

COMMISSION TERMINOLOGY

- 1 The Commission has updated and simplified the language it uses to make its reports and other documents more accessible. That said, there will always be a need for special terms to describe some concepts. This attachment provides a list of the main terms that have a meaning that is unique to the Commission.
- 2 Note: The term *State(s)* includes the Australian Capital Territory and the Northern Territory. The term *Australian average* refers to the average of all the States as defined. Where a defined term is used in a definition of another term, it is shown in *italics*.

Terms

(i) actual per capita method or actual per capita assessment method (APC)

The *assessed expense* or *assessed revenue* for each *State* is set equal to its actual expense or revenue. It is used when, in the Commission's judgment, the policies of all *States* are the same and any differences in expenses or revenues per capita are due to differences in *State* circumstances.

(ii) adjusted budget (previously called equalisation budget)

A representation of *State* budgets used by the Commission to calculate the *Australian average* per capita revenues and expenses. It covers all operating transactions (revenues and expenses) of the general government sector in *State* public accounts, except those excluded by terms of reference or the Commission's *SPP* guidelines. Other adjustments are also made for reasons of comparability between *States* and over time. Expenses for services provided by the Australian Government or local government are not included. The adjusted budget is dissected into revenue, expense and user charges categories and the data required to construct it are derived from the Australian Bureau of Statistics Government Finance Statistics (GFS), *State* budgets and other sources.

(iii) administrative scale factor

A *disability factor* that measures differences in costs *States* incur when there are differences in the scale of operation in policy development and administration. It relates to central office functions and to specialised *State*-wide services provided centrally.

(iv) assessed budget (previously called standardised budget)

The notional budget of a *State* if it were to follow *Australian average* revenue and expense policies. It consists of *assessed expenses*, *assessed revenues* and *SPPs* for the *State*, and the *average budget result*. The assessed budget involves adjustments to the *Australian average* for assessed differences to raise revenue, and in the cost of delivering services that are beyond the control of a *State*. The assessed budget for a *State* differs from the *adjusted budget* in that the latter is a national average of expenses and revenues whereas the former includes adjustments to the average for *disabilities*.

(v) assessed differences (formerly called needs)

The financial impact of a *State's disabilities* on its budget. They are measured as the difference between *assessed expenses* and *average expenses*, *average revenue* and *assessed revenue* or *average specific purpose payments* and actual *specific purpose payments* received. Assessed differences can be either positive or negative.

(vi) assessed expenses

The expense a *State* would incur if it were to follow *Australian average* expense policies, allowing for the *disabilities* it faces in providing services, and assuming it provides services at the average level of efficiency. Assessed expenses equals *assessed service use* multiplied by *assessed unit cost* (summed for all services). Assessed expenses exclude differences due to policy choices under the control of that *State*.

(vii) assessed revenue

The revenue a *State* would raise if it were to apply the *Australian average* policies to its revenue base, and raised revenue at the average level of efficiency. Assessed revenue excludes differences due to policy choices under the control of that *State*, for example a higher or lower tax rate applied by a *State* compared to the *Australian average*.

(viii) assessed service use

The requirements assessed by the Commission for a *State* to achieve *Australian average* service delivery to its population. Assessed service use can be influenced by many things especially the demographics of the *State's* population (for example, percentage of low income people, percentage in remote communities) and geography (which influences, for example, length of roads).

(ix) assessed unit cost (of a service)

The cost per unit of service assessed by the Commission for a *State* to deliver a particular service to a particular segment of the population at the *Australian average* standard (for example, cost per student of *State* primary education).

(x) assessment years (period)

Usually the financial years covered by a *review* or *update*. The Commission uses data for five financial years to determine *relativities*. For example, the *update* for determining the distribution of the *pool* in 2008-09 uses the average of five individual *relativities* calculated for the last financial year (2006-07) and the four financial years preceding this.

(xi) Australian average

The benchmark against which the performance or characteristics of a *State* are assessed. It is an average derived from the policies or financial data of all *States*, and hence may be a financial average or a policy average.

(xii) average budget result (see also fiscal capacity)

The *Australian average* per capita budget result (surplus or deficit) for the *adjusted budget*. It is calculated as the difference between total *State* revenues and total *State* expenses in the *adjusted budget*, divided by the Australian population.

(xiii) average expenses

The Australian average per capita expense, in a *category*, a group of *categories* or in total. It is calculated as the sum of expenses of all *States*, divided by the Australian population.

(xiv) average revenue

The *Australian average* per capita revenue, in a *category*, a group of *categories* or in total. It is calculated as the sum of *State* revenues, divided by the Australian population.

(xv) backcasting

Changes made to figures for past financial years in an *assessment period* to reflect current or future *State* policies, such as the replacement of one tax with another tax or the abolition of a tax. In effect, backcasting produces notional financial data that simulate the existence of a tax or other financial policy change before it may have actually been introduced. Except where required by the Commission's terms of reference, actual figures for the *assessment period* are adjusted to reflect only major changes in Commonwealth-*State* financial arrangements.

(xvi) budget analysis

The process used to prepare *adjusted budgets* from the Australian Bureau of Statistics Government Finance Statistics (GFS), *State* budget documents, other financial reports and special data collections.

(xvii) category

A classification of *State* government transactions relating to distinct services or revenue sources, used for analytical purposes. In this update, the adjusted budget is divided into 13 revenue categories, 39 expense categories and 25 user charges categories.

(xviii) category factor

The combined result of all the *disability factors* in a *category*, or where the *category* is made up of multiple *components*, the combined *disability factors* for all of those *components*.

(xix) component

A part of an expense or revenue *category* that is separated from others in the *category*, often because different *disability factors* will apply to it.

(xx) cost of service provision ratio

A *State's* per capita cost of providing services at *Australian average* standards, relative to the *Australian average* per capita cost. It is calculated by dividing per capita *assessed expenses* by per capita *Australian average* expenses.

(xxi) cross-border factor

A *disability factor* that measures the net effects on a *State's* costs of:

- the use of its services by residents of other *States*; and
- the use by its residents of services provided by other *States*.

(xxii) disability

An influence beyond a *State's* control that requires it:

- to spend more (or less) per capita than the *Australian average* to provide the average level of service; or
- to make a greater (or lesser) effort than the *Australian average* to raise the average amount of revenue per capita.

(xxiii) disability factor

A measure of a *State's* use, cost or revenue raising *disability*, expressed as a ratio of the *State's* usage, *assessed cost* or *assessed revenue* over the corresponding Australian average figure. Policy differences between *States* are specifically excluded when calculating disability factors.

(xxiv) dispersion factor

A *disability factor* that measures differences in costs that *States* incur because of the geographical distributions of their populations.

(xxv) distribution model

A formulation, mathematical or otherwise, of the way in which *relativities* are calculated.

(xxvi) equalising requirement (previously called standardised deficit or adjusted total financial assistance requirement (ATFAR))

A *State's* requirement for funds from the *GST and unquarantined Health Care Grants pool*. It is measured as its *assessed expenses*, less its *assessed revenue*, less the *average budget result*, less *specific purpose payments* treated by *inclusion*.

(xxvii) equal per capita assessment method (EPC)

Each *State's* *assessed expense* or *assessed revenue* in a category is set equal to the *Australian average* per capita amount. It is used when there are judged to be no *disabilities* between the *States* and any differences between the *States* in the cost of providing services or raising revenue reflect differences in

State policies. Such an assessment means that no differences are assessed for any *State* and that there is no impact on the relativities.

(xxviii) exclusion method

A method for treating an Australian Government payment in which both the receipt of the payment and the resulting expenses for which it is used are excluded from the *adjusted budget*.

(xxix) expense assessment framework

The general approach used to analyse expense categories. Under the current framework, an expense *category* is divided into *components*, separate *disability factors* are applied to each *component* and the final *category* assessment is achieved by summing the *component* assessments.

(xxx) factor assessment method

The calculation of *assessed expenses* for a *State* by the systematic application of *disability factors* to the *Australian average* expenses per capita.

(xxxi) factor income

A term used by the Australian Bureau of Statistics, and defined as follows: that part of the cost of producing the gross domestic product which consists of gross payments to factors of production (labour and capital). It is equivalent to compensation of employees plus the primary income of corporations (gross operating surplus in the case of incorporated enterprises and gross mixed income in the case of unincorporated enterprises).

(xxxii) financial averages

The *Australian average* per capita expenses and revenues for each *category* in the *adjusted budget*. They also include the *average budget results*.

(xxxiii) fiscal capacity

The budget surplus or deficit a *State* would achieve if it raised revenue from its own revenue bases at Australian average rates (*assessed revenue*), provided Australian average services to its population (*assessed expenses*) and received its actual *specific purpose payments*. The relative capacity of each *State* is a comparison of its fiscal capacity with the *Australian average* capacity.

(xxxiv) Goods and Services Tax (GST) and unquarantined Health Care Grants (HCG) pool

The pool of funds made available by the Australian Government for transfer to the *States* as untied financial assistance — also called the *pool*.

(xxxv) grant design inefficiency

A flaw in a method of assessment which would allow a *State* to influence its *relativity* by changing its expense or revenue policies (apart from any effect of these policies on the *Australian average*).

(xxxvi) GST and HCG pool

See *Goods and Services Tax (GST) and unquarantined Health Care Grants (HCG) pool*.

(xxxvii) horizontal fiscal equalisation

A distribution of the *Goods and Services Tax (GST) and unquarantined Health Care Grants (HCGs) pool* to *State* governments such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same level.

(xxxviii) inclusion method

A method of treating *SPPs* in which both the receipt of the funds from the *SPP* and the resulting expense for which they are used are included in the *adjusted budget*. The expense is included in the *State's* expenses and the *SPP* to each *State* is treated as revenue available to finance part of the *State's* total financial assistance requirement.

(xxxix) input costs factor

A *disability factor* that measures the differences between the *States* in the costs per unit of labour, accommodation and electricity.

(xl) isolation factor

A *disability factor* that measures differences in costs that *States* incur because of the location of their capital cities relative to other capitals and their distance from sources of supply.

(xli) joint factor

A *disability factor* in which more than one basis of *disability* is calculated simultaneously. The joint factor approach is most frequently used for the calculation of socio-demographic composition disability factors.

(xlii) land rights factor

A *disability factor* that measures the additional and unique costs that the Northern Territory incurs because of the operation of the Australian Government's Aboriginal Land Rights (Northern Territory) Act 1976.

(xliii) level of service provision ratio

A ratio that reflects how a *State's* policies on the level of services provided and the relative efficiency with which they are provided vary from the *Australian average* policies. It is measured by dividing actual per capita expense by *assessed expense* per capita.

(xliv) model

See *distribution model*.

(xlv) national capital factor

A *disability factor* that measures the additional costs that the ACT incurs because of Canberra's status as the national capital.

(xlvi) native title factor

A *disability factor* that measures differences in costs that *States* incur because of the operation of the Australian Government's Native Title Act 1993. Expenses assessed comprise the costs of administering the legislation and of compensating holders of native titles in settlement of claims.

(xlvii) needs

See *assessed differences*.

(xlviii) out of scope

Not within the *adjusted budget*. The term is most frequently used for *specific purpose payments* that are not relevant to the work of the Commission because they do not fund *State*-type services or they do not have direct impact on *State* budgets.

(xlix) policy neutral assessment

An assessment in which the *policy average* is applied to every *State*. The resultant assessment is therefore unaffected by the policies of individual *States*, other than through the influence of those policies on the *Australian average*.

(i) policy averages

The *Australian average* policies as reflected in the practices of the *States* in the collection of revenue and the provision of services. These averages are usually weighted according to the size of the user or revenue bases in each *State*.

(ii) pool

See *Goods and Services Tax (GST) and unquarantined Health Care Grants (HCGs) pool*.

(iii) quarantine

The treatment of an Australian Government payment (including *SPPs*), and where possible the expense for which it is used, in such a way as to have no impact on the *relativities*. Quarantining always results from instructions given directly to the Commission in its terms of reference and the term is used only in this context. Quarantining can be achieved in a number of ways including, most commonly, by *exclusion*. Quarantining is usually requested when the purpose of a payment is other than *horizontal fiscal equalisation*.

(iii) relativity

A per capita weight assessed by the Commission for use by the Australian Treasury in calculating the share of the *pool* that a *State* requires to achieve *horizontal fiscal equalisation*. The *Australian average* relativity is 1.0. By way of example, a *State* assessed by the Commission as having a relativity of 2.0 would require twice as much from the *pool* per capita than the Australian average to achieve *horizontal fiscal equalisation*.

(iv) revenue base

A measure of the transactions, activities, or assets that are taxed by the *States*. Differences between the revenue bases of each *State* are used by the Commission to determine the relative capacities of each to raise a particular type of revenue.

(iv) revenue effort

The intensity of use of a revenue base (the implied tax rate), measured by actual revenue divided by the *revenue base*. It is influenced by the rate of tax or charge, the exemptions, and concessions provided, and the effort put into ensuring compliance.

(lvi) revenue raising capacity ratio

A ratio which indicates the capacity of a *State* to raise revenue relative to the *Australian average*. It reflects the size of a *State's revenue base* per capita relative to the *Australian average* and is measured by dividing *assessed revenue* per capita by *average revenue* per capita.

(lvii) revenue raising effort ratio

A ratio which indicates the actual effort made by a *State* to raise revenue relative to the *Australian average* effort. It is primarily a measure of the deviation of a *State's* tax rates and efficiency in ensuring compliance from the average rates and compliance efficiency. It is measured by dividing actual per capita revenue by *assessed revenue* per capita.

(lviii) review

The process in which the Commission reconsiders the methods used to calculate *State relativities*, according to terms of reference given to it. From the 1989 Review onwards, reviews have usually been undertaken every five years. By contrast, an *update* is conducted every year other than a review year and updates the relativities — using the methods determined in the last review and the latest financial data.

(lix) service delivery scale factor

A *disability factor* that measures the additional costs of providing a service where it needs to be delivered but where the delivery is of less than economic size because the population served is small and remote from other points of service delivery.

(lx) socio-demographic composition factor

A *disability factor* that measures the budgetary impact, due to differences in both demand for and cost of providing services, that results from differences between *States* in the relative size of socio-demographic groups. It can reflect differences between *States* in some or all population characteristics such as age-sex structure, socio-economic status, Indigeneity, cultural and linguistic background, and location of residence.

(lxi) State(s)

Unless the context indicates otherwise, the term *State(s)* includes the Australian Capital Territory and the Northern Territory.

(lxii) specific purpose payments (SPPs)

Australian Government payments to *States* that are to be used for purposes specified by the Australian Government. They include payments published in Commonwealth of Australia's *Final Budget Outcomes* and Commonwealth own-purpose outlays paid to the *States* for the delivery of services. The Commission examines the purpose of each SPP and the guidelines we have established to decide the treatment of each.

(lxiii) tax base

See *revenue base*.

(lxiv) update

The annual assessment of *State relativities* undertaken by the Commission between *reviews*. *Update* assessments incorporate new budgetary developments and the most recent available data. In general, the methods used to calculate the relativities are those adopted in the most recent *review*.

(lxv) urban influences factor

A *disability factor* that measures differences in costs arising from differences between *States* in some or all of the characteristics of urban areas such as population density, centre size, urban form, population growth and congestion. Urban complexity refers to the particular influences arising from interactions between different characteristics of an urban area, resulting in the need for a particularly complex service delivery arrangement.

(lxvi) user charges

Fees and charges raised by *States* through the sale of goods or services. In the *adjusted budget*, user charges appear on the expense side to determine the net cost of an expense, but have a different assessment applied to them.

(lxvii) year of application

The year in which the *relativities* assessed are to be used to distribute the *pool*. In this update, the year of application is 2008-09.

(lxviii) years of assessment

See *assessment period*.

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