Australian Government
Department of Finance and Administration

Australian Government Cost Recovery Guidelines

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FINANCIAL MANAGEMENT GUIDANCE NO.4

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Contents

Contents

INTRODUCTION

Introduction

In December 2002 the Australian Government adopted a formal cost recovery policy to improve the consistency, transparency and accountability of Commonwealth cost recovery arrangements and promote the efficient allocation of resources.

The policy applies to all *Financial Management and Accountability Act 1997* (FMA Act) agencies and to relevant *Commonwealth Authorities and Companies Act 1997* (CAC Act) bodies that have been notified, under sections 28 or 43 of the CAC Act, to apply the cost recovery policy. These entities are collectively referred to as 'agencies' for the purposes of these guidelines. The policy applied immediately in respect of new or significantly amended cost recovery arrangements and will be phased in for all existing arrangements over a period not exceeding five years (to 2007-08).

For the purposes of this policy, 'cost recovery' broadly encompasses fees and charges related to the provision of government goods and services (including regulation) to the private and other non-government sectors of the economy.

The Australian Government's policy adopts the following key 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. Agencies should ensure that all cost recovery arrangements have clear legal authority for the imposition of charges.

5. Costs that are not directly related or integral to the provision of products or services (e.g. some policy and parliamentary servicing functions) should not be recovered. 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. Products and services funded through the budget process form an agency's 'basic information product set' and should not be cost recovered. Commercial, additional and incremental products and services that are not funded through the budget process fall outside of an agency's 'basic product set' and may be appropriate to cost recover.

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 ('significant cost recovery arrangements') depending on both the amount of revenue and the impact on stakeholders. A 'significant cost recovery arrangement' is one where:

    a. an agency's total cost recovery receipts 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

    b. an agency's cost recovery receipts are below $5 million per annum, but stakeholders are likely to be materially affected by the cost recovery initiative; or

    c. 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 Cost Recovery Impact Statements (CRIS). A CRIS will not be required where a Regulation Impact Statement (RIS) that also addresses cost recovery arrangements against these guidelines has been prepared.

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

    b. Agencies must include a summary of the CRIS in their portfolio budget submissions and statements.

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.

GLOSSARY OF TERMS

Glossary of Terms

Agency – FMA Act agencies and relevant CAC Act bodies that have been notified, under sections 28 or 43 of the CAC Act, to apply the policy are collectively referred to as 'agencies' throughout these guidelines.

Basic product set – products and services that the Government agrees should be taxpayer funded.

CAC Act bodies – entities that are subject to the *Commonwealth Authorities and Companies Act 1997*. These are:

- Commonwealth authorities - a statutory authority (i.e. a body created by legislation) that is a separate legal entity from the Commonwealth and which has the power to hold money on its own account
- Commonwealth companies - companies under the *Corporations Act 2001* in which the Commonwealth has a controlling interest.

Cost Recovery charge – 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:

- fees for goods and services; and
- 'cost recovery' taxes (primarily levies, but also some excises and customs duties).

Cost Recovery Impact Statement (CRIS) – a statement documenting compliance with the cost recovery policy. Only agencies with significant cost recovery arrangements must prepare a CRIS.

FMA Act agencies – agencies that are financially part of the legal entity of the Commonwealth and are subject to the *Financial Management and Accountability Act 1997*. FMA Act agencies include:

- Departments of State;
- Departments of the Parliament; and
- Agencies prescribed by the FMA Regulations.

Information activities – activities involved in collecting, compiling and disseminating information or any other activity of a non-regulatory nature. (See regulatory activities)

May – options in these guidelines that are denoted by the use of the term 'may' are to be considered by agencies and followed when deemed relevant.

Must – obligations in these guidelines that are denoted by the use of the term 'must' are to be complied with in all circumstances.

Regulation Impact Statement (RIS) – the RIS is a document prepared by the 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. Contact the Office of Regulation Review for further information regarding RISs.

Regulatory activities – activities involved in administering regulations.
(See information activities)

Should – obligations in these guidelines that are denoted by the use of the term 'should' are to be complied with as a matter of sound practice.

Significant cost recovery arrangement - a 'significant cost recovery arrangement' is one where:

- an agency's total cost recovery receipts 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
- an agency's cost recovery receipts 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.

OVERVIEW

Overview

What are these Guidelines?

These guidelines provide a framework to assist agencies to design and implement cost recovery arrangements that comply with the cost recovery policy.

Who should use these Guidelines?

These guidelines apply to all *Financial Management and Accountability Act 1997* (FMA Act) agencies and those *Commonwealth Authorities and Companies Act 1997* (CAC Act) bodies (collectively referred to as 'agencies' for the purposes of these guidelines) that have been notified of the cost recovery policy under sections 28 or 43 of the CAC Act.

Agencies should use these guidelines when:

- proposing a new cost recovery arrangement; or
- amending existing cost recovery arrangements; or
- reviewing cost recovery arrangements in line with the Australian Government's scheduled reviews (to 2007-08) or an agency initiated periodic review.

What is cost recovery?

Cost recovery is the recovery of some or all of the costs of a particular activity. Australian Government cost recovery charges fall into two broad categories:

- fees for goods and services; and
- 'cost recovery' taxes (primarily levies, but also some excises and customs duties).

Cost recovery is different from general taxation. Some levies or taxes are used to raise cost recovery revenues, but the direct link — or 'earmarking' — between the revenue and the funding of a specific activity distinguishes such cost recovery taxes from general taxation. General taxation, on the other hand, is a compulsory exaction of money by a public authority for public purposes, enforceable by law, and which is not a payment for services rendered.

Many arrangements are not cost recovery for the purposes of the policy. Exclusions include:

- any form of intra-agency or inter/intra-governmental charging;
- charges by government business enterprises. These businesses operate in competitive or potentially competitive markets and are subject to competitive neutrality principles;
- other commercial charging arrangements in competitive or potentially competitive markets that comply with competitive neutrality principles (eg. commercial research);
- general taxation;

- repayments of loans to the Australian Government;
- receipts from asset sales, rental of property, royalties, including the sale of rights to access resources;
- fines and pecuniary penalties;
- payments by customers to non-Australian Government organisations and firms where Commonwealth policies may affect prices;
- receipts from one-off specific policy measures that have explicitly been recognised by the Government as not being subject to the cost recovery policy – for example where the Australian Government introduces a levy to fund an exceptional policy measure. Ministers must obtain the Finance Minister's agreement where it is proposed to exempt a significant cost recovery arrangement that is new, materially amended or which has been reviewed (as part of the Government's review schedule) on the grounds that it is a 'one-off specific policy measure';
- charges relating to industry-government partnerships;
- statutory marketing levies; and
- fees charged by courts and tribunals.

Where Australian Government agencies have service level agreements or other cost recovery arrangements with State/Territory Governments or with other Australian Government agencies, these guidelines should be complied with to the greatest possible extent, depending on other government requirements.

If agencies are unsure about whether the charges they impose amount to cost recovery, then they should consult with the Department of Finance and Administration.

Why have cost recovery?

Used appropriately, cost recovery can provide an important means of improving the efficiency with which Australian Government products and services are produced and consumed. Charges for goods and services can give an important message to users or their customers about the cost of resources involved. It may also improve equity by ensuring that those who use Australian Government products and services or who create the need for regulation bear the costs.

However, cost recovery may not be warranted where:

- it is not cost effective; or
- it would be inconsistent with government policy objectives; or
- it would unduly stifle competition and industry innovation (for example through 'free rider' effects).

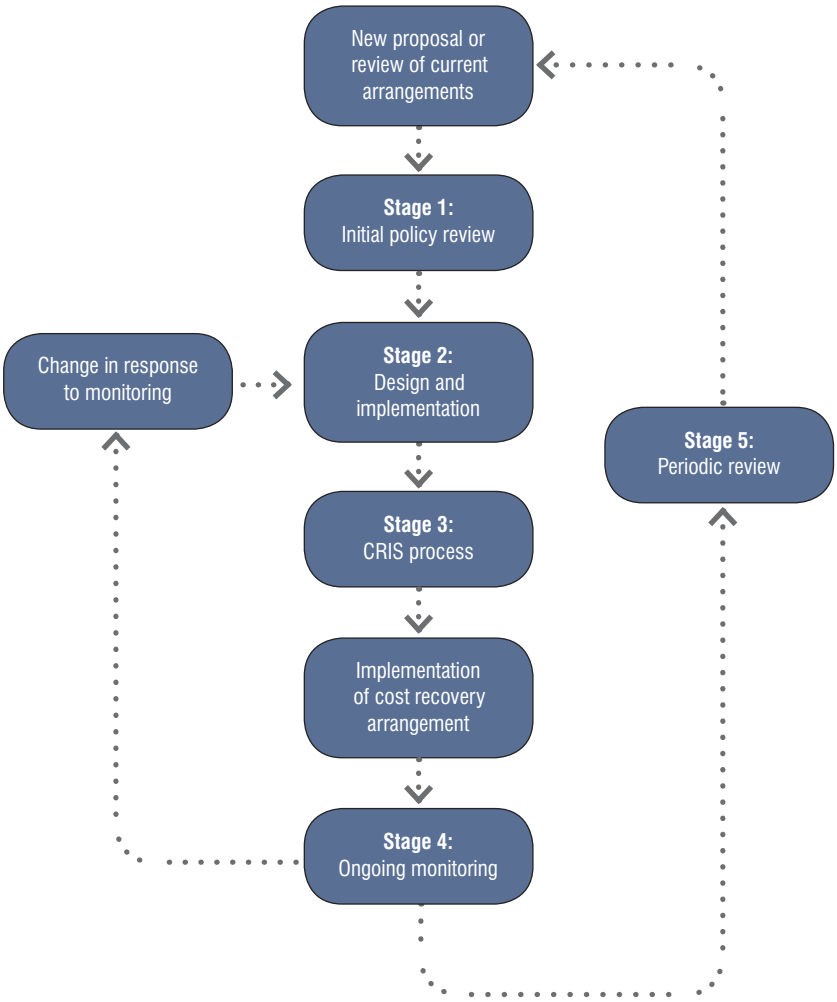
Designing cost recovery arrangements

The cost recovery policy and these guidelines should be applied to all cost recovery arrangements. However, only 'significant' cost recovery arrangements are required to document compliance with the policy in a Cost Recovery Impact Statement (CRIS).

The cost recovery process

These guidelines adopt a five-stage process for determining the appropriate approach to cost recovery for activities and products (Figure 1).

Figure 1 Process for assessing cost recovery



Overview

Stage 1: Initial policy review

The Stage 1 policy review considers the following questions:

- which of the agency's objectives are relevant to the activities or products being considered for cost recovery?
- should cost recovery be introduced?
- what mechanisms, including consultation, should be used for ongoing monitoring of the efficiency and effectiveness of cost recovery arrangements?
- how long (not more than five years) before the cost recovery arrangements should be reviewed again?

Stage 2: Design and implementation

If cost recovery is appropriate, Stage 2 considers the following questions:

- who should pay cost recovery charges?
- should cost recovery charges be imposed using fees or levies?
- what are the legal requirements for the imposition of charges?
- which issues should any legislation address?
- which costs should the charges include?
- how should charges be structured?
- how should costs be calculated and allocated?

Stage 3: Cost Recovery Impact Statement process

While all cost recovery arrangements must comply with the cost recovery policy, only significant arrangements need to document compliance with the policy in a Cost Recovery Impact Statement (CRIS). Together, the responses to the questions in Stages 1 and 2 form a CRIS.

Agencies with proposals in which policy issues have been settled and only design and implementation questions remain, or where a section of these guidelines does not apply, may prepare a less comprehensive CRIS. If significant cost recovery arrangements are not fully assessed against these guidelines where a policy decision precedes a funding decision, then these arrangements should be assessed against these guidelines prior to implementation and a CRIS should be prepared at that time.

Those agencies that are required to prepare a Regulation Impact Statement (RIS) do not need to prepare a separate CRIS.

Stage 4: Ongoing monitoring

Stage 4 provides for ongoing monitoring of cost recovery arrangements using the monitoring mechanisms determined as part of Stage 1. Ongoing monitoring provides an opportunity for continual improvement in cost recovery arrangements.

Stage 5: Periodic review

At least every five years, the appropriateness of cost recovery, the design of any cost recovery charges and the adequacy of monitoring arrangements need to be reviewed, to determine whether changes are necessary. The results of these reviews will be a Cost Recovery Impact Statement (CRIS) that will be considered in the Budget context.

STAGE 1

Policy Review

Stage 1: Policy Review

It is rare for all of an agency's activities and products to have identical characteristics. It is not possible, therefore, to assess the appropriate cost recovery arrangements on an agency-wide basis. Rather, an agency should assess the case for cost recovery for each activity or product. However, where it is efficient and effective to do so, agencies can group activities with similar characteristics or objectives.

Where agencies are proposing to introduce cost recovery arrangements it may be appropriate to seek government policy approval, including through the Budget processes.

Which of the agency's objectives are relevant to the activities or products being considered for cost recovery?

It is important for an agency to be aware of the agency objectives relevant to each activity or product to:

- understand the purpose of the activity and who benefits or creates the need for the activity;
- assess whether adopting cost recovery would undermine the objectives of the activity;
- if cost recovery is appropriate, choose an approach to charging that is consistent with the objectives of the activity; and
- ensure that cost recovery is not undertaken simply to earn revenue.

When more than one activity or product is being considered for cost recovery, it may be useful to group those with similar characteristics or objectives. These groups need to be small enough so the types of activity within a group have common characteristics and objectives, but large enough to make the review process manageable.

Activities undertaken by Australian Government agencies have been categorised into two types:

- ***Regulatory activities*** – these activities are involved in administering regulations; and
- ***Information activities*** – these activities are involved in collecting, compiling and disseminating information, as well as 'cultural institutions' and archives, and any other activities of a non-regulatory nature.

Regulatory activities are considered on pages 19 –29 and 37 – 65; information activities are considered on pages 29 – 66.

Should cost recovery be introduced?

The next step is to determine whether the agency should charge for all or only for some of its activities or products. The following discussion looks more closely at the classifications for the different types of activities and outlines how to assess the appropriate level of cost recovery.

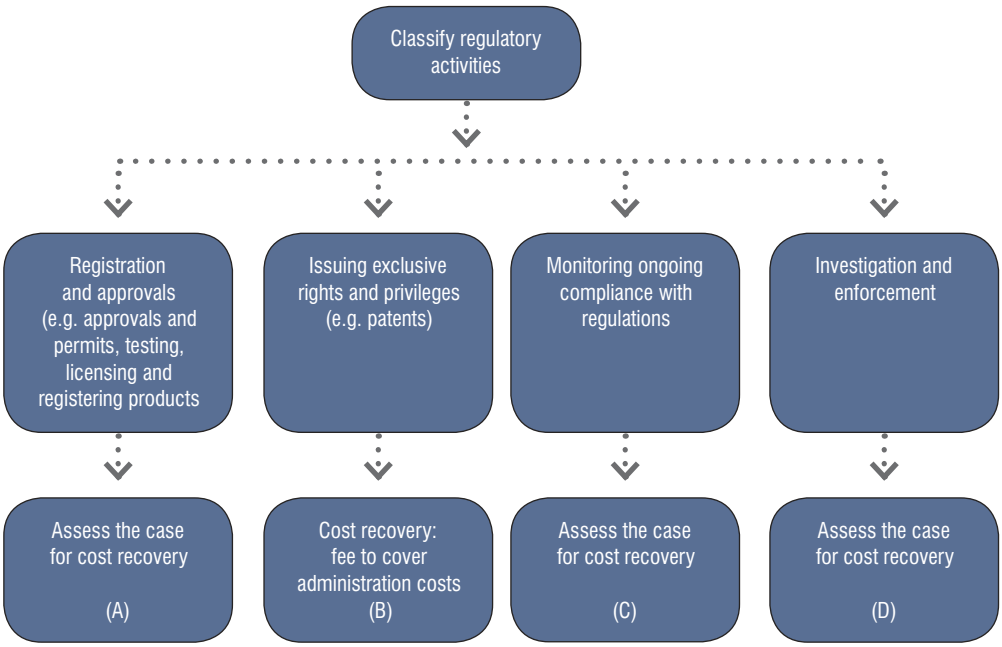
Regulatory activities

Information activities are considered on pages 29 – 66.

For regulatory activities, it is often useful to distinguish between different stages in the regulatory process. In particular, when looking at regulatory activities, it is important to separate pre-market and post-market regulation. Pre-market regulation activities (regulations with which firms or products must comply before a product can be offered for sale) involve registration and approvals, or issuing exclusive rights and privileges. Post-market activities (regulations with which firms or products must comply after a product is available for sale) involve monitoring compliance with regulations, investigation and enforcement.

It may also be useful to break down the regulatory activities further according to the various industry sectors regulated by the agency. Regulatory activities affecting competing sectors should be treated as a group so the design of the charges does not affect competition between sectors.

Figure 2 Classification of regulatory activities



Stage 1: Policy Review

A Registration and approvals

This first type of regulatory activity, as mentioned in Figure 2, includes pre-market regulation activities such as:

- inspecting and approving facilities, such as abattoir inspections by the Australian Quarantine and Inspection Service;
- registering firms or individuals before they can sell particular products or services, and renewing such registrations, such as the Australian Securities and Investments Commission licensing investment advisers and managed investment funds before they can trade;
- the evaluation of products for safety, quality and efficacy prior to supply in Australia, such as the Therapeutic Goods Administration's process for the evaluation and listing of medicines and medical devices;
- assessing and approving existing businesses to undertake particular activities that otherwise may be prohibited, such as Australian Competition and Consumer Commission authorisations; and
- rating or classifying products, such as the Office of Film and Literature Classification film ratings.

This type of regulatory activity can also include approval processes such as:

- providing post-entry quarantine services for plants and animals by Australian Quarantine and Inspection Service.

Figure 3 illustrates the questions that need to be considered to determine whether cost recovery should apply to such activities.

Figure 3 Registration and approvals

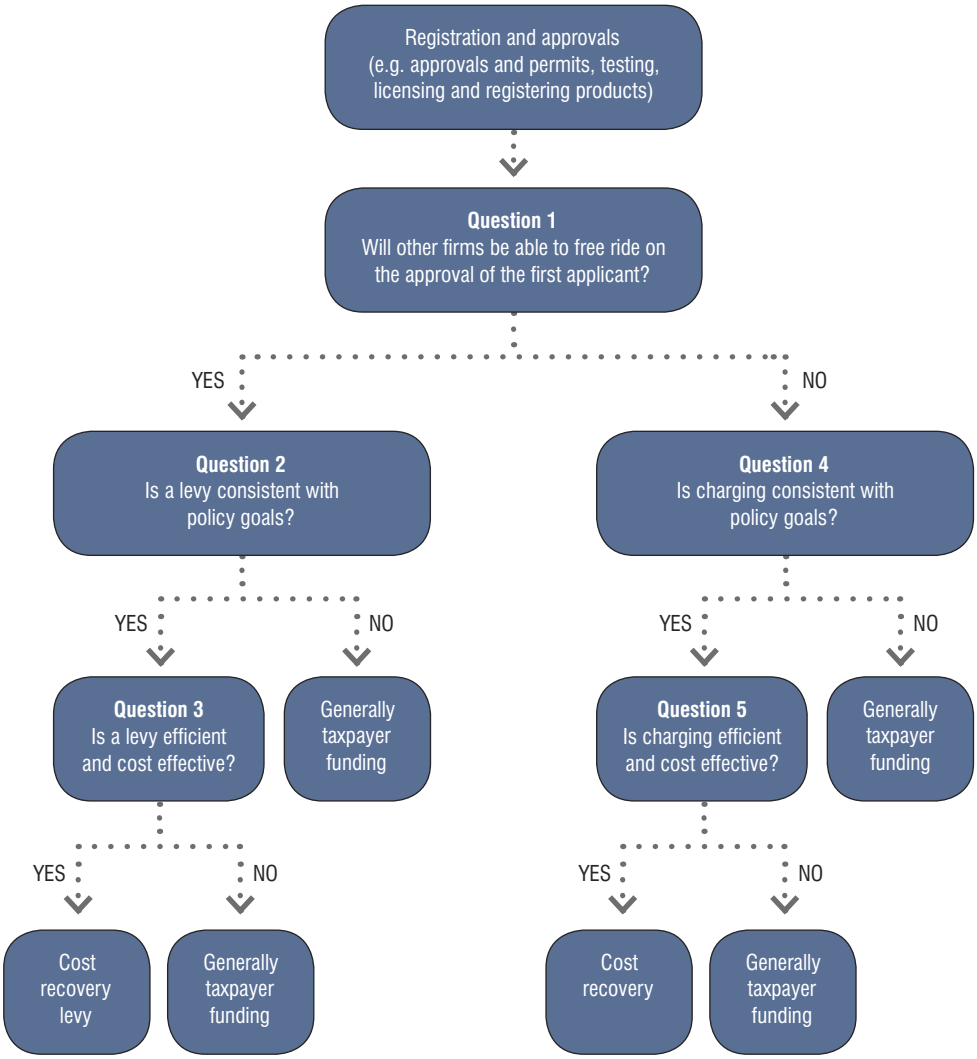


Figure 3, Question 1 **Will other firms be able to free ride on the approval of the first applicant?**	Charging for the assessment of new products can encourage firms to avoid the costs of approvals by waiting for others to seek approval first (thus 'free riding' on the approval of others). This is a problem for pre-market approvals (before the product is offered for sale) when the regulator requires the first new example of a product to go through a more onerous and costly process than that for subsequent examples. Charging for such approvals would penalise the first firm that introduces a new product to Australian customers and impair innovation and product development. An example of this type of regulation includes the approval of a new food standard. Cost recovery through a fee could be appropriate if the firm receives an 'exclusive capturable commercial benefit' (through patents, for instance). This test is similar to that applied by Food Standards Australia New Zealand to charging for the approval of food standards.
	Yes: Go to Question 2. **No: Go to Question 4.**
Figure 3, Question 2 **Are levies consistent with policy goals?**	Even where free rider effects make it undesirable to charge a direct fee for registrations or approvals, it may be appropriate to cost recover these regulatory activities using a levy.[1] But, in some rare cases, imposing a levy could reduce the effectiveness of the regulation or undermine the objectives of the regulation.
	Yes: Go to Question 3. **No: Consider funding the regulatory activity from general tax revenue.**
Figure 3, Question 3 **Is a levy efficient and cost effective?**	To design an efficient levy, the agency needs to be able to identify, accurately, a base for imposing the levy that reflects the cost of regulation and targets the firms creating the need for the regulatory activity. For example, it may be inappropriate to levy the whole industry if only a small group of firms creates the need for the regulation, and this group cannot be individually charged. In this event, a levy would have few advantages over general taxation. Even if a levy is efficient, it may not be appropriate if it is very costly or complex to collect.
	Yes: Use a levy to charge the regulated firms or individuals. **No: Consider funding the regulatory activity from general tax revenue.**

[1] A fee charges individual firms or consumers for particular activities; in contrast, a levy is imposed across a group of firms or consumers and is equivalent to a tax. The term 'charge' refers to both fees and levies.

Figure 3, Question 4 **Is charging consistent with policy goals?**	This question considers both fees and levies. Charging can be inconsistent with policy goals if it significantly increases the cost of enforcement. For example, charging to list products on a register could create incentives for firms to avoid registration, thus increasing the costs of enforcement and reducing the usefulness of the register. It may also be appropriate to consider whether a fee is needed to discourage frivolous or vexatious demand and to signal to users the costs of resources involved.
	Yes: Go to Question 5. **No: Consider funding the regulatory activity from general tax revenue.**
Figure 3, Question 5 **Is charging efficient and cost effective?**	Because they are directly related to costs, fees should be the preferred approach if they are efficient, consistent with policy goals and cost effective. A fee will not be efficient and cost effective if: • it is difficult to establish a fee that accurately links the costs of the activities to the regulated firms or individuals; or • the fee is costly to collect because it is difficult to identify and bill each regulated firm or individual. If the decision on whether a fee is cost effective is borderline then it may be appropriate to consider whether a fee is needed to discourage frivolous or vexatious demand and to signal to users the costs of resources involved. If a fee is not cost effective then a levy could be considered. Assessing whether a levy is efficient and cost effective is discussed under question 3.
	Yes: Fund the regulatory activity from cost recovery charges. **No: Consider funding the regulatory activity from general tax revenue.**

B Issuing exclusive rights and privileges

The second type of regulatory activity, depicted in Figure 2, is the issuing of legally exclusive rights and privileges. One common example is the issue of a patent. Issuing licences to use the radio frequency spectrum, and exploration and mining licences are other examples. Cost recovery in this context refers only to the collection of the cost of administering the licence system, not to the collection of any revenue generated from selling licences.

Patents are designed to ensure those who invest in researching and developing a new product are able to recoup those costs once the product is ready for sale. As a result, the process of issuing patents, as with other exclusive rights, provides firms with an 'exclusive capturable commercial benefit'; therefore, where practical, those that obtain the exclusive right should pay for the cost of administering this regulation.

This 'exclusive capturable commercial benefit' means that cost recovery is unlikely to undermine the goals of the regulation. In most cases it is cost effective to charge for issuing an exclusive right because the recipient needs to apply for the right. Therefore, costs are generally recovered via fees.

C Monitoring ongoing compliance with regulations

The third type of regulatory activity mentioned in Figure 2, relates to ongoing compliance with regulations. These activities are usually undertaken to ensure that regulatory standards are maintained.

Such activities include:

- regularly collecting and assessing information to check compliance with standards, such as the Australian Prudential Regulation Authority's regular reviews of the financial statements of institutions to monitor liquidity levels;
- conducting random audits to monitor compliance, such as the Civil Aviation Safety Authority's monitoring of airlines' compliance with aircraft safety standards; and
- managing complaints handling mechanisms, such as the Australian Securities and Investments Commission's oversight of the operation of the Superannuation Complaints Tribunal.

Figure 4 illustrates the questions that need to be considered when investigating the appropriate levels of cost recovery for these activities.

Figure 4 Monitoring ongoing compliance, and also investigation and enforcement

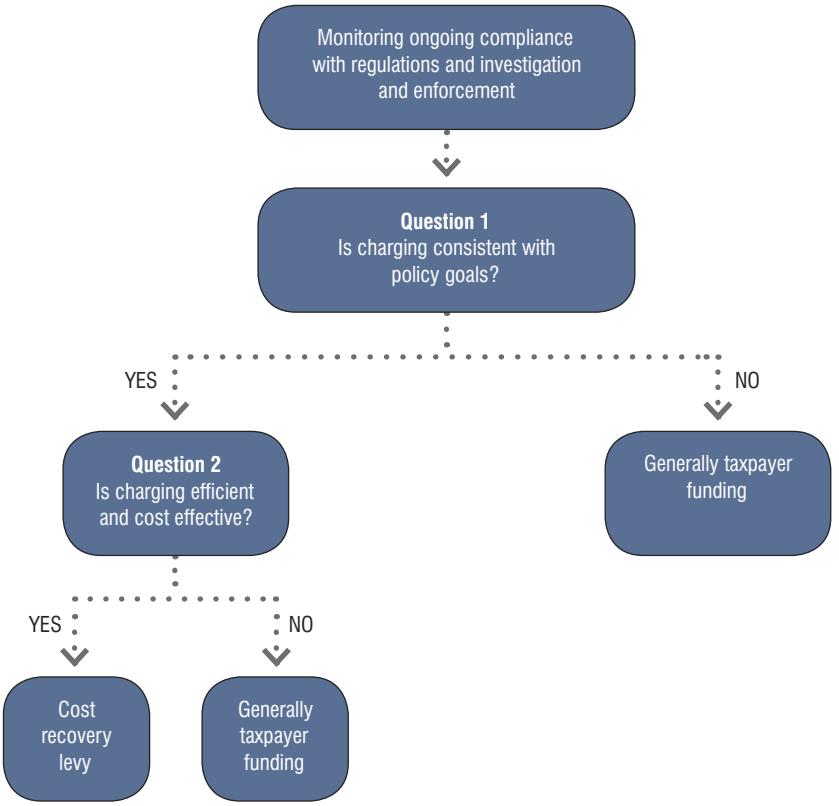


Figure 4, Question 1 **Is charging consistent with policy goals?**	In some cases involving the monitoring of compliance, charging fees could be counterproductive. For example, charging financial institutions to investigate their financial viability could exacerbate any difficulties they face. Where direct fees are inconsistent with policy goals, the agency should consider imposing levies. In this way, the industry would pay the costs of activities such as random audits. A levy could undermine policy objectives if it encouraged firms to misrepresent the nature of their business to avoid the levy and thus also avoid the regulation. The agency should not use cost recovery charges if they significantly reduce the effectiveness of the regulation or the level of compliance.
	Yes: Go to Question 2. **No: Consider funding the regulatory activity from general tax revenue.**
Figure 4, Question 2 **Is charging efficient and cost effective?**	In some areas of compliance monitoring, charges are unlikely to be efficient and cost effective. It may be difficult to link services to particular firms or identifiable groups; for example, it may be impractical to determine a basis for charging for monitoring compliance with broad based legislation, such as the Trade Practices Act 1974. As a result, an efficient charge may be difficult to establish, or if it can be established, it may be costly to implement. The same principles apply to assessing the efficiency and cost effectiveness of fees and levies for monitoring compliance as apply to registration and approvals (discussed under questions 3 and 5 of Figure 3).
	Yes: Fund the regulatory activity from cost recovery charges. **No: Consider funding the regulatory activity from general tax revenue.**

D Investigation and enforcement

The fourth type of regulatory activity mentioned in Figure 2, relates to investigation and enforcement. These activities are undertaken to ensure that regulatory standards are maintained.

Such activities include:

- conducting product recalls, such as the Food Standards Australia New Zealand recalls of food products;
- investigating complaints or evidence of non-compliance, such as the Australian Communications Authority's investigation of problems in telecommunications; and
- prosecuting companies that breach standards, such as the Office of the Gene Technology Regulator's enforcement of licence conditions.

Figure 4 illustrates the questions that need to be considered when investigating the appropriate levels of cost recovery for these activities.

Figure 4, Question 1 **Is charging consistent with policy goals?**	In many cases involving investigation and enforcement, charging fees would be counterproductive. For example, charging individual companies for product recalls may discourage them from notifying the regulator of faulty or dangerous products. Where direct charges are inconsistent with policy goals, the agency should consider levies if there is an identifiable group that could be levied. However, in some cases, a levy could also undermine policy objectives. For example, in legal proceedings, the court normally awards costs after considering the circumstances of the case. If an agency can automatically recover its legal costs from industry, then the discipline of potentially having costs awarded against it is reduced. In general, cost recovery charges should not be used if they would reduce the effectiveness of the regulation or the level of compliance.
	Yes: Go to Question 2. **No: Consider funding the regulatory activity from general tax revenue.**

Figure 4, Question 2 **Is charging efficient and cost effective?**	Charges are unlikely to be efficient and cost effective in some areas of investigation and enforcement. It may be difficult to link services to particular firms or identifiable groups. Again, the principles for assessing the efficiency and cost effectiveness of fees and levies for investigation and enforcement activities are the same as those applying under questions 3 and 5 for Figure 3. For example, while a direct fee would be inconsistent with policy objectives in the case of product recalls, a levy might be both consistent with policy objectives and cost effective.
	Yes: Fund the regulatory activity from cost recovery charges. **No: Consider funding the regulatory activity from general tax revenue.**

Information activities

Regulatory activities are considered on pages 19 – 29 and 37 – 65.

In general, information activities result from a combination of information collection, compilation and storage, analysis and enhancement, and dissemination. Information activities include all non-regulatory activities.

The two steps in considering whether to impose cost recovery for information products are:

- determining which products are taxpayer funded (basic product set) (Figure 5); and
- establishing the approach to cost recovery for other products (additional products) (Figure 6).

Determining the basic product set

An agency cannot decide alone what level of taxpayer funding it will receive. This decision is made by the Government in the Budgetary cycle. The principles outlined in these guidelines can help identify products for which taxpayer funding is appropriate.

A useful distinction that may inform this process is that between:

- general information products produced for the Australian community; and
- information products produced at the request of specific groups or individuals.

In addition, the questions in Figure 5 identify those products that the Australian Government may consider should be taxpayer funded, according to three criteria:

- they have 'public good' characteristics (Box 1—page 30); and/or
- they generate significant spillover benefits to the broader community; or
- there are other policy reasons for taxpayer funding.

The products funded by Australian Government as a result of this analysis form the 'basic product set'.

Box 1 Public and Private Goods

Public goods exist where provision for one person means the good or service is available to all people at no additional cost. Public goods are said to have two main economic characteristics: they are non-rivalrous (that is, consumption by one person will not diminish consumption by others); and they are non-excludable (that is, it is difficult to exclude anyone from benefiting from the good). Given that exclusion would be physically impossible or economically unfeasible, these goods are unlikely to be provided to a sufficient extent by the private market provision. The nature of public goods makes it difficult to assess the extent of demand for them. It is ultimately a matter of judgement whether demand is sufficient to warrant government provision.

This definition of 'public good' is important in economics. It should not be confused with phrases such as 'good for the public', 'public interest' or 'publicly produced goods'.

A **private good** is both rivalrous and excludable. If it is physically and economically feasible to identify and charge consumers and to exclude non-purchasers, then a private market will normally develop, providing it is profitable to do so.

There are few 'pure' public goods, but a range of goods have a mix of public and private good characteristics. Many information products, for example, are non-rivalrous (that is, information, once collected and compiled, can be used by many people without affecting the cost of collection and compilation). While it may be technically possible to exclude some people from using this information, it will be neither socially nor economically desirable if charging is likely to unduly deter potential users. Therefore, in assessing the public good characteristics of information products, it is often more important to assess the product's degree of rivalry than to assess the technical ability to exclude.

Figure 5 Assessing funding for information products

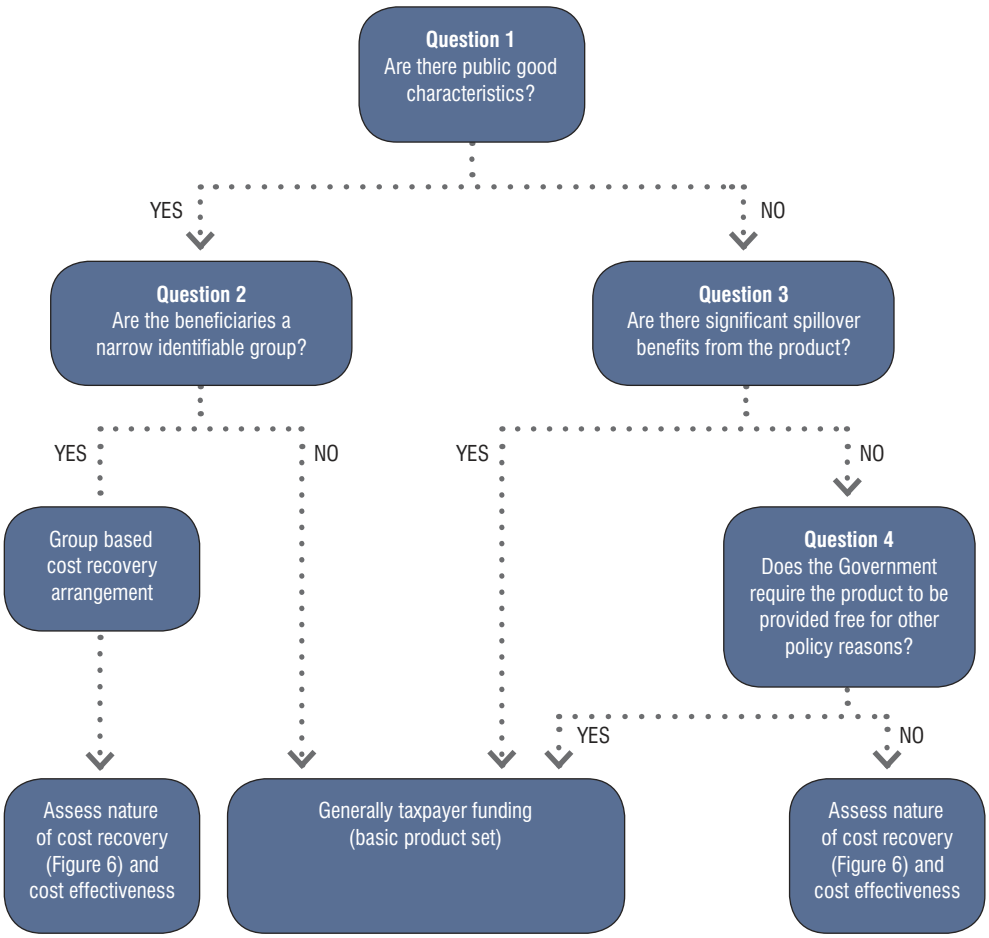


Figure 5, Question 1 **Are there public good characteristics?**	The assessment of whether a group of products has public good characteristics is not clear-cut. Agencies need to judge whether, on balance, the public good characteristics are significant enough to make it undesirable to charge for those products. Judgments about public goods typically consider two characteristics of the product: its level of rivalness and its level of excludability.
Is the product rivalrous?	A product is non-rivalrous when one person using the product has no impact on others' ability to use that product. The number of users can be increased at virtually zero cost. Most general information fits into this category. Agencies produce a range of products, some of which will be rivalrous and others non-rivalrous. Once information is collected and compiled, many people can use it without affecting the costs of collection or compilation. Such information, distributed via the media, is non-rivalrous. Many people can listen to the radio without affecting others' ability to use the information. The rivalness of information distributed by other methods, such as the Internet, will depend on the level of capacity in the system and the level of demand (Appendix B). A publication, however, may be rivalrous, because several people cannot use the same publication simultaneously. In assessing rivalness, the key question is whether more users of the product will increase the cost of provision.
	Yes: If the product is rivalrous, then it is not a public good and the assessment should consider spillover benefits. Go to Question 3. **No: If the product is non-rivalrous, then the next step is to consider whether it is possible and desirable to exclude users and charge for the product.**

Is the product excludable?	In the case of a pure public good, it is impossible to exclude people from using the product. However, in other cases, exclusion may be technically possible but undesirable. Two factors are important in assessing excludability. *Is it impossible to exclude people from using the product?* This occurs in a narrow range of circumstances. For example, once information has been released to the media it is virtually impossible to prohibit others from accessing that information. *Is it economically efficient to exclude people from using the product?* This assessment looks at whether the benefits from charging outweigh the reduced use of the information. A number of factors influence the magnitude of these benefits and losses, such as the responsiveness of customers to changes in price, the level of taxpayer funding that would be required to substitute for cost recovery, and the efficiency costs of general taxation relative to those of cost recovery charges. While, in most cases, the collection costs of establishing a cost recovery regime are likely to be small, they should be taken into account, particularly where the case for introducing cost recovery is borderline.
	Yes: If it is possible and desirable to exclude users from the product, then it is not a public good and the assessment should consider spillover benefits. Go to Question 3. **No: If it is not possible, or it is possible but not desirable to exclude people from the product, then go to Question 2.**
Figure 5, Question 2 **Are the beneficiaries a narrow identifiable group?**	Some products with public good characteristics are used only by a small group such as an industry or a specific consumer group. If it is possible to identify the group using the information product, then it may be possible to develop a levy mechanism that applies only to its members. In other cases, an industry association or other representative group may provide another avenue for recovering costs from most or all users of the product.
	Yes: Go to Figure 6 to assess the nature of cost recovery for additional information products, to determine which costs the levy should recover. **No: Consider funding the information product from general tax revenue.**

Figure 5, Question 3 **Are there significant spillover benefits from the product?**	The presence of significant spillover benefits strengthens the argument for taxpayer funding even where there are no public good characteristics. An information product will generate spillover benefits if one person having access to the information also benefits other unrelated parties. For example, weather information on storm conditions or fire risks allows the affected groups to prepare for possible problems and substantially reduces the costs to the general community of dealing with the results of storm or fire damage. The spillover benefits need to result directly from the availability of the information, rather than from activities (such as research) that incorporate the information. For example, health data may be used to assess trends in the incidence of specific diseases, and this assessment could have spillover benefits in improved planning of health infrastructure and reduced health costs. However, the Australian Government needs to consider these benefits when it develops policies on funding health research, not on information provision. The benefits do not justify taxpayer funding for the information products themselves.
	Yes: Consider funding the information product from general tax revenue. **No: Go to Question 4 to determine whether any government funding is justified to achieve other policy objectives.**
Figure 5, Question 4 **Does the Government require the product to be provided free for other policy reasons?**	Cost recovery may be inconsistent with the Australian Government's objectives for the agency, such as where cost recovery may hinder an objective that requires some forms of information to be disseminated as widely as possible. International agreements too may constrain the ability of Australian Government agencies to set cost recovery charges. Where appropriate, agencies should consult with the Department of Foreign Affairs and Trade to ascertain whether any international agreements are relevant to the products they are considering cost recovering.
	Yes: Consider funding the information product from general tax revenue. **No: Go to Figure 6 to assess the nature of cost recovery for additional information products.**

Recovering the cost of additional information products

An agency may wish to provide information products outside the taxpayer funded basic product set, consistent with its charter. These additional products should be assessed for cost recovery using the principles outlined below. Assessment should be on a case-by-case basis, with regard to the efficiency and cost effectiveness of charging. Charges will not be efficient and cost effective if:

- it is difficult to establish a charge that accurately links the cost of a product to the users of that product; or
- the charge is costly to collect because it is difficult to identify and bill each user of the product.

Figure 6 illustrates the questions agencies should answer to determine the extent of cost recovery for additional products.

Figure 6 Assessing the nature of cost recovery for additional information products

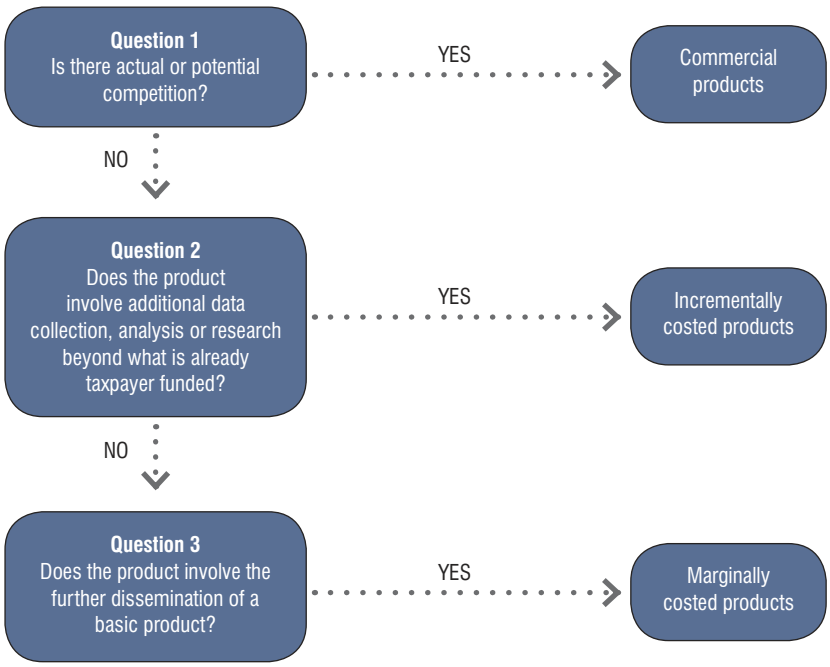


Figure 6, Question 1 **Is there actual or potential competition?**	There is actual or potential competition when an agency's information product is available from private sector providers or when the private sector could provide that product relatively easily.
	Yes: Cost recovery consistent with the Australian Government Competitive Neutrality Guidelines. **No: Go to Question 2.**
Figure 6, Question 2 **Does the product involve additional data collection, analysis or research beyond what is already taxpayer funded?**	Incremental products are those for which additional work has been undertaken to modify taxpayer funded information to meet the demands of a specific client or group. The additional work could involve: • extending a data collection; • expanding research to cover new issues; and/or • undertaking additional analysis or manipulation of the information.
	Yes: Cost recovery based on the incremental cost of the additional products (discussed further in Stage 2). **No: Go to Question 3.**
Figure 6, Question 3 **Does the product involve the further dissemination of a basic product?**	Usually, reasonable means of dissemination of the basic product set is taxpayer funded. However, users may want additional access to the information either using distribution methods that are not taxpayer funded or having greater access to the information than was intended to be taxpayer funded (for example, people may wish to hold private copies of publications).
	Yes: Cost recovery based on the marginal cost of distribution (discussed further in Stage 2).

Stage 1 Policy Review (continued) – regulatory and information activities

The next steps in the Stage 1 policy review are to determine:

- what mechanisms should be used for ongoing monitoring (including stakeholder consultation); and
- the appropriate period between cost recovery reviews.

What mechanisms, including consultation, should be used for ongoing monitoring of the efficiency and effectiveness of cost recovery arrangements?

The CRIS (or RIS) should examine and recommend mechanisms for ongoing monitoring that are appropriate for the individual circumstances of an agency. Ongoing monitoring is often a joint responsibility between the agency and stakeholders.

The extent of ongoing monitoring will depend on the significance of the cost recovery arrangements and the impact on stakeholders. Such monitoring would include assessing the agency's internal information collection and efficiency measures, and appropriate external arrangements. For significant cost recovery arrangements, it would include the appropriateness of the agency's existing consultative mechanisms and their ability to scrutinise cost recovery issues. Ongoing monitoring is discussed further in Stage 4.

How long before the cost recovery arrangements should be reviewed again?

An agency's circumstances can change. This means that cost recovery arrangements that were once appropriate may no longer be justified. A periodic review of all existing arrangements is therefore required, covering the appropriateness of cost recovery, the design of any cost recovery charges and the adequacy of monitoring arrangements. The CRIS (or RIS) should recommend a date for this review, no later than five years from the date of the previous CRIS (or RIS).

STAGE 2

Design and Implementation

Stage 2: Design and Implementation

Charges can be collected in a variety of ways and based on different measures of costs. Agencies should choose the appropriate approach for a particular product/service by:

- linking the charge or charges as closely as possible to the activity or product to be cost recovered;
- designing a system that is cost effective to calculate, collect and enforce;
- designing a system where the compliance costs of paying the charges are not excessive;
- balancing certainty with the flexibility to modify the approach to cost recovery if ongoing monitoring (Stage 4) indicates that this is desirable;
- ensuring all aspects of the charging mechanism are consistent with the policy objectives of the agency; and
- designing a charging mechanism that is not inconsistent with other Australian Government policies.

Partial cost recovery

Partial cost recovery is generally inappropriate. Where cost recovery is justified, all the costs of the activity should generally be recovered. Partial cost recovery may be acceptable where cost recovery is being 'phased in' for new arrangements (where an adjustment period is necessary) or where an agency adjusts charges for particular groups of clients in order to meet Australian Government endorsed community service obligations or for explicit Australian Government policy purposes.

If an entity is proposing to recover less than the total cost of providing the good/service, on the grounds that full cost recovery would not be in line with policy objectives, Ministers must obtain the Finance Minister's agreement.

Who should pay cost recovery charges?

Users of the Australian Government's information products being cost recovered or individuals/groups that have created the need for regulation should pay cost recovery charges.

Regulatory Activities

For each regulatory activity or product, the charge should incorporate the cost of regulation, subject to the caveats of efficiency, cost effectiveness and consistency with policy objectives.

This improves economic efficiency by ensuring that consumers and producers of regulated products recognise the administrative costs involved in regulation.

Charging the regulated firms is usually the most practical approach to setting cost recovery charges — particularly where the regulatory services needed differ substantially between firms. This is because, for example, the cost of assessments can vary according to the time and effort needed to undertake each assessment, and at different points over a product's life cycle.

Translating such differences into consumer charges would result in a highly differentiated approach to setting fees, and conceivably require different fees for different products, or for similar products marketed by different firms. Charging regulated firms for the regulatory activities would reflect costs more directly.

Information Activities

The Australian Government may agree to a taxpayer funded basic product set. Most other information products are funded through a fee charged to the individual or organisation using those information products. In some cases, the fee is charged to an organisation that represents the final users of the product (for example, universities may buy data on behalf of their staff). Also, some products may be funded by a levy or other charging arrangement that is targeted at an identifiable group that uses the product.

Should cost recovery charges be imposed using fees or levies?

Cost recovery charges can be introduced using:

- a fee that charges individuals or firms directly for the costs of providing the activity; or
- a levy on a group of individuals or firms (legally a form of taxation). Levies need to be established using a tax Act.

This issue has already been discussed to some extent for regulatory activities in Stage 1 (see, for example, Figure 3 on registration and approvals).

When cost recovery is appropriate, charges should be based on fees, as long as they are efficient, cost effective and consistent with the policy objectives of the agency. Because they are not so closely linked to the costs of individual activities, levies do not have the efficiency advantages of fees. They may also place less direct pressure on the agency to improve efficiency. Therefore, it is desirable, where possible, to charge for activities directly through fees.

Where levies are used, they should be closely linked to costs and focused on recovering costs from only those groups of firms or individuals that use the products or services or create the need for regulation. If this is not possible, then the efficiency advantages of a levy over general taxation are less clear.

What are the legal requirements for the imposition of the charges?

All cost recovery charges (both fees and levies) should have appropriate legal authority. However, different constitutional requirements govern the imposition of a tax and a fee. Also, while all charges can be imposed as taxes, not all charges can be imposed as fees. Whether a charge can constitutionally be imposed as a fee depends on a number of factors, including the kinds of costs sought to be recovered and how the costs are allocated between users of a service.

It is important therefore that legal advice be sought on cost recovery arrangements at an early stage of their design.

In addition, international obligations (for example, governing the sharing of information) could constrain the application of cost recovery charges. Where appropriate, agencies should consult with the Department of Foreign Affairs and Trade to ascertain whether any such obligations are relevant to the activities to be cost recovered.

Which issues should any legislation address?

Agencies should consider the level of specific guidance on cost recovery charges to be included in legislation or any regulations attached to that legislation. Such legislation could either specify the details (level, rates etc.) of the cost recovery charges or describe characteristics of the charges.

In designing any legislation, the agency should balance the level of certainty with the need for flexibility. While providing a high degree of certainty, legislated charges may be difficult to change in response to issues raised in ongoing monitoring.

If detailed guidance as to the basis of cost recovery is to be included in the legislation, legal advice should be obtained as to whether the basis chosen is consistent with constitutional requirements.

Which costs should the charges include?

The types of costs that should be included in charges may differ depending on the activity being recovered.

Any functions undertaken by an agency that are integral to the activity are appropriate and efficient to include in cost recovery (refer to Box 2—page 44 for more detail).

Regulatory activities

For regulatory products or services, cost recovery charges ideally should reflect the costs of undertaking individual activities. As far as possible, the agency should identify costs against particular activities to minimise the need to distribute costs arbitrarily among activities.

A very precise approach to charging can be costly. In nearly all cases, an agency will need a system to split overhead costs among the activities being charged.

Information activities

Information products fall into three different categories:

- ***Commercial products***, which the private sector could provide. These products may draw on the agency's basic product set but also include a substantial enhancement. Products subject to competitive neutrality principles are not subject to these cost recovery guidelines.
- ***Incremental products***, that only the agency can provide. These products build on or enhance the agency's basic product set.
- ***Marginally costed products***, which only the agency can provide. These products involve further dissemination of existing taxpayer funded products.

Activities that are funded through general taxation form the basic product set of an agency. All products to be cost recovered should recoup at least the additional direct costs incurred beyond those of the basic product set. Capital and overhead costs, on the other hand, should be recovered for only some cost recovered products.

Commercial products, where there is actual or potential competition and which are subject to the disciplines of competitive neutrality principles need not also apply these cost recovery guidelines.[2]

The charges for incremental products should be based on incremental cost and should include those costs (including capital costs) and overheads that arise as a result of providing the incremental product (or that would not have been incurred if the incremental product were not provided).

For marginally costed dissemination (for example, where additional copies of an information product are required), charges should not include any capital or overhead costs, only the direct costs such as labour and materials.

[2] For further information regarding competitive neutrality, refer to Financial Management Guidance No.9 – Australian Government Competitive Neutrality Guidelines for Managers, available from http://www.finance.gov.au.

Box 2 Policy development and meeting Parliamentary requirements that are unrelated to the provision of the activity

Policy development and parliamentary servicing functions that are integral to the activity are appropriate and efficient to include in cost recovery (for example, some costs relating to international regulatory standards conformance). The CRIS (or RIS) must clearly explain the circumstances in which these activities are to be cost recovered.

However, where policy development and meeting parliamentary service functions are not integral or directly related to the provision of regulatory activities, they will generally, where agreed by the Australian Government, be funded from general taxation.

Examples of activities that may not be directly related and so may need to be individually assessed include:

- advising Parliament on issues on which the agency has expertise;
- answering Parliamentary questions;
- briefing Ministers and responding to their correspondence;
- financial reporting; and
- complying with international treaties.

How should charges be structured?

The structure of charges may also differ depending on the activity being recovered.

Appendix A lists some complex issues in the designing of cost recovery charges for regulatory and information activities.

Regulatory Activities

To determine the best pricing structure, agencies need a good understanding of the cost drivers behind particular activities. Costs will usually depend on factors such as the complexity of the regulated product, the standards applied, the riskiness of the product (and thus the intensity of the testing process) and the amount of information that needs to be analysed to undertake the assessment.

Agencies may have insufficient information to formulate prices that reflect those cost drivers precisely; therefore, an agency will often need to use a proxy for the costs that are attributable to a particular firm in the industry. Such proxies include:

- classifying firms or products into groups that reflect the riskiness of each group and the agency's effort in regulating the group; and
- the size of the firm.

Information Activities

Most charges for information activities will be direct fees designed to collect the incremental or marginal cost of products. However, in some areas, complex issues may arise, such as:

- charging for a non-rivalrous product when the additional cost of others using the product is very low;[3]
- charging for a new product when the future demand for that product is unclear;
- charging for an incremental product that has large fixed costs (such as data collection or storage) and whether pricing differentials should be used to allocate those overheads between customers; and
- charging for products provided to other Australian Government agencies and other levels of government.

These matters require a degree of judgement. The guiding principle should be that agencies maximise the community's use of information while minimising their call on taxpayer funding for products outside the basic product set agreed by the Australian Government. CRISs should clearly explain how agencies have made these judgements. Appendices A and B discuss some selected charging issues for information activities.

How should costs be calculated and allocated?

Once the agency has decided on the structure of prices, its next step is to calculate and allocate the costs of the products. The full cost of each product is the value of all resources used or consumed in providing that output, and it includes direct, indirect and capital costs (Box 3—page 46).

The estimation and allocation of costs should follow several key principles:

- cost estimates should be based, wherever possible, on the efficient costs (Box 4—page 47), not actual costs; and
- costing systems should be transparent (Box 5—page 47).

[3] Many information products are non-rivalrous and often it will be inappropriate to charge for these products, so they form part of the taxpayer funded basic product set. This question arises only after the agency has concluded that taxpayer funding is not appropriate.

Stage 2: Design and Implementation

If capital costs and overheads are included in charges, then agencies also need to:

- develop a method to calculate all aspects of capital costs (Box 6—page 48); and
- develop a method to distribute capital and overhead costs among activities (Box 7—page 49).

Box 3 Cost definitions

Direct costs are costs that can be directly and unequivocally attributed to a product. They include labour (including on-costs) and materials used to deliver products.

Indirect costs are costs that are not directly attributable to a product and are often referred to as overheads. They can include corporate services costs, such as the costs of the Chief Executive Officer's salary, financial services, human resources, records management and information technology.

Capital costs comprise the user cost of capital and depreciation. The user cost of capital represents the opportunity cost of funds tied up in the capital used to deliver products. It 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 assets consumed each period in the production of output.

Fixed costs are costs that do not vary with output. Rent and capital are usually fixed costs in the short run.

Variable costs vary with output and typically include direct labour and materials.

Common or joint costs remain unchanged as the production of different products is varied. These costs are incurred if any one of the products is provided. For example, the cost of a telephone line remains unchanged whether it is used for local or long distance calls.

Box 4 Cost recovery arrangements should reflect efficient costs

While cost recovery can promote efficiency by instilling cost consciousness in the agency and its customers, poorly designed arrangements can create incentives for 'cost padding' and inefficiency. This could also give rise to legal arguments as to the appropriate level of cost recovery. Therefore, cost recovery arrangements need to ensure prices are based on the minimum cost necessary to deliver the product and still maintain quality over time.

If products are not provided efficiently, then the agency should, where possible, reduce cost recovery charges to reflect efficient costs. This applies to direct, capital and overhead costs.

Efficient costs are particularly important when measuring capital costs. Some agencies have been accused by users of 'gold plating' (that is, installing assets that are unnecessarily large or sophisticated relative to the needs of users). In that event, even a modest rate of return on capital could lead to the agency charging artificially high capital costs.

It is not a simple matter to establish efficient costs. In some cases, it is possible to benchmark the agency, both domestically and overseas, to determine the 'reasonableness' of its costs. Market testing or contracting out some aspects of the agency's activities are also good ways of gauging efficiency.

Box 5 Transparency of arrangements

Transparency is a key means of improving the efficiency and accountability of agencies. It requires agencies to articulate clearly their broad objectives and to explain how their activities, products and approaches to cost recovery (including costing systems) contribute to those objectives. Transparency also often requires consultation with stakeholders.

'Commercial in confidence' is not usually a sufficient reason for withholding costing information for most products. Only a small proportion of the products of these agencies are commercial in nature. Overall, the benefits of transparency greatly outweigh any commercial considerations.

Therefore, to meet their transparency obligations, agencies should adopt costing models sufficiently detailed to allow the Parliament, the Government and, where relevant, stakeholders to analyse their production costs. Agencies should develop clear costing models detailing actual costs, and how those costs relate to prices and be able to provide information on how capital costs are calculated and how capital costs and overheads are allocated among products.

The adoption of detailed costing models is also necessary in case the validity of the fees is challenged and an agency needs to demonstrate that the fees are authorised by the legislation - imposed on a basis that is consistent with fees rather than taxes for constitutional purposes

Box 6 Calculating capital costs

There are various approaches to calculating capital costs. Agencies need to justify the method used to determine capital costs and depreciation.

In general, the approach chosen needs to balance:

- the costs of implementing the method chosen;
- optimising asset valuations to remove from the asset base facilities or parts of facilities that are not necessary to produce cost recovered products efficiently;
- accounting for increases or decreases in the value of the asset over time; and
- being able to incorporate changes if feedback from the ongoing monitoring process indicates that such changes are necessary.

Box 7 provides further guidance on allocating capital costs.

Box 7 Allocating costs – including capital costs

All products to be cost recovered should recoup at least their direct costs. Allocating direct costs to products is relatively straightforward. Allocation becomes more difficult where indirect and capital costs (see also Box 6) are involved.

When fees or levies are imposed across a significant proportion of an agency's activities, they should include both the direct costs of the activities and the capital and indirect costs (including costs associated with setting and determining the appropriateness of fees charged). If cost recovered activities are a small proportion of the agency's activities, and they have little effect on the agency's overheads or capital expenditure, then it would generally be appropriate for the agency to recover only the direct costs of these activities. If taxpayer funded activities are only a small proportion of the agency's activities, then the Australian Government should meet only the direct costs of these activities.

For those agencies that provide information products, the costs of collecting, compiling and distributing the basic information product set account for most of their work and, therefore, most of its indirect costs and capital costs. In these circumstances, the Australian Government may agree to taxpayer funding covering the stand-alone cost of providing the basic information product set. However, when incremental information products are a large part of an agency's activities, the agency should look closely at which capital costs and indirect costs (including costs associated with setting and determining the appropriateness of fees charged) are attributable to the incremental product.

Indirect and capital costs can be distributed in a number of ways. For example, under Fully Distributed Costing[4], 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, Activity Based Costing[4], is more accurate in how it allocates indirect costs. It links an organisation's outputs to activities used to produce those outputs, which in turn are linked to the organisation's costs.

The appropriate approach to distributing capital and overhead costs can vary depending on the characteristics of the agency. The agency should balance accuracy and precision against the costs of particular methods, and justify the method chosen.

[4] Refer to the publication *Cost Allocation and Pricing*, available from the Australian Government Competitive Neutrality Complaints Office.

STAGE 3

Cost Recovery Impact Statement Process

Stage 3: Cost Recovery Impact Statement Process

While all cost recovery arrangements must comply with the cost recovery policy and these guidelines, only significant arrangements need to document compliance with the policy in a Cost Recovery Impact Statement (CRIS). Together, the responses to the questions in the preceding Stages 1 and 2 form a CRIS (discussed in the previous sections).

What is a significant cost recovery arrangement?

To determine whether a cost recovery arrangement is considered 'significant' both the revenue generated and the impact of cost recovery on stakeholders needs to be taken into account.

A 'significant cost recovery arrangement' is one where:

- an agency's total cost recovery receipts 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
- an agency's cost recovery receipts are below $5 million per annum, but stakeholders are likely to be materially affected by the cost recovery initiative; or
- Ministers determine other cost recovery arrangements to be significant on a case-by-case basis.

Triggers for preparing a CRIS

A CRIS should be prepared for significant cost recovery arrangements, when:

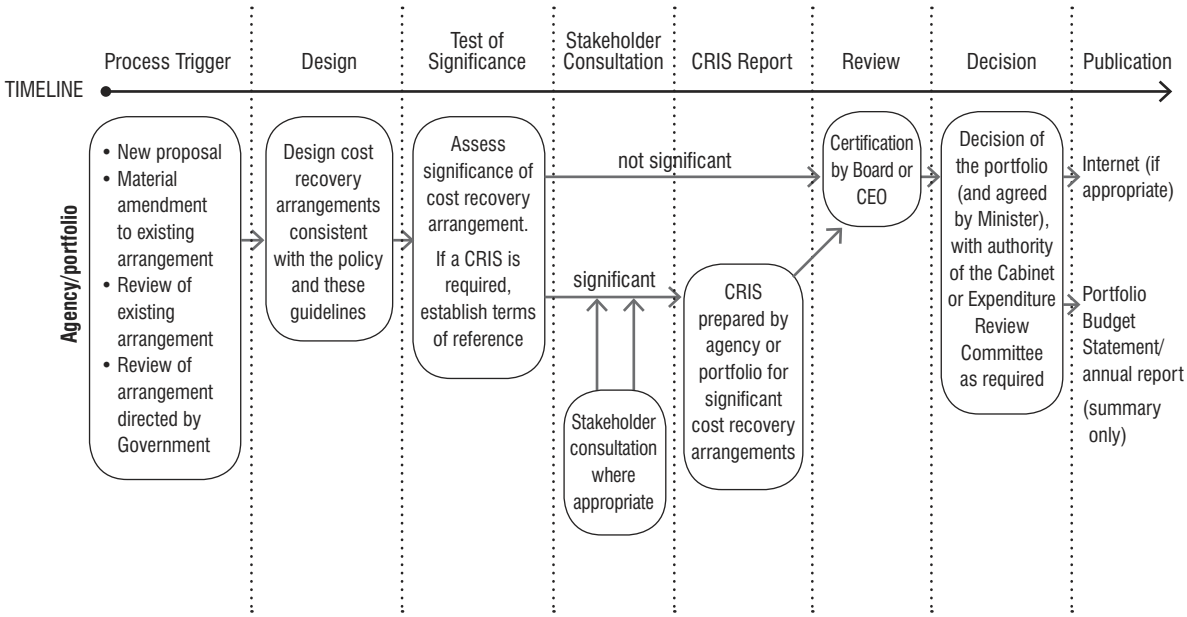
- reviews consistent with the Australian Government's review schedule for existing cost recovery arrangements are undertaken;
- new cost recovery arrangements are proposed;
- material amendments are made to existing arrangements (a general rule-of-thumb is that price changes greater than the Consumer Price Index would be considered material—however agencies should also consider the likely impact on stakeholders); and
- periodic reviews of cost recovery arrangements are undertaken.

For example, if an agency with cost recovery revenues over $5 million proposes to introduce cost recovery for a new activity, or intends to extend cost recovery to an existing activity that previously was not subject to cost recovery, a CRIS would be required under the 'new cost recovery arrangements' trigger. Where agencies already have cost recovery arrangements in place, and propose material increases/decreases in charging levels or changes to charging structures, a CRIS would be required under the 'material amendments' trigger. However, if agencies only propose a minor increase/decrease to charging levels, without any change to charging structures, a CRIS would not be required.

Chief Executive Officers (FMA Act agencies) or Boards (CAC Act bodies) are responsible for ensuring that CRISs are prepared.

For new arrangements or material amendments to existing arrangements, a CRIS needs to be prepared before the changes are introduced. The CRIS process is summarised in Figure 7.

Figure 7 CRIS development process summary



Agencies can seek guidance on whether a CRIS is required to be prepared from the Department of Finance and Administration.

Stage 3: Cost Recovery Impact Statement Process

What should be included in a CRIS?

In essence, a CRIS transparently documents how an agency's fees and charges comply with the cost recovery policy. The CRIS should:

- demonstrate that charges reflect the costs of providing the product or service;
- identify the beneficiaries of the good or service or the individuals/groups that have created the need for regulation; and
- identify the most appropriate means to impose the charge i.e. as a fee-for-service or as a levy.

Typically, a CRIS includes both a 'Policy' component (Stage 1) and a 'Design and Implementation' component (Stage 2).

Agencies with proposals in which policy issues have been settled and only design and implementation questions remain, or where a section of these guidelines does not apply, may prepare a less comprehensive CRIS. The agency must justify, in the CRIS, why a less comprehensive approach is warranted and should refer to where the omitted information is otherwise available (for example, an earlier CRIS).

If significant cost recovery arrangements are not fully assessed against these guidelines where a policy decision precedes a funding decision, then these arrangements should be assessed against these guidelines prior to implementation; a CRIS should be prepared at that time.

Consultation

The preparation of the CRIS should involve an appropriate level of consultation with stakeholders (including relevant departments, industry and small business), where appropriate. Where stakeholder consultation mechanisms exist, the agency preparing the CRIS document could utilise these mechanisms to consider cost recovery arrangements. At the discretion of the agency, its portfolio and/or their Minister, consultation may be extended to other stakeholders and take other forms.

What happens when the CRIS has been finalised by the agency?

Portfolio Ministers are ultimately responsible for agencies' compliance with these guidelines and are required to report annually in Portfolio Budget Statements. While the agency's management is responsible for completing the agency's CRIS, the CRIS will be reviewed by the Expenditure Review Committee. For this reason, when an agency has finalised a CRIS, it must provide the Department of Finance and Administration with a complete copy of the CRIS that has been certified by the Chief Executive Officer (FMA Act agencies) or Board (CAC Act bodies).

Comments made by the Department of Finance and Administration, at this stage, are generally in respect of whether the CRIS addresses the requirements of the cost recovery policy. Where relevant, consideration of the policy merits of a proposal may occur separately.

Summary CRISs

A summary of the completed CRIS must be included in the Portfolio Budget Submission for consideration by the Australian Government and in Portfolio Budget Statements for public scrutiny. Agencies should consider publishing the CRIS on their website.

The Department of Finance and Administration issues guidance on reporting requirements for Portfolio Budget Statements from time to time. The general requirements for a summary CRIS are:

- the title of the CRIS;
- a brief description of the cost recovery activity relating to the CRIS, including the type of charge(s) and in general terms, who pays the charge(s);
- the legislative authority for imposing the charge, if relevant;
- the costs incurred, the method proposed to recover costs and discussion on how the costs were determined to be appropriate to recover;
- the total revenues forecast to be recovered for the financial year;
- a description and justification of the level of consultation undertaken and a summary of the views expressed by those consulted (as appropriate); and
- a statement of when the cost recovery arrangements will be reviewed again.

Relationship between the CRIS and the RIS (for regulatory activities)

A Regulation Impact Statement (RIS) is required for proposed regulation (or amendment to regulation) that affects business. The RIS is examined by the Office of Regulation Review (ORR). Agencies that are required to prepare a RIS do not need to prepare a separate CRIS (Figure 8) because the RIS will incorporate the requirements of the CRIS identified in these guidelines. The cost recovery analysis segment of the RIS should be clearly identified, so that it can be reviewed in isolation.

Stage 3: Cost Recovery Impact Statement Process

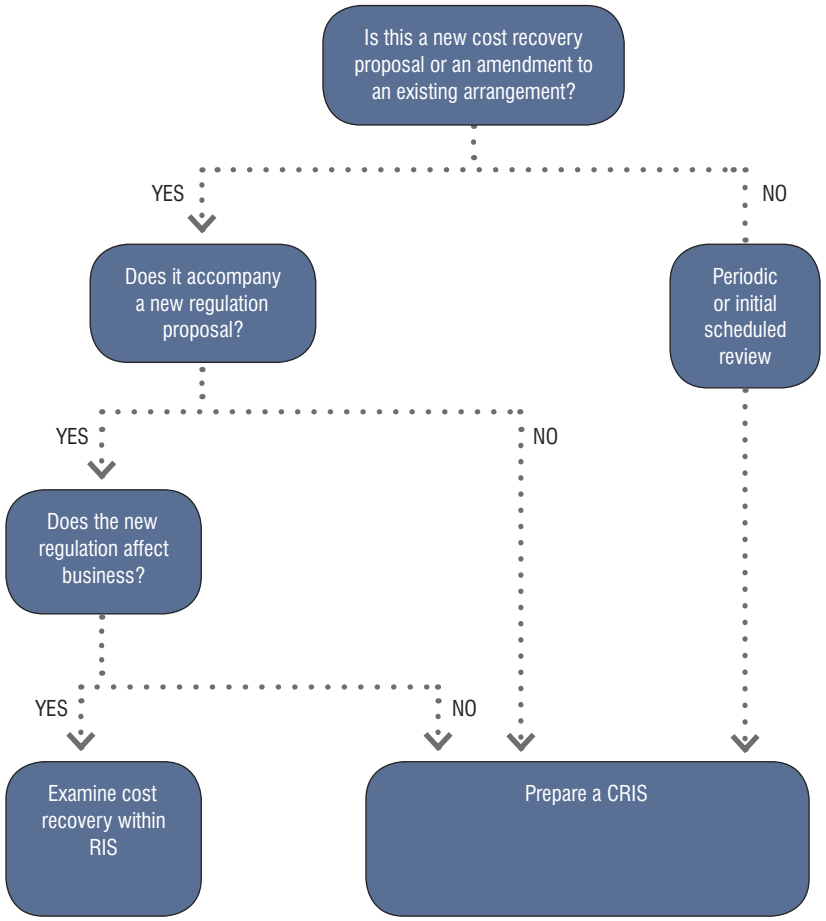
Generally a RIS will not be required, and hence a CRIS will be necessary where:

- the agency is undertaking a review of its cost recovery arrangements, without an associated review of regulation; or
- the new or amended cost recovery proposal is introduced administratively rather than through regulation; or
- the cost recovery proposal affects individuals, not businesses.

Figure 8 outlines instances in which a RIS, rather than a CRIS, would be required.

Agencies seeking to confirm when a RIS or a CRIS is required, should consult the ORR or the Department of Finance and Administration respectively.

Figure 8 Choosing between a CRIS and a RIS



STAGE 4

Ongoing Monitoring

Stage 4: Ongoing Monitoring

Once the cost recovery arrangements begin to operate, the agency should introduce effective ongoing monitoring mechanisms to:

- obtain feedback so it can adapt its approaches to cost recovery in response to changing circumstances;
- ensure fees and levies are based on efficient and transparent costs;
- ensure individual firms or industries do not have undue influence over the agency; and
- reduce the frequency of major reviews of cost recovery arrangements by allowing minor issues to be addressed as they arise.

Agencies with significant cost recovery arrangements should have adequate mechanisms in place to promote consultation with stakeholders (including relevant departments, industry and small business) where appropriate. The characteristics of a committee, if relevant, are a matter for each agency, with the approval of their Minister. However, agencies may consider the following where appropriate:

- stakeholder representation;
- ability to monitor agency efficiency;
- access to adequate information on agency processes and costs; and
- transparent reporting processes.

Details of agency cost recovery arrangements will also be available in financial statements (included in Portfolio Budget Statements and annual reports).

STAGE 5

Periodic Review

Stage 5: Periodic Review

Cost recovery arrangements should be subject to periodic review no less frequently than every five years. Where possible, this review should occur in conjunction with other relevant agency reviews.

New products can emerge, for example, that were not envisaged under the original regulation, resulting in a need to change the scope of the products regulated and, therefore, the scope of cost recovery arrangements. Community attitudes can change too, affecting the level of risk that the community is willing to accept and thus the appropriate level of regulation. Also, new technology can affect the costs and methods of testing regulated products, with implications for the agency's approach to cost recovery.

For information activities, the need for change can result from new technology, increased competition from overseas providers of information, new international protocols and changes in the demarcation between the Commonwealth and the States in some areas, for example. New technology could make it easier for the private sector or international competitors to provide products originally supplied by only the government sector. This change may not only affect decisions about the level of cost recovery, but also raise a question about whether the Australian Government should continue to provide the product.

Developments in technology have increased the range of options for distributing information and decreased the cost of existing modes of dissemination. This means, at a minimum, that costing information on which an agency's cost recovery charges are based can rapidly become obsolete. In some cases, the rationale for cost recovery may become open to question. This could happen if, for instance, new technologies mean that cost recovery is no longer consistent with an agency's objectives.

Where changes are particularly frequent, an agency will need to review the existing arrangements within a shorter timeframe. However, effective ongoing monitoring processes that facilitate continual improvements in efficiency, along with adjustments in response to changing circumstances, reduce the need for frequent periodic reviews (see Stage 4).

APPENDICES

Appendix A: Selected charging issues

Regulatory activities

Levy design

Poorly designed levies can create the possibility of cross-subsidies between firms and/or industries. This possibility arises because a levy (whether a flat or proportional tax) applies to all members of a leviable group equally. If, within that group, some members utilise the resources of the regulator less than others, then they can end up subsidising those members that require more intensive regulation.

One solution to the risk of inefficient cross-subsidisation is to define narrow leviable bands, based on identified regulatory cost drivers, so those that make similar calls on the regulator's resources pay the same levy.

Regulatory costs can also vary between industries. If a regulator straddles several industries, then the agency needs to consider whether the costs of regulation are the same across industries; for instance, the products of some industries may be more risky than others and thus require closer scrutiny by the regulator.

Usually, there will be a minimum threshold below which regulatory costs will not fall. At the other end of the spectrum, regulatory costs are unlikely to expand indefinitely. Thus, an agency should set minimum and maximum levies in some circumstances. However, the setting of thresholds and caps should reflect the cost of regulation so they do not create cross-subsidies.

Start-up costs

There are particular pitfalls and solutions in the treatment of start-up costs. An agency needs to consider two categories of start-up costs:

1. ***Agency start-up costs***. If cost recovery charges are designed inappropriately, then excessively high charges could occur in the early years of an agency's operations. This possibility arises for two reasons:
    - the agency has to recover 'one-off' establishment costs as they occur or shortly thereafter; and
    - the agency has to recover establishment and other overhead costs from a relatively small number of early users, leading to abnormally high charges for these users.
2. ***Regulated firm start-up costs***. The problems created by excessive early charges would be exacerbated in areas such as a new scientific field, where early entrants consist of mostly researchers and public institutions. Given their lack of commercial orientation in many cases, along with high start-up costs, few innovators are likely to have the capacity to absorb high cost recovery charges.

Both types of start-up costs could lead to the stifling of important scientific work in Australia if agencies recover costs inflexibly over time.

New products

In general, the regulatory approval process for new products precedes their introduction into the marketplace. This raises the possibility that producers (or importers) will be required to pay 'up front' for the approval of a product that may prove to be a commercial failure (or have a short shelf life). Further, because the product has not yet entered the market, the supplier may not have the cash flow necessary to meet the cost recovery charges.

Agencies might 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 (based on sales). This 'backloading' has the advantage of giving the producer access to sales revenue to cover regulatory costs. On the other hand, it transfers some of the commercial risk from the firm to the regulator: if the product fails commercially and is withdrawn from sale, then the regulator may be unable to recover all its initial assessment costs. There is also a risk of successful or high volume products subsidising unsuccessful products.

Some agencies have implemented concessional fees for 'low volume', 'minor use' and 'low hazard' products to avoid this problem. Those agencies for which high up-front costs are likely to be an issue should consult with regulated firms to devise a solution that suits their circumstances.

Information activities

Charging for non-rival products

For non-rival products, the additional cost of others using the product is low. Thus, it may be difficult to devise a charging approach that recovers the initial cost of providing the service without discouraging subsequent demand. Some ways of structuring prices, such as using access fees or two-part tariffs, will recover costs while minimising the direct charge for the use of additional units of the product.

Charging for products when future demand is unclear

When agencies are approached to provide a new product, it can be very difficult to estimate the future demand for that product. That is, the request for the product may be a one-off or the first of many such requests. This has implications for the fee that the agency should charge. The charging approach needs to balance:

- recovering the costs of extraction and manipulation;
- not discouraging others from using the information once it has been extracted; and
- not discouraging clients from coming forward with new requests for information that may benefit others.

Appendix A: Selected charging issues

For one-off requests, the agency should charge the full incremental cost of providing the product. When the request is the first of many, the agency should determine whether it is cost-effective to store the information with a view to meeting subsequent requests. If it is not, the first customer should be charged the full incremental cost of the product.

If the initial request is likely to be followed by many others, then the agency should strive to estimate the size of future demand, possibly using market research techniques. It will then be able to determine whether it is cost effective to store the product for future use (by the same customer and/or other customers). Estimates of future demand will also allow the agency to spread the cost over all users and thus to charge more equitably and efficiently.

The charging structure adopted will allocate costs between the client that requests the new product and subsequent users. Different charging structures will have different effects.

- Charges that average costs over all anticipated users of the product may encourage new requests for information products (because charges are less than the incremental cost) but could discourage some subsequent users of that product (because charges are more than the marginal cost of dissemination). The agency also bears the risk that revenues will be too high or too low if its estimates of demand are wrong.
- Charges that reflect the incremental cost of the first client requesting the service and marginal costs for subsequent clients could discourage new requests but will encourage subsequent users of that product. This form of charging provides more certainty in the agency's revenue.

The nature of the information product may help guide the agency on the approach to charging that best suits its circumstances.

Charging for products with large fixed costs

Where there are large fixed costs and hence substantial economies of scale, agencies may be tempted to adopt price discrimination to recover the overhead costs of collecting and compiling information. Price discrimination refers to charging different users different fees for the same product, even though the cost of supply is the same. This pricing policy is made possible by different customers having a different willingness to pay for the same product. This is reflected in their differing reactions to price changes. For instance, airlines charge business travellers more than they charge holiday makers because the former are more willing to pay and less sensitive to price increases.

Price discrimination can only work in limited circumstances where the person paying the lower price cannot on-sell to other users and customers cannot select to fall into one or another category. For instance, a media conglomerate should not be able to pass itself off as an individual customer. Price discrimination also requires the agency to identify customers' ability to pay with some precision. This is likely to be difficult for large agencies with many products.

The objective of cost recovery is not to maximise revenue. Charges are intended to recover the cost of non-taxpayer funded activities while encouraging the use of information products. Therefore, any use of price discrimination needs to be treated cautiously. In the case of fees, there is legal scope for fee structures to discriminate between different classes of users but there must be legally justifiable reasons for the adoption of a discriminatory fee structure. If a discriminatory fee structure is proposed, legal advice should be obtained on whether the pricing structure is consistent with constitutional principles.

If an agency is already pricing products at marginal cost, then there should be no scope for price discrimination.

Charging for products and services between agencies

Charges for products and services between agencies should be set on the same basis for both the Australian Government and other clients. Where one or both of the agencies involved in inter-agency transactions also provides services to purchasers outside the Australian Government, the inter-agency arrangements need to be transparent to avoid the introduction of cost shifting and cross-subsidies between the Australian Government and non-government parties.

To the extent that transactions between Australian Government agencies are more in a nature of a transfer of budget funding, inter-agency charges can reflect budget allocations more than cost recovery. Nonetheless, the proper allocation of costs brings efficiency and accountability benefits. The principles underlying appropriate cost recovery could be usefully applied to inter-agency transactions, even where they are governed by explicit contracts or by other 'arm's-length' arrangements.

Similar arguments apply to transactions between different levels of Government. Some arrangements reflect inter-government agreements on collectively provided services. Using pricing mechanisms can help to drive efficiency and accountability.

Appendix B: Case Study - Information on the Internet

The Internet can provide a relatively low cost way of distributing information to a large number of people. It has the added advantage that the data are conveniently available electronically. However, Internet sites are expensive to set up and then to expand as demand increases. The following discussion considers the public good characteristics of information on the Internet.

Usual case

General use clients are low volume, low frequency users. Some will be one-off, but others will visit the site regularly. Most use of the site by these clients will be non-rivalrous. Usually many people will be able to use the site without increasing the cost of delivering the data.

It is technically possible to exclude a person from using an Internet site. Banks, for example, have developed secure Internet sites that restrict access and enable charges to be levied on transactions. For general use clients, charging is not likely to be cost effective because the efficiency gains from charging are likely to be low and, usually, the use of Internet based information by these clients would fall dramatically if charging was introduced. Under these circumstances, distributing information over the Internet has sufficient public good characteristics to warrant taxpayer funding.

Special cases

High volume clients use large amounts of information regularly. They could drive the overall capacity of the Internet site because they will have the greatest effect on the volume of information stored and the speed of processing needed to retrieve and/or manipulate the information. In effect, these clients demand an incremental service, which consists of the extra investment in capacity (beyond what is required by general use clients) needed to meet their demands.

Use of the Internet site by this group may or may not be rivalrous, depending on how the long-term capacity of the site compares with the demands of the users. Charging based on incremental costs may be cost effective if high volume clients can be identified and charged without limiting the availability of information to general use clients.

Time sensitive clients require fast access to new data. This may be the release of new statistical collections or updates on information that changes frequently (such as the weather). If the demand by time sensitive clients results in congestion during peak periods, then the use of the site becomes rivalrous. One person's use of the site may prevent someone else from accessing it or reduce the speed with which they can download information. In these cases, the use of the Internet site does not have public good characteristics. It may be possible to charge for the product by, say, registering clients who want priority access to this information immediately following its release.