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Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Our ref Document1

29 October 2014

Dear Sir/Madam

Please find attached a paper that has recently been released by KPMG entitled *Unleashing Value: Rethinking Regulation in the Human Services Sector*.

We believe the paper will be of particular interest to the Competition Policy Review given the focus in the Review's draft report on the need for deepening competition in the human services economy, an area that is often neglected in competition policy reviews.

The issues outlined in the paper reflect some of the key insights we've gained through our work with a number of government and non-government organisations in the human services sector here in Australia and overseas.

We believe there are considerable gains to be made by fundamentally rethinking the approach to regulating human services and that Governments need to move swiftly to engender the right regulatory conditions for new consumer driven human services markets.

I trust the Review will find the paper an interesting and informative read and that it can help contribute to the debate about how best to introduce more competitive approaches in human services and deliver better outcomes for service users.

Please do not hesitate to contact me on (02) 9335 8233 or Tina Davey on (07) 322 56865, if you have any questions or wish to discuss our paper further.

Yours sincerely

Liz Forsyth

Deputy Chair, KPMG Australia,

National Sector Lead, Health, Ageing and Human Services

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KPMG

cutting through complexity

Unleashing value: rethinking regulation in the human services sector

kpmg.com.au

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Contents

1 **Foreword** 1

2 **Context and background** 2
- 2.1 Sector and market reform
- 2.2 The deregulatory agenda

3 **Regulation in the human services sector** 5
- 3.1 Traditional models
- 3.2 Reforms to date have only got us part of the way
- 3.3 Managing risk in the human services sector
- 3.4 Level of risk tolerance

4 **A new way** 11
- 4.1 Market maturity
- 4.2 Guiding principles
- 4.3 Using all the tools in the toolbox
- 4.4 Collaboration is vital to deliver outcomes

5 **A best practice framework** 21
- 5.1 Assessing performance
- 5.2 Role of Government in self-regulation and co-regulation

6 **The path to reform** 26

7 **About KPMG** 28
- 7.1 How KPMG can help
- 7.2 Our experience

8 **Contact us** 32

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Foreword

With the introduction of consumer directed care, contestability and other market type reforms in human services, governments across the country are having to fundamentally rethink the way they regulate the human services sector. This is happening across most of the human services economy including in the areas of health, disability, housing, community, aged care and child and family services.

Responding to these trends does not necessarily mean less regulation but it does mean smarter and more sophisticated regulation. Experience suggests that, where human services markets are in transition, it is more critical than ever for government to play a role in shaping those markets and ensuring they operate effectively to deliver services for the community.

In the case of human services, where services are provided to some of the most vulnerable and disadvantaged members of the community, there need to be clear frameworks for responding to market failures, ensuring quality services to individuals and providing stability and certainty for providers. However, the tools on which government has traditionally relied for regulating human services are no longer fit for purpose, and new ways of working are now required.

Government needs to radically redefine its role and relationship with service providers, individuals and the general community. The approach needs to shift from coercive prescriptive regulation of service providers to empowering both individuals and providers to manage risks and creating the right regulatory conditions for these fledgling markets to thrive and flourish.

New tools, skills and capabilities are urgently needed to help policy makers make this shift. Regulators and decision makers need a good understanding of market dynamics and the impacts of regulation on the operation of the market. Staff need to be trained in assessing and managing risk and how to design proportionate responses using the full range of alternative tools that are available in the regulatory toolkit (including non-regulatory responses).

Reform is not easy, and it is far more challenging to develop interventions that are built around a detailed understanding of risk and that differentiate based on performance than it is to simply create a one-size-fits-all licensing regime. However, governments that can redesign their regulatory systems and harness the power of these emerging markets will be well positioned to meet the growing demand for services and deliver value for money for taxpayers and service users.

Liz Forsyth
National Sector Leader
Health, Ageing and Human Services
Deputy Chair, KPMG Australia

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Context and background

The human services market – which covers health, disability, housing, child and family services and community and aged care – continues to grow in size and importance.

Governments are increasingly having to do more with less, while continuing to deliver outcomes and protect society's most vulnerable and disadvantaged.

Tightening budgets and an increasing demand for services provide a strong incentive for all governments to reconsider traditional models of service delivery. This has led to the adoption of market-based reforms in the provision of human services – for example in health, disability, aged care, housing, and child and family services. These approaches are redefining government's relationship with service providers, individuals and the general community, including the way it regulates services.

2.1 Sector and market reforms

The human services market – which covers health, disability, housing, child and family services and community and aged care – continues to grow in size and importance. The demand for health, aged care and child care services in particular is expected to continue to fuel growth in the sector. At the same time, there will be increasing challenges on the supply side with providers competing for a skilled workforce to meet growth in demand.

The human services market has been undergoing major change as governments move out of direct service delivery and seek to manage and deliver services through greater use of managed markets and consumer directed approaches. The recently released Competition Policy Review (the Harper report) has called for reforms in this area to go much further in order to drive much-needed productivity improvements across the sector[1]. As a result, governments across the country are having to fundamentally rethink the way they regulate the human services sector.

1. Australian Government (2014), Competition Policy Review, Draft Report.

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Contestability

Like other government services, human services are now being exposed to competition as Government seeks to drive greater efficiencies in the face of escalating demand for services. Contestability does not necessarily mean outsourcing of services but it does mean benchmarking publicly provided services against alternative modes of provision.

A number of jurisdictions are recommissioning human services including health, housing, and disability services and seeking interest from a range of providers in taking on services. The role of Government as a direct provider of services is progressively diminishing as it moves to more of a stewardship and purchasing function.

The potential for productivity gains from introducing greater competition and contestability is considerable with estimated gains of between 20 and 25 percent for Government services not previously exposed to competition.[2]

The market for human services is predominantly supported by government funding.

Person-centred approaches and consumer choice

The introduction of person-centred care through the National Disability Insurance Scheme (NDIS) and consumer-directed care in aged care is essentially about driving a more market-based approach to human services. Unlike the market for many other goods and services, the market for human services is predominantly supported by government funding. Services where individuals receive the services free, or where standard prices are set by government, do not provide price signals to individuals to distinguish between services based on an assessment of relative costs and value. Instead, services are usually funded via block or output funding models using contracts between government and service providers or in some cases, funded and provided directly by government itself. Where individuals are allocated directly to providers, this dulls the incentives for providers to respond to individuals' needs and preferences.

Person-centred care in the NDIS is about introducing an empowered consumer into the market for services with direct purchasing power and the ability to exercise choice and control over the services they need. While services are still reliant on government funding, the funds are being put in the hands of the consumer. This new funding approach is starting to be applied to people with complex needs and (in some limited cases) to homelessness services. This new approach will have profound implications for providers, who will no longer be able to rely on funding from the government and instead will have to compete for the purchasing dollar of increasingly informed consumers.

The markets for human services vary across different service types and, in some cases, are immature and evolving. For instance, the aged care and child care markets are fairly mature and well established and tend to be dominated by private and for-profit providers, with government playing a limited role. The disability services and social housing and homelessness services markets, on the other hand, are far less mature and have traditionally been associated with government and not-for-profit providers. Considering varying levels of market maturity will be critical in developing a new market-based approach to regulation in the sector.

The recently released Competition Policy Review (Draft Report) highlights that a number of important reforms are needed in the human services sector

"[It is recommended]... that deepening and extending competition policy in human services is a priority reform. Removing barriers to entry can stimulate a diversity of providers, which is a prerequisite for expanding user choice. Small gains in productivity (driven by competition)... have the potential to deliver large gains across the community."

In the human services sector the Panel recommends that:

"Australian governments craft an intergovernmental agreement establishing choice and competition principles in the field of human services."[3]

2. Sturgess, Gary L, Diversity and Contestability in the Public Service Economy (2012), p.7.
3. Competition Policy Review (Draft Report), page 26.

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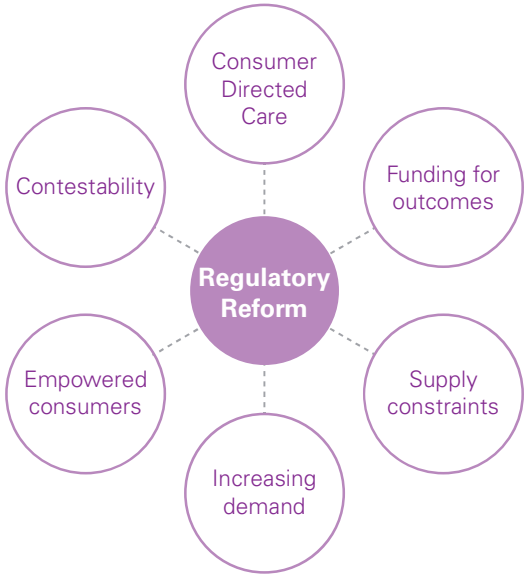
Figure 1: Factors influencing need for regulatory reform in human services



Source: KPMG, 2014.

2.2 The deregulation agenda

At a time when all levels of government are focused on repairing budgets and driving sector-specific reforms, they have also outlined clear objectives around regulatory reform and reducing 'red tape'. This reform platform builds on the idea that no one was ever regulated to excellence.[4]

The Australian Government has a clear commitment to reduce the regulatory burden by $1 billion per year.[5] To drive this agenda it has:

- asked policy makers to see regulation as an intervention of last resort
- included twice-yearly parliamentary repeal days (the first repeal day reported identified cost savings of $700 million)
- outlined that every substantive policy option must be considered in a Regulatory Impact Statement
- established Deregulation Units in every portfolio and tied the deregulation agenda to Secretaries' and senior officials' performance agreements.[6]

State and Territory governments' commitment to regulatory reform is also clear and unambiguous:

- New South Wales has a 'one on, two off' policy in place for all new legislation
- Victoria has a program to reduce red tape by 25 percent (or $500 million per annum)
- Queensland has set a target to reduce the burden of regulation by 20 percent by 2018
- South Australia is committed to a rolling five-year review of all State business regulation.

This strong focus on deregulation provides yet another incentive to rethink the way human services are regulated in Australia, and in particular provides a platform for applying more market-driven approaches.

4. The Hon. Christopher Pyne MP (May 2014), The Return of the Menzies Tradition in Australian Higher Education.
5. Australian Government (July 2013), The Coalition's Policy to Boost Productivity and Reduce Regulation.
6. Australian Government (2014), The Australian Government Guide to Regulation.

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Regulation in the human services sector

Regulation in human services has tended to be paternalistic in its approach, with risks framed around worst case scenarios and all service providers treated the same regardless of the level of risk to the individual or the performance of providers.

While these tools may have been effective in managing risks in the past, they have also encouraged a passivity among both providers and individuals which has stifled innovation and productivity.

While these tools may have been effective in managing risks in the past, they have also encouraged a passivity among both providers and individuals which has stifled innovation and productivity.

In regulating human services, governments have focused on traditional approaches which involve licensing/registration of providers, strict monitoring and compliance regimes and extensive reporting requirements.

Regulation is being defined more and more broadly to include not just black-letter law but other types of arrangements entered into by government which affect third parties, including service agreements and administrative guidelines. These have also tended to reflect heavy-handed master–servant type relationships. As the Productivity Commission noted in its report *Contribution of the Not-for-Profit Sector* (2010), "improving the overall efficiency and effectiveness of community services delivered by the not-for-profit sector has been constrained by the propensity for governments to combine short-term heavy-handed contracts with extensive reporting requirements and a tendency to 'micro-manage' service delivery".[7]

Notwithstanding the increasingly broad view of what constitutes regulation, there is a distinction between policy making and regulation. For example, decisions to introduce competitive type reforms in human services are policy decisions, as are decisions about how much funding human service delivery

7. Productivity Commission (2010), Contribution of the Not-for-Profit Sector, Chapter 12, p297.

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organisations should receive and what services government should fund. Regulatory behaviour comes into play in thinking about the types of interventions that will assist in achieving government policy objectives – for example, whether the government needs to use the force of law to compel behaviour towards achieving its particular goals.

Regulations and purchasing agreements have generally been designed internally by government with little attempt to work with stakeholders to look at different ways of addressing policy problems. Political imperatives often demand regulatory solutions to one-off problems, which end up creating systemic responses to non-systemic issues. In particular there has been little understanding of how markets work in a human services context and of the opportunities that government has through intervening in different ways to encourage more innovative service practices.

At the same time, it is important to recognise that human services markets have a number of unique characteristics which can be challenging for regulators. Most human services markets are characterised by information asymmetry, where consumers have difficulty judging the need for and quality of the services they receive. Consumers also include the vulnerable and disadvantaged, who are not well placed to exercise consumer choice. On the supply side, these markets tend to be dominated by not-for-profit providers who are largely dependent on government funding, and there can be particular problems with supply of services in rural and remote and Indigenous communities.

It is important to recognise that human services markets have a number of unique characteristics which can be challenging for regulators.

3.1 Traditional models

The culture of most human services agencies in government is to regulate with little or no consideration of alternative methods or models. Their approaches tend to be:

- overly prescriptive, providing little or no opportunity for more flexible or innovative approaches to deliver the outcomes
- overly focused on compliance and enforcement, placing unnecessary costs and burdens on regulated entities
- based on poor or limited understanding of the 'real' risks that they are trying to manage, and regulatory systems that are designed around these risks tending to focus on the worst case scenarios
- designed in a one-size-fits-all manner with limited 'real' variation in the regulatory obligations imposed on a provider depending on their performance
- focused on the relationship between the providers and government – with often little, if any, recognition of the role the market or sector can play in driving better outcomes and higher standards
- involve substantial duplication and overlap in licensing/registration and reporting requirements as various government agencies seek the same or similar information from providers
- focused on sanctions – although in practice there are limited examples of providers being defunded or deregistered, insufficient attention is paid to investing in up-skilling or assisting providers move towards 'better practice'
- designed with little opportunity to reward strong or outstanding performance (i.e. beyond just extending contract terms).

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3.2 Reforms to date have only got us part of the way

Governments have been pursuing deregulation agendas for a number of years in recognition of the increasing and often hidden costs of regulation to business and the impacts of regulation on Australia's overall economic performance and productivity.

While reforms have focused on reducing the regulatory burden on providers primarily by streamlining and reducing the frequency of reporting requirements, there has been no systematic attempt to adopt a more contemporary best practice approach to regulation. Nor has consideration been given to addressing the more fundamental issue of how government can regulate in an evolving human services market to secure the best outcomes for the community.

It is critical that there is a strong and diverse market for the full range of human services and sufficient supply of services to meet growing demands. Indeed, the success of contestability reforms is dependent on the capacity of non-government providers (including not-for-profit and for-profit providers) to provide a viable alternative to government provision. The key challenge for regulators is how to protect the most vulnerable in our community and ensure access to quality services while building the capacity and capability of a range of providers and not unduly constraining the market.

While reforms have focused on reducing the regulatory burden on providers, there has been no systematic attempt to adopt a more contemporary best practice approach to regulation.

The United Kingdom provides a useful reference when considering how best to introduce competition and choice into public services

Central to the UK model of more open public services are five key principles – increased choice, decentralisation, diverse provision, fairness and accountability. Some relevant examples of actual change include:

- Opening a total of 174 school 'free schools' – schools are being set up in response to local community need to improve educational outcomes in their communities.
- The development of personal budgets for health and social care services - similar to Australia's NDIS model, personal budgets will involve money being transferred from government in the form of direct payments to individuals that can then be used to purchase tailored services. In 2012-13, some 714,000 people received a personal budget.
- In the area of empowering consumer choice, students can now access more information on the performance of colleges and universities. It is estimated that almost 800,000 unique visitors a year access the relevant websites.

Source: United Kingdom Cabinet Office (2014), Open Public Services

3.3 Managing risk in the human services sector

Most regulatory decisions in the human services sector are made in the context of protecting individuals, providers and governments against risk. In the case of human services, these risks include both non-financial and financial risks. Non-financial risks include risks to the safety and well-being of the individual including some of the most vulnerable members of our community, such as people with a disability, children and the elderly, while financial risks relate to the need to protect government investment in human services.

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The Australian Government Guide to Regulation:

"Regulation can't eliminate every risk, nor should it. Therefore we seek better regulation not more regulation."

"Policy makers must seek practical solutions, balancing risk with the need for regulatory frameworks that support a stronger, more productive and diverse economy where innovation investment and jobs are created."[8]

The Hon. Josh Frydenberg MP

Separating the role of government as a regulator from its role as a funder and provider is a key recommendation from the Competition Policy Review report.

Human services are predominantly government funded, and government is likely to continue to be both regulator and funder. This contrasts with pure economic regulation where government intervenes in private markets with no associated direct financial interest. The need to protect the government's financial interests in human services has undoubtedly contributed to the types of prescriptive reporting-driven compliance regimes that have characterised the sector.

Separating the role of government as a regulator from its role as a funder and provider is a key recommendation from the Competition Policy Review report.[9] While there are strong arguments for separating out roles when government is both regulator and provider (to avoid direct conflicts of interest and a tendency for government to favour its own providers over third-party providers), the need to separate funding from regulation is less clear cut – although the trend is already evident with the establishment of independent regulatory bodies in health, higher education and vocational education and training. The OECD report Best Practice Principles for Regulatory Policy sets out key considerations for determining when it is appropriate to establish more independent and autonomous institutional arrangements taking into account the political environment and the type of regulation being considered.[10]

The identification of a risk (whether it be financial or non-financial) does not on its own justify government intervention. Any assessment of risk should consider risks from a range of perspectives, including the risks to government, the broader community and the individuals or beneficiaries of the regulation. Risk assessments should be based on an analysis of available data, stakeholder consultations and expert insights.

While it is one thing to develop a strong understanding of the key risks, it is another thing to decide what actions, if any, need to be considered. It is at this point that the notion of risk tolerance becomes critical.

8. The Australian Government Guide to Regulation, page i.
9. Australian Government (2014), Competition Policy Review, Draft Report
10. OECD (2014), Best Practice Principles for Regulatory Policy, 'The Governance of Regulators', p18

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The Productivity Commission commenting on the regulation of aged care in its Report on Caring for Older Australians released in 2011:

"This inquiry confirmed the findings of previous reports that the current aged care system contains a plethora of unnecessary, complex and burdensome regulations. Many of them relate to quantity and price restrictions and over-reaction to specific incidents."

"It is a system with complex, overlapping and costly regulations – with an embedded culture in governments of excessive risk aversion and a lack of independence of some regulatory activities."[11]

3.4 Level of risk tolerance

More so than in most other sectors, decisions to regulate or not in the human services sector are heavily influenced by a government's tolerance for risk. In the area of human services, risks have tended to be framed around worst case scenarios, with a one-size-fits-all approach that fails to distinguish between the different risk profiles of providers. An isolated adverse event in a nursing home or child care centre can provoke a system-wide response that is disproportionate to the problem and the risk and can impose unnecessary costs and burdens.

Understandably, governments do not want adverse outcomes being reported on the front pages of the national papers. However, the consequences of low or misinformed risk tolerance is often a quick decision to implement wide-ranging regulatory changes that will do little, if anything, to address the core problem at hand – that is, introduce a systemic response to a non-systemic issue.

While governments will ultimately determine their own risk tolerance, departments and agencies can play an important influencing role through:

- recognising that sometimes 'no action' is the correct response – sometimes adverse events occur despite people's best endeavours
- referring matters and issues to other, more appropriate regulatory authorities – for example, other regulators with a greater role in the specific issue at hand or, in the case of criminal actions, the police
- utilising data analysis techniques and/or evaluating existing regulatory or non-regulatory responses to demonstrate the link or lack of a link between the regulation and the adverse outcome
- communicating regulatory successes – developing the idea that regulations don't just manage risks but can also play an important role in delivering positive outcomes.

Any organisation should evaluate its risk profile on a regular basis. For regulators playing a role in the human service sector, the re-evaluation of risk should include an in-depth understanding and analysis not just of the risks faced by government but also from the perspective of individuals, providers and the market.

In the area of human services, risks have tended to be framed around worst case scenarios, with a one-size-fits-all approach that fails to distinguish between the different risk profiles of providers.

11. Report on Caring for Older Australian's and Page i for the Australian Government Guide to Regulation, page XLVI

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In rethinking regulation in the human services sector, consideration of these fundamental questions should inform any new approach:

Key Risk Considerations

Government

- What are the risks to government? Are the risks financial or non-financial? What data is there to support the assessment of risk?
- What would happen if government didn't intervene to address a particular problem or risk?
- Is this an emerging risk, a one-off isolated event or an ongoing risk which will require a more systemic response?

Providers

- How many providers will be affected by the government's intervention and how will they be impacted? Are there particular providers that will be more affected than others?
- Can industry bodies play a role in responding to the particular risks or problems?
- Does the problem only relate to a relatively small number of providers? Is it an isolated or a more systemic problem?

Market

- What is the current state of the market for the services being regulated? Is the market relatively mature or still evolving?
- What impacts will government regulation/intervention have on the market? Will addressing risks create barriers to entry or reduce competition in the market?
- Are the risks related to particular types of market failure, e.g. information asymmetry? What evidence is there to support the identification of risk and the impacts of market failure?

Individuals

- How many individuals are likely to be impacted by the problem or risk? Is there data on the level of complaints or adverse incidents?
- What can individuals do to help manage their own risks?
- What information is available to individuals and the general community about the level of risk and how they can protect against that risk?

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A new way

The public interest demands that government continue to play a role in protecting the most vulnerable and disadvantaged members of the community, particularly in ensuring equitable access to safe services. However, new ways of thinking about how government can best regulate to meet its social objectives while harnessing the power of markets to deliver more efficient and effective services are needed.

This requires a change in mindset on the part of regulators and decision makers and a willingness on the part of government to radically redefine its relationship with service providers, individuals and the general community. There needs to be much greater focus on understanding market dynamics and the way in which regulation can create unnecessary barriers to entry and reduce the potential for competition in the market for human services.

The table below outlines the current operating model for the delivery of a significant proportion of human services, and contrasts how new ways of thinking could influence the delivery of services.

Current state	Potential future state
Government is often both a funder and regulator of human services and in some cases also a provider	Contemporary approaches (for example, the recent Harper Report) suggest separating the regulatory functions from government's funding and providing roles
Organisations can be subject to regulation from a range of agencies at the State level as well as at the Commonwealth/Local Government level – this results in overlap and duplication with no accounting of the cumulative effect	There is a consistent, systematic and harmonised approach to regulations within and across government boundaries. Overlap and duplication is removed thereby reducing costs for regulated entities
Regulation is designed internally and there is little regard to the impact on providers or the market	Co-design principles are embedded in any regulatory reform process, drawing on the feedback from all stakeholders
Objectives of regulation can be ambiguous and ill-defined making it difficult to establish links between the intervention and the outcome being sought	Objectives of the regulatory (and non-regulatory) responses are clear and measurable, allowing an evidence-based to be developed to support future evaluations
Use of traditional licensing and registration as a means of controlling entry with a strong focus on compliance, enforcement and sanctions	Regulatory approaches seek to encourage and enable innovative services by adopting performance/risk based arrangements and rewarding good outcomes
The relationship often centres on that between government and provider, failing to incorporate the 'market' and individuals	Regulation is built around a deep understanding of market dynamics and the impact of barriers to entry on supply of services and considers the needs of individuals
Reforms often take a siloed approach to change addressing particular regulatory hotspots but fail to address the fundamentals	Recognises that best practice outcomes are delivered through reforms to the rules, governance and instructional frameworks, operational practice and staff capability[12]

12. OECD (2014), Best Practice Principles for Regulatory Policy, The Governance of Regulators

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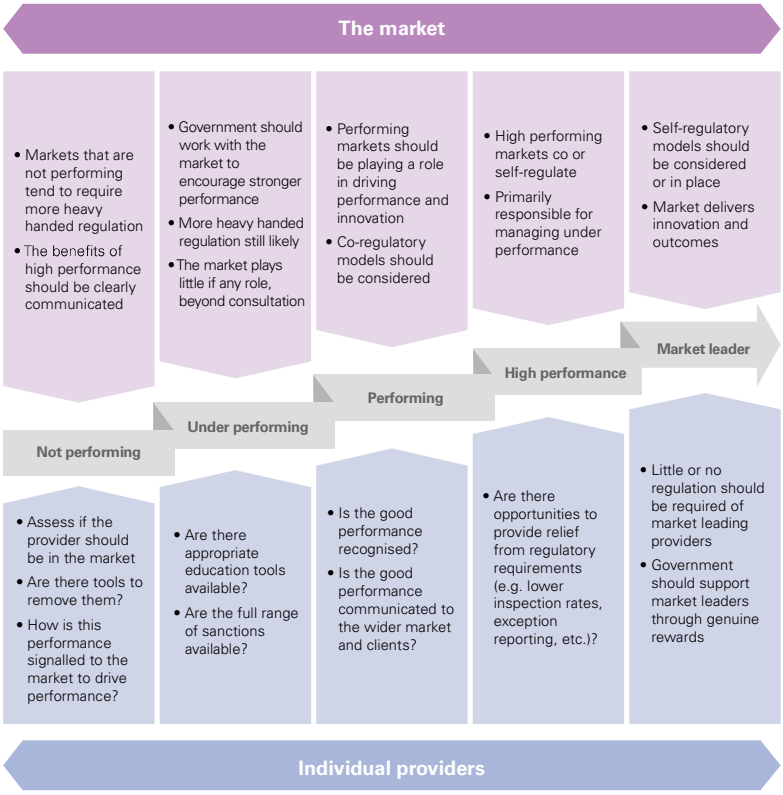
4.1 Market maturity

Importantly, regulation needs to take into account varying levels of market maturity in terms of both the overall market being regulated and the participants operating within the market. Government continues to have overarching responsibly for protecting society's most vulnerable and therefore risks to the safety and wellbeing of individuals remain the central consideration. However, risk assessments need to be overlaid with an assessment of the market maturity of the services being regulated.

Performance-based approaches to regulation should be considered which allow for a level of differentiation among providers based on their performance.

Figure 2: Market maturity curve (the market and individual providers)



Source: KPMG, 2014.

Performance-based approaches to regulation are best designed through a collaborative approach with industry and other stakeholders. While there have been plenty of complaints about government regulation, service providers have tended to be the passive recipients of government regulation and have not sought to proactively influence the agenda and demonstrate to government how they can play a greater self-regulatory role.

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In seeking to protect the users of human services, there has been a tendency to adopt overly paternalistic approaches which have failed to recognise that individuals are becoming increasingly informed and sophisticated. Advances in technology now give individuals much better access to information about the quality and availability of services. Government can play a much greater role in ensuring information on human services is readily and widely available for individuals to exercise their own judgement about services and quality.

Behavioural economics – helping regulators understand markets and participant behaviour

Behavioural economics is a relatively new field of economics that uses insights from psychology to understand the behaviour and motivations of individuals in markets. It has particular application in regulatory decision making as it can help regulators think about alternative approaches to explicit regulation and, when regulations are necessary, how best to tailor compliance and enforcement approaches.

Empowering consumers is a key feature of the reforms occurring in human services, and ensuring consumers have access to information is seen as critical in helping consumers to make informed choices about the range of human services and drive improvements in the market. However, research shows that it is not how much information is provided but, more importantly, how information is presented or 'framed' that determines how effectively consumers are able to use that information.

In an effort to demonstrate openness and accountability, governments can often deluge the public with information that is not always particularly useful. This can create information overload or lead to a focus on information that is not crucial. The release of hospital waiting list data is a good example. While data is now becoming increasingly available to the public, it is not presented in a user friendly way and there is no evidence to suggest that consumers are using the data to inform their choice of hospital or doctor.

When it comes to the regulation of providers in human services, the research in behavioural economics shows that an understanding of the cultural characteristics and motivations of particular groups of providers is also important. An example often quoted is the payment of a fee to GPs to notify communicable diseases. Rather than motivating the GPs to notify the relevant agency, the fee – which had been deliberately set at a low level – had the unintended effect of reducing the incentive to notify as it was seen as 'a professional insult'.

This highlights the importance of developing a deep understanding the market that is being regulated and the views and perceptions of the participants in that market. In the case of the human services market, most non-government organisations operate on a not-for-profit basis with a strong commitment to helping their local communities. Policy makers should not underestimate the motivations of particular groups and the likelihood that if people consider something 'the right thing to do' then explicit regulation may not be required.

Source: Australian Public Service Commission (2009), Smarter Policy: choosing policy instruments and working with others to influence behaviour; Productivity Commission (August 2007), Behavioural Economics and Public Policy; OECD (2014), Regulatory Policy and Behavioural Economics

The new approach to regulation should be informed by:

- a set of overarching principles that provide a flexible framework for designing policy and regulatory responses
- a detailed analysis of all the regulatory tools available to policy makers (including non-regulatory responses)
- a recognition that all stakeholders can play an important role in delivering outcomes (this includes individuals, families, carers, providers and industry groups).

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Learning from other sectors – VET Reforms

Introducing competition into the provision of government services is not new and there are various sectors where these reforms have been introduced.

Vocational Education and Training (VET) services have generally been dominated by government owned and run institutions. While still predominantly government funded, public providers have increasingly been exposed to the threat of competition and government funding is being made contestable, with both public and private providers competing for funding in a more demand-driven funding environment.

Victoria was one of the first States to introduce a more demand-driven funding model into its VET system, where students were essentially given the freedom to choose which courses they wanted to undertake. This resulted in a much higher than expected uptake of students, which in turn led to significant budget pressures given that the services remained predominantly government funded. This highlights the potentially conflicting roles of government as both funder and regulator of services and the tension between freeing up controls and managing fiscal exposures – an issue that is particularly relevant to human services, which are underpinned by large amounts of government investment.

In the regulatory response to these changing market conditions, the trend has been to establish special-purpose independent regulatory bodies at arm's length from government which focus on promoting quality standards. A National VET Regulator was established in 2012 and similar recommendations are being made in a range of other areas, including aged care. Separating the roles of funder and regulator is considered to be a best practice approach to regulation, as it avoids the inherent conflicts between the two roles as highlighted by the Victorian experience with VET.

4.2 Guiding principles

There is no one-size-fits all approach to regulating the human services sector (or any other sector for that matter). Each risk and problem needs to be considered on its merits. Rather than a prescriptive approach to regulatory development, a principles-based approach should be adopted.

The following table outlines contemporary best practice regulatory principles – drawn from key government guidelines including the Australian Government's new *Guide to Regulation* (2014), the Productivity Commission's *Regulator Audit Framework* (2014), the Australian National Audit Office's *Administering Regulation* (2007), and the Victorian Government's *Guide to Regulation* (updated 2014) – that could be used to guide the development of new regulatory approaches in the human service sector.

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Principle	Comments
Evidence based	Decisions to regulate are based on evidence about the scope and nature of the risk being addressed
Collaborative	Regulatory responses should be developed jointly with shared objectives and processes where regulations intersect with other parts of government
Measureable	Regulation is only attached to objectives that can be clearly measured and the achievement of which can be tracked over time Information on the achievement of regulatory objectives should be reported and published on a regular basis
Reciprocal	Regulatory responses recognise the role of other regulators at the Commonwealth, State and Local Government levels and do not duplicate their efforts
Streamlined	Regulations are streamlined with standardised rules and procedures where appropriate
Outcomes focused	Regulation should be outcomes focused rather than prescribing or specifying inputs and allow the flexibility to respond to changing circumstances and individual needs
Co-designed	Regulation should be co-designed with key stakeholders as far as possible to increase ownership and encourage innovation
Cost-effective	Regulations will be fit for purpose to support timely decision making and minimise reporting and compliance costs on regulated entities
Proportionate	The level of regulation, including the type of enforcement and compliance regime, will take into account the size, nature and impact of the problem and risks being addressed
Targeted	Regulations will be targeted to where they can deliver the most benefit – this includes consideration of which level of government is best placed to respond to a particular problem or issue requiring regulation

Source: Adapted from Australian Government (2014) The Australian Government Guide to Regulation; Productivity Commission (2014), Regulator Audit Framework; Australian National Audit Office (2007), Administering Regulation; Victorian Government (2014) Guide to Regulation.

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4.3 Using all the tools in the toolbox

There are also well-established alternatives to regulatory intervention that have been canvassed in various government guidelines and publications. Regulatory interventions are generally considered along a spectrum from self-regulation at one end to explicit regulation at the other.[13] While these tools are widely available the adoption of these types of approaches has been slow, particularly in the human services sector, where traditional approaches are still widely employed.

Regulatory tools	Description	Considerations	Adoption in the human services sector
Self-regulation	• Self-regulation involves industry developing its own written rules and codes of conduct. Industry is also solely responsible for enforcement. The government plays either no role, or a purely advisory role. • For example, the Australian Association of Social Workers is currently working with the National Alliance of Self-Regulating Health Professions to consider models for authorised self-regulation for health professions in Australia not currently included in the National Registration and Accreditation Scheme.[14]	• Use when the risks of non-compliance are assessed as low and industry can see from its level the risks that need to be managed. • More suited to mature and well informed markets or industry bodies that have appropriate skills/ expertise in deterring non-compliance.	Low
Co-regulation	• Co-regulation sees an industry or a professional body developing and administering its own standards, codes, etc., with government providing the underpinning legislation to enable enforcement. • For example, co-regulation is used in the United Kingdom for social housing. Under the UK *Housing and Regeneration Act 2008*, the regulator was given authority to define a regulatory framework for providers' services and conduct. While quality aspects are defined in the Act, providers are given the freedom to choose how to provide services and conduct business while the regulator retains the power to monitor and enforce compliance.[15]	• Most suitable when there is government interest in ensuring integrity of a regulatory approach, but self-regulation is unlikely to address all government concerns. • Appropriate where there are clear advantages to industry having strong ownership of the standards or other regulatory requirements.	Low
Explicit government regulation	• Includes the more traditional primary and subordinate legislation, and is typically the most common form of regulation. • For example, aged care regulation is explicit black-letter regulation which sets out an accreditation and prescriptive compliance regime for providers.	• Most appropriate when a heavy-handed approach is required with minimal industry input.	High

13. Adapted from Victorian Competition and Efficiency Commission (2014), Victorian Guide to Regulation, Toolkit 1: Purposes and types of regulation
14. Australian Association of Social Workers, available at https://www.aasw.asn.au/social-policy-advocacy/self-regulation
15 European Commission (2011), Study on Social Services of General Interest

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Even within explicit government regulation there are a range of alternative tools available that should be considered, beyond the traditional 'command and control' approaches.[16]

Alternative approach	Description	Considerations	Adoption in the human services sector
Rewarding good behaviours	• Using the 'carrot' to encourage compliance rather than the 'stick', this tool uses economic incentives that encourage compliance and send appropriate signals to the public about the government's priorities. It fits well with a performance-based approach.	• Useful when government wants to provide an incentive to lift performance	Low
Negative licensing	• A process whereby individuals or organisations can be excluded from operating in a particular industry or carrying out a particular industry function. This is in contrast to registration or licensing by which a person or organisation is allowed entry into a market or activity upon meeting certain conditions.	• Could be used when non-compliance with standards or requirements is the exception • Suitable when monitoring requirements are low	Low
Public information	• Public release of regulatory information in the form of fact sheets, guidelines, standards, and awareness campaigns etc. This tool tries to ensure that the public is aware of all the pros and cons of using the products. In turn, this can reduce the cost to government and the community due to a higher level of awareness.	• Useful where the problem to be addressed results from a lack of knowledge among consumers of participants in the industry • Appropriate for issues where a light-handed approach is needed or where awareness is used to support another regulatory tool	Medium
Market-based instruments	• A number of market-based instruments are available for use in regulation to deliver outcomes: subsidies, allocation, taxes, etc. Market-based approaches are particularly useful when there are issues associated with access and equity and the problem is financially based. This tool provides greater flexibility for the regulated entity in terms of the method of compliance, but it may be difficult to determine the required amount of the instrument to reach the intended outcome.	• Best used when there are issues associated with access and equity and the problem is financially based	Medium
Funding and contracting	• Government can achieve its objectives via the direct purchase or payment of funds to individuals, organisations and other levels of government.	• Best used where the risks are considered low and can be addressed via contractual rather than legislative remedies.	High

16. Adapted from Victorian Competition and Efficiency Commission (2014), Victorian Guide to Regulation, Toolkit 1: Purposes and types of regulation

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Regulators need to ensure they understand and assess the merits of all regulatory options. This assessment should consider the advantages and disadvantages of each tool from the perspective of government, providers the market, and individuals.

In designing regulatory options, consideration should be given to these different perspectives:

Government

- Have all possible alternatives to regulation been considered to address the identified policy problem and the government's policy objectives?
- What are the roles of other existing regulators at the Commonwealth, State and Local Government levels in addressing the problem?
- Have the costs and benefits of each of the regulatory options been considered to ensure the most cost-effective and efficient response is introduced?

Providers

- Does the option impose the minimum necessary costs and administrative burden on regulated entities?
- How can you incentivise good performance among providers? Can you differentiate between providers and recognise and reward providers with proven track records? What reward mechanisms could be considered?
- Could self-regulation and co-regulation options be considered – are there established industry bodies that could play a role? Are there service and quality standards already in place?

Market

- What is the size, scope and structure of the market being regulated? Does the market operate as a national market with wide coverage or is it state based?
- How mature is the market and how sophisticated are the providers? Is the market concentrated around a small number of players or are there a diverse range of participants?
- How competitive is the current market? Are there existing barriers to entry? How will the different alternatives impact on competition in the market?
- Are the services provided similar across the market or do they vary considerably, making comparisons difficult for consumers?

Individuals

- What research is available about what consumers are seeking in terms of protections from government?
- Could the problem be addressed by requiring information disclosure to consumers?
- Would public information or education campaigns assist with improving the quality and distribution of information among consumers and the general community?

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Some examples of self-regulatory and co-regulatory models:

Australian telecommunications industry – embedding the idea in legislation

The Broadcasting Services Act 1992 requires that the regulator, the Australian Communications and Media Authority, provide industry with an opportunity develop self-regulatory solutions before other regulatory tools are considered. This approach requires the industry to assume responsibility for dealing with their own sector in an effective manner. If industry fails to delivery an effective approach, the regulator can exercise its reserve powers to ensure an effective outcome.

Australian Direct Marketing Association – using codes of practice developed by industry

The Australian Direct Marketing Association uses an intuitional code to regulate the behaviour of over 400 organisations involved in information-based marketing. One of the advantages of the code is that it covers a variety of sectors including financial institutions, publishers, and catalogue and mail-order traders.

General Insurance Code of Practice – an industry code with mandatory compliance

Compliance with industry-designed and monitored codes of practice can have the force of law. For example, the Insurance Act 1973 requires general insurers (of certain policies) to be members of the General Insurance Code of Practice.

4.4 Collaboration is vital to deliver outcomes

Any new approach will require key stakeholders to play an active role in the design and delivery of regulatory responses in human services. No longer will governments and providers be the main stakeholders – all parties will need to have clear roles and responsibilities in order to achieve optimal outcomes.

Designing interventions internally within government has reinforced the tendency to default to traditional regulatory responses because that's what government knows and does. Co-design with stakeholders opens up opportunities to get new ideas and is the most effective way of determining which non-regulatory alternative may be best suited to a particular problem or service area.

Government needs to share data and information that only it can access and to combine this with the grassroots knowledge and insights that providers and consumers can bring to solving the challenges of regulating the new environment. This is particularly important in identifying where experimental approaches can best be applied.

Implementation science is about understanding how best to implement new ideas and approaches, and has emerged primarily in the health arena to help translate medical research findings into clinical practice. It seeks to understand the barriers and facilitators that influence successful implementation of new interventions/responses and what strategies work best to disseminate adoption of best practice across various settings. Experience with implementation science suggests that the best way to put new methods of working into real-world practice is for all affected stakeholders to share their knowledge and expertise.

Designing interventions internally within government has reinforced the tendency to default to traditional regulatory responses because that's what government knows and does.

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A well-managed co-design process can also help create a common understanding around risk and the implications of different levels of risk tolerance for individuals, providers and the broader community. It can also help bring the concept of fidelity into play in considering the impacts of particular interventions. Often regulations can be designed with a particular intent but not be implemented in a way which is faithful to the original concept. Ensuring all stakeholders have a clear understanding of how a particular intervention is meant to work in terms of cause and effect will help manage expectations about outcomes.

Desired outcomes for each stakeholder group are set out below:

Stakeholder	Outcomes
Government	• Unnecessary Government intervention in the market and community is ceased • Government plays more of an enabling role working in collaboration with other partners • Better allocation of scarce Government resources to where it can deliver the best outcomes
Providers	• Good performance is recognised and rewarded while poor performance is remediated and when necessary, sanctioned • Providers have more certainty and stability in the regulatory operating environment • Providers are free to innovate and have the flexibility to respond to changing circumstances
The Market	• Barriers to entry are reduced and supply is sufficient to meet increasing service demands • Competition helps deliver improvements in productivity and better quality services • Innovation in service delivery is encouraged
Individuals	• Consumers are informed and empowered to manage risks • Consumers are placed at the centre of regulatory design processes. • More effective regulation delivers better outcomes for individuals and higher quality services

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A best practice framework

The following diagram shows how the various elements of contemporary best practice regulation come together to form an integrated framework. The framework encompasses the guiding best practice principles, recognises the role all parties play in delivering outcomes and, above all, is focused on managing risk.

Figure 3: Integrated regulatory framework

Source: KPMG, 2014.

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5.1 Assessing performance

The first step in any reform process is to develop a strong understanding of the 'current state' against the backdrop of what is to be achieved. This assessment does not have to be comprehensive to provide a strong insight into areas that need particular attention, but it does have to be honest and impartial.

Assessment against the principles

The principles outlined earlier provide a good framework to assess the performance of a policy or regulation. These principles could be used to assess a specific program or an entire unit or agency.

Each principle could be assessed against three simple scaled criteria:

Criteria	Description
Evident	• Adherence to this principle is clearly evident • The department/agency has a proven track record of delivering against this principle
Emerging	• There is some evidence that this principle is being applied and/or it is applied inconsistently across a particular program or department/agency • The department/agency can clearly improve against this principle
Not evident	• There is no adherence to this principle • The department/agency needs to implement changes to deliver this principle

Assessment against the key stakeholder groups

All stakeholders will play a critical role in driving and delivering reform. Assessing stakeholders' current role in the policy/regulatory process is important and could provide valuable insights as to where reforms could be focused. As with the assessment above, the evaluation could be against scaled criteria of evident, emerging and not evident.

The following table illustrates how this assessment could be performed. Figure 4 illustrates where further consideration could be given.

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Stakeholder group	Possible assessment elements
Government	• How robust and complete is the problem/risk identification process? Has the core problem been recently reassessed and quantified? • Are the objectives of an action clear and measureable? • Have all the regulatory and non-regulatory solutions been identified and assessed?
Providers	• Are providers assessed on a performance basis? • Can providers offering services in one market easily extend their services to include other comparable services without experiencing unnecessary regulatory hurdles? • Are providers offered sufficient rewards to delivering above minimum standards? • Can providers 'earn their autonomy' from regulations through sustained performance above minimum standards?
The market	• Has a robust assessment of the maturity of the market been completed? • Can the market play more of a role in delivering outcomes and managing quality (i.e. co-regulation)? • Are markets sufficiently empowered to improve the efficiency and effectiveness of the services offered by the market?
Individuals	• Do individuals play an active role in the regulatory assessments of providers? • Are individuals given sufficient information on the performance of providers to enable a truly informed assessment?

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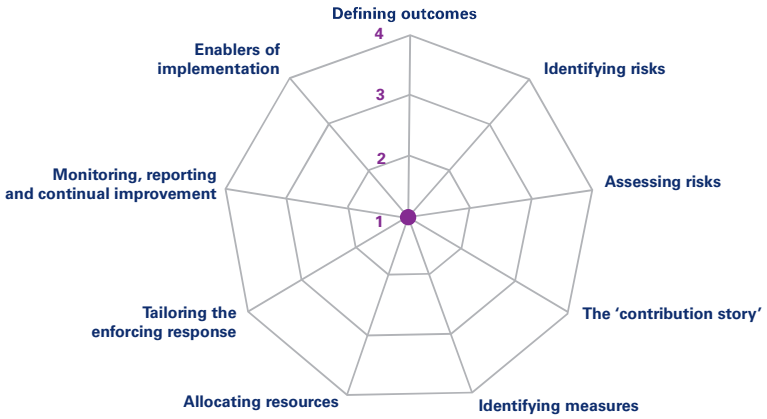
Other assessments

There are a range of tools that could be applied to assess regulatory performance against contemporary best practice. Recently, KPMG worked closely with the NSW Department of Premier and Cabinet to develop guidance for regulators to implement outcomes and risk-based regulation.[17] As part of this project detailed guidelines were developed as well as a diagnostic tool (shown below) to enable regulators to assess their current approach against a risk-based and outcomes framework. Regulators can assess their performance as 1 – not evident, 2 – implementing, 3 – established or 4 – good practice.

Figure 4: Diagnostic report



Source: NSW Department of Premier and Cabinet, Outcomes and risk-based regulation diagnostic report.

Specifically, the diagnostic tool has been developed to help regulatory agencies prioritise and implement areas for improvement by:

- providing a high-level assessment of whether a regulator's current approach aligns to the key principles of outcomes and risk-based regulation
- prioritising areas that will deliver the greatest benefits over the current approach
- identifying targeted actions for regulators to implement improvements
- directing regulatory agencies to sections within the accompanying guidance material most relevant to the suggested actions.

This diagnostic tool is publicly available on the website of the NSW Department of Premier and Cabinet.

17. NSW Department of Premier and Cabinet (July 2014), Quality Regulatory Services initiative – Guidance for NSW regulators to implement outcomes and risk-based regulation

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Government wide assessment

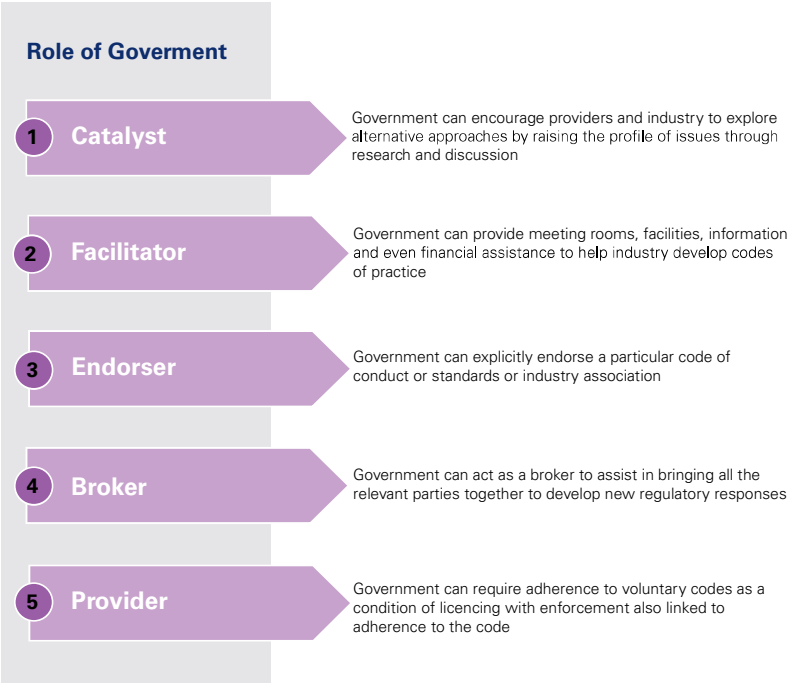
As well as assessing the performance of particular areas with responsibility for regulation, there needs to be an assessment of the impact of regulation across all relevant areas within an agency and across Government agencies. Human services providers often have to deal with different agencies across multiple programs.

Assessing the potential to simplify entry points by introducing pre-qualification for service providers across multiple programs can bring immediate benefits and reduce the overall regulatory burden.

5.2 Role of Government in self-regulation and co-regulation

Government can play a variety of roles in helping providers and industry move towards co-regulation and self-regulation approaches. However, irrespective of which role Government choses to adopt, it needs to be very clear upfront about its roles and responsibilities and the roles and responsibilities of the other key parties.

Figure 5: Role of government in self-regulation and co-regulation



Source: Adapted from Australian Government Treasury (2000), Taskforce on Industry Self-Regulation.

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The path to reform

The path to regulatory form is not easy and requires achieving and sustaining a significant cultural change across the public sector. There must be strength and consistency of support at the highest political level and a will to challenge and overcome vested interests in maintaining the status quo. The speed of and pathway to reform will also differ across organisations depending on their specific cultural practices and their history of regulation making. For example, reforming human services regulation is a complex and challenging exercise given the accretion of regulation over decades and the traditionally risk-averse approach that has been adopted.

We have identified the range of alternative tools that are available to policy makers and regulators. However, finding the right regulatory balance is difficult and time consuming and requires consultation with and cooperation by all stakeholders in the process.

Regulators and decision makers will need to fundamentally change the way they approach policy problems, and new tools, skills and capabilities are needed. In particular, staff need to be trained in engaging effectively with stakeholders, assessing and managing risk and designing proportionate responses.

Regulators and decision makers need a good understanding of market dynamics and the impacts of regulation on the operation of the market. This will require organisations to invest in developing new skills, competencies and tools across the public sector. Organisations should be looking to recruit staff with economic and data analytics skills and investing in data systems that allow for proper risk assessments and intelligence gathering about markets and market participants.

Consultation is vital and must involve industry, consumers and other stakeholders in a concerted and sustained effort to build consensus around a new approach. Rather than treating all providers the same, there needs to be much greater emphasis on performance-based regulation – and in particular how to incentivise high-performing providers.

More experimentation is required with alternative tools to achieve best practice. In order to create more innovative approaches, government needs to select and trial projects where staff have the opportunity to work with providers and individuals on small-scale 'safe to fail' projects to encourage the adoption of genuinely alternative approaches. This requires both bureaucratic and political buy-in and more open debate and discussion about the nature of risks being regulated and about government and community tolerance for risk.

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"At present too much public innovation involves frontline employees (public servants and community workers) being forced to find workarounds to the heavily prescribed processes under which they operate. To encourage a culture of innovation across the community sector, the (Victorian) Government needs to grant greater autonomy to service providers. It needs to encourage the public and community sector, in alliance, to pilot and demonstrate new service delivery approaches. In the implementation of services, there should be a willingness to trial often, fail early and learn quickly from mistakes."

Professor Peter Shergold on the need for more innovation and experimentation in the Victorian public sector (Service Sector Reform: A roadmap for community and human services reform – Final July 2013).

Pathway to regulatory reform

Leadership/ governance	Risk management	Planning and co-design	Capacity/ capabilities	Communication and engagement
Strong leadership is vital in driving the cultural change needed to support regulatory reform	Risk management is at the core of regulatory reform and this needs to be supported by robust data systems	Regulatory reform plans should be developed collaboratively with industry, providers and individuals	New staff skills and capabilities are needed to help shift away from traditional ways of regulating	Governments need to build the case for reform and get buy-in from stakeholders and the general public
• There needs to be a clear vision of where the reforms are heading and the expected benefits • Senior decision makers must understand market dynamics and the impacts of regulation on competition in markets • Political will is needed to avoid systemic regulatory responses to isolated adverse incidents	• Risks need to be well understood and clearly defined, including risks to health and safety and financial risks • The government's risk appetite should be tested and agreed • There should be strong data-based systems for managing and monitoring risks over time	• Regulatory reforms need to be planned and targeted to where they can deliver the most benefits • Regulated entities should be involved in developing new approaches to encourage new ideas and more innovative thinking • Empowering individuals to manage their own risks through information should be considered	• Staff will need training and improved capabilities in designing more performance-based regulatory responses • Improved capabilities in understanding markets and risk assessments are needed • Highly skilled market regulators should be available to be deployed across organisations	• Communication and engagement strategy should be developed • Clearly articulate the benefits of reform and the costs of doing nothing • Inform and educate the public about the need for shared responsibilities in managing risks • Share early successes with stakeholders

Source: KPMG, 2014.

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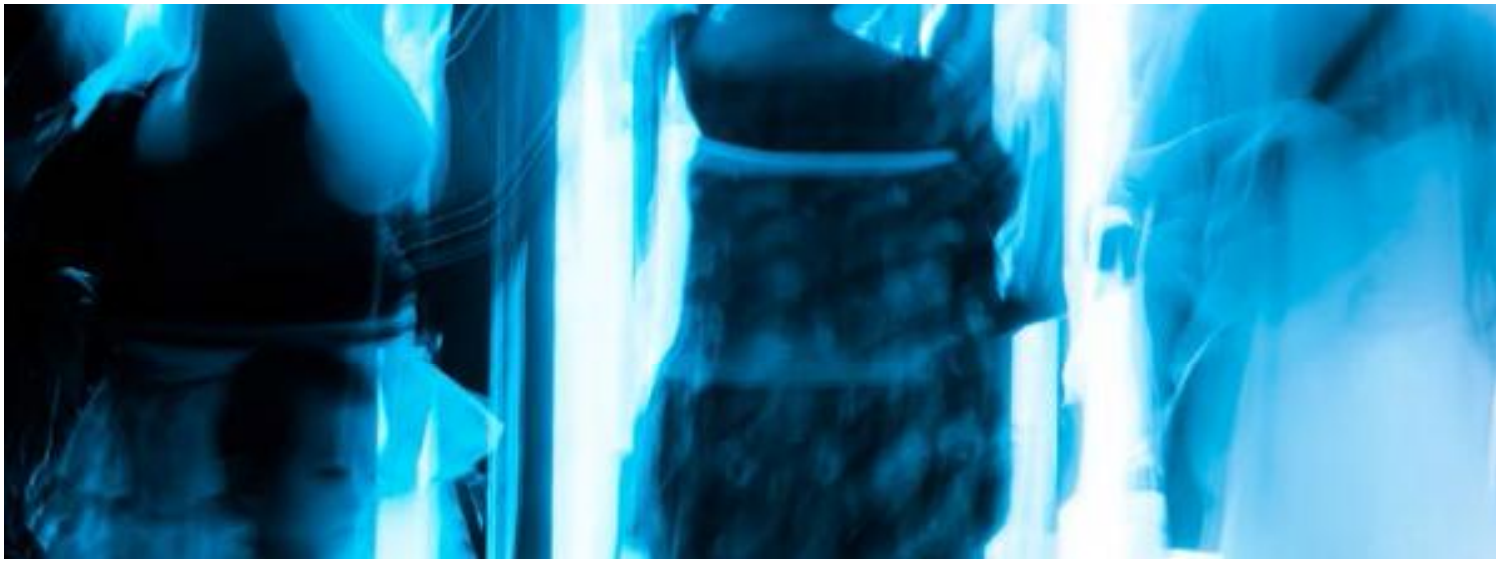

About KPMG

7.1 How KPMG can help

KPMG has been at the forefront of thinking about regulatory redesign and we bring a unique mix of skills and experience combining deep knowledge of human services with economic and regulatory expertise. We can help organisations think about how best to:

- approach an assessment of whether a regulator's current approach aligns to the key principles of best practice risk based regulation
- help develop tailored regulatory toolkits for agencies including risk assessment and monitoring tools
- improve staff capabilities and competencies in market and risk analysis
- identify targeted strategies to implement regulatory best practice and prioritise areas that will deliver the greatest benefits
- help regulators develop an understanding of the relevant markets including market intelligence on future trends
- match particular regulatory interventions depending on the market, risks and industry capacity
- engage with stakeholders and build the capacity of providers and individuals to participate effectively in designing regulatory and non-regulatory responses.

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7.2 Our experience

We have developed model regulatory frameworks to guide best practice and improve the capability of regulators and assisted regulators with undertaking market analysis and costing alternative regulatory interventions.
We have experience preparing Regulatory Impact Statements for various State and Federal agencies on a wide range of reforms across areas including early childhood education, environmental licensing and food regulation.

KPMG has a track record of working closely with a range of government agencies providers and industry bodies to help them deliver better quality health and human services and develop and implement large-scale reform programs. We have been closely involved in redesigning human service delivery systems across the country, including developing strategic frameworks for person-centred disability service systems.

We have also assisted State governments with reforms to health, aged care, housing and homelessness, child protection and domestic violence services and worked closely with non-government organisations on capability and business planning reviews. If you would like more information on KPMG's experience in regulatory reform please contact those listed on the back cover.

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