



Independent Pricing and Regulatory Tribunal

# Local Land Services Funding Guidelines

**Other Industries — Guidelines**  
May 2014





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# 1 Introduction

These guidelines will assist you to implement the funding framework recommended by IPART.<sup>1</sup>

The guidance provided here is high level and generally applicable, it is not intended to be comprehensive or overly prescriptive. You will need to apply the funding framework to your local circumstances. For example biosecurity risks and natural resource management issues differ between regions. Adoption of a common framework will ensure that the same underlying rationale is applied to funding each LLS board even though outcomes may vary (on a case by case basis).

## 1.1 What are the steps?

The following 6 steps summarise the cost recovery framework:

1. Understanding the problem and confirming that LLS should take action.
2. Specifying the activity required to address the problem.
3. Determining who should pay and how much they should pay.
4. Deciding on an appropriate funding approach.
5. Deciding how the fee or rate will be collected.
6. Assessing the extent to which efficient cost recovery pricing has been applied (CRIS and audit).

The framework is designed to help you set charges that are efficient, targeted, consistent and transparent. The decisions and information provided in steps 1 to 5 will enable you to establish an audit trail that will be used in step 6 to demonstrate the extent to which you have complied with the framework. An audit trail pro-forma, called *Cost Recovery Impact Statement (CRIS)*<sup>2</sup> and worked examples are included in Appendix A and Appendix B respectively.

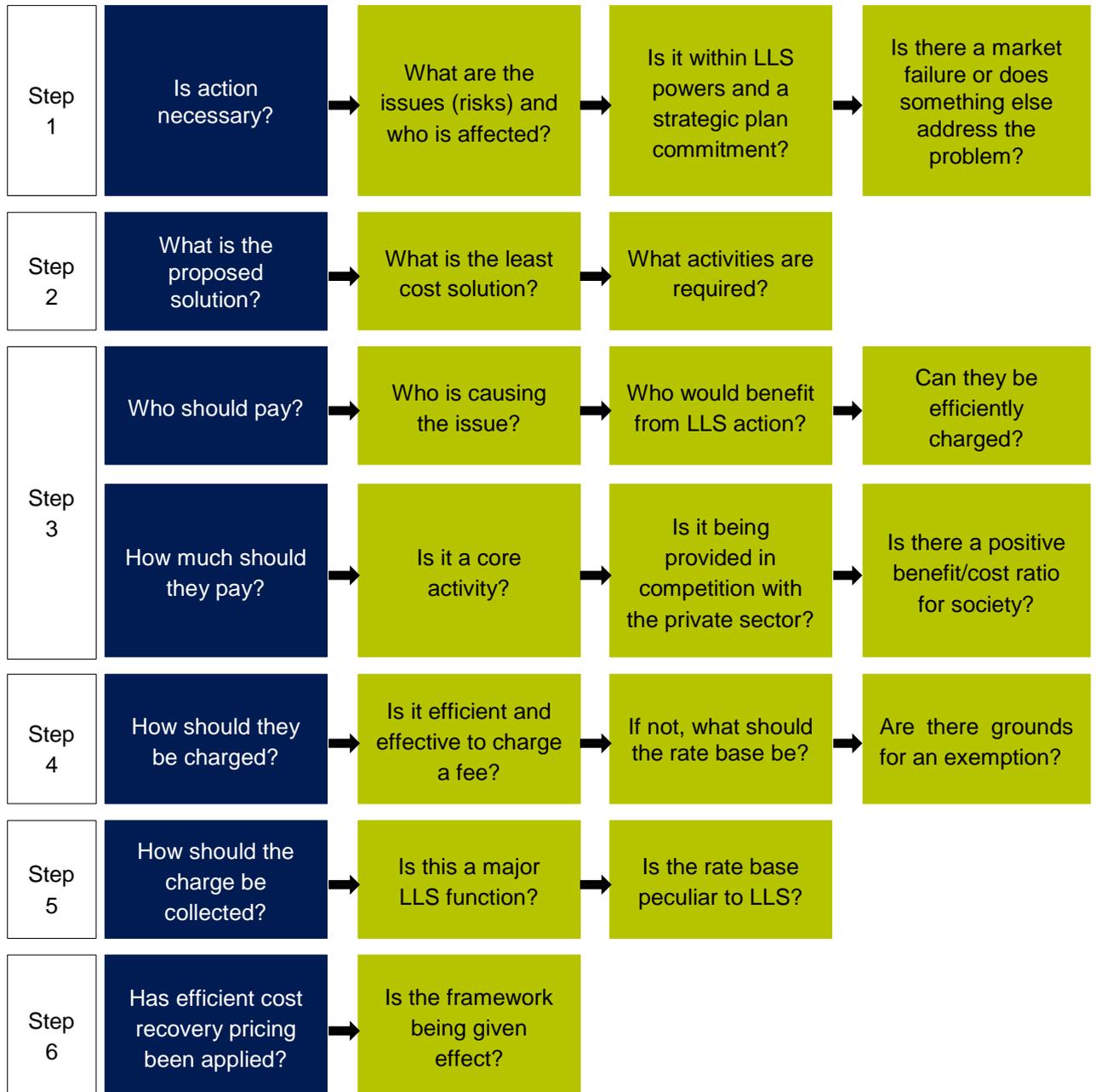
Figure 1.1 summarises the cost recovery framework into a series of questions related to each step in the funding framework. Your responses to these questions will enable them to implement the framework and demonstrate the extent to which you have complied with the framework.

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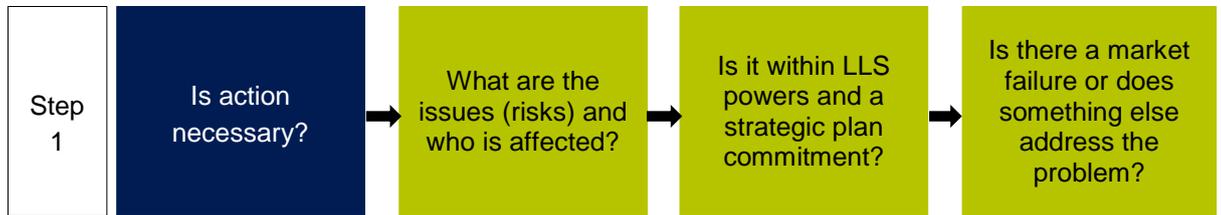
<sup>1</sup> The funding framework, and the rationale behind it, is explained in IPART's Report: IPART, *Review of funding framework for Local Land Services NSW – Final Report*, March 2014.

<sup>2</sup> Developed from the Australian Government publication:  
<http://www.finance.gov.au/financial-framework/financial-management-policy-guidance/docs/CRIS-template.pdf>.

**Figure 1.1 Funding Framework**



## 2 Step 1: Is action necessary?



The first step in the funding framework is to establish the need for action and the LLS' ability to take action.

LLS' functions are set out in the *Local Land Services Act 2013* (NSW) (LLS Act). Other Acts (eg, *Public Finance and Audit Act 1983* (NSW)) and government directions (eg, *Treasurer's Directions*) also apply to LLS' operations.

This chapter outlines the process that you are required to follow to justify your funding decisions.

### 2.1 Why is action required?

To understand if LLS action is needed, you should:

- ▼ accurately describe the nature of the issue being addressed
- ▼ undertake a risk analysis to understand its magnitude and assess the need for action
- ▼ avoid supplying a service that is more efficiently provided by the private sector.

The need for action should relate directly to:

- ▼ a function under the LLS Act (see Box 2.1) and an approved local strategic plan objective, and
- ▼ an identified failure of the market to address the identified issue (ie, to provide the service).

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## Box 2.1 Local Land Services functions

LLS boards are required to perform various functions under the LLS Act including to “administer, deliver or fund local land services”.

In the LLS Act, Local Land Services are defined as:

...programs and advisory services associated with agricultural production, biosecurity, natural resource management and emergency management, including programs and advisory services associated with the following:

- agricultural production
- biosecurity, including animal pest and disease and plant pest and disease prevention, management, control and eradication
- preparedness, response and recovery for animal pest and disease and plant pest and disease emergencies and other emergencies impacting on primary production or animal health and safety
- animal welfare
- chemical residue prevention, management and control
- natural resource management and planning
- travelling stock reserves and stock watering places
- control and movement of stock
- related services and programs.

The LLS Act provides that the LLS “may do anything necessary, or supplemental or incidental, to the exercise of its functions”.

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## 2.2 Strategic plans

The purpose of strategic plans is to link objectives to outcomes, actions (activities) and resourcing. Applying the framework will enable you to identify how your planned outcomes will be funded.

The LLS Act requires LLS NSW to prepare a State wide strategic plan<sup>3</sup> and each LLS board to prepare a local strategic plan.<sup>4</sup> Local strategic plans must be reviewed by LLS NSW and approved by the Minister.<sup>5</sup> The process of preparing a local strategic plan will assist you in developing your funding proposals.

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<sup>3</sup> LLS Act, ss 14(1)(c) and 37.

<sup>4</sup> LLS Act, s 29(1)(a).

<sup>5</sup> LLS Act, ss 49-51.

The LLS Act requires that local strategic plans are audited within 3 years of ministerial approval to determine whether the plans' provisions are being implemented.<sup>6</sup> Audits of compliance with the funding framework are undertaken at the same time as the audits of local strategic plans. Preparation of a cost recovery impact statement (CRIS) will provide the necessary paper trail for this audit to be carried out.

Following the steps and documenting them will assist you to produce a CRIS. We propose that a CRIS be released simultaneously with local strategic plans.

Each LLS board is required to prepare a local strategic plan which has effect for a period of 5 years.<sup>7</sup> The LLS Act prescribes the content of a local strategic plan.<sup>8</sup> This will provide ratepayers with indicative 5-year prices, coinciding with consultation on the local strategic plan, and will assist ratepayers in their forward planning.

As events unfold over the 5-year life of your local strategic plan<sup>9</sup> it may be necessary to depart from the charges specified in the CRIS. Any new or revised charges should be set in accordance with the framework with supporting documentation that aligns with that required for the CRIS.

You are required to publish in your annual report<sup>10</sup> a statement of the coming years' charges certifying that all fees and rates are set in accordance with the funding framework and explaining any variation from the CRIS. These variations are also subject to possible audit.

If there is particular concern with proposed charges the Minister may arrange for an audit at any time of 'all or any particular function of LLS'.<sup>11</sup> Similarly the Minister may at any time arrange for an audit of your local strategic plan.<sup>12</sup>

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<sup>6</sup> LLS Act, s 54.

<sup>7</sup> LLS Act, s 45.

<sup>8</sup> LLS Act, s 47.

<sup>9</sup> LLS Act, s 45.

<sup>10</sup> LLS Act, s 30. A local board is required to prepare before 30 March each year an annual report on the performance of its functions.

<sup>11</sup> LLS Act, s 24(3).

<sup>12</sup> LLS Act, s 54(3).

## 2.3 Identifying market failure

Market failure arises when the allocation of goods and services in a market is not efficient. Examples of market failure include:

- ▼ Public goods – where the market cannot efficiently charge whoever uses the good. This includes where you cannot exclude parties from enjoying a service they have not paid for. For example, preparation and release of an emergency response plan.
- ▼ Spill over costs – where costs are imposed on a person or group that are not involved in the original activity. For example, where one landholder fails to take action to curb wild dogs on their property and this failure to act affects nearby properties.

While you may identify a market failure, not all cases of market failure will require you to act, eg, where the costs of addressing the market failure exceed the benefits.

If no market failure is identified you should consider not taking action. If you decide to undertake an activity in competition with the private sector then you must comply with the government’s policies on competitive neutrality (see section 5.5).<sup>13</sup>

## 3 Step 2: What is the proposed solution



Once the nature of the issue is understood and the need for you to address it has been confirmed, the next step in the funding framework is to determine the least cost solution and specify the activity (or activities) required to address the issue.

This involves clearly describing each activity including, for example, the intended outcome, the resources required and where these resources will be used.

Situations will arise where:

- ▼ multiple activities are required to solve a single problem
- ▼ one activity may contribute to solving multiple problems.

Examples of both situations are outlined in Table 3 below.

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<sup>13</sup> NSW Treasury, *Policy Statement on the Application of Competitive Neutrality*, January 2002; NSW Treasury, *Guidelines for Pricing of User Charges*, June 2001.

If more than one activity is required to solve a problem, you should generally assess each activity separately, including who is best placed to undertake that activity. This is important for Step 3 of the framework, which involves identifying the impactor/risk creator or beneficiary of the activity.

If diverse activities are assessed together, it will be more difficult to accurately identify the individual or group to charge. It will also increase the likelihood of cross-subsidisation and weaken the case for cost recovery.

Cost apportionment is necessary where one activity contributes to multiple services. Your costing systems (eg, activity based costing) should facilitate effective cost tracking and the attribution of common/joint costs to different services.

It is also important that any potential for economies of scope are realised. For example, where an activity both increases agricultural production and contributes to improved natural resource management.

**Table 3.1 Activities and services examples**

Type of cost	Examples
<b>Multiple activities contributing to a single outcome</b>	<ul style="list-style-type: none"> <li>▼ Co-ordinating weed eradication - this may require enforcement, advice and on-ground action to achieve the same objective.</li> <li>▼ Emergency management - achieved through preparation of a State Emergency Plan, establishing Emergency Management Committees and arrangements for controlling emergency operations.</li> </ul>
<b>A single activity contributing to multiple outcomes</b>	<ul style="list-style-type: none"> <li>▼ Training - Sustainable land management training could aim to improve natural resource management and agricultural productivity.</li> <li>▼ Traceability - The National Livestock Identification Scheme (NLIS) can be used to provide market assurance, aid disease and pest initiatives, track the spread of weeds (if ingested by animals) and inform policy formation/development.</li> </ul>

### 3.1 Defining the activity and resourcing levels

Step 2 involves:

- ▼ nominating the activities required to address the problem, and
- ▼ determining the efficient costs of undertaking those activities.

In nominating activities to address an identified problem, you should:

1. **Define the required or intended outcomes.**
2. **Develop performance indicators** to help assess whether an activity has been successful in addressing the issue. Development of performance indicators will also enhance your ability to undertake sensitivity analysis to assist in determining the level of service to be targeted.
3. **Establish the minimum necessary level of activity to achieve the intended outcomes.** Service levels and service costs can be informed by benchmarking against other LLS boards and service providers in other jurisdictions providing similar services.

### 3.2 Establish the level of efficient costs

Cost recovery can promote efficiency by instilling cost consciousness in both the service provider and the party being serviced. However, poorly designed arrangements can create incentives for inefficiency and 'cost padding'.

There are a number of techniques that can help you keep costs at 'efficient' levels, for example:

- ▼ **Benchmarking of performance and costs:** This is a tool for measuring the relative efficiency of LLS operations. It involves comparison of performance and/or costs over time or between service providers undertaking similar activities.
- ▼ **Consultation with affected stakeholders:** LLS' ratepayers have an interest in the design, delivery and cost of the activity provided. When the parties paying for an activity are both informed and sufficiently organised, they can exert pressure to keep costs down. Consultation with affected parties can therefore provide an important discipline to maintain costs at efficient levels.<sup>14</sup>
- ▼ **Introduction of competitive pressures:** You can use market testing to determine if another party should provide a specific service. That is:
  - market testing involves putting the provision of an activity out to tender (eg, running a tender to choose a private consultant to undertake specific research).<sup>15</sup>

Introducing competition allows the users of a service to choose from multiple providers (eg, alternative providers of mandatory assessment services could be licensed or certified to operate/compete in these markets).<sup>16</sup>

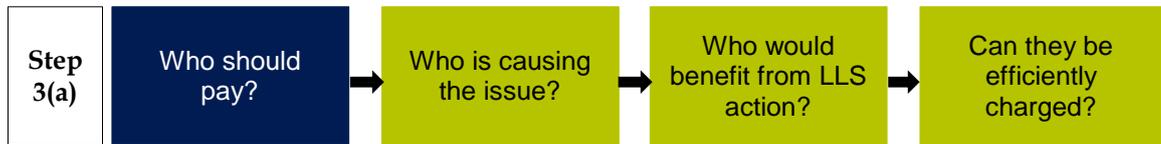
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<sup>14</sup> Victorian Department of Treasury and Finance, *Cost Recovery Guidelines*, January 2013, p 29.

<sup>15</sup> *Ibid*, p 29.

<sup>16</sup> *Ibid*, p 29.

## 4 Step 3(a): Who should pay?



The objective of Step 3 is to determine who should fund the activity (Step 3(a)) and to decide what share of the costs they should pay (Step 3(b)).

Depending on whether the activity is a regulatory activity or non-regulatory activity, the outcomes may differ. For example:

- ▼ in the case of **regulatory activities**, the impactor/risk creator is likely to be the person to pay under the cost recovery hierarchy
- ▼ in the case of **non-regulatory activities**, the beneficiary is likely to be the person to pay under the cost recovery hierarchy.

### 4.1 Identify whether the activity is regulatory or non-regulatory

**Regulatory** activities are services provided by you that relate to the monitoring and enforcement of legislative requirements imposed on owners and occupiers of landholdings. For example, by placing enforceable obligations on them to take certain actions, such as controlling pests on their land, animal disease prevention, complying with pesticide control orders and the clearing of native vegetation. These activities generally relate to monitoring, managing and enforcing compliance with these obligations.

**Non-regulatory** activities are all other activities, for example, developing research partnerships and extension services such as the PROfarm program.<sup>17</sup>

### 4.2 Apply the hierarchy

The funding framework is targeted at recovering costs from those parties responsible for you undertaking an activity, whether it is regulatory or non-regulatory.

<sup>17</sup> PROfarm is the training program developed by NSW Department of Primary Industries (NSW DPI) to meet the needs of farmers, primary industries, agribusiness and the community.

The funding framework for LLS follows a hierarchy to determine who should fund a service, as follows:

- ▼ **Impactors or risk creators** - at the top of the hierarchy are those causing an adverse impact (eg, degrading the environment) or creating a risk (eg, harbouring pest animals on their property). They are best placed to control the demand for services. This includes public land management agencies. The cost of the activity should be allocated to the impactor(s) or risk creator(s) in proportion to their contribution to the impact or risk created, where it is efficient and cost effective to charge them.
- ▼ **Beneficiaries** - second in the hierarchy are landholders benefitting from a service where it is either not practical to charge the impactor or risk creator or there is no adverse impact or risk created (eg, production advice).
- ▼ **Taxpayers** - as a last resort the cost of a service should be borne by taxpayers. That is where it is not feasible, efficient or cost effective to identify and charge either an impactor or beneficiary. As discussed above, where public land management agencies are identified as impactors or beneficiaries then they should pay for their share of services.

This hierarchical approach ensures that the selected funder is the party closest to the problem and most able to influence an outcome.

#### 4.3 Who could be charged?

You should develop a short-list of possible entities to charge. This list might include, but is not limited to:

- ▼ **private parties**, such as individuals or business enterprises
- ▼ **collectives**, including industry or community organisations or distinct groups of enterprises or individuals
- ▼ **the community**, either all LLS rate payers or all landholders within your boundaries
- ▼ **taxpayers**, where activities provide benefits to the general community (eg, pure public goods, see section 4.5), or where all other possible alternative charging options are not practical or cost effective, ie, funder of last resort.

#### 4.4 Identifying the appropriate funder(s)

You should work through the list of potential funders beginning with the most narrowly defined group until the appropriate funder(s) is (are) identified. Key questions are:

- ▼ **Is it feasible to charge this candidate?** Can this candidate (individual or group of individuals) be clearly identified?
- ▼ **Is it efficient to charge this candidate?** This involves considering whether there is a reason for not charging the candidate. There may be cases where recovering costs from an individual may lead to undesirable outcomes or behaviour. To be efficient, the cost recovery mechanism should align the incentives of the person being charged with the desired outcome of the activity.

For example, it may not be sensible to charge an individual who reports an outbreak of a disease on their property. This could create an incentive to not report outbreaks. Another reason why it may not be efficient to charge this candidate is that they may not be able to respond to mitigate the need for the activity. In such cases, it may be more efficient to charge a group of similar individuals that have an obligation to report an outbreak of a disease and who will benefit from controlling the disease.

- ▼ **Is it administratively efficient to charge this candidate?** This involves considering whether a fee (for individuals) or a rate (for group) mechanism exists that would collect enough to fund the activity above the collection costs. If not, charging this candidate would lead to an inefficient outcome and other candidates should be considered.

#### 4.5 Distinguishing public/private goods

To assist you apply the hierarchy and apportion costs Table 4.1 shows the different types of public and private goods and associated charging considerations. Here goods mean both goods and services.

To apply the table it is necessary to understand what comprises a public good. The characteristics of a public good are:

- ▼ the use of a good by one person does not impede another person from using the same good
- ▼ it is not possible to preclude another person from accessing the good because the additional cost of provision is negligible, and hence makes it difficult to charge.

A pure public good has both characteristics, eg, the development of an emergency action plan. These characteristics may mean that it is more efficient for government to provide a good if it wishes to maximise net social benefits. Governments may, and usually do, provide a good with significant public good characteristics.

The Board of Chairs will coordinate the approach of LLS boards to the application of the funding framework to the assessment of whether all or part of the costs of a specific service should be funded by general taxpayers or only that part of the taxpayer base comprising LLS ratepayers. You will have to make special applications to the State and Commonwealth Governments for special grants (eg, for catchment activities).

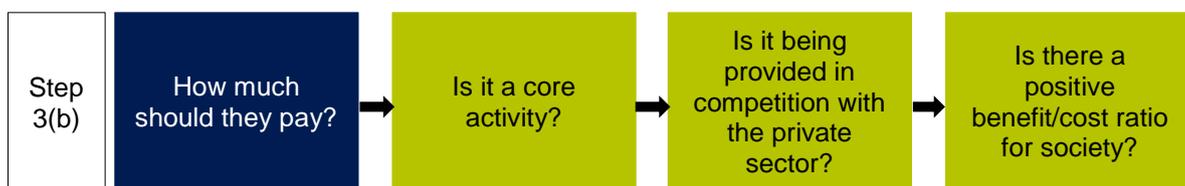
Where government funding is not forthcoming for an activity that the application of the funding framework indicates should be government funded, you will have to reconsider whether you provide the service. This will be a local board decision.

**Table 4.1 Types of public and private goods and charging considerations**

Description	(Examples of programs or services performed by predecessor entities)				Charging consideration	Public / Private benefit
	LHPA	CMA	DPI Extension	Emergency response		
<p><b>'Pure' public goods</b> Any party can use the good without affecting another party's enjoyment, and it is not efficient to prevent access to the good to anyone once it is provided.</p>	Maintain corridors of native vegetation in Travelling Stock Reserves for wildlife movement.	Catchment Action Plan; service point for government programs; community resilience programs.	Basic extension eg, noxious and environmental weed control handbook; improve linkages with researchers.	Preparation of plans to deal with emergency.	The nature of public goods means they are not easily traded in a market. A strong case exists for <b>taxpayer</b> funding where a net benefit is provided to the community.	Public.
<p><b>'Selective' public goods</b> Have the characteristics of a public good but mainly benefit a narrow group of users.</p>	Animal health – record maintenance and reporting of disease; Livestock identification (emergency response zoonotic).	Integrated land management program; salinity reduction; weed management advice and control program.	Applied extension – employs results from applied research directed at specific problems eg, new crop varieties.	Prevention – identification of hazard and (control) measures to reduce risk.	These types of public goods lend themselves to be funded by the identifiable <b>beneficiaries</b> through compulsory rates. Funding may also come from the public sector where there are <b>significant</b> external benefits to society.	Private with a degree (low to high) of public benefit.
<p><b>Club goods</b> Goods/services that can be used by anyone within a group without affecting anyone else's use but can be excluded to non-club members.</p>	Livestock identification (information, market access); pest & weed control; active surveillance – monitoring endemic disease in livestock and plants.	NA.	Development extension – adopting research results in a commercial environment eg, crop variety advice; reproductive management; market access	Response – providing immediate relief to affected parties such as agricultural damage assessment; and recovery.	May be provided and funded by <b>collectives</b> of beneficiaries (eg, industry organisation). The public sector may provide club goods, and charge the members of the 'club' through <b>rates</b> .	Private.

Description	(Examples of programs or services performed by predecessor entities)				Charging consideration	Public / Private benefit
	LHPA	CMA	DPI Extension	Emergency response		
			advice.			
<p><b>Private goods</b> Are rivalrous in consumption and excludable which means another party is prevented from their use.</p>	Animal health – non-zoonosis; animal husbandry; livestock identification (product differentiation).	Farm plans.	Specific financial and technical advice.	Assist in co-ordinating relocation and feeding of livestock.	Costs should be recovered from those that benefit from private goods ( <b>user pays</b> ).	Private.
<p><b>Positive externalities</b> Some goods provide unrelated third parties to a transaction with benefits that are not paid for. The market is likely to under-provide this type of activity.</p>	NA.	Support community NRM infrastructure.	Some basic and applied extension.	Preparation and prevention activities more likely to result in externalities.	There may be a case for <b>co-funding</b> to encourage beneficial externalities, but should be considered in light of additional benefits beyond the by-product of private actions.	Public good (pure/selective).
<p><b>Negative externalities</b> Governments may need to regulate certain activities to reduce the risk of harm that may occur to consumers, the community or the environment.</p>	Plant and animal health regulation; chemical residue regulation.	Native vegetation regulation; threatened species regulation.	NA.	Breaches of stock movements in an emergency.	On economic efficiency grounds the administrative costs should be internalised into the cost structure of the regulated industry – as an <b>impactor/risk creator</b> . Practical considerations usually mean businesses are charged, but ultimately costs are shared along the supply chain.	Public bad (pure/selective).

## 5 Step 3(b): How much should they pay?



This step of the funding framework helps to:

- ▼ decide which costing approach to adopt
- ▼ identify the costs to be recovered
- ▼ decide whether to continue with the activity.

### 5.1.1 Different costing approaches

You need to choose a costing approach for each activity.

Table 5.1 outlines 2 approaches to determining the cost base (along with some variants of these models), it also describes the circumstances where they are applicable.<sup>18</sup>

The first is **fully distributed costs**. This approach allocates all costs (direct and indirect costs including capital costs) to an activity. This is typically used where an activity is stand alone and a core activity of the entity.

The second is the **incremental cost** approach. This is typically adopted where an activity represents an 'add on' to an existing core activity. The incremental cost approach can be further broken down into the following 2 approaches:

- ▼ 'marginal cost' approach
- ▼ 'avoidable cost' approach.

These are conceptually similar – the main distinction is that marginal costing focuses on the change in costs arising from one extra unit of output, whereas the avoidable cost approach considers the costs that would be avoided if an entire function or operation were not undertaken.

<sup>18</sup> Victorian Department of Treasury and Finance, *Cost Recovery Guidelines*, January 2013, pp 22-23.

**Table 5.1 Costing approaches**

Costing approach	Description	When to use
<b>Fully distributed costs</b>	The total costs of an service provider are allocated across all outputs (non-commercial and commercial) – direct and indirect costs (including capital costs). Direct costs are allocated to their respective output, while indirect costs are allocated across all outputs (using either a pro-rata approach, or the activity-based costing approach).	Where activities account for a large proportion of LLS boards’ activities usually associated with core activities. <b>For example, for regulatory activities.</b>
<b>Incremental costs</b> This approach includes 2 main methods: ▼ marginal costs ▼ avoidable costs	Allocates the increase in costs that are attributable to undertaking the activity.	Where overhead and capital costs would be incurred anyway even if the activity were not undertaken (eg, activities accounting for a small proportion of LLS boards’ activities). <b>For example, for non-regulatory activities.</b>
1. Marginal costs	The increase in cost involved with producing an additional unit of output. Costs that are unaffected by the level of activity in the short run (such as capital costs) are excluded.	▼ May be used in situations where a product or service is provided predominantly for a core user, and where additional capacity is available at little or no extra fixed cost. ▼ This approach will often be appropriate for setting charges for services provided in off-peak periods where demand fluctuates.
2. Avoidable costs	The costs that would be avoided if a particular activity was no longer undertaken.	▼ Suitable for recovering the additional costs of undertaking ‘add-on’ work outside core activities. The recovered costs are those that would have been avoided if the ‘add-on’ activity had not been undertaken.

**Source:** Adapted from Victorian Department of Treasury and Finance, *Cost Recovery Guidelines*, January 2013, pp 23-24.

### 5.1.2 Types of costs

There are a number of different types of costs that may be included in the calculation of the cost base. These are:

- ▼ direct costs
- ▼ indirect costs
- ▼ capital costs.

These are summarised, with examples, in Table 5.2 below.

**Table 5.2 Types of cost**

Type of cost	Examples
<b>Direct costs</b> are costs that can be directly attributed to an activity because they are incurred exclusively for that particular activity.	<ul style="list-style-type: none"> <li>▼ Labour costs (and on-costs), such as base wage/salary, payroll tax, superannuation, training costs, workers' compensation premiums, overtime and other allowances.</li> <li>▼ Operating expenses, such as office accommodation, equipment, supplies, materials, power and maintenance.</li> </ul>
<b>Indirect costs</b> are not directly attributable to the particular activity – often referred to as 'overheads'.	<ul style="list-style-type: none"> <li>▼ Corporate services costs, such as salary of the chief executive, financial services, human resources, records management and information technology.</li> </ul>
<p><b>Capital costs</b> are the costs a business must earn to justify retention of assets in the medium to long term – they may be directly or indirect involved in providing the activity –such as:</p> <ul style="list-style-type: none"> <li>▼ depreciation of owned assets (which reflects the extent to which capital is 'consumed' over a period and hence must be replenished)</li> <li>▼ the opportunity cost of capital (which recognises that the funds tied up in the capital used to deliver the activity could have been invested elsewhere).</li> </ul>	<ul style="list-style-type: none"> <li>▼ Depreciation (return of asset).</li> <li>▼ Opportunity cost of capital (return on asset).</li> </ul>

**Source:** Adapted from Victorian Department of Treasury and Finance, *Cost Recovery Guidelines*, January 2013, p 24 and Commonwealth Competitive Neutrality Complaints Office (CCNCO) 1998, *Cost Allocation and Pricing*, CCNCO Research Paper, Productivity Commission, October, p 8.

## 5.2 Exclusion of costs that are not integral to the activity

It is important that the costs of any activity that are **not** a fundamental part of, or directly related to, the activity are excluded from the cost base. For example, costs associated with:<sup>19</sup>

- ▼ a review of the effectiveness of a regulatory function, and assessment of regulatory alternatives (eg, costs of undertaking a regulatory impact statement process and/or a major consultation process as part of regulatory development)
- ▼ advising Parliament on issues within the service provider's (ie, LLS) expertise
- ▼ answering parliamentary questions
- ▼ briefing Ministers and responding to their correspondence.<sup>20</sup>

<sup>19</sup> The examples listed could be considered to be pure public goods and are undertaken for the benefit of the entire NSW community.

<sup>20</sup> Victorian Department of Treasury and Finance, *Cost Recovery Guidelines*, January 2013, p 25.

Other considerations that need to be taken into account when setting the level of cost to be recovered in a year are discussed below.

### 5.3 Smoothing fluctuations: under and over-recovery of costs

Stability in charges is important to assist landholders and industries in their planning. Fluctuating and unpredictable cost recovery charges can create uncertainty that hinders efficient planning and investment. These problems are exacerbated when charges account for a large proportion of an entity's overall expenses.

Under these circumstances, it may be appropriate to 'smooth' fluctuations in charges and facilitate a degree of stability from year to year. This may result in under or over-recovery of costs in any one year.<sup>21</sup>

### 5.4 Avoiding cross-subsidisation

Cross-subsidies occur when one group of users pay more than the costs of the activities (or products) they receive and the 'surplus' is used to offset the cost of activities provided to other users. Cross-subsidies may also occur when a rate collected for one purpose is used to fund unrelated activities.

Poorly designed cost recovery rates can lead to cross-subsidies between parties. This may occur when a rate is applied equally to all members of a group. If some ratepayers within that group require less regulatory supervision than others, they may end up subsidising ratepayers who require more intensive regulation/supervision.

A way to overcome the risk of cross-subsidisation is to define narrow rateable bands, based on identified regulatory cost drivers. This ensures that parties making similar demands on your resources pay the same rate.<sup>22</sup>

### 5.5 Competitive neutrality adjustments

Where a government service provider is in competition with the private sector NSW Treasury Guidelines require the government service provider to:

- ▼ adjust the costs actually incurred to include notional costs representing the costs that must be met by the private sector that the government service provider avoids because of its government ownership, eg, taxes and other charges<sup>23</sup>

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<sup>21</sup> Victorian Department of Treasury and Finance, *Cost Recovery Guidelines*, January 2013, p 27.

<sup>22</sup> Victorian Department of Treasury and Finance, *Cost Recovery Guidelines*, January 2013, p 28.

<sup>23</sup> NSW Treasury, *Policy Statement on the Application of Competitive Neutrality – Policy & Guidelines*, p 15.

- ▼ at least charge (minimum charge) avoidable cost where avoidable costs are ‘those costs that would be avoided by the service provider if the good or service were not provided’.<sup>24</sup>

## 5.6 Allocating costs to impactors/risk creators

If the selected funder is a single impactor, or a collection of impactors with common characteristics (eg, intensive poultry industry), you should allocate 100% of the costs to them. If they are a more diverse group – for example, all livestock farmers in the LLS region, or all landholders (public and private) to control for wild dogs – you should allocate the costs proportionately. This involves identifying a way of estimating each group member’s contribution that is appropriate to the activity. For example, the activity may require different resources based on region or how livestock productivity is affected.

## 5.7 Allocating costs to beneficiaries

If the selected funder is a single beneficiary or group of similar beneficiaries they generally have the choice whether they will pay to receive the service or decide not to receive the service, based on whether they think they will receive a net benefit.<sup>25</sup>

To efficiently allocate costs across multiple beneficiaries, you should be guided by 2 important principles – the sufficiency and additionality principles. In addition, you should choose from 3 approaches to value benefits to assist you in allocating costs.

### The sufficiency principle

This principle applies where the benefits received by the direct beneficiaries exceed the cost of providing the service, even though others in society may also indirectly benefit. Under the hierarchy, the group of landholders who directly benefit would pay the full cost of the service.

For example, an LLS board may provide advice to apiarists on increasing the number of bees per hectare. The benefits to the apiarists may exceed the cost of providing the advice. Indirect beneficiaries may be landholders whose fields are pollinated by bees kept by the apiarists. Given that the cost to the apiarist is less than the benefit they receive it is neither efficient to assess the level of the indirect benefits nor charge them for the provision of the service. In this case, the apiarists would fund the full costs of providing the service.

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<sup>24</sup> NSW Treasury, *Policy Statement on the Application of Competitive Neutrality – Policy & Guidelines*, p 16.

<sup>25</sup> An industry group may agree to a compulsory levy on its members, based on the industry’s decision to have LLS provide a service.

## The additionality principle

This principle applies where the benefits received by the direct beneficiaries are less than the cost of providing the service. If this occurs you should assess and charge for indirect benefits in addition to the direct benefits. Indirect beneficiaries could be an individual land holder or a group (eg, other landholders). Where it is not cost effective to recover (charge) the balance of the cost of providing the service from the indirect beneficiaries it may be appropriate to seek government funding, especially where there is a net benefit to society.

For example, an LLS board may provide advice to apiarists on increasing the number of bees per hectare. In this example the cost of providing the advice exceeds the benefit received by the apiarists. However, the combined benefits received by the apiarists and the landholders whose fields are pollinated by bees kept by the apiarists may exceed the cost of providing the advice. If it is not efficient to charge these indirect beneficiaries (ie, landholders), consideration should be given to taxpayer funding to cover the difference between the contribution from the apiarists (ie, the direct beneficiaries) and the total cost of providing the service.

## Valuing benefits and attributing cost shares

Three approaches can be used by the LLS board to value benefits and attribute cost shares. These are:

- ▼ **Detailed assessment**, which focusses on quantifying the expected net benefits to the beneficiaries from the activity. This may require a detailed cost-benefit analysis.
- ▼ **Auction (or tender) approach** to draw out bids from interested parties, which results in cost sharing. We understand some Catchment Management Authorities previously used an auction approach to obtain voluntary contributions to conservation activities above the minimum required.
- ▼ **'Rule of thumb'** approach to approximate who benefits and thus who should pay. This approach may involve a basic cost-benefit analysis and possibly a sliding scale approach.

Generally, the more detailed the cost allocation exercise, the more time consuming and costly it will be. However, utilising the first and second approaches is more likely to lead to efficient outcomes compared with a 'rule of thumb' approach. Therefore, the first and second approaches should be used where possible (preferred).

A sliding scale approach to valuing benefits and attributing costs is outlined in Table 5.3. This is a fall back approach that may be used until better processes and information is available.

**Table 5.3 Funding ratio between public and private based on a sliding scale approach**

Impact <sup>a</sup>	Public	Private (Industry or Landholders)
Significantly public	100%	0%
Public > Private	80%	20%
Public ≈ Private	50%	50%
Public < Private	20%	80%
Significantly Private	0%	100%

<sup>a</sup> Adapted from the Emergency Plant and Animal Biosecurity Deeds, augmented to include a significantly private category.

**Note:** The Industry and Landholders private groupings are mutually exclusive.

**Source:** IPART.

The result of a cost sharing arrangement is likely to be a rate on the private parties (including public land management agencies) and a contribution from the taxpayer (subject to a net benefit for the public).

## 5.8 Undertake cost-benefit analysis and consultation

The aim of a cost-benefit analysis (CBA) is to ensure that LLS resources are being used efficiently and results in a net benefit to society. The CBA will assist you in assessing the size of any cost share to be borne by taxpayers.

In most cases you may not be required to conduct a comprehensive and detailed CBA, this should be determined on a case by case basis. The detail of the CBA depends on how material the charges are to be recovered from the selected funder(s):

- ▼ Where it will not have a significant impact on those being charged (eg, either because the amount of the charge is low or is similar to what they are currently being charged for the activity), a basic CBA should be sufficient.
- ▼ Where the activity has a significant impact on those being charged, a detailed CBA will be required. Guidelines on detailed CBA have been prepared by NSW Treasury<sup>26</sup> and the Commonwealth Office of Best Practice Regulation.<sup>27</sup>

To ensure the CBA is accurate you should consult with relevant stakeholders. Consultation serves 2 purposes:

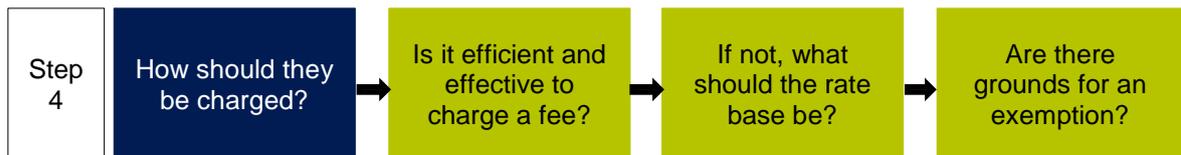
- ▼ to obtain information to ensure the benefits and the costs are accurate and the activity is the minimum required to achieve the defined objectives
- ▼ to involve stakeholders in the process which aids transparency and improves the prospects of stakeholder acceptance.

<sup>26</sup> NSW Treasury, *Guidelines for Economic Appraisal*, July 2007. See, [http://www.treasury.nsw.gov.au/\\_\\_data/assets/pdf\\_file/0016/7414/tpp07-5.pdf](http://www.treasury.nsw.gov.au/__data/assets/pdf_file/0016/7414/tpp07-5.pdf).

<sup>27</sup> See, [http://www.finance.gov.au/sites/default/files/Handbook\\_of\\_CB\\_analysis.pdf](http://www.finance.gov.au/sites/default/files/Handbook_of_CB_analysis.pdf).

If the cost-benefit analysis shows that the **activity does not result in a net benefit to society** (ie, its costs erase its total benefits), the activity should not be undertaken by LLS as it will lead to a reduction in efficiency.

## 6 Step 4: How should they be charged?



### 6.1 What is the appropriate funding mechanism?

Once you have costed the activity, you need to select the most appropriate funding mechanism to recover the cost. This should be done using the guidance below and the answers to the questions in steps 1-3. The hierarchy of funding options is as follows:

1. Fee-for-service and reverse auction (eg, applies to some natural resource management activities).
2. Rates and negotiated contributions from public land management agencies.
3. Government funding (as funder of last resort).

#### 6.1.1 Fee-for-service and reverse auction

**Fee-for-service** is the default funding mechanism for LLS. This is because it provides a strong link between the activity and the charge. In general, the stronger the link between a service and its charge, the stronger the pricing signal and the more efficient the outcome will be.

A clear price signal allows each impactor or beneficiary to assess the level of benefit they receive from the service and/or compare the charge imposed on them with the cost of taking action to mitigate the risk themselves. If the cost (price) of the service is higher than the cost of taking mitigating action, the individual or group is likely to alter its behaviour.

In general, fees are most suitable where there are clear private benefits to an identifiable party (such as an individual commercial or non-commercial landholder).

While a fee provides a clear price signal it may not be the most efficient way to recover the cost of a service. For example, a fee may be more expensive than a rate to administer, especially where the impactors or beneficiaries are a group.<sup>28</sup> There are circumstances where a fee would be:

- ▼ ineffective to charge (eg, where it would create a perverse incentive), or
- ▼ not feasible to charge (such as when the party selected to fund the activity is a group).

A **reverse auction** approach may be cost effective for large natural resource management (NRM) projects. Where beneficiaries can capture private benefits, the auction should maximise their contribution in line with the benefits they receive. It is not appropriate to use this method for funding biosecurity services.

Alternatively, for environmental and NRM services a clear price signal can be achieved through direct negotiation with landholders. This would involve private individuals applying for government investment in projects on their land. This would also allow the LLS boards and landholders to assess the benefit to the public and the private individual respectively and ensures efficient and targeted outcomes can be reached for both parties.

### 6.1.2 Rates

You should only use rates if it is inefficient or impractical to charge a fee.

It is more appropriate to use a rate than a fee in the following circumstances:

- ▼ the activity is of a general industry nature rather than of immediate application to one identifiable farm (or person)
- ▼ it is difficult or impossible to identify the users of a particular service or the extent of their use
- ▼ although the users can be identified, charging a direct fee would impede the objectives of the activity, for example, by creating a perverse incentive<sup>29</sup>
- ▼ administrative complexity means that it is simpler and cheaper to recover regulatory costs for a defined industry through a single industry levy rather than by collecting a large number of smaller fees.<sup>30</sup>

As with all cost recovery arrangements, rates should take into account administration costs, transaction costs and compliance costs.

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<sup>28</sup> Australian Productivity Commission, *Cost Recovery by Government Agencies – Part 1*, Report No.15, August 2001, p 176.

<sup>29</sup> Ibid, p 176.

<sup>30</sup> Ibid, p 176.

If the benefit received by private parties is equal to or exceeds the cost of the service there will be no need to seek government funding. However, in some cases the cost of the transaction, even in the form of an industry levy, would exceed the benefit to society from the service. In such cases, taxpayer funding may be preferable.<sup>31</sup>

It should be noted that the minimum rateable land area is 2ha, therefore LLS rates can only be charged to properties 2ha or larger.

### 6.1.3 Intensive industry rates

An intensive industry rate covers the same risks that arise from the same non-intensive activity but are magnified (increased) by the level of intensity. It is also designed to acknowledge and charge for the different level of risk related to different activities (eg, a poultry enterprise vs cattle feed lot). While the minimum rateable land area is 2ha, intensive operations should be charged intensive industry rates irrespective of the minimum rateable land area. This is to acknowledge and account for the risks associated with these operations regardless of their scale.

Intensive industry rates, in common with all rates, are recommended to have a fixed and a variable component. The fixed component would be a set amount for each intensive operation. The variable component should be based on:

- ▼ Notional carrying capacity for intensive livestock.
- ▼ Land area or notional carrying capacity for intensive poultry.
- ▼ Land area for intensive horticulture.

### 6.1.4 Government service provider contributions

**Public land management agencies** should contribute to LLS boards where the service provider is identified as the primary impactor or beneficiary of specific activities. This may include in-kind contributions.

Public land management agencies make up the largest land holders in NSW. As such, it is more efficient for LLS to negotiate directly with these public land management agencies to leverage funds and /or in-kind contributions instead of charging rates. This should allow for coordination between LLS and public land management agencies to produce a more efficient and effective outcome.

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<sup>31</sup> Ibid, p 177.

Local authorities and the Catchment and Lands Division of DPI, where relevant, should jointly participate in such negotiations. Some public landholders (eg, local authorities<sup>32</sup>) have existing obligations to maintain land assets. In addition, local authorities may be unable to recover costs incurred in managing Crown Lands.<sup>33</sup> In other cases, however, local authorities may be the landholder of lands used for the purpose of an agricultural enterprise.<sup>34</sup>

#### **6.1.5 Government budget funding**

You should only seek direct government budget funding:

1. where there is a net benefit, when the benefit received by the primary beneficiaries is less than the cost of the service and there is a public good element
2. as a last resort because it is not efficient, effective or feasible to charge impactors or beneficiaries.

Table 6.1 contains a summary of funding sources available to the LLS matched with the appropriate beneficiaries or impactors.

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<sup>32</sup> Local Government NSW, LLS Board of Chairs Submission on Funding Framework, 9 December 2013, p 2; Orana Regional Organisation of Councils, Response to LLS Board of Chairs Submission, 16 December 2013, p 2.

<sup>33</sup> *Local Government Act 1993* (NSW), s555; Orana Regional Organisation of Councils, Response to LLS Board of Chairs Submission, 16 December 2013, p 2.

<sup>34</sup> LLS Regulation, cl 15(1)(c).

**Table 6.1 Funding source(s) matched with specific beneficiaries and impactors<sup>a</sup>**

Funding Source	Individual (farm or business) <sup>b</sup>	Non-farming/ lifestyle groups	Farming groups		All LLS ratepayers/ General rate	Government	
			Non-livestock	Livestock		Public land management agency	NSW community
<b>Fee-for-service</b>	✓						
<b>Rates: Notional Carrying Capacity</b>				✓	✓ <sup>c</sup>		
<b>Rates: Per Hectare</b>		✓	✓	✓	✓		
<b>Government agency contributions<sup>d</sup></b>						✓	
<b>Government funding from State Budget<sup>e</sup></b>							✓

<sup>a</sup> Unimproved capital value of land is not included because it is only currently used for the Hunter flood mitigation rate.

<sup>b</sup> This could be a single farm or collection of farms that are considered contiguous.

<sup>c</sup> Notional Carrying Capacity can only be used as a basis for general rating by the Western LLS board.

<sup>d</sup> Because public land management agencies make up the largest land holders in NSW it would be more efficient for the LLS to negotiate directly with public land management agencies to leverage funds and /or in-kind contributions. This will also allow for coordination between LLS services and land management agency activities.

<sup>e</sup> Direct budget funding is only used if a community public good or community positive externality was identified in Step 1 or as a funder of last resort.

Source: IPART.

## 6.2 How to set a rate?

The following questions should be answered using the guidance below and the answers to questions in steps 1-3.

### 6.2.1 What type of rate should be used?

LLS boards have the power to charge:<sup>35</sup>

- ▼ a general rate, which all LLS boards are required to charge and is paid by all landholders
- ▼ specific purpose rates, which LLS boards can charge for specified purposes (including an animal health rate).<sup>36</sup>

A service should be included in the general rate when it is a core LLS activity that is broadly applicable to all LLS ratepayers.

A specific purpose rate should be used to fund activities that address a particular issue applicable to either the entire LLS ratepayer base or a clearly defined subset.

### 6.2.2 What is the appropriate rate base?

The appropriate rate base depends on who is being targeted. Table 6.2 matches the appropriate rate base to specific groups of impactors and beneficiaries.

**Table 6.2 Rate base matched with beneficiaries and impactors<sup>a</sup>**

Rates	Non-farming/ lifestyle group	Farming Group	
		Non-livestock	Livestock
Notional Carrying Capacity (NCC)	x	x	✓
Per Hectare	✓	✓	✓

<sup>a</sup> Only Western LLS board can use NCC, in place of land area, for general rates.

<sup>35</sup> *Rural Lands Protection Act 1998* (NSW), s 61. This structure is continued under the new legislative framework: LLS Regulation, Schedule 9, cl 5.

<sup>36</sup> The LLS Act refers to these rates as special purpose rates. The Terms of Reference refer to special purpose rates as specific purposes rate, so for the purpose of these guidelines the terms are interchangeable.

### 6.3 Rate or fee structure

Both general and special purpose rates must comprise a fixed amount and a variable amount.<sup>37</sup> The fixed amount applies to each holding of rateable land, while the variable amount is calculated on a per unit basis. The variable amount is calculated based on the appropriate rate base of each holding.

In determining the fixed and variable components of a rate, you should take into account the:

- ▼ direct and indirect costs associated with the specific service or activity
- ▼ impactors or beneficiaries being targeted.

The fixed component should at least cover the indirect costs of the service. The variable component should be equal to the total cost of the activity or service less the total fixed component divided by the rate base (NCC or land area). Ideally, the variable amount should be linked to the risk created or benefit received by identified impactors or beneficiaries.

You should also consider that a higher fixed component will have a greater impact on smaller properties and a higher variable component will have a greater impact on larger properties.<sup>38</sup>

#### 6.3.1 Calculating the fixed and variable components

The equations below show how to calculate the fixed and variable components for a rate designed to recover the costs of service 1, where  $FC_1$  is the fixed component charged to each rateable property,  $TFC_1$  is the total fixed component and  $TC_1$  is the total cost,  $VC_1$  is the variable component, TP is the total number of rateable properties and TRB is the total rate base (land area or notional carrying capacity). For service 1:

$$(1) \quad \text{Fixed Component} \quad FC_1 = \frac{TFC_1}{TP}$$

$$(2) \quad \text{Variable component} \quad VC_1 = \frac{TC_1 - TFC_1}{TRB}$$

The fixed component (FC) of a service is calculated by dividing the total fixed component (TFC) by the total number of properties (TP) identified as beneficiaries or impactors.

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<sup>37</sup> *Rural Lands Protection Regulation 2010* (NSW), cl 7. This requirement is continued under the new legislative framework: *LLS Regulation*, cl 6.

<sup>38</sup> Australian Productivity Commission, *Cost Recovery by Government Agencies – Part 1*, Report No. 15, August 2001, p XL.

The variable component is then calculated by subtracting the total fixed component from the total cost of the service and dividing it by the total number of units of rate base, total land area or NCC of all identified properties. This is then multiplied by the land area or NCC of each property to calculate the total variable component for each property.

#### **6.4 Principles for allowing exemptions**

It may be appropriate to allow exemptions for fees or rates. The LLS should develop a NSW wide exemptions policy for use by all LSS boards. This policy should be in line with the following principles.<sup>39</sup>

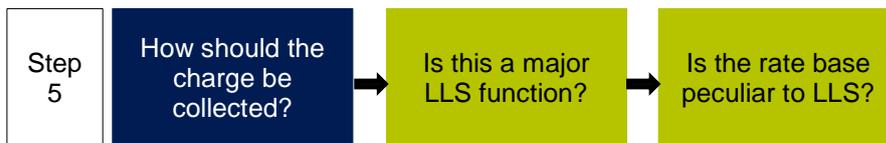
1. All landholders should be subject to the fees or rates determined by their respective LLS board, except where they are specifically granted an exemption.
2. Criteria for eliminating risks should be clearly set out by the LLS boards and those criteria should be reasonable, well-founded in risk management practice and reflect the activities and expenses that can be avoided by LLS. A common approach governing all LLS boards is preferable.
3. Exemptions should only be granted for fees and rates that are easily linked to specific areas of avoidable risk or avoidable cost (not all risk is avoidable). That is, rates and fees should be grouped in terms of avoidable and non-avoidable risk, and should not be aggregated to the point where they cannot be subject to an exemption or rebate.
4. Exemptions should be granted by way of application by the landholder and assessment conducted by its respective LLS board.
5. Landholders should only be granted an exemption after having been assessed against the predetermined criteria.
6. The exemption assessment process may be carried out by the same personnel that currently carry out enforcement activities or by private certifiers (accredited by the LLS).
7. Assessment requirements should be proportionate to potential risk (ie, stricter requirements for higher risks). For small landholders (eg, less than 20 ha), LLS should permit self-assessment, subject to review by LLS and penalties for false or misleading statements.
8. Landholders should meet the cost of assessment for their own land. Where assessment is carried out by LLS, only the marginal cost of conducting the assessment should be charged.
9. There should be clear guidelines on when exemptions may be revoked. For example, when there is an infringement of the terms of the exemption, when a property is subdivided or on transfer of property ownership.

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<sup>39</sup> This will require legislative change.

10. LLS boards should be required to make documentation relating to the application and assessment of exemptions readily available to affected landholders.
11. LLS boards should make all documentation relating to the application and assessment of exemptions available for audit.

## 7 Step 5: How should the charge be collected?



LLS should investigate and develop options for an efficient centralised collection mechanism, taking into account the existing Livestock Health and Pest Authority's (LHPA's) collection system. The main issue to consider when determining the efficiency of fee collection mechanisms is the transaction costs – that is, the costs associated with collecting rates from landholders/occupiers. These may include:

- ▼ labour costs (\$/hour)
- ▼ legal costs associated with challenges to the LLS rate system
- ▼ cost of the materials (eg, printing) used to issue rate notices
- ▼ other costs (eg, postage, collection costs, etc).

### 7.1 When should a LLS board contract with non LLS fee collection services?

LLS fee collections will be managed on a state wide basis. An individual LLS board should not contract other service providers without the explicit agreement of LLS NSW.<sup>40</sup>

<sup>40</sup> For example, under LLS Regulation, cl 40: LLS may (with ministerial approval) enter into an arrangement with an appropriate local agency for the collection of catchment contributions.

## 8 Step 6: Has efficient cost recovery pricing been applied?



The final step in the funding framework is to determine whether efficient cost recovery pricing has been applied.

The CRIS content which has been produced by applying each of the previous steps (refer to CRIS content for each step) should be the starting point for this final step.

Each local strategic plan is required to be audited within 3 years of its approval.<sup>41</sup> Your compliance with the funding framework should be audited at the same time as the local strategic plan audit.

### 8.1 Audit

The audit trail created by the CRIS will form the basis for the audit.

As part of the CRIS, you should compile a “summary of charging arrangements table”<sup>42</sup> (see Table 8.2). This table summarises the information provided in the CRIS.

We propose that each LLS board publish in its annual report<sup>43</sup> a statement verifying that all fees and rates are set in accordance with the funding framework and explaining any variation from the CRIS. An example is shown at section 8.3.

Variations from the CRIS may be necessary as events unfold over the 5-year life of a local strategic plan.<sup>44</sup> You should document all variations in the annual report.

If there is particular concern with proposed charges, the Minister may arrange for an audit at any time of ‘all or any particular function of LLS’<sup>45</sup> and similarly the Minister may at any time arrange a local strategic plan to be audited.<sup>46</sup>

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<sup>41</sup> LLS Act, s 54(2).

<sup>42</sup> The Australian Government is reviewing its cost recovery guidelines and associated documents. The material referenced here is from the current published documents.

<sup>43</sup> LLS Act, s30, A local board is required to prepare before 30 March each year an annual report on the performance of its functions.

<sup>44</sup> LLS Act, s 45.

<sup>45</sup> LLS Act, s 24(3).

<sup>46</sup> LLS Act, s 54(3).

## 8.2 Example: Summary of charging arrangements table (pro-forma)

Table 8.2 summarises the current charges by activity and those proposed by the LLS boards together with the revenue generated. The table will need to show charges year by year if major changes are proposed over the 5-year term of the local strategic plan.

**Table 8.1 An example of a summary of charging arrangements (adapted from Australian Government guidelines)**

Activity	Method of recovery	Projected volume of activity Y <sub>1</sub>	Current price Y <sub>0</sub>	Current revenue (Volume Y <sub>1</sub> * Price Y <sub>0</sub> )	Cost recovery price Y <sub>1</sub>	Cost recovery revenue Y <sub>1</sub>	Revenue surplus or (shortfall)	
1.1	Processing costs of an application	1,000 applications	\$200 per application	\$200,000	\$200 per application	\$200,000	\$0	
2.1	Sale of information publications	1,200 publications	None	\$0	\$10 per publication	\$12,000	\$12,000	
3.1	Agricultural advice	200 queries	\$160 per query	\$32,000	\$160 per query	\$32,000	\$0	
4.1	Locust levy	5,000 landholdings	\$10 per holding	\$50,000	\$12 per holding	\$60,000	\$10,000	
<b>Total fee-for-service</b>						\$232,000	\$244,000	\$12,000
<b>Total rates recovered</b>						\$50,000	\$60,000	\$10,000
<b>TOTAL</b>						\$282,000	\$304,000	\$22,000

**Note:** Actual charges in Year 1 will be as per the table increased by the percentage change in the CPI.

**Source:** Adapted from the Australian Government's Cost Recovery Impact Statement Template sourced 24 September 2013 from: <http://www.finance.gov.au/financial-framework/financial-management-policy-guidance/docs/CRIS-template.pdf>.

### 8.3 Example: Annual report statement (pro-forma)

We recommend a statement of charges proposed for the coming year be included in LLS boards annual reports, together with an explanation of any variance in charges from the CRIS. An additional column could include charges in current dollars (ie, after CPI adjustment).

You should publish the annual statement of charges, Table 8.2, on your respective board's website prior to the introduction of charges. You should also notify relevant stakeholders at least 28 days before charges are to come into effect. If charges apply from 1 July and the annual report is published by 30 March<sup>47</sup> then this condition will be met.

**Table 8.2 Example of Annual statement Year 2 (Y<sub>2</sub>)**

Activity	Method of recovery	Current price Y <sub>1</sub>	Price in CRIS Y <sub>2</sub>	Proposed price Y <sub>2</sub>	Comply with CRIS
1.1 Processing costs of an application	Fee-for-service	\$200 per submission	\$200 per submission	\$200 per submission	Yes
2.1 Sale of information publications	Fee-for-service	\$10 per publication	\$10 per publication	\$10 per publication	Yes
3.1 Agricultural advice	Fee-for-service	\$160 per query	\$160 per query	\$120 per query + \$40 per hour if query is longer than 1 hour	No
4.1 Locust Levy	Rate	\$12 per holding	\$12 per holding	\$12 per holding	Yes

#### Explanation of variations from CRIS:

##### (i) Agricultural advice

The proposed price (Y<sub>2</sub>) is \$120 per query plus \$40 per hour if a query takes longer than 1 hour. This compares to the CRIS price for Y<sub>2</sub> of \$160 per query. The variation is a result of a review of consultation services. A copy of the review is available at (website address). It highlighted:

- ▼ an increase in the length and sophistication of consultations particularly consultations associated with programs x and y
- ▼ landholders receiving short consultations were subsidising those receiving longer consultations.

<sup>47</sup> LLS Act, s 30.





## **Appendices**



## A Cost Recovery Impact Statement (Pro-Forma)

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### Box A.1 CRIS content for Step 1

#### Purpose

The purpose of the CRIS is to demonstrate how the LSS board has complied with the funding framework for Local Land Services in developing its proposed charges for the coming 5 years.

#### Background

This section should provide an overview of the link between the local strategic plan, identified problems requiring action and proposed activities.

It should highlight:

- ▼ the nature of the problems requiring action, including:
    - risks involved
    - affected stakeholders
    - market failure
  - ▼ the legislative basis for the LLS Board's action (the statutory function it relates to)
  - ▼ links to the objectives of the local strategic plan.
- 

### Box A.2 CRIS content for Step 2

#### Nominate activities

For each problem identified in Step 1 the LLS board should nominate the activities to address it. The LLS should outline:

- ▼ the required or intended outcomes
- ▼ key performance indicators linking activities to outcomes
- ▼ the minimum service levels required to achieve the intended outcomes.

#### Efficient costs

The LLS board should justify the level of cost for the activities by demonstrating how LLS costs compare with costs of similar service providers and how LLS costs relate to the minimum service levels required to meet stated objectives.

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**Box A.3 CRIS content for Step 3(a)****Regulatory or non-regulatory activity**

The LLS board should classify the activities as either regulatory or non-regulatory.

- ▼ Regulatory activities generally relate to monitoring, managing and enforcing compliance and their cost should generally be charged to impactors/risk creators.
- ▼ Non-regulatory activities are all other activities and may include advisory services and product sales. Cost for these activities should generally be charged to beneficiaries.

**Specification of the funding source**

The LLS board should demonstrate how it has applied the hierarchy to identify who should fund the activity. The following questions may assist in this process:

- ▼ Who is creating the need for an activity by causing an adverse impact or exacerbating a risk? This will generally apply to regulatory activities.
  - ▼ If the activity is not directed at addressing an adverse impact or risk, or it is not practical to charge the landholder(s) responsible, who is benefitting from the activity? This will generally apply to non-regulatory activities.
  - ▼ Can it be claimed that it is not feasible, efficient or cost-effective to charge either the impactor or beneficiary?
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**Box A.4 CRIS content for Step 3(b)****Choice of costing approach**

For each activity the LLS board should identify:

- ▼ the costs to be included in charges
- ▼ the choice of costing approach (eg, marginal cost)
- ▼ why the costing approach was chosen
- ▼ the cost shares to be borne by the different funders.

**Cost activities**

Table A.1 should be completed for each activity.

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**Table A.1 Activity description: Table of costs to be included in charges**

<b>Expense</b>	<b>Provide a brief explanation of what the cost represents and what it includes</b>	<b>Provide a rationale for the inclusion of the cost - eg, fully distributed costs.</b>	<b>Provide an estimate of the total annual cost of this component</b>
Expense 1 (eg, employee expenses, materials)			
Expense 2 (eg, depreciation)			

**Source:** Commonwealth of Australia, *Australian Government Cost Recovery Impact Statement Template*, p 5. [Accessed on 11 October 2013, <http://www.finance.gov.au/financial-framework/financial-management-policy-guidance/docs/CRIS-template.pdf>.

### **Cost-benefit analysis for society**

Based on the cost-benefit analysis already undertaken (see section 5.8), calculate the cost/benefit ratio. A cost benefit ratio of 1 or greater supports the LLS board undertaking the activity. A cost benefit ratio of less than 1 supports the LLS board not undertaking the activity.

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### **Box A.5 CRIS contents for Step 4**

#### **Choice of funding mechanism**

The LLS board should nominate whether costs will be recovered on a fee-for-service basis (preferred), reverse auction, negotiated contribution or rate or whether it will source direct government budget funding. The LLS board should also provide justification for any departure from a fee-for-service.

#### **Choice of rate base (applicable only for rates)**

Where the LLS board has chosen a rate, it should nominate the rate base (eg, land area, notional stock carrying capacity) and demonstrate how the chosen rate base conforms to the guidelines.

#### **Calculation of fee or rate**

The LLS board should forecast demand for the activity and relate this to the cost of the activity to derive a unit rate. The charge will comprise a fixed and variable component.

#### **Exemptions**

Each LLS board should implement the exemption policy developed by LLS NSW.

LLS boards should explain how exemptions have been allowed for in calculating the unit rates to ensure full cost recovery.

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**Box A.6 CRIS content for Step 5****Choice of fee collection mechanism**

The fee collection service provider will be nominated by LLS NSW. The cost to the local LLS board of fee collection services should be shown as an itemised expense item in the LLS board's cost build-up (as assessed at Step 3).

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## B Examples

### Step 1: Is action necessary?

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
<b>Identified problem</b>	Private horticulturists are not investing in beneficial research as: <ul style="list-style-type: none"> <li>▼ the cost of the research exceeds the private benefits gained by any one landholder</li> <li>▼ the outcomes of the research, once available, may be used by others without contributing to the cost.</li> </ul>	A disease outbreak occurs on a landholding posing a threat to livestock on adjoining properties. It is not a public health risk or threat to native animals.	Wild dogs are found in national park, on forestry land and private landholdings attacking livestock and native fauna.
<b>What are the issues &amp; who is affected?</b>	The opportunity for productivity improvement by landholders is lost.	The disease could spread affecting the health of livestock on other properties and the industry may be banned from export markets.	<ul style="list-style-type: none"> <li>▼ Private landholders: Loss of farm production &amp; danger to domestic animals.</li> <li>▼ Community: Reduced biodiversity.</li> </ul>
<b>Is it within LLS powers &amp; strategic plan commitments?</b>	Yes. <ul style="list-style-type: none"> <li>▼ Relevant LLS function under LLS Act s4.</li> <li>▼ Linked to objective of increasing agricultural production in 2014 Local Strategic Plan.</li> </ul>	Yes. <ul style="list-style-type: none"> <li>▼ Relevant LLS function under LLS Act s4.</li> <li>▼ Linked to animal disease management, control and eradication objective in 2014 Local Strategic Plan.</li> </ul>	Yes. <ul style="list-style-type: none"> <li>▼ Relevant LLS function under LLS Act s4.</li> <li>▼ Linked to animal pest management, control and eradication objective in 2014 Local Strategic Plan.</li> </ul>
<b>Is there a market failure or does something else address the issue?</b>	Yes there is a market failure. Selective public good: <ul style="list-style-type: none"> <li>▼ Unable to restrict the benefits of the research to those who contributed to its cost.</li> </ul> The market failure may be overcome by an industry group pooling its resources to hire a private firm to address the issue. In which case, no action required by LLS.	Yes there is a market failure. Negative externality: <ul style="list-style-type: none"> <li>▼ The landholder with the diseased livestock may be discouraged from reporting the disease if they are charged the full costs of the preventative action.</li> <li>▼ Requires LLS to coordinate action for the benefit of the entire industry.</li> </ul>	Yes there is a market failure. Negative externality: <ul style="list-style-type: none"> <li>▼ Requires action from LLS co-ordinating the response of national parks, forestry and private landholders.</li> </ul>

Source: IPART analysis.

**Step 2: What is the proposed solution?**

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
<b>What is the least cost solution?</b>	Coordinated research made available to all in the industry.	Intervention on the infected property to eliminate the disease.	Eliminate, to the extent practical, wild dog population through baiting program.
<b>What activities are required?</b>	<ul style="list-style-type: none"> <li>▼ Define scope of possible research program.</li> <li>▼ Cost the proposed research program.</li> <li>▼ Liaise with industry on demand for program &amp; refine scope. It may be a service that industry is already providing or already well serviced by private sector providers.</li> <li>▼ If decide to proceed, undertake market testing to compare in-house Vs market provided service.</li> </ul>	<ul style="list-style-type: none"> <li>▼ Removal &amp; disposal of diseased livestock.</li> <li>▼ Testing of livestock on adjoining properties.</li> <li>▼ Publicising disease outbreak to encourage reporting of other possible cases.</li> </ul>	<ul style="list-style-type: none"> <li>▼ Scope extent of problem.</li> <li>▼ Develop a co-ordinated plan with national parks, forestry and private landholders to reduce wild dog numbers and on-going monitoring of problem.</li> </ul>

Source: IPART analysis.

**Step 3a: Who should pay?**

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
<b>Who is causing the issue?</b>	<ul style="list-style-type: none"> <li>▼ Non-regulatory activity.</li> <li>▼ No risk creators identified.</li> </ul>	<ul style="list-style-type: none"> <li>▼ Regulatory activity.</li> <li>▼ Landholder with diseased stock is the primary risk creator.</li> <li>▼ To charge this landholder may discourage reporting of disease.</li> <li>▼ All landholders carrying this livestock increase risk of disease spreading.</li> </ul>	<ul style="list-style-type: none"> <li>▼ Regulatory activity.</li> <li>▼ All landholdings are potential harbourers of wild dogs &amp; dogs will move from one property to another.</li> </ul>
<b>Who would benefit from LLS action?</b>	All growers of specified crops.	Livestock producers.	Private landholders and the community.
<b>Can they be efficiently charged?</b>	No risk creators identified. Beneficiaries are second on the hierarchy and they can be identified & efficiently billed.	Risk creators and beneficiaries are identical. They can be identified & efficiently billed.	Risk creators (private and public landholders) are at the top of the hierarchy. They can be identified and efficiently billed.

Source: IPART analysis.

**Step 3b: How much should they pay?**

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
<b>Is it a core activity?</b>	Assume in this case the service being provided is an adjunct to existing agricultural advice. Charge at incremental cost.	Yes, recover fully distributed cost	Yes, recover fully distributed cost.
<b>Is it being provided in competition with the private sector?</b>	If yes, calculate charges at least at avoidable costs. If not, charge at marginal cost.	No, fully distributed cost remains the cost base.	No, fully distributed cost remains the cost base.
<b>Is there a positive benefit/cost ratio for society?</b>	To be calculated in accordance with Treasury guidelines: <ul style="list-style-type: none"> <li>▼ If no, reassess LLS involvement.</li> <li>▼ If yes continue to the next step.</li> </ul>	To be calculated in accordance with Treasury guidelines: <ul style="list-style-type: none"> <li>▼ If no, reassess LLS involvement.</li> <li>▼ If yes continue to the next step.</li> </ul>	To be calculated in accordance with Treasury guidelines: <ul style="list-style-type: none"> <li>▼ If no, reassess LLS involvement.</li> <li>▼ If yes continue to the next step.</li> </ul>

Source: IPART analysis.

**Step 4: How should they be charged?**

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
<b>Is it efficient &amp; effective to charge a fee-for-service?</b>	No, unable to restrict the benefits to paying landholders.	No, landholder with diseased stock is the primary risk creator. To charge this landholder may discourage reporting of disease.	<ul style="list-style-type: none"> <li>▼ Yes for private landholders.</li> <li>▼ No for public landholders.</li> </ul>
<b>If not, what should be the rate base?</b>	Negotiated contribution from industry to at least recover avoidable costs of LLS.	A fixed component plus a variable component based notional carrying capacity.	Negotiated contribution from public landholders.
<b>Are there grounds for an exemption?</b>	No.	No.	No.

Source: IPART analysis.

**Step 5: How should the charge be collected?**

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
<b>Is this a major LLS function?</b>	No, it was assumed in step 3b that these are an adjunct to an existing advisory offering.	Yes, this is a core standalone LLS function servicing a significant proportion of the LLS rate base.	Yes, this is a core standalone LLS function servicing a significant proportion of the LLS rate base.
<b>Is the rate base peculiar to LLS?</b>	Yes, money to be collected centrally by LLS.	Yes, money to be collected centrally by LLS.	Yes, money to be collected centrally by LLS.

Source: IPART analysis.

**Step 6: Has efficient cost recovery pricing been applied?**

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
<b>Is the framework being given effect?</b>	<ul style="list-style-type: none"> <li>▼ Audit undertaken at time of strategic plan audit (ie, within 3 years of strategic plan being approved) has/has not confirmed compliance. The audit trail included:               <ul style="list-style-type: none"> <li>▼ a cost recovery impact statement (CRIS) released to coincide with preparation of the 5 year local strategic plan</li> <li>▼ annual statement verifying charges comply with the CRIS &amp; where they deviate they have been calculated in line with funding framework.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▼ Audit undertaken at time of strategic plan audit (ie, within 3 years of strategic plan being approved) has/has not confirmed compliance. The audit trail included:               <ul style="list-style-type: none"> <li>▼ a cost recovery impact statement (CRIS) released to coincide with preparation of the 5 year local strategic plan</li> <li>▼ annual statement verifying charges comply with the CRIS &amp; where they deviate they have been calculated in line with funding framework.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▼ Audit undertaken at time of strategic plan audit (ie, within 3 years of strategic plan being approved) has/has not confirmed compliance. The audit trail included:               <ul style="list-style-type: none"> <li>▼ a cost recovery impact statement (CRIS) released to coincide with preparation of the 5 year local strategic plan</li> <li>▼ annual statement verifying charges comply with the CRIS &amp; where they deviate they have been calculated in line with funding framework.</li> </ul> </li> </ul>

Source: IPART analysis.

## Glossary

Avoidable cost	The costs that would be avoided if a particular activity was no longer undertaken.
Audit trail	The documented history of a transaction or event.
Beneficiary	Some entity that benefits from the activity. This requires identification of the beneficiaries and assessment and apportionment of net benefits across them. The 'beneficiary pays' principle has 2 elements, ie: <ul style="list-style-type: none"> <li>▼ user pays – requires anyone who derives a direct private benefit from the activity to contribute to the costs of undertaking the activity</li> <li>▼ beneficiary compensates – requires anyone who derives an indirect benefit from an activity to contribute to the cost of undertaking it. This component of 'beneficiary pays' is usually associated with government funding.</li> </ul>
Club good	Products or services from which it is possible, at low costs, to exclude non-payers outside of a distinctive group of beneficiaries from its use, such as an industry. Its use by one party within the group, however, does not detract from its use by another.
Competitive neutrality	A policy principle that involves achieving a fair market environment by removing or offsetting any competitive advantages or disadvantages due to public ownership of government businesses.
Cost recovery	The recovery of the costs of government-provided or government-funded products or services that, at least in part, provide private benefits to individuals, entities or groups, or reflect the costs their actions impose.
CRIS	Cost Recovery Impact Statement. To be prepared for release with the local strategic plan every 5 years. Preparation of this statement provides the necessary paper trail for an audit.
Cross-subsidisation	Where one group of users pays more than the costs of the goods/services that they receive, and the 'surplus' is used to offset the cost of goods/services provided to other users.
Direct costs	Costs that can be readily and unequivocally attributed to a product or activity because they are incurred exclusively for that particular product/activity (eg, labour and materials).
Efficiency (allocative)	In the context of cost recovery, efficiency tends to mean the allocation of resources to the most valuable uses for society as a whole.
Equity	In general, the term 'equity' reflects concepts of fairness or justice. In a public finance context, relevant to this review, 'horizontal equity' refers to treating people in similar situations in similar ways. 'Vertical equity' refers to those with greater means contributing proportionately more than those with lesser means.
Excludability	The extent to which it is possible to exclude a party from the consumption/benefits of a good/service.
Externality (spillover)	The uncompensated effects on a third party to a transaction (or action) that is not fully accounted for in the price or cost of the transaction. Externalities can be either positive, when an external benefit is generated, or negative, when an external cost is imposed upon others.
Free rider	A party who derives a benefit at no personal cost from the provision of a good/service that is being provided at a cost to another party.

Full cost recovery	The recovery of all those costs associated with those activities or products. Full cost represents the value of all the resources used or consumed in the provision of an output or activity. In addition to the costs directly associated with the output/activity, full cost includes an appropriate allocation of indirect (including capital) costs.
Fully distributed costing	An accounting framework that allocates the total costs of all resources used/consumed in the provision of the output, not just those that are directly attributable to the output (eg, including indirect and capital costs).
Impactor	Person or group responsible for the activity that has directly caused the problem, for example pollution or contamination. The entity that has caused the problem should internalise the costs that it imposes on others.
Incremental costs	The increase in costs attributable to the production of a particular type of activity.
Market failure	A condition where the allocation of goods and services in a market is not efficient.
Private goods	Products or services where consumption by one party conflicts with its consumption by another, and where the benefits of consumption only accrue to the consuming party.
Public benefit	'The public' is the aggregation of all private individuals (eg, big business, polluters, taxpayers, consumers). Therefore, private benefits accrue to a narrowly defined individual or group of individuals and public benefits accrue to everyone else.
Public goods	A good (or service) that is non-rivalrous and non-excludable, which means consumption of the good by one individual does not reduce the amount of the good available for consumption by others, and no one can be effectively excluded from using that good.
Reverse auction	A type of auction where the roles of the buyer and seller are reversed. Where a buyer requests a good or service and the seller bids the amount they are willing to be paid for the good or service. In the context of natural resource management this is where land holders (who supply natural resource projects on their land) bid for funding from the Government (who demand natural resource management services).
Risk creators	The activity that creates the risk, rather than the activity that is known to cause the damage. This term can also be known as the risk generator. The characteristics of the activity include: <ul style="list-style-type: none"> <li>▼ susceptibility – a risk creator may be undertaking an activity that is susceptible to a potential threat. That is, the threat/issue exists because they are undertaking the disruptive activity.</li> <li>▼ exacerbation – a risk creator may also be someone that increases the probability of the risk occurring by not undertaking actions to reduce the risk or actively doing something that intensifies the problem.</li> </ul>
Rivalry	The extent to which a party's use of a good/service affects another party's use of the same good/service.