

VICTORIA

Victorian
Auditor-General

Audit summary
of
Fees and Charges
— cost recovery by
local government

Tabled in Parliament
14 April 2010

Audit summary

Background

Local councils provide a wide range of services to their communities, often for a fee or charge. The nature of these fees and charges generally depends on whether they relate to compulsory or discretionary services. Some of these, such as statutory planning fees, are set by state government statute and are commonly known as 'regulatory fees'. In these cases councils usually have no control over service pricing.

User fees and charges are a significant source of income for councils, each year totalling around \$900 million; on average, 14 per cent of all council revenues.

The *Local Government Act 1989* (the Act) gives councils the power to set these fees and charges to offset the cost of their services. A widely accepted public sector pricing principle is that, fees and charges should be set at a level that recovers the full cost of providing the services, unless there is an overriding policy or imperative in favour of subsidisation.

In so doing, councils must apply principles of sound financial management and need to consider a range of 'Best Value' principles including service cost and quality standards, value-for-money, community expectations and values, as well as balance the affordability and accessibility of their services.

Councils must also comply with the government's *Competitive Neutrality Policy* for significant business activities they provide and adjust their service prices to neutralise any competitive advantages when competing with the private sector.

The 2006 *Inter-governmental Agreement Establishing Principles Guiding Inter-Governmental Relations on Local Government Matters* further commits councils to demonstrate sound public governance through fiscal management, to develop appropriate pricing regimes and to improve their strategic planning.

This audit assessed whether councils are effectively managing the cost of their community services, particularly those that have an associated fee or charge.

The service costing and pricing policies and practices of a sample of services—waste management, aged care, preschool and child care, and recreation—were examined at four randomly selected councils:

- Whitehorse City Council
- Frankston City Council
- City of Ballarat
- Campaspe Shire Council.

Conclusion

The councils examined are not effectively managing the full costs of the services they provide. Further, they are not basing their fees and charges on any clear understanding of these costs, or of the other societal, economic and legal factors that must be taken into account when establishing prices for community services.

While the results relate directly to the councils we examined, the consistency of our findings is considered indicative of practices in other councils. In this context, the audit has identified a number of issues that should be considered by all councils in service costing and fee setting.

Findings

None of the four councils had adequate policies on service costing and fee setting. None provided sufficient guidance to staff on the procedures required to achieve good practice. Frankston and Campaspe had policies on service pricing, but while they made general references to cost recovery and fee setting principles they did not offer any detailed guidance.

The lack of common corporate policies and guidance coupled with the devolved responsibilities at each council has led to individual business units developing their own approaches to fee setting and cost management. While service fees and costs were centrally reviewed, in most cases these procedures were not adequately documented and fell short of good practice.

All councils had financial systems that captured the direct cost of services. However, only Campaspe had a system for systematically identifying and allocating all its indirect costs to service areas to establish their full cost. But while Campaspe had knowledge of its full costs, it did not apply this when setting its service fees and charges. The absence of full costing at the three other councils precluded these considerations. In effect, none of the councils accurately determined the full extent of subsidisation of services.

Additionally, there was insufficient assurance that the four councils had paid adequate attention to Best Value principles in determining their user fees and charges. While these principles require councils to:

- set service cost and quality standards
- consider value for money
- consider community expectations and values
- balance the affordability and accessibility of their services

there was no evidence of critical analysis of these issues in support of local fee setting decisions.

There was also a lack of staff awareness at councils about the requirements of the Competitive Neutrality (CN) policy. While some councils had considered CN obligations for some activities, none were able to provide adequate evidence to fully substantiate their associated 2008–09 statements of compliance. In the absence of adequate evidence these statements provide little assurance of compliance or that appropriate actions were taken to achieve CN when setting fees and charges for significant council business activities.

All councils regularly monitored the financial and operational performance of their services. However, management reports at Whitehorse, Frankston and Ballarat are limited to the extent they report only on the direct, not full, cost of services.

Furthermore, none of the councils had reports that enabled senior management and council to fully assess the efficiency of their services, the extent to which they are subsidised, and the extent to which revenue from fees and charges collected recovered service costs.

Analysis of variances was rudimentary and unsophisticated, comparing budgeted to actual revenues and expenses. There was no analysis of the unit cost of each service against cost standards, nor of any underlying price or quantity variations.

Similarly, while each council reviewed their fees annually as part of their budgetary process, in most cases these reviews were not adequately supported by information on full costs, or by rigorous analysis of the accessibility, affordability and efficiency of services, or of the actions required to meet CN requirements. Instead, most fees and charges are adjusted based on movements in the Consumer Price Index or the results of price benchmarking with other councils or private providers. While these are relevant considerations, adjusting fees based on these factors alone does not constitute strategic fee setting.

Recommendations

Number	Recommendation	Page
1.	Councils should develop and endorse central policies on service costing that provide guidance to staff on: <ul style="list-style-type: none"> principles of cost recovery and their relationship to service delivery objectives the methodology for costing council services and the associated rationale. 	19
2.	Councils should review and, where necessary, enhance their current cost allocation practices by: <ul style="list-style-type: none"> developing a costing model and related processes to allocate indirect costs recognising and reporting the full cost of their services. 	19
3.	Councils should strengthen oversight of service costs by: <ul style="list-style-type: none"> setting cost standards based on efficient costs regularly reporting to senior management and council on the efficiency and full cost of their services and relate this to fees and charges collected. 	19
4.	Councils should develop and endorse central policies on fee setting that provide guidance to staff on: <ul style="list-style-type: none"> principles for fee setting and their relationship to service delivery objectives appropriate fee setting methods, including factors to be considered in determining the required level of cost recovery procedures for assuring compliance with competitive neutrality requirements procedures for monitoring service costs and fees and charges. 	28
5.	Councils should strengthen fee setting practices to assure that decisions are evidence-based and demonstrate consideration of: <ul style="list-style-type: none"> both the direct and indirect cost of goods and services to establish the full cost Best Value principles including accessibility, affordability and the efficient cost of services Competitive Neutrality policy requirements. 	28
6.	Local Government Victoria (LGV), in consultation with stakeholders, should develop guidance for councils on setting fees and charges.	28