



The Hon Dr Sharman Stone MP

Federal Member for Murray
Parliamentary Secretary to the Minister for Finance and Administration

Mr Alan Morris
Chairman
Commonwealth Grants Commission
Cypress Court
5 Torrens Street
BRADDON ACT 2612

Dear Mr Morris

I am writing to convey to you the attached terms of reference for the Commission's 2010 Methodology Review of State Revenue Sharing Relativities. The terms of reference provide guidance to the Commission to simplify its methodology and to develop a continuous programme of improvement of its assessments. This work programme will place the Commission's methodology on a sounder and more sustainable basis.

At the meeting of the Ministerial Council for Commonwealth-State Financial Relations on 23 March 2005, all states and territories agreed with these terms of reference.

The terms of reference require the Commission to report to the Ministerial Council in 2006 and 2007 on aspects of simplification and to provide the relativities and the Review report by 26 February 2010.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Dr Sharman Stone'.

Dr Sharman Stone

26 May 2005

TERMS OF REFERENCE

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

- (b) The Commission will report to the Ministerial Council in 2007 on its conclusions in relation to paragraphs 3(a) and 4(a) and progress in relation to paragraphs 4(b), 4(c) and 5.
- (c) The Commission will report to the Ministerial Council in 2006 and 2007 on any conclusions it has reached in relation to paragraphs 6(a) and 6(b) which, in the Commission's opinion, should be implemented in advance of its 2010 Report. In drawing any such conclusions, the Commission should apply the principle of Horizontal Fiscal Equalisation used for the 2004 Review.
- (d) The Commission will report on the conclusions in relation to the remaining items in paragraphs 3, 4 and 5 as part of its 2010 Report.

7. The Ministerial Council will give further instruction to the Commission on transitional arrangements, if and as necessary.

SHARMAN STONE