

The Auditor-General
Audit Report No.23 2007–08
Performance Audit

The Management of Cost Recovery by Selected Regulators

Australian National Audit Office

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of Australia 2008

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Canberra ACT
21 February 2007

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit across agencies in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *The Management of Cost Recovery by Selected Regulators*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

ABC	Activity Based Costing
APVMA	Australian Pesticides and Veterinary Medicines Authority
AQIS	Australian Quarantine and Inspection Service
ARPANSA	Australian Radiation Protection and Nuclear Safety Agency
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CFS	Consolidated Financial Statements
CRIS	Cost Recovery Impact Statement
DITR	Department of Industry, Tourism and Resources
DoHA	Department of Health and Ageing
Finance	Department of Finance and Deregulation
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMOs	Finance Minister's Orders
IP	Intellectual Property
ITSA	Insolvency and Trustee Service Australia
NICNAS	National Industrial Chemicals Notification and Assessment Scheme
OBPR	Office of Best Practice Regulation
PBS	Portfolio Budget Statements
RIS	Regulation Impact Statement
TGA	Therapeutic Goods Administration

Glossary

Agencies	FMA Act agencies and relevant CAC Act bodies that have been notified, under sections 28 or 43 of the CAC Act, to apply the Australian Government's cost recovery policy.
CAC Act bodies	Entities that are subject to the <i>Commonwealth Authorities and Companies Act 1997</i> .
Cost recovery	<p>The recovery of some or all of the costs of a particular activity provided by the Australian Government, including:</p> <ul style="list-style-type: none">• fees and charges for the provision of goods and services to non-government sectors; and• charging for activities for which there is no actual or potential competition.
Cost recovery charges	<p>Modes by which agencies recover costs for some of the products and services they provide. Australian Government cost recovery charges fall into two broad categories:</p> <ul style="list-style-type: none">• fees for goods and services; and• 'cost recovery' taxes (primarily levies, but also some excises and customs duties).
Cost Recovery Impact Statement (CRIS)	Statement documenting compliance with the Australian Government's cost recovery policy which must be prepared by all agencies with significant cost recovery arrangements.
FMA Act agencies	Agencies that are financially part of the legal entity of the Commonwealth and are subject to the <i>Financial Management and Accountability Act 1997</i> .
Information activities	Activities involved in collecting, compiling and disseminating information or any other activity of a non-regulatory nature.

Regulatory activities	<p>Activities involved in administering regulations, including:</p> <ul style="list-style-type: none"> • registration and approvals; • issuing exclusive rights and privileges; • monitoring ongoing compliance with regulations; or • investigation and enforcement.
Regulation Impact Statement (RIS)	<p>Document required by the Office of Best Practice Regulation from any department, agency, statutory authority or board responsible for a regulatory proposal following consultation with affected parties, formalising and evidencing some of the steps that must be taken in good policy formulation.</p>
Significant cost recovery arrangement	<p>One where an agency's total cost recovery receipts:</p> <ul style="list-style-type: none"> • equal \$5 million or more per annum - in this case every cost recovery arrangement within the agency is considered, prima facie, to be significant, regardless of individual activity totals; or • are below \$5 million per annum, but stakeholders are likely to be materially affected by the cost recovery initiative, or Ministers have determined the activity to be significant on a case-by-case basis.

Summary and Recommendations

Summary

Introduction

1. Irrespective of the particular economic, social or environmental objectives of regulation, there is general acceptance by governments that regulation should be designed to meet its objectives effectively, with minimal cost to the community.¹ One component of the cost to the community is the recovery of regulatory costs.
2. Regulatory agencies are expected to have in place arrangements to provide assurance that they are charging the correct amount under cost recovery regimes, while industry and other customers want assurance that the fees and charges they are paying are fair and reflect only those costs incurred in the provision of the activity.
3. The Australian Government expects to collect \$246.8 billion in revenue in 2007–08, of which an estimated \$5.2 billion, or two per cent, will be from the sale of goods and services (including regulatory activities).²
4. In December 2002, the Australian Government introduced guidelines for reviewing agencies' cost recovery arrangements, with the aim of improving the transparency, consistency and accountability of cost recovery.³ The guidelines, which Finance revised in 2005, require agencies providing government goods and services (including regulation) to the private and other non-government sectors of the economy to set charges to recover all the costs of such products or services, where it is efficient to do so, in consultation with stakeholders.⁴
5. The guidelines also set out a better practice management framework to assist agencies to design and implement cost recovery arrangements. This enables all agencies, including regulatory agencies, to decide on the

¹ ANAO *Better Practice Guide-Administering Regulation*, ANAO, Canberra, 2007, Foreword, available at <www.anao.gov.au>.

² Australian Government, *Budget Paper No. 1: Budget Strategy and Outlook 2007–08*, Statement 5: Revenue, available at <www.finance.gov.au/budget/2007-08>. Note: This excludes GST revenue.

³ Department of Finance and Administration, *Australian Government Cost Recovery Guidelines July 2005*, Financial Management Guidance No.4, Canberra, 2005, available from <www.finance.gov.au>.

⁴ The policy covers all *Financial Management and Accountability Act 1997* (FMA Act) agencies and some *Commonwealth Authorities and Companies Act 1997* (CAC Act) bodies. These are Commonwealth authorities and wholly-owned Commonwealth companies that the responsible Minister has notified to apply the policy (under sections 28 or 43 of the CAC Act). This report will collectively refer to all such entities as 'agencies'.

appropriateness of cost recovery for their activities, and the best approach to implementation. In this way, customers paying for government products and services would have greater confidence in the reasonableness of specific cost recovery arrangements.

6. Regulatory agencies are required to recover the costs of all activities involved in regulation. These include pre-market activities such as registrations and approvals, or issuing exclusive rights or privileges. They also include post-market activities which involve monitoring compliance, investigation and enforcement.

7. Cost recovery charges can take the form of:

- fees that are collected from individual customers for particular activities, for example, inspection, audit or application fees; and/or
- levies that are imposed across a group of customers, for example, annual registration or licence charges. In this case, specific legislation is required to establish a levy as it is equivalent to a tax.

8. The Government's guidelines require agencies to conduct a review of cost recovery arrangements at least once every five years. Following reviews, agencies document compliance with the guidelines in a Cost Recovery Impact Statement (CRIS) which is provided to the Department of Finance and Deregulation (Finance) and summarised in Portfolio Budget Statements (PBS).

Audit scope and objectives

9. The objective of the audit was to assess whether selected regulatory agencies have cost recovery procedures and practices which comply with the Government's guidelines. To address this objective, the audit assessed the management of cost recovery against the following criteria:

- regulatory agencies have clear and consistent cost recovery procedures to identify their activities and costs, and set fees and levies;
- regulatory agencies have effectively implemented their cost recovery procedures;
- regulatory agencies regularly monitor and review their cost recovery activities; and
- regulatory agencies regularly report on their cost recovery.

10. The audit assessed the selected agencies' procedures and practices against the Government's cost recovery guidelines. In the main, the guidelines are principles-based rather than prescriptive guidance to agencies on how to implement cost recovery. This allows agencies significant flexibility to tailor cost recovery approaches to the industry sectors regulated. Therefore, the audit assessed whether regulatory agencies' interpretation and application of the Government's guidelines was consistent with the cost recovery principles.

11. The audit was conducted in the following agencies:

- IP Australia;
- the Insolvency and Trustee Service Australia (ITSA); and
- the National Industrial Chemicals Notification and Assessment Scheme (NICNAS).

12. These three agencies will collect approximately \$166 million from cost recovery measures in 2007–08. Two of these—IP Australia and NICNAS—initially reviewed their cost recovery under the Government policy in 2004–05. Both of these agencies operate on a full cost recovery basis, obtaining most of their revenue directly through the collection of fees and levies. ITSA, which is Budget funded,⁵ conducted its first cost recovery review over 2003–04 and 2004–05 and concluded it in February 2005. Its second review was undertaken in 2005–06 and concluded in June 2006, prior to introducing full cost recovery from July 2006.

Conclusion

13. Since introduction, the guidelines have assisted agencies in determining the best approach to cost recovery for the types of activities undertaken and enabled them to improve their cost recovery. In particular, the requirement to review cost recovery at least every five years and prepare a CRIS, prompts agencies to regularly focus on their cost recovery arrangements.

14. Each of the regulatory agencies selected for audit had in recent years conducted a cost recovery review and prepared a CRIS which Finance had accepted as meeting requirements. This meant that, prior to the audit, all had the opportunity to assess their approach to cost recovery management against the guidelines and to make any needed improvements.

⁵ ITSA is funded by government appropriation with revenue collected from fees paid into the Consolidated Revenue Fund.

15. Overall, the ANAO concluded that the audited regulatory agencies had cost recovery procedures and practices which complied with the Government's guidelines. The agencies had implemented the procedures described in their CRISs, including identifying cost recovery activities, determining the costs of these activities, and setting appropriate fees and levies in consultation with customers and stakeholders. They regularly monitored, reviewed and reported on their cost recovery arrangements. However, although the audited agencies incorporated sound practices in cost recovery management, there were opportunities for improvement.

16. The audited agencies' internal cost recovery policies and procedures were contained in a range of documents. This was likely to create inefficiencies in agency management of cost recovery, and it made access by customers and stakeholders difficult. The ANAO recommends that, over time, agencies should consolidate their cost recovery policy and procedures into a single reference document.

17. All the audited agencies used activity based or similar costing methodologies to allocate their direct, indirect and capital costs to their activities. However, the agencies needed to improve the documentation which outlined their methodologies to ensure that it was up-to-date, accessible and easily understood by staff.

18. Two of the audited agencies had identified the business risks associated with their cost recovery function, however, only one had determined appropriate risk treatment strategies. The other agency had not identified and assessed its cost recovery risks. Two of the three audited agencies took account of the risks associated with financial sustainability by budgeting for an operational reserve. Nevertheless, the ANAO considered that agencies would benefit from documenting their cost recovery risks, and proposing risk reduction strategies, in their risk management plans at the organisational or divisional level.

19. The Government's cost recovery guidelines require agencies to separately identify all cost recovery revenues in notes to financial statements. The ANAO considers that, consistent with the guidelines, agencies should report in their financial statements the revenues collected through the various fees and levies they charge for regulatory activities. This would improve the visibility of, and accountability for, cost recovery activities.

Key Findings by Chapter

Cost recovery arrangements (Chapter 2)

20. The audited agencies had appropriate legislation which provided the authority to impose the fees and levies charged for recovering the costs of their activities. This authority was set out in Acts, regulations and/or determinations. During cost recovery reviews, two agencies had sought independent legal advice regarding their authority to impose particular charges. On each occasion, the legal advice received by agencies confirmed the legality of their arrangements.

21. All of the audited agencies had internal cost recovery policies and procedures which, on the whole, complied with the Government's guidelines. However, these were contained in a range of documents, such as standard operating procedures, minutes of meetings, consultancy reports and CRISs, which made them difficult for staff, customers and stakeholders to access. The ANAO recommends that, over time, agencies should consolidate their cost recovery policy and procedures into a single reference document. This might reasonably be done before, or in conjunction with, the next cost recovery review.

22. The availability of such a document would significantly assist the agency in undertaking cost recovery activities, and inform customers and stakeholders about how the agency applies the Government's cost recovery guidelines. Agency benefits would include staff having a better understanding of the agency's fee setting structures and approaches, more efficient fee reviews and CRIS development, and the ability to apply cost recovery consistently during periods of high staff turnover. Benefits to customers and stakeholders would include a more co-ordinated agency policy response to any cost recovery concerns, a reduction in the time taken to respond to their concerns, and a better understanding of the agency's fee setting structures and approaches.

23. The audit found that one agency had a comprehensive approach to identifying, assessing and treating its cost recovery risks. Another agency had a risk management plan but had not included risk reduction strategies for its cost recovery risks. The third agency did not have a risk management plan. However, the latter two agencies had internal policies to budget for an annual operational reserve. This suggests that, while these agencies did not always

have written risk reduction strategies, the risks associated with cost recovery were taken into account in financial planning.

24. The ANAO suggests that agencies should consider the business risks related to cost recovery when developing organisational or divisional risk management plans, including treatment strategies. Risk management treatments will depend on the significance of issues, the size of the agency and the extent to which its financial viability depends on cost recovery. Such an approach contributes to good governance and provides reasonable assurance to agencies and customers that agencies will achieve organisational objectives within a tolerable degree of risk.

25. All audited agencies had developed an activity based or similar costing methodology to determine the cost of providing each service delivered. However, internal documentation on how these costing systems assigned costs to activities was not always accessible, up-to-date and easily understood by staff. Providing a succinct and current explanation of the methodology used to assign costs to activities would assist staff in understanding the agency's approach to cost recovery and improve the consistency of its application.

26. The audited agencies had made decisions, consistent with the requirements of the Government's guidelines, on whether to use fees or levies to recover particular regulatory costs. Agencies used fees if costs could be directly linked to the delivery of a service, and the individual beneficiary of the service could be identified. Alternatively, levies are used where it was not possible to allocate costs to an individual beneficiary. The costs of some regulatory activities are therefore spread across all customers subject to the regulation.

Implementing cost recovery arrangements (Chapter 3)

27. The audited agencies employed methodologies for setting fees and levies which were consistent with the guidelines, and implemented costing methodologies in accordance with internal procedures. These methodologies involved quantifying direct, indirect and capital costs, allocating these costs to activities, and setting fees and levies to reflect these costs. The agencies allocated direct costs to activities based on average staffing levels, or the number of full-time staff employed in the areas delivering the activities. Indirect and capital costs were allocated to each activity based on the numbers of staff engaged in that particular activity, or on the basis of the share of direct costs devoted to that activity.

28. The level of cost recovery in the audited agencies was generally in line with the cost of providing the activity, with any variations attributable to fluctuations in activity levels. Audited agencies had systems to forecast activity levels, which included an analysis of historical records and, in some cases, the consideration of a variety of economic indicators which affected regulated industries. However, it is difficult to predict activity levels, and it takes time for agencies to make the necessary adjustments to fees and levies when there were variations in volumes. This resulted in short periods when fees and levies did not match costs.

29. The two audited agencies which relied on cost recovery revenue for operational funding had established an internal policy to budget for an operational reserve. This was to ensure the financial sustainability of operations, and lessen the risk associated with making calls on Government funding. This strategy was detailed in agency CRISs, which Finance approved.

30. Each agency had established industry consultative mechanisms which were used to provide information to customers and stakeholders on how it determined costs and set charges. Agencies' industry consultative mechanisms provided an opportunity for major customer groups and stakeholders to comment on costing methodologies, and processes for determining fees and levies, and whether agency charges reflected costs.

31. Two of the audited agencies conducted annual customer satisfaction or opinion surveys to gauge how customers and stakeholders viewed the quality of services. The other audited agency conducted surveys approximately every two years. Surveys provided agencies with an opportunity to ask customers and stakeholders about their understanding and acceptance for the agency's costing methodology and charge rates. While one agency included specific questions on its fee structures and rates in its survey, all provided an opportunity for respondents to make additional comments on any issue of concern. The ANAO suggested that agencies include direct questions on cost recovery in their surveys, as this was likely to elicit more detailed customer and stakeholder views of the agency's costing and charging methodology.

Reviewing and monitoring cost recovery (Chapter 4)

32. All audited agencies conducted reviews of their existing cost recovery arrangements in accordance with the Government's schedule, and produced a CRIS which summarised their cost recovery approach against the five-stage process suggested in the guidelines. Finance had accepted each agency's CRIS after certification by the agency's chief executive or secretary. The ANAO found that the agencies had implemented the cost recovery arrangements described in their CRISs.

33. In addition to the Government scheduled reviews of existing cost recovery arrangements, the audited agencies had conducted fee reviews and produced a CRIS when proposing new cost recovery arrangements, or when making material amendments to existing arrangements. This approach was consistent with the requirements of the guidelines.

34. Overall, the audited agencies had effective mechanisms to monitor and review their cost recovery arrangements. Each produced regular internal financial and management reports which generally showed cost recovery revenue against the agency's budget and expenses. The agencies used these reports to monitor the status of cost recovery targets and actual results, and to provide an updated profile on any issues leading up to fee reviews.

35. The audited agencies conducted reviews of their regulatory charges at least annually to determine whether fees and levies needed to be revised. The agencies had the capacity to amend the rates of fees and levies during these reviews. However, they weighed this against their obligation to provide some level of certainty and stability for their customers by not changing fee and levy rates too often.

36. The audited agencies consulted with customers and stakeholders during cost recovery reviews, and considered the comments received when proposing changes to regulatory charges. The result of this consultation included charges not being increased at the rate originally proposed by an agency, and a new fee not being introduced as a result of concerns expressed by the agency's customers and stakeholders. In one agency, staff were consulted on proposed changes to cost recovery arrangements in order to broaden their understanding of the impact on the agency.

Reporting to management and stakeholders on cost recovery (Chapter 5)

37. Overall, the ANAO considered that all audited agencies used the reporting mechanisms available to them to report on their cost recovery activities to management and stakeholders. A number of monthly or quarterly financial reports were available to the agency executive, to inform of the status of cost recovery targets and actual results. Chief Executives of the agencies provided similar reports, or summary information to meetings of their industry consultative committees.

38. Each of the three audited agencies published a summary of its CRIS in its PBS in the year that it completed the scheduled review, in accordance with the Government's guidelines. Each agency also included information on its cost recovery arrangements in annual reports, posted a summary of its CRIS on its website for the benefit of its customers and stakeholders, and reported on its cost recovery arrangements to customers through industry consultative committees.

39. The Government's cost recovery guidelines require agencies to separately identify all cost recovery revenues in notes to financial statements. This is intended to allow readers of financial statements to readily identify cost recovery revenue. Two audited agencies included the amount of revenue collected through the sale of goods and services in a note to their financial statements in their annual reports. One of these agencies also identified income administered on behalf of government in its PBS. The other audited agency identified total revenue from industry cost recovery in Section 4 – Other Reporting Requirements in its PBS.

Agency responses

IP Australia

40. IP Australia welcomes the ANAO performance audit on Management of Cost Recovery and agrees with the recommendation. The report recognises IP Australia's ability to manage cost recovery processes, and provide improved service for customers and Government. IP Australia has been and is committed to continually improving the cost recovery arrangements ensuring efficiency and effectiveness in accordance with relevant legislation and Commonwealth policies.

Insolvency and Trustee Service Australia

41. ITSA welcomes independent scrutiny by the ANAO of its management of its cost recovery arrangements and agrees with the recommendation made.

The Department of Health and Ageing

42. The Department of Health and Ageing (DoHA) acknowledges the work of the ANAO and agrees with its recommendation. This recommendation will assist in improving governance procedures and practices at NICNAS, as part of the Department's ongoing commitment to continuous improvement. Actions to implement the recommendation are underway.

The Department of Finance and Deregulation

43. The Department of Finance and Deregulation (Finance) supports the report's recommendation. Finance agrees that the consolidation of cost recovery policy and procedures into a single document that is current, accessible and easily understood should serve as a means to enhance the transparency and integrity of the cost recovery information produced by FMA agencies and CAC bodies, thus providing further assurance of compliance with cost recovery policy.

44. Consistent with our responsibility for cost recovery policy, we intend to advise Chief Financial Officers of the report's recommendation and will subsequently incorporate these requirements in cost recovery guidelines which are scheduled to be reviewed in the second half of 2008.

Recommendations

Recommendation No. 1

Para. 2.38

The ANAO recommends that, in order to increase transparency for stakeholders and assist staff to apply the Government's cost recovery guidelines, agencies should:

- (a) over time, consolidate their cost recovery policy and procedures into a single reference document; and
- (b) ensure documentation outlining their costing systems is up-to-date, accessible and easily understood.

Agencies' responses to the recommendation

The audited agencies and Finance agreed to the recommendation. Where provided, agencies' additional responses to the recommendation are provided in the body of the report.

Audit Findings and Conclusions

1. Introduction

This Chapter outlines the Government's policy and guidelines on cost recovery and the audit approach, including the objective, criteria, scope and coverage.

Background

1.1 Irrespective of the particular economic, social or environmental objectives of regulation, there is general acceptance by governments that regulation should be designed to meet its objectives effectively, with minimal cost to the community.⁶ One component of the cost to the community is the recovery of regulatory costs.

1.2 Regulatory agencies are expected to have in place arrangements to provide assurance that they are charging the correct amount under cost recovery regimes, while industry and other customers want assurance that the fees and charges they are paying are fair and reflect only those costs incurred in the provision of the activity.

1.3 The Australian Government expects to collect \$246.8 billion in revenue in 2007–08, of which an estimated \$5.2 billion, or two per cent, will be from the sale of goods and services (including regulatory activities).⁷

1.4 In December 2002, the Australian Government introduced guidelines for reviewing agencies' cost recovery arrangements. The guidelines were revised in July 2005. The policy aim is to 'improve the transparency, consistency and accountability of cost recovery by agencies and promote the efficient allocation of resources'.⁸ The guidelines require agencies providing government goods and services (including regulation) to the private and other non-government sectors of the economy to set charges to recover all the costs of such products or services, where it is efficient to do so, in consultation with stakeholders.⁹

⁶ ANAO *Better Practice Guide-Administering Regulation*, ANAO, Canberra, 2007, Foreword, available at <www.anao.gov.au>.

⁷ Australian Government, *Budget Paper No. 1: Budget Strategy and Outlook 2007–08*, Statement 5: Revenue, available at <www.finance.gov.au/budget/2007-08>. Note: This excludes GST revenue.

⁸ Department of Finance and Administration, *Australian Government Cost Recovery Guidelines July 2005*, Financial Management Guidance No.4, Canberra, 2005, available from <www.finance.gov.au>.

⁹ As previously noted in footnote 4, this report collectively refers to the FMA Act agencies and CAC Act bodies covered by the Government's Cost Recovery Guidelines as 'agencies'.

Cost recovery policy and guidelines

1.5 The guidelines define cost recovery as the fees and charges for provision of government goods and services (including regulation) to the private and other non-government sectors of the economy. Cost recovery charges can take the form of:

- fees that are collected from individual customers for particular activities, for example, inspection, audit or application fees; and/or
- levies that are imposed across a group of customers, for example, annual registration or licence charges. In this case, specific legislation is required to establish a levy as it is equivalent to a tax.

1.6 The guidelines also set out a better practice management framework to assist agencies to design and implement cost recovery arrangements. This enables all agencies, including regulatory agencies, to decide on the appropriateness of cost recovery for their activities, and the best approach to implementation. In this way, customers paying for government products and services would have greater confidence in the reasonableness of specific cost recovery arrangements.

1.7 Regulatory agencies are required to recover the costs of all activities involved in regulation. These include pre-market activities such as registrations and approvals, or issuing exclusive rights or privileges. They also include post-market activities which involve monitoring compliance, investigation and enforcement.

1.8 The Government's guidelines require agencies to conduct a review of cost recovery arrangements at least once every five years. Following reviews, agencies document compliance with the guidelines in a Cost Recovery Impact Statement (CRIS) which is provided to the Department of Finance and Deregulation (Finance) and summarised in Portfolio Budget Statements (PBS).

1.9 Many regulatory agencies operate on a full cost recovery basis in that they meet all, or nearly all, of their operating costs through fees and charges on those that they regulate. Other regulators that recover some or all of their costs through fees and charges receive all or part of their operating costs from Government appropriations through the Budget.

1.10 The guidelines outline a number of key principles, which are summarised in Table 1.1.

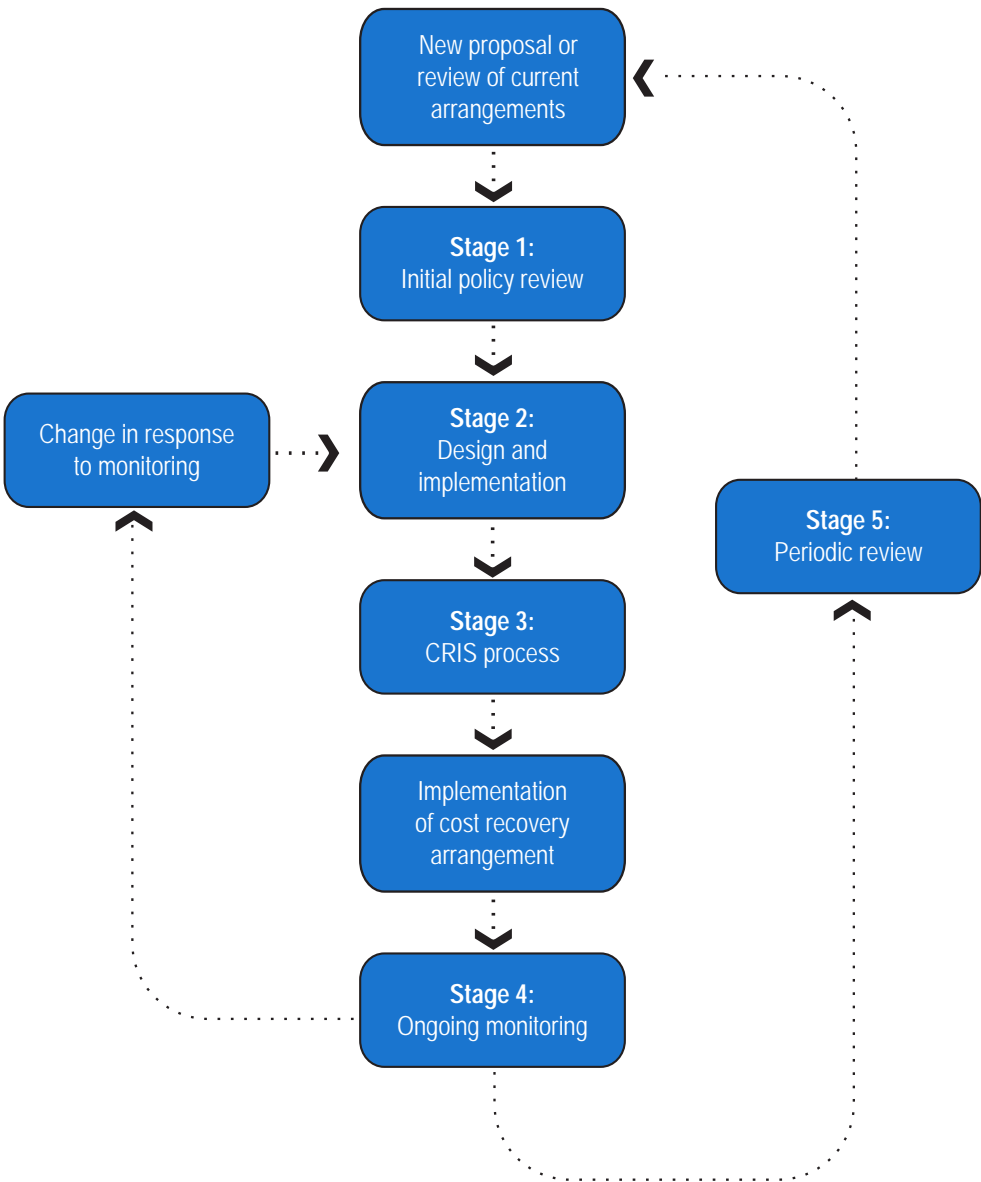
Table 1.1**Key principles of cost recovery**

Principles
1. 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 only where new arrangements are phased in, where there are government endorsed community service obligations, or for explicit government policy purposes
2. 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
3. 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
4. All cost recovery arrangements should have clear legal authority for the imposition of charges
5. Agencies should not recover costs that are not directly related or integral to the provision of products or services (for example, some policy and parliamentary servicing functions). Agencies that undertake regulatory activities should generally include administration costs when determining appropriate charges
6. Where possible, cost recovery should be undertaken on an activity (or activity group) basis rather than across the agency as a whole. Cost recovery targets on an agency-wide basis are to be discontinued
7. Agencies should not cost recover for products and services funded through the budget process, but may cost recover, where appropriate, for commercial, additional and incremental products and services that are not funded through the budget process
8. Portfolio Ministers should determine the most appropriate consultative mechanisms for their agencies' cost recovery arrangements, where relevant
9. Cost recovery arrangements will be considered 'significant' depending on both the amount of revenue and the impact on stakeholders and where Ministers have determined the activity to be significant on a case-by-case basis
10. Agencies with significant cost recovery arrangements should ensure that they undertake appropriate stakeholder consultation, including with relevant departments
11. All agencies with significant cost recovery arrangements will need to prepare a CRIS, unless they have prepared a Regulation Impact Statement (RIS) that also addresses cost recovery arrangements against these guidelines, and must include a summary of the CRIS in their portfolio budget submissions and statements. The chief executive, secretary or board must certify that the CRIS complies with the policy and provide a copy to Finance
12. Agencies are to review all significant cost recovery arrangements periodically, but no less frequently than every five years
13. Agencies will need to separately identify all cost recovery revenues in notes to financial statements – to be published in portfolio budget statements and annual reports consistent with the Finance Minister's Orders
14. Portfolio Ministers are responsible for ensuring that the cost recovery arrangements of agencies within their portfolios comply with the policy and will report on implementation and compliance in portfolio budget submissions

Source: Australian Government Cost Recovery Guidelines July 2005, pp. 2–3. Some principles have been paraphrased.

Figure 1.1

Process for assessing cost recovery



Source: Australian Government Cost Recovery Guidelines July 2005, p. 13.

1.11 The guidelines set out a five-stage process for determining the appropriateness and best approach to cost recovery for all agency activities. These stages (as outlined in Figure 1.1) include:

- an initial policy review to determine whether cost recovery is appropriate and for which activities;
- design and implementation of the cost recovery system;
- development of a Cost Recovery Impact Statement (CRIS) and consultation with the Department of Finance and Deregulation (Finance);
- ongoing monitoring, including consultation with stakeholders; and
- periodic reviews.

1.12 Finance has policy responsibility for cost recovery and for providing guidance to assist agencies with its application. However, responsibility for compliance with the policy rests with relevant portfolio ministers, while agencies are responsible for conducting cost recovery reviews and preparing impact statements.

1.13 Finance developed a Cost Recovery Review Schedule, in consultation with agencies, to phase in the policy for existing arrangements across all portfolios over the five year period 2003–04 to 2007–08. In July 2005, Finance revised the schedule of reviews for existing cost recovery arrangements for the period 2005–06 to 2007–08.

Impact statements

1.14 Agencies with ‘significant cost recovery arrangements’¹⁰ must document compliance with the policy for new or materially amended cost recovery arrangements, or where reviews are undertaken, in a CRIS which they provide to Finance. Agencies are also required to publish a summary CRIS in their Portfolio Budget Statements (PBS). Finance has developed a template to assist agencies in preparing a CRIS.

1.15 Agencies are expected to consult with Finance to confirm that impact statements include the required information and reflect the requirements of the Government’s policy. Finance does not ask agencies to validate the information that they include in their reviews as part of this process.

¹⁰ The policy defines a ‘significant cost recovery arrangement’ as one where an agency’s total cost recovery receipts equal \$5 million or more per annum, or are below \$5 million per annum, but stakeholders are likely to be materially affected by the cost recovery initiative, or where Ministers have determined the activity to be significant.

1.16 For proposed regulation (or amendment to regulation) that affects business, agencies are required to prepare a Regulation Impact Statement (RIS). If a RIS incorporates cost recovery arrangements, the agency addresses compliance with the cost recovery policy in this document rather than in a separate CRIS.

1.17 Where a cost recovery initiative has regulatory implications, Finance refers the agency concerned to the Office of Best Practice Regulation (OBPR) in the Productivity Commission for assessment as to whether a RIS is required. Similarly, when the OBPR becomes aware of regulatory proposals incorporating cost recovery, it advises the relevant agency to consult with Finance. The OBPR seeks advice from Finance before formally assessing the RIS. Finance and the OBPR have a Memorandum of Understanding which sets out the roles and responsibilities of each agency.

1.18 The OBPR is responsible for examining each RIS and advising whether it meets the Government's requirements, and whether it provides an adequate level of analysis, including cost-benefit and risk analysis.

Previous ANAO publications

1.19 The ANAO has conducted a number of performance audits of regulatory agencies in the past few years which have considered cost recovery issues.¹¹ The findings from these audits were reported in:

- ANAO Audit Report No.52 2006–07, *The Australian Taxation Office's Approach to Regulating and Registering Self Managed Superannuation Funds*, Australian Taxation Office, June 2007;
- ANAO Audit Report No.25 2006–07, *Management of Airport Leases: Follow up*, Department of Transport and Regional Services, February 2007;
- ANAO Audit Report No.14 2006–07, *Regulation of Pesticides and Veterinary Medicines*, Australian Pesticides and Veterinary Medicines Authority (APVMA), December 2006;
- ANAO Audit Report No.7 2006–07, *Visa Management: Working Holiday Makers*, Department of Immigration and Multicultural Affairs, October 2006;

¹¹ All ANAO reports are available at <www.anao.gov.au/publications>.

- ANAO Audit Report No.30 2004–05, *Regulation of Commonwealth Radiation and Nuclear Activities*, Australian Radiation Protection and Nuclear Safety Agency (ARPANSA), March 2005;
- ANAO Audit Report No.18 2004–05, *Regulation of Non-prescription Medicinal Products*, Department of Health and Ageing, Therapeutic Goods Administration (TGA), December 2004;
- ANAO Audit Report No.50 2003–04, *Management of Federal Airport Leases*, Department of Transport and Regional Services, June 2004;
- ANAO Audit Report No.17 2003–04, *AQIS Cost-recovery Systems Follow-up Audit*, Australian Quarantine and Inspection Service (AQIS), December 2003; and
- ANAO Audit Report No.10 2000–01, *AQIS Cost-Recovery Systems*, Australian Quarantine and Inspection Service, September 2000.

1.20 The ANAO also published a Better Practice Guide on *Administering Regulation* in March 2007, which addresses aspects of the cost recovery policy for regulatory agencies.¹²

Audit approach

Audit objective and criteria

1.21 The audit objective was to assess whether selected regulatory agencies have cost recovery procedures and practices which comply with the Government's guidelines.

1.22 The audit assessed the management of cost recovery against the following criteria:

- regulatory agencies have clear and consistent cost recovery procedures to identify their activities and costs, and set fees/levies;
- regulatory agencies have effectively implemented their cost recovery procedures;
- regulatory agencies regularly monitor and review their cost recoverable activities; and
- regulatory agencies regularly report on their cost recovery.

¹² ANAO Better Practice Guides are available at <www.anao.gov.au/publications>.

Audit scope

1.23 The audit assessed agency procedures and practices against the Government's cost recovery guidelines. In the main, the guidelines are principles-based rather than prescriptive guidance to agencies on how to implement their cost recovery functions.¹³ This allows agencies significant flexibility to tailor their cost recovery approach to the industry sectors they regulate. The audit assessed whether each regulatory agency's interpretation and application of the Government's guidelines was consistent with the cost recovery principles previously outlined in Table 1.1.

Audit coverage

1.24 The audit examined the management of cost recovery in three regulatory agencies:

- IP Australia;
- the Insolvency and Trustee Service Australia (ITSA); and
- the National Industrial Chemicals Notification and Assessment Scheme (NICNAS).

1.25 IP Australia is a prescribed agency under the FMA Act within the Innovation, Industry, Science and Research portfolio. It operates on a full cost recovery basis, obtaining most of its funding from collection of fees for intellectual property services through a Special Account.¹⁴ IP Australia's total operating budget for 2007–08 is \$134.2 million, of which \$130.7 million will be revenue from cost recovery.

1.26 ITSA is an agency in the Attorney-General's portfolio that administers and regulates Australia's personal insolvency system. Its funding is from general government revenue through Budget appropriation. Its total budget allocation for 2007–08 is \$38.3 million. ITSA estimates that it will collect \$27.2 million in revenue from cost recovery in 2007–08, repaid to consolidated revenue.

1.27 NICNAS is a statutory scheme within the Department of Health and Ageing (DoHA). It operates on a full cost recovery basis, obtaining all of its

¹³ While most of the guidelines detail actions which agencies should comply with as a matter of sound practice, in some instances they outline actions which agencies should comply with at all times.

¹⁴ A Special Account is a ledger account recording a right to draw money from the Consolidated Revenue Fund (CRF), which can be established either by the Finance Minister under s20 of the FMA Act, as for IP Australia, or by enabling legislation as recognised under s21 of the FMA Act, as for NICNAS.

funding from its collection of fees and charges through a Special Account. NICNAS' total revenue estimate for 2007–08 is \$8.4 million, all of which is from cost recovery.

1.28 Table 1.2 outlines the regulatory activities undertaken by the three agencies, the types of fees and levies charged, the legislative authority for cost recovery, and estimated revenue from cost recovery in 2007–08.

1.29 Two of the three agencies—IP Australia and NICNAS—initially reviewed their cost recovery under the government policy in 2004–05, while ITSA conducted its first review over 2003–04 and 2004–05. These agencies will collect approximately \$166 million from cost recovery measures in 2007–08.

1.30 At each of these agencies, fieldwork involved interviews with key staff, a review of relevant policy and associated documentation, and the examination of files and records relating to the agency's review of cost recovery and its development of a CRIS. The ANAO also consulted Finance and the OBPR during the audit. Following the fieldwork, the ANAO provided each agency with an issues paper detailing the audit findings, conclusions and, where appropriate, recommendations for improvement, specific to that agency.

1.31 In addition to findings related to the above agencies, this report draws upon the findings, where relevant to this audit's objective and criteria, of ANAO's earlier audits of the management of cost recovery in other agencies. As noted earlier, these agencies included APVMA, ARPANSA, TGA, and AQIS. This enabled the ANAO to form a broader cross portfolio opinion of cost recovery in regulatory agencies.

1.32 The audit was undertaken in accordance with the ANAO's Auditing Standards, and was completed at a cost of \$489 917.

Table 1.2

Regulatory agencies audited

Regulatory Agency	Regulatory Activities	Cost Recovery Authority	Estimated Revenue from Cost Recovery 2007–08
IP Australia	Administers IP for patents, trade marks, designs and plant breeder's rights by issuing exclusive rights and privileges to customers. Customers pay fees for lodgement, registration, examination, and renewal of IP rights and hearings.	<i>Patents Act 1990</i> <i>Trade Marks Act 1995</i> <i>Designs Act 2003</i> <i>Plant Breeder's Rights Act 1994</i>	\$130.7m ¹⁵
ITSA	Administers Australia's personal insolvency system, including regulation of bankruptcy trustees and debt agreement administrators, provision of public bankruptcy services, and the administration of personal insolvencies when a private trustee is not appointed. It also controls and deals with property under Proceeds of Crime (POC) legislation. Customers pay fees for personal insolvency agreement processing, issue of bankruptcy or official receiver notices and estate administration services. ITSA imposes levies to cover regulation, compliance and enforcement activities.	<i>Bankruptcy Act 1966</i> <i>Bankruptcy (Estate Charges) Act 1997</i>	\$27.2m ¹⁶
NICNAS	Aids in the regulation of industrial chemicals in Australia by assessing risks of new and existing chemicals, and approving the introduction of new chemicals. Customers pay fees for new chemical assessments. NICNAS imposes a registration charge as a levy on all importers and manufacturers of industrial chemicals to cover compliance, information and education activities, and reviews of existing chemicals.	<i>Industrial Chemicals (Notification and Assessment) Act 1989</i> <i>Industrial Chemicals (Registration Charge – Customs) Act 1997</i> <i>Industrial Chemicals (Registration Charge – Excise) Act 1997</i> <i>Industrial Chemicals (Registration Charge – General) Act 1997</i>	\$8.4m ¹⁷

Sources: Agency websites, annual reports and Portfolio Budget Statements 2007–08 (see footnotes).

¹⁵ Commonwealth of Australia, *Portfolio Budget Statements 2007–08 Industry, Tourism and Resources Portfolio*, Budget Related paper No 1.14, 2007, p. 93, available at <www.industry.gov.au/publications>.

¹⁶ Commonwealth of Australia, *Portfolio Budget Statements 2007–08 Attorney-General's Portfolio*, Budget Related paper No 1.2, 2007, p. 445, available at <www.ag.gov.au/publications>.

¹⁷ Commonwealth of Australia, *Portfolio Budget Statements 2007–08 Health and Ageing Portfolio*, Budget Related paper No 1.12, 2007, p. 63, available at <www.health.gov.au/publications>.

Structure of this report

1.33 The report has five Chapters , as summarised below:

- Chapter 1 outlines the Government's policy and guidelines on cost recovery and the audit approach, including the objective, criteria, scope and coverage;
- Chapter 2 confirms the legislative basis for charging, and examines the policy and procedures supporting cost recovery arrangements. It also assesses risk management procedures, and the methodologies used for costing activities and setting fees and charges;
- Chapter 3 assesses regulatory agencies' implementation of cost recovery arrangements and management of cost recovery revenue. It also examines the mechanisms agencies used to check customer understanding and acceptance for costing methodologies and regulatory charges;
- Chapter 4 examines the processes used by regulatory agencies in conducting cost recovery reviews and developing CRISs, reviewing and monitoring cost recovery arrangements, and consulting customers and stakeholders during cost recovery reviews; and
- Chapter 5 examines the mechanisms used by regulatory agencies to report internally and externally on cost recovery arrangements and outcomes, and whether cost recovery revenue is reported in financial statements.

2. Cost Recovery Arrangements

This Chapter confirms the legislative basis for charging, and examines the policy and procedures supporting cost recovery arrangements. It also assesses risk management procedures, and the methodologies used for costing activities and setting fees and charges.

Legislative basis for charging

2.1 As shown in Table 1.1, Principle 4 of the Government's guidelines states that 'all cost recovery arrangements should have clear legal authority for the imposition of charges'.¹⁸ In order to assure themselves that their authority for cost recovery is valid, the guidelines suggest that agencies seek legal advice on cost recovery arrangements at an early stage of their design.

2.2 Different constitutional requirements govern the imposition of a levy and a fee. In order to charge a levy, which is legally a form of taxation, there must be a separate tax Act established.¹⁹ The authority for charging fees is set out in other legislation, which are not tax Acts, and the levels and rates of the fees are usually included in regulations or determinations related to that legislation.

2.3 Each of the audited agencies had appropriate legislation which provided the authority to impose the fees and levies charged for recovering the costs of particular activities (as shown in Table 1.2). This legislation provided for changes to regulatory charges to be made through regulations or determinations. Two agencies had arrangements that set the levels of these charges in regulations, and used amendments to the regulations to increase charges or introduce new ones. These agencies indicated that this approach provided flexibility to alter charges when required, as legislated charges can be difficult to change. The other audited agency outlined its charge rates in determinations. This allowed fees and levies to be set in a timely fashion in response to the changing cost of services and stakeholder concerns.

2.4 When conducting scheduled cost recovery reviews, two of the audited agencies had sought independent legal advice regarding their authority to impose particular charges. NICNAS sought legal advice on whether there was

¹⁸ Such as formal approval from the Government, a Cabinet decision or Ministerial directive.

¹⁹ Consistent with the general form of Australian taxation legislation, under s55 of the Australian Constitution, a law imposing a tax can have no other effective provisions. For the text of the Australian Constitution, see <www.comlaw.gov.au>.

authority for registration charges to be imposed on industry by a levy. Its legal advice confirmed that the legislation which imposed its registration charges as a levy complied with section 55 of the Constitution.

2.5 ITSA sought advice on whether the charges imposed by the *Bankruptcy (Registration Charges) Act 1997* were levies or fees for service. Legal advice received by ITSA was that the charges imposed by the Act were fees. As a result, the Government repealed this Act, and incorporated the authority for the newly classed fees in the *Bankruptcy Act 1966*.

2.6 ITSA also sought separate legal advice on whether it could amend its legislation to set its fee rates by Ministerial determination, rather than through regulations. It received advice that such an approach conferred clear legal authority for its fees. ITSA now sets rates for fees and charges imposed under the *Bankruptcy Act 1966* and the *Bankruptcy (Estate Charges) Act 1997* in this manner.

Cost recovery policy and procedures

2.7 As noted earlier, the Government's cost recovery guidelines outline the key principles of good cost recovery practice. Agencies can assist their management of cost recovery by having a consolidated cost recovery policy and procedures document which addresses consistency with better practice and government policy. Relevant matters for such a document include the definition of cost recovery, the legal basis for charges, a description of the agency's activities, and the methodology used to calculate costs and charges.

2.8 The ANAO examined whether each of the audited agencies had an internal cost recovery policy and procedures document which outlined how it applied the Government's cost recovery guidelines. The ANAO found that cost recovery policy and procedures were contained in a range of documents, such as standard operating procedures, minutes of meetings, consultancy reports and CRISs, which made them difficult for staff and customers to access.

2.9 Agencies produced a CRIS during scheduled reviews of cost recovery arrangements, and this had resulted in each of them having a summary of cost recovery arrangements showing how the agency complied with the Government's guidelines. However, none of the agencies had a single internal policy and procedures document which contained the detail on how they had applied the Government's cost recovery policy.

2.10 The ANAO summarised the major features of each agency's cost recovery policies using the information from the various documents available, as shown in Table 2.1.

Table 2.1

Agency cost recovery policies

Major features	IP Australia	NICNAS	ITSA
Authority for cost recovery	Acts and regulations	Act and regulations	Act and determinations
Financial arrangements for cost recovery revenue	Revenue credited to a Special Account	Revenue credited to a Special Account	Revenue is administered and is independent of the agency's government appropriation
Types of charges	Fees	Fees and levies	Fees and levies
Stakeholder consultation	Institute of Patent and Trade Mark Attorneys of Australia Australian Manufacturer's Patents, Industrial Designs, Copyright and Trade Mark Association Plant Breeder's Rights Advisory Committee Trade Marks Combined Interest Group Customers and general public (through the website)	Industry Government Consultative Committee Community Engagement Forum Customers and general public (through the website)	Cost Recovery Reference Group Correspondence and meetings with practitioners Customers and general public (through the website)
Reviews of fees and charges	Annual fee review	Annual fee review	Ongoing, but fees reviewed every two years at a minimum
Managing cost recovery revenue	Budgets for an operational reserve	Budgets for an operational reserve	Budgets for costs to match fees
Cost recovery reporting²⁰	CRIS every 3 years. Summary in PBS and on website	CRIS every 5 years. Summary in PBS and on website	CRIS every 2 years. Summary in PBS and on website

Source: Agency records.

²⁰ While the guidelines require agencies to conduct a review and prepare a CRIS at least every five years, IP Australia and ITSA decided to conduct reviews more regularly (every three and every two years respectively).

2.11 There would be significant benefits for agencies if they consolidated their cost recovery policy and procedures into a single document to assist in their application of the guidelines. Such benefits would include:

- an opportunity for agencies to provide a more co-ordinated policy response to its customers and stakeholders on cost recovery issues;
- a better understanding amongst agency staff, customers and stakeholders of its fee setting structure and approaches;
- a reduction in the time taken by agencies to respond to customer and stakeholder concerns about charges due to increased visibility of the cost recovery process;
- more efficient fee reviews, CRIS development and the reporting of cost recovery arrangements in public documents due to staff being able to access policy and procedures easily; and
- the likelihood that cost recovery arrangements would continue to be consistently applied during periods of high staff turnover in agency finance areas.

2.12 This might reasonably be done before, or in conjunction with, the next cost recovery review.

2.13 During the audit, one agency advised that it will develop a policy document which details how the agency's cost recovery procedures and methodology meet the Government's cost recovery policy and guidelines. Another agency advised that it proposes to engage an independent consultant in early 2008 to review its procedures and policies for cost recovery and to prepare a cost recovery policy and procedures manual.

2.14 In two previous audits, the ANAO found that regulatory agencies did not have consolidated policies and procedures documents to assist their staff and to inform stakeholders of their cost recovery arrangements. In 2004–05, the ANAO noted that ARPANSA did not have a documented cost recovery policy or other guidance addressing cost recovery.²¹ The ANAO made a recommendation, to which ARPANSA agreed, that ARPANSA develop a policy framework to guide its cost recovery function, in order to provide

²¹ ANAO Audit Report No.30 2004–05, *Regulation of Commonwealth Radiation and Nuclear Activities*, March 2005, p. 45, available at <www.anao.gov.au/publications>.

assurance that its cost recovery was consistent with better practice and government policy.²²

2.15 Similarly, in reporting on an audit of AQIS' cost recovery systems in 2000–01, the ANAO recommended that AQIS fully document its cost recovery policies to promote accuracy, consistency and understanding of its cost recovery.²³ In the 2003–04 follow-up to that audit, the ANAO found that AQIS had implemented this recommendation. AQIS had developed a *Fees and Charging Policy* document which it reviewed annually and made available on its website. This document, revised in September 2002, outlines the broad parameters AQIS adopted when setting fees and charges under cost recovery arrangements. AQIS stated that it designed the document for the use of AQIS's programs and their industry consultative committees in considering resourcing levels and fee and charging structures. AQIS also included *AQIS Charging Guidelines* for each of its programs on its website (for example, the *Meat Inspection Program Fees and Charging Guidelines*, January 2003).²⁴

Risk management

2.16 Business risk is the level of exposure to uncertainties that an organisation must understand and effectively manage as it executes its strategies to achieve its business objectives.²⁵ By managing their business risks well, regulatory agencies can contribute to the effectiveness with which they discharge their regulatory responsibilities. Ineffective management of risks can seriously impact on the agency's ability to achieve its objectives.

2.17 The cost recovery process has a number of business risks, and is therefore a factor that regulatory agencies should take into account when developing risk management strategies. The risks inherent in cost recovery can include:

- failure to accurately assign costs to activities;
- not setting fees to recover the full costs of products and services;

²² *ibid.* p. 50.

²³ ANAO Audit Report No.10 2000–01, *AQIS Cost-Recovery Systems*, p. 45, and ANAO Audit Report No.17 2003–04, *AQIS Cost-recovery Systems Follow-up Audit*, p. 29, available at <www.anao.gov.au/publications>.

²⁴ Available at <www.daff.gov.au/aqis/about/reports-pubs/fees-charging>.

²⁵ J DeLoach, *Managing Risk, Managing Value*, Pearson Education Ltd, London, 2000, p. 11.

- not aligning levy rates with the cost of the agency regulatory functions delivered to customers;
- failure to accurately forecast the demand for agency products and services; and
- cost recovery revenue not matching costs.

2.18 Managing risks effectively is particularly important when a regulatory agency operates on a full cost recovery basis because its financial viability depends on its revenue from fees and levies. Two of the audited agencies, NICNAS and IP Australia, relied fully on cost recovery revenue to fund their operations. In 2006–07, NICNAS recovered all of its costs (\$8.0 million)²⁶, and IP Australia recovered 98 per cent (\$120.5 million) of its total revenue (\$123.5 million) from fees and levies.²⁷

2.19 One of these agencies did not have a risk management plan which identified, assessed and outlined treatment options for its business risks. This could be an issue considering that the agency relied on its revenue from industry to meet its legal obligations as a regulator. During the audit, the ANAO recommended to this agency that it develop a risk management plan which included the cost recovery risks to the organisation and outlined risk reduction strategies. The agency advised that its review of cost recovery in early 2008 will include identifying financial risks related to its cost recovery function, determining the risks from not meeting key performance indicators identified in its operational plan, and proposing mechanisms to manage any identified risks.

2.20 The other full cost recovery agency had a risk management plan which identified and assessed its business risks, but did not include risk reduction strategies for these risks. The ANAO examined whether specific risk treatment options were included in the group operational plans for this agency's two main activity groups. One group had identified risks and proposed risk reduction strategies. The other group identified 'a failure to accurately estimate current and future income streams' as a cost recovery risk and included key initiatives targeted at controlling this risk in the overall plan. The ANAO suggested that it could improve its risk management by including risk reduction strategies in its agency plan. The agency advised that it will include

²⁶ Commonwealth of Australia, *Portfolio Budget Statements 2007–08 Health and Ageing Portfolio*, Budget Related paper No 1.12, 2007, p. 63, available at <www.health.gov.au/publications>.

²⁷ Commonwealth of Australia, *Portfolio Budget Statements 2007–08 Industry, Tourism and Resources Portfolio*, Budget Related paper No 1.14, 2007, p. 107, available at <www.industry.gov.au/publications>.

risk reduction strategies in its Risk Management Plan to ensure that it adequately assesses financial risks associated with the cost recovery function and develop treatment strategies.

2.21 The ANAO noted, however that both these agencies had internal policies to budget for an annual operational reserve. This suggests that, while they did not always have written risk reduction strategies, they were taking account of the risks associated with cost recovery in their financial planning.

2.22 The ANAO suggests that agencies should consider the business risks of cost recovery when developing organisational or divisional risk management plans, including treatment strategies. Risk management treatments will depend on the significance of issues, the size of the agency and the extent to which its financial viability depends on cost recovery. Such an approach contributes to good governance and provides reasonable assurance to agencies and customers that agencies will achieve organisational objectives within a tolerable degree of risk.

2.23 ITSA had the most comprehensive approach to identifying, assessing and treating risks, including risks associated with the cost recovery function. The ANAO considers that its approach represents an example of good management practice. ITSA's risk management plan contained a systematic process to identify, analyse, assess, manage and monitor risks.²⁸ Each branch, business line and functional area forwarded a copy of its risk register to the Finance Manager, who collated these into the organisation's risk register, and reported high to extreme residual risks to the Executive Board. Cost recovery risks included those associated with the complexity of accounting for receipts between separate activities, and system requirements related to reviews. Table 2.2 outlines the major features of this risk management approach.

²⁸ In compliance with Standards Australia, *Australia/New Zealand Standard: Risk Management*, AS/NZS 4360:2004, available for purchase from <www.riskmanagement.com.au>.

Table 2.2**Good risk management practice**

Features	Inclusions
Risk Management Plan (revised annually)	<ul style="list-style-type: none"> • risk criteria for determining likelihood and consequence; • a self assessment approach for risk identification and assessment; • a hierarchy of simple-to-use tools for risk identification and assessment; and • establishment of a risk register to identify, analyse, assess, manage and monitor all the agency's residual risks.
Risk Registers in branches, business lines and functional areas (revised annually and monitored by national managers)	<ul style="list-style-type: none"> • a description of the cost recovery risk; • the assessed level of the risk; • what existing controls or strategies are in place to prevent or minimise the risk; and • the proposed treatment strategies and person/s responsible to reduce the impact of the risk.

Source: ANAO analysis of ITSA's data.

2.24 The benefit of ITSA's risk management approach was that it:

- established risk criteria;
- assisted employees to consider risks and manage them, having regard to their potential impact on agency operations;
- assisted with risk treatment analysis;
- promoted consistency in risk management practices;
- provided a basis for regular reporting to the executive; and
- provided practical knowledge of best practice risk management to employees.

Costing methodology

2.25 Agencies need to have a robust costing methodology to determine their costs and to set their charges. Principle 3 of the Government's cost recovery guidelines states that:

Any charges should reflect the costs of providing a product or service and should generally be imposed by agencies on a fee for service basis or, where efficient, as a levy.²⁹

2.26 All products or services to be cost recovered should recoup at least their direct costs. Allocating direct costs to products or services is relatively straightforward. Allocation becomes more difficult where indirect and capital costs are involved.³⁰ The definitions of direct, indirect and capital costs included in the guidelines are shown in Table 2.3.

Table 2.3

Cost definitions

Costs	Definition
Direct costs	Costs that are directly and unequivocally attributed to a product. They include labour (including on-costs) and materials used to deliver products.
Indirect costs	Costs that are not directly attributable to a product and are often referred to as overheads. They can include corporate services costs, such as financial services, human resources, records management and information technology (IT).
Capital costs	Costs include the user cost of capital and depreciation. The user cost of capital is the rate of return that must be earned to justify retaining the assets in the medium to long term. Depreciation reflects the portions of the assets consumed each period in the production of outputs.

Source: Australian Government Cost Recovery Guidelines July 2005, p. 46.

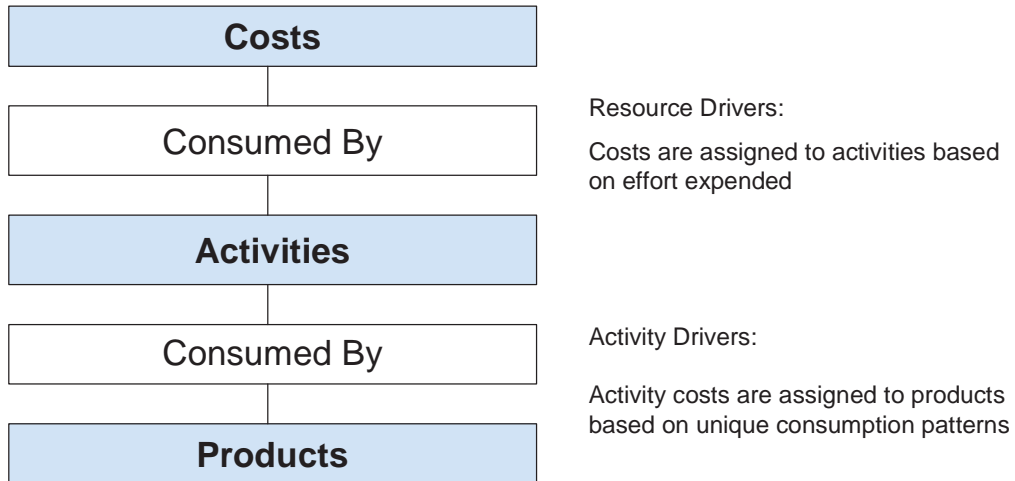
Activity Based Costing systems

2.27 Agencies can distribute indirect and capital costs in a number of ways. Under Fully Distributed Costing models,³¹ costs are allocated on a pro rata basis, for example, according to the number of staff involved in the activity or on the basis of the shares of direct costs devoted to the activity. One form of Fully Distributed Costing is Activity Based Costing (ABC), which is more accurate in how it allocates indirect costs. It links an organisation's products and services (outputs) to the activities used to produce those outputs, which in turn are linked to the organisation's costs. Figure 2.1 outlines a typical ABC model.

²⁹ Department of Finance and Administration, *Australian Government Cost Recovery Guidelines July 2005*, Financial Management Guidance No.4, Canberra, 2005, p. 2, available from <www.finance.gov.au>.

³⁰ *ibid.*, p. 49.

³¹ Australian Government Competitive Neutrality Complaints Office Research Paper, *Cost Allocation and Pricing*, 1998, available at <www.pc.gov.au/agcnco/reports/research/costallo/index.html>.

Figure 2.1**ABC model**

Source: G. Cokins, A. Stratton and J. Helbling, *An ABC Manager's Primer*, McGraw-Hill, 1992, p. 11.

2.28 All three audited agencies had developed an ABC or similar costing methodology to determine the cost of providing each service delivered. Agencies had included the direct costs of each service, as well as the costs shared with other activities (indirect costs) and capital costs, such as depreciation, in the costs of services.

Documenting the costing system

2.29 One agency produced business rules for its ABC system which detailed how it assigned costs to its activities. However, the ANAO noted that the procedures for the operation of its system were out of date. Another agency had produced a set of instructions for its staff on how to assign costs to its activities using its costing system. The third agency had not produced any written guidance on the operation of its costing methodology.

2.30 During the audit, one agency advised that it proposes to engage an independent consultant in 2008 to document how its costing system allocates and distributes funds across its cost centres. Another agency advised that it intends to develop a manual to ensure the consistent application of direct and indirect costs to its cost recoverable activities.

2.31 Documentation on how the agencies allocated their direct, indirect and capital costs to their activities needs to be written in a user-friendly fashion for easy reference by their staff, and kept up-to-date and accessible. Providing a succinct explanation of the methodology used by each agency to assign costs to

activities would assist staff in understanding the agency's approach to cost recovery and improve the consistency of its application.

Setting cost recovery charges

2.32 Setting fees and levies requires consideration of direct, indirect and capital costs, fluctuating activity levels, and any customer and stakeholder concerns. Once regulatory agencies have an understanding of the costs associated with their activities and the likely demand for products and services,³² they are in a position to determine the likely rates of their charges.

2.33 However, regulators need to balance the accuracy and precision of their charge setting mechanisms against the costs. The guidelines point out that a very precise approach to charging can itself be costly, and needs to be weighed against the likely benefits.³³ In addition, regulators have to balance the level of what they can charge for services against what the market will bear, based on consultation with their customers and stakeholders. The guidelines state agencies should set charges to recover the full costs of regulation, with partial cost recovery sought only where new arrangements are phased in, where government endorsed community service obligations exist and/or for other explicit policy purposes. Where conflict exists with a policy objective and charging the full cost of a product or service, an agency may seek the Finance Minister's approval for partial cost recovery.

Fees and levies

2.34 The Government's guidelines state that, where possible, it is desirable to charge for activities directly through fees in order to realise efficiency gains.³⁴ However, sometimes agencies cannot directly attribute the cost of a product or service to an individual beneficiary. In these cases, the guidelines state that it may be more efficient to use levies.

2.35 All audited agencies had made decisions, consistent with the requirements of the guidelines, on whether to use fees or levies to recover particular regulatory costs. Agencies used fees if costs could be directly linked to the delivery of a service, and the individual beneficiary of the service could be identified. Alternatively, levies were used where it was not possible to

³² It is this variable which causes agencies the most uncertainty and risk in setting fee rates.

³³ Department of Finance and Administration, *Australian Government Cost Recovery Guidelines July 2005*, Financial Management Guidance No.4, Canberra, 2005, p. 43, available from <www.finance.gov.au>.

³⁴ *ibid.*, p. 41.

allocate costs to an individual beneficiary. The costs of some regulatory activities are therefore spread across all customers subject to the regulation.³⁵

2.36 One audited agency used only fees to recover its costs, while the other two agencies used both fees and levies. The latter two had conducted a policy review, as required by the guidelines, and determined that the most efficient and effective method to recover the costs of certain activities provided to groups of customers was through charging a levy.

2.37 For example, ITSA used levies to recover the costs of the following regulation, compliance and enforcement activities which were aimed at maintaining their customers and stakeholders confidence in the personal insolvency system:

- information and education;
- monitoring compliance and investigations;
- reviews of certain decisions made by trustees;
- administration of bankruptcies with potential assets; and
- investigation of Bankruptcy Act offences.

Recommendation No.1

2.38 The ANAO recommends that, in order to increase transparency for stakeholders and assist staff to apply the Government's cost recovery guidelines, agencies should:

- (a) over time, consolidate their cost recovery policy and procedures into a single reference document; and
- (b) ensure documentation outlining their costing systems is up-to-date, accessible and easily understood.

Agencies' responses

2.39 Each of the audited agencies and Finance agreed with the recommendation. Specific comments provided were:

³⁵ In this case, services were being delivered to a group.

IP Australia

IP Australia agrees with the recommendation. IP Australia will consolidate the cost recovery related policy and procedures and implement a schedule of quality assurance reviews on related documentation to ensure accuracy, currency, accessibility and readability.

Department of Finance and Deregulation

The Department of Finance and Deregulation (Finance) supports the report's recommendation. Finance agrees that the consolidation of cost recovery policy and procedures into a single document that is current, accessible and easily understood should serve as a means to enhance the transparency and integrity of the cost recovery information produced by FMA agencies and CAC bodies, thus providing further assurance of compliance with cost recovery policy.

Summary of findings

2.40 Each of the audited agencies had appropriate legislation which provided the authority to impose the fees and levies that they charged for recovering the costs of their activities. Two agencies obtained legal advice to assure themselves that they had valid authority for their cost recovery charges.

2.41 All of the audited agencies had internal cost recovery policies and procedures which, on the whole, complied with the Government's guidelines. However, they were contained in a range of documents which made them difficult to access. The ANAO considers that, before or in conjunction with, the next cost recovery review, agencies should consolidate their cost recovery policy and procedures into a single reference document. This would assist staff and inform customers and stakeholders about how they apply the Government's cost recovery guidelines.

2.42 Two of the audited agencies had identified the business risks associated with their cost recovery function. However, one agency had not outlined risk treatment options. The other audited agency had not identified, assessed and proposed treatment options for its cost recovery risks.

2.43 The audited agencies had developed an ABC or similar costing methodology which they used to determine the cost of providing each service they delivered. However, they could improve the documentation they provided to staff on their costing systems.

2.44 The audited agencies had made decisions, consistent with the requirements of the Government's guidelines, on whether to use fees or levies to recover particular regulatory costs.

3. Implementing Cost Recovery Arrangements

This Chapter assesses regulatory agencies' implementation of cost recovery arrangements and management of cost recovery revenue. It also examines the mechanisms agencies used to check customer understanding and acceptance for costing methodologies and regulatory charges.

Applying cost recovery procedures

3.1 As noted in Chapter 2, the audited agencies had developed cost recovery policies and procedures which, on the whole, complied with the Government's guidelines. This Chapter assesses how the agencies implemented their cost recovery procedures and applied their costing methodology to determine their costs and set fees and levies.

Determining costs

3.2 Using their costing methodologies, agencies determined their direct, indirect and capital costs and allocated them to their cost recovery activities using a variety of approaches.

Direct costs

3.3 The agencies allocated their direct costs to activities based on average staffing levels or the number of full-time staff employed in the areas delivering the activities. Where the same staff delivered a number of activities, agencies developed systems to allocate costs between activities. One agency used time recording to determine the amount of time staff spent on each activity, and then costed that time and allocated it to each recoverable activity. Another agency used staff surveys to determine the amount of time spent on each activity, and then validated this information by conducting interviews and using time recording to cost staff time to each recoverable activity.

Indirect and capital costs

3.4 Agencies generally distributed indirect and capital costs to each activity either proportionally based on the numbers of staff engaged in that particular activity or on the basis of the shares of direct costs devoted to the activity. Table 3.1 summarises how each agency allocated costs to activities.

Table 3.1**Allocation of costs**

	NICNAS	IP Australia	ITSA
Direct costs	Time sheets used to determine the amount of time staff spent on each activity. Employee time then costed on a weighting of staff at level.	Costs allocated to customer groups then to each of the cost recoverable activities based on employee effort.	Interviews with managers and staff surveys used to calculate how much employee time spent on activities, subsequently corroborated by selective time recording.
Indirect costs	Activity based costing system used to allocate shared and corporate costs based on average staffing levels. ³⁶	Activity based costing system used to allocate most corporate overheads on the basis of average staffing levels. IT costs allocated based on IT usage, and accommodation costs on an actual cost basis or a per square metre usage basis.	Cost model used to allocate human resource, IT, legal and rent costs primarily on the basis of staff head counts.
Capital costs	Separate cost centre maintained for each principal area of activity to which depreciation allocated based on the portions of the assets consumed for the relevant period.	Depreciation costs captured and allocated to activities based on the portions of the assets consumed for the relevant period.	Depreciation allocated to activities based on staff involved in each activity. This excludes IT costs which are directly allocated to activities.

Source: ANAO analysis of agency data.

3.5 Two regulatory agencies previously audited by ANAO had developed costing systems similar to those observed in the agencies included in this audit. In 2006–07, the ANAO noted that APVMA used an ABC model to identify the cost of its regulatory and corporate activities.³⁷ This involved APVMA grouping its activities (into registration, compliance, chemistry and revenues, and other services); holding staff workshops to document key processes for each activity group; and identifying the resources and costs of each activity group. Using its model, APVMA identified that the principal determinant of its

³⁶ Average staffing levels calculated on weighted average of staff at level.

³⁷ ANAO Audit Report No.14 2006–07, *Regulation of Pesticides and Veterinary Medicines*, pp. 78–79, available at <www.anao.gov.au/publications>.

costs was the time taken by staff or external parties to perform activities. Therefore, any improvements in the timeliness of processing applications for registration had the potential to reduce the cost of regulation in APVMA. APVMA advised that it will review its cost recovery arrangements again in 2007–08. The ANAO suggested that in conducting its next review, APVMA consider the costs and benefits of collecting data on the time taken by staff to process individual applications, and obtain information from providers of scientific advice on the actual time taken to provide that advice.

3.6 The ANAO's 2004–05 audit of TGA noted that it also allocated revenues and expenses for its regulatory functions using information captured by an ABC system.³⁸ TGA advised that it conducted a review of its ABC model every two years to ensure that it aligned costs and revenues and minimised cross-subsidisation. The ANAO considered that, to meet its obligations as a regulator operating under cost recovery arrangements, TGA could provide more information to its stakeholders about the relationship between its fees/charges and the costs of activities.

Forecasting demand for products and services

3.7 Once agencies have determined the costs of individual activities, they need to forecast the likely level of demand for their products and services so they can set charges to reflect their costs. All the audited agencies had systems to forecast the demand for their products and services. These included projections based on an analysis of historical records and, in some cases, the consideration of a variety of economic indicators which affected regulated industries. Overall, the level of cost recovery in all the audited agencies was in line with costs. However, predicting the likely demand for products and services was difficult and often revenue did not align with costs.

3.8 The ANAO acknowledges that agencies found it difficult to predict the demand for their products and services. It also took a certain amount of time for agencies to make the necessary adjustments to fees and levies when there were variations in activity levels. This was due to agencies' concern to provide certainty to customers by not making too many changes to fees and levies; and to ensure charges reflected efficient costs under the Government's guidelines.

³⁸ ANAO Audit Report No.18 2004–05, *Regulation of Non-prescription Medicinal Products*, pp. 114–116, available at <www.anao.gov.au/publications>.

Determining fees and levies

3.9 Determining the level of fees and levies involves costing the relevant activities which deliver products and services to customers, and forecasting the likely level of demand for those products and services.

3.10 The audited agencies set their fees by breaking down services into their components and then costing them by:

- estimating the cost of the staff employed in the delivery of each service;
- allocating indirect and capital costs based on average staff numbers or the number of full-time staff employed in the areas delivering the activities; and
- factoring in the expected demand for services, often referred to by agencies as activity levels.

3.11 The two audited agencies which used levies set levy rates by costing those activities which were delivered to the regulated group, determining the number of organisations or individuals which required regulation or the pool of funds available to the beneficiaries of the regulation. They then either set levy rates to apply to all members of the group equally, or established levy bands so that those making different calls on the regulator's resources paid the same levy.

3.12 NICNAS determined its registration levy by calculating whether the projected registration revenue, based on the expected level of registration, was adequate to fund those activities in its Operational Plan that were funded through registration monies.

3.13 Similarly, ITSA set its levies by:

- identifying the cost of its regulation, compliance and enforcement activities;
- offsetting that cost by the interest earned on funds held in estate bank accounts under bankruptcies and personal solvency agreements;
- estimating the expected levels of realisations in bankruptcies and personal insolvency agreements; and
- expressing the amount not recovered through interest as a percentage of the level of realisations.

3.14 In 2004–05, the ANAO found that ARPANSA had not based its fees on a robust analysis of the costs of regulating its clients or providing services, as it could not readily identify and monitor the cost of regulatory effort by type of service due to system limitations. It had set its fees on the basis of comparability to fees set by State and international regulators. ARPANSA agreed to the ANAO’s recommendation that it required sufficiently reliable data and analysis to support management decisions on cost recovery, including recording relevant costs and aligning fees and charges with costs.³⁹

Strategies used to set fees and levies

3.15 As noted in Chapter 1, regulatory agencies can administer pre-market activities such as registrations and approvals and issuing exclusive rights or privileges, or post-market activities which involve monitoring compliance, investigation and enforcement. The ANAO noted that, depending on the type of regulation administered, each agency employed different strategies to set the levels of fees and levies. The strategies that agencies employed were consistent with the objectives of the Government’s cost recovery guidelines, other government policy objectives and the requirements of the various industry sectors which they regulated.

3.16 IP Australia issues exclusive rights and privileges and had adopted a cost recovery strategy designed to accelerate the commercial application of ideas, promote innovation and reduce barriers to market entry for its customers. IP Australia chose this strategy as there was a possibility that IP Australia’s customers will be required to pay ‘up front’ for the approval of a product that may prove to be a commercial failure. Further, because the product has not entered the market, the supplier may not have the cash flow necessary to meet cost recovery charges.

3.17 The Government’s cost recovery guidelines suggest regulatory agencies can avoid this problem by spreading the cost of regulation over the market life of the product by lowering initial assessment fees and raising ongoing annual fees—termed ‘back-loading’. This has the advantage of giving the producer access to sales revenue to cover regulatory costs.⁴⁰ IP Australia adopted such an approach to its fee setting for Patents and Trade Marks to meet these aims.

³⁹ ANAO Audit Report No.30 2004–05, *Regulation of Commonwealth Radiation and Nuclear Activities*, p. 49, available at <www.anao.gov.au/publications>.

⁴⁰ Department of Finance and Administration, *Australian Government Cost Recovery Guidelines*, July 2005, Appendix A, available at <www.finance.gov.au>.

3.18 NICNAS recovered the costs of its compliance, information and education, existing chemical reviews and scheme support (including international activities) through the imposition of a registration levy. NICNAS applied this charge as a three-tiered levy based on the volume of the manufactured or imported product requiring regulation. It levied a higher registration charge on companies with larger industrial chemicals turnovers to reflect the greater benefit they obtained from existing chemical reviews, reform initiatives and international activities.

Managing cost recovery revenue

3.19 The ANAO examined whether regulatory agencies recovered the full costs of their products and services as required by Principle 1 of the guidelines, and had systems in place to address instances where cost recovery revenue did not match the costs incurred by the agency. As noted earlier, this can occur when there are fluctuations in the demand for an agency's products or services which result in an over recovery or under recovery of revenue. Because agencies' forecasts of their likely demand are never exact due to the many variables that influence customer behaviour, there are times where revenue does not align with costs. This can result in agencies having a short period of cross-subsidisation between its activities until likely demand is established and charges revised.

Matching cost recovery revenue with costs

3.20 All audited agencies monitored revenue and costs on an ongoing basis through the use of internal management and financial reports. Agencies addressed mismatches at least annually in order to match charges as closely as possible with the cost of individual activities. Two agencies had some cross-subsidisation between activities which they were taking action to remove. The other audited agency did not have any cross-subsidisation between its activities.

3.21 An example of the difficulties encountered by agencies in matching revenue with costs was apparent in IP Australia. During 2005–06 there was a major shift in the volumes of applications between Patents and Trade Marks as a result of strong growth in Trade Marks applications. IP Australia adopted a cautious approach to fee changes, as it did not wish to reverse any adjustments within a short time after they made them. Therefore, it delayed revising fees until it conducted further analysis of its costs with a view to estimating projected volumes over the forward estimate period and consulted with

customers and stakeholders on other government policy requirements (particularly innovation policy).

Operational reserves

3.22 Two of the audited agencies had established an internal policy to budget for an operational reserve in order to ensure the financial sustainability of their operations and lessen the risks associated with making calls on Government funding. One agency budgeted for an operational reserve to cover contingencies and reform activities. The agency used any funds collected over and above its budget to increase reform activities or reduce fees and levies. The other agency had a policy to plan for budget surpluses at the agency level in each separate financial year. This policy allowed the agency to plan for future investment to improve its customer services in line with its objectives.

3.23 The third agency did not retain revenue from fees and levies to fund its operations. However, the Government required this agency to explain any variations to its revenue forecast through the Budget process. The ANAO noted that cost recovery revenue in this agency had been fairly consistent over the last three years, which had assisted the agency in making revenue forecasts.

3.24 Principle 6 of the guidelines (see Table 1.1) states that:

Where possible, cost recovery should be undertaken on an activity (or activity group) basis rather than across the agency as a whole. Cost recovery targets on an agency-wide basis are to be discontinued.

3.25 The two agencies which budgeted for operational reserves advised they had consulted their industry bodies and obtained agreement to this approach. They stated that the beneficiaries of the operational reserve funds were their customers. The reserve funds enabled the agencies to increase capital investment, streamline customer services and/or fund reform initiatives, and where possible, to reduce regulatory charges.

3.26 These agencies detailed their strategies to budget for an operational reserve, and their reasons for doing so, in their CRISs, which Finance approved. Finance advised that it has no objection to the use of small operational reserves provided that any surplus remains linked to the activity in question. In view of the above, the ANAO considers that the agencies approach is consistent with the Government's guidelines.

Under recovery of costs

3.27 The two agencies which budgeted for an operational reserve reduced the possibility of under recovering their costs by adopting such a strategy. One agency advised that it budgeted for an annual operational reserve of ten per cent of revenue. This agency also advised that it employed staffing practices which provided the agency with the flexibility to react in a timely fashion to fluctuations in its activity levels and to reduce its costs to prevent under recovery. These practices included employing a mix of ongoing and non-going employees and some contract staff, and maintaining a mix of skills that facilitated the mobilisation of staff from areas of low activity to high activity.

3.28 The other agency had not set a rate for its operational reserve, but budgeted for a surplus in each financial year. This agency had made two major budget commitments ('sustainable operations' and 'no budgeted loss in any year') and needed to obtain permission from its Minister before budgeting for a loss or recording an actual loss.⁴¹ The final agency budgeted for revenue to equal costs.

3.29 In three previous audits, the ANAO found that regulatory agencies had experienced management issues in matching regulatory charges with costs. In 2006–07, the ANAO noted that APVMA maintained a risk reserve to protect itself against unexpected falls in its revenue.⁴² In 2004–05, the ANAO found that TGA had one area operating in surplus while another was operating in deficit. It was thus using reserves in one area to offset deficits in another. TGA was in the process of making significant changes to its regulatory charges in order to move to a full cost recovery position.⁴³

3.30 Previously, in 2000–01, the ANAO noted that AQIS' revenue often fell short of or exceeded the amount required to deliver services due to the cyclical nature of industries it regulated. However, AQIS had adopted a strategy to recoup under recoveries through future revenue collection against the relevant

⁴¹ Estimates Memorandum 2007/44 Budget Operational Rules paragraph 56 and Estimates Memorandum 2007/50 Finance Ministers Instructions, state agencies need to seek approval from the Finance Minister before budgeting for a loss.

⁴² ANAO Audit Report No.14 2006–07, *Regulation of Pesticides and Veterinary Medicines*, December 2006, p. 80, available at <www.anao.gov.au/publications>.

⁴³ ANAO Audit Report No.18 2004–05, *Regulation of Non-prescription Medicinal Products*, p. 115, available at <www.anao.gov.au/publications>.

program, and it placed over recoveries in reserve accounts to prevent surpluses in one program being used to offset deficits in another program.⁴⁴

3.31 Overall, regulatory agencies recognised the need to develop strategies to manage their cost recovery revenue. This included having systems to monitor revenue and costs, and the capacity to react to changing circumstances. Those agencies which relied on cost recovery revenue to fund their operations usually did so through budgeting for a small reserve. This was used to ensure their continued financial viability and to protect themselves against the under recovery of costs.

Checking customer understanding and acceptance of costing methodology

3.32 The guidelines state that in order to improve the visibility of cost recovery arrangements, agencies should adopt costing models sufficiently detailed to allow the Government and, where relevant, stakeholders and customers, to analyse their production costs. This also assists agencies to improve their efficiency and accountability.⁴⁵ Consultation with stakeholders on cost recovery should therefore include checking their understanding and acceptance of the methodology the agency has used to determine its costs and set its fees and levies.

3.33 The ANAO found that the audited agencies consulted with their customers and stakeholders on an ongoing basis with regard to their costing methodology and charge rates. Agencies also consulted their customers and stakeholders, and took account of their views and comments, when reviewing their cost recovery arrangements and proposing changes to fees and levies. This section of the report covers the former, while the latter is covered in Chapter 4.

Consultative mechanisms

3.34 The audited agencies had established industry consultative mechanisms which they used to brief customers and stakeholders on how they determined costs and set charges. This involved explaining the overall methodology the agency used to recover its costs, including why it had

⁴⁴ ANAO Audit Report No.10 2000–01, *AQIS Cost-Recovery Systems*, September 2000, p. 33, available at <www.anao.gov.au/publications>.

⁴⁵ Department of Finance and Administration, *Australian Government Cost Recovery Guidelines July 2005*, Financial Management Guidance No.4, Canberra, 2005, p. 47, available from <www.finance.gov.au>.

selected fees or levies to recover particular costs, and the direct, indirect and capital costs included in its charges. In addition, the audited agencies provided to customers and stakeholders, through their industry consultative mechanisms, financial reports which detailed the cost recovery revenue collected against the agency's costs for a particular period. This provided customers and stakeholders with information on whether agencies were recovering cost recovery revenue in line with their costs.

3.35 Agencies' industry consultative mechanisms provided an opportunity for the agencies' major customer groups and stakeholders to comment on the agencies costing methodology, its process for determining fees and levies and whether agency charges reflected its costs.

Customer surveys

3.36 The three agencies conducted customer satisfaction or opinion surveys to gauge how customers and stakeholders viewed the quality of their services. These provided agencies with an opportunity to ask customers and stakeholders about their understanding and acceptance for the agencies' cost setting mechanisms and charge rates. All audited agencies provided an opportunity for respondents to make additional comments at the end of their surveys on any issue of concern.

3.37 In one agency's survey, 12 respondents had provided comments on the appropriateness of its cost recovery methodology. Such comments included 'I don't receive benefits from payments' and 'fees are excessive for my type of business'. This agency used its survey results to identify areas where the agency could make improvements.

3.38 One agency included specific questions in its survey on customer satisfaction with its fee structures and rates. It found a high degree of overall satisfaction, with the great majority of customers rating fees as low, very low or moderate. The ANAO considers that the inclusion of survey questions on charges had provided this agency with valuable information about how its customers and stakeholders viewed its cost recovery arrangements.

3.39 During the audit, the ANAO suggested that agencies include direct questions on cost recovery in customer satisfaction surveys, as this was likely to provide a more detailed picture of how the agency's customers and stakeholders viewed its costing and charging methodology. One agency, which had not previously included such questions, advised that it will do so in its next survey in 2008.

Letters of complaint

3.40 The ANAO noted that NICNAS received 51 letters of complaint after extending its two-tiered registration levy to a three-tiered registration levy.⁴⁶ This required organisations and individuals, who were previously exempt from the payment of a levy, to pay a charge for the first time. NICNAS responded to all complaints from new registrants by explaining the rationale for the charge and the consultation which had taken place prior to its implementation.⁴⁷

3.41 During the audit, the ANAO suggested that NICNAS examine whether all registrants in the new tier were making the same calls on NICNAS' regulatory resources in order to determine whether it had applied the levy in an equitable manner. NICNAS advised that it plans to analyse the responses to its June 2007 Customer Survey to ascertain the degree of use of NICNAS' regulatory resources by registrants in various tiers. If required, NICNAS will design a separate survey in 2008–09, targeting registrants from each tier to determine their resource usage.

3.42 Previous ANAO audits also found that customers and stakeholders of regulatory agencies often raised their concerns about the agency's costing methodologies and regulatory charges. For example, the ANAO's 2004–05 audit of ARPANSA found that, in response to fee increases, a number of its clients had requested that the agency justify the basis of its fees and charges.⁴⁸

Summary of findings

3.43 The regulatory agencies audited by the ANAO employed methodologies for setting fees and levies which were consistent with the Government cost recovery guidelines. These methodologies involved quantifying direct, indirect and capital costs, allocating these costs to activities, and setting fees and levies to reflect these costs.

3.44 The level of cost recovery in the audited agencies was generally in line with the cost of providing the activity, with variations attributable to fluctuations in activity levels. While agencies had difficulties in forecasting

⁴⁶ Department of Health and Ageing, *NICNAS Annual Report 2004–05*, 2005, p. 43, available at <www.nicnas.gov.au/publications>.

⁴⁷ NICNAS consulted widely with a range of stakeholders including industry, the public and government agencies through a series of public consultations and focus groups.

⁴⁸ ANAO Audit Report No.30 2004–05, *Regulation of Commonwealth Radiation and Nuclear Activities*, March 2005, p. 46, available at <www.anao.gov.au/publications>.

activity levels, due to the nature of the industries that they regulated, they used various means to derive projections. These included analyses of historical records and the consideration of a variety of economic indicators which affected regulated industries.

3.45 All audited agencies regularly monitored revenue and costs through the use of internal financial and management reports in order to match charges as closely as possible with the cost of individual activities.

3.46 Agencies checked their customers and stakeholders understanding and acceptance of their costing methodology and regulatory charges through industry consultative mechanisms and customer surveys.

3.47 Regulatory agencies recognised the need to develop strategies to manage their cost recovery revenue. This usually involved budgeting for a small reserve to protect them against under recovery of costs.

4. Reviewing and Monitoring Cost Recovery

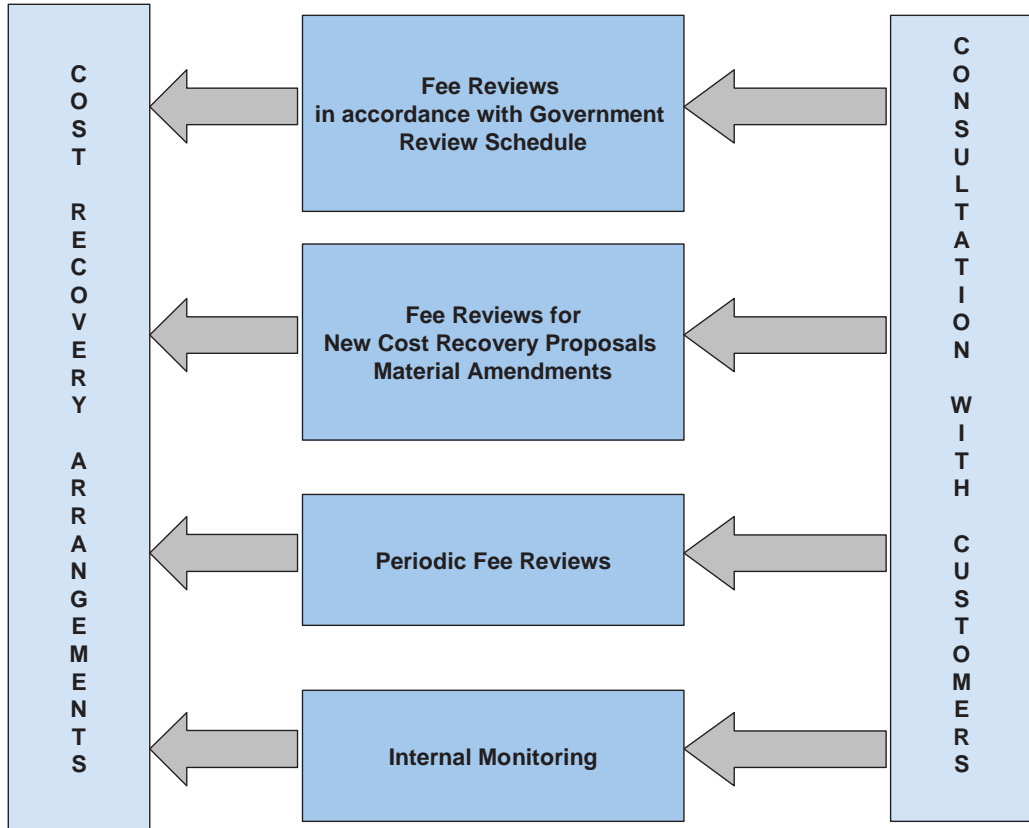
This Chapter examines the processes used by regulatory agencies in conducting cost recovery reviews and developing CRISs, reviewing and monitoring cost recovery arrangements, and consulting customers and stakeholders during cost recovery reviews.

4.1 The Government's guidelines specify that agencies should regularly monitor and review their cost recovery policy, procedures and implementation to ensure ongoing appropriateness. This includes conducting cost recovery reviews at least every five years consistent with the Government's review schedule for existing cost recovery arrangements, and when proposing new cost recovery arrangements or making material amendments to existing arrangements.⁴⁹ Additionally, agencies should establish mechanisms for ongoing monitoring of their cost recovery arrangements, conduct periodic reviews in order to make adjustments in response to changing circumstances and consult with their customer and stakeholders during fee reviews. Figure 4.1 shows the reviewing and monitoring processes outlined in the guidelines.

⁴⁹ Material amendments are changes to fees/levies greater than movements in the Consumer Price Index.

Figure 4.1

Reviewing and monitoring cost recovery



Source: Adapted from Australian Government Cost Recovery Guidelines.

Cost recovery reviews and impact statements

Reviews under the Government review schedule

4.2 The guidelines require each agency with significant cost recovery arrangements to conduct a review of its existing cost recovery arrangements periodically but no less frequently than every five years to confirm compliance with the Government's policy. Finance requires agencies to submit a CRIS following these reviews. Principle 11 of the guidelines (see Table 1.1) states that:

All agencies with significant cost recovery arrangements will need to prepare a CRIS, unless they have prepared a Regulation Impact Statement (RIS) that also addresses cost recovery arrangements against these guidelines, and must include a summary of the CRIS in their portfolio budget submissions and

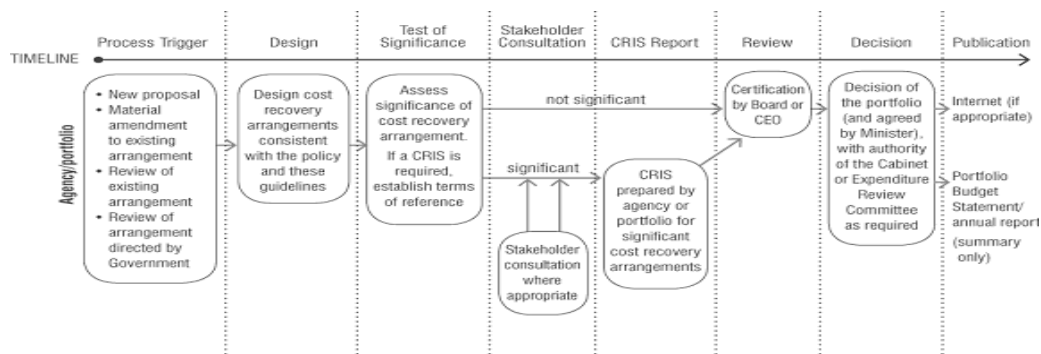
statements. The chief executive, secretary or board must certify that the CRIS complies with the policy and provide a copy to Finance.

4.3 An agency's circumstances can change and cost recovery arrangements that were once appropriate may no longer be justified. For example, there may be changes in the cost of delivering products and services, or the demand for products and services may increase or decrease. Finance encourages agencies to submit draft CRISs to them for comment when proposing new cost recovery arrangements or making material amendments to existing arrangements. However, the guidelines only require that final certified CRISs be provided to Finance.

4.4 Figure 4.2 outlines the CRIS process.

Figure 4.2

CRIS development process summary



Source: Australian Government Cost Recovery Guidelines, p. 53.

4.5 NICNAS decided to conduct a review of its existing cost recovery arrangements and produce a CRIS every five years, IP Australia every three years and ITSA every two years. The ANAO found that the audited agencies had conducted their reviews in accordance with the Government's schedule and had produced a CRIS which summarised their cost recovery approach against the five-stage process suggested in the guidelines. This included:

- a policy review to determine which activities should be cost recovered;
- a check on the efficiency and effectiveness of the design and implementation of the cost recovery system;
- a description of the development of the CRIS;
- an outline of ongoing monitoring and review of cost recovery arrangements; and

- detail of cost recovery reporting arrangements.

4.6 The ANAO found that the cost recovery arrangements detailed in each agency's CRIS were consistent with its practice. For example, during its 2005 fee review, IP Australia conducted a policy review of its customer groups. The policy review concluded that customers received an 'exclusive capturable commercial benefit' and, in accordance with the guidelines, customers should pay for the cost of the administration conducted in receiving the commercial benefit. IP Australia had established mechanisms to recover its costs and had an internal cost recovery policy which directed its action.

4.7 The 2005 review confirmed that IP Australia set its fees to recover the full cost of its IP rights. It did this by keeping application fees low to promote innovation and reduce barriers to market entry and increased annual renewal fees later in the IP rights life cycle. Consistent with this objective IP Australia chose not to increase any patent application fees during its 2005–06 fee review in order to keep its entry cost low, although it increased annuity fees later in the budget period. Also, IP Australia reduced the Trade Mark registration fee during its 2006–07 fee review to keep entry costs low and increased its fees for annual renewals to balance cost recovery revenue across the four year budget period. These actions were consistent with the strategy described in its 2006 CRIS.

4.8 In addition, the audit confirmed that IP Australia was using the ABC system described in its CRIS to allocate direct, indirect and capital costs to its recoverable activities. It also had systems to forecast activity levels and this informed the setting of its fees.

4.9 In its 2005 review, NICNAS determined which activities it should recover using fees and which activities should be recovered using levies. The audit confirmed that NICNAS implemented its fees and levies in the manner described in its CRIS. It derived the rate of fees from the cost of staff engaged in each chemical assessment, with indirect and capital costs applied on a proportional basis depending on the number of staff employed against each activity. It applied levies to specific services which provided identifiable benefits to customers but where there was no single beneficiary. In addition, the audit confirmed NICNAS had a cost model which assigned costs to its recoverable activities. It consulted with its Industry Government Consultative Committee before implementing proposed changes to its fees and levies, and it applied annual increases to its fees and levies in accordance with its internal cost recovery policy.

4.10 Similarly, ITSA had implemented its cost recovery function in the manner described in its February 2005 and June 2006 CRIS.⁵⁰ It applied its fees and levies to those activities and functions described in its CRIS and its cost model assigned direct, indirect and capital costs to its recoverable activities. It consulted with its Cost Recovery Reference Group before implementing proposed changes to its fees and levies.

Submission of CRIS to Finance

4.11 The audited agencies submitted to Finance CRISs which were certified by either their chief executive or secretary confirming they complied with the Government's guidelines. The ANAO noted that Finance requested IP Australia to amend and resubmit the CRIS it prepared in February 2005. IP Australia submitted its revised CRIS to balance its cost recovery budget with its four year budget forecast.⁵¹ Finance accepted IP Australia's revised CRIS.

Reporting of the CRIS

4.12 Each audited agency published a summary of its CRIS in its Portfolio Budget Statement in accordance with the cost recovery guidelines. They also posted a summary of their CRIS on their websites for the benefit of their customers and stakeholders.

Fee reviews for new policy arrangements

4.13 As noted earlier, as well as the Government-scheduled reviews of existing cost recovery arrangements, the guidelines state that agencies need to conduct a fee review and produce a CRIS when proposing new cost recovery arrangements or when making material amendments to existing arrangements.

4.14 ITSA had done three fee reviews since its first CRIS in February 2005. ITSA's second CRIS was to document material amendments and provide assurance to customers and stakeholders with respect to the level of proposed fees and charges before their introduction. ITSA's third CRIS in April 2007 was prepared to ensure that the costs associated with the new registration system for debt agreement administrators was recovered appropriately. ITSA's fourth CRIS was raised due to the introduction of the *Bankruptcy (Estate Charges) Amendment Act 2007*, which extended the realisations charge and interest charge to apply to moneys recovered in debt agreements.

⁵⁰ ITSA detailed in its 2005 CRIS its intention to complete another CRIS in 2006, immediately prior to the introduction of its new fees and charges regime on 1 July 2006.

⁵¹ These budgets did not balance in the first CRIS and Finance believed IP Australia's budget forecast should be the same as the sum of its cost recovery outputs.

4.15 NICNAS had no new cost recovery policy arrangements or material amendments to existing arrangements since their first CRIS under the Government's review schedule. IP Australia produced two additional CRISs after its first CRIS in February 2006. These were in January 2007 for the introduction of two new trade mark fees pursuant to the passing of the *Intellectual Property Laws Amendment Act 2006*, and in February 2007 for the introduction of a new patents fee.

Mechanisms used to monitor and review fees and levies

4.16 The guidelines state that the extent of the ongoing monitoring of fees and levies depends on the significance of cost recovery arrangements and the impact on stakeholders. All the audited agencies had mechanisms to regularly monitor and review their fees and levies.

Monitoring processes

4.17 The audited agencies used internal management reports to monitor their fees and levies. These reports generally monitored cost recovery revenue against the agency's budget and expenses. The ANAO noted that the agencies used these reports to monitor the status of cost recovery targets and actual results, and to provide a revised profile on any issues leading up to their fee reviews.

4.18 IP Australia monitored its cost recovery arrangements using monthly financial reports and quarterly financial and ABC reports. These reports monitored revenue received against revenue expected, and alerted it to changes in activity levels and costs across its customer groups.

4.19 NICNAS produced a monthly ABC report and a quarterly financial report. The monthly ABC report detailed each new chemical assessment activity and progress against the expected completion date and revenue earned so far against the established fee. This provided NICNAS with information to calculate its forward estimates. The quarterly financial report, which NICNAS provided to its Industry Government Consultative Committee, detailed total revenue derived from its fees and levies and compared it to its operating expenses for the period and year to date. This report also formed the basis for consultation with its customers and stakeholders during its fee reviews.

4.20 ITSA produced a monthly Chief Finance Officer's report which incorporated a detailed cost recovery report. In addition, each business area produced a quarterly report for the Executive. This report analysed

performance in each area of ITSA's operations. Quarterly revenue was compared to revenue in the previous quarter, the annual revenue estimate was revised, trends highlighted, risks identified, key strategies and significant activities for the next quarter documented and recommendations made to the Executive Board. The report assisted the Executive to understand the major business issues effecting ITSA's bankruptcy functions.

Periodic fee reviews

4.21 The ANAO noted that all the audited agencies also conducted reviews of their regulatory charges at least annually to determine whether they needed to revise their fees and levies.

4.22 NICNAS conducted annual fee reviews to enable it to continue satisfactorily discharging its mandatory obligations under its Act. This process involved applying its costing methodology to revise fees and levies, in consultation with its Industry Government Consultative Committee. NICNAS applied a price escalation formula⁵² to reflect the major costs in delivering its services which were staff related. NICNAS did not apply the price escalation unilaterally, but considered it in the context of each year's revenue, expenditure and performance, as well as any efficiencies achieved in its operations.

4.23 IP Australia monitored the status of its cost recovery targets and actual results annually in order to keep an up to date profile of any issues leading to its cost recovery review. If analysis showed there was an urgent need for fees to be changed, the agency had a provision to alter fees. However, IP Australia's preferred option was not to alter fees other than during the review which led to its three yearly CRIS. IP Australia had chosen not to inconvenience customers too much by regularly changing fees except when there was an urgent need for a variation.

4.24 ITSA did not use its ongoing fee reviews to significantly alter pricing structures unless there were major technological or policy developments which required it to revise its charges. In the absence of such developments, ITSA has committed to a periodic review every two years.

4.25 In two previous ANAO audits, agencies conducted annual fee reviews. In 2004–05, the ANAO noted that TGA generally increased its fees in line with

⁵² The formula was based on a mixture of the Consumer Price Index, weighted at 25 per cent and the Wage Cost Index, weighted at 75 per cent.

a combination of the Consumer Price Index and Wage Cost Index,⁵³ which is similar to the approach taken by NICNAS. In 2003–04, the ANAO noted that AQIS reviewed its fees and charges to align them with costs during its internal budget process.⁵⁴

4.26 Overall, the ANAO considered that the audited agencies had effective mechanisms in place to monitor and review their cost recovery arrangements. They used this information to inform their periodic fee reviews and the development of their CRISs.

Consultation with customers and stakeholders during cost recovery reviews

4.27 As noted earlier, the guidelines state that fee reviews and the preparation of the CRIS should involve an appropriate level of consultation with customers and stakeholders. A description of the approach taken, level of consultation and resulting comments and advice provides an opportunity for agencies to explain and justify fee changes to their customers. The ANAO found that agencies consulted with customers and stakeholder during cost recovery reviews. This included:

- meetings with industry, professional and community groups;
- stakeholder briefings/information sessions;
- posting proposed fee schedules on websites;
- circulating discussion papers;
- consolidating stakeholder input; and
- providing formal responses to stakeholders regarding fee review outcomes.

Results of customer consultation

4.28 Agencies considered the comments they received from their customers and stakeholders when proposing changes to regulatory charges. The ANAO noted that one agency's industry committee did not initially accept the outcome of its 2005 fee review and undertook to pursue it outside of the

⁵³ ANAO Audit Report No.18 2004–05, *Regulation of Non-prescription Medicinal Products*, p.145, available at <www.anao.gov.au/publications>.

⁵⁴ ANAO Audit Report No.17 2003–04, *AQIS Cost-Recovery Systems Follow-up Audit*, p.65, available at <www.anao.gov.au/publications>.

committee. The main concern of the industry committee was the likely burden on customers of passing on the cost of government policy and compliance activities which had been funded previously through government appropriation. After consultation with the industry committee, the agency chose to absorb these costs through efficiency gains rather than pass the costs onto customers.

4.29 In addition, during the agency's 2005–06 periodic fee review, it did not increase its charges in accordance with its initial proposal. This was due to adverse comment from its industry committee, which believed the increase would place an unnecessary impost on customers. This resulted in the agency negotiating an increase in its charges which was below the rate initially proposed.

4.30 Another agency consulted with customer groups and stakeholders during its 2005 review. It advised its customers and stakeholders of the policy parameters that would guide its review and they were accepted. However, during its 2006–07 periodic fee review, one of its stakeholder groups did not agree with its stated objective to modify or promote certain behaviours from its customers in the way it set its fees. The ANAO noted that the agency considered the comments of this stakeholder group, but, as the majority of other stakeholders' views were positive, the agency chose not to amend its policy objectives.

4.31 The ANAO noted that there were a number of issues raised by ITSA's stakeholders during its 2005 fee review. Two policy issues are detailed below. The first issue was the proposed introduction of a processing fee for debtors' bankruptcy petitions and debt agreement proposals. The processing fee received adverse comment from stakeholders. The stakeholders' major concern was that many people would be denied the opportunity to enter into petitions or agreements due to their inability to pay the proposed fee and this was not in the public interest. As a result of stakeholders concerns, ITSA chose not to introduce the fee.

4.32 The second issue in the 2005 fee review was ITSA's objective to fund the costs associated with the examination of estates which warranted investigation but did not ultimately generate funds to pay ITSA's fees. ITSA recommended that the realisation charge levied on estates with realisable assets fund the examination of estates with potential assets. A stakeholder group queried the fairness of such a recommendation, arguing it penalised creditors of estates which produced realisations. ITSA responded to these

concerns by noting that creditors at large benefited from investigations into estates with potential assets. Such investigations gave them confidence that a debtor's affairs would be investigated if the initial assessment suggested this was warranted. ITSA therefore argued that, as principal beneficiaries, creditors should pay.

Employee consultation

4.33 In addition to consulting its industry body, ITSA invited its employees to comment on proposed changes to its fees and levies during its cost recovery review. The Chief Executive sent an email to all employees inviting comment on a discussion paper on cost recovery. The agency established an intranet site to keep employees informed of additional information as it became available and conducted information sessions. The ANAO noted that employee consultation was appropriate to broaden the understanding of the impact of the proposed changes on customers and was an example of good management practice.

Summary of findings

4.34 All audited agencies conducted reviews in accordance with the Government's schedule and produced a CRIS which summarised their cost recovery approach against the five-stage process suggested in the guidelines.

4.35 Finance had accepted each agency's CRIS after certification by the agency's chief executive or secretary that they complied with the Government's guidelines. The ANAO found that the agencies had implemented the cost recovery arrangements described in their CRISs.

4.36 All the audited agencies had effective mechanisms to monitor and review their cost recovery arrangements. These included internal reports to monitor revenue forecasts against actual results, and periodic fee reviews to amend fees and levies in response to changing circumstances.

4.37 Agencies consulted their customers and stakeholders during cost recovery reviews. The agencies also took customer and stakeholder views into account when proposing revisions of fees and levies following regular fee reviews.

5. Reporting to Management and Stakeholders on Cost Recovery

This Chapter examines the mechanisms used by regulatory agencies to report internally and externally on cost recovery arrangements and outcomes, and whether cost recovery revenue is reported in financial statements.

Reporting mechanisms

5.1 Regulatory agencies have a range of mechanisms available to report on their cost recovery arrangements and outcomes, both internally to management and the executive, and externally, to customers, other stakeholders and government. For the audited agencies, these mechanisms included internal financial and management reports, portfolio budget statements, annual reports and the agency's website.

5.2 The ANAO considers that regular internal reporting on the agency's administration of its cost recovery arrangements is essential for sound financial management and budget forecasting. External reporting provides information and assurance to stakeholders and the Government that the agency is administering its cost recovery arrangements in accordance with the Government's guidelines, the agencies' cost recovery policies, and customer and stakeholder interests.

Internal reporting

5.3 As noted in Chapter 4, the finance areas in the audited agencies produced a range of regular financial reports that they used in monitoring cost recovery revenue and reviewing cost recovery arrangements, fees and charges. They provided these reports to the executive of the agency, either monthly or quarterly, to inform on the status of cost recovery targets and actual results. Chief Executives of the agencies provided similar reports, or summaries of these, to meetings of industry consultative committees.

5.4 These reports generally included comparisons of actual revenue against the budget forecast, and revenue and expenses for each recoverable activity. They also highlighted cost recovery issues, such as unexpected variations in volumes of activities and revenue, for senior management consideration.

External reporting

5.5 As previously outlined, the audited agencies had all conducted reviews of their cost recovery arrangements, and prepared a CRIS, in line with Finance's schedule. Each audited agency published a summary of its CRIS in its PBS in the year that it completed the scheduled review, in accordance with principle 11 of the Government's guidelines (see Table 1.1).

5.6 The three audited agencies included information on their cost recovery arrangements in annual reports. IP Australia published a short summary of its cost recovery process in the 2005–06⁵⁵ and 2006–07⁵⁶ Department of Industry, Tourism and Resources (DITR) Annual Reports. NICNAS included a summary of its financial performance against its cost recovery policy in its 2005–06⁵⁷ and 2006–07⁵⁸ Annual Reports. ITSA published a summary of the changes to its legislation which affected its cost recovery arrangements in its 2005–06 Annual Report.⁵⁹ ITSA also included a summary of its fee reviews which had resulted in a CRIS in its 2006–07 Annual Report.⁶⁰

5.7 In addition to reporting on cost recovery in their PBS and annual reports, each agency had posted a summary of the CRIS on its website for the benefit of its customers and stakeholders. Where agencies had conducted additional fee reviews during the period between scheduled reviews, they also put summaries on their websites. From July 2008, all agencies will be required to publish a full CRIS, rather than a summary, on their website following scheduled cost recovery reviews.⁶¹ This will give users more information.

5.8 Each agency also reported on its cost recovery arrangements to its customers through industry consultative committees. IP Australia regularly met and consulted with patents, trade marks and plant breeders' rights

⁵⁵ Department of Industry, Tourism and Resources, *Annual Report 2005–06*, Canberra, August 2006, p. 133, available at <www.industry.gov.au/publications>.

⁵⁶ Department of Industry, Tourism and Resources, *Annual Report 2006–07*, Canberra, October 2007, p. 145, available at <www.industry.gov.au/publications>.

⁵⁷ National Industrial Chemicals Notification and Assessment Scheme, *Annual Report 2005–06*, Canberra, August 2006, p. 33, available at <www.nicnas.gov.au/publications>.

⁵⁸ National Industrial Chemicals Notification and Assessment Scheme, *Annual Report 2006–07*, Canberra, October 2007, p. 9, available at <www.nicnas.gov.au/publications>.

⁵⁹ Insolvency and Trustee Service Australia, *Annual Report 2005–06*, September 2006, p. 12, available at <www.itsa.gov.au/publications>.

⁶⁰ Insolvency and Trustee Service Australia, *Annual Report 2006–07*, October 2007, p. 51, available at <www.itsa.gov.au/publications>.

⁶¹ Department of Finance and Administration, *Information Session on the Simplification of the Financial Framework*, 30 May 2007.

industry advisory groups, providing information on its revenue and fees. ITSA reported on cost recovery issues to its stakeholders through its Cost Recovery Reference Group, which included representatives from the Bankruptcy Reform Consultative Forum, and directly through its branch networks. NICNAS reported twice a year on its financial results and budget outlook, and any cost recovery issues, to its Industry Government Consultative Committee.

5.9 In two previous ANAO audits of regulatory agencies that examined reporting of cost recovery, one agency had included a copy of its CRIS on its website and in its PBS, while another had reported on cost recovery in its annual report and reports to its clients and industry committees.

5.10 Overall, the ANAO considered that all audited agencies used appropriate reporting mechanisms to report on their cost recovery activities internally and externally.

Reporting cost recovery revenue in financial statements

5.11 Principle 13 of the Government's cost recovery guidelines states:

Agencies will need to separately identify all cost recovery revenues in notes to financial statements - to be published in portfolio budget statements and annual reports consistent with the Finance Minister's Orders.⁶²

5.12 The 2006–07 Finance Minister's Orders (FMOs)⁶³ required agencies to disclose total costs recovered for administered and departmental items in their reporting of outcomes and outputs in financial statements. The FMOs further stated that agencies must report outcomes and outputs in accordance with the Government's cost recovery policy.⁶⁴

5.13 The Australian Government's Consolidated Financial Statements (CFS) preparation process currently requires agencies to disclose, by way of notes, 'charges for goods and services' (note 9), which incorporates cost recovery arrangements.⁶⁵ The ANAO noted that charges for goods and services in note 9 included other types of revenue, which does not facilitate identification of total

⁶² Department of Finance and Administration, *Australian Government Cost Recovery Guidelines July 2005*, Financial Management Guidance No.4, Canberra, 2005, p. 3, available from <www.finance.gov.au>.

⁶³ Department of Finance and Administration, *Finance Minister's Orders 2006–07 – Requirements and Guidance for the Preparation of Financial Reports of Australian Government Entities*, pp. 128–129, available at <www.finance.gov.au>.

⁶⁴ The draft 2007–08 FMOs continue to require such disclosure.

⁶⁵ Commonwealth of Australia, *Consolidated Financial Statements for the Year Ended 30 June 2006*, Canberra, 2007, p. 145, available from <www.finance.gov.au>.

cost recovery revenues. Finance advised that it was willing to further explore how to more explicitly identify and report on cost recovery revenues in the CFS. Finance, the Department of the Treasury and the Australian Bureau of Statistics are currently reviewing a number of budget classifications, including tax revenue and fees for service, and will consider this issue as part of the 2008–09 CFS process.

5.14 The ANAO examined each agency's financial statements in portfolio budget statements for 2006–07 and 2007–08, and annual reports for 2005–06 and 2006–07, to determine whether they separately identified revenue collected through cost recovery. The result of this analysis is included in Table 5.1.

Table 5.1

Reporting on cost recovery revenue in notes to financial statements

	IP Australia	ITSA	NICNAS (c)
2005–06 Annual Report	Yes (a)	Yes (b)	No
2006–07 Annual Report	Yes (a)	Yes (b)	No
2006–07 PBS	No	No(e)	No (d)
2007–08 PBS	No	No (e)	No (d)

Notes:

- (a) IP Australia's income statement identified total revenue from the sale of goods and services and Note 3B split this into revenue from patent fees, trade mark fees, design fees, plant breeder's rights fees, and other goods and services.
- (b) ITSA introduced full cost recovery from July 2006, so 2006–07 was the first year for which it could separately identify cost recovery revenues. Note 16 to ITSA's 2005–06 and 2006–07 financial statements included a table of the income administered on behalf of government which identified the amounts of taxation revenue and non-taxation revenue from fees and charges by source.
- (c) As part of DoHA, NICNAS' financial statements are included with those of DoHA in the PBS and annual reports. NICNAS also includes a financial summary in its own Annual Reports.
- (d) The Health and Ageing PBS identified total revenue from industry cost recovery by NICNAS in Section 4 – Other Reporting Requirements.
- (e) ITSA identified total income administered on behalf of government in Table 5.7 of its PBS.

Source: DITR Annual Reports 2005–06 p. 339 and 2006–07 p. 341; ITSA Annual Reports, 2005–06 p. 108 and 2006–07 p. 108, ITSA PBS 2006–07 p. 390 and ITSA PBS 2007–08 p. 445, NICNAS Annual Reports 2005–06 p. 33 and 2006–07 p. 73, DoHA Annual Reports 2005–06 p. 248 and 2006–07 p. 349, Industry, Tourism and Resources PBS 2006–07 p. 85 and 2007–08 p. 93, Health and Ageing PBS 2006–07 p. 201 and 2007–08 p. 198, Attorney-General's PBS 2006–07 p. 390 and 2007–08 p. 445.

5.15 The Health and Ageing PBS for 2006–07 and 2007–08 reported total revenue collected by NICNAS through industry cost recovery within the 'Other Reporting Requirements' section rather than in the financial statements. Both IP Australia and ITSA included the amount of revenue collected through the sale of goods and services in notes to their financial statements published

in their annual reports.⁶⁶ However, these did not separately identify amounts the agencies classified as cost recovery revenue, as required by the guidelines.

5.16 In most cases, the ANAO could deduce the total amount of cost recovery revenue by excluding interest received from revenue collected from the sale of goods and services using data contained in the financial statement income tables. However, it would be difficult for government and stakeholders to easily determine total cost recovery revenue from these financial statements. In addition, the statements did not always identify the revenue obtained from fees and charges on particular regulatory activities.

5.17 Consistent with the guidelines, agencies are expected to separately publish in their financial statements the revenues collected through the various fees and levies they charge for regulatory activities. Doing so would improve the visibility and accountability of their cost recovery activities through publication of the amounts of revenue collected through each activity. It would also enable the Government to publish in its CFS the total amount of revenue collected from cost recovery by government agencies.

Summary of findings

5.18 The audited agencies used appropriate reporting mechanisms to report on their cost recovery activities internally and externally. These included financial and management reports, portfolio budget statements, annual reports, the agency's website and through industry consultative committees.

5.19 The Government's guidelines require agencies to separately identify cost recovery revenue in notes to their financial statements. This is intended to allow readers of financial statements to readily identify cost recovery revenue. Two of the audited agencies included the amount of revenue collected through the sale of goods and services in a note to their financial statements in their annual reports. The other agency identified total revenue from industry cost recovery in another section of the PBS.



Ian McPhee
Auditor-General

Canberra ACT
21 February 2008

⁶⁶ Note 26 in ITSA's 2006–07 financial statements (published in its annual report) identifies costs recovered from the provision of goods and services to the non-government sector by output.

Appendix

Appendix 1: Agencies' Comments

This Appendix contains general comments received on the audit report.

Each of the agencies selected for audit and the Department of Finance and Deregulation were provided with the opportunity to comment on the proposed audit report in accordance with the provisions of section 19 of the *Auditor-General Act 1997*.

Agencies' responses to recommendations have been included in the main body of the report under the subheading 'Agencies' responses' directly following each recommendation.

General responses are produced below.

IP Australia

IP Australia welcomes the ANAO performance audit on Management of Cost Recovery and agrees with the recommendation. The report recognises IP Australia's ability to manage cost recovery processes, and provide improved service for customers and Government. IP Australia has been and is committed to continually improving the cost recovery arrangements ensuring efficiency and effectiveness in accordance with relevant legislation and Commonwealth policies.

Insolvency and Trustee Service Australia

ITSA welcomes independent scrutiny by the ANAO of its management of its cost recovery arrangements and agrees with the recommendation made.

Department of Health and Ageing

The Department of Health and Ageing (DoHA) acknowledges the work of the ANAO and agrees with its recommendation. This recommendation will assist in improving governance procedures and practices at NICNAS, as part of the Department's ongoing commitment to continuous improvement. Actions to implement the recommendation are underway.

Department of Finance and Deregulation

The Department of Finance and Deregulation (Finance) supports the report's recommendation. Finance agrees that the consolidation of cost recovery policy and procedures into a single document that is current, accessible and easily understood should serve as a means to enhance the transparency and integrity

of the cost recovery information produced by FMA agencies and CAC bodies, thus providing further assurance of compliance with cost recovery policy.

Consistent with our responsibility for cost recovery policy, we intend to advise Chief Financial Officers of the report's recommendation and will subsequently incorporate these requirements in cost recovery guidelines which are scheduled to be reviewed in the second half of 2008.

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