

A SHORT GUIDE TO THE INTERGOVERNMENTAL AGREEMENT ON FEDERAL FINANCIAL RELATIONS AND THE FEDERAL FINANCIAL RELATIONS FRAMEWORK

INTRODUCTION

On 29 November 2008, COAG agreed the *Intergovernmental Agreement on Federal Financial Relations* (Intergovernmental Agreement) which establishes the overarching framework for the Commonwealth's financial relations with the States and Territories (the States). The federal financial relations framework came into effect on 1 January 2009, representing the single most significant shift in Commonwealth-State relations for decades.

Previously, federal financial relations were characterised by arrangements whereby the Commonwealth placed a high degree of prescription on a large number of payments to the States, which constrained flexibility and innovation in service delivery, making it difficult for States to set their own priorities and address their own circumstances to achieve the best overall community outcomes. It also created inefficiencies, with the Commonwealth devoting unnecessary time to administering the many payments and agreements.

To address these issues, the framework was intended to provide the States with flexibility to deliver quality services where they are most needed, while increasing governments' accountability to the public through a combination of a focus on the achievement of outcomes, clearer specification of roles and responsibilities, and enhanced performance reporting.

The shift toward greater collaboration in achieving the objectives of governments is a significant and worthwhile improvement on the previous, compliance based approach to federal financial relations. It focuses the attention of all parties on the achievement of policy objectives, including those that are part of the COAG reform agenda, which aim to improve outcomes for all Australians.

OVERVIEW

The Intergovernmental Agreement aims to benefit all Australians through fair and sustainable financial arrangements that:

- recognise the primary role of the States in delivering government services in key sectors and provide ongoing financial support for those services, while acknowledging the role of the Commonwealth in supporting the achievement of national outcomes to improve the wellbeing of all Australians; and

- allow governments to support innovation and efficiency in the delivery of services and focus on long term policy development, including to facilitate the implementation of economic and social reforms in areas of national importance.

It is a key component of the COAG reform agenda and establishes the foundation on which the Commonwealth and the States collaborate on policy development and service delivery to implement that agenda.

A summary of the structure of the Intergovernmental Agreement is at Appendix A.

OBJECTIVE

The objective of the federal financial relations framework is the improvement of the well-being of all Australians through:

- collaborative working arrangements, including clearly defined roles and responsibilities and fair and sustainable financial arrangements, to facilitate a focus by the parties on long term policy development and enhanced government service delivery;
- enhanced public accountability through simpler, standardised and more transparent performance reporting by all jurisdictions, with a focus on the achievement of outcomes, efficient service delivery and timely public reporting;
- reduced administration and compliance overheads;
- stronger incentives to implement economic and social reforms;
- the ongoing provision of Goods and Services Tax (GST) payments to the States; and
- the equalisation of fiscal capacities between the States.

PRINCIPLES

The objective of the framework is supported by a series of principles that focus on:

- acknowledging that States have primary responsibility for many areas of service delivery but coordinated action is necessary to address the economic and social challenges that confront the Australian community;
- improving the quality, efficiency and effectiveness of government service delivery;
- coordinating federal action through a shared commitment to cooperative working arrangements, with COAG monitoring progress on all aspects of the framework and parties to the Intergovernmental Agreement acknowledging the need to pursue ongoing reform of federal financial relations;

- improving public accountability of governments to their communities, not just for expenditure in delivering services, but for the quality and efficiency of the services delivered and the outcomes achieved;
- providing ongoing financial support for the States' service delivery efforts; and
- providing for economic and social reform through National Partnership Payments to the States to support the delivery of specified outputs or projects, to facilitate reforms or to reward those jurisdictions that deliver on nationally significant reforms or service delivery improvements.

KEY FEATURES OF THE FEDERAL FINANCIAL RELATIONS FRAMEWORK

Agreement types

Under the Intergovernmental Agreement, there are two types of agreements: National Agreements and National Partnerships.

National Agreements

National Agreements define the objectives, outcomes, outputs and performance indicators, and clarify the roles and responsibilities that will guide the Commonwealth and the States in the delivery of services across a particular sector.

There are currently four National Agreements covering key areas of skills and workforce development, disability services, affordable housing and Indigenous reform. Each National Agreement, with the exception of the National Indigenous Reform Agreement, is associated with a National Specific Purpose Payment (National SPPs), which are required to be spent in the relevant sector.

The former National Agreements for healthcare and schools have been replaced with revised funding agreements.

National Partnerships

A key element of the framework is **National Partnership agreements** which define the mutually agreed objectives, outcomes, outputs and performance benchmarks or milestones related to the delivery of specific projects, improvements in service delivery or reform.

Implementation Plans are subsidiary documents to some National Partnership agreements and outline what is to be achieved by a jurisdiction and when.

Project Agreements are a type of National Partnership used to implement projects that are considered low-value and/or low risk. Project Agreements are simple, standalone, outputs-focussed documents that are generally bilateral although they may be multi-lateral in certain limited circumstances.

For National Agreements, National Partnerships, Implementation Plans and Project Agreements, primary policy responsibility rests with the relevant portfolio minister.

Design principles for agreements

The objective and principles of the Intergovernmental Agreement are supported by a series of design principles for agreements that are intended to improve the quality, efficiency and effectiveness of government service delivery through agreements that:

- clarify which level of government is responsible for the achievement of outcomes and outputs so that the appropriate government can be held accountable;
- provide flexibility in the delivery of services by the States, including through reduced Commonwealth prescription, a focus on the achievement of outcomes and incentives for implementing reforms and the achievement of outcomes; and
- enhance accountability to the public for the outcomes achieved or outputs delivered under National Agreements or National Partnerships.

Clarifying roles and responsibilities

A key objective of the framework is increased accountability of Commonwealth and State governments to the public, underpinned by clearer roles and responsibilities in respect of each jurisdiction. Clearly specified roles and responsibilities are important so that the community understands which government is responsible for particular outcomes and outputs.

Shared roles and responsibilities should be minimised to improve public transparency by clarifying where accountability resides under the framework. They should also be limited to administrative arrangements such as participating in consultations, negotiating new or revised agreements or schedules and conducting reviews and/or evaluations. For all shared roles and responsibilities, it is important that these are clearly explained, so that there is an understanding of how the outcomes are to be achieved through joint action.

Providing flexibility

The Intergovernmental Agreement provides for a reduction in Commonwealth prescription on service delivery by the States and states that agreements will not include financial or other input controls, giving the States more flexibility in how services are provided and projects are delivered to achieve the outcomes for which they are responsible.

Rather than seeking to control how States deliver outcomes, it aims to improve the quality and effectiveness of government services by reducing Commonwealth prescription, aligning payments with the achievement of outcomes and/or outputs and giving States the incentive and flexibility to determine how to achieve those outcomes efficiently and effectively. Accordingly, agreements must focus on outcomes

and outputs rather than inputs and should avoid specifying in detail how outcomes and outputs are to be achieved.

In the case of National SPPs, States are required to spend each National SPP in the relevant sector – for example, the States are required to spend the National Schools SPP in the schools sector – but they have budget flexibility to allocate funds within that sector in a way that ensures they achieve the mutually agreed objectives of the associated National Agreement.

In the case of National Partnership Payments, States retain Commonwealth funding where they deliver outcomes and/or outputs for less than the agreed estimated cost of the project and bear all risk should the final cost exceed the agreed estimated cost.

Enhancing accountability

While the States have increased budget flexibility under the framework, they are also subject to greater accountability. Commonwealth and State governments have committed to improving service delivery, by ensuring that the appropriate government is accountable to its community, not just for its expenditure in delivering services, but more importantly, for the quality and efficiency of the services it delivers and the outcomes it achieves.

The flexibility provided by the Intergovernmental Agreement must be balanced with appropriate levels of accountability achieved through well-designed agreements that include:

- clearly defined and articulated objectives, outcomes and outputs;
- clearly delineated, accepted and understood roles and responsibilities;
- fully disclosed estimates of Commonwealth and non-Commonwealth financial contributions;
- good payment design, i.e. payments that are designed to create an incentive for the achievement of outcomes and/or outputs by being appropriately weighted and linked to the achievement of performance benchmarks or milestones; and
- appropriate scope and frequency of performance monitoring and reporting with progress reported against performance benchmarks or milestones that are clearly linked to outcomes and/or outputs.

Payment types

The Commonwealth currently provides financial support for the States' service delivery efforts through:

- GST payments and other general revenue assistance;

- National SPPs to be spent in the key service delivery sectors of healthcare¹, schools, skills and workforce development, affordable housing and disability services;
- National Health Reform funding (from July 2012); and
- three types of National Partnership Payments – project payments, facilitation payments and reward payments – which can be made under both National Partnerships and Project Agreements.

Payments classified as either direct to Local Government Authorities or for Commonwealth Own Purpose Expenses fall outside the framework. See the [Short Guide to Payments under the Federal Financial Relations Framework](#).

A summary of accountability arrangements under the framework is at Appendix B.

Centralised payment arrangements

A key feature of the framework is centralised payment arrangements which simplify payments to the States, aid transparency and improve the States' budget processes.

Under these arrangements, all payments are processed centrally by the Commonwealth Treasury and paid directly to each state treasury. State treasuries are responsible for distributing the funding within their jurisdiction. Having state treasuries distribute Commonwealth sourced funding to state portfolio agencies helps reinforce that state agencies are primarily accountable to their respective parliaments and public for their service delivery performance, including their delivery of programs for which the Commonwealth provides a financial contribution.

In the Commonwealth, the Treasurer is accountable for the appropriations, estimates and payments under the framework.

Institutional arrangements

Council on Federal Financial Relations

The Intergovernmental Agreement is an agreement of COAG. COAG is the key decision-making body with respect to the implementation of the framework, and monitors progress on all its aspects. COAG has delegated responsibility for the general oversight of the operation of the Intergovernmental Agreement, and an ongoing role in monitoring the maintenance of reforms in the Agreement and making associated recommendations to COAG, to the Council on Federal Financial Relations. The Council consists of the Treasurers of the Commonwealth and the States.

¹ From 1 July 2012 the National Healthcare SPP was replaced by National Health Reform funding which is subject to the terms and conditions of the National Health Reform Agreement.

The role of Commonwealth and State first ministers and treasury departments in administering the federal financial relations framework stems from the overarching responsibility of COAG and the Council on Federal Financial Relations for the Intergovernmental Agreement.

Legislative framework

The arrangements for federal financial relations are set out in the Intergovernmental Agreement, the *Federal Financial Relations Act 2009* and the *COAG Reform Fund Act 2008*.

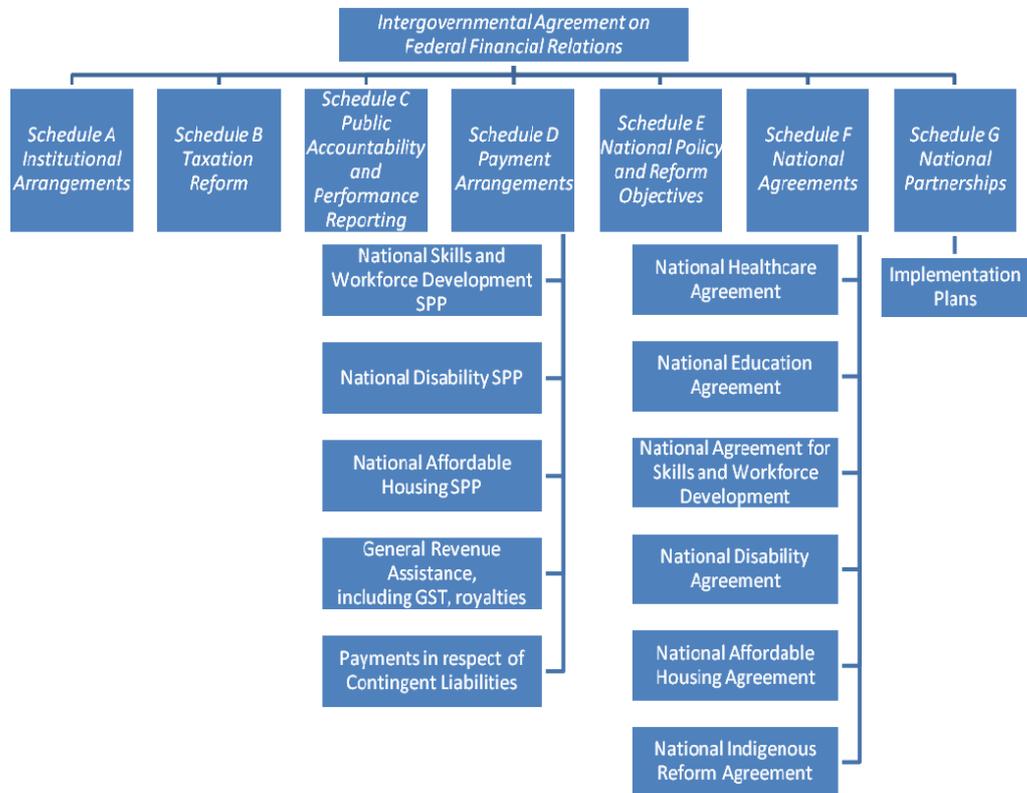
The *Federal Financial Relations Act 2009* provides an appropriation for the Commonwealth to make GST payments and National SPPs in the areas of health, schools, skills and workforce development, disability services and affordable housing. It also provides for the Treasurer to determine amounts to be credited to the COAG Reform Fund for the purpose of providing financial assistance to the States in the form of National Partnership Payments and general purpose financial assistance. Determinations are published and subject to parliamentary scrutiny.

The *COAG Reform Fund Act 2008* establishes the COAG Reform Fund for the purpose of making grants of financial assistance to the States and Territories. The COAG Reform Fund Act specifies that the terms and conditions on which financial assistance is granted are to be set out in written agreements between the Commonwealth and the States.

FURTHER INFORMATION

The Intergovernmental Agreement and further information including guidance material, templates and existing agreements, may be found at www.federalfinancialrelations.gov.au

Appendix 1: The structure of the federal financial relations framework



Appendix 2: Accountabilities under the new federal financial framework

Payment type	Policy	Payments			Portfolio Budget Statements		Performance reporting	Default CGC treatment ^(e)
		Design	Estimates	Processing	Financial reporting	Non-financial reporting		
National Agreements	Portfolio minister	No payments	No payments	No payments	No payments	Portfolio minister	Independent Assessor	No payments
National SPPs	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Inclusion
National Partnerships								
Facilitation payment	Portfolio minister	Treasurer	Treasurer ^(b)	Treasurer ^(b)	Treasurer	Portfolio minister	Portfolio minister	Exclusion
In advance project payment	Portfolio minister	Portfolio minister	Treasurer ^(b)	Treasurer ^(b)	Treasurer	Portfolio minister	Portfolio minister ^(c)	Inclusion
In arrears project payment	Portfolio minister	Portfolio minister	Treasurer ^(b)	Treasurer ^(b)	Treasurer	Portfolio minister	Portfolio minister ^(c)	Inclusion
Reward payment	Portfolio minister	Treasurer	Treasurer ^(b)	Treasurer ^(c)	Treasurer	Portfolio minister	Independent Assessor	Exclusion
General revenue assistance	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Inclusion
Local government payments ^(a)	Portfolio minister	Portfolio minister	Portfolio minister	Portfolio minister	Portfolio minister	Portfolio minister	Portfolio minister	Out of scope
Commonwealth Own Purpose Expense ^(a)	Portfolio minister	Portfolio minister	Portfolio minister	Portfolio minister	Portfolio minister	Portfolio minister	Portfolio minister ^(d)	Out of scope

(a) Payments classified as to Local Government Authorities or for Commonwealth Own Purpose Expenses fall outside the framework.

(b) On advice from the Portfolio minister.

(c) The Treasurer will process reward payments after Cabinet considers the performance benchmarking report following an independent assessment of performance.

(d) Non-financial performance data for project payments are normally reported to Commonwealth portfolio ministers. However, the Intergovernmental Agreement provides that any independent assessor will also publish performance data relating to National Partnerships to the extent that they support the objectives in National Agreements. Where project based National Partnerships support the objectives in National Agreements, the independent assessor is expected to incorporate the relevant performance information in its reports so as to provide a more complete understanding of whole-of-sector performance. Financial performance data are reported to the Treasurer.

(e) The Commonwealth Grants Commission treats payments by 'inclusion' or 'exclusion' by in its annual assessments of fiscal equalisation depending upon the classification of the payment type. The default classifications are set out in Schedule D – Payment Arrangements of the Intergovernmental Agreement. However, the Commission also has discretion to treat a payment differently if it considers a different treatment is more appropriate. The Commonwealth and State Treasuries are consulted on, and provide advice to the Commission in respect of, the appropriate classification of payments. Similarly, while local government payments and functions and Commonwealth own purpose expenses are normally out of scope of the Commission's assessments of fiscal equalisation, it has the discretion to include such payments in its assessment if it considers it appropriate (for example, where Commonwealth expenditure displaces standard State own expenditure).

