The Treasury

Budget 2018 Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

From: Joseph Sant [TSY]
Sent: Wednesday, 15 November 2017 5:07 PM
To: Andrew Marshall
Cc: 'Alexandra Jackson'; 'JC Somers'; Kathryn MacIver; Carolyn Palmer [TSY]; Emily Irwin [TSY]; Carolyn Palmer [TSY]
Subject: Monitoring comments for budget bid advice

Hi Andy (and team),

Thanks for the opportunity for monitoring to contribute to MBIE's advice on ACC's Cost Pressures and budget bid. Per our discussion today I would like to propose three considerations for your advice to the Minister, detailed below. These points should be taken as monitoring input into MBIE's process and do not constitute Treasury specific advice. Our Vote team will consider the budget bid and associated materials once submitted.

Altogether, the rationale for the budget bid is relatively clear. The narrative as I see it is:

- The funding position is broadly consistent with last year; where the benefit of the change in funding policy, introduction of management responses and movement in discount rates from June '16 to Dec '16 were already taken.
- Since this time, new cost pressures on volume (population – new year claims) and social rehabilitation (OCL) are driving an increase to the budget bid. Each of these changes warrant discussion.
- The under-funded position inherited is driven by moving discount rates since the last full re-baseline and increasing costs that have not been funded (Sensitive Claims, LOPE) or accepted but fall into the funding adjustment (GP U13s, Ambulance). There have been few efficiency/experience gains over this period.

1) Population assumptions (+50k starting point and steeper trajectory – equates to $46-$80m impacts by year)

ACC has supplied a graph illustrating the gap between the prior assumption. Therefore, there is no challenge on the assumption used being reasonable. Other things to consider:

- Volume growth in the last 12 months in the NEA (to September 2017) is -1.1% (source: ACC Q1 report). This is important as frequency is a much stronger driver of volume/claim costs than population is (note the June '17 valuation report – 9% average growth in payments over 5 years, 5% of which is frequency and 1% is population). Would need to understand what impacts on volume other than population for net impact.
- Frequency also has a $2.7-$5.8m per annum pressure – Other medical (sensitive claims offsets physio, elective surgery). These are fundamentals driven and no specific change to volume expectations.
- Input assumption was taken from December 2016. The steeper trajectory of population growth may be dampened by wider government policy; there would likely be an increase in unemployment due to minimum wage, however meaning an offset from wider policy.

- **Recommendation: Option to fund lower than 100% of population pressure to reflect the lower starting point for volume.** This would also promote a conversation with the Minister around other volume driver assumptions.

2) Cost pressures related to Social Rehabilitation Serious Injury ($8.9-$10.1m increase to new year claims and $74m down to $33m over 4 years for OCL impact)

Based on experience of increasing care hours above expectations – target of ~2% growth in care packages with actuals of +3%/+3%/+4% over last three years. Considerations:

- Monitoring conversation with ACC in May 2017 described a series of operational control failures that have contributed to the lower than expected performance.
- Management response to reinforce core controls (national consistency panels, appropriate capability on service needs assessments, centralising serious injury service to improve monitoring) in place.
- Recent performance to that management response = -0.5% growth in care hours over 12 months. This is not a full recovery in performance but indicates the ability to apply controls
  - Note; 4,000 hours per week saving quoted by ACC (source: attached email from ACC dated 14/11/17);
  - Making a broad assumption of 50% of saving in NEA and average $30/hour agency cost = 4,000/2 * 30 * 52 = ~$3m per annum off new year costs;
  - Social Rehab Serious Injury multiplier (per valuation report) = 39.7. 3m * 39.7 = ~$120m (or $12m per annum using funding policy).

- **Recommendation; Advise that a challenge for a further management response is warranted.**
  - Conservative estimate based on 4,000 hours being sustained ($3m + $12m per annum).
  - A more aggressive estimate would be to either
    - Straight top-down cut of 50% of the cost increase (ie. $5m + $$37m in year 1; $5m + $16m in year 4)
    - Backload the management response – less challenge in year 1, increasing to, say, 100% of growth in cost in year 4)

3) Management response on increased capital expenditure ($3m-$5m reduction to liability per annum; net of cost pressures in 'other social rehabilitation')

- Investment into enabling independence through training or provision of equipment. Growth in the liability has been ~$30m per annum for Capital expenditure (SI and non-SI combined; 7.5% average growth), significantly above inflation.
- The scale and success of management response to date is underwhelming and appears to carry risk – a much higher baseline of capital expenditure without the requisite impact on care hours (where the opposite has been happening).
- PwC has reverted an assumption it had for the rate of growth in capital expenditure to return to historic normal levels at some point (even though a higher base) but has now incorporated the higher growth rate (source: June '17 valuation report).

- **Recommendation; Discussion with ACC management at when they would reassess the approach for its success** and what would a reversal look like? What impact does the provision of equipment have on client satisfaction and is the ~$110-120m investment in the last four years worthwhile? How would this be assessed?

We discussed these three points at length in our meeting today. However, I'm available for any further questions.

Kind regards,
Joe

Joseph Sant | Senior Analyst | **The Treasury**
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