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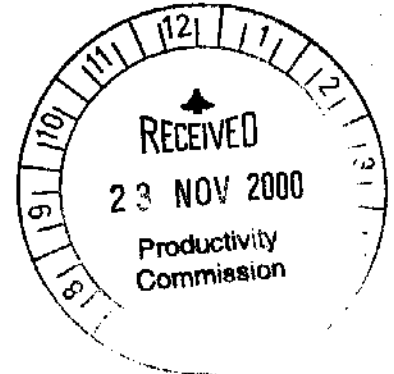
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Ms. Delwyn Rance
Cost Recovery Inquiry
Productivity Commission
Locked Bag 2
Collins St., East Post Office
Melbourne VIC 8003

Dear Ms. Rance



REVIEW OF COST RECOVERY BY COMMONWEALTH AGENCIES

Thank you for the valuable opportunity to contribute to your inquiry. Whilst I am in a position to offer specific examples to illustrate the points I wish to make I would prefer to confine my comments to broad principles in the interests of brevity and diplomacy.

Introduction:

It is often a difficult and sensitive balancing act for a government regulatory agency to be responsible for regulating certain conduct of a specific industry and at the same time rely virtually exclusively on that industry for its funding through the imposition of fees and charges. There are at times tensions of both a management and political nature that need to be addressed and the mechanisms that are used are often inadequate and/or poorly designed to handle the task. I now wish to explore this in more detail. In terms of the issues canvassed in your Issues Paper of October 2000, my comments focus predominantly on cost recovery design, implementation, accountability and review.

Trust

One of the fundamental principles of cost-recovery sought by industry is that the revenues gained on a user-pays basis for a specific function are quarantined to that function so as to prevent leakage into other portfolio expenditures. The standard finance mechanism (other than for a statutory authority) is the Trust Fund. This implies that expenditure can only occur in accordance with the terms of the trust. This raises the key issue of monitoring and accountability to ensure that:

- Agency expenditure does not venture outside the terms of the trust; and
- Agency expenditure is responsible within the terms of the trust.

This issue is important from a number of perspectives not the least of which is that it can lead to agency pressure to increase fees unnecessarily and without justification, i.e. in an extreme case the agency may consider it has a blank cheque to do whatever it likes on the premise that industry will pay.

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A key issue facing the fee paying industry is whether the accountability mechanism established by the agency for monitoring overall performance of the agency with the view to resource allocation and fee setting is adequate to be able to detect such instances. (This often comprises a committee with peak industry and agency membership). If there is not full disclosure of all agency expenditure/forward estimates etc. this may be difficult if not impossible. Also the openness of such accountability mechanisms may change over time with successive administrations such that new styles of management may emerge that are resistant to full disclosure to the industry they are entrusted to regulate.

If evidence exists that the agency has ventured outside the terms of the trust (eg. perhaps by funding an exercise at great expense that does not directly relate to the operations of the agency) what mechanisms exist to make the agency accountable? Should the industry lodge a complaint with the Attorney-General, the Ombudsman or the responsible Minister? This is not clear.

The second point concerns the responsibility of the agency to appropriate standards of financial management. This in turn raises a number of issues that touch on operational efficiency and corporate governance (eg. executive salary packaging).

In terms of operational efficiency it raises the issue of the ambit of the agency's legitimate charter within the terms of the legislation and the terms of the trust. For example, if an agency is merely empowered to regulate Australian activity would it be legitimate for the agency to decide to attempt to export its expertise on a commercial basis to other countries in our region at industry expense? If such an activity created a profit or broke even there may be some justification if industry agreed, but if the activity costed say \$1mill. p.a. and only recouped \$350,000 p.a., industry is indirectly funding a loss making venture. Other areas of apparent inefficiency may arise where the agency decides to create additional organisational units at a substantial increase in expenditure in circumstances where the relevant workload is static or declining.

Such agency conduct without industry endorsement will lead to increased expenditure which in turn will lead to pressure from the agency to increase existing fees and to identify potential new sources of revenue by broadening the fee base. If the agency is relatively small and the responsible staff are isolated from mainstream finance areas which operate under tried and proven SOP's, the processes adopted to increase revenue may be arbitrary, ad-hoc, or even outside legislative authority.

Conclusion

I have offered these perceptions to assist in developing guidelines for the future, particularly the design of cost-recovery arrangements. Whilst other issues such as 100% cost recovery funding public interest functions need to be addressed, I wish to confine my comments to the issues outlined above.

An appropriate accountability mechanism should have some form of legislative support so as to prevent successive administrations attempting to dilute its effectiveness. However, it is, of course, essential that the design preserve the independence of the regulatory function. The design should include features such as:


- Adequate representation by all stakeholders;

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- Frank and open disclosure by the agency of resource allocations and strategic planning to enable all stakeholders to have a full knowledge and understanding of the financial management of the agency;
- Ensuring stakeholders have the capacity to identify the nexus between the resourcing of the agency and the nature and level of the fees and charges being imposed;
- A model for reviewing fees and charges that ensures informed consent on the part of all stakeholders, including a dispute resolution mechanism;
- Provision for stakeholder input and endorsement of proposals to amend the terms of the trust.

I look forward to discussing these issues further at the public hearing in Canberra on Tuesday 28 November 2000.

Yours sincerely



DOUG KENTWELL
Managing Director

23 November 2000