
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: February 28, 2008

IBA Report Number: 08-20

Budget and Finance Committee Agenda Date: March 5, 2008

Item Number: 1

Need for Comprehensive Annual User Fee Review Process as Part of the Annual Budget

OVERVIEW

For two years in various reports, the IBA has discussed the need for the City to identify the full cost of service for activities that charge user fees; to determine current cost recovery rates for these activities; to develop “target” cost recovery policies and, to propose recommendations to Council for achieving these targets. The Kroll report released in August 2006 also included a recommendation “that activities supported by user fees should be fully cost recoverable.”

A Government Finance Officers Association (GFOA) best practice of “Setting of Government Charges and Fees” (1996) also supports the use of charges and fees as a method of financing governmental goods and services. They make the following key recommendations to guide the process:

1. A formal policy regarding charges and fees should be adopted.
2. The full cost of service should be calculated in order to provide a basis for setting the charge or fee.
3. Charges and fees should be periodically reviewed and updated based on factors such as the impact of inflation, adequacy of coverage of costs and current competitive rates.
4. Information on charges and fees should be made available to the public.

In IBA Report 06-4, “City Council Budget Priorities for FY 2007” (January 25, 2006), the IBA recommended that the City Council request in their first Budget Priorities Resolution that the Mayor provide information on “current cost recovery levels for all fee supported programs and services and recommend action for achieving higher cost

recovery revenues.” In a March 3, 2006 press release, the Mayor announced a requirement for the FY 2007 Budget “that where fees are imposed, they need to be cost-based and support the programs for which they are charged.”

In IBA Report 06-18, “Review of the Mayor’s Proposed FY 2007 Budget” (April 28, 2006), we noted that there was no discussion of fees for services in the Proposed Budget. We also reported that “no comprehensive, cost-based annual user fee review exists in the organization; fees are currently not based on service cost models; and it is unknown whether fees are supporting total program costs.”

On January 17, 2007, the City Council participated in a “Strategic Budget Prioritization Process” in order to provide guidance to the Mayor in advance of development of the FY 2008 budget regarding key service priorities, critical issues, and possible budget solutions including an assessment of revenue enhancement options. Through this polling process, Council members expressed a preference for “Program Cost Recovery” over most other revenue options. These results were provided to the Mayor as part of the Council’s FY 2008 Budget Priorities Resolution.

We continued the discussion of user fees and cost recovery levels in our review of the “Mayor’s Five Year Outlook 2008-2012” (IBA Report 07-36, March 22, 2007):

“An annual fee cost-recovery analysis should be done each year and the results reported as part of the annual budget process. This will facilitate decision-making by incorporating it into the context of annual budget decisions. Once such a program is in place, costs can be easily updated each year. Once fees have reached appropriate cost-recovery levels, the City should consider annual systematic increases in order to keep up with inflation in future years.”

We raised this issue again in our “Preliminary Report on the Mayor’s Proposed 2008 Budget” (IBA Report 07-46, April 27, 2007):

“The City’s Administrative Regulation 95.25 outlines the City’s procedures to establish fees to recover the cost providing City services. Once established by Council, the Mayor is authorized to conduct annual reviews of the fees and charges to ensure that reasonable costs incurred in providing these services are being recouped.” (This language is also reflected in Council Policy 100-50.)

“The City does not currently have an updated or accurate analysis of the full cost of many fee-supported services, nor is there a comprehensive list of all cost-recovery fees. This information is critical in order to determine whether current cost recovery policies are being met, and in developing recommendations for rate increases, if appropriate.”

In IBA Report 08-9, January 25, 2008, “Review of the Mayor’s 2009-2013 Five Year Financial Outlook,” we noted that the Executive Summary of the report stated that “budget solutions include enhanced revenue to ensure cost recovery of fee-supported

services.” However, there was no further discussion of this matter nor was any such solution reflected in the strategies incorporated to help offset future budget deficits.

We have carried this issue forward in our “IBA Policy Recommendations” matrices for both FY 2007 and FY 2008 as items that require attention. The City’s user fees and cost recovery rates have not been comprehensively reviewed on a department-wide basis in many years. The City is facing a stated \$32 million deficit for FY 2009, as well as a structural budget deficit as discussed in IBA Report No. 08-14 and presented to the Budget & Finance Committee on February 20, 2008. The City Council should be made aware of where existing user fees are not recovering the full cost of service and how much revenue is potentially recoverable. This is an option that could help minimize service reductions and should be deliberated during the annual budget process.

A fee proposal for FY 2009 was scheduled to be discussed by the Mayor’s Office at the March 5, 2008 Budget & Finance Committee meeting in preparation for the FY 2009 Budget Process. The Mayor’s Office has indicated that this item will likely not be ready for next week’s Committee meeting or for FY 2009 budget deliberations.

CONCLUSION

The following steps are recommended for Committee consideration in order to get this process underway, with the goal of returning to City Council with the results of a comprehensive annual user fee review by January 2009 in time for consideration during the FY 2010 budget process. In the interim, we encourage the CFO to complete any work on user fees that was underway for FY 2009 and provide a written update to the Council and the IBA in advance of the release of the Mayor’s Proposed FY 2009 Budget. This issue is of growing importance given the budget deficits this City is facing in FY 2009 and beyond.

1. Recommend that the Budget & Finance Committee and the Audit Committee request the City Auditor to undertake an audit of the City’s user fee process as part of his Annual Audit Work Plan. If additional resources are necessary, this should be discussed during the budget process. Attached is an Executive Summary of a “Fee Structure Review” audit prepared by the City of Austin, Office of the City Auditor, for the Austin City Council which recommended process improvements for “setting and evaluating fee levels and structures” for that municipality. (Attachment 1)
2. Recommend that the Audit Committee discuss with the City Auditor what role the Auditor’s Office should play in assisting Financial Management and other City departments to implement a comprehensive annual user fee review process. This could include providing uniform guidance on current cost of service and cost recovery calculations; assisting in implementation of a City-wide approach to achieving cost recovery “targets,” as well as a systematic process for annual inflationary adjustments; and compiling a master fee schedule for the City of San Diego.

The City of Phoenix provides an example where the City Auditor plays a significant role in the annual user fee review each year by working with City departments to achieve accurate and uniform cost accounting. This is done as a routine step in the City's annual budget process. As fee revenues drop below policy targets, the Council is able to evaluate potential fee increases along with other annual budgetary actions. Attached are the summary results of the City of Phoenix's Annual User Fees Audit for FY 2008. (Attachment 2)

3. Recommend that as a follow-up to the above, a user fee and cost recovery policy be developed for Council review and consideration by January 2009.

[SIGNED]

Andrea Tevlin
Independent Budget Analyst

Attachments (2)