



# **Costing Fees and Charges**

## *Guidelines for Use by Agencies*

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Department *of* Treasury  
*and* Finance



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## **PREFACE**

This fourth edition of the *Costing Fees and Charges – Guidelines for Use by Agencies* updates the third edition that was issued by the Department of Treasury and Finance in May 2003. The main changes relate to:

- the impact of CPI and wage impacts on fees and charges imposed under the *Fee Units Act 1997*; and
- removal of outdated references.

Whilst the guidelines are comprehensive, there are likely to be situations where agencies are uncertain about how to treat some components of expenditure in the course of a costing exercise. In those circumstances, advice and assistance should be sought from Treasury.

The nature of a fee or charge is often a matter which needs to be considered before deciding how to approach the costing task. The purpose may influence the range of factors ultimately taken into consideration in decision making processes and may affect judgements about the treatment of some expenses.

Agencies requiring advice or further information in relation to the guidelines or costing exercises should contact their Budget Analyst in the Budget Management Branch of Treasury in the first instance.



## **PART 1 INTRODUCTION**

### ***1.1 The Purpose of the Guidelines***

These guidelines have been produced to assist agencies in preparing information about the costing of their goods and services (Outputs) to help determine appropriate fees and charges.

They will help agencies to better understand their costs and the factors which have the greatest influence on those costs (ie the cost drivers). They should also clarify the appropriate point in the process of setting fees and charges at which the social implications of applying the fee or charge should be considered in determining whether a subsidy or concession should be provided to some users.

The guidelines also incorporate policy information relating to the treatment of some cost items.

These guidelines are intended to be of assistance to a wide range of users. They should be regarded as an instructive guide to the factors which should be taken into account when carrying out a costing exercise. However, there is no costing methodology which can be applied universally.

The importance of costing is such that it is a function which needs to be acknowledged and endorsed by senior management. Accountable officers need to be aware of the assumptions and judgements made in any costing exercise and to that extent these guidelines should be of interest to them.

### ***1.2 Role of the Department of Treasury and Finance***

As well as producing these guidelines, Treasury has a role to:

- provide advice and assistance in resolving practical difficulties which may arise when undertaking a costing exercise;
- provide information about relevant policies; and
- review information provided in support of schedules for user charges.

When using the guidelines it is important to remember that, whatever the purpose of the costing exercise, the approach used and the assumptions made in deriving the costs must be explicitly stated.

All costs must be verifiable, that is, capable of being confirmed through independent analysis.





## **PART 2 COSTING PRINCIPLES AND CONCEPTS**

### ***2.1 Pricing Policy and Principles***

Fees and charges should be set at a level which ensures that the full cost (direct, indirect and imputed costs, such as a return on equity and taxation equivalents) of providing a good or service can be accounted for explicitly and recovered at an appropriate level.

Fees and charges should initially be costed on a full cost recovery basis. The social implications of applying the fee or charge should then be taken into consideration in determining whether a government subsidy should be provided to some users. The level of government subsidy, if any, to be provided should then be determined in association with the relevant portfolio Minister on the basis of a comprehensive and clearly documented social impact analysis.

This policy should be applied in the context of the following principles:

- where a subsidy or concession is provided the amount of that subsidy or concession should be transparent and explicitly stated;
- all fees and charges are to take into account the Government's competitive neutrality requirements;
- fees and charges should be set at the higher of full cost recovery or market price;
- fees and charges must be set to ensure that the level of revenue from that source is no less than is provided for in agencies' Budget and Forward estimates, even if this results in them being higher than required by the previous principle;
- where not prevented from doing so by legislation or regulation, variations to fees and charges should only require approval by the relevant Minister;
- fees and charges should be formally reviewed at least annually (or more often if required by changes in market or cost parameters) by agencies, in association with the relevant portfolio Minister;
- agency specific charging manuals and pricing policies should be established; and
- the level of fee and charge for a good or service should only be varied in accordance with actual changes to its cost structure, market conditions or any applicable subsidy.

## **2.2 Agency Specific Charging Manuals and Pricing Policy**

All agencies which levy fees and charges are required to develop and maintain an agency specific manual for costing fees and charges, using these guidelines as a basis.

An agency pricing policy should also exist, which will assist in setting the appropriate level of fee or charge.

The manual and pricing policy should be reviewed and updated at least annually by agencies.

## **2.3 Requirements under the Fee Units Act 1997**

The *Fee Units Act 1997* (the Act) ensures that changes in the costs of delivering services are reflected in changes in the revenues received for providing those services. It implements a system of fee units - similar to the system of penalty units but with automatic annual indexation based on movement in the Consumer Price Index (CPI).

The Act provides for a 'fee unit adjustment factor' which can discount the CPI movement. At proclamation in May 1998, one fee unit was set equal to \$1.00, with all references to dollar amounts in legislative instruments being interpreted as referring to the equivalent number of fee units. Appendix 1 details the annual movement in the value of a fee unit.

While the value of the fee unit is set annually in line with movements in the CPI, there is nothing to prevent the level of any fee or charge being altered (either up or down) through amending legislation to change the number of fee units that apply to a particular service.

It is important to ensure that fees and charges covered by the Act are reviewed regularly, as CPI increase may not reflect the movements in the cost of service delivery. This is important where wage and salary costs form a significant portion of service delivery costs. In such cases, a wage index will be a more accurate indicator of the movement in costs. Regular update of fees and charges to reflect wage movements will ensure fees and charges more closely align with full cost recovery than only CPI movements, and allow detailed assessments to be conducted less frequently.

The Act requires agencies to prepare a complete schedule of current and new fees for publication in the *Gazette* each year. The requirement for agencies to establish the appropriateness of the current levels of fees and charges which are subject to the provisions of the Fee Units Act, gives a base for the development of a specific charging manual.

## ***2.4 Requirements under the Subordinate Legislation Act 1992***

The *Subordinate Legislation Act 1992* (the Act) requires all proposed subordinate legislation to be assessed as to whether it imposes a significant burden, cost or disadvantage on any sector of the public. If a significant impact would be imposed, the Act requires agencies and authorities to prepare a regulatory impact statement (RIS) and undertake public consultation.

Under section 6(a) of the Act, an agency may be exempt from preparing an RIS. When amending fees and charges the most relevant exemption (as set out in Clause 1 of Part 2 of Schedule 3 of the Act) occurs "...where the rate of increase in a fee or group of fees does not exceed the rate of increase in the Consumer Price Index since the fee or fees were last fixed."

Agencies should consider the requirements under the Subordinate Legislation Act when assessing the appropriate level of fee or charge to be levied. For further information on the Subordinate Legislation process, agencies should contact the relevant Regulation Review Unit officer at Treasury.

## ***2.5 Defining the Output to be Costed***

Developing an unambiguous description of the Output or service for which a fee or charge is to be levied is an essential prerequisite to any costing exercise. Without a clear definition it is impossible to verify costs or to conduct comparisons between the alternatives and comparisons over time.

A consideration of the following factors can assist in developing a clear description and understanding of the Output which is to be costed.

1. What is the purpose of the Output?
2. Is the Output measurable in a verifiable and consistent manner?
3. What are the processes associated with the Output (the production system) and where do they begin and end?
4. Is the Output already defined in the organisation's operating structure?
5. What is the context within which the Output takes place (relevant policy issues, Government directives, standards or principles of operation)?

When carrying out a costing exercise the aim should be to focus on the Output rather than the processes and/or relationships to the organisation's structure. For example, the activity should also describe the Output in terms of factors such as:

- size;
- volume;
- regularity/frequency;
- quality; and
- accountability - who is accountable for the activity?

## 2.7 Definition of Cost

The glossary at the end of the guidelines provides definitions of several types of costs.

The inter-relationship between some of the cost concepts needs to be understood.

Some costs are sub-sets of others. For example, *full cost* includes all variable and fixed costs while *direct costs* may be fixed or variable. The relationship can be shown as follows:

<b>Direct Costs</b>	Mostly variable	Little fixed
<b>Indirect Costs</b>	Some variable	More fixed
<b>Capital Costs</b>	Little variable	Mostly fixed

Defining the period for the costing of an Output can be critical in some cases. For example, where a price is being established for a specific product or service, consideration needs to be given to whether it is to be provided on a one-off or continuing basis, and therefore whether costs need to be examined in the long run as well as the short run.

When undertaking a costing exercise, agencies should be aware of all the costs associated with the activity, both cash and non-cash, including those costs which may be paid by other agencies (eg debt servicing costs or property outgoings).

## PART 3 TYPES OF COSTS

It is recommended that full cost be determined by explicitly considering *direct costs*, *indirect costs* and *capital costs*. In determining these costs, the cost net of any goods and service tax (GST) input tax credits should be utilised.

### 3.1 Direct Costs

*Direct Costs* are costs which can directly and unequivocally be attributed to an Output. They are the costs which can most easily be identified when examining the Output which is to be costed, and they are the costs which are most likely to be considered as *variable costs*, that is, they will change in direct proportion to changes in the level of activity.

In the public sector, where labour is often the dominant input, *direct costs* are usually divided into direct staffing costs and other direct costs (eg direct material costs).

Direct staffing costs include more than just the wages or salaries of staff (eg superannuation, payroll tax, workers' compensation insurance, leave loading, uniforms or protective clothing etc.)<sup>1</sup>.

The ease with which direct staffing costs can be determined will depend on the nature of the Output being costed, and in particular whether there is a neat match between the activity and the structure of the organisation. For example, there are cases where staff in an organisational unit provide services under two Outputs. If one Output is being costed then the *direct costs* attributable to the Output would need to be determined on a rational basis.

Direct staffing costs are easily identified when the whole of an organisational unit or the whole of an Output is included in the cost analysis.

Other *direct costs*, such as direct material costs, are those which, again, can be easily identified as being directly related to the Output.

The dominance of some direct costs, particularly staffing costs, may result in those costs being used as the basis for estimating the extent of other, indirect costs.

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<sup>1</sup> It should be noted that in the short-term, staffing costs may be considered as fixed rather than variable because it can be difficult to redeploy staff if there is a change in the level of activity.

The following are examples of some costs which might be included as direct costs:

- staffing costs;
- consumable supplies;
- office equipment which is expensed on purchase; and
- maintenance.

Process costing and job costing (cost accounting approaches which allocate direct costs to production processes or to individual jobs) can be usefully applied to the identification of direct costs.

On this point, it must be remembered that systems for the allocation of staff costs need to make allowance for the fact that some staff time can be unproductive in relation to a particular activity, for example, time spent on administrative tasks or on training.

### **3.1.1 Staffing Costs**

The starting point when identifying staffing costs is to determine the method to be used in deciding whether or not a staff member's time should be allocated to the relevant Output. If it is too difficult or too costly to estimate a time allocation for each employee, then it should be possible to at least identify the extent to which groups of staff are associated with the Output.

Where it is unclear whether a staff member or a group are exclusively associated with the relevant Output, it may be necessary to establish some basis of estimating involvement in different Outputs. This can be done by collecting data during a survey period of relatively short duration, where staff are requested to keep a record of their time involved in a pre-determined and defined range of activities.

Alternatively, an experienced person with a good working knowledge of the area could make an estimate of the time associated with an Output. The basis of any estimation needs to be recorded and verifiable.

While direct wage and salary costs may be relatively easy to identify, there is a significant additional cost incurred by all organisations in relation to the employment of staff. Those costs relate to the provision of additional benefits, other award payments, training, providing an office environment and working tools, insurances etc. These on-costs can be very significant.

Because there can be significant differences in on-costs between different types of employees it is recommended that agencies develop their own models for estimating staffing on-costs.

The following factors should be included if applicable and material:

- base wage or salary
- overtime
- shift loading
- leave loading
- superannuation
- severance benefits
- other allowance (eg on-call allowance)

- travel expenses
- uniforms
- training
- protective clothing
- payroll tax (see discussion on taxes)
- workers' compensation insurance premium
- fringe benefits tax
- housing
- office accommodation
- power
- equipment (including computer equipment)
- stationary
- other office consumables

Some of these factors require additional explanation:

<b>Overtime:</b>	Only include the employee's overtime associated with the activity being costed (if the employee(s) works on more than one activity).
<b>Shift Loading:</b>	Ensure that the shift penalties reflect the staffing roster which is being proposed for the activity.
<b>Leave Loading:</b>	Include accrued as well as cash costs.
<b>Superannuation:</b>	Government employees may be members of the Retirement Benefits Fund Scheme, or they may elect to contribute to some other complying superannuation fund. The superannuation expense should include the employer amount paid, including any additional GAP payment to Treasury, but not include any payments of pensions to superannuants as this would not constitute part of the cost of services in the current period.
<b>Travel Expenses:</b>	Include all relevant expenses, especially allowance payable under award provisions.
<b>Training:</b>	Training information may be available from data collected for other purposes. However, the costs included would need to exclude the costs attributed to the wages and salaries paid to staff while they are attending training courses.
<b>Housing:</b>	If housing is provided through the Government, then the cost included in the analysis should be an estimation of the net cost to government of providing the housing (ie net of rent paid by the staff but inclusive of the annualised cost to government, based on full market rent analysis, of having the Government provide the house).

The estimation of staff costs must include all relief requirements (eg to replace staff who are absent on annual leave, long service leave etc.). The full time equivalent (FTE) staff numbers should be used rather than an estimate of the number of jobs or tasks to be performed.

In some circumstances it may be appropriate to determine an hourly rate for staff time spent on an activity. In those cases it may be necessary to identify fee earning hours which exclude unproductive time spent on activities such as travel, setting up equipment, general work planning and rest breaks.

Special attention should be paid to the treatment of the liability for accrued leave entitlements. Accrued entitlements for annual leave and long service leave can represent payments which must be paid in the future. However, if the staff numbers used for the estimation of staffing costs include relief for staff absent on leave, then care should be taken not to double count salary costs.

For example, in a warehouse security operation the staff roster has 28 names. At any time, two staff are absent on annual leave and one is absent on long service leave. The remaining 25 staff carry out the required duties. One way of costing the operation is to determine the cost of all 28 staff members (28 FTEs). An alternative is to measure the cost of the 25 jobs which are performed each day and then add a component for leave liability. The results of the two methods will be different if some staff have an accrued leave entitlement which results in them being absent from duty for a period longer than the norm.

### **3.2 Indirect Costs**

*Indirect costs* are those which are not directly attributable to the Output and are sometimes referred to as *overheads*. They can include, for example, the Head of Agency's salary, head office and general administration costs, the cost of personnel and finance services and the cost of office accommodation. Consistent with the objective of reporting on the full cost of Outputs, wherever possible these "corporate services" costs should get allocated to the relevant Outputs where there is a rational basis for doing so.

The fact that indirect costs are more difficult to attribute to the Output being costed does not make them any less relevant. They may make a significant contribution to *full cost*.

The method used to estimate indirect costs needs to be carefully considered and explicitly identified so that independent verification is possible.

The identification and inclusion of *indirect costs*, will involve a trade-off between accuracy and the cost of producing the cost information. Care should be taken to avoid devoting resources to the allocation of a small indirect cost pool at the expense of the analysis of more significant factors.

Two methods are advocated for consideration:

- a) a "usage" or "benefit" approach; and
- b) a pro rata approach.

There are several matters to be considered for each method.

#### **a) The "Usage" or "Benefit" method**

This approach is concerned with measuring or estimating the actual usage of resources. If costs are measurable the "usage" or "benefit" method is the most accurate method available for presenting information about indirect costs.



Actual resource usage may be estimated in several ways. Depending on the nature of the resources concerned, usage of a particular indirect cost pool may be measured by direct observation, time records (in the case of staff costs) or through the use of sampling techniques.<sup>2</sup> The method used must be verifiable and efficient.

*Activity Based Costing* provides a detailed and accurate method of determining the actual attribution of costs in an indirect cost pool. The aim is to dissect the resources in an indirect cost pool to an individual Output through the use of cost drivers<sup>3</sup>.

The following example helps to illustrate the application of activity based costing:

<b>PURCHASING AND SUPPLY BRANCH</b>			
The Purchasing and Supply Branch of a Department which provides services throughout the State is located within the Department's head office in Hobart.			
The Branch performs the following functions:			
<ul style="list-style-type: none"> <li>• purchasing, storing and distributing all consumable supplies;</li> <li>• sorting all Departmental mail; and</li> <li>• arranging for the purchase, delivery and servicing of all departmental motor vehicles.</li> </ul>			
The total cost of operating the Branch is \$600 000 per annum with 90 per cent, or \$540 000, of that amount represented by staff costs (including oncosts).			
After keeping a record of their activities for a three week period, staff in the Branch estimate that their time is divided between their various activities as follows:			
<b>Activity</b>	<b>FTEs</b>	<b>% of salaries</b>	<b>\$</b>
Purchasing	3.2	22.8	123 000
Stores Management	3.3	23.6	127 500
Distribution	3.5	25.0	135 000
Mail Sorting	2.5	17.9	96 500
Vehicle Management	1.5	10.7	58 000
<b>TOTAL</b>	<b>14.0</b>	<b>100.0</b>	<b>540 000</b>
The Department provides two Outputs, one employing 2 000 FTEs and the other employing 1 500 FTEs. The cost of the Purchasing and Supply Branch is to be allocated to those Outputs.			
Under an activity based costing approach to the allocation of those costs, each activity of the Branch is analysed to determine a principal cost driver with the following results:			
<b>Activity</b>	<b>Cost Driver</b>		
Purchasing	Number of orders		
Stores Management	Value of Stores		
Distribution	Number of Deliveries		
Mail sorting	Number of staff		
Vehicle Management	Number of vehicles		

<sup>2</sup> An indirect cost pool is the sum of the resources associated with an indirect cost which is to be attributed to a number of activities. For example, the total rental cost of an office building would represent an indirect cost pool with the total cost having to be divided among the various activities which take place in the building.

<sup>3</sup> A cost driver is the factor or variable which has the greatest effect on the level of activity.

The staff cost of \$540 000 can be allocated to the two Outputs by analysing known information about the cost drivers within each Output. For example, because it is known that the volume of mail sorted (and therefore the cost of that activity) varies in accordance with the number of staff in each Output, the estimated total cost of that activity (\$96 500) can be allocated to each Output as follows:

$$\frac{\text{Output related staff}}{\text{Total staff}} \times \$96\,500$$

Therefore we have:

$$\text{Output 1} \quad \frac{2\,000 \text{ FTEs}}{3\,500} \times \$96\,500 = \$55\,150$$

$$\text{Output 2} \quad \frac{1\,500 \text{ FTEs}}{3\,500} \times \$96\,500 = \$41\,350$$

The same method is applied to each activity (eg Output 1 has a 200 vehicle allocation while Output 2 uses only 75 vehicles and therefore the vehicle management costs of \$58 000 are allocated as follows:

$$\text{Output 1} \quad \frac{200 \text{ vehicles}}{275} \times \$58\,000 = \$42\,200$$

$$\text{Output 2} \quad \frac{75 \text{ vehicles}}{275} \times \$58\,000 = \$15\,800$$

The results for the other activities are:

Purchasing:

$$\text{Output 1} \quad \frac{1\,200 \text{ orders}}{2\,500} \times \$123\,000 = \$59\,000$$

$$\text{Output 2} \quad \frac{1\,300 \text{ orders}}{2\,500} \times \$123\,000 = \$64\,000$$

Stores:

$$\text{Output 1} \quad \frac{\$10 \text{ million}}{\$20} \times \$127\,500 = \$63\,750$$

$$\text{Output 2} \quad \frac{\$10 \text{ million}}{\$20} \times \$127\,500 = \$63\,750$$

Distribution:

$$\text{Output 1} \quad \frac{350 \text{ deliveries}}{800} \times \$135\,000 = \$59\,000$$

$$\text{Output 2} \quad \frac{450 \text{ deliveries}}{800} \times \$135\,000 = \$76\,000$$

The total allocation of the branch's salaries cost is therefore:

Output 1      \$279 100

Output 2      \$260 900

### **b) The Pro-rata approach**

This approach may be used where it is not possible or too costly to identify actual resource usage from an indirect cost pool. The costs in the pool are allocated on a proportionate allocation basis to activities by using measures such as:

- staff involved in the activity as a percentage of total staff;
- direct resource use for the activity as a percentage of total resource use; and
- budget for the activity as a percentage of total budget.

The same type of pro-rata allocation can be used for indirect cost pools of different types. A simple approach to allocating indirect costs is to group all the costs into one pool and use a proportionate allocation basis similar to those outlined earlier. However, the more disaggregated the approach (ie the greater the number of indirect cost pools used), the more likely it is that the pro-rata method will yield results similar to those achieved under the "usage" or "benefit" approach.

Using the Purchasing and Supply Branch example, the total salary cost for the branch could be treated as one pool and then allocated to each Output on a pro-rata basis in accordance with staff numbers in each Output (previously identified as 2 000 and 1 500 respectively). The cost of \$540 000 would then be allocated as follows:

Output 1	\$308 500
Output 2	\$231 500

This differs somewhat from the results under the activity based costing approach (the variation being in the order of 10 to 15 per cent). As an activity based costing approach is considered to be more accurate, as illustrated by the example, it should be used wherever possible.

### **3.3 Capital Costs**

There are two aspects relating to the use of assets which must be considered in any analysis of cost:

- the determination of an appropriate depreciation charge; and
- recognition that the funds invested in the assets have alternative uses and therefore some allowance should be made for a rate of return on those assets (otherwise known as the opportunity cost of capital).

### 3.3.1 Asset Depreciation

Two common methods of determining the depreciation charge are:

- the prime cost or straight line method which allocates the cost of the asset over the number of years of useful life; and
- the diminishing value method which allocates a higher proportion of the cost of the asset to the earlier years of its life.

A depreciation charge is not relevant in all circumstances. For example, where agencies purchase equipment, receive an input tax credit, hold the equipment for a relatively short period of time and sell it at a price close to the original purchase price, there is no need for a depreciation charge.

The valuation of the assets employed is an important matter because the valuation has such a significant impact on the depreciation charge. Asset valuation policies are outlined in the Treasurer's Instructions.

### 3.3.2 Opportunity Cost of Capital

The inclusion of the opportunity cost of capital is recognition of the fact that funds invested in assets, or used to service the cost of borrowing to invest in assets, have alternative uses.

To achieve improved Output costing and improved asset management, the cost of capital to the Government should be measured in terms of the cost to the Government of borrowing the funds required for its investment in agency assets.

Treasury recommends that the Tascorp long term borrowing rate be used as the central estimate for the cost of capital for funds invested in agency assets (the opportunity cost of capital).

Where cost information including opportunity costs is to be used for decision making purposes, (and particularly where comparisons are being made between the costs of alternative suppliers), it is recommended that sensitivity analysis be conducted using rates of 2 per cent above and below the central estimate. This will help to assess whether the result is affected by the estimate for the cost of capital to an excessive extent.

To calculate the required return on assets, Treasury has derived the following formula:

$$\begin{array}{rcl} \text{cost of} & & \text{total estimated replacement value or current} \\ \text{capital} & \times & \text{cost equivalent of assets employed less} \\ \text{(\%)} & & \text{accumulated depreciation} \end{array} \quad \begin{array}{r} \text{less} \\ \text{less} \end{array} \quad \begin{array}{l} \text{the interest portion of} \\ \text{any relevant debt} \\ \text{servicing cost} \end{array}$$

The cost of capital is applied to an agency's total non-current asset base, with an allowance deducted for the interest portion of any relevant debt servicing costs. This approach avoids a double impost for any agencies meeting interest payments on funds borrowed for asset related purposes.

### ***3.4 Services and Resources Received Free of Charge***

Agencies often receive resources or services free of charge, especially from other Government agencies. In some cases this reflects that fact that charging systems have not been developed.

Costs for such services and resources should be included in the full cost of an Output.

The following are some of the services that may be provided at no cost:

- property management services provided by the Procurement and Property Branch of Treasury; and
- shared telephone and communications services.

As the costing process is undertaken on a whole-of-government basis, careful attention should be paid to the identification and estimation of the cost of services which are received free of charge.

### ***3.5 Taxation***

A number of government agencies are exempt from a range of taxes and other charges. The treatment of Commonwealth, State and Local Government taxes is an important consideration in the determination of the cost of Outputs involving actual or prospective competition with the private sector. Competitive neutrality requires that, where taxes and charges are not currently being paid, notional taxes should be calculated and included in the costing process.

Whilst individual agencies should examine their own circumstances to determine the taxes and other statutory charges from which they are exempt, the following are often not paid by government agencies, and should be included in the calculation process:

- land tax;
- local government rates; and
- stamp duty, where the Crown is exempt or not liable to pay.

#### **3.5.1 Goods and Services Tax**

Division 81 of the *A New Tax System (Goods and Services Tax) Act 1999* provides for the Australian Government Treasurer to make a determination which allows for government taxes, fees and charges to be exempted from GST. Fines and penalties which are not imposed in relation to a supply are not subject to GST, and do not require listing in the determination.

If a tax, fee or charge is not excluded from the GST by the Treasurer's determination, agencies will be required to charge GST on the supply at the applicable GST rate (currently 10%).

The following criteria will assist in determining whether the fee or charge is required to have GST added.

<b>GST free</b>	<b>GST applicable</b>
Registration fees	Entry fees
Application fees	Sale of Goods and Services
Charges for duplicates	Inspection and testing fees
Fees for transferring rights	Information search fees
Fees for lodgement notices	Fees for manuals, information and advice
Fees for access, rights	Examination fees
Royalties	

Where the fee or charge is required to have GST added, this amount is added after the full or final cost of providing the good or service has been determined. GST collected on the supply must be remitted to the Australian Taxation Office.

### **3.5.2 Division 81 Determination**

The coordination of fees and charges to be included in the Australian Government Treasurer's determination under Division 81 is undertaken by the Department of Treasury and Finance.

An agency wishing to have a fee or charge amended or included in the determination should forward a detailed request to Treasury which advises the nature of the fee or charge and the circumstances relating to the request for exemption or amendment. If supported, Treasury will then forward this request to the Australian Government Treasury for inclusion on the next determination. A complete listing of Division 81 determinations is located on the Australian Government Department of Treasury website.

### **3.6 Summarising Costs**

The full cost of an Output is represented by the aggregation of direct, indirect and capital costs. Most of these costs will be attributable to agencies. However, some costs may be met by other agencies. Some costs will be represented by cash transactions while others will represent the potential for a future call on expenditure (eg accrued long service leave).

The finer details of any costing exercise will depend on the nature of the activity being costed and the purpose of the costing exercise. Some different factors need to be considered for specific purposes and these are discussed in the following sections of the guidelines.

The table below provides a summary of various costs.

## TYPES OF COSTS

### *Direct Costs*

Staffing costs (including on-costs such as training and travel)

Base wage or salary	Overtime
Shift loading	Leave loading
Superannuation	Retirement/severance benefits
Other allowances (eg on-call allowance)	Travel expenses
Uniforms	Training
Protective clothing	Payroll tax (see discussions on taxes)
Workers' compensation insurance premium	Fringe benefits tax
Housing	Power
Office accommodation	Stationary
Equipment (including computer equipment)	Other office consumables
Consumable supplies	Maintenance
Office Equipment	

### *Indirect Costs*

Includes corporate services costs

### *Capital Costs*

Depreciation  
Opportunity cost of capital

### *Taxation*

Commonwealth  
State  
Local Government

### *Services and Resources provided free of charge*

Property management services  
Legal services  
Telephone and communication services

The estimation of the cost of an Output should be only the first step in the analysis of costs. At the end of an accounting period, actual results should be compared with the estimates of cost as part of a process of continually improving costing procedures.





## **PART 4 APPLYING THE COSTS**

### ***4.1 Fees and Charges - Determining Costs for Pricing***

Explicit knowledge of pricing policies enables the Government to properly assess the implications of its pricing decisions.

Pricing goods and services in Government is a complex matter and, after considering all relevant issues, different approaches to pricing may be required for different circumstances. Two approaches to pricing are discussed briefly below.

### ***4.2 Full Cost Recovery***

Under a full cost recovery approach to pricing, full cost should be measured in the manner outlined in Part 2 of these guidelines.

In order to determine a price, the full cost may need to be expressed in a per unit of Output terms. The unit may be anything from an hourly rate for the provision of a service to a cost per unit of production. In some cases the important consideration may be the cost of providing services on an annual basis, in which case there would be no need to determine a per unit price.

There are many factors which influence the relationship between full cost and prices. In some cases agencies will be required to set fees and charges at a level which is less than full cost. This will particularly be the case where the fee or charge relates to a function which is in the nature of a community service and where there has been some direction from the Government to undertake that function.

Restriction on increases in fees and charges may result from Government direction or from legislative requirements. In these cases the estimation of full cost serves the purpose of providing Government with information about the cost of public goods subsidies. If costs are known, decisions about the future level of charges can be made in full knowledge of the financial implications.

### ***4.3 Marginal Cost Pricing***

Marginal or avoidable cost pricing has particular application in circumstances where a product or service is provided predominantly for a core user and additional capacity is available to supply secondary or one-off users.

This type of pricing may lead to a situation where different customers pay different prices. The equity of such a situation needs to be considered and prices must be set in a manner which can be fully justified.

Good examples of marginal cost pricing exist in situations where capital equipment is used to carry out functions for government but where, due to either the scale of the equipment or the limitation of demand for the Government services, additional Output can be produced with the additional cost restricted to the variable cost of materials and/or power.

The following example helps to illustrate the application of marginal cost pricing:

The kitchen in a metropolitan public hospital produces meals for the 400 patients. By using cook/chill technology the cooking operations can be restricted to five days per week. Meals are cooked, chilled and then reheated in infra-red ovens when required.

On a full cost recovery basis, the cost per meal has been calculated to be \$2.25.

The equipment used in the kitchen (ovens, deep fryers, gas rings, stainless steel pans and the rapid chiller) has sufficient capacity to produce 10 000 meals per week compared with the 8 400 meals per week being prepared, on average, at present.

A nearby private hospital with 60 patients has its kitchen out of operation for six months. It has a requirement for 1 260 meals per week and has approached the public hospital to determine whether it is in a position to provide meals for that period and, if so, at what price.

It has been estimated that the cost of producing the additional meals is \$1.95 per meal to cover ingredients, power, water and the wages and on costs of an additional part time kitchen hand. An infra-red reheating oven can be leased for a total cost of \$2 000 for the six month period of \$0.10 per meal. This would be arranged by the private hospital.

The price for the meals can therefore be set as low as \$1.95 by the public hospital. However, the price is only valid for the range of Output up to 10 000 meals per week and it makes no contribution to the replacement of the kitchen equipment.

#### **4.4 Competitively Neutrality**

Under the National Competition Policy Agreement between all Australian Governments, agencies are required to implement a full cost pricing policy for significant business activities being undertaken, in order that a level playing field exists with the private sector. Specifically, the policy ensures that agencies do not enjoy a competitive advantage over the private sector simply by virtue of their public ownership, as well as eliminating any disadvantages which may also exist.

##### **4.4.1 Application**

The competitive neutrality principles only apply to those business activities of an agency which are 'significant'.

Tasmanian has adopted a broad definition of a significant business activity, in that it applies if an agency produces goods and/or services in an actual, or potentially, competitive market.

The *Application of Competitive Neutrality Principles under National Competition Policy*, which was published in 1996, provides guidance in the implementation of Full Cost Attribution (FCA) principles which are required to be implemented by agencies.

FCA does not impose pricing obligations on agencies, rather it assists in the recognition of what is a fully attributed cost of an activity, so that a pricing decision can be made.

It is important to distinguish between the terms 'costing' and 'pricing'.

Costing involves the determination of the value of resources required in the production of a good, or the delivery of a service. It acts as a benchmark against which a pricing decision can be made.

Pricing refers to the process of determining a figure at which the good or service will be exchanged in the marketplace. While cost is an important consideration in this process, pricing policies also reflect additional market and competitive considerations as well as including a return on equity invested.

FCA can be described as consisting of the following:

1. operating costs (direct and indirect) per unit or period; plus

2. capital costs (direct and indirect) per similar period or unit; plus
3. competitive neutrality costs per similar unit or period.

There are a range of potential advantages and disadvantages that can arise from public ownership. These include:

#### Potential Advantages

- Exemption from Commonwealth, State and Local taxes;
- No requirement to return a profit, a return on investments or interest on borrowings;
- Tied clients and the opportunity to cross-subsidise commercial operations from government funded departmental activities;
- Exemptions from various Commonwealth and State legislation applicable to private sector equivalent entities;
- Access to various corporate overheads free of charge or a reduced rate, including office accommodation, payroll services, human resource, marketing, information technology and financial services; and
- Cash flow advantages through budget arrangements which provide agencies with access to funds.

#### Potential Disadvantages

- Difficulty in accessing taxation benefits of depreciation, investment allowances, transfer of taxation losses and other deductions;
- Public sector award conditions and higher public sector superannuation contributions;
- Lower degree of managerial autonomy, due to the requirement to comply with Ministerial directives;
- Higher accountability costs given the public sector's reporting and regulatory requirements;
- Lack of flexibility in reducing or restructuring corporate overheads
- Constitutional and legal constraints; and
- Requirement to undertake non-commercial activities.

Each of these need to be considered in determining the total competitive neutrality cost to be applied in the calculation of the fully attributed cost of a good or service.

#### **4.4.2 Complaint Mechanism**

An important part of competitive neutrality arrangements is the complaints mechanism. The Government Prices Oversight Committee (GPOC) has been set up to receive complaints from private sector businesses about unfair competition from government business. The role of GPOC is to receive complaints, undertake investigations and provide advice to Government.

A complaint is usually received by GPOC if the complainant considers that they have been adversely affected by the failure of a government business to compete fairly, and

they have unsuccessfully attempted to resolve this matter directly with the government business.

In investigating complaints received, GPOC will review all documentation associated with the calculation of the fee or charge being investigated, so agencies should ensure that all supporting documentation is retained when the level of a fee or charge is being determined.

On completion of their investigation, GPOC will report on its findings jointly to the Treasurer and the respective agency Minister, and make its recommendations public in an annual report.

## **PART 5 PUBLIC GOODS**

### ***5.1 Application of the Concept of Public Goods to Fees and Charges***

There are a wide range of goods and services provided in the public sector for a number of social, political and economic reasons.

It may be appropriate for the cost of a public good or service to be fully or partially funded from general Government revenue.

A public good is something which will not be properly provided by the market because it is non-rival in consumption. A key feature of it is that if it is provided for one then it is provided for all: one person's consumption is not at the expense of others. A radio broadcast is an example of a non-rival provision: one person tuning in does not reduce the ability of another to tune in and also enjoy the good. Other examples are defence, or the provision of lighthouse, police, and fire brigades.

It is important that public goods and services are fully costed. A decision can then be made as to the level of subsidy applicable in a particular case given an assessment of all the relevant factors. This allows the level of subsidy or concession to be transparent and facilitates proper resources management and public policy analysis.

A subsidy may be appropriate where:

- benefits for the good or service do not only accrue to direct users. It would be inequitable for some identified users to meet the total cost the services when non-users or users entitled to exemptions or concessions also benefit;
- users cannot be readily identified;
- services are provided specifically to disadvantaged groups who do not have the capacity to pay; and
- the Government has a longer term policy objective of encouraging or supporting an activity or a specific group of people.

The level of government subsidy, if any, applying to fees and charges should be determined in association with the relevant portfolio Minister on the basis of a comprehensive and clearly documented social impact analysis taking into account the issues outlined above, and should, ideally, be clearly indicated in invoices and other statements provided to customers.



## **GLOSSARY OF TERMS**

Activity based costing	An approach to costing which focuses on identifying activities required to produce Outputs.
Avoidable cost	Costs that will not continue if an ongoing operation is changed or deleted.
Cost of capital	Also known as the opportunity cost of capital, in the context of these guidelines is defined as the cost to the Government of borrowing funds for investment in agency assets.
Current cost	A cost stated in terms of current market prices rather than historical cost.
Direct costs	The costs which can be directly and unequivocally attributed to the activity being costed.
Fixed costs	Costs that remain unchanged in total for a given time period despite fluctuations in activity level.
Full cost	The total value of all of the resources used in the production of a good or service or in carrying out an activity or program.
Indirect costs	The costs which, while related to an activity, are not directly attributable to it.
Marginal cost	The cost of the last unit of production.
Opportunity cost	The income (or cost) that could be earned (or saved) from the next best alternative use of a resource.
Replacement cost	The cost to replenish a given amount of an asset.
Sunk cost	A cost that is already incurred and is therefore irrelevant to any decision making process.
Transition cost	The once-off costs incurred in changing an activity from public to private operation and vice versa.
Variable cost	Costs that fluctuate in direct proportion to changes in the level or volume of activity.

## REFERENCES

NSW Premier's Department, 1991, *Competitive Tendering and Contracting out - Costing Guidelines*

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## APPENDIX 1 – FEE UNIT ACT

The *Fee Units Act 1997* (the Act) provides that fees and charges in new legislation are expressed in terms of fee units, in order to facilitate the indexation of fees.

The value of a fee unit is set each year by the Treasurer based on changes in the Consumer Price Index (CPI) for Hobart, with provision for adjustment to be made if the change in the CPI is considered to overstate the increase in the cost of providing Government services. The value of one fee unit was initially set equal to \$1.00. The annual movement in the value of a fee unit is identified in the following table:

<b>Financial Year</b>	<b>Fee Unit Value</b>
1998-99	\$1.00
1999-00	\$1.01
2000-01	\$1.02
2001-02	\$1.05
2002-03	\$1.08
2003-04	\$1.11
2004-05	\$1.14
2005-06	\$1.17

The Act provides that the Treasurer is to gazette the value of a fee unit for the next financial year by the middle of February prior to the commencement of that financial year.

All agencies that collect fees subject to the Act are required to publish in the *Gazette* by 31 March each year, a schedule of current fees and new fees that will apply for the following financial year, in accordance with the value of the fee unit for that financial year. The schedule must outline: -

1. the amount of the current fee, excluding goods and services tax;
2. the amount of the fee for the next financial year, excluding goods and services tax;
3. whether or not the fee is excluded from the goods and services tax under section 81-5(2) of the *A New Tax System (Goods and Services Tax) Act 1999* of the Australian Government;
4. if the fee is not excluded from the goods and services tax, the amount of goods and services tax payable in respect of the fee; and
5. the total fee payable.

Fees calculated pursuant to the provisions of the Act are to be rounded down to the nearest cent. The rounding provision applies only to the calculation of the fee, and not necessarily to the amount collected. Where fees are collected in cash, standard cash collection rounding to the nearest five cents will apply. In the case of a fee being set at a per unit rate, the rounding provisions in the Act are applied to the total amount of the fee or charge to be paid and not the rate.

Under the Act, the Treasurer may, through the publication of a notice in the *Gazette*, exempt fees from the provisions of the Act. Such exemptions are considered by the Treasurer in cases where it would be inappropriate for the Act to apply.

## CASE STUDY

The following example helps to illustrate some of the principles and concepts of costing government activities. The case study is based on a case study contained in the document *NSW Premier's Department 1991, Competitive Tendering and Contracting Out - Costing Guidelines*.

### *Specialist Warehouse Operations*

Specialist Warehouse Operations is a division of an agency providing warehousing services for high value items such as information technology, medical equipment and medical supplies.

The division's activities are shown in the agency's program statements as comprising "Operations" and "Administration". The operations activity is concerned with the receipt, handling, distribution and security of goods (the two sub-programs being goods handling and security). The administration activity is concerned with human resource, finance and general administration support functions.

The division operates from a large warehouse building which incorporates office space. The building has an electronic security system comprising movement detectors, security card readers (to control access) and security cameras, all linked to a central computer.

The goods handling operation is also computerised with a stand alone system located at the warehouse.

The total operation handles goods worth more than \$300 million per annum and has the following expenditure profile:

	<b>Operations</b>	<b>Administration</b>	<b>Total</b>
	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Salaries and wages	4 560	3 680	8 240
Other staffing costs	1 162	920	2 082
Telephone	0	120	120
Office supplies	0	50	50
Floor space rental	700	500	1 200
Cleaning	0	56	56
Power and water	0	150	150
Maintenance	50	120	170
<b>Total</b>	<b>6 472</b>	<b>5 596</b>	<b>12 068</b>

### *Measuring Full Cost*

The costs above exclude a number of important components of full cost:

- **Depreciation**  
The following depreciation expenses should be included in the measurement of full cost.

	<b>Written Down Value \$'000</b>	<b>Depreciation Charge \$'000</b>	<b>Expected Remaining Life years</b>
IT Equipment	1 840	320	5
Security Equipment	1 000	100	7
Handling Equipment	5 000	700	5

The inclusion of depreciation as a capital cost will ensure that some allowance is made for the use of capital equipment.

- **Other Staffing Costs - Superannuation**  
The Other Staffing Costs need to reflect an annual superannuation expense of \$980,000.
- **Head Office Overheads**  
The Specialist Warehouse Operations Division has to bear its share of the department's administrative costs for items such as the Head of Agency's salary. These are estimated to be \$96,000.
- **Cost of Capital**  
The Government should be able to assume a real rate of return on the assets employed by the Division. At a current replacement cost of \$9 million, and using a cost of capital rate of 8 per cent for illustrative purposes only, a return of \$720 000 should be expected.

The full cost of the operation is therefore:

	<b>\$'000</b>
Costs identified in accounts	12 068
Depreciation	1 120
Superannuation	980
Cost of Capital	720
Contribution to head office costs	96
<b>Total</b>	<b>14 984</b>

### *Establishing User Charges*

Having established the full cost of the division's operations, decisions can now be made in relation to user charges for warehousing services provided for other agencies.

In particular, the division wishes to establish user charges for services provided for the Hospitals Division of the State Health Services.

After considering the nature of the warehousing operations, it is decided that the most appropriate unit of service delivery (i.e. the measure which best describes how the level of service delivery varies from customer to customer) is square metres of shelf

space occupied in the warehouse. Given that there are 30 000 square metres of warehouse shelf space available, the full cost of \$14 264 000 translates to a cost of \$499.47 per square metre per annum. This is the base rate charged to the Hospitals Division for the secure storage of their goods, on which GST of \$49.95 would be added, giving a total cost of \$549.42.