

**TREASURER'S INSTRUCTION**  
**GOVERNMENT BUSINESS ENTERPRISES ACT 1995**

**GBE 13-114-04**

**COMMUNITY SERVICE OBLIGATIONS**

**BACKGROUND**

Section 114 of the *Government Business Enterprises Act 1995* (GBE Act) provides that the Treasurer may issue Instructions, in writing, in respect of guidelines, principles, practices and procedures to be observed by Government Business Enterprises in relation to community service obligations (CSOs). Section 115 imposes an obligation on each Board to ensure compliance with all Treasurer's Instructions.

The purpose of this Instruction is to provide a CSO policy and implementation guidelines for Government Business Enterprises (GBEs).

While the GBE Act provides broad requirements in relation to funding, costing and review of CSOs, matters associated with the implementation of the framework specified in the GBE Act need to be determined. These include principles relating to the identification, costing, funding and delivery arrangements for CSOs.

The main objectives of the CSO policy are to ensure that the Government's economic, social and other objectives are achieved without impacting on the commercial performance of GBEs and to improve the transparency, equity and efficiency of CSO service delivery.

**DEFINITIONS**

Words and phrases used in this Treasurer's Instruction have the same meaning as under the GBE Act.

**TREASURER'S INSTRUCTION**

The Board is to ensure that its CSO policies comply, and are consistent, with the "Community Service Obligation Policy for Government Business Enterprises" and "Guidelines - Community Service Obligations", attached to this Instruction.

Applications submitted for declaration of a CSO are to comply, and be consistent, with section 60(2) of the GBE Act and Treasurer's Instruction GBE 09-60-01.

**ATTACHMENTS**

- "Community Service Obligation Policy for Government Business Enterprises"
- "Guidelines - Community Service Obligations"

**COMMUNITY SERVICE OBLIGATIONS POLICY**  
**FOR**  
**GOVERNMENT BUSINESS ENTERPRISES**

July 1996

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## 1. Introduction

The implementation of an approved CSO policy is integral to the enhanced performance and accountability of Government Business Enterprises (GBEs) under the *Government Business Enterprises Act 1995* (GBE Act). GBEs are expected to improve performance by focusing on commercial goals. This means that non-commercial activities and functions, not all of which may qualify as community service obligations (CSOs), will need to be clearly identified, justified and separately accounted for.

Whilst the GBE Act provides broad requirements in relation to funding, costing and review of CSOs, matters associated with the implementation of the framework specified in the GBE Act need to be determined. These include principles relating to the identification, costing, funding and delivery arrangements for CSOs. The accompanying paper provides guidelines to GBEs on the CSO process, and implementation issues.

## 2. Policy Rationale

**The main objectives of the CSO policy are:**

- **to ensure that the Government's social and other objectives are achieved without impacting on the commercial performance of a GBE; and**
- **to improve the transparency, equity and efficiency of CSO service delivery.**

CSOs are presently funded internally by GBEs through cross subsidisation, resulting in distorted efficiency and equity effects and a lack of funding transparency. The lack of funding transparency means benefits are provided without scrutiny by either Government or the Parliament and are directed to consumers who are unaware of the true cost of service delivery.

In essence, existing CSOs differ from other Government outlays because they are not subjected to the Budget process and are not subjected to the scrutiny normally applied to the outputs funded through annual appropriations from the Consolidated Fund. There is currently no Minister accountable for the outcomes of CSOs.

The attached CSO policy provides a process for ensuring that existing CSOs are considered in the Budget context. New CSOs proposed in future will be considered in the Budget context in the same way as any other proposal for new outlays.

GBEs require:

- clarity of CSO objectives in order to know what Government requires them to deliver; and
- funding for CSOs undertaken, to ensure the achievement of their financial objectives.

However, from the Government's perspective, the key issues are whether a CSO:

- is appropriate and effective in terms of meeting social objectives and Government priorities;
- is most appropriately delivered by a GBE, or some other provider; and
- has a minimal impact on the Consolidated Fund.

The GBE Act provides for the identification, costing and funding of CSOs to remove the disadvantages inherited by GBEs which are required to undertake non-commercial activities on behalf of the Government.

The CSO policy for GBEs describes how these functions are to be undertaken, and provides an implementation time frame. The policy also provides for the removal of non-commercial activities which no longer reflect Government policy. Consequently, the implementation of this policy will move GBEs closer to competitive neutrality with the private sector.

### **3. Policy Context and Development Process**

#### **3.1 GBE reform context**

The Tasmanian Government is committed to the implementation of the competition policy principles embodied in the package of National Competition Policy Reforms endorsed by the Council of Australian Governments (COAG). The fundamental objective of competitive neutrality policy is to promote resource use efficiency in government business activities. Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership.

Over recent years, commercialisation reforms have attempted to remove special advantages that GBEs may have derived from being a public sector organisation. Concepts of competitive neutrality were introduced to put GBEs on a level playing field with their private sector counterparts (e.g. through the application of guarantee fees, dividends and tax equivalents and recognition of social policies of Government undertaken by GBEs).

The GBE Act reflects this competitive neutrality principle.

#### **3.2 Policy development process**

This Policy paper has been developed by Treasury in consultation with key stakeholders. It incorporates comments made by GBEs on a CSO discussion paper circulated in December 1993, and reflects the GBE Act provisions relating to CSOs. Extensive consultation took place during drafting of the GBE Act. The Policy paper is also consistent with the policy direction recommended by the Industry Commission in relation to CSOs.

## **4. Key Policy Issues**

### **4.1 Identification of non-commercial activities**

**The GBE Act provides the following criteria for defining CSOs undertaken by Tasmanian GBEs:**

- **a specific directive from Government must exist;**
- **there is a net cost to the GBE from providing the function, service or concession; and**
- **the function, service, or concession must be one which would not be performed under normal commercial circumstances.**

A number of GBEs were required by their Ministerial Charters to identify their non-commercial activities prior to 1 July 1996. This process should be completed as soon as possible and an application for declaration of a CSO submitted to the Portfolio Minister by 30 October 1996.

Cabinet will review whether the non-commercial activities proposed as CSOs by GBEs reflect Government policy. If the non-commercial activities no longer reflect Government policy, the GBE will discontinue the function, service or concession, or continue it unfunded if it is assessed to be a good corporate citizen activity by the Board of the GBE. Cessation of these activities may require legislative change.

Cabinet will also need to select a Purchasing Minister(s). The Purchasing Minister will be the Minister responsible for the social outcomes of a CSO. The Purchasing Minister may, in some cases, be the Portfolio Minister.

### **4.2 Costing of CSOs**

**In general, the avoidable cost method is the Government's preferred method of estimating the cost of provision of CSOs.**

The principle is to establish all the costs that would be avoided if CSOs were not carried out by GBEs.

Whilst avoidable cost is the generally preferred costing method, the GBE Act provides flexibility in the use of costing methodologies in certain circumstances.

### 4.3 Funding

**The funding of CSOs directly from the Consolidated Fund is a medium term objective of Government.**

**The Government intends that the funding of CSOs will have a minimal impact on the Budget.**

In principle, the preferred method of funding a CSO is directly from the Consolidated Fund through the Budget process. Whilst this is the preferred method, it is a medium term rather than an immediate goal. The scope and cost of many CSOs have yet to be reviewed and are unknown variables. Severe budgetary constraints limit the ability of the Government to place further demands on the Budget.

The Government's imperative, at this stage, is that the implementation of the CSO policy is to have a minimal impact on the Budget. Any additional outlays from the Consolidated Fund to purchase CSOs will be recognised as revenues by the GBEs. These increased revenues also will be reflected in profits and thus largely recouped through increased tax equivalent and dividend payments. There should also be improvements in the profitability of GBEs from the cessation of non-commercial activities identified in this process.

### 4.4 Contracting

**CSOs will be clarified by way of a contract between the Purchasing Minister and the GBE providing the function, service or concession.**

Where CSOs are required under legislation, details such as type, quantity and quality will need to be specified in a contract to clarify the purchasing arrangement for the GBE and the Government.

The Purchasing Minister(s) will be nominated by Cabinet as the Minister most directly responsible for the social outcomes associated with the CSO.

#### 4.5 Reporting

**Primary responsibility for monitoring, including policy compliance and performance under CSO contracts, rests with the Purchasing Minister to whom funding for CSOs is allocated.**

Annual reviews will be undertaken to ensure CSO delivery is in accordance with contract specifications. Performance indicators will be established and agreed by all parties to ensure an assessment of effectiveness and efficiency can be achieved.

### **5. Implementation Outline**

Implementation of the CSO policy will be undertaken over the next three years. GBEs undertaking non-commercial activities are required in their respective ministerial charters to identify and cost non-commercial operations by 30 June 1996. Reviews by the Portfolio Ministers are to be completed by 31 March 1997, and declarations from the Stakeholder Minister sought by 30 June 1997.

Funding and performance criteria for CSOs will be established during the 1997-98 Budget process. The process will be completed when a funding allocation is provided to the Purchasing Minister to contract for the delivery of the CSO. Direct funding of all CSOs is envisaged by 1998-99 Budget. It is possible that some CSOs will be directly funded in the 1997-98 Budget.

## **6. Policy Outcomes**

The main objectives of the implementation of the CSO policy will be:

- improved performance in terms of achieving social objectives desired by Government;
- improved financial performance by GBEs and the ability to meet pre-determined financial targets; and
- greater accountability to the Parliament and the community due to transparency of cost and price information.

## **7. Future Developments**

Consideration of CSOs within the Budget context provides the Government with an opportunity to identify social and other objectives currently being achieved, and to make a decision on future delivery (i.e. whether the service should be provided at the current level and whether there are more efficient means of achieving the desired outcome). To do this, the Government needs to be 'at arms length' from the GBE, with a clear role as a buyer, or potential buyer of CSO services.

The CSO arrangements detailed in the CSO Guidelines Paper separate the purchaser and provider roles of the Government and the GBE. The arrangements provide a framework whereby the Government's role is to decide how to effect its social and other objectives.

In the first year of direct funding of CSOs, the Purchasing Minister will contract with the GBE for the provision of the CSO activity. In future years the Purchasing Minister will consider whether the outcomes could be achieved through purchasing services from the GBE, from the private sector, from voluntary organisations or by other alternative means (e.g. provision of vouchers to intended beneficiaries). This stage of the CSO policy framework is envisaged to occur by the year 1998-99 but is not addressed in the CSO Guidelines Paper.

# **GUIDELINES**

## **COMMUNITY SERVICE OBLIGATIONS**

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## 1 Introduction

The Tasmanian Government is committed to the implementation of competition policy principles embodied in the package of National Competition Policy Reforms. The key principle underlying competitive neutrality is that Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership.

The introduction of dividends and a tax regime through the *State Authorities Financial Management Act 1990* was the first step in introducing competitive neutrality to Government Business Enterprises. The identification and funding of Community Service Obligations (CSOs) represents another step towards establishing a commercial environment for GBEs.

The objective of the CSO policy is that the provision of non-commercial activities in the form of CSOs will no longer compromise the achievement of the commercial objectives of a GBE. It is also proposed to phase out other "non-commercial" activities that do not contribute to the commercial objectives of a GBE. The implementation of the CSO policy will create the proper framework of incentives for improved GBE performance and expose any inefficiencies in their operations.

GBEs which were considered to have non-commercial activities were directed in their ministerial charters to identify potential CSOs by 30 June 1996. These GBEs are required to review all their activities and identify potential CSOs in accordance with the CSO policy framework

The guidelines detail the implementation process and provide advice to assist GBEs in making a submission for CSO declaration. In summary, the CSO implementation process involves four major steps (as shown in Attachment 1):

1. the Portfolio Minister submits potential CSO for review by Cabinet;
2. Cabinet review to determine CSOs and to select a Purchasing Minister;
3. Purchasing Minister to identify services to be provided, efficiency gains and to enter into a 'contract' with the CSO supplier (i.e. the GBE); and
4. GBE to supply the CSO specified in the 'contract'.

## 2. Definition

### 2.1 Definition of a CSO under the GBE Act

**A Community Service Obligation (CSO), as defined by the GBE Act, is a function, service or concession provided, allowed or performed by a GBE as a result of a direction under the GBE Act or any other Act of Parliament, or a specific requirement in any Act, and which would not have been performed, provided or allowed if that GBE were a business in the private sector operating in accordance with sound commercial practice.**

A CSO arises from a specific directive which induces departure from otherwise commercial decisions regarding the conditions of supply and demand of goods and services.

Section 60(1) of the GBE Act provides that following a request from the Board of a GBE, the Portfolio Minister may apply to the Stakeholder Minister for a declaration that a specified function performed, service provided or concession allowed by a GBE, or proposed to be performed, provided or allowed, is a CSO. The Portfolio Minister must not agree to this request unless satisfied that the CSO is a **net cost to the GBE**. That is, the cost of providing the CSO is greater than the revenues received. GBEs will not be compensated for profitable CSOs. This is discussed further in Section 3 below.

Under Sections 61(3) and 65(1), the Stakeholder Minister may not declare any function performed, service provided or concession allowed by a GBE to be a CSO unless that function, service or concession:-

- (a) is performed, provided or allowed as the direct result of:
  - (i) a direction given to the GBE (by a Minister) under this, or any other Act; **or**
  - (ii) a specific requirement by, or under this or any other Act; **and**
- (b) would not, in the opinion of the Stakeholder Minister, have been performed, provided or allowed if the GBE were a business in the private sector acting in accordance with sound commercial practice.

**The key elements of a CSO are:**

- 1. a specific directive from Government must exist (either in legislative form or a direction underwritten by legislation); and**
- 2. the activity is one which would not be performed if the GBE was free to act commercially (because it incurs a net cost).**

A direction given by a Minister which is not given under the terms of any Act cannot give rise to a CSO. That is, if a Minister directed a GBE to provide concessions to a class of citizens, and there was no provision in any Act for the Minister to assume authority to direct in such circumstances, then the concession cannot be declared a CSO.

Under the second part of the definition, the Stakeholder Minister is required to assess whether the GBE would in fact provide the CSO if it were operating in the private sector. This requirement is difficult to satisfy as there is often no clear cut answer. In some cases the service may be provided in the private sector, but perhaps not to the extent that it is currently provided by the GBE. This would imply that a proportion of the function, service or concession is a CSO. That is, the CSO may be funded to a level over and above what might reasonably be expected of an enterprise operating as a 'good corporate citizen'. This issue is discussed in the next Section.

In the case where an explicit directive does not exist and Government considers the non-commercial activities should continue, an explicit direction can be issued under section 65(1) of the GBE Act. This provision enables the Portfolio Minister and Stakeholder Minister to require the performance of a function if they are satisfied this function would not be undertaken if the GBE were a business in the private sector acting in accordance with sound commercial practice.

This provision provides greater flexibility for the recognition of CSOs and is the primary difference between the GBE Act and SAFMA with respect to CSOs.

## 2.2 Special Commercial Activities that are not CSOs

**The following activities which appear non-commercial in nature are not CSOs:**

- **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.**

### 2.2.1 Regulatory Requirements

Regulations imposed by Government on a GBE that are also imposed on any other firms operating in the industry do not give rise to CSOs. These are requirements which relate to a range of legal and regulatory obligations impacting on the operations of both GBEs and private sector firms. Examples include environmental controls, industrial awards and occupational, health and safety regulations.

The prevailing environment of a GBE which is part of the public sector is also not a CSO. That is, public sector awards and employment conditions, prevention from operating in certain markets (e.g. competing with local businesses), audit requirements, provision of advice to Ministers, and so on are not CSOs.

It is considered that the private sector is also subject to a number of requirements, which are not required of public sector entities, which impose a similar cost burden (e.g. shareholder and Director demands, share market reporting requirements etc).

CSOs relate to what a GBE is required to do, rather than what it is prevented from doing. However, specific input restrictions such as tied purchasing arrangements with particular firms for industry assistance purposes could be construed to represent CSOs.

### 2.2.2 Market Segmentation to Maximise Profit

Many private sector firms undertake activities such as providing concessions to segments of the market (eg. to pensioners) to maximise their profits from various market segments. While such an activity would appear to be non-commercial in nature and, viewed in isolation, as non-profit making, the activity is performed with the intent of increasing total demand for goods and services or advertising a corporate image and hence maximising sales or profits.

Similarly, GBEs which engage in sponsorship or provide concessions may simply be doing so for the commercial benefit of their business. These activities are not CSOs.

### **2.2.3 Good Corporate Citizen**

The definition of a CSO excludes services being provided by a GBE as a result of the GBE acting as a good corporate citizen. The motive for the provision of such services is not overtly for profit reasons, but is usually a public relations exercise to enhance the corporate image of the firm. Many private sector bodies provide such non-commercial services (eg. sponsorship of community events) to enhance their corporate image. Examples of such non-commercial services include:

- discounts provided to pensioners, social club members or other groups;
- public tours of facilities;
- public education programs by professional associations such as the CPA and AMA, and companies such as Australian Newsprint Mills;
- advertising for educational purposes; and
- sponsorships of sporting clubs, donations to churches etc.

There is a degree of subjectivity in respect of what activities could be construed as acts of good corporate citizenship. The Stakeholder Minister (ie. Minister for Finance) reserves the right to declare certain activities undertaken by a GBE as being an act of good corporate citizenship and therefore not a CSO.

### 3. Costing Basis for CSOs

**The avoidable costing method is the preferred method of costing CSOs.**

**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 GBE. 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.**

The purpose of measuring the cost of CSOs is to determine the economic or opportunity cost of the resources used in the production of CSOs. There is a variety of methods available to cost CSOs, including:

- avoidable cost;
- fully distributed cost;
- revenue forgone;
- marginal cost; and
- stand alone cost.

For more information in relation to the different costing methods, reference should be made to the *Report of the Steering Committee on National Performance Monitoring of Government Trading Enterprises*, June 1993 on definitional, costing and funding issues relating to CSOs.

**Avoidable cost** is the nationally preferred benchmark for measuring the costs of CSOs. Although there are several complications with deriving avoidable cost, it generally reflects the best estimate of the marginal cost of providing CSOs.

In certain cases, GBEs will not need to create additional capacity to deliver CSOs, implying there will be no capital cost component of the costing exercise. In other cases, delivery of CSOs will require additions to capacity such as the extension of networks etc. In these circumstances, the capital costs of additional capacity are relevant and should be included in the cost of CSOs.

Under Section 62 of the GBE Act, the costing basis is to be jointly agreed by the Stakeholder Minister (ie. the Minister for Finance) and the Portfolio Minister after consulting with the GBE.

The Stakeholder Minister may, in some cases, engage an independent review of costings undertaken by GBEs or use information from independent bodies (such as the Government Prices Oversight Commission) in assessing the costing basis.

The avoidable costing basis is the preferred method of determining the cost of CSOs, however, alternative methods may be agreed in certain circumstances.

Where a GBE considers that a different costing method is a more appropriate method of calculating the cost of CSOs, the GBE will need to clearly justify departure from the avoidable cost basis and seek joint agreement from the Stakeholder Minister and Portfolio Minister.

One example where a departure from avoidable costs could be justified is when the cost of (or contribution to) CSOs is specified in legislation. Legislation could provide a formula or method for determining the cost of the CSO which is not based on avoidable cost. In these circumstances, funding would be provided on the basis of the formula provided in the legislation, however, in the longer term legislation should be amended to be consistent with the avoidable cost methodology.

It could be argued that the use of avoidable costing may provide a barrier to private sector participation in the provision of CSOs. In an open market, the market price of CSOs would incorporate a profit margin. If GBEs priced on the basis of avoidable costing without including a profit margin, there is potential for crowding out the private sector.

The need for competitive neutrality suggests that a 'normal' profit element should be included in the cost estimate of a potential CSO. To do otherwise would mean that a GBE would have little incentive to provide a CSO under contract and it would be better to concentrate its energies on its more profitable commercial activities. Further, it is important from the point of view of performance monitoring that a profit element be included, otherwise a GBE will be required to devote resources (foregone profit) to an activity that does not yield it a return and hence reduces its economic rate of return on assets.

The GBE Act requires the Portfolio Minister to determine if there is a net cost to the GBE from the provision of the proposed CSO. The avoidable costs to be subtracted from revenues, in determining if there is a net cost, should also include a normal profit element based on the GBE's target rate of return.

## 4. Funding CSOs

### 4.1 Funding efficient delivery of CSOs

**Costing disciplines which should be used where feasible to ensure funding of CSOs at an efficient cost include:**

- **benchmarking;**
- **best practice;**
- **competitive tendering; and**
- **pricing mechanisms.**

Whilst it is generally preferred to fund GBEs for the provision of CSOs on an avoidable cost basis, there are several commercial disciplines that will be used to ensure that inefficiencies in operations are not funded. That is, it is imperative that the delivery of CSOs be on a commercial basis and funded at an efficient cost level.

Benchmarking is the process of comparing the performance of an organisation, both at an organisational level and at a process level, with other organisations, be they best practice organisations or competing organisations.

Best practice is the international 'best' measure of performance that has been determined for an activity. This measure is one that should be aimed for, and against which performance should be evaluated.

Benchmarking and best practice will be used, where feasible, to establish efficient cost levels for particular services. It is recognised that in some instances this may not be feasible. Alternatives such as competitive tendering will be considered in the second stage of the process and should ensure an efficient market price for the delivery of CSOs.

In summary, national and international performance measures will be used as benchmarks for the price or cost of delivery of CSOs.

The introduction of contestability to the process, by way of competitive tendering for the delivery of social outputs, will be a consideration in the longer term and will ensure that

CSOs are funded at an efficient market price. This process may identify that the private sector is able to deliver social outputs at a lower price than a GBE.

Different pricing mechanisms also can be used to modify or manipulate demand in order to reduce the cost of CSOs. For example, off-peak late night services could be priced considerably differently to peak services in order to manipulate demand and drive the cost of provision of CSOs downwards.

The fundamental objective of applying a costing discipline is to ensure efficiency in delivery of CSOs by GBEs.

## 4.2 Sources of funding of CSOs

**The estimated cost of a CSO and the funding provided for it may well differ. Funding will only be provided for 'best practice' delivery of CSOs.**

**The preferred method of funding CSOs, in the longer term, is directly from the Consolidated Fund through the Budget process.**

There are several ways of funding CSOs including:

- direct funding from the Budget;
- cross-subsidisation between different users;
- user charges; and
- acceptance of a lower rate of return on capital (i.e. an implicit cross-subsidy from the owners of the GBE, the people of Tasmania).

The latter three funding methods require a trade-off between efficiency and other objectives. In Tasmania, cross-subsidisation and acceptance of lower rates of return on capital have been the traditional funding mechanisms for CSOs. As a result, the cost and level of CSO delivery has been concealed.

The preferred method of funding CSOs is directly from the Consolidated Fund through the Budget process, as this approach provides greater transparency of the real costs of providing CSOs. It is also more consistent with a commercial contractual approach and provides a review mechanism and prioritisation process. It also provides the means to achieve the social objectives of Government in a more focused and efficient manner.

The Government's imperative, at this stage, is that the implementation of the policy is to have a minimal impact on the Budget. That is, any additional outlays from the Consolidated Fund to purchase CSOs will be recognised as revenues by the GBEs. These increased revenues will be reflected in profits and thus largely recouped through increased dividends and tax equivalent payments. There should also be improvements in the profitability of GBEs from the cessation of non-commercial activities identified in this process. Transparency is the main objective at this stage. Direct funding could be phased in by 1997-98.

Advantages of the direct funding method include:

- improved equity due to the cost of the CSO being spread over the community as a whole and not just other users, some of whom may have less capacity to pay than the general community;
- review of funding occurs annually as part of the Budget review process, requiring detailed verification of the costs involved;
- greater flexibility for the Government, which is able to decide on the level and method of provision of the CSO;
- GBEs are able to set prices at commercial levels to promote efficiency in resource allocation;
- greater accountability to the Parliament and the community due to transparency of the cost/price data;
- objectives of Government policy are made more explicit; and
- improved financial performance monitoring of GBEs is possible, as the cost of providing CSOs is recompensed and no longer hidden (which previously impeded actual performance).

Disadvantages of the direct funding method include:

- community resistance to the funding of CSOs may increase as GBEs become more profitable;

- funding for CSOs is not stable as funds are scrutinised on an annual basis and subject to economic, financial and political pressures imposed by the Government; and
- there is a negative impact on the Consolidated Fund. This will be largely offset by increased taxes and dividends arising from the CSO payment, and improved efficiency of delivery of CSOs.

Direct funding of CSOs will only be considered where GBEs have been fully commercialised (i.e. the GBE is subject to dividends and is paying tax equivalents). The primary reason for this is that the competition policy reforms are a package. Further, minimising the budgetary impact of CSOs is a key concern for the Government in the short term. In cases where GBEs are not fully commercialised, alternative funding mechanisms will be considered.

It is proposed that funding will be provided to the Minister responsible for the policy goal being targeted, the Purchasing Minister, to enter into a contract with the GBE for the delivery of the CSO. This will enhance accountability and allow the Government to assess whether the way in which each CSO is delivered is the best means of achieving the Government's social objectives, within limited Budget resources.

The scope and cost of many CSOs have yet to be reviewed. Direct funding of all CSOs could be phased in by the 1997-98 Budget. The proposed implementation process is detailed in Section 6 below.

## 5. Performance Monitoring

**Funding of CSOs will be accompanied by the setting of financial performance targets to ensure that GBEs are operating in a commercial manner.**

**A sound performance monitoring system is necessary to identify those GBEs which are operating efficiently in a commercial manner.**

**Performance indicators will be developed to ensure that CSOs are efficiently and effectively delivered.**

Accountability to the Parliament is provided by the requirement in section 55(2)(h) of the GBE Act to disclose details of a GBE's activities, including CSOs, in its annual report. However, the Government as owner of the GBEs requires additional information to ensure the funds invested by the people of Tasmania are being effectively, efficiently and economically managed. Without details of the CSOs undertaken and the net cost of these, comprehensive and fully effective performance monitoring of GBEs cannot be achieved.

Accountability of GBE Boards for the commercial performance of GBEs should provide the incentive for any non-commercial activity which is not funded or recognised as a CSO to be critically reviewed by the Board. Making these costs transparent will permit improved performance monitoring of GBEs.

With clear financial performance objectives, and payment received from the Government for CSOs, the non achievement of a commercial rate of return will expose:

- non-commercial activities being undertaken without Government sanction;
- operational inefficiency; and
- temporary demand deficiencies or long term market characteristics which dictate that a commercial rate of return is unable to be achieved.

Although CSOs are non-commercial activities for the GBE, the Government will require CSOs to be delivered efficiently and effectively. Performance indicators will be developed to assist in this task

## 6. CSO Implementation Process

Appendix 1 illustrates the CSO implementation process in terms of the Funder/Purchaser/Provider Model. The process provides a mechanism whereby activities undertaken by GBEs can be assessed in terms of being either commercial services or CSOs. It also provides the mechanism to cease activities which no longer reflect the social policy goals of the Government.

Major steps in the process include:

### 6.1 Identification of 'potential' CSOs

**GBEs considered to undertake non-commercial activities were required under their Ministerial Charters to identify potential CSOs by 30 June 1996. This stage now should be completed as soon as possible.**

GBEs are required to review all of their activities and consider which of their activities are 'commercial' or potentially a 'CSO'.

Nomination by the Board of a GBE of a potential CSO is to clearly identify:

1. the scope of the activity or non-commercial service provided;
2. the Government objective being pursued;
3. under what legislative authority the CSO is being provided;
4. the past or intended where results of the CSO activity;
5. the cost of delivery of the CSO activity on an avoidable cost basis;
6. whether there is a net cost to the GBE from delivering the CSO, as per Section 60(3) of the GBE Act;
7. details of any revenues associated with the CSO;

8. the continued relevance of the CSO to community needs; and
9. why, having regard to Section 61(3)(b) of the GBE Act, the potential CSO would not have been performed, provided or allowed if the GBE were a business in the private sector acting in accordance with sound commercial practice.

During this review process, GBEs may identify special commercial services that may appear non-commercial in nature that the GBE may wish to continue to provide. These include activities associated with corporate image and good corporate citizenship. These types of activities are not CSOs and should not be put through the CSO identification process.

It should be noted that the costing of the 'potential CSOs' should be provided on the basis of avoidable cost. Costing issues are discussed in detail earlier in this paper.

## **6.2 CSO Request Submitted to Portfolio Minister**

**The GBE Board is to submit an application for declaration of a CSO to the Portfolio Minister by 30 October 1996.**

GBE Boards will be required to submit to the Portfolio Minister justifications why a non-commercial function, service or concession it provides, or proposes to provide, should be declared a CSO by the Stakeholder Minister. This submission should address all of the points referred to in 6.1 above. These points will form the basis of a Treasurer's Instruction as specified in Section 60(2) of the GBE Act.

## **6.3 Review by Portfolio Minister and Cabinet**

**Portfolio Minister and Cabinet to review CSO submissions by 31 March 1997.**

It is the Portfolio Minister's responsibility to decide at this point whether the application should proceed to the next stage of Cabinet Review. If the Portfolio Minister decides not to proceed, the GBE Board will need to determine whether the activity should cease or continue.

In some cases, the activity may be continued as there may be an indirect benefit enjoyed by the GBE (i.e. corporate image, positive publicity) or there may be alternate ways of recovering the costs of such activities (i.e. sponsorship, user pays etc).

Where the Portfolio Minister wants a GBE to cease a non-commercial activity, a Ministerial direction will need to be given in the ministerial charter. Where a Portfolio Minister wants the GBE to continue a non-commercial activity, it will be considered in the CSO process outlined, and may result in the issue of a directive under Section 65 of the GBE Act.

Cabinet will become involved in the review process at this stage, in order to determine the relevance of the proposed CSOs to the Government's policies. It is unlikely that the Portfolio Minister will be fully aware of the relationship between the CSO and other policies designed to achieve the Government's social objectives. It is for this reason also, that Cabinet needs to select a Purchasing Minister(s) with responsibility for the policy outcomes relevant to the CSO.

Stakeholder interests will be represented during the consultation phase of CSO submissions to Cabinet. It is the responsibility of the Purchasing Minister's agency to consult with community groups about CSOs being considered by Cabinet during the consultation process.

Non-commercial activities nominated by GBEs as being 'potential CSOs' will be reviewed by the Portfolio Minister and Cabinet, taking into consideration the following matters:

- whether the subject activities meet the criteria for CSOs, in particular whether there is a net cost to the GBE as required in section 60(3) of the GBE Act from providing the CSO;
- the continued relevance to the Government's social policies;
- whether the activities/programs in their current form are achieving desired social outcomes;
- whether the GBE is the appropriate vehicle for delivery of the CSO; and
- whether the Purchasing Minister wishes to seek funding for their continuation.

Section 60(4) of the GBE Act provides that where the Portfolio Minister agrees to the request of the Board, the request becomes an application for the declaration of a CSO.

If the Portfolio Minister rejects the CSO submission, the GBE Board will be required to decide whether to cease the activity, or pursue an alternate course of action.

#### **6.4 CSO submitted for Declaration by the Stakeholder Minister**

Section 61 (3) of the GBE Act provides for the Stakeholder Minister to declare a function, service or concession to be a CSO if satisfied that:

- the function, service or concession is provided as a result of a direction under an Act including section 65(1) of the GBE Act, or is a specific requirement under any Act; and
- the function, service or concession would not have been provided if the GBE were a business operating in the private sector acting in accordance with sound commercial practice.

Section 61(4) provides for a declaration under section 61(2) to take effect on and from the first day of the financial year following the date on which the application was lodged, unless the Stakeholder Minister determines otherwise.

#### **6.5 Activity, Service or Concession declared a CSO**

If an activity, service or concession is declared a CSO, the GBE is required to report all relevant details in its annual report.

#### **6.6 Budget Committee Process**

**All approved CSOs will be directly funded on an avoidable cost basis from the Consolidated Fund from the 1998-99 Budget.**

**Funding will only be provided at a level consistent with the efficient delivery of CSOs.**

#### **Budget Allocation**

The funding decision will be dependant on the financial impact on the State Budget. It may be necessary to phase in direct funding over a period of time, by accepting indirect funding or lower rates of return from GBEs in the short term.

Funding will be provided on the basis of best practice levels (where these can be determined) to ensure inefficiencies are not being subsidised, and performance targets will be set. That is, the funding provided may be less than the estimated cost of delivery of the CSO using current production processes.

CSOs will be subject to the same level of scrutiny as other Budget sector expenditure proposals during the Budget process. This will include a review of the CSO for appropriateness, effectiveness, efficiency and economy. Output performance indicators will be identified.

The Budget Committee will make a recommendation to the Portfolio Minister, the Stakeholder Minister, the Treasurer (and the Purchasing Minister) as to the level of funding to be provided. The level of funding will be dependent on a number of factors, including:

- the type and quantity of CSO to be purchased;
- the price or cost of the CSO;
- the quality of CSO; and
- the priorities of Government (i.e. CSO funding will be assessed against other competing expenditure outlays during the Budget process).

## **6.7 Costing Basis and Funding for CSOs**

Section 62(1) of the GBE Act provides that the Stakeholder Minister and Portfolio Minister must jointly agree the costing basis for a CSO after consulting with a GBE. Section 63 provides that the Stakeholder Minister, Portfolio Minister and Treasurer, jointly, must determine the method and basis on which a GBE will be funded.

The funding process will be completed when a budget allocation is approved by the Cabinet and incorporated in the allocation of the relevant department in the State Budget.

If the Stakeholder Minister makes a declaration that the activity is not a CSO, or the Budget Committee does not recommend funding, the GBE will need to review the activity to decide whether it should continue. If the GBE wishes to discontinue the activity, amending legislation will be necessary. The Portfolio Minister will be responsible for the amending legislation.

## 6.8 Implementation by Purchasing Minister

**The Purchasing Minister will receive a budget allocation for the delivery of a CSO in the State Budget.**

The Purchasing Minister, on receiving a budget allocation to purchase a CSO, will enter into a contract with the GBE for the delivery of the CSO. CSO negotiations will proceed in parallel with the budget process, however, finalisation of the contract will not occur until a budget allocation has been made.

## 6.9 Contracting with the GBE

**CSOs will be clarified by way of a contract between the Purchasing Minister and the GBE providing the function, service or concession.**

**Contracts will specify the following:**

- **the type and quality of CSO service required to be provided;**
- **the focus of the benefits, together with performance indicators to ensure that CSOs are effectively and efficiently achieved;**
- **how the CSO service is to be provided;**
- **the time period;**
- **where possible, the quantity of service to be provided; and**
- **the agreed method and basis of funding for the CSO.**

The contract price for a CSO (ie. the funding provided) may be less than the actual cost associated with the delivery of the CSO. The differential may result from factors, such as inefficiency revealed 'best practice' benchmarks.

The need for contracts having a duration longer than one year has been a concern of some GBEs. The process proposed would accommodate longer term agreements provided appropriate accountability arrangements are established.

However, it is proposed that in the first year of direct funding of the CSO from the Budget, the Purchasing Minister would use the GBE for delivery of the CSO. After this first year tenders for the provision of the CSO would be sought from the GBE and other providers.

Purchasing Ministers will be required to 'sign off' on the contract arrangements by forwarding details to the Stakeholder Minister (i.e. the Minister for Finance).

### **6.10 Performance Review**

The GBE is accountable to the Purchasing Minister for performance of the CSO contract.

Annual reviews will be undertaken by the Purchasing Minister to ensure CSO delivery is in accordance with contract specifications. The content of contracts will vary according to the type of services being delivered. Performance indicators will be established and agreed by all parties to ensure an assessment of effectiveness and efficiency can be achieved.

GBEs will be required to include financial details of CSOs, undertaken on behalf of the Government, in their corporate plans and annual reports.

Annual reviews of the costing basis and funding arrangement will also be undertaken by the Budget Committee. Section 64(1) of the GBE Act specifies that the Stakeholder Minister must review annually the costing basis and the method and basis on which the undertaking of a CSO is funded, having particular regard to the efficiency and effectiveness of the GBE in undertaking the CSO.

The review process will allow the costing basis to be amended, or revoked and substituted with a new costing basis. Similarly, the review process will allow the method and basis on which funding is provided to be amended, or revoked and substituted with a new method or basis of funding.

## Appendix 1

### Community Service Obligation (CSO) Implementation Process

