

*Department of Premier and Cabinet*  
*Local Government Division*

Community Service Obligation  
Policy and Guidelines

for

Local Government in Tasmania

November 2000

## 1. Background

The Tasmanian Government is committed to the implementation of the competition policy principles embodied in the package of National Competition Policy Reforms (NCP) endorsed by the Council of Australian Governments (COAG). The application of NCP to Local Government in Tasmania has been guided by the publications *The Application of National Competition Policy to Local Government*, Government of Tasmania June 1996, and *Corporatisation Principles for Local Government Business Activities*, Department of Treasury and Finance, December 1998.

The competitive neutrality principles incorporated within NCP include elements aimed at promoting efficiency in use of resources by the significant business activities of Councils.

The significant business activities of Tasmanian Councils were identified in a peer review process undertaken by Councils in March 1997. Generally those significant business activities were related to the water and sewerage activities of Councils. However, a significant business activity can include other business and organisational structures used to perform a function on behalf of a Council or Councils, such as a single or joint authority created under the provisions of the *Local Government Act 1993*, or business entities created by a Council to perform specific functions.

This policy statement has been prepared to assist Local Government in identification of Community Service Obligations (CSOs) which might have arisen, or will arise, from policy decisions made by Councils which impact on the competitive neutrality of their significant business activities. NCP does not preclude Governments from administering subsidies and Government businesses are able to set prices below cost on certain activities where there is a strong public interest in doing so. However, where prices are set below the efficient level it is essential that governing bodies are aware of the full cost of the activity and can continually monitor and review its delivery.

Implementation of this policy will enable Councils to ensure that their significant business activities comply with the competitive neutrality principles contained in the NCP Competition Principles Agreement, and will also engender enhanced performance and accountability of Council significant business activities generally.

## 2. What does this Policy intend to achieve?

The main objectives of this CSO policy are:

- to ensure that a Council's social and other objectives are achieved without impacting on the commercial performance of its significant business activities; and
- to improve the transparency, equity and efficiency of CSO service delivery.

Without this CSO policy in place, non-commercial activities undertaken by significant business activities on behalf of Councils can lead to circumstances where cross subsidisation occurs, resulting in distorted efficiency and equity effects and a lack of funding transparency. A lack of funding transparency can result in benefits being provided without proper scrutiny by the Council or its community and to consumers who are unaware of the true cost of the service delivery.

This CSO policy establishes a framework through which CSOs can be properly identified and included within the Council's budget and strategic and operational planning process.

Proper implementation of the Policy will not only enable officers responsible for the operation of Council significant business activities to have the objectives of Council CSOs clearly identified, but will also ensure that they are properly funded by the Council without impacting on the commercial viability of the significant business activity.

Application of the Policy guidelines will also enable Councils to determine whether a CSO:

- is an appropriate and effective method of meeting its social objectives and priorities; and
- is most appropriately delivered by the significant business activity or by some other service provider.

Proper application of the policy will ensure that CSOs are correctly identified, costed and funded to an approved level, thus removing any potential disadvantages which the significant business activity might otherwise bear in undertaking the non-commercial activity on behalf of the Council. The resulting transparency also establishes an environment in which it may become possible for competition in the provision of a CSO to be introduced in the longer term, and for it to be delivered at a lower cost.

### **3. What is a CSO?**

A CSO is created when a Council requires a significant business activity to undertake a non-commercial function in order to achieve a Council policy objective. In determining whether CSO exists, the following factors should be taken into consideration:

- the function, service or concession provided, allowed or performed must arise as a direct result of a direction from Council; and
- the function, service or concession provided, allowed or performed would not be undertaken if the significant business activity were a business in the private sector operating in accordance with sound commercial practice.

CSOs should be used to achieve a specific community outcome for a well defined target group and should not be used to provide generic operating subsidies to significant business activities.

### **4. Identification and funding of CSOs**

In order to comply with NCP principles, Councils are required to identify non-commercial activities which are being undertaken by their significant business activities. Councils must then decide whether they wish the significant business activities to continue to provide the CSO and, if so, ensure that the CSO is funded transparently within the Council Budget and identified in the Council Annual Report.

For a CSO to exist there must be:

- a specific policy directive from the Council;
- a net cost to the significant business activity from providing the function, service or concession; and
- a function, service or concession imposed on the significant business activity which would not be performed as part of its normal commercial activities.

A specific policy directive should only be issued after full consideration by the Council, including a rigorous analytical process. Such a directive must be made in writing and specify a commencement date for the CSO.

From the Council's perspective, the key issues are whether a CSO:

- is appropriate and effective in terms of meeting the social objectives and priorities of the Council;
- is most appropriately delivered by a significant business activity, or some other provider; and
- has a minimal impact on the Council's budget.

There are some special commercial activities which may appear non-commercial in nature but which are excluded from the definition of CSOs. Examples are:

- costs incurred in meeting regulatory requirements that are also incurred by private sector enterprises;
- market segmentation initiatives to maximise profit; and
- good corporate citizen activities.

Examples of such regulatory requirements are environmental controls, industrial awards and occupational health and safety regulations.

Market segmentation is a marketing strategy undertaken by private enterprise to maximise profits from various market segments. For example a concession to pensioners could appear to be non-commercial in nature and, when viewed in isolation, as non-profit making. However, where such an activity is undertaken with the intention of increasing the total demand for goods and services, or to enhance a corporate image and thus maximise sales or profits, it would not be regarded as a CSO. A similar circumstance could arise from the provision of sponsorships or concessions for the commercial benefit of a significant business activity.

Similarly, public relations activities undertaken to enhance the corporate image of a significant business activity could be regarded as arising from the significant business activity acting as a good corporate citizen. Examples of such non-commercial activities might include:

- discounts provided to pensioners, social club members or other groups;
- public relations exercises including public tours of facilities and public education programmes; and
- sponsorship of sporting clubs, donations etc

Because there is a degree of subjectivity in determining whether a particular activity would be a CSO or an act of good corporate citizenship, Councils should satisfy themselves that decisions would be acceptable to the National Competition Council (NCC), which is responsible for monitoring implementation of the NCP.

## **5. Funding of CSOs and NCP reform obligations**

There are instances where the provision of CSOs may conflict with Tasmania's Water Reform obligations under the National Competition Policy. These primarily relate to the following NCP water reforms:

- the introduction of consumption based pricing (two part tariffs) for urban water services (where cost effective); and
- the requirement to conduct robust independent appraisal processes to determine economic viability and ecological sustainability prior to investment in new rural irrigation schemes, augmentation of existing schemes and dam construction.

Two part tariffs involve a fixed component intended to recover the fixed costs of the supplier and a volumetric related charge to recover the costs of supply related to actual consumption. Councils that set, or have plans to set, two part tariffs should note that CSO funding cannot be applied to the volumetric component of two part pricing. Where two part tariffs are imposed, the volumetric charge should reflect the marginal cost of water supply. A CSO imposed would reduce the volumetric charge to customers and would not provide the correct price signals to the community about appropriate water use. Instead, it would lead to overuse and would not discourage wasteful consumption of water.

Similarly, the NCP obligations with regard to investment in rural irrigation schemes require that a robust assessment be undertaken regarding the economic viability and ecological sustainability prior to the construction of new schemes, augmentation of existing schemes or dam construction. Under this reform commitment, Councils should be aware that strong economic justification must be demonstrated where rural schemes are subsidised.

## **6. Costing of CSOs**

In general Councils should apply the avoidable cost method to identify the cost of providing CSOs. The intention is to establish all the costs that would be avoided if the CSO were not performed by the significant business activity.

Avoidable costs are all the costs, including capital costs and a return on capital, that would be avoided if the specific CSO in question was not provided by the Council significant business activity. Avoidable costs include the incremental variable costs of the extra output, the estimated additional capital costs per unit where additional capacity is required for delivery of the CSO, and the administration costs of measuring and maintaining the CSO.

While the avoidable cost method is the nationally preferred method and benchmark for costing CSOs there are other mechanisms which might be applied where the significant business activity is of the view that a different method is more appropriate. Other methods include fully distributed costs, revenue foregone, marginal costs and stand alone costs.

Where an alternative costing basis is to be applied the significant business activity must provide clear justification for departure from the avoidable cost method and the Council must report

clearly on the basis of the alternative costing regime in its Budget and Annual Report and when reporting to Treasury on the progress of implementing the NCP reforms.

## **7. Contracting**

CSOs can best be defined by way of a contract between the Council and the significant business activity which provides the function, service or concession.

Such contracts should specify the type, quantity and quality of the CSO so as to clearly define the expectation of the Council. Performance indicators should also be established to enable regular monitoring of the effectiveness and efficiency of the delivery of CSOs.

## **8. Reporting**

NCP requires that there be an on-going identification and monitoring of significant business activities to ensure that competitive neutrality principles are upheld and activities continue to be appropriately defined, managed and delivered.

So that delivery of CSOs can be regularly assessed by Councils there should be an annual review of each CSO. Where a Council decides that a CSO should no longer be specifically funded within the Annual Budget the non-commercial activities must be removed from the significant business activity's service obligations.

## **9. Implementation**

Councils must identify existing CSOs and establish costing, funding, reporting and contracting principles of this policy in sufficient time to demonstrate adequate compliance with this NCP reform commitment prior to the third tranche assessment to be undertaken by the NCC in June 2001.

Councils are required to develop a programme for identification and review of CSOs and provide sufficient evidence to demonstrate ongoing compliance with this NCP reform element.

## **10. Resource material**

*Community Service  
Obligations:  
Policies and Practices of  
Australian Governments  
Published: Feb 1997  
Cat. No. 9608680*

*Community Service  
Obligations.  
Some definitional,  
costing and funding  
issues  
Published: April 1994  
Cat. No. 9706623*

*NCC Annual Reports:  
available at:  
<http://www.ncc.gov.au>*