and treatments have a considerable, and growing, cost to government, the Commission is concerned about the lack of an identifiable framework that helps government to prioritise, set and evaluate its commitments in this area. There is no cohesive whole-of-government approach to determining concessions policy. Nor are concession arrangements systematically reviewed to ascertain their effectiveness and efficiency. This has some implications, including:

- the number of concessions across agencies has grown organically
- the impact of concessions, tax expenditures as well as other rebates/schemes may not have always been fully understood.
- certain concessions may be inequitable, poorly targeted or no longer consistent with current policy. They may also be inconsistent with or overlap other concessions. For example an IPART Report on Reform Priorities in 2011 found that water rebates are around four times greater than energy rebates. Water rebates also differ significantly between water utilities – rebates for a Sydney Water customer could be three times higher than a customer of Hunter Water, Gosford City Council or Wyong Shire Council
- anecdotally, as tax expenditures reflect revenues forgone, they have not always received the same level of scrutiny as expenditure initiatives – even though the Budget impact is just as significant.

Concessions and tax expenditures serve an important purpose in delivering on the government"s social and economic objectives. It is important that they are targeted, effective and provided in a systematic, cohesive way. They should also be prioritised and balanced within the fiscal envelope.

The Commission believes that a policy and economic framework should be adopted to guide concession and tax expenditures advice and decisions across government. Central agencies, working closely with clusters and agencies, should lead the development and implementation of the proposed framework.

Recommendation: The Commission recommends that Central agencies, working closely with clusters and agencies, should establish a policy framework to assist government to prioritise, set and evaluate commitments on concessions and tax expenditures.

It is important that the proposed framework establishes several key principles, namely that concessions and tax expenditures should:

- have demonstrated linkages to government policy and priorities
- exist to target real need – there should be a defined and suitably evidenced need
- be subjected to the same rigour as expenditure initiatives, including transparency around costs and benefits and the requirement for a business case and prioritisation within the Budget
- be considered as a part of suite of social and economic arrangements that exist across government and not in isolation
- be consistent with Commonwealth Government policy so that is there is no doubling up in concessions
- have consistency and relativity with other arrangements in terms of targeting, eligibility and the level of benefit conveyed
- be periodically evaluated to determine their effectiveness, efficiency and continued relevance.

The Commission believes that the proposed framework also has applicability for informing commitments around Community Service Obligations (CSOs). Around $4 billion is provided annually as grants to government businesses for non-commercial activities. However, a Treasury review of CSO policy in 2010 suggests that the processes for identifying, seeking Ministerial Direction and costing of CSOs has not been followed. There has also been a lack of understanding between parties of their individual roles and responsibilities, and insufficient emphasis on monitoring and reviewing – not only of value for money but of delivery of social policy outcomes.

Review existing arrangements

Existing concessional arrangements have grown organically. Numerous arrangements may be poorly targeted, ineffective or based around objectives that are no longer a priority for government. Whether or not this is the case should be checked through review. Where appropriate depending on the concessional arrangement, reviews should be conducted by either:

- the Independent Pricing and Regulatory Tribunal
- Central agencies
- the Audit Office.

Recommendation: The Commission recommends that Government should periodically review all concessional arrangements across government, starting with major concessions.

With regard to the above recommendation, the proposed reviews should consider the principles outlined above.

A reliable central access point for all NSW government concessions also warrants some consideration. It is noted that the IPART website provides information on NSW government concessions, as do individual agencies on their respective concessions.

Victoria"s Department for Human Services provides an intuitive concessions portal (http://www.dhs.vic.gov.au/concessions) with materials in Plain English and easy to navigate eligibility requirements. Based on a similar approach, NSW could go further by offering a single application point for concessions, subject to eligibility. The application process would be simple and respectful, cutting back for instance on the need for people to tell their story. There would also be potential administrative benefits for government agencies.

Recommendation: The Commission recommends that following the review of concessional arrangements across government a central access point or portal should be set up in Plain English for customers.

Part V: Next Steps

15. Program and expenditure evaluations

Key points

- NSW does not have a rigorous framework or even the information to evaluate expenditure outcomes and demonstrate value for money or otherwise.
- There is little or no transparency on what agencies achieve with their expenditure.
- Comprehensive information about program expenditure is lacking and needs to be improved.
- Robust business cases should accompany new expenditure proposals to demonstrate their merits and establish meaningful baselines against which performance can be evaluated.
- Mandated requirements should be set around the evaluation of both new and existing programs across government. All programs should have a sunset clause setting out when expenditure will stop. Prior to this date the program should be reviewed if it is to continue.
- Evaluation of large and significant programs should be led by Treasury and conducted on a rolling basis. From time to time Treasury should have their evaluations independently reviewed to assure agencies that the process is fair and comprehensive.

15.1 Overview

NSW lacks a rigorous framework for evaluating the effectiveness of government spending and whether it offers value for money. Consequently, there is little or no transparency on what agencies achieve with their expenditure. Many programs and initiatives continue to be funded on an historic basis, some well beyond their original intended duration, without meaningful evaluation of whether:

- their objectives and outcomes are still relevant and warrant priority
- they are effective and efficient
- expenditure represents value for money
- there are better ways to achieve the desired objective and outcomes.

Smaller programs and sub-programs are particularly relevant to these comments. The number of smaller programs has built up over time and reflect commitments of previous governments .By virtue of their size, they receive even less attention and scrutiny. How many such programs there are across government and what they cost is not clear. Expenditure on small programs can range from tens of thousand dollars to as much as $10 million. Further costs go beyond the direct costs of the programs, there is significant expenditure being incurred on administration. The importance of evaluating smaller program spending is that the costs really do add up.

Robust, objective and periodic evaluations of programs can assist by:

- validating the relevance of specific programs and initiatives against government priorities
- exposing ineffective programs to wide scrutiny and therefore assist in overcoming sectional interest support for ineffective programs
- promoting innovation and considering alternative approaches to the same objective (if that objective is still valid) and guiding the reallocation of resources to other programs and areas
- creating discipline in the design of new programs. The knowledge that programs will be evaluated is likely to focus program designers on what works and less on speculative proposals
- providing a good quality evidence base on which future programs can be designed
- improving resource allocation decisions.

The value of program evaluations is not just in the evidence base built. Setting systematic evaluations and forcing an environment of greater transparency is likely to influence performance and behaviours on the ground.

To the degree that program evaluations occur at present, they are incorrectly viewed as a potential threat to the continuance of programs and funding. Program evaluation has also been compromised by:

- a lack of information on performance, cost, goals and objectives, linkages and program history
- evaluations typically being done by the agency and people involved in running the program which creates a conflict of interest
- insufficient resources being devoted to program evaluations
- the results of program evaluations being undermined by vested and sectional interests that inevitably develop in support of programs.

The Commission is of the opinion that effective and sustainable expenditure in large part hinges on greater transparency of government expenditure, including robust and systematic program evaluations for both existing and future programs. The importance and value of better program transparency should not be underestimated.

15.1 Increasing transparency

Effort is required to increase transparency and instil a culture of performance evaluation. This encompasses:

1. Improved program information

Fundamentally, agencies have little incentive to collate program information: agencies are not generally held accountable for program performance:

- there is no requirement for systematic program evaluations
- performance reporting in the Budget papers has shifted away from programs, as discussed in Section 3.2.3 of the Interim Report
- most program performance reporting that occurs is usually ad hoc and/or against a limited set of Key Performance Indicators (KPIs).

Program information needs to be better. An accurate picture on even the number of programs across the public sector is difficult to gauge, let alone understanding what these programs achieve and actually cost. Some agencies struggle to provide even basic program information pertaining to cost, performance, milestones or explain linkages with other programs. Examples include lack of information on periodic reviews and program „sunsets". A proliferation of sub-programs has built up over time, serving to add this confusion.

Whilst some agencies are able to provide program information, much effort is required to collate such information given:

- limitations with the architecture of financial and data systems
- lack of information management as comprehensive program knowledge, particularly around cost, rationale and objectives, generally sits with the program originators. As programs transfer between agencies or as staff leave, program knowledge is sometimes lost
- a lack of definition around program and the type of program information that should be collated by agencies.

With regard to the last point, programs should be defined consistently across the sector, as far as practicable. A consistent definition should make clear that all expenditure must be allocated to some program. The term 'program' is not limited to grants, named programs or other subsets of agency activity and set some parameters for scale to ensure a comparable level of information is captured across agencies.

Greater outsourcing across government will serve to further reduce program transparency unless appropriate information and data requirements, around performance and cost, are established from the outset and embedded into contracts with third party providers.

The lack of timely information means that central agencies also have limited visibility on agency programs. This creates difficulties in providing Government with informed advice on the costs and benefits of programs.

Recommendation: The Commission recommends that the breadth and quality of government program information should be improved through the following measures:

- central agencies, working together with agencies, should define what is meant by a program and the type of program information to be collated by agencies
- CEOs should ensure that their financial and data systems are able to capture and report program information
- CEOs should ensure appropriate information management exists within agencies to ensure program knowledge and history is maintained.

The ultimate goal is that government should be able to access comprehensive program information at the „press of a button‟.

2. Better scrutiny of new proposals and building evaluations into all approvals

Decisions to fund new programs, pilots and initiatives must be informed by a clear understanding of the costs, expected benefits and how they link to government priorities. In addition, useful performance baselines and targets and requirements for ongoing data collection should be set at the time of funding approval.

To achieve this, robust businesses cases should accompany proposals for new programs or initiatives. Business cases should establish appropriate baselines and KPIs, with some specificity, to enable objective evaluation across:

- financial performance, for example cost and financial or economic returns on target and
- non-financial performance, for example objectives and outcomes being achieved.

Recommendation: The Commission recommends that robust business cases should accompany proposed programs, pilots and initiatives to establish their cost, benefits and linkage to government priorities. Business cases should also specify appropriate baselines across financial and non-financial performance as well as relevant KPIs to facilitate objective evaluation.

Program termination points and the requirement for periodic evaluations should also be built into the approval process. Business cases should include an agreed and suitable evaluation methodology, clear assessment criteria and an agreed time frame to undertake the evaluation and report back to government. Funding should also be identified and set aside for the evaluation.

Recommendation: The Commission recommends that approvals of all new programs and initiatives should be explicit about when they will terminate and specify requirements for program evaluations (and ongoing data collection requirements to support this) and reporting back to government, where required. Funding should also be identified and set aside for the evaluations.

The Commission understands that reforms to the procedural and operational rules for the Expenditure Review Committee (ERC) of Cabinet now reinforce the need for robust business cases to accompany new proposed initiatives that are to be considered by ERC. This requirement should be adopted for Cabinet and other Subcommittees whenever new initiatives are brought forward for consideration.

3. Adherence to program 'sunsets'

It is vital that programs funded on a time-limited basis do not exceed their intended funding parameters without proper evaluation of their merits and continued priority.

Recommendation: The Commission recommends that Treasury and the Department of Premier and Cabinet should implement a systematic way to monitor time-limited programs/initiatives to ensure they are discontinued as intended or not carried forward without proper assessment.

Under this systematic approach:

- Treasury‟s Budget financial system should have appropriate, preferably automated, mechanisms to monitor the status of time-limited initiatives and stop their funding from being rolled forward without proper assessment and approval
- every year, DPC and/or Treasury should write to agencies informing them of their programs and initiatives due to lapse in the next Budget cycle
- agencies wishing to continue a particular program or initiative should submit a proposal and business case for Government‟s prioritisation in the Budget process.

The Commission understands that the Commonwealth adopts a similar approach with respect to managing the „sunset" on its time-limited programs and initiatives.

It is also important that any vested and sectional interests are managed upfront as initiatives are announced. Announcements should be clear about the approved funding parameters, including any subsequent milestones or decisions required for the continuation of funding beyond the approved period – if continuation is a possibility.

4. Program evaluations should be mandated

Agencies should be required to conduct periodic evaluation of their smaller scale programs and pilots in collaboration with central agencies. For larger scale programs, these should be conducted independently, see below. Agencies will therefore need to establish a schedule of evaluations for both new and existing programs.

Recommendation: The Commission recommends that agencies, in collaboration with central agencies, should conduct periodic evaluations of their smaller programs and pilots (both existing and new).

The Interim Report by the Commission has highlighted an underlying need for increased capability across the NSW public sector. This will include increasing the skill base across agencies and central agencies to undertake program evaluations. An important element of this capability will be access and involvement of external parties and in particular academics, NGOs and independent statistical and research bureaus, such as the Bureau of Crime Statistics and Research and the Bureau of Health Information, in designing and reviewing programs.

5. Ensuring the independence of major and significant program evaluations through third party review

As noted, conflicts of interest, when program reviews are controlled by agencies and vested or sectional interests can serve to undermine the efficacy of program evaluations. This creates challenges and complexities for major program reviews, particularly for those that involve multiple agencies or have broader whole-of-government implications.

In most cases, individual agencies should continue to have responsibility for smaller scale evaluations. However, the Commission proposes that the evaluation of large and significant programs (both existing and new) should be led by a central agency within government and conducted on a rolling basis. Agencies and central agencies must work collaboratively on such evaluations.

The Commission believes that Treasury is best placed to lead such evaluations given that:

- they need to have the most holistic view of agency expenditure and programs across government
- they already has capability in this area
- assessment of the economic impacts of programs are a vital component of evaluations and this is an area where Treasury has existing frameworks and capability.

It should be recognised that as evaluations will be sector specific, differing skills and expertise will be required across certain evaluations. This could require Treasury to contract out evaluations, engage appropriate resources on an as required basis, and access and involve external parties and academics to support evaluations. Treasury as the lead agency would be responsible for ensuring that evaluations are scheduled, resourced, and ultimately come together with other involved parties under a cohesive framework.

To maintain objectivity and ensure consensus within evaluations, the Commission reinforces that agencies and central agencies must be strongly engaged and involved in the reviews. Agencies and central agency must ensure adequate resources for the formal evaluation teams and for involvement in the governance frameworks. Executive representation on Steering Committees is important.

Agencies responsible for conducting smaller scale evaluations should follow an agreed evaluation framework, provide evaluation results to an independent body, and will require ongoing support, guidance and monitoring. Treasury should develop and become custodian of the framework and have additional associated functions. These may include:

- working with agencies to determine a schedule of program evaluations
- supporting the development of agency evaluation capacity through partnerships, dissemination of best-practice guidance, networking and formal education activities;
- developing or endorsing evaluation methodologies for agencies
- monitoring and reporting upon agency evaluation activities.

Recommendation: The Commission recommends that evaluation of large or significant programs (both existing and new) should be scheduled on a rolling basis and led by Treasury. The responsibility for leading these evaluations in a collaborative manner should also rest with Treasury who must have strong engagement from the agencies and other relevant stakeholders.

Evaluations need to drive continuous improvement, they should not produce reports and recommendations that „end up on a shelf". Evaluation outputs should include benchmarks for what the programs need to deliver in terms of outcomes and benefits. There should also be concise recommendations and milestones around next steps. It is clear that a monitoring framework needs to support the post evaluation phase to ensure that the appropriate actions are taking place.

16. Recommendations

No.	Cluster:	Theme:	Recommendation:
1	Treasury	Budget constraint	The Commission recommends that each year Treasury review the allocation of general government current expenditure to check that it is reflecting government policy and priorities, namely improving the capability of the public service, devolution of service delivery to more local levels, strengthening non government organisation (NGO) arrangements, focussing on early intervention, keeping people healthy (prevention) and out of hospital, and improving medium to long term planning. Implementation Timeframe: Short term (6 -12 months)
2	Treasury	Budget constraint	The Commission recommends that each year Treasury review the allocation of capital expenditure to check that it is reflecting government policy and priorities, namely an increase in IT spending to enable devolution, a focus on transport, critical infrastructure including freight and port connections, further road upgrades, and an increase in IT systems to improve financial reporting and management of people and physical assets. Implementation Timeframe: Short term (6 -12 months)
3	Treasury	Transparency and evidence based decisions	The Commission recommends that the reporting of Public Trading Enterprises in the Budget splits out non-commercial Public Trading Enterprises so that their increasing capital expenditure and debt, and reliance on general government is not hidden through their aggregation with commercial Public Trading Enterprises. Implementation Timeframe: Short term (6 -12 months)
4	Treasury	Budget constraint	The Commission recommends that the general government operating result (generally called the Budget result) should be managed to avoid a deficit in order to achieve sustainable current expenditure. Implementation Timeframe: Short term (6 -12 months)
5	Treasury	Budget constraint	The Commission recommends that Treasury review the target measure of 0.9% of gross state product for general government net debt to gross state product and explain the reason for the chosen target. In this review they should consider both general government and the reliance of the non-commercial Public Trading Enterprise sector on general government. Implementation Timeframe: Short term (6 -12 months)

6	Treasury	Budget constraint	The Commission recommends that to achieve sustainability the budget operating result should aim to run a surplus each year of around $500-900 million to fund general government and non-commercial infrastructure. Implementation Timeframe: Long Term (>24 months)
7	Health	Partnerships, outsourcing	The Commission recommends that HealthShare NSW should investigate whether some of its functions would be more effectively provided through outsourced arrangements. Implementation Timeframe: Medium Term (12 -24 months)
8	Health	Devolution	The Commission recommends that Health Infrastructure consider what level of capital project delivery should be done centrally, by the Ministry for Health, and what should be the responsibility of the new Local Health Districts. Implementation Timeframe: Medium Term (12 -24 months)
9	Health	Devolution	The Commission recommends that Health discusses its reform progress (and difficulties) with the Directors General of the central agencies (including the Health Efficiency Improvement Taskforce and the Public Service Commission) at least annually; and seek their assistance when this is judged helpful. Implementation Timeframe: Medium Term (12 -24 months)
10	Health	Budget constraint	The Commission recommends that Treasury and NSW Health identify clearly what specific funding measures are required to meet the Health budget between now and the commencement of the National Health Reform Agreement in 2014-15. Implementation Timeframe: Medium Term (12 -24 months)
11	Health	Budget constraint	The Commission recommends that the Ministry for Health and Treasury examine the Health capital budget with a view to increasing it so that each Local Health District is able to meet maintenance standards and so that new facilities can be added when supported by business case assessments. Implementation Timeframe: Medium Term (12 -24 months)
12	Health	Devolution	The Commission recommends that the Ministry for Health set up training for Local Health District Boards and their senior management in effective engagement with clinicians and the community. Implementation Timeframe: Short term (6 -12 months)

13	Health	Devolution	The Commission recommends that the Ministry for Health set up a system to monitor Local Health Districts consultation obligations and advise on how consultation may be improved. This system could be embedded in the existing Performance Framework for Local Health Districts. Implementation Timeframe: Short term (6 -12 months)
14	Health	Devolution	The Commission recommends that Local Health Districts devolve both annual budgets and four-year budget forecasts to the cost-centre level, having assured themselves that financial and management systems, including accountability frameworks, are appropriate at that cost centre level. Implementation Timeframe: Short term (6 -12 months)
15	Health	Devolution	The Commission recommends that Local Health Districts and the Ministry for Health ensure they have adequate financial and administration support to undertake their new roles in managing a budget at both the Ministry for Health level and cost centre level. Implementation Timeframe: Medium Term (12 -24 months)
16	Health	Transparency and evidence based decisions	The Commission recommends that the Ministry for Health prioritises the implementation of systems to allow the cost of services in different hospitals to be compared. Implementation Timeframe: Medium Term (12 -24 months)
17	Health	Devolution	The Commission recommends that the Ministry for Health and Local Health Districts continue to communicate and educate their workforce on their accountability, responsibility and governance arrangements under the new reforms. Implementation Timeframe: Short term (6 -12 months)
18	Health	Devolution	The Commission recommends that the Ministry for Health identify and, where appropriate, modify statewide policies and agreements that limit the options available to Local Health District Chief Executives to deliver high quality services within their Local Health District budget. Implementation Timeframe: Short term (6 -12 months)
19	Health	Devolution	The Commission recommends that the Ministry for Health"s new ICT strategy should balance local and statewide initiatives and set very clear standards for ICT statewide. Consultation is required and a set of ICT operating rules established. Implementation Timeframe: Short term (6 -12 months)

20	Health	Budget constraint	The Commission recommends that the Ministry for Health and Treasury investigate why innovations that could save money but which may need some upfront funds, are not being delivered. Implementation Timeframe: Short term (6 -12 months)
21	Health	Partnerships, outsourcing	The Commission recommends that Local Health Districts investigate ways to establish partnerships with other parts of the health system, including between hospitals and local GPs, and between hospitals and residential aged care. The Commission recommends that the Agency for Clinical Innovation work with Local Health Districts to help establish these partnerships. Implementation Timeframe: Medium Term (12 -24 months)
22	Health	Devolution	The Commission recommends that the Clinical Excellence Commission (CEC) and Agency for Clinical Innovation (ACI) work with Local Health Districts to establish a framework for effective engagement with clinicians in the development and implementation of CEC and ACI recommendations. This role for the CEC and ACI should also be reflected in their Service Compacts with the Ministry for Health. Implementation Timeframe: Medium Term (12 -24 months)
23	Health	Devolution	The Commission recommends that Local Health Districts, with the assistance of the Ministry for Health and the Health Education Training Institute (HETI) focus on building up their management and leadership capabilities. The Public Service Commission should, with HETI, review progress and assist where possible. Implementation Timeframe: Short term (6 -12 months)
24	Health	Budget constraint	The Commission recommends that the Ministry for Health articulate its capital investment priorities. The Ministry for Health and Treasury should then investigate ways to increase funding for capital works from all potential sources, and make adjustments to the capital expenditure limit to ensure there is no disincentive in using non-government funding sources. Implementation Timeframe: Medium Term (12 -24 months)
25	Health	Devolution	The Commission recommends that the Ministry for Health articulate the timetable for implementing reform to the health system and commit itself to allowing the system adequate time to adjust before benefits are expected. The current round of reforms should be allowed to bed down for around five years or more. Implementation Timeframe: Short term (6 -12 months)
26	Health	Transparency and evidence based decisions	The Commission recommends that Government and Local Health Districts define and communicate the level of service that Health can appropriately provide and what is provided at present within the community. This should include consideration of the appropriate level of out of hospital care, the role of the private health sector, primary health and aged care, and interactions with other parts of the

			Government such as the Department of Family and Community Services. Implementation Timeframe: Short term (6 -12 months)
27	Health	Devolution	The Commission recommends that Local Health Districts pursue service and hospital reconfigurations that lead to more appropriate and safer mix of services in their Local Health District. Implementation Timeframe: Medium Term (12 -24 months)
28	Health	Devolution	The Commission recommends that the Ministry for Health select case studies of experience with devolution and use those case studies to assist in their transition to devolution. The case studies may be from another jurisdiction, outside the public sector or an entirely different business. Moving beyond the familiar may make the lessons of experience clearer. Implementation Timeframe: Medium Term (12 -24 months)
29	Education and Communities	Devolution	The Commission recommends that: • TAFE Institute budgets be extended beyond one year and out to four years, and that retained earnings may be carried forward for use in the next year • commercial „fee for service" courses be increased and that Institutes be given the authority (and accountability) to pursue opportunities in a responsible manner • that the cost of corporate and shared services be identified and borne by the party (schools and TAFE) using that service. Implementation Timeframe: Short term (6 -12 months)
30	Education and Communities	Workforce flexibility	The Commission recommends that the TAFE sector adopt and prepare a long term strategy to achieve improved productivity, including more face to face hours for TAFE teachers and more flexible employment arrangements. Implementation Timeframe: Short term (6 -12 months)
31	Education and Communities	Workforce flexibility	The Commission recommends that the Department of Education and Communities continue to actively manage any remaining over-establishment staff and especially provide assistance and if necessary exits for poor performers to keep the number of staff on this list to a minimum. Implementation Timeframe: Short term (6 -12 months)

32	Education and Communities	Transparency and evidence based decisions	The Commission recommends that: • The Department alert principals about any staff whose sick leave behaviour appears to be atypical. Principals should then undertake an investigation of sick leave in their school, to determine whether some individuals may be abusing their entitlement. • Principals implement measures to require the use of coverage provisions in the Award prior to temporary or casual staff being employed to cover for short term absences. Enforcement of this provision should be made by the school and related savings should stay with the school. Implementation Timeframe: Short term (6 -12 months)
33	Education and Communities	Workforce flexibility	The Commission recommends that the Department of Education and Communities review the cost of long service leave entitlements for NSW teachers, comparing these to other jurisdictions and examining options for reducing the cost of long service leave entitlements over the long term. For example, Teachers may prefer more pay rather than generous long service leave entitlements, and a negotiated settlement may be better for both teachers and the Education budget. Implementation Timeframe: Short term (6 -12 months)
34	Education and Communities	Workforce flexibility	The Commission recommends that the Department of Education and Communities, in consultation with the Public Service Commission, implement measures to improve the management of poor performing teachers. Implementation Timeframe: Short term (6 -12 months)
35	Education and Communities	Devolution	The Commission recommends that the legal autonomy for TAFE be considered as a matter of priority, in particular: • TAFE Institutes be established as separate corporate entities, reporting to the TAFE Commission, which would retain responsibility for overall coordination of TAFE policy • the government provide TAFE Institute Directors with greater autonomy over the management of TAFE Institutes, including for financial and staff management • TAFE Institute Directors be given greater autonomy over the hiring and remuneration of staff, to acquire necessary management and training capabilities required in a competitive Vocational Education Training market. Implementation Timeframe: Short term (6 -12 months)

36	Education and Communities	Devolution	The Commission recommends that: • demand management tools be used to ensure that the cost of a demand driven or entitlement based funding model is consistent with TAFE funding allocation • demand management tools, along with communication and information programs, be actively used to ensure that entitlement based funding models are consistent with future state wide skill requirements. Implementation Timeframe: Medium Term (12 -24 months)
37	Education and Communities	Devolution	The Commission recommends that the Department of Education and Communities at the cost centre clearly sets out the roles and functions to be done by the centre and by schools. This should identify resources (including staff no longer needed) and the additional resources needed at the school level. The aggregate budget will be generally stable but expenditure decreases at the centre and increases at a school level. Implementation Timeframe: Medium Term (12 -24 months)
38	Education and Communities	Devolution	The Commission recommends that: • NSW Government proceed with greater autonomy in NSW schools, particularly in relation to staffing and financial management • as part of the implementation of greater school autonomy, detailed consultation and profiling of schools be undertaken to identify those schools where greater autonomy can be provided in the near term • for other schools, the government invest in leadership development and training for schools, in advance of providing greater autonomy • a structured program of school leadership and support be developed for both current and future school principals. Implementation Timeframe: Short term (6 -12 months)
39	Education and Communities	Devolution	The Commission recommends that the Department of Education and Communities select case studies of experience with devolution and use those case studies to assist in their transition to devolution. The case studies may be from another jurisdiction, outside the public sector or an entirely different business. Moving beyond the familiar may make the lessons of experience clearer. Implementation Timeframe: Short term (6 -12 months)

40	FACS	Partnerships, outsourcing	The Commission recommends that the NSW government reach agreement with not for profit community organisations on the establishment of a community partnership forum along the lines of that in Western Australia. The Forum should establish its own set of principles and behaviours and require a high level of continuous participation and commitment from both government and not for profit members. Implementation Timeframe: Short term (6 -12 months)
41	FACS	Partnerships, outsourcing	The Commission recommends that the NSW government transition to a performance-based contracting model for all services provided by the Non Government Organisations (NGO) sector. This model should provide strong assurance around the quality, effectiveness and efficiency of services provided by the sector but give flexibility in how funding is spent. Implementation Timeframe: Medium Term (12 -24 months)
42	Finance and Services	Collaboration, Coordination	The Commission recommends that the Department of Family and Community Services increase its commercial and contract management capabilities to allow it to effectively undertake its significant contracting function and become an effective purchaser of services. Implementation Timeframe: Short term (6 -12 months)
43	FACS	Partnerships, outsourcing	The Commission recommends that the growth of the NSW Community Housing Sector should be conducted in a staged approach to enable capacity building of the Community Housing Sector and greater clarity around matters relating to governance and cost. Implementation Timeframe: Long Term (>24 months)
44	FACS	Partnerships, outsourcing	The Commission recommends that the decisions by Government to transfer further social housing stock to the Community Housing Sector, over and above the 6,019 dwellings currently committed, should be undertaken in an informed manner to achieve this. Family and Community Services should implement an evaluation framework to clarify the achievements of Community Housing Providers with the current round of stock transfers. Implementation Timeframe: Long Term (>24 months)
45	Health	Devolution	The Commission recommends that NSW agencies investigate other opportunities to pilot individualised funding models, including across health services and services for the ageing. Implementation Timeframe: Medium Term (12 -24 months)

46	Premier and Cabinet	Collaboration, Coordination	The Commission recommends that the NSW Government trial a centralised Family Recovery Unit (hosted by the Department of Premier and Cabinet) which is able to provide intensive support programs for multiple and complex needs families. Implementation Timeframe: Short term (6 -12 months)
47	Attorney General and Justice	Workforce flexibility	The Commission recommends that the NSW Police Force adopt revised workforce allocation practices that allow resourcing at the Local Area Command level to be more flexible and efficient and better attuned to community needs. In particular, the authorised strength concept should be replaced by outcome measures that allow more flexibility in the NSW Police Force. Implementation Timeframe: Medium Term (12 -24 months)
48	Attorney General and Justice	Transparency and evidence based decisions	The Commission recommends that the Department of Attorney General and Justice should evaluate the effectiveness of offender management programs with a view to consolidating and rationalising less effective programs and investing in the more successful ones. Implementation Timeframe:
49	Treasury	Collaboration, Coordination	The Commission recommends that the trial of the Social Benefits Bonds be monitored and after three years evaluated for progress to date. Implementation Timeframe: Short term (6 -12 months)
50	Health	Transparency and evidence based decisions	The Commission recommends that: • the NSW Mental Health Taskforce and the subsequent NSW Mental Health Commission should include a suitable level of focus on mental health issues that impact corrective services • greater investment be made in prevention and early intervention programs to ensure that individuals with mental health problems receive the support they need well before they offend and end up in the prison system • the NSW Government should continue to engage the Commonwealth Government on the matter of funding for increased mental health services. Implementation Timeframe: Short term (6 -12 months)
51	Attorney General and Justice	Workforce flexibility	The Commission recommends that negotiations around the next Corrective Services Industrial Agreement should ensure that provisions that effect staffing deployment and levels do not impact better and more effective service provision. Implementation Timeframe: Short term (6 -12 months)

52	Attorney General and Justice	Partnerships, outsourcing	The Commission recommends that the Government should explore further opportunities to outsource correctional facilities with appropriate governance and performance frameworks. Implementation Timeframe: Medium Term (12 -24 months)
53	Attorney General and Justice	Partnerships, outsourcing	The Commission recommends that the Department of Attorney General and Justice examine the potential to outsource prisoner transportation and escort services in NSW and provide options for Government"s consideration. Implementation Timeframe: Medium Term (12 -24 months)
54	Premier and Cabinet	Collaboration, Coordination	The Commission recommends that the Government, through the Department of Premier and Cabinet, should examine measures to promote a concentrated and whole-of-government approach to dealing with juvenile crime. Implementation Timeframe: Medium Term (12 -24 months)
55	Attorney General and Justice	Partnerships, outsourcing	The Commission recommends that for the same reasons outlined for Corrective Services outsourcing should be considered and potentially bundled in the same tender process for the transport of juvenile offenders. Implementation Timeframe: Medium Term (12 -24 months)
56	Central Agencies	Budget constraint	The Commission recommends that strong support be given to Transport for NSW and Infrastructure NSW to enable long lasting transport plans to be developed and implemented in stages over future decades. Treasury, the Department of Premier and Cabinet and the Department of Planning all have important support roles in this work. Implementation Timeframe: Short term (6 -12 months)
57	Transport	Budget constraint	The Commission recommends that the proportion of expenses met from the RailCorp fare box increase to over 30%. This would be achieved by a mix of cost savings and modest fare increases until the ratio of 30% is reached. Fares should then increase by CPI each year. Implementation Timeframe: Medium Term (12 -24 months)
58	Transport	Workforce flexibility	The Commission recommends that RailCorp"s safety and engineering operations be reviewed and benchmarked to identify areas of unnecessary complexity and cost which are of limited or no safety benefit. Measures that lead to better transparency and accountability for safety and operating standards should be identified and implemented while maintaining or improving safety outcomes. Implementation Timeframe: Short term (6 -12 months)

59	Transport	Workforce flexibility	The Commission recommends that RailCorp investigate whether additional outsourcing of maintenance and cleaning activities is more efficient than current in house arrangements. If so, more outsourcing should be implemented. Implementation Timeframe: Short term (6 -12 months)
60	Transport	Workforce flexibility	The Commission recommends that, as part of its reforms, RailCorp consider the feasibility of implementing one-person (driver only) operated trains and if feasible identify how long the move to such a system would take. The modifications and expenditure required to do so should be identified. Implementation Timeframe: Long Term (>24 months)
61	Transport	Workforce flexibility	The Commission recommends that the Government consider the feasibility of expanding the number of unattended stations across the NSW railway network, having regard to best practice. Implementation Timeframe: Medium Term (12 -24 months)
62	Treasury	Budget constraint	The Commission recommends that Treasury and Roads and Maritime Services Authority simplify the funding arrangements that apply following natural disasters and put in place a system that does not leave Roads and Maritime Services Authority carrying an unreasonable burden on its budget. Non state road costs should also be examined Implementation Timeframe: Short term (6 -12 months)
63	Transport	Partnerships, outsourcing	The Commission recommends that the Roads and Maritimes Services Authority bring forward a proposal to conduct a competitive tender for the road maintenance of the Southern Sydney road network. Implementation Timeframe: Short term (6 -12 months)
64	Transport	Collaboration, Coordination	The Commission recommends that the Roads and Maritime Services Authority, working with Councils, investigate and report back to Government on the potential opportunities to enhance the operation Road Maintenance Council Contracts (RMCC), including: • transitioning the current RMCCs to relational or alliance contract forms • for road maintenance purposes, “bundling” a number of adjacent Councils under single road maintenance contracts to enable pooling of capacity/capability and increase scale across Councils. Implementation Timeframe: Short term (6 -12 months)

65	Transport	Transparency and evidence based decisions	The Commission recommends that to assist in managing reforms of motor registries appropriate benchmarking of the cost per face-to-face registry transaction be compared to online transactions. Such a benchmarking exercise could include data from Australia Post and other major transaction based operations. Implementation Timeframe: Short term (6 -12 months)
66	Central Agencies	Collaboration, Coordination	The Commission recommends that the proposed “one-stop-shop” strategy for services should accommodate a range of channels that reduce the need for “face-to-face” transactions when customers interact with government. The number of motor registry and maritime offices should reduce, though service, convenience and choice for customers should improve. As part of these improvements Roads and Maritime Services Authority should examine the registration system used in Western Australia. Implementation Timeframe: Short term (6 -12 months)
67	Transport	Partnerships, outsourcing	The Commission recommends that Transport for NSW"s new performance-based Metropolitan Bus Contacts demonstrate cost efficiencies over the existing contracts where possible, target a reduction in dead running, ensure sufficient flexibility to accommodate long term development of bus services and establish appropriate Key Performance Indicators along with a reward/sanctions framework that is monitored. Implementation Timeframe: Short term (6 -12 months)
68	Transport	Partnerships, outsourcing	The Commission recommends that Transport for NSW investigates the possibility of franchising passenger rail services in NSW to ascertain whether such a move would improve commercial outcomes and service. If the franchise options appear to offer benefits a staged process of trial and possible implementation should be established. Implementation Timeframe: Long Term (>24 months)
69	Transport	Collaboration, Coordination	The Commission recommends that high priority continues to be given to the requirements emerging for Port Botany, Moorebank and the M5 expansion. Implementation Timeframe: Short term (6 -12 months)
70	Electricity	Transparency and evidence based decisions	The Commission recommends that capital expenditure efficiency for incremental capacity in electricity networks be systematically benchmarked, commencing in 2012 as a part of the network reform. In particular, attention should be on whether replacement rather than maintenance of existing assets is efficient. Implementation Timeframe: Medium Term (12 -24 months)

71	Premier and Cabinet	Transparency and evidence based decisions	The Commission recommends that the various state based environmental schemes aimed at encouraging renewable energy and sustainability be evaluated and those that are not achieving their objectives be closed down or modified. Implementation Timeframe: Short term (6 -12 months)
72	Treasury	Transparency and evidence based decisions	The Commission recommends that the NSW Government re-evaluates the decision-making process and business cases for major investments and projects of state significance based on the likely market scenarios, timeframes for economic payback and the evolving regulatory environment. Business cases should also supported by Gateway reviews. Implementation Timeframe: Short term (6 -12 months)
73	Electricity HoldCo.	Transparency and evidence based decisions	The Commission recommends that the Board and CEO of the new electricity Holding Company ensure that a robust baseline is agreed so that benefits realisation can be planned and measured within an implementation program. Implementation Timeframe: Short term (6 -12 months)
74	Treasury	Budget constraint	The Commission recommends that the options and appetite to divest the public ownership of Snowy Hydro Limited be reviewed. Implementation Timeframe: Medium Term (12 -24 months)
75	Central Agencies	Budget constraint	The Commission recommends that the government undertakes a study that considers the scope and implementation strategy for the privatisation of state owned electricity utilities. The scoping study should address: • Structure • Improvements • Likely market interest and price • Timing • Sale structure • Consultation with community interest groups Implementation Timeframe: Medium Term (12 -24 months)
76	Central Agencies	Partnerships, outsourcing	The Commission recommends that Treasury should assess any likely regulatory reforms in electricity and evaluate their impact on each possible sale scenario. Implementation Timeframe: Short term (6 -12 months)

77	IPART	Transparency and evidence based decisions	The Commission recommends that IPART review the Operating Licences of the water utilities with the aim of producing a more simplified less cumbersome Licence that maintains water quality and appropriate delivery standards. Implementation Timeframe: Short term (6 -12 months)
78	IPART	Transparency and evidence based decisions	The Commission recommends that IPART review the Operating Licences of water utilities and recommend a change to standards and other requirements that do not meet cost/benefit criteria. Implementation Timeframe: Short term (6 -12 months)
79	Premier and Cabinet	Transparency and evidence based decisions	The Commission recommends that the Department of Premier and Cabinet, Treasury and IPART examine the *IPART Act* with the intention of improving IPART"s regulation by making its objectives clear. As the water industry becomes more competitive with more private sector involvement it is also timely to consider the introduction of an Appeal or Review mechanism. Implementation Timeframe: Medium Term (12 -24 months)
80	Premier and Cabinet	Transparency and evidence based decisions	The Commission recommends that IPART be subject to merit based reviews of its decisions and that work commence on the various options to achieve this outcome. Implementation Timeframe: Medium Term (12 -24 months)
81	IPART	Partnerships, outsourcing	The Commission recommends that IPART ensures that the access regimes for water and wastewater encourage competition and new entrants, while ensuring that the access owner receives a commercial return on their assets. Implementation Timeframe: Short term (6 -12 months)
82	Water	Partnerships, outsourcing	The Commission recommends that Sydney Water and Hunter Water examine options to extend the competitive tender of operations, maintenance and lease / ownership of new and existing water treatment and wastewater treatment and recycled water plants. A public private partnership approach should also be considered as part of this analysis. Implementation Timeframe: Short term (6 -12 months)
83	Water	Partnerships, outsourcing	The Commission recommends that Sydney Water and Hunter Water investigate the option of moving their billing system from a property base to a person base, similar to that for energy customers. Implementation Timeframe: Short term (6 -12 months)

84	Water	Transparency and evidence based decisions	The Commission recommends that the Sydney Catchment Authority review future water supply for specific parts of Sydney and the Illawarra where resilience of supply may not be sufficient. Implementation Timeframe: Medium Term (12 -24 months)
85	Finance and Services	Transparency and evidence based decisions	The Commission recommends that the Department of Finance and Services and the Department of Planning set out strategies for community consideration about the long run security of water supply in the lower Hunter. Implementation Timeframe: Short term (6 -12 months)
86	Water	Partnerships, outsourcing	The Commission recommends that Sydney Water investigate further ways to improve productivity in its maintenance work. This review should examine existing outsourced contracts, work practices internally and how more maintenance work can be outsourced if that is the most cost effective option. Implementation Timeframe: Medium Term (12 -24 months)
87	IPART	Transparency and evidence based decisions	The Commission recommends that IPART examines the gap between its regulated asset base (RAB) value and the Modern Engineering Equivalent Replacement Asset (MEERA) value and takes steps to have the RAB value approach the MEERA or depreciated optimised replacement values over a shorter time frame that is currently the case. Implementation Timeframe: Short term (6 -12 months)
88	Water	Budget constraint	The Commission recommends that the three urban utilities, Sydney Water, Hunter Water, and the Sydney Catchment Authority continue to improve their commercial outcomes and that IPART and the shareholders put in place a strategy that will move the utilities to a more commercial capital structure. Implementation Timeframe: Medium Term (12 -24 months)
89	Water	Transparency and evidence based decisions	The Commission recommends that the regulator of State Water examines its regulated asset base and its MEERA (Modern Engineering Equivalent Replacement Asset) base value and consider how to bring the two more closely together over a reasonable period of time. Implementation Timeframe: Medium Term (12 -24 months)
90	Premier and Cabinet	Transparency and evidence based decisions	The Commission recommends that an independent review be conducted of the standards set by the Dam Safety Committee following a thorough risk and cost benefit assessment. Implementation Timeframe: Medium Term (12 -24 months)

91	Water	Transparency and evidence based decisions	The Commission recommends that State Water and its present and future regulator examine its capital structure and propose changes that would leave State Water financially viable. Implementation Timeframe: Short term (6 -12 months)
92	Water	Transparency and evidence based decisions	The Commission recommends that the Office of Water regularly reports to the government in some detail on progress made in each of the rural and regional water utilities to improve performance. Where local utilities are not compliant with drinking water standards, the actions being taken to remedy the situation and over what timeline, should be specified. Implementation Timeframe: Short term (6 -12 months)
93	Premier and Cabinet	Transparency and evidence based decisions	The Commission recommends that the government consider moving the operational activities of the Office of Water to State Water. The regulatory roles of the Office of State Water should be reviewed and made clear. Implementation Timeframe: Short term (6 -12 months)
94	Finance and Services	Budget constraint	The Commission recommends that the Government should request the WorkCover Authority to consider a number of reform options to improve injury management and return to work outcomes under the WorkCover Scheme. WorkCover should liaise with other jurisdictions and consider directions taken elsewhere. The objective is to reduce the cost of weekly payments and in due course lead to lower employer premiums. Reform options should be presented to Government for consideration and should cover: • the introduction of a specialist return to work inspectorate • revised Scheme Agent remuneration structures to create better incentives for improvements in active case management • enhanced incentives, or penalties, to encourage employers to offer suitable duties or not terminate the employment of workers who have made a claim • changes to work capacity certification, that is arrangements whereby an injured person"s capacity to do work is medically assessed, documented and used to support a return to work plan • introduction of specialist claims management providers • introduction of a work capacity test as a condition for receiving long term partial incapacity, i.e. weekly top-up payments – similar to the one used in Victoria and South Australia • changing the step-down in weekly benefit levels – the point in time when the weekly payment an injured worker receives changes to a lower rate. Implementation Timeframe: Short term (6 -12 months)

95	Finance and Services	Budget constraint	The Commission recommends that WorkCover Authority should bring forward for Government‟s consideration a number of legislative and procedural reforms that better manage the rising incidence of Work Injury Damages claims. The proposed reforms for Work Injury Damages Claims should serve to address the following concerns: • the current ineffective statute of limitations • ineffective testing of negligence by the Court and others • increasingly porous impairment threshold • ineffective testing of economic loss • incentives for legal providers and claimants to pursue damages at the expense of recovery and returning to work. Implementation Timeframe: Short term (6 -12 months)
96	Finance and Services	Budget constraint	The Commission recommends that the WorkCover Authority should: • prepare for Government‟s consideration, a business case for introducing a regulation making power that would allow for specific determinations of what constitutes reasonable treatment and associated schedules of rates • undertake further analyses across service types, commencing with the largest medical treatment types by cost to the scheme, to identify the extent of over-servicing and establish more thorough clinical guidelines • enhance procedures and systems for early identification of aberrant provider behaviour and conduct targeted compliance interventions • consider contracting a specialist organisation to negotiate highly complex fee schedules, e.g. private hospital fee schedules • consider contracting a specialist third party to perform compliance reviews and invoice processing e.g. surgical and private hospital • investigate and report to Government on alternate medical certification avenues that better enable an early return to work. Implementation Timeframe: Short term (6 -12 months)
97	Finance and Services	Collaboration, Coordination	The Commission recommends that the WorkCover Authority should consult with the Health Care Complaints Commission and make a joint submission to the Government on improved and coordinated arrangements for investigating and responding to allegations of over-servicing and poor clinical practice. Implementation Timeframe: Medium Term (12 -24 months)

98	Finance and Services	Budget constraint	The Commission recommends that a comprehensive review of the NSW workers" compensation benefits regime should be undertaken. The review should seek to identify reforms to workers" compensation benefits that bring them more in line with other states, and balance the need to lower premiums and assist workers recover and return to work. Implementation Timeframe: Short term (6 -12 months)
99	Finance and Services	Collaboration, Coordination	The Commission recommends that the WorkCover Authority, the Dust Diseases Board and the Life Time Care and Support Authority should jointly develop, for Government"s consideration, options that allow their respective investment funds to be managed jointly in separate funds under a consolidated entity. Periodic independent reviews should also be undertaken to validate the ongoing performance, investment strategies and management of the funds. Implementation Timeframe: Short term (6 -12 months)
100	Central Agencies	Collaboration, Coordination	The Commission recommends that the Compensation Authorities, working closely with Central Agencies, should examine options and provide recommendations to Government on approaches to merge the Compensation Authorities and achieve a greater commercial focus. This should be supported by a concise Charter and Statement of Business Intent which sets out expectations, objectives and targets for the merged Authorities. This structure may change once the scheme is stabilised. Implementation Timeframe: Short term (6 -12 months)
101	Finance and Services	Workforce	The Commission recommends that WorkCover should expand the Authority"s staff capability and should discuss and implement this measure with the Public Service Commission. Implementation Timeframe: Short term (6 -12 months)
102	Finance and Services	Collaboration, Coordination	The Commission recommends that WorkCover should investigate options to improve the data interfacing between itself and its Scheme Agents. This should include options to access more comprehensive live data feeds from its Scheme Agents or gaining real time access to their workers" compensation data systems. Implementation Timeframe: Medium Term (12 -24 months)
103	Finance and Services	Transparency and evidence based decisions	The Commission recommends that the Corporate and Shared Services reforms in each cluster include detailed plans that when implemented mitigate against the risks associated with change management, workforce capabilities, required staff reductions and technology that needs upgrading and/or is non-standard. Implementation Timeframe: Short term (6 -12 months) The Commission recommends that the importance of communication and change management in the Corporate and Shared Services reform be recognised in the preparation of a detailed communication plan for Directors General, CEOs, staff,

			agencies and to cover progress reporting to central agencies. Implementation Timeframe: Short term (6 -12 months)
104	Finance and Services	Collaboration, Coordination	The Commission recommends the following Corporate and Shared Services strategies for the short-medium term: • The Health and Education and Communities clusters should continue to improve their single providers. • The clients of ServiceFirst and BusinessLink be moved to a new shared service provider (NewCo). This new service provider is to be gradually populated with systems and functions in a way that brings efficient service. The plan to transition certain clusters and agencies (such as Trade Investment Regional Infrastructure Services and the Office of Environment and Heritage) to this vehicle by 2015 should proceed • The Transport cluster should continue to consolidate its shared services in-house and upgrade its systems. This will take at least a year. Consideration should then be given to using different sourcing strategies and amalgamation with other NSW Government shared service providers, including working with the NewCo on outsourcing certain functions. • The Attorney General and Justice cluster should continue with its plan to merge its shared services, based on Fire and Rescue NSW‟s systems. The Police Force should remain separate until the merger is complete, then should be amalgamated into it. • The Government must ensure that there is adequate investment in these transformations and that it is expertly managed. • The Department of Finance and Services should monitor the progress and benefits of the various CSS programs across the sector and report on progress (or otherwise) to Ministers in a robust and transparent way. Implementation Timeframe: Medium Term (12 -24 months)
105	Finance and Services	Collaboration, Coordination	The Commission recommends that the Directors General of the Health, Education and Communities, Attorney General and Justice, and Transport clusters consider establishing a skills based board to oversight the provision of shared services within their cluster to drive a more commercial approach. Consideration should be given to whether the current governance structures are appropriate or whether a more commercial driven approach which better leverages independent expertise from the shared service industry may advance the introduction of more effective shared service arrangements. Implementation Timeframe: Short term (6 -12 months)

106	Finance and Services	Workforce flexibility	The Commission recommends that the Department of Finance and Services should work with cluster Directors General to: • make clear that fleet policy is understood and complied with. Fleet cars should be pool managed and not exist for individual operational requirements; • install and activate GPS in government vehicles, after consultation with employees and their unions, to improve employee safety and vehicle utilisation; • introduce vehicle pools within a cluster, and across all agencies in the same geographic region, to improve utilisation and dispose of any surplus vehicles; • standardise vehicles within specific agencies/clusters. Implementation Timeframe: Short term (6 -12 months)
107	Finance and Services	Transparency and evidence based decisions	The Commission recommends that the recent move to PCards be accompanied by a benefits realisation program in each cluster. This should identify the changes in the type and numbers of transactions occurring and the positions that are redundant because of the change. Implementation Timeframe: Short term (6 -12 months)
108	Finance and Services	Partnerships, outsourcing	The Commission recommends that: • the Director General of the Department of Finance and Services explore the benefits and risks of outsourcing of specific functions (eg payroll) the new vehicle servicing the clients of ServiceFirst and BusinessLink. • the Director General of the other clusters examine whether or not they wish to join the outsourced model for any specific services in that vehicle. Implementation Timeframe: Short term (6 -12 months)
109	Finance and Services	Collaboration, Coordination	The Commission recommends that: • the Department of Finance and Services develop an estimate of the investment required across the sector for the Corporate and Shared Services reform programs across the clusters • Treasury provision a central pool for clusters" investment in Corporate and Shared Services reform programs • Clusters monitor and check that benefits are being realised and take steps to ensure this outcome which in turn would cover their investment in the reform program. Implementation Timeframe: Short term (6 -12 months)

110	Finance and Services	Collaboration, Coordination	The Commission recommends that the mandatory requirements to use whole of government contracts be applied only to those that clearly provide value for money for both the specific goods and the related services. Over time as contracts expire, the mandatory requirement to use whole of government contracts should be restricted to those that add value for money. Implementation Timeframe: Short term (6 -12 months)
111	Transport / Education and Communities	Workforce flexibility	The Commission recommends that Transport, Education, and other heavy users of the Contingent Workforce Contract (C100) examine whether this large annual spend on temporary contract staff is value for money and the best way to manage their workforce. Implementation Timeframe: Short term (6 -12 months)
112	Finance and Services	Transparency and evidence based decisions	The Commission recommends that the Department of Finance and Services provides agencies with information about their major expenditure on contracts at least annually and if possible more regularly. Agencies should then review this data and consider whether this procurement was the best way to meet their requirements and if so was the procurement value for money. Any lessons should be noted for future implementation by agencies and if relevant Finance and Services. Implementation Timeframe: Short term (6 -12 months)
113	Finance and Services	Transparency and evidence based decisions	The Commission recommends that all procurement strategies examine both the direct cost of procuring goods and services and also the indirect costs of their ongoing delivery and service. Implementation Timeframe: Short term (6 -12 months)
114	Finance and Services	Transparency and evidence based decisions	The Commission recommends that both the Eligible Customer definition, and the fees they pay to use NSW Government contracts, should be reviewed by the Department of Finance and Services. The Victorian and Queensland approach should be considered, along with other alternatives to narrow the number of Eligible Customers. Options should go to the Government for consideration along with any recommended changes to fees paid by Eligible Customers. Implementation Timeframe: Short term (6 -12 months)
115	Finance and Services	Partnerships, outsourcing	The Commission recommends that the Department of Finance and Services, in partnership with the Public Service Commission, continue to improve the procurement capabilities of the NSW public sector. Implementation Timeframe: Medium Term (12 -24 months)

116	All	Transparency and evidence based decisions	The Commission recommends that the procurement staff in agencies review and consider the detailed scope of their capital projects before committing to a contract. The way the project fits into the asset management plans should also be identified. Implementation Timeframe: Short term (6 -12 months)
117	Finance and Services	Transparency and evidence based decisions	The Commission recommends that a review of risk and allocation by an experienced outside party, for projects over $20 million, be conducted. Implementation Timeframe: Short term (6 -12 months)
118	Finance and Services	Partnerships, outsourcing	The Commission recommends that in Public Private Partnerships optimal value for money is sought by allowing the private sector to conduct non-core activities where their provision of these activities is more cost efficient than public sector provision. Implementation Timeframe: Short term (6 -12 months)
119	Treasury	Partnerships, outsourcing	The Commission recommends that Infrastructure NSW and Treasury should investigate options to optimise risk transfer arrangements for future toll road Public Private Partnerships (PPPs), with a view to ensuring that associated infrastructure remains off the State"s balance sheet and encourages private sector participation. In particular, the risk allocation in tenders for toll road PPPs be reconsidered so that the entire traffic volume risk is appropriately allocated and that toll costs are kept as low as possible for customers. Implementation Timeframe: Short term (6 -12 months)
120	Finance and Services	Transparency and evidence based decisions	The Commission recommends that before IT projects commence the technical providers are made fully aware of both what the business needs (and does not need) and the available budget. The project should be business led not technically led. Implementation Timeframe: Short term (6 -12 months)
121	Finance and Services	Transparency and evidence based decisions	The Commission recommends that IT projects be carefully scoped and that no budget be set until a firm costing can be made after the design phase. Implementation Timeframe: Short term (6 -12 months)
122	Treasury	Budget constraint	The Commission recommends that NSW Government agencies and entities with insurance arrangements outside of the Treasury Managed Fund (TMF) should work with SICorp to transition their insurance across to the TMF scheme as their current insurance arrangements expire. Implementation Timeframe: Short term (6 -12 months)
123	Treasury	Collaboration, Coordination	The Commission recommends that WorkCover and SICorp should jointly prepare instructions to all agencies, to be issued either as a Treasurer"s Direction or Premier"s Memorandum, clarifying the

			following: • the injury case management function that is to be performed within agencies and how this complements and differs from the function performed by the TMF Claims Agents • the appropriate qualifications that agency injury case managers are required to hold • the optimal number of case managers that should be employed by agencies by applying relevant benchmarks. Implementation Timeframe: Short term (6 -12 months)
124	Central Agencies	Transparency and evidence based decisions	The Commission recommends that Central agencies, working closely with clusters and agencies, should establish a policy framework to assist government to prioritise, set and evaluate commitments on concessions and tax expenditures. Implementation Timeframe: Medium Term (12 -24 months)
125	Central Agencies	Budget constraint	The Commission recommends that Government should periodically review all concessional arrangements across government, starting with major concessions. Implementation Timeframe: Medium Term (12 -24 months)
126	Finance and Services	Transparency and evidence based decisions	The Commission recommends that following the review of concessional arrangements across government a central access point or portal should be set up in Plain English for customers. Implementation Timeframe: Long Term (>24 months)
127	Central Agencies	Collaboration, Coordination	The Commission recommends that the breadth and quality of government program information should be improved through the following measures: • central agencies, working together with agencies, should define what is meant by a program and the type of program information to be collated by agencies • CEOs should ensure that their financial and data systems are able to capture and report program information • CEOs should ensure appropriate information management exists within agencies to ensure program knowledge and history is maintained. Implementation Timeframe: Short term (6 -12 months)

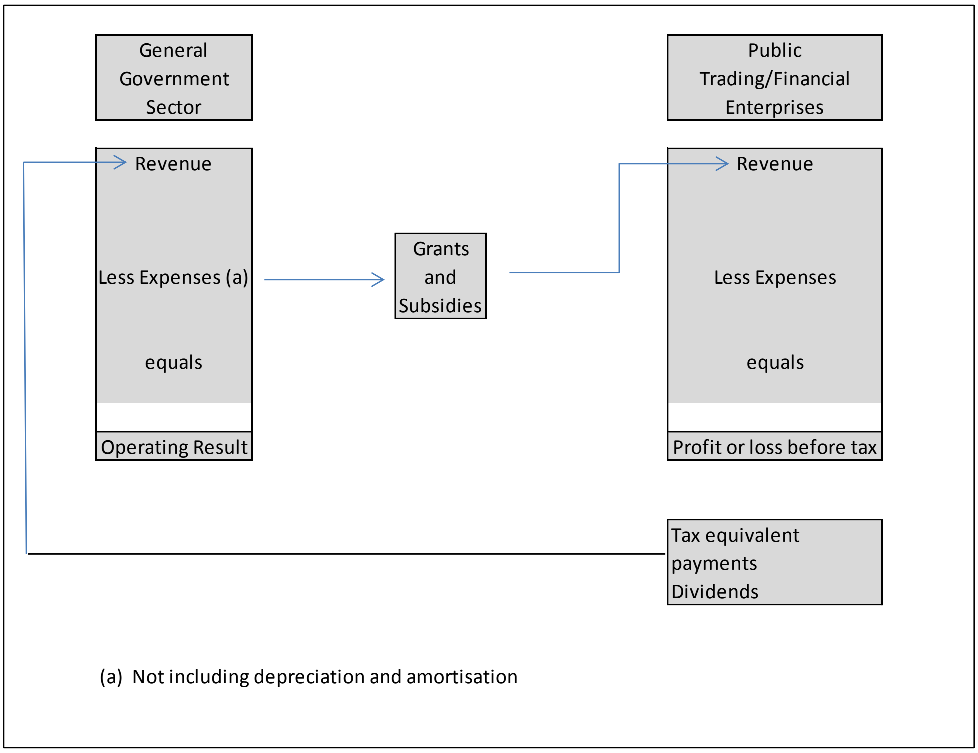
128	Treasury	Transparency and evidence based decisions	The Commission recommends that robust business cases should accompany proposed programs, pilots and initiatives to establish their cost, benefits and linkage to government priorities. Business cases should also specify appropriate baselines across financial and non-financial performance as well as relevant Key Performance Indicators to facilitate objective evaluation. Implementation Timeframe: Short term (6 -12 months)
129	Treasury / Premier and Cabinet	Transparency and evidence based decisions	The Commission recommends that approvals of all new programs and initiatives should be explicit about when they will terminate and specify requirements for program evaluations (and ongoing data collection requirements to support this) and reporting back to government, where required. Funding should also be set aside for the evaluations. Implementation Timeframe: Short term (6 -12 months)
130	Treasury / Premier and Cabinet	Transparency and evidence based decisions	The Commission recommends that Treasury and the Department of Premier and Cabinet should implement a systematic way to monitor time-limited programs/initiatives to ensure they are discontinued as intended or not carried forward without proper assessment. Implementation Timeframe: Short term (6 -12 months)
131	Central Agencies	Transparency and evidence based decisions	The Commission recommends that agencies, in collaboration with central agencies, should conduct periodic evaluations of their smaller programs and pilots (both existing and new). Implementation Timeframe: Short term (6 -12 months)
132	Treasury	Transparency and evidence based decisions	The Commission recommends that evaluation of large or significant programs (both existing and new) should be scheduled on a rolling basis and led by Treasury. The responsibility for leading these evaluations in a collaborative manner should also rest with Treasury who must have strong engagement from the agencies and other relevant stakeholders. Implementation Timeframe: Short term (6 -12 months)

Appendices

Appendix 1: The relationship between general government and PTE's

There is an important relationship between general government and the Public Trading Enterprises. A significant amount of funds flow between these sectors; from the general government to public enterprises (in the form of grants and subsidies) and similarly from public enterprises to the general government (as dividends and tax equivalent payments). This is shown in figure 1.1.

Figure 1.1: NSW Government structure



The financial transfers between the general government and public enterprise sectors are significant. In 2010-11 the commercial public trading enterprises (mainly the electricity and water utilities, and ports) paid about $2.2 billion in dividends, tax equivalents and government guarantee fees. This excludes the one off $3.4 billion special dividend from the electricity sales in that year. The grants and subsidies paid to public trading enterprises amounted to $2.5 billion for current expenditures and $1.8 billion for capital expenditure. These payments from general government went to both non-commercial public trading enterprises, mainly transport, and to cover community service obligations by the commercial enterprises, mainly pensioner rebates.

Appendix 2: A sustainable level of net investment

An analysis for NSW

The first step is to estimate a medium term infrastructure requirement based on population growth, changing community expectations of service delivery standards, technological change and ongoing replacement of the existing capital stock. A concept of net infrastructure is introduced which is defined as capital expenditure less depreciation. An adjustment is also made to measure social public private partnerships and finance leases within the capital expenditure estimate. Their definition is:

- Net infrastructure investment = capital expenditure less depreciation.

The parts of this definition are then defined. Depreciation = D, and is estimated in the government financial statements each year.

The gross infrastructure investment is the sustainable annual investment needed to meet the additional demand for services. This additional demand is due to:

- population growth (denoted by p)
- community expectations that the quantity and quality of services will increase over time (an enhancement factor denoted by g)
- savings due to technological change each year (denoted by t)
- plus the investment need to replace the depreciating existing capital stock each year, expressed as a percentage of the existing capital stock (denoted by d).

If K is the capital stock of buildings, land, plant and equipment and other infrastructure then:

- Net investment = [(p + g – t + d) * K – D.

The capital stock is revalued each year by a price factor, $K = K_{-1} * (I + c)$ where c is the capital inflation factor.

This approach is an economic capital stock adjustment model for a medium term outlook. The parameters the Commission has used are:

- population growth p = 0.9%
- service enhancement g = 2.0%
- technological change d = 3.5%
- capital stock K = closing balances adjusted for on balance sheet PPPs and finance leases
- cost escalation c = 3.0%.

The Victorian review estimated that the level of general government net infrastructure investment required in Victoria would be of the order of 0.5% of GSP. Using the same approach for NSW suggests that the general government net infrastructure requirement is 0.6% of GSP or $2.6 billion in 2010-11. This implies capital expenditure in general government of about $2.6 billion plus depreciation of about $2.8 billion. In total this is $5.4 billion of required capital expenditure in general government for 2010-11. Table 2.1 below shows the medium term estimates for infrastructure that may be required in general government following this economic analysis. It also provides a comparison with the NSW budget figures.

Table 2.1: Required infrastructure: medium term general government

$billion	2010-11	2011-12	2012-13	2013-14	2014-15
Required net infrastructure (0.6% GSP)	2.6	2.7	2.9	3.0	3.2
Depreciation	2.8	3.0	3.3	3.5	3.6
Required capital expenditure	5.4	5.7	6.2	6.5	6.8
Budget capital expenditure	7.0	6.8	6.7	6.4	5.2

This high level analysis suggests that in general government at present the level of capital expenditure has been above the medium term required trend. However the analysis also suggests that by the end of the budget period (2014-15) the capital expenditure planned is below the medium term trend. On the basis of this analysis there is no evidence that the aggregate spend on infrastructure in general government has been too low. At the end of the budget period the position may need to be assessed.

This examination of capital expenditure adequacy at an aggregate level for general government does have limitations. The values assigned for enhancement factors, technological change, population growth, rate of depreciation and cost inflation are estimates. Some are more difficult than others to estimate and the analysis should be reviewed regularly for its relevance. The cost inflation factor for example varies with the construction cycle.

Appendix 3: Changes in TAFE arrangement in other states

Victoria

Victoria has the most autonomous TAFE Institutes and the most flexible and devolved system with regard to funding arrangements. Deregulation of VET service delivery occurred in Victoria in advance of the changes announced by the Australian Government and it has had a wider impact than the federal reforms.

TAFE Institutes in Victoria have been established as legislatively autonomous institutions (statutory authorities) since 1993.They are governed by separate Institute boards with TAFE Institutes have a high degree of autonomy in the management and delivery of services.

In 2008 the Victorian Government announced that funding of its VET sector would move from a highly regulated funding model to a deregulated model. The deregulated model is based on three elements:

- an entitlement model for the funding of VET training comprising a guarantee that:
    - for those aged under 20 years of age, a subsidised place will be available for training at any qualification level
    - for those aged 20 and over, a guarantee of a government subsidised training place for accredited training at higher levels
- all government funding for training places will be fully contestable between all registered training providers – public and private
- more efficient and accurate pricing of courses through tuition fees, reflecting the benefits of the courses:
    - fees for subsidised training will vary in line with the expected benefits individuals and businesses obtain from their training
    - tuition fees will be determined at the individual provider level up to a specified cap, with the flexibility to offer programs at lower prices.

The government announced at the time an increase in investment in TAFE to reflect an expected increased demand for TAFE courses

In October 2011, the relevant Victorian Minister announced a number of changes to TAFE funding arrangements aimed at better managing demand for courses in the entitlement based funding model. These changes were primarily aimed at removing differences in subsidies and pricing arrangements between different providers that may have distorted demand and course choices. Minimum and maximum fee caps charged by training providers to students were also removed.

The changes announced by the Minister followed a significant increase in demand for TAFE courses following the move to entitlement funding and an overrun in government expenditure allocated to accommodate the increase in demand.

Compared to estimated enrolment growth of between 3 and 6%between 2008 and 2011, with an estimated additional expenditure of $139 million over four years, actual growth was 44%, costing $440 million more than was initially estimated.

The changes also followed a report by the Victorian Essential Services Commission that found that the move to entitlement funding had removed restrictions on the quantity of course places available, while the pricing of courses remained regulated. The review commented that the remaining restrictions on fee and subsidy arrangements limited the ability of prices to adjust as they would in a competitive market to balance supply and demand.

South Australia

The South Australian government announced changes in the delivery VET services in March 2011, in a policy statement, *Skills for All*. The strategic direction for VET in South Australia outlined in the statement reflects the same approach that is currently being implemented in Victoria. As with Victoria, the changes in South Australia are:

- a move from a regulated model to a deregulated model of service delivery
- a move from centralised capped funding allocations to a demand driven, user choice model
- changes to governance arrangements to provide greater autonomy to TAFE institutes.

Features of the move to a decentralised funding model include:

- eligible students 16 and over will be eligible for a government funded training place, with those holding an existing qualification able to access the training subsidy to obtain a qualification above or at the same level they already hold
- eligible learners will be able to enrol with any training provider that is registered and qualified as a training provider
- the government will extend funding to more training providers by increasing the contestability of public funds
- individuals will be able to choose what subsidised training they do and the provider they use – the supply of training will be demand driven and the public training subsidy will eventually be fully contestable.

As in Victoria, tuition fee arrangements in South Australia will also change, so that the combination of the published government subsidy and tuition fee will provide a transparent market price for VET services across different providers, as follows:

- training providers will be reimbursed by the Government at a published subsidy price
- the government will work with the market to establish a subsidy price that supports sustainable delivery and quality, value for money training services
- Tuition fees will be set by qualification level or prescribed skill set and subject to a cap; training providers will be able to charge at a rate below the cap and may be required to provide concessions for access or equity requirements.

Currently, TAFE Institutes in South Australia operate under the control of TAFE SA, a unit of the central Department of Further Education, Employment, Science and Technology. TAFE SA operates as both the purchaser and provider of TAFE services. Under the *Skills for All* the governance of TAFE SA will moved to a more autonomous structure in two stages:

- first, an Office of TAFE SA will be established, which will remain an administrative unit of the department, but with the features of an autonomous entity
- next ,TAFE SA will be established as a separate government owned statutory authority with each institute as a subsidiary.

Queensland

The Queensland Government has announced it will implement changes to its funding arrangements for TAFE, that move toward a full entitlement model:

- a funding entitlement for individuals for a first qualification up to advanced diploma level in their provider of choice, with consistent fees and charges in each qualification level
- sufficient public funding and equitable student contributions to meet demand for the entitlement
- capped funding for students with initial qualifications up to degree level, with higher fees to reflect higher individual returns
- full fees for individual students in areas of high labour market return.

TAFE institutes in Queensland are statutory authorities, operating as a body corporate, with the capacity to manage funds and assets and to employ staff.

Appendix 4: A decentralised model: Victorian Schools

The allocation of decision making responsibilities in Victorian schools is based around a clearly defined leadership role for school principals, supported by a:

- strong and well established local governance structure for schools, based around legally recognised school councils that have an active role in setting the direction and objectives of their local school
- high level of autonomy for school principals over the selection and management of staff and the management of financial resources
- structured program of investment in leadership skills and culture.

The devolved governance and decision making in the Victorian model provides the opportunity for principals to:

- exercise leadership, through local governance and autonomy
- have the opportunity to demonstrate leadership qualities.

In a 2007 OECD study on school leadership, Victoria was chosen as a case study:

> „as an innovative example of school leadership development because of the State"s remarkable drive to improve school effectiveness, in which leadership development plays a central part".

The report outlines the school leadership program initiated by the Victorian government based on a professional learning and leadership development culture. The OECD described this approach as „cutting edge" in international terms.

As well as the structured program of leadership development, the study also pointed to the relationship between school governance and leadership in Victoria, as follows:

- decentralisation has progressed further in Victoria than elsewhere in Australia owing to the devolved decision making to the principals and school councils of government schools, which gives them considerable operational autonomy
- the principals of government schools are required to work with their staff and community to develop strategic plans with clearly articulated outcome targets and improvement strategies
- school leadership is increasingly shared or distributed, with an expectation that school principals will work with others in leadership roles.

Governance

The process of devolving both governance and management responsibilities from the centre to individual schools has taken place over many decades. The main steps in this process were:

- in 1958 Victoria was the first Australian school system to provide legal provision for the establishment of school committees comprising parents and the local community to advise school principals.
- in 1975, amendments to the *Education Act 1958* provided for the establishment of school councils comprising representatives of school staff, parents, students and the community. Councils were made mandatory, corporate governing bodies with greater authority and responsibility.

A series of changes from 1993:

- devolved over 90% of schools recurrent funding was to the school site, with flexibility for schools to allocate funds according to local needs
- required the school council to develop a school charter – in effect a contract between the government and the council – that provided parents with greater say on school performance
- the charter provides for the learning that will take place in the school and the way it will be monitored and reported to government along with the devolution of staff selection to the school.

Reviews of the schools based management approach in Victoria in 1999 and 2005 retained the devolved system, with greater clarity of the delineation between the role of school councils and schools, with operational matters to be left with schools.

The practical implications of the devolved model of school based management in Victoria is the high degree of autonomy that a school and its local community has in setting the direction and delivery of school education in their local school. This includes:

- school governance that explicitly rests with school councils. The latter have the power to set the key directions for the school and are a legal entity in their own right
- a high degree of autonomy over the expenditure of the school budget, although the quantum of the budget is set and allocated centrally.

Devolved resourcing and budgeting

The Australian Council for Education Research estimates that almost 100%of funding for government schools is decentralised in Victoria. The features of the model are:

- schools are allocated a single Student Resource Package (SRP) that is calculated to cover the costs of student education delivery (staffing costs), other operational costs and special initiatives
- schools have a high degree of autonomy over the allocation of funding through the SRP, including a relatively high autonomy over types of staff appointments and allocation of allowances
- constraints on allocation of funding include principal positions, enterprise bargaining agreements on class sizes, teaching hours and promotions
- the main element of the SRP funding is a student per capita loading, with a higher loading for secondary students
- minor capital works is also provided for in the SRP
- funding for equity programs, other targeted programs and special needs are provided in addition to the SRP
- work insurance costs are also allocated to schools so that schools have an incentive to maximise health and safety and gain budget savings (or risk overruns).

Central allocations of funding are made in Victoria for major capital works and emergency repairs, transport and student assistance schemes.

Appendix 5: A comparison of centralised NSW Schools and decentralised Victorian Schools

The views of nine principals on autonomy in NSW and Victoria, in 2007 are summarised in the table below.

NSW Secondary School (a)	Victoria Primary School (b)
Staffing budget is constrained by number of enrolments and so flexibility is limited. He reported that tied funding restricts principals. He would like some untied resources and wouldn"t mind where it came from.	Has used surplus in school budget for teaching staff to employ leading teachers in the role of curriculum coaches.
Decisions regarding the number of staff are not the school"s responsibility, but the school has some responsibility for the professional mix of staff.	Significant levels of autonomy in the selection of staff and setting of the staff profile, within a broad framework.
[The principal] would be happy to have less autonomy in decisions regarding maintenance as there is little funding and it is tied through whole-of-government contracts and whole-of-government procurement	This principal reported that the allocation of a global budget has also provided funds to make physical changes to facilities to reflect the educational vision of the school.
[The principal] is reasonably happy with the current system of schooling and school leadership in NSW. He agrees with accountability for staff and public funds, but the system needs to reconcile responsibilities and accountabilities.	The principal indicated that the devolution of responsibilities for school staffing and financial management have increased the workload for principals. Despite the increased workload, this principal referred to the increase in school responsibilities as a positive outcome. She reported that the flexibility in school governance enabled her to focus every aspect of her school on the needs of the local community and the school vision.

(a) Large urban high school employing 120 staff and enrolling 1100 students from predominantly middle class community.

(b) Regional Victoria, 500 students.

Appendix 6: Case studies of devolution

1. Decentralising a large Australian bank

Several years ago, a large Australian bank began a multi-year project to turnaround relatively poor levels of customer satisfaction and employee engagement. The bank made a public commitment to make banking 'more convenient'. The bank adopted an outward-focussed operating model. This was based on what mattered most to customers, and on prioritising service excellence within the staff culture. The program propelled the bank ahead of its peers both for levels of customer satisfaction, including reducing complaints by 50%, and employee engagement. As a result of the program, the bank moved from the middle of the pack to the number one spot and maintained its position for many years.

To become more outwardly-focussed, the bank created a network of strong local branch businesses supported by, not controlled by, head office. The role of local branches was to help customers, while the role of head office was to support branches in achieving this. A cornerstone of the program was that 80% of back-office effort was focussed on customer service. The effect of this was two-fold: it directed resources to what mattered most and also led the bank to simplify administrative processes so that these could be completed in the remaining 20% of time. Five years into the strategy, staff nominated 'customer focus' and 'community involvement' as the bank's two most visible cultural values.

The model relied on both competition and collaboration. Branches could bid for additional resources, such as staff or branch refurbishments, with funding allocated to the best ideas supported by robust business cases. At the same time, the model was designed to build capability within the network by using staff from the highest performing branches to coach those in poorer performing branches. Relationships between local areas were further strengthened by establishing new forums to generate and share knowledge and ideas.

The bank's strategy for engaging with customers was based on three principles:

1. Understanding the customers' needs and preferences:

- Customer surveys and complaints data were used to identify the top five broken processes and then fix them. This included reducing queues, extending call centre hours, and making it quicker and easier to replace credit cards. Customer information and data was then gathered at a local level to inform local improvements and tailoring of service at this local level.
- Needs within local areas were met by opening a number of new branches and installing ATMs in more places. Improvements were highlighted in marketing campaigns to demonstrate the bank's commitment to change.

2. Setting the bank up with the capability to continuously respond to local customer needs and preferences:

- High-calibre local leaders who were appointed were responsive to the needs of customers. To attract candidates with an entrepreneurial skill set, the bank increased compensation but also made a large component of it variable based on measures of success, including minimum customer satisfaction levels.
- Greater autonomy was provided for branch managers to make decisions on local marketing. The bank referred to this publically as its 'community investment strategy'. This gave staff the opportunity to engage with their local community and support causes that were important to them and to foster affiliation. For example, branches could organise local promotions for the bank as well as invest in a range of benefits for their community such as sponsoring local sporting teams, clubs or charities.
- Branch managers were given a greater level of financial responsibility. Managers had control of their profit and loss statements and were expected to achieve specific targets tailored at the local level. These were based on customer outcomes, staff engagement, financial performance and risk management and compliance.
- Branch managers could make a business case for resources to make changes that would improve customer service in their area. Improvements ranged from extending opening hours to making branches more accessible, as well as bringing in new specialists to serve local needs, such as more mobile bankers.

3. Providing customers with better information about the services available to them, and the expectations they should have of the bank:

- Many branches introduced new concierge-style staff, and located the branch manager on the floor, to assist and direct customers and resolve issues on-the-spot as required.
- The centre developed and published a customer charter that established minimum acceptable service levels applicable across the network. This charter became a key tool for engagement at the local level. By making a public commitment to customers, and measuring and reporting publicly on improvements, the charter drove the program to provide customers with reliable service every day, and provided the framework for tailoring customer service at the local level.
- The centre also repackaged products to make them easier to understand, including simplifying fees and charges, to assist branches and customers everywhere.

As this was a very public transformation, the bank used extensive marketing campaigns to highlight the changes underway and demonstrate the difference they were making to customer outcomes.

2. A decentralised community of schools

The Cape York Aboriginal Australian Academy is a decentralised schooling organisation, catering for almost 500 primary-age children. It aims to close the academic achievement gap between indigenous and mainstream students while also supporting the bicultural identity of Cape York children. The Academy operates as a partnership between Education Queensland (EQ) and Cape York Partnerships (CYP) and is a not-for-profit organisation within the Queensland public education system. While EQ is responsible for some operational aspects, such as hiring staff, the Academy oversees the pedagogy and delivery of the EQ curriculum, and drives the community engagement efforts. The Academy is organised around three learning domains: Class, Club, and Culture. It uses a Direct Instruction teaching method.

Formed in 2010, the Academy initially served two Cape York communities. Indicators of its success to date include improvements in students' NAPLAN results, higher school attendance (almost doubling in one community), and a rapidly increasing number of students at or above grade level in literacy and numeracy. The Academy's success has generated demand for further schools in the Cape. It was extended to a third community in 2011 and two more communities will join in 2012.

A critical element of the Academy's success has been its ability to engage with parents, the community, and third parties from the public and private sector (such as philanthropists), to create a sense of shared ownership over student outcomes. In particular, effort has focussed on building capability within communities and providing incentives for community members and others to get involved, and then stay involved with the Academy.

The Academy"s strategy for engagement is based on a number of distinct, but related elements. The main three are:

1. Academy and CYP cultivating informal communication at the school level:

- A hotline between the schools and their community was forged based on very strong relationships between key community members, such as the mayor and local elders") and the Academy's CEO and Executive Principal who are responsible for managing the cluster of three schools. This channel allows the views or concerns of parents and families to be escalated. Maintaining these networks is a priority for both staff, who collectively devote at least one to two days a week to this task. The capability to build and manage informal relationships was a critical factor in their appointment.

2. Formal support from the centre was provided to engage the community:

- Communications tailored to each community to generate excitement and pride in their school, were produced. They include achievement and attendance certificates specifically designed for Academy students, as well as monthly newsletters which feature education.

- Members of the local community were involved to 'coproduce' parts of the curriculum. For the Culture domain, schools employ members of the local community to design and deliver a rich, relevant cultural program including language, music and arts. This builds a shared sense of ownership over the program"s success.
- Local teacher aides were employed. They are groomed for teaching roles, both to fill the pipeline of teachers and also to engage the local community in the program's future success.
- Incentives for parents to send their kids to school were drawn on to improve attendance. Schools are connected to the local welfare reform pilot projects and attendance data is provided to the Family Responsibilities Commission (FRC). If attendance becomes a serious issue, the Academy and EQ can use the community-endorsed FRC 'carrot and stick' approach with parents and carers to encourage student attendance.

3. A broad group of stakeholders were involved in the program's success, and implementation:

- CYP helped schools to comply with reporting requirements for funding. KPIs have been designed for each learning domain and are regularly reported on, including performance on standardised tests (Class), community participation (Club), and number of events (Culture).
- Higher than traditional levels of decision-making and autonomy are permitted by the governing Board. These cover the strategic direction of the schools, including pedagogy and how to meet the EQ curriculum„ and influencing key appointments. The Board comprises representatives from EQ, regional Indigenous organisations, elders from the communities, the non-government sector and independent educationalists.
- School tours were organised to promote the concept of the Academy and engage with prospective families and funders. These are coordinated by the Academy in close consultation with schools. The tours reflect the Academy's holistic approach to improving outcomes and include elements such as a demonstration of Direct Instruction, a tour of facilities, classroom visits and a visit to the school nurse.
- CEO visits in the Cape were set up for corporate and philanthropic partners. These visits require significant preparation to ensure schools and other community initiatives can demonstrate progress first hand. Tours include cultural experiences such as visits to homes, walkabout tours, art exhibitions and performances, as well as interacting with local authorities such as the mayor, FRC, police and schools.
- NGOs and other support programs were engaged outside of the Education Department. Examples include Student Education Trusts (SETS), which help

families to save for education costs and plan their future finances, and the Higher Expectations Program (HEP), which identifies and supports academically talented Indigenous students throughout the Cape, Palm Island and Yarrabah communities, to complete secondary education and progress to tertiary studies. To help students qualify for HEP, the Academy schools identify talented students and assist them with the application process.

The Academy's rapid expansion from one school in 2010, to a proposed cluster of five schools in 2012, is a testament to its success. A large part of this success is due to the Academy's ability to engage with a range of stakeholders (from families to funders) to create a shared sense of purpose and collectively deliver better outcomes for students and communities.

3. Decentralised health services

Reforms in the early 1990s fundamentally reoriented the National Health Service (NHS) in the United Kingdom. Previously health had been a highly centralised system with all decisions on resourcing, budgeting and staffing made by the national government. As a result of the reforms, management responsibility transferred from government to hospitals. Over time, this promoted greater transparency around hospital performance and greater choice for patients.

Although General Managers were first appointed to hospitals in the early 1980s, they were largely executing orders from regional health authorities or the NHS executive. In 1990, the government accelerated reform by creating 'Trust' hospitals and community health services, and District Health Authorities (DHAs).

DHAs were allocated funding, based on their populations, along with the power to decide which providers to purchase medical care from, including local and other Trust Hospitals, or the private sector. GPs also had the opportunity to become 'Fund Holders', and purchase some forms of care for their patients. In this sense, Hospital Trusts competed for the business of DHAs and GP Fund Holders.

Initially, neither DHAs nor Trusts adopted substantially new governance models. Their CEOs still reported to the Regional Health Outpost of the NHS Executive. While some local advisory boards were set up, they had little influence over management or purchasing decisions.

In 2002, Foundation Trusts brought about a new era of community engagement and influence. These Trusts were phased in over four years, with institutions having to prove their capability along a range of financial, managerial and clinical dimensions, before gaining 'Trust' status. Those who could not achieve independence were provided with direct and specific assistance, often involving a new management team being installed to boost capability. Likewise, purchasers took an incremental approach to change, maintaining current levels of supply for the first year or two.

To achieve a more outward-facing orientation and a higher degree of local responsiveness, the NHS focussed on a number of elements:

1. Create a form of managed competition between hospitals:

   - Performance reporting was dramatically improved. Initially this was for internal purposes but over time, external reporting began to allow patients and their GPs to select better providers.
   - Volume-based contracting was introduced so that District Health Authorities could make purchases of annual, bulk services from Trusts, especially for elective interventions. These can be reviewed each year on the basis of quality and price.
   - Some flexibility was allowed around surpluses. For example, GPs that managed costs within their Fund Holder budgets could invest the surplus in services that reduced their own workload, for example after hours locum services.

2. Capabilities to manage autonomously were improved.

   - Management positions at Trust level became contested with the aim of increasing accountability for hospital performance, including patient satisfaction.
   - An intensive hiring campaign was undertaken to source managers, largely without a healthcare background, from the private sector.. This resulted in an injection of a cadre of professionals for whom managing to budget, and actively courting patients and purchasers, were normal ways of doing business.

3. Responsiveness was supported by increased reporting:

   - More information was given to patients through public reporting of efficiency and quality scores.
   - Three levels of reporting were set up within the hospital:

     i. population health – to evaluate DHAs and Fund Holders and to identify whether the systemic changes were improving health outcomes overall

     ii. hospital efficiency – costs per standardised treatment episode, and, where warranted, rates of specific high or low value interventions were measured

     iii. patient satisfaction – routine sampling was made of people admitted to hospital to gauge their satisfaction with the services and information provided to them.

While 20 years have passed since the first NHS Trust began, reform is still ongoing. In terms of engagement, the first wave of improvements came about without the direct involvement of community members and formal consultation mechanisms. This came after the management teams had embedded improvements against a set of standard KPIs.

4. Decentralised TAFE Industries

In Australia, a number of TAFE Institutes operate, to varying degrees, as autonomous institutions. While some have only recently begun the transition to decentralisation, others made the shift many years ago and lessons can be learned from their experience.

These Institutes typically have full legal accountability for what they do, and secure their revenues either directly from students and business clients, or from governments that 'purchase' social, educational and other outcome. The government purchases are in part or wholly, contestable with the private sector. The TAFE Institutes are wholly responsible for managing their staff.

To run a TAFE autonomously meant Institutes required new capabilities, new leadership styles, and new modes of engagement. Fundamental changes were needed.

Three main elements characterise the strategy used by decentralised TAFEs to promote better engagement:

1. Adjusting to a new relationship with the centre:

- Decentralisation called for a new relationship with the centre. Readiness for change was important on both sides. This was a two-way process and it took considerable time to build a different kind of working relationship. A key challenge was defining what should and should not be managed at arm's length, especially relating to risk or politically contentious issues.
- The TAFE Institute had to adapt to much higher levels of accountability and had to build and acquire new capabilities to support that.

2. New ways of engaging with community and industry:

- The biggest change in relationships was not with the direct customers (students) but with industry and community stakeholders. Decentralisation places a higher premium on the relationships that TAFE leaders have with their community and client industries. For CEOs, this meant up to 70% of their time focussed on engaging with stakeholders. For managers in the next layer down, the external focus more than doubled, with managers moving from spending around 10-15% of their time on these relationships in the centralised model, to devoting up to 30-40% of their time to external relationships a in decentralised setting.
- With industry, after decentralisation, these relationships, which were typically already strong, became more critical. Previously, 'TAFE' tended to deal with

peak industry bodies. After decentralising the focus shifted to Institutes dealing directly with businesses themselves. Specifically, Institutes sought to understand and align their offerings with client businesses' strategies and needs. This led to a much more flexible and responsive relationship between the two parties.

- A consequence of this increased interaction with industry was that Institutes, beyond their base load community and social obligations, were forced to consider who their stakeholders really were in terms of which industries they would or would not specialise in. Leaders spent far more time understanding which direction an industry was heading in to adapt their offering accordingly. This in turn led to greater customisation of courses and closer alignment with particular industries and the skills they needed. When deciding where to invest their budgets, entities had to gather and analyse much more customer intelligence to build robust business cases. In doing so, they needed to forge strong partnerships with industry clients. This moved well beyond what had previously been a more transactional relationship, to one based on shared values and trust. The organisational structure of entities also become more adaptive - changing more rapidly, and more often. Being attuned to local opportunities has made the identity of Institutes more flexible year to year. Course offerings and industry sectors are more open to change.
- Institutes themselves also became more integrated with their local community. All staff, not just the leadership group, became involved in local initiatives (such as local business awards and committees), and spent a lot more time talking to members of the community and getting their feedback. There is with a specific focus on keeping the community informed about planned changes to the physical environment, such as new buildings or facilities. Some Institutes also had a renewed focus on Corporate Social Responsibility, drawing on the goodwill and practical skills of staff and students to assist others in their local community.

3. New skills needed to run a decentralised entity are discussed as follows:

- One CEO described running a decentralised Institute in the phrase: 'everything's for real'. Leaders of decentralised Institutes had to become comfortable with higher levels of accountability across all the commercial aspects of the entity. This included the marketing strategy, cash flow, and balance sheet management. Institutes were also more accountable to their Board and this required a focus on developing robust business cases and strategies.
- New skills and capabilities were needed, in the entity and on the Board. These included relationship management, commercial orientation and acumen, strategy and strategic planning, risk management, and governance and legal. Institutes now train and recruit for these skills, incorporating them into the selection criteria for relevant roles. Ultimately this has resulted in much more

diverse senior management teams, combining staff who have moved through the ranks of TAFE with others from external backgrounds. Employing new people from outside the system has helped to break the 'dependency mould' that existed between Institutes and government agencies under the centralised model. Although TAFEs still operate within public sector constraints they are able to attract a stronger field of applicants with the promise of greater autonomy.

Making the transition from a centralised entity to being fully decentralised requires a huge commitment by those involved in the transition. Institutes who have made the transition successfully displayed a willingness to embrace a more commercial and responsive mindset and better understand the needs of their customers, community and the industry sectors they serve.

Transition to decentralised service delivery

As the case studies have shown decentralisation of service delivery has a profound impact on service-based organisations and the way they operate. Successful decentralisation calls for front-line organisations to engage with their stakeholders differently, and typically to a much greater extent than has previously occurred.

The transition towards decentralisation brings about the changes examined below. These changes are also obvious in the case studies.

Dealing with the centre:

- **Adjusting to a system that is less centralised and hierarchical**: Decentralisation does not have to be directly linked to a more market-based system, but the two are often related. At the very least, a decentralised system requires a step away from a strict hierarchical operating structure, perhaps to a network of providers, or potentially to a market of competing providers. The further the system shifts from a strict hierarchy the more the norms of managing that system fundamentally change. New skill-sets and capabilities are required.
- **Capability to manage risk**: Moving away from a highly centralised system also means that responsibility for managing risk, including financial, operational, legal and community risk, moves to the service organisation or front line unit. The ability to adjust to higher levels of accountability and scrutiny is a key to success for local leadership. Central administrators and political leaders must reinforce that local leadership assume that accountability and scrutiny is key.

Developing new capabilities:

- **Attracting and rewarding new types of leadership**: In a decentralised setting, leaders have to refocus effort and capabilities within their organisation to manage new accountabilities and foster a greater level of engagement. The balance of effort shifts from managing the organisation, in an administrative sense, to being more focused on engaging with clients and stakeholders and relationship management. New leadership and management capabilities should be supported by recruiting strategies and changes to the incentive and recognition systems. There is often a move to link performance and competitive-based results to reporting and compensation.
- **Developing new skill sets**: Executives and staff in decentralised organisations require leadership and management skills, in addition to, and sometimes instead of, specialist or professional skills. They require far higher levels of financial and people-management skills and the ability to match, over time, the asset base of the service to the needs of its customers. Far higher degrees of commercial acumen are also required in services that have revenue streams independent of central government. These new skill sets also help to create a more outwardly-focussed culture within the organisation.
- **Systems and technologies to support the change**: Organisations need to identify the most appropriate tools and technologies to engage with stakeholders in the manner they expect. New forms of technology can offer platforms for collaboration and a rich source of data to help organisations understand their customers better. To exacerbate the management challenge, these can sometimes require whole-of-system scale notwithstanding the general shift to decentralisation. A number of case studies show what happens with decentralisation. One is in the private financial services sector and the others are in education and health.

Dealing with direct customers/clients:

- **New and diverse types of communications**: Organisations need to move beyond traditional broadcast style communications to modes that allow them to consult more widely. This includes involving customers in the co-production of services where appropriate. At the same time, organisations need to meet customers' increasingly higher expectations around choosing how and when to communicate and engage with them.
- **Diversified or tailored offerings for customers, in response to their needs and preferences**: This involves both refining a service to suit local conditions and priorities as well as designing different offerings for different customer groups or segments across regions. Doing this well relies on a deep understanding of the customer and citizen.

- **Deeper customer segmentation**: Organisations need to be able to analyse their customer or client base in a meaningful way so they can understand how different groups are likely to respond to different offerings, and what needs are being served or targeted and why.

Dealing with other stakeholders:

- **A broader approach where stakeholders are included in discussions and decision-making and a variety of channels are used to reach them**: Organisations will have to find ways to reach a much wider group of stakeholders than just their direct customers. This includes staff and experts, funders and owners, and leaders from the community and from industry. The format of these interactions is likely to be diverse. They range from formal boards and committees, to surveys, and to building and maintaining active personal networks. Strengthening relationships with stakeholders is critical to encouraging shared ownership over outcomes.
- **Ability to partner effectively with Boards:** Well-constituted accountable boards with a mixture of government and non-government members bring a whole new level of accountability and rigour to local management. New skill-sets in financial and strategic planning, business cases and risk management will be required as well as the interpersonal skills to engage the diversity of a board. Done well, the combination of both management and board drives outcomes and results significantly.
- **Working effectively with other providers**: In a decentralised setting, the individual service needs to coordinate with other service providers in their network to make the most of available and shared resources, and to respond to customer needs. These are likely to cut across service-based organisational silos such as schools, health care, after hours care and counselling services. To do this well, organisations need people with the skills to consult, negotiate and build teams, as well as those who understand and analyse business needs across the network.

The transition to a decentralised setting is an iterative process. Organisations that manage the transition well are those that are agile, resilient to change, and prepared to shoulder greater levels of accountability and influence. These same qualities allow them to engage effectively with stakeholders on key decisions.

Appendix 7: Areas for possible cost improvements in the electricity industry

Common capital expenditure improvement areas

Industry diagnostic and benchmarking exercises in a variety of utility organisations have indicated that efficiency improvements in capex in the region of 5-10% are possible. The following are examples of the common areas where savings can be realised:

Improved prioritisation of asset creation: Current prioritisation practices places a weighting on financial performance but sometimes environmental considerations may be given undue emphasis. Benchmarking has suggested comparable commercial companies place more importance on financial metrics (e.g. NPV, IRR etc.). Financial metrics, underpinned by up to date information and reviewed on an on-going basis, provide a systematic ranking.

Some very large programs are prioritised as one unit, meaning that some non-critical projects „inherit" a high priority from the over-arching program. Best practice performs prioritisation at a more detailed level to enable the company to defer any non-critical components and free up capital to use elsewhere.

Whole life costing in asset creation: Designing for outcomes rather than producing design standards often results in diversity of assets across networks. This causes difficulty in standardising operations, maintenance and stores.

Adequate consideration needs to be given to real costs of operations and maintenance, rather than using assumed costs. This requires close collaboration with Finance. Minimising asset diversity across the network and considering actual operational costs of assets ensures the lowest life cycle costs.

Abandoning over-prescriptive design: Design functions can be over-prescriptive in their designs (by including commercial, legal and some construction-specific constraints). This places a significant administrative burden on commercial functions in lengthy contracts and dealing with contractor clarifications. There tends to be a "Cut and Paste" culture on specification documents leading to contract documents that are incorrect for the project specified and unnecessary repetition of specific requirements.

When outsourcing design it is often the case that designers still spend a considerable time writing detailed specs and retaining a review option and approval of externally designed plans. This can add time and cost for no benefit.

Avoiding sub-optimal work package structure: Projects often involve many different work packages (20-30) and can require several tender cycles per project. This results in time delays through handovers of work packages and small work pack values restrict the number and type of contractor in the market. Bundling work can potentially save 10-15% by reducing the number of tender processes to develop and review.

Reducing ineffective resourcing of delivery: There is often scope to merge some roles, such as Contract Managers and Project Managers, during the delivery phase. Furthermore teams are often sized to manage peaks in workloads This could be improved by reducing permanent team size and meeting demand gaps through effective use of external or contracted staff. Or, where delivery teams are split by geographic region or asset type it may be more efficient to manage the department as a pool of resources.

Increasing control of materials: There are frequent cases where Bill of Material (BOMs) for projects are incorrect (and cases have been cited where up to 50% of BOM on jobs are incorrect). This results in inefficiencies in time and productivity delays due to incorrect materials being ordered, delivered and issued. In turn this leads to additional ordering and cost inefficiencies from ordering incorrect asset spares and equipment and storing them in depots.

Common operating expenditure improvement areas

Industry diagnostic and benchmarking exercises in a variety of utility organisations have indicated that efficiency improvements in the operating expenditure of corporate functions in the region of 10-20% are possible. The following are examples of the common areas where savings can be realised:

Duplicated overhead activities after retail split: It has been observed that some businesses have yet to achieve the efficiencies expected from the sale and separation of retail functions. Full complements of staff in Finance, HR, ICT and procurement have been retained in the distributors, and new recruitment has occurred in the separated new retailers.

Streamlining transactional processes: High volume transaction processes are inefficient in distribution businesses when assessed against comparators organisations (Examples include accounts payable, accounts receivable and for example in payroll). Low utilisation of Purchasing Cards (P-Cards) within the business for low value transactions (e.g. less than $1,000) has been observed.

Renegotiating outsource contracts: Little evidence has been seen of distribution businesses working together to increase their buying power in outsourced contracts (e.g. fleet and facilities management) and other large scale procurements.

Automating manual procurement

Reliance on highly manual tendering process using paper systems is commonplace, with documentation printed at each stage in the process for sign off and often delivered by hand/internal mail. A high amount of sign off required at each stage in the process, regardless of procurement value, and often several disparate systems are used in the end-to end process.

Holding suppliers and contractors to account

There are cases of poor performance by contractors and suppliers with no resulting consequence (For example many contracts have KPIs but no reference for penalties of non-compliance). Contracts with Service Level Agreements are often difficult to enforce and specification documents (for Request For Tender) are often not detailed or specific enough for market. Suppliers frequently have several contracts across different services (and different category managers and multiple contact points within businesses).

Network functions: common opex improvement areas

Industry diagnostic and benchmarking exercises in a variety of utility organisations have indicated that efficiency improvements in the operating expenditure of network functions in the region of 5-10% are possible. The following are examples of the common areas where increasing field staff productivity may be realised by:

Standardising crew sizes and structures

Very little standardisation in approach to internal crew sizes and structures across depots and regions has been observed. There are varied levels of multi-skilling or specialisation within crews and instances where crew skill sets are not aligned with current depot work profile. This non-standard delivery model leads to inefficiencies and cost variations across depots and skilled resources are potentially undertaking lower skilled work – causing a high labour cost.

Eliminating inefficient work processes

There are cases of a wide range of non-standard work practices across depots and regions leading to variability in efficiency and costs of depots, and a lack of best-practice sharing.

A number of inefficient processes are present that reduce productivity of labour (e.g. paper timesheets, and onerous audit requirements).

Optimising the scheduling approach

Examples of sub-optimal scheduling include: non-standard processes, limited use of GPS or data-to-vehicle for crews leading to increased travel time, insufficient standard task times defined and limited system enablement for automated scheduling. A lack of travel information prevents accurately separating travel time to jobs from overall job completion time. This sub-optimal scheduling can then lead to high labour costs due to excessive overtime.

Appendix 8: Regulatory framework and the main features of the Workers' Compensation system

The regulatory framework

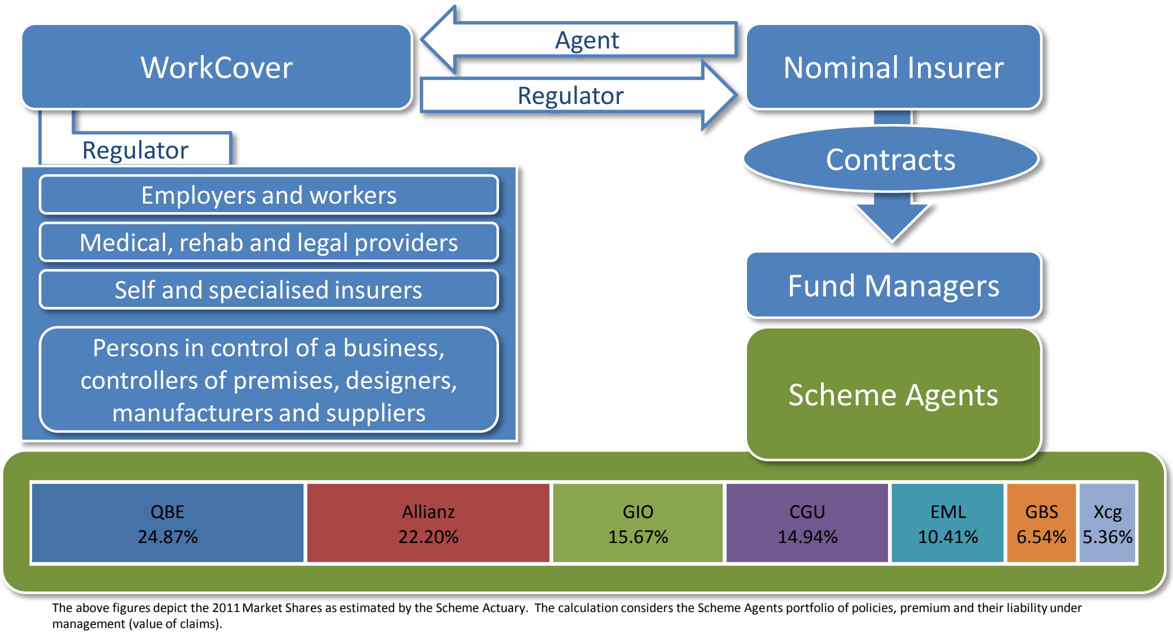
The workplace safety of the 3.5 million workforce in the private and public sector is regulated through the *Occupational Health and Safety Act 2000* (OHS Act), the *Workers Compensation Act 1987* and the *Workplace Injury Management and Workers Compensation Act 1998*. The legislation:

- sets workplace safety standards to safeguard the health, safety and welfare of workers
- provides for the rehabilitation and return of injured workers back to employment and the community
- provides for consultation and co-operation between employers and employees.

WorkCover NSW is responsible for monitoring, regulating and delivering the system. It provides advice and assistance to help businesses meet their health and safety responsibilities. When necessary, WorkCover enforces work health and safety legislation through inspections, investigation of incidents and complaints, mediation of disputes and penalties and prosecutions. WorkCover:

- assists workplaces to provide a safe and healthy environment to prevent work related injury and disease
- promotes prompt, efficient and effective management of work injuries
- ensures efficient operation of workers" compensation insurance arrangements
- ensures appropriate monitoring of the WorkCover Scheme and workers" compensation system performance
- manage investments of around $12 billion that underwrite claims liabilities.

WorkCover also licenses self and specialised insurers to provide Workers" Compensation insurance, assists Scheme Agents to meet statutory requirements and manages the scheme on behalf of the Nominal Insurer. The Nominal Insurer is the sole insurer in the WorkCover Scheme and appoints agents to provide claims, policy and investment services. WorkCover acts for the Nominal Insurer. The legislation specifically provides that the Nominal Insurer does not represent the state. The Nominal Insurer is the largest workers" compensation insurer in Australia.



The Workers' Compensation system

The main features of the workers" compensation system in NSW are:

- **it is compulsory**: all employers must cover their employees
- **it is no-fault**: entitlement is not dependent on the injury being proven the fault of another
- **coverage**: injuries, includes disease, arising out of or in the course of employment, including while travelling to and from work or during an ordinary recess are covered
- **it has long-tail hybrid benefits**: long term access is available to periodic compensation, medical and rehabilitation services – with a focus on providing support during recovery and return to work. Access to Work Injury Damages are permitted in limited circumstances.

The NSW system has four mechanisms by which an employer may obtain insurance cover:

- **WorkCover Scheme**: public sector insurer responsible for underwriting risk, funds management and premium setting. Private sector agents are under contract to collect premium, conduct case management and debt management. Employer premiums are determined by a combination of industry risk and employers" claims experience. Premium rates are also affected by the performance of the scheme"s investment fund and the level of liabilities

- **Self-insurance**: sixty large employers are licensed by WorkCover to underwrite their own risk, and manage their own claims. Some self-insurers do so under a Comcare (Commonwealth) national licence issued by the Safety, Rehabilitation and Compensation Commission. WorkCover does not regulate these national self-insurers. The Comcare national self-insurance system is currently closed to new applicants. The Federal Government is expected to revisit this policy position in the medium term, following the introduction of harmonised national workplace safety laws
- **Specialised insurance**: seven specialised insurers are licensed by WorkCover to underwrite workers" compensation insurance risk for specific industry classes. NSW is the only Australian state that allows specialised insurance. The class is currently closed to new applicants. Current specialised insurers include Catholic Church Insurances Limited and Racing NSW
- **Treasury Managed Fund**: SICorp, through the Treasury Managed Fund, manages workers" compensation, administration and the financial liability for most public sector employers. This includes underwriting risk, funds management and premium setting. This is discussed in more detail in Chapter 14.

Appendix 9: Financial performance of the WorkCover Scheme

The table below describes in more detail the scheme‟s financial performance over several years and the relative impact of several factors.

Table 1: Change in the scheme‟s financial position – by category

Valuation date	Six monthly change in WorkCover Scheme funding position (sources of surplus/deficit)						
	Funding ratio	Underwriting operations profit/loss	Change in Claims Handling Expense	Actual v expected investment return (a)	Discount rate impact	Risk margin	Total change
	%	$m	$m	$m	$m	$m	$m
Jun-02	67%	108	0	-351	0		-243
Dec-02	65%	194	0	-225	-399		-430
Jun-03	66%	258	0	65	-75		248
Dec-03	68%	-397	0	188	262		53
Jun-04	73%	221	0	256	99		576
Dec-04	83%	514	0	417	-233		698
Jun-05	80%	404	-513	178	-323	-89	-343
Dec-05	90%	487	0	467	-118	0	836
Jun-06	101%	1,082	0	41	288	-164	1,247
Dec-06	104%	459	0	541	62	-731	331
Jun-07	107%	320	-118	88	189	-83	396
Dec-07	109%	421	41	-58	-9	0	395
Jun-08	104%	58	62	-776	92	0	-565
Dec-08	89%	-151	28	-1,370	-904	0	-2,397
Jun-09	89%	-245	52	-88	467	103	289
Dec-09	92%	-359	6	651	-32	0	266
Jun-10	89%	28	31	-79	-346	0	-366
Dec-10	91%	-208	33	216	174	0	215
Jun-11	85%	-888	94	85	-286	0	-995

Source: PriceWaterhouseCoopers (WorkCover Scheme independent actuary)

(a) Expected investment return based on "risk free" rate from prior valuation

Some of these are outside the control of the scheme and relate to external factors, including:

- **the underwriting operation**: which represents performance on core activities of levying premiums and payment of claims. This is considered the best indicator of the scheme‟s underlying financial health, as it excludes the impact of external factors such as discount rates

- **claims handling expenses***:* include allowance for the cost of managing claims and WorkCover claims related operations. This accounts for 7.5% of the gross outstanding claims liability at 30 June 2011
- **investment returns**: the valuation result is impacted by the rate of investment return, compared to the forecast rate of return, i.e. if actual performance is better than the expected rate, the financial position improves, if it is worse than expected, the position deteriorates. The impact of the GFC was notable in 2008
- **discount rates**: accounting and actuarial standards require the outstanding claims liability expected to be paid in future years to be discounted to the valuation date using the risk free return rate on Commonwealth Government Bonds. Changes in the bond rate and future inflation assumptions in the six month period of the valuation impact the outstanding claims liability. With low yields, the discount rate impact is severe
- **risk margins**: the current risk margin has applied since 2007 and is based on a probability of adequacy of 75%. This equates to a risk margin of 12% to the net liability for outstanding claims.

Appendix 10: Managing and preventing injuries

WorkCover conducts a range of compliance enforcement and education activities to assist industry manage risk and prevent injury, including:

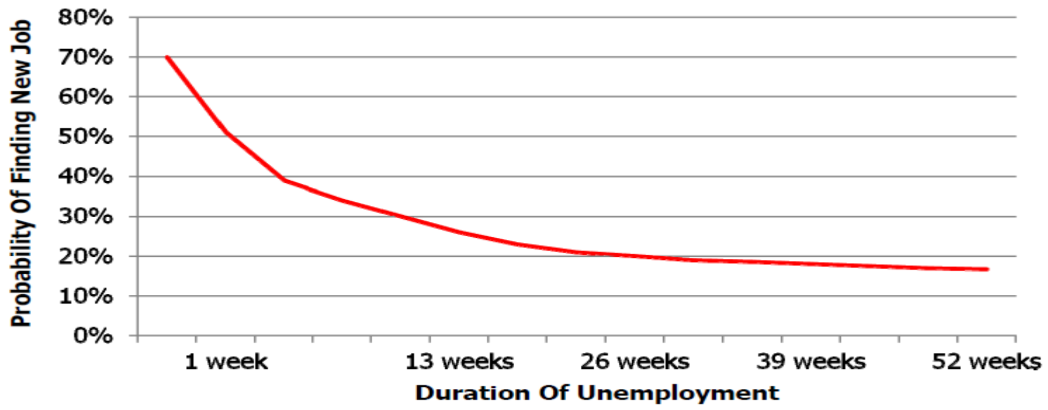
- workshops and advice for industry
- inspections and issuing of Improvement Notices, Penalty Notices and Prohibition Notices
- prosecutions
- an information call centre
- an online self-assessment tool.

There is scope to target further improvements, primarily through targeted prevention strategies. In this respect, the Commission notes that WorkCover has begun to target the ten highest risk industries, the top five illnesses and the top five injuries. The program involves analysing the sources of risk in each of the target industries and their precise causes for the purpose of developing tailored Industry Action Plans that achieve improved safety and return to work outcomes. These Action Plans will be delivered in partnership with industry.

Improving injury and case management

Prolonged absence from the workforce has an adverse effect on the physical and mental health of injured workers and their families. Research shows employment prospects are also severely impacted the longer a work absence continues.

Chart 1: Probability of re-employment by duration of unemployment



Source: American Economic Review Proceedings, vol. 98, no. 2

For most individuals, activity-based rehabilitation and an early return to suitable work after injury improves general health and wellbeing and reduces psychological distress. This leads to better recovery and can correspond to a reduction in both the claims and claim duration, lowering overall scheme costs. As depicted earlier in Chart 1.6, return to work outcomes have deteriorated since 2008-09, with claimants remaining on weekly benefits for longer. The September 2011 assessment of return to work performance shows the average duration on weekly payments within 26 weeks of injury was around 37 days. This is two days higher than pre-September 2008 levels.

It has been estimated that every one day improvement in the scheme"s average return to work performance would result in annual compensation payment savings of up to $16.5 million, and a claims liability reduction of up to $56 million per year.

It is vital that action is taken to restore the scheme"s return to work performance. A considerable body of evidence indicates that effective case management of injured workers has a major influence on the recovery outcomes for the injured workers and their early return to suitable work.

As noted earlier, WorkCover will review the formula for remunerating Scheme Agents in order to drive improved scheme performance. Existing remuneration arrangements are not facilitating the necessary investment required to address deteriorating performance.

As well as enhancements to agent remuneration, the Commission is aware of other potential reforms that could be implemented to drive improvements in injury management and restore the return to work performance of the scheme. The following options have been recommended for further investigation:

- the introduction of a specialist return to work inspectorate (as in Victoria and South Australia) and/or a regional network of return to work/rehabilitation professionals taking direction from WorkCover – focused on improving return to work outcomes
- enhanced incentives, or penalties, to encourage employers to offer suitable duties or not terminate the employment of workers who have made a claim
- reforms to work capacity certification including potential broadening of the class of medical providers able to issue certificates and education and awareness initiatives to improve work capacity certification quality
- the introduction of specialist providers (market segmentation) to allow for the centralisation of the following scheme functions with one or more specialist providers:
    - tail claim management
    - severe injury claim management
    - premium collection and debt management
    - psychological injury claim management

- introduction of a work capacity test similar to the one used in Victoria and South Australia for partially incapacitated workers at 130 weeks duration from injury
- changing the step-down in weekly benefit levels from 26 weeks duration from injury to 13 weeks.

Appendix 11: Addressing the increase in Work Injury Damages claims

The following table summarises a number of concerns with the current framework around Work Injury Damages and puts forward potential lines of reform and action that should be prioritised for further investigation.

Table 1: Concerns with the deteriorating Workplace Injury Damages experience and potential lines of reform and action

Issue	Description	Potential lines of reform and action
Ineffective statute of limitations	More than 80% of Work Injury Damages claims lodged are technically out of time (i.e. lodged after the three year statute of limitations). This occurs because the legislation gives discretion to the District Court to allow an out of time application. The Court applies this discretion generously and it is only in the most exceptional circumstances that leave would not be given.	Engagement with the Courts/Attorney General"s Department to dispel the false view that not allowing a damages claim to proceed would leave a claimant with no compensation. Legislate to restrict the circumstances in which the statute of limitations may be waived.
Ineffective testing of negligence by the Court	The legislation does not provide a strong test of negligence. The *Civil Liability Act* places a much stronger onus of proof on the applicant to demonstrate negligence than the existing workers compensation arrangements. This is compounded by the absolute obligation on an employer to prevent work injury (under pre 2011 occupational health and safety laws), which has been interpreted to mean that any work injury is evidence of negligence.	Adoption of the Civil Liability Act test of negligence. Improve early identification of potential Work Injury Damages claims . Conduct detailed contemporaneous factual investigations in the context of negligence provide exhaustive rehabilitation focused on achieving at the very least a deemed capacity to earn (to reduce the degree of economic loss). *Note: this has flow on benefits for return to work.*
Increasingly porous impairment threshold	NSW legislation does not in practice allow the finalisation of a person"s level of impairment. Consequently, claimants are able to have their degree of permanent impairment reassessed multiple times over a period of years and to have secondary conditions taken into account. Several applicant solicitors systematically revisit old claims, seeking to revisit (and top up) impairment levels with a view to reaching the impairment threshold.	Urgently finalise current reviews of the *Independent Medical Examination Guidelines* and the NSW *Guides to the evaluation of permanent impairment* (particularly refinements to scarring, digestive impairment). Replace the current approved medical assessor model with a medical panel, with enhanced performance monitoring and service standards - to ensure accurate and consistent assessments. Legislate to finalise the level of whole person impairment upon acceptance of a permanent impairment lump sum payment (i.e. no opportunity to repeatedly revisit the level of impairment) Introduce a specialist claims Agent (or other third party provider) to manage all scheme Work Injury Damages claims.
Ineffective testing of economic loss	Settlements are intended to be based on the degree of past and future economic loss. If this was occurring in practice, a larger standard deviation in settlement sizes would be expected. This suggests that the test of economic loss is not being effectively applied, encouraging claimants to pursue Work Injury Damages regardless of actual loss.	Improve early identification of potential Work Injury Damages claims and conduct exhaustive rehabilitation focused on achieving a capacity to earn.
Incentives	The remuneration available to legal providers for	Consider introduction of scheme legal panel or

Issue	Description	Potential lines of reform and action
for legal providers and claimants	WID actions is far more lucrative than other workers compensation benefit services. Applicant solicitors are able to make individual costs agreements (to contract out of the scheme schedule of fees). It is common practice for solicitors doing so to set fees based on a percentage of any settlement. As there is a very high success rate, this can result in disproportionately high returns to solicitors.	other arrangements for ensuring legal providers participating in Work Injury Damages matters meet appropriate standards. Adjust fee schedules so that legal provider remuneration is proportionate with representation in statutory benefit matters. Prevent applicant solicitors from “contracting out” of the fee schedules. Discourage Work Injury Damages claims by educating workers and the community about the adverse health and financial outcomes associated with Work Injury Damages and benefits of the statutory regime.

The proposed lines reforms and actions would serve to limit common law claims to serious injuries. This is consistent with the intent of the 2001 reforms.

Appendix 12: Potential reforms to the benefits regime

The following table summarises a number of concerns with the current workers" compensation benefits regime and puts forward potential lines of reform and action that should be prioritised for further investigation.

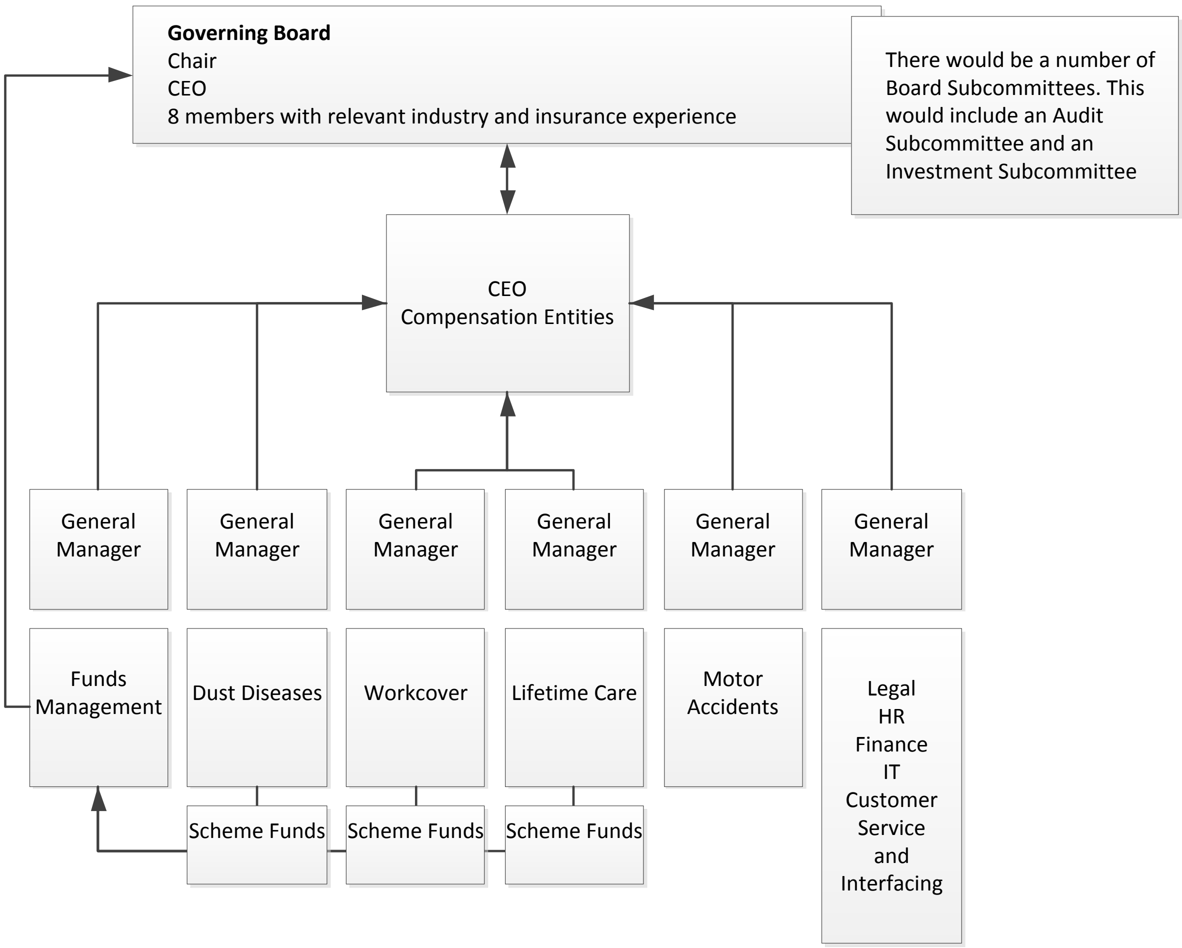
Table 1: Concerns with the NSW workers" compensation benefits regime and potential lines of reform and action.

Issue	Description	Potential lines of reform and action
Defining pre-injury earnings	The current method is complicated, difficult to administer and does not adequately address changing employment arrangements, e.g. part-time, multiple jobs, casual work	Replace the current weekly wage rate (CWWR) and average weekly earnings (AWE) definitions with a single measure based primarily on the injured worker"s income during the 12 months prior to injury, with consistent treatment of overtime and allowances.
Weekly benefit step down	The existing step-down at 26 weeks is longer than most Australian jurisdictions and is not aligned with typical injury recovery and return to work duration and consequently does not provide an optimal incentive to return to work.	Replace the current step-down at 26 weeks with an earlier step down at 13 weeks.
Payment levels – before step down	The current method is complicated, difficult to administer and can disadvantage certain workers	Simplify the calculation of benefit entitlement for Total Incapacity prior to the step- down. The ratio prior to the step-down should be set higher than the ratio post the step-down (probably somewhere in the range 85% to 100% of pre-injury income).
Payment levels after step down	Post the current step-down of 26 weeks, almost all benefit recipients receive the statutory maximum, which is a relatively low amount. This low maximum disadvantages medium and higher earning workers.	Increase the payment level for Total Incapacity to 75% of the workers own pre-injury earnings, capped at a multiple of state AWE, but with a floor to protect lower income earners.
Return to work incentives	A key focus of the scheme is not just to compensate injured workers but to assist in their rehabilitation and return to work.	Improve vocational training, return to work assistance and incentives to hire partially incapacitated workers as part of a balanced benefit reform package.
Partial incapacity	Injured workers who have achieved a partial return to work are paid top-up weekly benefits. For a range of workers this can place them in the situation where their post injury earnings plus top-up payment equals pre-injury earnings. This may create a disincentive to achieve any further improvement in returning to work. In addition, it has an ineffectual continuing incapacity entitlement test (Section 52a of the 1987 Act).	Limit the amount of Partial Incapacity benefit so that together with post-injury earnings there remains a gap compared to pre-injury earnings, similar to the ratios discussed for Total Incapacity. Strengthen the continuing incapacity entitlement test (perhaps similar to Victoria) for partial incapacity and/or limit the maximum period of compensation to a set period of time.
Legal representation	The current benefit design requires legal representation on claims, where arguably a more administrative approach would produce cost savings without any disadvantage to injured workers.	Action to reduce legal involvement in dispute management and benefit decisions and replacing legal process with more administrative processes (e.g. for S66 and S67 statutory lump sums).

Appendix 13: Governance model for the potential merger of the Compensation entities

The following diagram proposes a consolidated governance model that could be applied to the currently separate compensation entities.

Diagram 1: Proposed high-level governance model for the merging of the compensation entities.



The key features of this proposed model are:

- a single, unified Governing Board would be established and given a clear mandate. There currently five Boards across the CASD, none of which have a clear governing mandate. A number of the Board members would have relevant insurance industry experience
- funds management across the schemes would be consolidated. This offers improved leverage in investment markets and higher degrees of expertise in asset/risk management for Dust Diseases and the Lifetime Care and Support
- the funds management would oversighted by the Investment Board which is a sub board of the Governing Board. Representation includes the Chair of the

Governing Board, the CEO and two to three other members with relevant funds management experience

- provides a single point of accountability to Parliament and one all-encompassing legislative framework
- builds on other amalgamations taking place in the Compensation Authorities such as back office and finance functions
- offers efficiency in administration and management costs, e.g. lower cost of fund management, by facilitating synergies and removing duplicated functions
- allows for a more consistent customer approach and experience across the schemes.

Appendix 14: Definition of frontline and back office functions

"Doing the business"

(1) Frontline (core) services

Core activities of the department or agency

Front line service delivery

(1a)
Client facing

Examples: nurses, police officers, teachers

(1b)
Non client facing

Examples: policy officers, regulatory staff

(2) Business services

Services that support the frontline, typically heavily ICT or finance enabled, that are unique to the business.

Examples – rostering, operational training, specific information systems.

Not included in corporate overheads

" Running the business"

(3) Corporate services delivered at "head office" or cluster level

Critical functions for managing risk and driving the business, delivered at the head office of the agency

Strategy
- Development of overall strategic objectives
- High-level, long term planning

Policy & control
- Policy and standards setting
- Development of controls
- Measurement of compliance

(4) Shared Services

Services that are delivered in a shared way, to more than one internal client

Transactional
- Relatively simple and repeatable
- High volumes
- Leverage economies of scale and skill

Routine advisory & value add
- Advisory services
- Applying professional judgement
- Interpretation of policy
- Issue management

(5) Corporate and transactional services delivered at agency level

Corporate and transactional services that are generic in type, but are delivered at a local level.

Examples – requisitioning, goods receipting, Ministerial correspondence.

Included in corporate overheads

Appendix 15: End state and current state of Corporate and Shared Services: by cluster

Cluster	End state, as per Blueprint	Current state
Health cluster	• *Corporate services* – to be delivered centrally through head office in Ministry of Health. • *Shared services* – in-house provider Health Shared Services.	• Central corporate services well-established. • HSS well-established, but will need a substantial investment in the next few years to upgrade its technology.
Education and Communities cluster	• *Corporate services* – to be delivered centrally through head office in Department of Education and Communities. • *Shared services*: – a unit called Learning Management and Business Reform (LMBR) to support . the Education side. – Office of Communities to be serviced by NewCo.	• Central corporate services well-established. • LMBR established and IT investment continuing.. • Office of Communities has many disparate systems (see case study box earlier in the chapter). It is incrementally moving to NewCo.
Transport cluster	• *Corporate services* – to be delivered centrally through TransportforNSW. • *Shared services* – Transport Shared Services (TSS) to support the whole cluster (including the principal department TransportforNSW, RailCorp, Roads and Maritime, the State Transit Authority and other related transport entities).	• Central corporate services function being established in TransportforNSW. • Reform project subject to Cabinet approval for funding. • TSS created for about two years.
Attorney General and Justice cluster	• *Corporate services* – to be delivered centrally through the Department of Attorney General and Justice (DAGJ). • *Shared services* - a shared services unit to support the whole cluster.	• Corporate services in the clusters and agencies. • Shared services unit is being formed which will initially service: – DAGJ (including Corrective Services, Juvenile Justice); – Ministry for Police and Emergency Services – Fire and Rescue NSW – Rural Fire Service – State Emergency Services – NSW Crime Commission. • Initially, the NSW Police Force will keep servicing itself and will later merge.

Cluster	End state, as per Blueprint	Current state
Premier and Cabinet cluster	• *Corporate services* – to be delivered through: – Department of Premier and Cabinet (DPC); – Office of Environment and Heritage (OEH) – Department of Planning and Infrastructure (DP&I) – the various accountability institutions (eg ICAC, Ombudsman, etc). • *Shared services* – to be provided by NewCo for all except accountability institutions.	• Corporate services being delivered. • ServiceFirst currently supports DPC (except OEH); and DP&I. • Remainder of shared services (eg OEH) will transition to NewCo before 2015.
Finance and Services cluster	• *Corporate services* – to be delivered centrally through the Department of Finance and Services. • *Shared services* – to be provided by NewCo.	• Corporate services mostly amalgamated. • Shared services mostly delivered through ServiceFirst; remainder will transition before 2015.
Treasury cluster	• *Corporate services* – to be delivered centrally. • *Shared services* – to be provided by NewCo.	• Corporate services delivered centrally. • Supported by ServiceFirst.
Trade & Investment, Regional Infrastructure & Services cluster	• *Corporate services* – to be delivered centrally through the Department of Trade & Investment, Regional Infrastructure & Services. • *Shared services* – to be provided by NewCo.	• Corporate services being amalgamated. • Shared services mostly delivered through the Orange office; some further amalgamation under way. • Shared services are planned to transition to NewCo before 2015.
Family and Community Services cluster	• *Corporate services* – to be delivered centrally through the Department of Family and Community Services. • *Shared services* – to be provided by NewCo.	• Reforms under way to centralise corporate services. • Shared services delivered by BusinessLink since 2002, relatively well-established. Juvenile Justice and Aboriginal Affairs to transition elsewhere.

Appendix 16: Case study: United Kingdom (UK) joint venture for health shared services

The UK Department of Health employs some 4,000 staff and is the central policy and funding body. The National Health Service (NHS) comprises about 450 autonomous trusts and other bodies (such as the Warwickshire Primary Care Trust or the Sheffield Teaching Hospitals Trust). Together, the NHS trusts employ 1.3 million people and have a total budget of £100 billion.

In 2005, the Government entered into a 50:50 Joint Venture with a private sector partner, Steria. The Joint Venture, called NHS SBS, is a limited private sector company with joint public:private governance. Its Board is independently chaired and has equal numbers of members from the Government (from the Department and a representative from a NHS trust) and the private sector partner.

NHS trusts can choose to use NHS SBS for a range of services, or none. They are not mandated to use it. By 2010, 40% of NHS trusts were its clients. It provides:

- finance and accounting
- payroll and HR
- Family Health Services
- commercial procurement solutions.

NHS SBS offshored 37.5% of its work to India, which it has now raised to 50%. Strict limitations were put on the offshoring arrangements, For example no clinical data being accessible from India. The savings from the offshoring arrangement were hypothecated to fund increased doctor and nurse numbers.

NHS SBS is the largest multiple-client shared services provider in the UK. It has 1,200 employees, including 550 in India. Its clients include:

- 130 finance and accounting clients, with over £43 billion payments each year
- 47 payroll clients, paying 150,000 employees and processing 2.5 million payroll transactions annually.

The Joint Venture is now profitable. In 2010, it returned a dividend of £1 million to its NHS trust clients. It expects to deliver around £250 million savings over 10 years. NHS SBS guarantees to return 20% savings to each trust client and a proportion of any savings above that. The return of savings provides a powerful incentive to actively drive internal reform.

The transition to a Joint Venture arrangement:

- saved the Government the £20 million cost of closing the previous Shared Services Centres

- brought private sector skills in transition, transformation, business development and performance measurement
- brought commercial arrangements with customers, such as enforceable contracts
- provided flexibility and ability to change service with policy changes and restructures
- clarity of data, management information and improved reporting.

Appendix 17: Case study: Australian Government: Department of Human Services (DHS)

Human Services is responsible for the delivery of services that provide the national social safety net. The portfolio comprises the Department of Human Services (DHS), which performs a policy and coordination role, and five agencies delivering national support services across Australia: Centrelink, Medicare, Child Support Program, Hearing Australia and the Commonwealth Rehabilitation Service. The portfolio delivers over 200 different services, makes $100 billion in payments each year, sends out about 100 million letters each year and manages 70,000 online transactions each day.

In 2009, the Federal Government announced strategic changes to the way services would be delivered in the Human Services portfolio. These included more community involvement in service design, improved customer access and greater support through online services. To support these reforms, a single service delivery agency was created from the merger of Centrelink and Medicare into DHS. The new DHS has around 37,500 employees.

Before the single agency was created, the three agencies moved to a uniform services function. This occurred over a two year period, as they:

- integrated people, legal, communication, finance, records management and parliamentary and ministerial services
- created a single staff internet, and a single phone and email directory
- consolidated the three HR and finance systems into a single platform.

Key features of the transition to a single integrated shared services function were:

- a significant investment – both financial and in staff support – to minimise disruption to staff and customers
- upgrading and changing existing systems, before transition to a single IT platform
- the savings arising from the reform program were invested in ICT systems over a number of years, as agreed with the Department of Finance and Deregulation.

The Government provided $297 million over four years to facilitate the transition. About $90 million was sourced from within DHS"s existing resources. This funding was invested in a range of change management projects, including staff training and redesigning positions within the single service delivery structure

The integration of three shared service providers into a single provider will generate savings of $69 million over four years. These savings will accrue both internally, from more efficient delivery and externally, from the economies of scale achieved through a single corporate entity in the acquisition of goods and services.

Appendix 18: NSW Correctional Centres

Correctional Centre	Primary Security Classification
Goulburn Correctional Centre	Maximum and Minimum
Lithgow Correctional Centre	Maximum
Special Purpose Centre (Long Bay Correctional Complex)	Maximum
Metropolitan Remand & Reception Centre (MRRC)	Maximum
Metropolitan Special Programs Centre (MSPC) (Long Bay)	Maximum and Minimum
Parklea Correctional Centre	Maximum and Minimum
Silverwater Women's Correctional Centre (formerly Mulawa)	Maximum
South Coast Correctional Centre (Nowra)	Maximum, Medium and Minimum
Wellington Correctional Centre	Maximum and Minimum
Bathurst Correctional Complex	Medium and Minimum
Broken Hill Correctional Centre	Medium and Minimum
Compulsory Drug Treatment Correctional Centre	Medium and Minimum
Cooma Correctional Centre	Medium
Dillwynia Correctional Centre (Windsor)	Medium and Minimum
Grafton Correctional Centre	Medium and Minimum
John Morony Correctional Centre (Windsor)	Medium
Junee Correctional Centre	Medium and Minimum
Kariong Juvenile Correctional Centre (Gosford)	Medium
Mid North Coast Correctional Centre (Kempsey)	Medium and Minimum
Tamworth Correctional Centre	Medium and Minimum
Brewarrina (Yetta Dhinnakkal) Centre	Minimum
Cessnock Correctional Centre	Minimum and Minimum
Dawn de Loas Correctional Centre Areas 1 & 2	Minimum
Emu Plains Correctional Centre	Minimum
Glen Innes Correctional Centre	Minimum
Ivanhoe (Warakirri) Centre	Minimum
Mannus Correctional Complex (Tumbarumba)	Minimum
Oberon Correctional Centre	Minimum
Outer Metropolitan Multi Purpose Correctional Centre	Minimum
Silverwater Correctional Centre	Minimum
St Heliers Correctional Centre (Muswellbrook)	Minimum

Correctional Centre	Primary Security Classification
High Risk Management Correctional Centre – part of Goulburn	Maximum security centre in own right
Long Bay Hospital – medical and psychiatric cases; Long Bay CC	Maximum security centre in own right
Other: Balund-a-Tabulam Biyani Cottage Miruma Cottage	

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