Australian Government

Australian Communications and Media Authority

SUBMISSION

TO THE

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

INQUIRY INTO THE EFFECTIVENESS OF THE ONGOING EFFICIENCY DIVIDEND ON SMALLER PUBLIC SECTOR AGENCIES

JULY 2008

Summary

In principle, ACMA strongly supports well designed incentives to promote ongoing efficiency improvements for Commonwealth agencies.

However, ACMA considers that the current “efficiency dividend” model can be a blunt tool that in practice causes problems when applied to small agencies, particularly those composed of very mixed, complex and variable businesses, which ACMA is.

In summary, the current arrangement effectively operates to impose a descending cap on smaller agencies, especially if they have a limited ability to supplement funding via New Policy Proposals (NPPs). The cumulative effect of a 1.25 % efficiency dividend over time can be corrosive, particularly on top of cost pressures from the macro-economic environment. The additional 2% one-off efficiency dividend exacerbates this position.

ACMA is the kind of agency that is subject to a significant number of one-off requests from Government to undertake support activities, many of which are not funded. For the last 12 years, agencies have generally been required to absorb new proposals that cost less than $5 million. Given ACMA’s size and the nature of our work, we have been required to continue to absorb many such activities. ACMA’s experience since its inception in July 2005 is that the scale of these unfunded one-off requests had been, if anything, increasing.

While ACMA was subject to a funding review in 2006 (which followed the merger of the Australian Communications Authority and the Australian Broadcasting Authority in July 2005), the logic of Table 1 below, combined with our experience over the last several years of the increasingly complexity of our work, has confirmed our growing view that this base funding is unlikely to be adequate to meet the range of anticipated Government and community expectations of ACMA going forward. If nothing changes, ACMA’s effective funding gap will widen over the next four years to the equivalent of a 17% reduction. For an agency with a budget of $94.5 million in 2008/09, a funding shortfall of that magnitude will require reprioritisation, even of elements within its core activities.

ACMA has a particular concern about the innovation issue identified in the Committee’s Term of Reference 2. ACMA was formed in 2005 by the merger of the former ABA and ACA with specific recognition that the pace of convergence among the various communications’ industries was accelerating and that this would create pressures on the regulatory environment. ACMA’s experience to date suggests that that view was not only correct but, if anything, understated. If the current small agency funding arrangements continue in their present form, ACMA is likely to lose, its strategic capacity to frame regulatory responses to the convergent environment when that capacity is most needed.

Comments against the Terms of Reference

ACMA offers the following thoughts on each of the Committee's Terms of Reference (ToRs).

TOR 1 - whether the efficiency dividend has a disproportionate impact on smaller agencies, including whether or not smaller agencies are disadvantaged by poorer economies of scale or a relative inability to obtain funding for new policy proposals

The efficiency dividend is having a disproportionate effect on ACMA. ACMA sees itself as almost a test case in how this kind of uniform approach can have unintended consequences for a small, diverse agency that is facing complex environmental pressures.

On the cost side, ACMA faces a number of scale and, perhaps more particularly to our situation, scope disadvantages. The scale disadvantages arise because, like many smaller agencies, ACMA's underlying cost base has a large proportion of fixed costs over which it has little control. ACMA's current cost profile consists of 57% in staff costs, 23% in fixed costs (mainly accommodation) and 4% in specific costs related to programs leaving a remaining 16% (i.e. approximately $15m), to cover general administration, travel, transformation, learning and development activities, trade creditors, contractors and consultants for specific one-off assignments.

This cost base is already subject to significant cost pressures that are largely driven by macro-economic circumstances. These include the need to fund salary increases averaging between 4-5% annually, rental rises based on the CPI, and other costs such as increasing fuel costs (remembering that ACMA have an extensive Australia-wide field presence). This automatically means ACMA is under significant, and above average, financial pressure, excluding the efficiency dividend. Table 1 below captures the relevant effects including the DoFD parameter adjustments which, while helpful, do not fully cover these pressures.

The scope disadvantages arise principally because ACMA is a "mixed business", even when compared with similarly sized regulators. The nature of this diversity in functions is described in TOR 5 below. The main practical effects of this diversity is to significantly limit ACMA's flexibility in redeploying resources and to create significant constraints on recruitment and restructuring strategies. For example, an ACMA content assessor is usually not going to be able to be redeployed as a radiocommunications spectrum engineer, and vice versa. At the same time, ACMA has a core cadre of spectrum engineering expertise in Canberra that would be very difficult (if not impossible) to replicate sufficiently quickly in another location and would create significant risks to the performance of ACMA's functions and a significant potential loss to the national interest at a time when spectrum considerations will become significantly more prominent.

On the revenue side, ACMA has had some access to NPPs. However, this has been by its nature patchy and not sufficiently flexible to keep pace with changing conditions. A downside of depending on the NPP funding for some significant functions is that they have been ongoing after the funding has lapsed. Also, ACMA's regulatory diversity, peak periods of activities, convergence projects and specific programs create difficulties in creating an aggregated project of sufficient scale to attract NPP attention.

As a regulatory agency, ACMA is not directly responsible for taking forward policy proposals - Budget proposals are primarily driven out of the Portfolio department. As such there are limits to our ability to bid directly for additional funding through the new policy proposals in the budget process.

The net effect of the above is that for ACMA's to maintain 2007/08 funding levels, ACMA needs to absorb $4.3m of increased expenditure and funding shortfalls. At the same time, our effective cost base is rising at a rate of 4-5 % annually, as described earlier.

Table 1 shows the components, and the net financial impact of the falls in revenue and increases in cost.

Table 1 – Funding impacts relating to ACMA's budget position resulting from decreases in revenue and increases in expenditure that must be absorbed.

Funding Impact	**2008/09 $'000**	**2009/10 $'000**	**2010/11 $'000**	**2011/12 $'000**
Loss of funding from the one-off 2% increase in the efficiency dividend	1,777	1,695	1,700	1,700
Loss of funding from the ongoing increase in the efficiency dividend to 1.25%	1,165	2,225	3,290	4,142
Increased expenditure resulting from employee pay increases	2,511	4,725	7,012	9,292
Increased expenditure from the annual increase in fixed expenses	651	1,322	2,012	2,724
Funding gained from the parameter adjustments received	(1,838)	(1,811)	(1,642)	(1,578)
Net funding 'shortfall'	**4,266**	**8,155**	**12,373**	**16,279**
Shortfall as a percentage of ACMA's appropriated funding in the relevant year	**4.5%**	**8.6%**	**13.1%**	**17.2%**

Table 1 illustrates that, if there is no change to ACMA's funding base over the coming years and current policies continue, our 2008/09 funding of $94.5 million will need to absorb $16.3m to maintain ACMA's 2007/08 funding level, in 2011/12, despite the parameter adjustments. This means ACMA will be facing an effective net funding shortfall of $16.3 million or (17.2 % of budget). While ACMA is currently focussing on a significant organisational transformation with 'best of breed e-facing outcomes' as its principal KPI, the benefits of the transformation are several years away. It is problematic that internal efficiencies will be able to bridge a gap of that magnitude.

While the ACMA was recently subjected to a funding review following the merger, the logic of Table 1, combined with our experience over the last several years of the increasingly complexity of our work, has confirmed our growing view that this base funding is unlikely to be adequate to meet the range of anticipated Government and community expectations of ACMA going forward.

TOR 2 - whether the efficiency dividend is now affecting the capacity of smaller agencies to perform core functions or to innovate

ACMA must accommodate the efficiency dividend for the 2008/2009 financial year. However, this will require ACMA to prioritise services across the organisation with the possible consequential impact on the quality, effectiveness and timeliness of its outcomes. The 2009/2010 financial year will be a continuation of the reduction in resources with outcomes being impaired as ACMA accommodates the year's overall funding reduction of 5.1%, representing a decrease of $5m, as represented in the Portfolio Budget Statements. As the shortfalls, illustrated in Table 1 increase over coming years, so too will the effect on ACMA's ability to meet the expectations of Government and the Australian community. The efficiency dividend model operates in practice as an austerity measure and does not seem to take account of the following:

- The agency's outcomes to be achieved (which can vary between years)
- Ongoing policy shifts and programs
- The agency's ability to devote sufficient resources and head space to transform itself, and on a sustained basis
- Statutory regulatory obligations and associated activities and the degree to which matters will be increasingly contested in courts and elsewhere
- Reinvestment to ensure sustainability and organisational resilience through transformation and innovation
- Specific responsibilities assigned to agencies that in some instances require additional resources
- Additional tasks and responsibilities determined by stakeholders
- Fixed costs
- Employee morale (especially exacerbated against a backdrop of increasing professional skills' shortages in relatively unique areas of ACMA's responsibilities (e.g. radiocommunications' specialists and broadcasting licence planning))
- Ongoing surety
- Flexibility aligned to supporting core activities.

In relation to core functions, as resources diminish, the ACMA will adopt responsible risk minimisation strategies to deal with the circumstances it would find itself in. These strategies will be increasingly focussing on responding to immediate pressures and/or which have a higher governance requirement (e.g. revenue protection). In turn, this is likely to manifest as increased delays in our regulatory and other functions and a reduced capacity to have time, head space, energy and the will to re-invest internally and transform the agency into an organisation of sufficient resilience and adaptability to cope with the multiple paradigm shifts that an increasingly converging Communications sector will manifest.

While these matters can be initially partially offset by looking at efficiency measures, it is worth noting that the nature of some of those measures affect the character and the ability of ACMA and the way it undertakes its core functions, projects and meets its legislative mandate. For example, within the current cost environment, ACMA is already examining the role, structure and indeed existence of its regional presence.

Also, ACMA is subject to peak periods in regulatory obligations and projects – albeit the peaks seem to be both coming more frequently and increasing in scale. In 2006 and 2007, ACMA was often required to perform additional tasks as a result of Ministerial direction and/or legislative change. These activities were often comparatively minor in nature and therefore did not meet required thresholds for new policy funding. However, when combined, these range of activities had a cumulative effect that impacted significantly on the agency's ability to continue to deliver all services.

Calendar year 2007 saw a particularly high level of such requests from Government, which created particular pressures. Two recent examples of this include some intensive work associated with the closing of the Telstra CDMA network; and a report to the Minister on filtering technologies used by internet service providers. ACMA generally undertakes such tasks by re-prioritising other activities resulting in subsequent delays on other tasks. One such delay has been the increased time taken to finalise broadcasting investigations, which has led to criticism in a recent ANAO report.

There is also a risk to regulators such as ACMA that a highly constrained financial environment will affect our ability to undertake regulatory compliance actions where these are likely to have significant resource implications. In turn, this means that financial constraints are limiting the effectiveness of the regulator in ways that may not always be obvious. This is also of relevance to situations where major and costly investigations, or the development of significant new policies, may be required. Of greater concern, however, is the potential effect of these cost pressures on ACMA's ability to innovate.

One of the benefits of the merger has been to demonstrate the range of very different approaches to sometimes similar issues across the range of communications legislation, much of which is based on the touchstone concepts within the communications' sector that are becoming increasingly strained as the result of technological and market developments. While all agencies need some capacity for forward thinking, the ACMA considers that the nature of the changes occurring in communications – which are at the level of a genuine paradigm shift – is over and above the changes occurring in most other industries. The organisation's mindset, approaches and processes must shift in response and undergo organisational transformation. The related imperative to have an evidence-based outlook in regulating is increasing, rather than decreasing, for otherwise the risk to decision-making, including criticism and challenge, will inevitably rise.

Communications regulators need to have, and indeed nurture, a genuine and robust capacity to think strategically about how to respond and position regulatory decision-making, including a capacity to usefully input into broader government thinking about potential structural regulatory change. It is also important that ACMA have a capability to inform our stakeholder community about developments and interact appropriately. The capacity to do this, and to reap the anticipated benefits of a transformed converged regulator, is a large part of what is at stake in a contracting financial environment.

More generally, there is a structural problem in that smaller agencies without direct access to NPP processes may identify issues that could be useful for Government and the community and/or that may produce broader efficiencies, but are constrained in their ability to bring ideas to Government because there is no conduit for doing this, other than writing to Portfolio ministers and attempting to reach NPP thresholds. In turn, this acts to stifle innovation as there can be a disincentive on smaller agencies attempting to do this – which collectively means that many good ideas probably do not see the light of day. One idea for addressing this issue is identified in TOR 6 below.

TOR 3 - what measures small agencies are taking to implement the efficiency dividend, and the effect on their functions, performance and staffing arrangements

ACMA has been pursuing efficiency improvements on a number of fronts. Some examples are provided below.

Field Operations

Over the past few years, ACMA, and before it the Australian Communications Authority (ACA), has been significantly streamlining its approach to field operations. This has resulted in considerable savings from the downsizing and closure of regional operations' centres, and the centralisation and rationalisation of a number of functions. While this activity is likely to continue, further downsizing is limited. ACMA's direct regional presence is disappearing.

Business Process Re-engineering

Supporting those changes, ACMA is currently working on a significant business process re-engineering exercise called "Project Spectrum". While this is mainly focussed on our high volume business transactions (e.g. the ACMA issued over 148,000 radiocommunications licences in 2006/07), this project also has the capacity to set ACMA up for a more efficient way of operating right across the agency, to be best in breed as a true e-facing government organisation. We anticipate that this will, if fully executed, create longer term savings as ACMA moves to an e-business model as part of the transformation process, and to better ways of interacting with our stakeholders. Of all the government agencies, ACMA should be 'best in breed' as an e-facing organisation because of its intimate relationship with the digital and IP world.

Streamlining Functions

ACMA has been streamlining a range of regulatory functions across a number of functional types by looking at its approaches to investigations across the organisation. While ACMA is pursuing these efficiency improvements for a range of reasons – to implement a more resilient structure that we anticipate will be necessary for the communications environment for the future – it does not anticipate that the cost savings from these improvements will be on a scale sufficient to compensate for the funding gap described earlier.

New Regulatory Approaches

Perhaps more fundamentally, ACMA sees some of the more significant improvements in efficiency in communications – both for itself and for industry – as potentially coming from changes to regulation and harmonising approaches between the disparate legislation for which it is responsible. While it is not ACMA's role to advise directly on legislation, ACMA is institutionally well placed to identify and offer advice to Government on options for improving current processes that can be implemented to provide efficiencies. However, ACMA's ability to do the necessary analysis depends on having the organisational capability to manage these processes. In that situation, the efficiency dividend counter productively erodes its 'discretionary' capability.

TOR 4 - any impacts of the efficiency dividend on the use by smaller agencies of "section 31" agreements to secure non-appropriation receipts (e.g. through user charges and cost recovery) - noting that these receipts are not subject to the efficiency dividend

One notable change for ACMA in comparison with its predecessor organisations (the ACA and the Australian Broadcasting Authority (ABA)) has been the shift from being a Commonwealth Authorities and Companies Act agency to a Financial Management and Accountability Act agency. This has meant that its ability to retain funds from a range of sources, including non-appropriation receipts, has diminished markedly (as has its general financial flexibility). Another important change has been the loss of flexibility in managing losses or surpluses from year-to-year. This is significant in ACMA's case because a proportion of its work is externally driven by demand. For example, the ACA was given initial NPP funding for three years to fund the early development of the now internationally proclaimed submarine cable protection zones and to develop much of its processes going forward. However, NPP funding for that project ceases in 2008/09 with implications for future protection zone requests. This is likely to occur at a time when it will be, increasingly certain that there will be an expected exponential increase in international data flows from the implementation of the government's NBN vision. The assumption is that somehow this can be funded from our base funding. While these are subject to cost recovery arrangements, ACMA does not retain these earnings.

TOR 5 - how application of the efficiency dividend is affected by factors such as the nature of an agency's work (for example, cultural, scrutiny, or regulatory functions) or the degree of discretion in the functions performed by smaller agencies

As noted earlier, ACMA is unusual in that, for an agency with less than 600 staff, we cover a particularly broad portfolio of subject matter and, more importantly, types of activity.

In relation to subject matter, our portfolio includes telecommunications; broadcasting and media laws; and internet regulation. In turn, this subject matter requires a range of skill sets that cover technical, economic and relevant social analysis (e.g. classification) skills, and an ability to be able to manage and integrate these skills with policy development expertise. Ironically, our work includes each of the "cultural, scrutiny or regulatory functions" mentioned in the Committee's TOR 5 along with a significant range of other functions. This all happens within what is a complex and increasingly contested legal framework that involves both direct and indirect forms of regulation (the latter including co-regulatory code arrangements). Public concerns and commercial pressures in these areas appear if anything to be growing rather than diminishing, as is scrutiny of ACMA's performance.

The ACMA also manages the radiocommunications spectrum, which is in itself, a highly specialised and important function that has been growing in importance and will be crucial to the national interest over the next five years as the analogue switch off and the digital dividend debate plays out. At the same time, this is an area where across the entire sector there are specific skills acquisition and retention issues.

There has also been a tendency for any initiative that ACMA is then working on (and skills requirements) to continue to proliferate in terms of types of work and complexity. For example, in recent years ACMA has acquired a range of internet gambling, SPAM, and e-security functions as these new concerns have arisen. This has involved acquiring new sets of technical and related expertise specific to those aspects of the internet.

In addition to regulation, ACMA also has a significant revenue collection function. ACMA annually raises approximately $700 million in revenue for the Commonwealth. This revenue is returned to the budget and there is no recognition for the collection of revenue when determining the ACMA budget allocation. The application of the efficiency dividend to the overall budget of ACMA can effectively preclude ACMA from devoting additional resources to ensure that this revenue is collected and not at risk.

Recently, ACMA has been required by Government to take on some program management functions in addition to its traditional regulatory roles. For example, ACMA now manages the Do Not Call Register program, and also administers a number of contracts that were formally administered by the DBCDE. These new functions, some of which were not funded, now also means ACMA needs to have a range of contract management skills at a significantly higher level than in the past.

TOR 6 - if appropriate, alternatives to an across-the-board efficiency dividend to encourage efficiency in the Commonwealth public sector, including consideration of whether certain agencies should be exempted from the efficiency dividend, or whether the rate of the dividend should vary according to agency size or function.

In addition to the exemption options described under the Committee's TOR6, other potential variables could be:

- potential risk to mandated outcomes from a funding shortfall; and
- an assessment of the level of 'innovation' versus process within an agency.

Other models apart from simple exemption that could be considered include :

1. Treating "mixed" agencies such as ACMA as full cost recovery agencies that measure their outcomes against revenue raised and ensure through the Commonwealth's cost recovery policy that expenses (inclusive of innovation, investment and continuous improvement activities) can be met out of revenue. Several Commonwealth agencies have adopted this position and are expense neutral whilst still adhering to policy, delivering outcomes and retaining their own funds for specific internal investment aligned to increasing requirements, improving services and reducing costs of regulation and services.

2. Moving to some form of multi-year funding with a regular review (e.g. triennial funding) for agencies which are considered to have particular circumstances that warrant such an approach – for example those that are in a particularly complex environment with a high premium on innovation and where circumstances are more difficult than normal to predict.

3. Allowing smaller agencies to put forward on some regular basis (maybe annually or biannually) a kind of 'omnibus' equivalent of a new policy proposal that enables the agency to identify issues and draw together a proposal to government that may address a range of smaller activities that individually would not meet normal thresholds for a major NPP.

4. The committee may also wish to consider whether there is any scope for allowing smaller agencies to identify areas of variable or contingent funding and have these

funded separately from an agency’s base funding. For example, in ACMA’s case, it is difficult to predict what our Budget for litigation might be as this will depend on circumstances and whether or not ACMA’s decisions are challenged in court. Under this model, regulatory agencies such as ACMA would be given a litigation contingency reserve that was transparent and independent from normal base funding. It should be noted that the ACCC currently benefits from such an arrangement.

5. The committee may also wish to consider other approaches that provide incentives for agencies and ‘reward’ efficient operation, innovation, and good financial management, while not reducing services. Some initial ideas include:

- allowing smaller agencies to retain some or all of the earnings from cost-recovered activities – particularly where such activities are subject to significant variability in demand; and

- providing ‘rewards’ for agencies that effectively reduce ongoing cost bases – e.g. by giving greater flexibility in allowing small agencies that are seen as financially responsible to carry-over surpluses and/or losses between financial years.

Thank you for the very timely opportunity to submit these observations on what is perceived by ACMA on the seemingly blunt nature of the ongoing efficiency dividend. We are concerned that it is likely to give rise to unintended consequences.

Chris Chapman
Chairman