

## CONTRACTING FOR CSOs

This document aims to assist Government Ministries to prepare draft contracts for Community Service Obligation (CSO) activities. The document is organised as follows:

1. Objective of contracting for CSOs
2. Guiding principles for contract negotiation
3. Information to include in CSO contracts

### Objective of contracting for CSOs

The main objective of contracting for CSOs is to formalise the agreement between the Government Ministry responsible for purchasing the CSO and the SOE or business entity that is to provide the CSO. This helps to specify the exact requirements of the CSO activity and assign responsibility of any unexpected changes in costs. This in turn should:

- enhance the accountability of the provider
- make it easier to identify whether the Government's social objectives are being met; and
- help to manage risks, especially by providing the SOE with a high degree of commercial certainty through access to a well-developed body of law if the government does dispute or want to amend the terms of the CSO.

CSO contracting is to be undertaken as part of the Statement of Corporate Objective (SCO) process.

### Key principles for negotiating a CSO contract

CSO contracts are to be negotiated between the purchasing Ministry and the SOE or business entity. The following are offered as basic principles to consider when negotiating a CSO contract:

#### **1. recognition of benefits to both parties.**

The intention is to enter into a contract that creates a relationship for the mutual benefits of the parties. This needs to be taken into account during the contract negotiation process as well as during the implementation of the CSO activity.

#### **2. recognise the legitimate commercial interests of the supplier;**

For example, where the provision of certain community services requires the construction and operation of major infrastructure assets, a short-term contract is unlikely to provide the degree of certainty that would reasonably be expected by organisations operating in a commercial environment. Therefore, a longer-term contract is likely to be more appropriate.

### **3. allocate specific risks to the party that is best able to manage those risks;**

Service suppliers should be encouraged to adopt appropriate commercial insurance against natural disasters and other events that may impact on its ability to continue to provide the community service at the specified quality.

### **4. price should be based on efficient, best-practice costs and made clearly transparent.**

In the absence of a highly competitive market, the price that is negotiated should be based on efficient, best-practice costs of comparable service suppliers (i.e. benchmarking). Where relevant, this should include costs of service suppliers in other Pacific Island Countries such as Vanuatu.

Also, the nature and form of funding provided by the relevant Ministry should, as far as practical, be transparent and publicly available to the general community (eg. identified in the annual Budget statement of the relevant Ministry; service supplier's annual report etc). SOE's should also include information in their annual reports on the actual cost of carrying out the CSO.

## **Information to include in CSO contracts**

Fundamentally, CSO contracts should be structured using the same principles that would apply in contractual arrangements that are established in the private sector. An important distinction for CSO contracts however is that the service or activity is provided to a third party - the community. This feature will need to be taken into account in structuring the contract, particularly in terms of the responsibilities for receiving and handling complaints.

As outlined in the Solomon Islands Community Service Obligations (CSO) policy framework, CSO contracts should include the following components:

1. good or service to be provided;
2. the quality, frequency, quantity, and location of the goods or services to be provided (i.e. good or service standards);
3. financial arrangements, including contract price, frequency of payment, and agreed provision for variations;
4. performance measures against which the SOE shall be held to account and the mechanism(s) for reporting on these performance measures;
5. sanctions for non-performance; and
6. any other matter that the parties consider should be specified in the contract.

Specific information to be included in a CSO contract is offered for each component in turn.

**1. good or service to be provided as a CSO;**

- description of good or service (e.g. access to water services)
- target group (e.g. rural and remote communities, low-income households)
- eligibility criteria (e.g. households receiving CSO must be from the bottom quartile of income distribution)
- customer information (e.g. number of customers expected to be provided CSO by area, quantity consumption of CSO per household by area)

**2. good or service standards;**

- quality (e.g. water must meet certain minimum drinking standards);
- frequency (e.g. domestic letter postal service must be provided to each provincial post office at least once per week)
- quantity (e.g. 40 litres of water per day to each eligible household)
- location (the contract should specify each location/area that the CSO is to be provided)

**3. financial arrangements, including contract price, frequency of payment, and agreed provision for variations;**

- billing arrangements (invoice, cycle)
- funding method (e.g. direct budget payment, lower rate of return to Government)
- timing of payments (e.g. quarterly payments, 30 days after provision of CSO)
- price (in per unit terms if possible)
- service level incentives (e.g. an additional 10 per cent payment per unit if water quality testing over the period shows E.coli bacteria levels are below a certain number of forming units per 100ml)
- other payment terms, especially any conditions that must be met before payments are made, and each party's responsibilities for demonstrating or disputing that these conditions have been met

**4. performance measures against which the SOE shall be held to account and the mechanism(s) for reporting on these performance measures;**

- performance measures
  - o performance measures will assess quantity, quality, frequency, and location as per good and service standards
  - o it should also include actual cost(s) of delivering community service, some measure of community satisfaction, and, if possible, some measure of CSO effectiveness in addressing the identified social problem.

- responsibility and timing of monitoring (e.g. quarterly water quality monitoring report prepared by SOE, independent monitoring report once per year)
- reporting arrangements (timing)
  - o e.g. SOEs may be required to provide quarterly water quality monitoring reports or other such performance information to the purchasing Ministry
  - o SOEs must also include statistical information on, and assessment of, all key performance criteria/measures in their half-yearly and annual reports
- auditing (auditing may be required for some or all of the performance measures. Where possible, this should be done as part of the Office of the Auditor General (OAG) auditing activities specified under the SOE Act.)
- responsibility and timing of reviews (in general, CSO reviews will be undertaken by the purchasing Ministry, in co-operation with the Accountable Ministries, as part of the Existing CSO Annual Review process)

#### **5. sanctions for non-performance; and**

- payment reductions (e.g. if a SOE does not meet a given performance target, per unit payment is reduced by 10 per cent)
- default and termination (if the SOE fails, or is anticipated to fail, to perform its contractual obligations, the Government has the right to completely or partially terminate the contract)
- dispute resolution procedures (a series of procedures to be used by the parties in an attempt to resolve any dispute that arises between them)
- escalation procedures (procedures to be followed if dispute resolutions procedures fail to achieve resolution)

#### **6. any other matter that the parties consider should be specified in the contract.**

- definition of change events (description of any provision under which the contract may be renegotiated. E.g. oil prices increase by more than 50 per cent)
- subcontracting/agency provisions (the Government may require that the SOE do not subcontract any of its obligations under the contract)
- customer complaints procedures (a series of procedures to be followed by the SOE to record, respond, and report on customer complaints)
- confidentiality (confidentiality provisions ensure that information is accessible only to those authorized to have access)

- force majeure (force majeure refers to an “act of god”. This is a natural or unavoidable interruption to the provision of the CSO which excuses either party from meeting its contractual obligations)
- indemnity and insurance (indemnity insurance provides protection to business owners and employees for when they are found to be at fault for a specific event such as misjudgement).

It should also be noted the Solomon Islands CSO policy framework requires all contracts to be reviewed by the Minister for Finance and Treasury. Moreover, CSO contracts must comply with the SIG contract, procurement, and tendering rules set out in the *Financial Instructions 2010*.

The CSO registry contains copies of all previous and current CSO contracts (amended for confidentiality as required) and may be a useful resource for drafting CSO contracts. The CSO registry can be viewed at <http://www.mof.gov.sb/ReportsNew/CSOs.aspx>.