

Local Government
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Using fees and charges - cost recovery in local government

Richard Boyle

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It is important that authorities are clear about where the use of cost recovery is justified and can show that all necessary efforts are being made to ensure that fees and charges are applied efficiently and effectively.

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Using fees and charges - cost recovery in local government

Report No.3
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EXECUTIVE SUMMARY

Cost recovery is concerned with recouping a portion of or all costs associated with a particular service provided by the local authority to the public, normally by way of fees or charges. Fees and charges are a significant source of income for councils. The level of fees or charges determines the percentage of service costs that is recovered.

For local government services which are generally used by a large cross-section of the community it is often impracticable or unacceptable to charge fees for these services. On the other hand, where the services are used by a sub group of the community, it is more common for these public services to be provided for a specified fee or charge.

Fees and charges are made for the provision of a wide range of services including housing rents, planning fees, fire call out charges, burial ground fees, litter fines, land fill charges, bring centre and civic amenity site fees, pay parking, motor tax fees, driving license fees, swimming pool fees, museum fees and library fees. When determining the level of fees or charges to be set, factors to consider include the need to regulate demand, the desire to subsidise a certain product, administrative concerns such as the cost of collection, and the promotion of other economic or social goals.

This report identifies three key issues to be addressed concerning cost recovery: (a) setting cost recovery policy and principles; (b) capturing, monitoring and reviewing the cost of services; and (c) fee and charge collection and enforcement. Questions that local authorities should consider under each heading when developing their cost recovery options are outlined, together with recommendations as to how these questions should be addressed.

Cost recovery policy and principles

Good practice guidance suggests the need for clear policies and principles to decide if cost recovery is appropriate, and the setting of fees and charges when it is agreed cost recovery should be pursued. Clear policies provide a context and framework within which decisions can be made and provide a rationale for action taken.

Does a policy exist for the authority with regard to cost recovery?

If so, it will need to be periodically reviewed. If not, a policy should be developed setting out the main principles of cost recovery to be observed, guidance to staff on the procedures required to achieve good practice, and the methodology for costing council services and the associated rationale.

Are services periodically reviewed to determine if the use of fees and charges is appropriate?

Services should be examined to determine whether or not they should be funded or part funded through fees and charges, in the light of the policy statement.

Capturing, monitoring and reviewing the cost of services

Systems should be capable of capturing both direct and indirect costs in order to determine the full cost of services. This information is needed to guide the fee or charge setting process, to determine that fees and charges are set at appropriate levels. Regular reporting to senior management and the council is necessary to ensure the efficient use of resources and for the effective management of costs.

What basic level of information on fees and charges is available?

Each authority should maintain a comprehensive log of all fees and charges. This should include the name, amount and description of all charges and fees, the department responsible for collection and the date of the last review. This information should be publicly available.

Is the information base for cost attribution sufficient?

Both the direct and the indirect costs associated with the service should be determined. In the case of small scale services, it may be appropriate to use estimates for allocating indirect costs rather than develop elaborate cost accounting systems.

What review and reporting procedures are in place?

Effective reporting should include a detailed analysis for senior management and the council of the full costs and revenues against targets or benchmarks relating to the cost of services in order to assess operational efficiency. There should be regular reporting to senior management and council on the efficiency and full cost of services and how this relates to fees and charges collected.

How frequently are fees and charges reviewed?

High cost recovery charges and fees may warrant an annual review whereas low cost recovery charges and fees, particularly those assessed infrequently, may justify a review once every three to five years.

Are differential fees considered?

A product or service may be differentiated on the basis of quality or on the basis of time, such as an express option for service delivery, in order to accelerate throughput and heighten customer convenience. Online payment may be facilitated by setting lower fees for online payments or higher charges for over the counter payments, in recognition of the administrative costs involved.

Fee and charge collection and enforcement

Revenue collection performance is challenging for local authorities at the best of times, but poses particular difficulties in the current economic climate. An effective and efficient system for collecting user charges is critical for the credibility of any user charging regime.

Is collection of fees and charges periodically analysed?

Analysis of data held by local authorities can be helpful in determining how to improve fee collection. Analysis of fee collection over time and the factors that may affect payment is needed periodically as it can provide information to improve collection rates.

What incentives and sanctions are in place for fee collection?

A range of incentives (carrots) and sanctions (sticks) are available to authorities to encourage collection of fees and charges. A judicious mix of carrots and sticks is needed to maximise revenue collection.

Are payment method options periodically scrutinised?

Setting collection targets can be helpful and should be encouraged. Having multiple options and increased use of online payments has been shown to enhance revenue collection.

What enforcement mechanisms are in place?

Non-payment of fees and charges should be followed up immediately. Appropriate enforcement mechanisms should be in place prior to the fee or charge coming into effect. Recourse to these mechanisms needs to be clearly defined and transparent.

1.

INTRODUCTION

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In 2012, 27 per cent of local authority income came from cost recovery in the form of receipts from goods and services
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Local councils provide a wide range of services to their communities, often for a fee or charge. In 2012, 27 per cent of local authority income came from cost recovery in the form of receipts from goods and services. Fees and charges are made for the provision of a wide range of services including housing rents, planning fees, fire call out charges, burial ground fees, litter fines, land fill charges, bring centre and civic amenity site fees, pay parking, motor tax fees, driving license fees, swimming pool fees, museum fees and library fees.

Fees and charges are a significant source of income for councils. In many cases the charge or fee is set locally although certain charges or fees are fixed at national level (Department of Environment, Community and Local Government, 2012). The nature of the fees and charges generally depends on whether they relate to compulsory or discretionary services. Some, such as statutory planning fees, are set by government statute and are commonly known as ‘regulatory fees’. In these cases councils usually have no control over service pricing. In the Irish case, planning fees, for example, are set at a substantially lower rate than in Northern Ireland, which affects the degree to which cost recovery is possible¹. The Local Government Efficiency Review Group (2010: 132) recommended that planning fees be increased with an aim of achieving full cost recovery and found with regard to fees that ‘A move to full cost recovery over a 5 year period, based on 2009 application levels and existing processes, with an interim move to 75% cost recovery after 3 years, would lead to additional income of €22 million after 3 years, rising to €30 million after 5 years’.

Cost recovery is concerned with recouping a portion of or all costs associated with a particular service provided by the local authority to the public. The level of user fees or charges determines the percentage of service costs that is recovered. Cost recovery has two important rationales: (a) revenue enhancement through full cost accounting, thereby improving government efficiency; and (b) maintaining equity considerations in regard to the provision of public services.

International comparison indicates that local fees and charges also provide a significant proportion of local revenue in other countries. In most instances, local authorities have significant power in determining the extent, level and incidence of the local charge. In Denmark, for example, charges for services are levied on a wide range of activities including kindergartens, nursing homes, urban road transport and so on. Charges for other basic and essential services, for example, water, electricity and district heating relate to the actual cost of provision and generally cover 100 per cent of the gross expenditure in each case.

¹ See for example <http://www.environ.ie/en/Publications/DevelopmentandHousing/Planning/FileDownLoad,17072,en.pdf>

Fees and charges can be classified in various ways, as Table 1.1 illustrates.

Table 1.1 Fees and charges classifications

<i>Fees and charges classification</i>	<i>Description</i>
<i>Entrance fees</i>	<i>Charges to enter places such as large parks, botanical gardens, or other developed recreational areas. The areas are usually well defined but not necessarily enclosed</i>
<i>Admission fees</i>	<i>Charges made to enter a building or structure</i>
<i>Rental fees</i>	<i>Payments made for the privilege of exclusive use of a tangible property</i>
<i>User fees</i>	<i>Defined as charges made for the use of a facility, participation in an activity such as a gym lesson</i>
<i>Sales revenues</i>	<i>Revenues obtained from the operations of a concession, store, or sales of merchandise</i>
<i>License and permit fees</i>	<i>Issued as a written acknowledgement of consent to do some lawful thing</i>
<i>Special service fees and charges</i>	<i>Charges made for supplying extraordinary commodities, activities, or services</i>

Source: adapted from Bastian, 2003.

When to use fees and charges for cost recovery

For local government services which are generally used by a large cross-section of the community it is often impracticable or unacceptable to charge fees for these services. For example services such as the use of local roads and parks are funded by the general property rate or untied grants. On the other hand, where the services are used by a sub group of the community, it is more common for these public services to be provided for a specified fee or charge. The Indecon (2005) report on local government financing stated that:

Charging can bring many benefits such as efficiency, transparency and consistency with the polluter pays principle. Acceptability is an issue with the introduction of new charges to fund services that were previously subsidised or provided at zero price. However, there is greater acceptability of charging where there is a clear link between the level of payment and consumption. There are equity issues concerning persons on lower incomes, but we believe that appropriate targeting, waiver schemes or other initiatives can address these concerns.

Coughlan and de Buitléir (1996: 104-105) suggest that:

The extent to which a good is a public or a merit good, and the costs of assessment and collection, are factors which influence the decision whether to charge for a service. Charges have, however, potential to improve the allocation of resources in particular cases.

The Report of the Special Group on Public Service Numbers and Expenditure Programmes (2009) mainly reviewed central government spending, but also made reference to local government structures. Their report proposed that local government should become self-financing in the long-term and that additional forms of revenue were needed for the local government system, as well as the need for increased cost recovery for services provided.

The pros and cons of using fees and charges

In its evaluation of local authority charges for services, KPMG (1996) identified the following advantages associated with fees and charges:

- There is a clear link between the payment of the charge and the consumption of the service
- Charges are transparent. The customer knows the cost of availing of the service and can, therefore, judge whether or not it provides value-for-money
- Conservation on the part of both the consumer and the local authority is encouraged
- Charges can be linked to national policy in such areas as the environment

They also identified a number of disadvantages associated with setting user fees and charges:

- The perception of 'double taxation'
- Charges are not always easily linked to ability to pay
- Sometimes it is difficult to assess the true cost of the service or the actual level of consumption
- Some charges can be difficult to collect

Arguments for and against cost recovery initiatives such as fees and charges are summarised in Table 1.2.

Table 1.2 Arguments for and against cost recovery initiatives

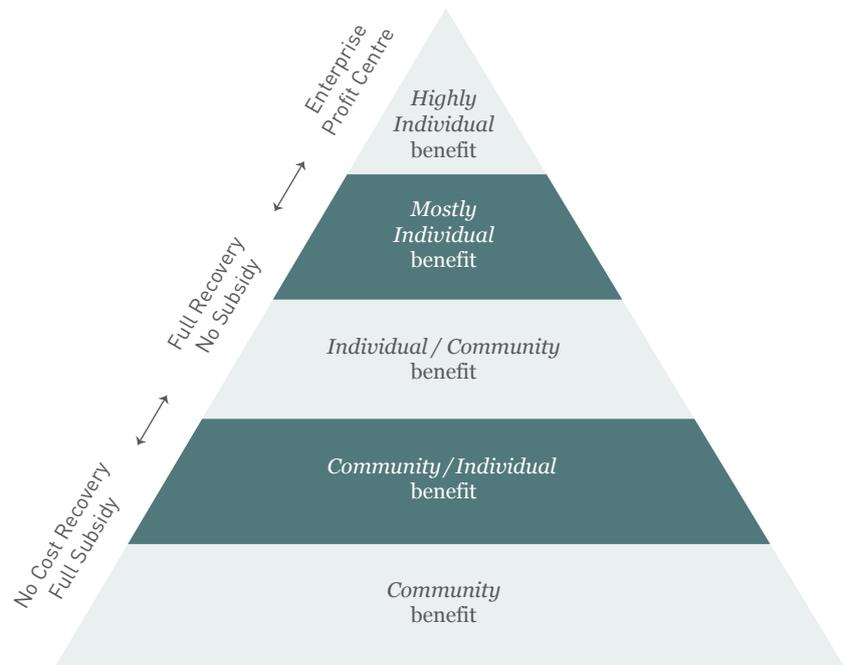
<i>Arguments for fees and charges</i>	<i>Arguments against fees and charges</i>
<i>Creates equity by charging user directly</i>	<i>Monopoly supplier may over charge leading to inefficiencies</i>
<i>Increases economic efficiency</i>	<i>Administrative complexity</i>
<i>Generates revenue to offset costs and protect services</i>	<i>Potential exclusion of those who can't pay – social inclusion issues</i>
<i>Increases direct accountability by providing a link between services and fees charged</i>	<i>Impact on competitiveness and economy of charges on businesses and individuals</i>
<i>Not charging or under-charging can result in over consumption and subsidisation from other revenue sources</i>	<i>Potential appearance of double taxation</i>
	<i>Fee collection process usually not as efficient as tax based financing</i>

What level of cost recovery is appropriate?

One of the primary policy issues to consider when establishing fees and charges is the desired level of cost recovery for the services being provided. Some rates are established to recover 100 per cent of the costs, whereas other rates may recover less than the full cost of providing the services. Factors to consider include the need to regulate demand, the desire to subsidise a certain product, administrative concerns such as the cost of collection, and the promotion of other economic and social goals. Many local authority services have a social dimension which, in turn, restricts the possibility for charging the economic cost to the user. Library fees as well as charges in respect of the use of sports and recreational facilities are examples here. There are, however, instances where local authorities may attempt to recoup the actual cost of providing a service; fire call out fees is a possible example.

The City of Fort Lauderdale in the USA sets out a pricing and cost recovery pyramid (Figure 1.1) as a model to guide thinking on which facilities and services should be fee based and to what extent. Those services which are fundamental to the authority benefit the entire community and should not be subject to cost recovery. As you move up the pyramid, the more the balance shifts towards benefiting the individual rather than the community, and the case for fees and charges to generate cost recovery increases.

Figure 1.1 Pricing and Cost Recovery Pyramid



Source: City of Fort Lauderdale (2008: 49)

Report focus and structure

In summary, charging for services is an option for local authorities in raising funds in some circumstances. This can, with an adequate pricing structure, promote efficiency and conservation. The principal difficulty, however, often stems from the more fundamental problem of developing an acceptability of the need and merits of such charges. Also, as the Indecon report (2005: 178) points out:

...while some additional funds could be secured by increases or more effective collection methods in charges on rents, planning fees, waste and other areas such as fire services, it would be a mistake to overestimate the revenue potential from such initiatives. Changes to charging policies on their own will not, however, be sufficient to meet the funding requirements of local authorities and will not be sufficient to address key issues of accountability, the alignment between local demand for service improvement and the willingness of local communities to fund such services.

In the following sections of the report, good practice in a number of areas of cost recovery is examined. First, in section 2, the need for clear policies and principles to guide cost recovery is highlighted. In section 3, the issues of capturing, monitoring and reviewing fees and charges are examined. Section 4 looks at challenges associated with the collection and enforcement of fees and charges. Finally, some conclusions and recommendations for good practice are set out in section 5.

Where possible, examples from international good practice are cited to stimulate thinking and encourage lesson learning. Australia provides the basis for many of the examples presented here. This is because Australian local governments rely heavily on revenue from rates and services fees. Indeed, these sources of revenue comprise at least 75 per cent of the revenue base of most local governments in Australia (Carnegie and Baxter, 2006: 104).

2.

PRINCIPLES AND POLICIES ON SERVICE COSTING AND FEE SETTING

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In broad terms, policy on cost recovery seeks to achieve a balance between the desire to maximise revenue to facilitate service provision and the need to ensure competitive neutrality and the promotion of social inclusion

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Good practice guidance suggests the need for clear policies and principles to guide cost recovery and the setting of fees and charges. Clear policies provide a context and framework within which decisions can be made and provide a rationale for action taken.

The absence of clear policies may provide difficulties for local authorities if audits or reviews of practice are undertaken. For example, the Auditor General of Victoria in Australia carried out a review of fees and charges in the state (Victorian Auditor-General's Office, 2010). One of the main points emphasised in the audit report was that none of the four councils examined in detail had adequate policies on service costing and fee setting. None provided sufficient guidance to staff on the procedures required to achieve good practice. This absence of clear policies was identified as a major weakness. Responsibility for service costing was devolved to individual business units across all councils and ad hoc arrangements arose, without any guiding principles, which tended to fall short of good practice.

The report of the Victorian Auditor-General's Office (2010: 11) suggested that a comprehensive set of policies and supporting cost management procedures should encompass:

- Principles of cost recovery to be applied
- The methodology for costing council services and the associated rationale
- Procedures for setting cost standards and monitoring the efficiency of service costs

Guiding principles

In December 2002 the Australian federal government adopted a formal cost recovery policy to improve the consistency, transparency and accountability of its cost recovery arrangements and promote the efficient allocation of resources. The underlying principle of the policy is that entities should set charges to recover all the costs of products or services where it is efficient and effective to do so, where the beneficiaries are a narrow and identifiable group and where charging is consistent with Australian government policy objectives. Drawing on this work, typical working principles that should inform policies on service costing and fee setting include:

- Agencies should set charges to recover all the costs of products or services where it is efficient to do so, with partial cost recovery to apply where new arrangements are phased in, where there are government endorsed community service obligations, or for explicit government policy purposes
- Cost recovery should not be applied where it is not cost effective, where it is inconsistent with government policy objectives or where it would unduly stifle competition or industry innovation
- Any charges should reflect the costs of providing the product or service and should generally be imposed on a fee-for-service basis or, where efficient, as a levy
- Agencies should ensure that all cost recovery arrangements have clear legal authority for the imposition of charges
- Costs that are not directly related or integral to the provision of products or services should not be recovered. Agencies that undertake regulatory activities should generally include administration costs when determining appropriate charges
- Agencies with significant cost recovery arrangements should ensure that they undertake appropriate stakeholder consultation. Agencies should disclose their costs and charging practices to give the public an opportunity to comment on and question them
- Agencies should review all significant cost recovery arrangements periodically, but no less frequently than every three to five years

Carnegie and Baxter (2006: 107) identify six principles which are proposed for consideration and adoption, if not already adopted in whole or in part, within specific local governments with regard to the setting of fee levels:

- **Efficiency** – the fees are simple and are not cumbersome to administer
- **Transparency** – the nature and use of the service is understood by users
- **Effectiveness** – the fees provide value for money for users
- **Clarity** – users are clear about when and how fees apply
- **Equity** – the fees are fairly applied across a range of users.
- **Ethics** - users with special service needs (for example, due to temporary or permanent disabilities) are not charged exorbitant fees directly in accord with the cost of higher servicing requirements

Box 2.1 Cost attribution rules in Wellington, New Zealand

In determining when to use fees and charges to promote cost recovery and when to fund services out of general taxations and rates, Wellington City Council in New Zealand apply the following cost attribution rules to its services and activities (Productivity Commission, 2008: 176):

- If a service (or activity) benefits identifiable individuals or groups the cost should be allocated to those individuals or groups (user pays), for example, swimming pools
- If those that benefit directly cannot be identified or if those that benefit directly cannot be excluded from using the service, the costs should be allocated to the community (public good), for example, footpaths
- If there are indirect or 'flow-on' benefits and those that receive these benefits cannot be identified, the costs should be allocated to the community (positive externality), for example, libraries
- If the service prevents the negative effects of the actions of identifiable people the costs should be allocated to those people (polluter pays), for example, parking fines
- If the service will benefit future generations, costs should be allocated to reflect the distribution of benefits over time (intergenerational equity), for example, where council capital expenditure is funded through borrowings

In a number of areas, local authorities are statutory monopolies. In these situations, authorities have the ability to set fees and charges above competitive levels. This leads to misallocation of resources and can create poor incentives for authorities to control their cost base. As a principle, local authorities should set fees and charges as though they operate in a competitive market (Productivity Commission, 2008: 180). But this is difficult to achieve without a clear benchmark to measure appropriate costs against. In some cases, comparative benchmarking of costs against those imposed by other authorities can act as a proxy for competitive cost information. In other cases, government may choose to regulate fees and charges to prevent monopoly power from being exercised.

In broad terms, policy on cost recovery seeks to achieve a balance between the desire to maximise revenue to facilitate service provision and the need to ensure competitive neutrality and the promotion of social inclusion. The Local Government Efficiency Review Group (2010: 161) stance on this for Irish local authorities is outlined in their report:

The normal principle that should apply from an efficiency perspective is that the user pays for the cost of the service. While full reimbursement might not be justified in certain cases (for example, when dealing with disadvantaged groups or where costs relate to the provision of general public good services e.g. public parks), the guiding principle should generally be that the user pays for the cost of the service provided, with the burden of proof falling on cases where it may be necessary to depart from this principle.

3.

CAPTURING, MONITORING AND REVIEWING THE COST OF SERVICES

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Identifying and allocating indirect costs can be challenging for authorities
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Capturing the cost information needed

Systems should be capable of capturing both direct and indirect costs in order to determine the full cost of services. This information is needed to guide the fee or charge setting process, to determine that fees and charges are set at appropriate levels. For example, the Local Government Efficiency Review Group (2010: 161) noted that in relation to water, the Government's water pricing policy requires local authorities to recover the cost of providing water services to the non-domestic sector from users of these services, but that there is no mechanism to ensure that all local authorities are achieving cost recovery. The Group found that moving to full cost recovery in this area would provide local authorities with an additional income of €58 million per year.

Direct costs are costs that can be readily and unequivocally attributed to a service or activity because they are incurred exclusively for that particular product/activity. Indirect costs are costs that are not directly attributable to an activity, but which are incurred in the provision of the service, often referred to as overheads. Examples of direct and indirect costs are given in Table 3.1.

Table 3.1 Cost components

<i>Type of cost</i>	<i>Categories</i>	<i>Examples</i>
<i>Indirect</i>		
<i>Costs that are not directly attributable to an activity</i>	<i>Capital</i>	<i>License and maintenance fees for corporate computer software</i>
	<i>Administrative expenses</i>	<i>Cost of printing the annual report</i>
	<i>Materials and supplies</i>	<i>Stores and stationery used by corporate services staff</i>
	<i>Labour</i>	<i>Chief Executive Officer and directors' remuneration</i>
<i>Direct</i>		
<i>Costs that can be readily attributed to a service or activity because they are incurred exclusively for that particular product/activity</i>	<i>Capital</i>	<i>Depreciation or lease costs of specific-purpose buildings, vehicles, computers, and other equipment used directly in delivering services</i>
	<i>Administrative expenses</i>	<i>Transport expenses for service delivery staff</i>
	<i>Materials and supplies</i>	<i>Spare parts, inventory, fuel</i>
	<i>Labour</i>	<i>Salaries and wages of 'works unit' employees; payments to contractors and service providers</i>

Source: Victorian Auditor-General's Office (2010: 12)

Costs may also be categorised as fixed, variable and marginal. Fixed costs are costs that do not vary with the amount of activity or product, such as many capital costs. Variable costs vary with the volume of activity and include such items as direct labour costs and materials. Marginal costs refer to the change in total cost that arises when the quantity produced changes by one unit.

Identifying and allocating indirect costs can be challenging for authorities. In the Victorian Auditor-General's Office (2010: 12) report, all four councils examined had systems that captured the total direct cost of services, and some had allocated selected indirect costs to some services. However, only one had a central system for systematically identifying and allocating its indirect costs to service areas to establish their full cost. None of the three other councils systematically identified or allocated their indirect costs because:

- They considered the effort needed to develop and maintain an attribution model that appropriately distributes indirect costs to service areas to be impractical or unnecessary

- Line managers perceived they had little capacity to control or influence indirect costs

Determining full costs can be complex, especially when joint costs must be allocated. OECD (1998) guidance suggests that the effort made in costing should be commensurate with the scale of the service being charged for. In the case of small scale services, it may be appropriate to use reasonable estimates for allocating joint costs rather than develop elaborate cost accounting systems. Attempts to apply unduly complicated or overly sophisticated cost allocation approaches to service delivery within local government are likely to fail on the basis of the associated costs outweighing the asserted benefits. However, while indirect costing is less straightforward it does not have to be complex. Two widely used methods to allocate indirect costs are:

- Activity-based costing (ABC) which links an organisation's outputs or goods and services to the activities used to produce them, and then assigns a cost to each output based on the rate of consumption of associated activities
- The pro-rata approach which allocates indirect costs on a proportionate basis by using measures that are easily available, such as staff involved in the activity as a percentage of total staff, or the service unit's share of total office space

Monitoring and review

Regular reporting to senior management and the council is necessary to ensure the efficient use of resources and for the effective management of costs. Effective reporting includes a detailed analysis of the full costs and achievements against targets or benchmarks relating to the efficient cost of services in order to assess operational efficiency.

In the report of the Victorian Auditor-General's Office (2010: 18) all the councils audited have internal reporting processes to monitor financial and operational service performance. Reports are provided to senior management and council, either monthly or quarterly that provide comparisons of actual revenue and expenses against the budget forecast for each service. However, the audit found that while these reports contained useful data they did not provide information about whether council resources were being managed efficiently and effectively, or whether services were being provided at an appropriate cost and quality. The value of the reports from a fee setting and service costing perspective in three of the four cases studied was further limited as they did not report on the full cost of services. Coupled with the absence of reporting on explicit cost standards this meant that these councils were unable to fully assess the efficiency of the services, the extent to which they were subsidised, and the extent to which fees recover service costs.

Box 3.1 Guidance for when reviewing fees and charges

In terms of reviewing fees charged, guidance from the Controller and Auditor General of New Zealand (2008) suggests that there are four main questions that agencies should consider when reviewing and setting fees:

- What legal authority does the agency have to charge fees? When considering the authority to charge a fee, the agency has to understand the purpose and scope of its authority to charge. The agency also needs to know whether the fees are consistent with this authority and within its scope
- What is the justification for charging? Where an agency is not obliged to set a certain fee, the justification for charging needs to be considered, along with a decision on the proportion of costs to recover
- Is it clear how the costs have been calculated? The fees for a particular good or service should reflect the costs estimated to be incurred by the agency in producing that good or service. Sound methodologies that identify the cost of resources, and allocate the costs to individual goods or services, are essential aspects of good charging practice. The agency should have a system in place to collate the cost information. The type of systems developed should take account of the context and should be in proportion to the level of revenue and costs that the entity needs to track. The appropriate basis for charging a fee will depend on the nature of what is being produced. If the goods or services are standardised, it may be as simple as dividing the total costs by the estimated volume to be produced. However, if the costs incurred in producing individual goods or services vary significantly, an average cost might not be the best method. More specific charges may be needed according to what is being provided.
- Are the entity's decisions, charging system, and revenue and costs for that system clearly documented and transparent? An agency that has this information will be able to demonstrate to external reviewers that it has a rational and reasonable process for identifying the costs of its activities and setting its fees.

Where there is discretion for setting fees locally, it can be helpful as part of the review process to benchmark against similar local authorities. In England, the Planning Advisory Service (PAS) teamed up with CIPFA to bring benchmarking to all planning authorities in England. The benchmarking club gives authorities a basis for better management decisions and for setting their own planning fees².

One way of enhancing returns under a revenue management scenario is to use differential fees in order to derive a higher return on the segmented product or service with a view to enhancing the total return. A product or service may be differentiated on the basis of quality or on the basis of time, such as an express option for service delivery, in order to accelerate throughput and heighten customer convenience.

There are several options for updating charges and user fees:

- Base the change on an updated analysis of the actual costs, with such an analysis conducted at stated intervals
- Adjust the charges and fees based on a stated formula, such as the annual increase in the consumer price index
- Set the charges and fees based upon those assessed by comparable authorities. However, this third option has the risk associated with it that the actual costs for one authority may vary considerably from those of others

Different time periods for a review and update may be justified for different types of charges and fees. High cost recovery charges and fees may warrant an annual review whereas low cost recovery charges and fees, particularly those assessed infrequently, may justify a review once every three to five years.

² The publication of a statutory instrument that will devolve cost recovery fee setting to local planning authorities is still awaited. This work by PAS and CIPFA was in anticipation of such a move.



4.

COLLECTION AND ENFORCEMENT

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A judicious mix of carrots and sticks is needed to maximise revenue collection. Incentives can include financial incentives for early or on-time payments, through to the use of non-financial incentives such as prizes. Sanctions can range from increased charges for late payment to prosecution
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The challenge of collection

Call out charges for fire services brought in by Dublin City Council illustrates problems of collection and enforcement. Under the scheme householders must pay fees of €500 for the first hour Dublin fire brigade attends a blaze. The €500 levy also applies when the fire officers are called to tackle a chimney fire or respond to a 999 emergency only to find it is a false alarm. The fee rises to €610 for the first hour attending a road traffic incident. And for every subsequent hour, charges of €450 to €485 apply for each tender. However, for the first quarter of 2012, 184 invoices were issued in relation to domestic callouts amounting to €101,860 of which only €12,350 had been collected by late July.

The experience of the Barcelona fire department in collecting user charges for certain of its non-emergency services, as documented in OECD (1998) guidance on user charging, also illustrates this problem. The department experienced significant problems with their collection as only 20-30 per cent of invoices were actually paid. Various factors accounted for this. Responsibility for collection was unclear, the processing time for issuing invoices was lengthy, the invoices themselves were complicated, and enforcement mechanisms for non-payment were very limited.

With regard to water charges, service indicator data for Irish local authorities shows that some local authorities have experienced significant difficulties with collecting water charges from the non-domestic sector, with almost half of water charges being unpaid across all local authorities. The Local Government Efficiency Review Group (2010: 162) consequently recommended the need for a more simplified approach to penalties for non-payment

More generally, revenue collection performance is challenging for local authorities at the best of times, but poses particular difficulties in the current economic climate. A review by the Local Government Audit Service (2012) of revenue collection in the rates, housing rents, commercial water and housing loans areas illustrates the challenges, as shown in Table 4.1.

Table 4.1 Revenue collection performance

	<i>Collected</i>		<i>Arrears</i>		<i>Percentage collected</i>	
	<i>2009 (€m)</i>	<i>2010 (€m)</i>	<i>2009 (€m)</i>	<i>2010 (€m)</i>	<i>2009 (%)</i>	<i>2010 (%)</i>
<i>Rates</i>	1128	1109	188	268	86	81
<i>Housing rents</i>	268	277	47	47	85	85
<i>Commercial water</i>	166	176	152	160	52	52
<i>Housing loans</i>	100	94	18	24	85	80

It can be seen from Table 4.1 that overall collection arrears either deteriorated or remained static from 2009 to 2010, while the level of arrears at the year-end increased in most cases. These trends support auditors' concerns, as expressed in their audit reports, which included references to:

- Deterioration in some or all of the revenue collection areas
- Significant increases in levels of arrears at the year-end
- Particular difficulties in the collection of commercial water charges

Explanations given to the auditors, or referred to in management responses, included financial difficulties experienced by customers in the current economic climate and, in the case of commercial water charges, problems experienced with water metering projects. Management responses referred to proposed actions to deal with the poor collection performance, including:

- Better debt management procedures
- Diversion of resources to debt collection
- Withdrawal of services or legal action
- Engagement of debt collection services
- Review and / or write-off of arrears

Guidance on good collection practice

OECD (1998) guidance states that an effective and efficient system for collecting user charges is critical for the credibility of any user charging regime. Responsibility for collection should rest with the organisation levying the charge. This does not preclude an organisation from contracting with a third party for collection services.

Box 4.1 Collection lessons from Scotland

In Scotland, lessons learned about management tools and practices to promote the collection of council tax are of relevance to the broader issue of fee collection. Important elements of a good management approach to maximising fee collection while minimising costs are³:

Setting quantitative targets: In all councils, it is a strategic goal to increase in-year collection rates and reduce arrears. However, more refined target-setting allows closer monitoring of the costs and benefits of different billing or recovery procedures and the evaluation of targeted initiatives. Managers are also able to motivate staff by ensuring regular feedback on collection performance against target.

IT developments: Most good practice councils have introduced document-imaging software to speed workflow and improve accuracy. Other software provides links to property ownership databases or serves automated payments online or over the telephone. A dedicated IT focused on developing supports to increase revenues increasing revenues was found particularly effective in one case.

Customer-orientation: All of the better performing councils stressed the need to actively develop customer orientation. This could entail decentralised 'one-stop shops' as well as the centralised telephone answering system covering all council services.

Specialist teams: Separating collection and arrears teams with visiting capabilities or teams dedicated to large debtors were reported to be essential to improving collection.

Staff attitude and motivation: For all councils training and development and team spirit/motivation were important.

³ See <http://www.scotland.gov.uk/Publications/2006/07/18161737/8> for more details.

More generally, it is important to be aware of the range of incentives (carrots) and sanctions (sticks) available to authorities to encourage collection of fees and charges, as illustrated in Table 4.2. A judicious mix of carrots and sticks is needed to maximise revenue collection. Incentives can include financial incentives for early or on-time payments, through to the use of non-financial incentives such as prizes. Sanctions can range from increased charges for late payment to prosecution.

Table 4.2 Collection incentives and sanctions

<i>Collection incentives (carrots)</i>	<i>Collection sanctions (sticks)</i>
<i>Financial incentives for early or on-time payment</i>	<i>Statutory lien on property</i>
<i>Non-financial incentives (prizes)</i>	<i>Discontinuation of service</i>
<i>Payment plans</i>	<i>Set-off debt collection</i>
<i>Feedback on performance to staff against targets for collection rates</i>	<i>Prosecution</i>
	<i>Increased charges for late payment</i>

Improving fee collection – the importance of analytics

Analysis of data held by local authorities can be helpful in determining how to improve fee collection. In Milwaukee in the USA, non payment of property related fees was identified as a major problem for the city. A collaboration between the Robert M. La Follette School of Public Affairs at the University of Wisconsin-Madison, and the Budget and Management Division of the City of Milwaukee's Department of Administration led to students examining data files from city departments to analyse fee collection over time and the factors that may affect payment (Berger et al, 2011). First, they examined the current collection process across city departments and fees. Second, they looked at factors influencing fee collection, including characteristics of fees, characteristics of properties, and characteristics of collection practices. Third, they used regression analysis to identify the effects of the above sets of characteristics on payment rates. Amongst other things they found that:

- Milwaukee's system for billing and collecting municipal fees is decentralised; practices and outcomes vary significantly by department and by fee. For example, water works, public works, and neighbourhood services differ in their bill notification practices, late penalty issuance, and payment option practices. These variations create considerable complexity in administration
- Certain collection practices - particularly penalties for late payment - are associated with higher collection rates. Increasing payment options for consumers may also result in increased initial collection rates

The study recommended that the city consider standardising practices based around three practices:

- Including mailing invoices with due dates. Invoices are associated with higher collection rates than letters
- Issuing late penalties for all unpaid fees. There is a strong relationship between late penalties and fee payment
- Increasing payment options for all fees

Methods of payment

Linked to the issue of incentives and sanctions for payment is the issue of method of payment. Increasingly, authorities are looking for ways to encourage more users to pay fees and charges using payment methods that are administratively simple and cost effective. In Scotland, again the experience with council tax collection offers some lessons with regard to payment methods. Councils offer a range of payment methods that suit different income patterns and lifestyles in their area, and staff are trained to promote most appropriate methods. All of them stress that a key improvement is the extension of payment by direct debit. Councils set yearly targets to increase the proportion of accounts on direct debit, but there are still considerable disparities. One constraint to widening payment by direct debit is the number of payers that have suitable bank accounts. In Scotland this varies between 20 per cent and 90 per cent. For people on low or irregular income, payment at the post office or at the 'rent office' has been traditional. This is generally available and payers are now increasingly issued with payment cards. Some councils have subscribed to PayPoint which allows payment in shops and supermarkets and seems popular in several Scottish council areas. Easy payment methods introduced in recent years also include paying over the telephone, usually via a dedicated number; automated telephone payment; and online payment.

An American study of payment options stresses the benefits of having multiple options and increased use of online payments. Offering a variety of payment options provides flexibility and convenience to payers of user fees and may increase a local government's ability to collect revenue. In some communities, the availability of on-line payment capability resulted in payments the community did not expect to receive. For example, City of Madison officials pointed out that the ability to pay parking tickets on-line resulted in increased collections from individuals who lived outside the city (Wisconsin Legislative Audit Bureau, 2004).

On-line payments systems are increasingly prominent for local authorities. For example the South-East region local authorities have introduced an online payment system under the 'ebygov' project, a South-East Regional Authority initiative financed with the support of the European Union ERDF - Interreg IIIB Atlantic Area, for areas such as traffic fines and housing rents. People

are also being encouraged to pay the household charge online: <https://www.householdcharge.ie/default.aspx>

It is possible to discriminate in favour of online payments as being more cost effective and efficient in some cases. For example with regard to the Non-Principal Private Residence Charge (NPPR) introduced in 2009 as a charge on second homes, the Local Government (Household Charge) Act 2011 provides for a handling fee where the charge is paid over the counter at local authority offices. The Local Government (Charges) Regulations 2011 (SI 721/2011) introduced this handling fee of €10 with effect from 1 January 2012. This is seen as a way of encouraging online payment and reducing costly over the counter payments.

Enforcement

OECD (1998) guidance emphasises the importance of enforcement. The guidance recommends that non-payment of user charges should be followed up immediately. Appropriate enforcement mechanisms should be in place prior to the charge coming into effect. Recourse to these mechanisms needs to be clearly defined and transparent. The level of non-payment of user charges should be transparent. If a user charge is so small that it will not justify collection action, then the form of the charge should be considered for change.

A particular challenge for enforcement is identification of the non-payer. The use of the Personal Public Service Number and unique property identifier would be significant aids in facilitating enforcement practice.

The Local Government Efficiency Review Group (2010: 166) looked at the issue of arrears due to local authorities and suggested that recent systems introduced for new charges should be used as a model for existing charges, citing the annual charge on non-principal private residence (NPPR) as setting out a clear and simple process for dealing with non-payments or late payments of the charge.

Box 4.2 Enforcement of non-principal private residence charge

Where payments of the charge are not paid within a grace period of one month of the due date, a late payment fee of €20 per month applies. The amount involved is cumulative from year 1 and is significant if the liability is not discharged. For example, if no charge were to be paid for five years after it first fell due, the amount owed would, assuming the property continued to attract liability over the entire period, be €4,300 (of which €1,000 would be the €200 charge over 5 years, and €3,300 would relate to excess charges accumulating over the same period).

Local authorities may also take criminal prosecutions against owners that fail to pay the charge. Prosecution is by way of summary jurisdiction and a Court may impose a fine of up to €2,000.

A key feature of this model is that both the charge and any late payment fee is a charge against the property – therefore, where a property liable for the charge is being sold, any unpaid charge and late payment fee will pass to the new owner of the property. This is the case with other property taxes such as stamp duty, and can create difficulties for vendors in the sale process where a purchaser's solicitor can identify outstanding charges due before a contract to sell the property can be executed, or where a solicitor will seek some kind of legally binding undertaking that no liabilities are extant on the property before contracts for purchase are executed. In practice, this means that a property is unlikely to be conveyanced before the discharge of any charge or late payment fee due in respect of it. Thus far this system has proven its worth in creating a strong incentive for those liable to the NPPR charge to pay it on time.

Source: Local Government Efficiency Review Group (2010: 166)

With regard to the general issue of enforcement, the Law Reform Commission (2010: 6) suggests that any debt enforcement mechanism should be proportionate (the least restrictive and most effective) and that the debtor is left with a minimum standard of living for him/her and any dependants. In addition, the Commission suggests that any mechanism must be based on a complete picture of the person's indebtedness (the holistic approach to debt) so as to ensure an appropriate balance between the creditors and the debtor in a specific case. The Commission notes that this also means that creditors and debtors do not become involved in the expensive, and often fruitless, debt enforcement processes currently in place.



5.

CONCLUSIONS AND RECOMMENDATIONS FOR GOOD PRACTICE

“
In the current economic climate, and as international experience would suggest, the use of fees and charges to generate revenue for local authorities is likely to be a continuing and probably increasing feature of local government financing
”

Cost recovery is a contentious subject. A NESF (2007: 66) report indicated the kind of opposition to fees and charges that can occur, and the reasons for this, in this case referring to library charges:

A number of those consulted for this report stated that some library services charge for membership, and a very small number charge for Internet access. Although the charges are small these can make a difference for those on very low incomes, and many of those consulted would like to see the charges abolished altogether. The low charges mean that this would cost very little.

Conversely, the Local Government Efficiency Group (2010) recommended the wider use of cost recovery by local government, noting for example that ‘...unless otherwise justified, local authorities should be reimbursed for the economic cost of providing services for Government departments and other agencies and bodies’. The Group (2010: 162) also recommended that greater cost recovery be pursued in a number of areas such as in planning fees and waste collection (in those individual local authorities that continue to be involved in this latter activity).

Clearly any final decision on cost recovery is a political one for the relevant authorities to determine. But in the current economic climate, and as international experience would suggest, the use of fees and charges to generate revenue for local authorities is likely to be a continuing and probably increasing feature of local government financing. In these circumstances, it is important that authorities are clear about where the use of cost recovery is justified and can show that all necessary efforts are being made to ensure that fees and charges are applied efficiently and effectively.

In particular it is important to determine areas where cost recovery principles should be applied and if there are any new areas where user fees and charges might be appropriate. Possibilities here include, but are not limited to:

- A levy on insurance companies who are the beneficiaries of the fire service e.g. a reduction in property damage associated with the work of the fire service reduces the claim value
- Fire prevention advisory service
- Tenant contribution to housing maintenance
- Contribution by local road users to maintenance of tertiary local road network
- Charges for public lighting
- Full economic cost recovery of the development management system
- Heritage and conservation advisory services
- Land drainage maintenance

The evidence provided in this study suggests a number of key questions that local authorities should be asking with regard to cost recovery. These questions and the associated text may be regarded as recommendations and guidelines for good practice.

Cost recovery policy

- **Does a policy exist for the authority with regard to cost recovery?** If so, it will need to be periodically reviewed. If not, a policy should be developed setting out the main principles of cost recovery to be observed, guidance to staff on the procedures required to achieve good practice, and the methodology for costing council services and the associated rationale.
- **Are services periodically reviewed to determine if the use of fees and charges is appropriate?** Services should be examined to determine whether or not they should be funded or part funded through fees and charges, in the light of the policy statement.

Capturing, monitoring and reviewing the cost of services

- **What basic level of information on fees and charges is available?** Each authority should maintain a comprehensive log of all fees and charges. This should include the name, amount and description of all charges and fees, the department responsible for collection and the date of the last review. This information should be publicly available.
- **Is the information base for cost attribution sufficient?** Both the direct and the indirect costs associated with the service should be determined. In the case of small scale services, it may be appropriate to use estimates for allocating indirect costs rather than develop elaborate cost accounting systems.

- **What review and reporting procedures are in place?** Effective reporting includes a detailed analysis for senior management and the council of the full costs and revenues against targets or benchmarks relating to the efficient cost of services in order to assess operational efficiency. There should be regular reporting to senior management and council on the efficiency and full cost of services and how this relates to fees and charges collected.
- **How frequently are fees and charges reviewed?** High cost recovery charges and fees may warrant an annual review whereas low cost recovery charges and fees, particularly those assessed infrequently, may justify a review once every three to five years.
- **Are differential fees considered?** A product or service may be differentiated on the basis of quality or on the basis of time, such as an express option for service delivery, in order to accelerate throughput and heighten customer convenience. Online payment may be facilitated by setting lower fees for online payments or higher charges for over the counter payments.

Fee and charge collection and enforcement

- **Is collection of fees and charges periodically analysed?** Analysis of data held by local authorities can be helpful in determining how to improve fee collection. Analysis of fee collection over time and the factors that may affect payment can provide information to improve collection rates.
- **What incentives and sanctions are in place for fee collection?** A range of incentives (carrots) and sanctions (sticks) are available to authorities to encourage collection of fees and charges. A judicious mix of carrots and sticks is needed to maximise revenue collection.
- **Are payment method options periodically scrutinised?** Setting collection targets can be helpful and should be encouraged. Having multiple options and increased use of online payments has been shown to enhance revenue collection.
- **What enforcement mechanisms are in place?** Non-payment of fees and charges should be followed up immediately. Appropriate enforcement mechanisms should be in place prior to the fee or charge coming into effect. Recourse to these mechanisms needs to be clearly defined and transparent.



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