



Cost recovery at MPI

Findings from the First Principles Review of MPI's cost recovery arrangements

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Executive Summary

This document summarises the findings of the Ministry for Primary Industries (MPI) first principles review of its cost recovery arrangements. This includes the development of the MPI cost recovery policy guidance through phase one, the key findings from the second phase and what we plan doing to continue improving MPI's approach to cost recovery. Supplementary information to support this report is available in a separate document *Findings of the Review - Supporting Information* and referenced as applicable.

MPI's purpose is growing and protecting NZ. Our ambition is that "New Zealand is the most trusted source of high value natural products in the world". Cost recovery has an important role in achieving this, by ensuring that we have sufficient funding to provide the services critical to the operation and viability of the primary industries.

Approximately 40% of MPI's departmental funding comes from cost recovery. Costs are generally recovered from the users who benefit from the services we provide and/or create the risks that we must manage. Given its importance, we are investing in improvements to the way we manage cost recovery.

After updating a large number of fees in 2015, MPI has undertaken a First Principles Review (the Review) of cost recovery across all of the systems we manage. The purpose of the Review was to support a more consistent and transparent approach to cost recovery across MPI, and make sure the approach aligns with the cost recovery guidance published by the Treasury and the Controller and Auditor-General (CAG).

For the Review to be successful it was important to involve the users of MPI's cost recovered services. As part of ensuring this happened we have worked with a Cost Recovery Industry Reference Group (IRG) that includes representation from key industry bodies. We also sought feedback from the public as part of developing a policy framework to support cost recovery across MPI.

We progressed the Review in two phases. During the first phase we developed policy guidance that we are now using to support decision making on cost recovery. The second phase involved a more detailed review of existing cost recovery arrangements across the organisation.

Our analysis found that cost recovery settings are broadly appropriate across all the systems we manage and generally aligned with the Treasury and Controller and Auditor-General (CAG) guidance. We are actively managing charges to make sure we recover the right amounts.

There are some areas where we can improve how we manage and apply cost recovery. These include how we manage information on the costs of services, and providing transparent and consistent reporting. There are also opportunities to improve how the costs for some services are allocated and make some charging arrangements simpler for customers.

We have an ongoing work programme to implement improvements to MPI's cost recovery arrangements. This includes a package of changes that came into force on 1 July 2018 in the biosecurity and food safety systems. Working with the IRG, we are developing the next package of proposals targeting implementation from 1 July 2019.

We have also progressed work to improve how we manage cost information. This will improve alignment across all MPI systems and make maintaining and reporting of cost information easier. We have also been working with the IRG to develop a cost recovery performance reporting framework. The framework will be the basis for a consistent approach to industry reporting and improving the transparency of MPI's service costs.

We are now closing the Review and will continue to implement the changes to address the findings as part of the ongoing cost recovery work programme.

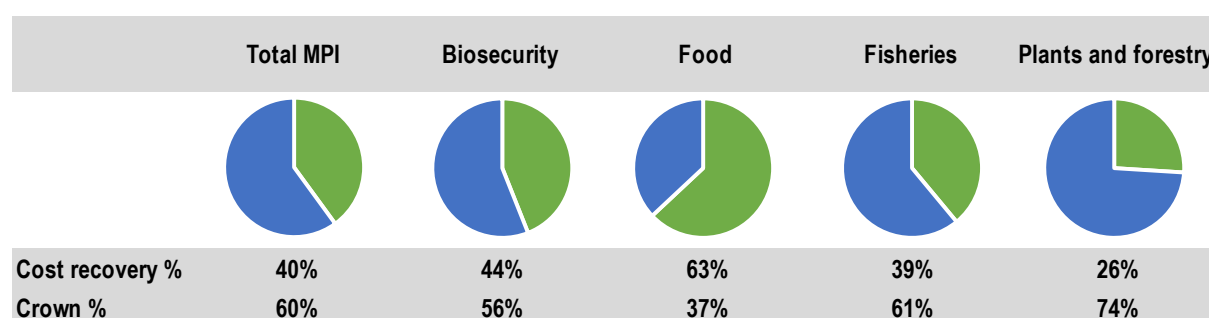
Cost recovery is important to MPI

MPI provides a range of services to protect New Zealand from biosecurity risks, ensure that food is safe to eat and that our natural resources are sustainable. These services also enable the primary sector to grow the value of its exports. Services we provide include:

- biosecurity inspections to prevent pests entering the country
- developing and maintaining domestic and overseas standards for food and other products
- monitoring and testing products to ensure consumer safety
- gaining market access and providing assurances to overseas customers.

Cost recovery ensures that MPI can continue to deliver these services. We recover costs for services under ten separate Acts and associated regulations. Approximately 40 percent of our departmental funding comes from cost recovery (approximately \$200 million in 2016/17). The proportion recovered varies between systems, as shown in Figure 1.¹

Figure 1: Comparison of how services are funded in different systems across MPI



We have undertaken a First Principles Review of MPI's cost recovery arrangements

Given the scope and significance of cost recovery, MPI has undertaken a First Principles Review (the Review) to identify and progress improvements to our cost recovery arrangements. The Review sought to promote a consistent and transparent approach to cost recovery across all of our systems and identify ways we could improve how we manage cost recovery in future.

MPI progressed the Review in two phases. Phase one focussed on developing a policy framework to guide our approach to cost recovery. Following public consultation on the framework we developed policy guidance that we are now using to support decision making when setting fees, levies and charges. In phase two, we applied what we had learned in the first phase to identify ways to improve our existing cost recovery arrangements.

We are now closing the Review and implementing changes to address the findings as part of the ongoing cost recovery work programme.

This report summarises the development of the MPI cost recovery policy guidance through phase one, sets out the key findings from the second phase and outlines what we plan doing to continue improving MPI's approach to cost recovery. Supplementary information to support this report is available in a separate document *Findings of the Review - Supporting Information* and referenced as applicable.

¹ This breakdown is indicative. It uses 2016/17 budgeted output expenditure, compared with revenue data from memorandum accounts and the Fisheries and Conservation Services levy model. It may not include small amounts of third party revenue not managed through memorandum accounts or the fisheries levy model.

The views of those using MPI services are important to us

From the start MPI recognised the importance of involving the users of our cost recovered services in the Review. To ensure this happened we set up a Cost Recovery Industry Reference Group (IRG) that includes representation from key industry bodies.² The IRG was established to help us identify and understand issues common across all sectors and to provide advice and information to support the Review.

We met with the IRG during development of the policy framework. Discussions were constructive and included their interest in improved transparency of costs and wanting to see improvements to the efficiency and effectiveness of service delivery. Following public consultation on the framework we discussed the key themes from submitters with the IRG and revisions that could be made before finalising the policy guidance.

We also discussed the findings of the second phase of the Review (examination of existing cost recovery settings across the organisation) with the IRG and how we plan to address these findings. This included meeting with them as part of progressing an initial package of high priority changes in the biosecurity and food safety systems that came into force from 1 July 2018.

The IRG remains an important part of ensuring we understand industry perspectives and how any cost recovery proposals might impact on them. We continue to seek their input and advice as part of developing policy proposals in the cost recovery work programme.

We developed MPI cost recovery policy guidance

Generally, MPI recovers costs from those who benefit from our services or create risks the services are in place to manage. We also have a responsibility to make sure service delivery is effective and efficient, and to be transparent about our costs and how we manage revenue received through cost recovery.

During phase one of the Review, we developed a framework to guide MPI's approach to cost recovery. We drew heavily on cost recovery guidance published by the Treasury and the CAG. Their guidance helps ensure that best practice is used consistently across all of Government. We also considered previous cost recovery policies developed by predecessor agencies the New Zealand Food Safety Authority, the Ministry of Agriculture and Forestry and Biosecurity New Zealand.

To give stakeholders an opportunity to provide feedback, in June 2016 MPI released the discussion document *Developing a Cost Recovery Framework for the Ministry for Primary Industries*. The document set out the key principles and policies that we considered should underpin how we develop and manage cost recovery across all MPI systems.

An independent review of the draft discussion document prior to release by the New Zealand Institute of Economic Research (NZIER) found the framework to be soundly based on New Zealand and international best practice.

In general, submitters agreed with the principles and supported us in developing a consistent and transparent approach to cost recovery. Key themes raised include:

- the impact of cost recovery charges on business
- more consideration of cost sharing arrangements
- more information on costs, and comparability with other countries

² Board of Airline Representatives of New Zealand, Customs Brokers & Freight Forwarders Federation of New Zealand, Port Companies of New Zealand, Deer Industry New Zealand, Meat Industry Association, Dairy Companies Association of New Zealand, Dairy New Zealand, Seafood New Zealand, New Zealand Wine, Federated Farmers, Horticulture New Zealand, Pipfruit New Zealand, New Zealand Forest Owners Association, New Zealand Association of Animal Health & Crop Protection (AGCARM), Food & Grocery Council, and Retail New Zealand (including Pet Industry Association of New Zealand).

- more frequent reviews, especially of levies
- improved incentives for efficiency.

A discussion of the key themes and MPI's response is included in the supporting information for this document.

Taking account of feedback received, we shaped the framework into a simple internal policy. We then tested this through the second phase of the Review and formalised it into the MPI cost recovery policy guidance, now an organisational policy. This requires all parts of MPI to apply the principles-based approach set out in the guidance whenever we make changes that impact on cost recovery.

We have included a summary of the policy guidance in Figure 2 and the supporting information for this document. You can also read the full guidance and summary on our website *here*. We are committed to continuing to improve the transparency of our cost recovery arrangements. Publishing our guidance is part of this.

Figure 2: Summary of the Ministry for Primary Industries Cost Recovery Guidance

One of the key outputs from the First Principles Review was the MPI cost recovery policy guidance, now an organisational policy. This diagram provides a summary of the policy guidance. A full copy is available *here*.

INTRODUCTION	About this document:		MPI's approach to cost recovery seeks to:		
	<ul style="list-style-type: none">• This guidance should be used to inform development of cost recovery proposals regardless of whether or not they are authorised in legislation. It is not determinative; each situation needs to be considered on its merits.• When developing cost recovery proposals you also need to consider cost recovery guidance from the Treasury and the Office of the Auditor-General, and be able to demonstrate any requirements set out in legislation have been met.• This is a living document; as our context and operating models change, this guidance will need to evolve.• This document has been developed for MPI's internal use only.		<ul style="list-style-type: none">• Ensure those who use services which enable commercial or private benefits pay for the services that deliver those benefits• Encourage those undertaking certain activities to take responsibility for managing risks to public health, biosecurity, or the sustainability of New Zealand's primary resources by ensuring they pay for the costs of managing those risks.• Promote transparency for those who pay for services.• Encourage efficient service delivery, while minimising transaction costs for service users and stakeholders wherever possible.• Recover costs in a way that ensures MPI can provide services essential to growing and protecting New Zealand and meet regulatory and wider government objectives.		
GUIDING PRINCIPLES: Equity, Efficiency, Justifiability, Transparency					
DEVELOPING POLICY	Understanding the nature of the service	Identifying parties that could pay	Understanding the impacts of charging	Identifying the costs to be recovered	Designing charges
	<p>Consider:</p> <ul style="list-style-type: none">• Is there authority to charge?• What are the outputs produced?• What are the outcomes sought? <p>If services are provided pursuant to legislation, the authority to cost recover will usually be set out in the relevant statute. When developing or changing cost recovery arrangements authorised in legislation it is important that any and all legislative requirements are met.</p> <p>The outputs of services are relevant to understand who uses the service, receives the benefits or creates risks the service is designed to manage. MPI's charges seek to recover the costs of delivering outputs, rather than outcomes.</p> <p>Understanding outcomes sought is important context for understanding the impacts of charges.</p>	<p>Consider:</p> <ul style="list-style-type: none">• Who receives direct benefits, or creates risks services are designed to manage?• What is the economic character of the service (public, private, club, merit goods)?• What impact will charging have on the behaviour of parties? <p>When a service delivers benefits to third parties, charging the direct beneficiaries of outputs is likely to be most equitable and efficient.</p> <p>When a service is designed to manage risks created by third parties, charging the risk exacerbator is likely to be most equitable and efficient.</p> <p>Understanding economic characteristics helps to identify which options are likely to be practical or efficient to implement, but they are not determinative. For example, a service can be a public good, but it may still be appropriate to charge those that create risks if they can be identified and efficiently charged.</p> <p>Application of the principles, equity and efficiency in particular, help to identify the best option. Often this will come down to which party is best placed to influence the long term supply of the service by how much they choose to consume, or by taking steps to reduce the risks they create.</p>	<p>Consider:</p> <ul style="list-style-type: none">• What are the impacts of charges likely to be (including cumulative impacts of government charges)?• Is there a good reason not to recover, to partially recover, phase in, or share costs? <p>In some situations, the government may choose not to recover costs, to partially recover, or to phase in cost recovery. This needs to be considered on a case by case basis. It may be appropriate to:</p> <ul style="list-style-type: none">➢ further other policy objectives, manage significant impacts, or competition issues➢ provide funding on behalf of direct beneficiaries or risk exacerbators where it would not be feasible to identify and equitably charge them➢ avoid perverse incentives, or where it is inefficient to charge➢ fund where significant free riding may occur➢ fund where full recovery is prohibited, inconsistent with international obligations or may create technical barriers to trade. <p>Cost sharing is appropriate when government funds on behalf of different types of beneficiaries that cannot be identified or charged. In some situations there may be a case for cost sharing with the taxpayer to reflect specific public benefits, but quantifying public benefit is difficult; the materiality of costs and certainty about benefits are relevant factors when determining whether this approach is desirable.</p>	<p>Consider:</p> <ul style="list-style-type: none">• What are the direct costs, indirect costs and shared costs?• How strong is the link between costs and the outputs/services?• How should costs be allocated and/or apportioned? <p>Only the reasonable costs of providing a service should be recovered. MPI recovers all direct costs associated with a service and a fair proportion of indirect costs (e.g. wider business support or common costs, including corporate costs).</p> <p>When recovering indirect costs, it is important to identify an appropriate method for working out what represents a fair proportion (allocation driver).</p> <p>Costs should also be allocated as closely as practicable to the services, including the period in which the service was provided.</p> <p>Recovery of significant one-off costs can create equity issues e.g. where one party pays, but a future party benefits, so this needs to be considered on a case by case basis. This is why MPI recovers appropriate capital costs through depreciation and capital charge.</p>	<p>Consider:</p> <ul style="list-style-type: none">• How could design of charges influence behaviour?• How strong is the link between the party and the output, benefit or risk?• How fixed or variable are the costs?• How simple will the charges be to understand and administer?• How predictable do the charges need to be? <p>Design of charges should incentivise services users, beneficiaries, risk exacerbators and MPI to make efficient choices about how much of a service to consume, how to manage their risks, and how to perform services efficiently.</p> <p>Fees are suitable where there is a clear link between a party and their use, benefit, or the risk they create. Levies may need to be used where it is more difficult to link use, benefit or risk to an individual, but possible to link it to a group.</p> <p>Levies should still aim to approximate the level of use, benefit or risk created by levy payers to the extent practical. Levies tend to be less transparent so it is also important to clearly describe what activities the levy is being used for.</p> <p>Design should recognise the variability of costs. Fixed fees are suitable for limited variation in costs. Charging actual costs (e.g. hourly rates) are suitable when costs vary significantly.</p>
MANAGEMENT PROCESSES	Frequency of review		Stakeholder engagement and consultation		Monitoring and reporting
	<ul style="list-style-type: none">• In general MPI aims to comprehensively review charges at least once every three years. However, some Acts require more frequent reviews and limit MPI's ability to recover historic deficits.• In determining frequency it is important to weigh up the administrative and transactional costs of more regular reviews with the need to ensure that charges are set at the right levels, as well as legislative requirements.• Considerations include the status of memorandum accounts and how charges are performing, how much the population of service users is likely to change and how much the costs and demand for the service has or is likely to change.		<ul style="list-style-type: none">• In many cases MPI's regulated sectors can assist with our understanding of likely changes in service demand and emerging risks. Consideration should be given to engaging service users in determining the nature and level of service, but care must be taken to avoid or manage conflicts of interest.• Consultation on cost recovery arrangements should be meaningful, and stakeholders provided with adequate information to ensure they understand: the principled basis and rationale for charges, the forecast and actual costs of service delivery, relationship between costs, volumes of outputs and, where appropriate, quality standards of MPI services.		<ul style="list-style-type: none">• Regular reporting to stakeholders about the performance of cost recovered services supports improved transparency and accountability for delivery of efficient and effective services.• Reporting should include information on the types of costs that are involved in service delivery (both direct and indirect costs), service volumes and achievement of service standards.• It is important that when seeking to cost recover for services to consider whether appropriate performance standards and measures are in place.

We reviewed MPI's cost recovery arrangements

Phase two of the Review involved a detailed examination of existing cost recovery settings across the organisation. This focused on four key areas:

- are legislative provisions related to cost recovery appropriate?
- are charges well targeted and justified, and the right type of charge being used?
- are we recovering the right amount for all services?
- are MPI's systems and processes fit for purpose?

Our analysis found that cost recovery settings are broadly appropriate across MPI, but also identified a range of opportunities for improvements. A summary of the key findings from this work is set out below. The report then discusses areas identified through the Review where we can improve how we manage and apply cost recovery.

Key finding 1: Legislative frameworks generally enable good practice

Ten Acts authorise MPI to recover costs for a range of services. We assessed the consistency of the cost recovery provisions in these Acts. We found that the frameworks do vary, but this does not seem to be driving significant differences in the overall approach to cost recovery. The legislation generally allows good practice, and current arrangements are in line with Treasury and CAG guidance. Key differences are discussed below.

Cost recovery principles are broadly consistent across our Acts

MPI takes a principles-based approach to decision making for cost recovery. This allows flexibility to ensure that a range of different and sometimes complex factors can be considered, while also encouraging consistency of approach.

Four key principles underpin MPI's approach to cost recovery: equity, efficiency, transparency and justifiability. There are some differences in how these are currently provided for in the legislation. While the Acts almost always refers to equity and efficiency; justifiability and transparency are sometimes not reflected. The National Animal Identification and Tracing Act 2012 (NAIT Act) also refers to the principles of "administrative efficiency" and "flexibility".

The Fisheries Act 1996 takes a more prescriptive approach to cost recovery principles, but it is clear that they are underpinned by consideration of equity and efficiency. The Airports (Cost Recovery for Processing International Travellers) Act 2014 does not include a statutory requirement for consideration of any principles.

Despite these differences, we concluded there is no pressing need to make changes to the principles as set out in the various Acts - there is scope to apply best practice in line with MPI's policy guidance.

Time constraints on recovering deficits and returning surpluses

Most of the Acts MPI administers place time constraints on our ability to recover deficits and encourage timely return of surpluses. For example, the Acts in the food and forestry systems allow us to recover deficits or return surpluses relating to the last four financial years.

The timeframe needs to provide enough time for a deficit or surplus to be identified, assess whether it is likely to self-correct, and if needed change regulations to correct it. If the timeframe is too short it is difficult to effectively manage and can result in write offs, with the Crown having to pay for the portion of costs not recovered. If the timeframe is too long, the fee and levy payers may be different to those originally charged. We consider that four years is the minimum period that historic deficits can practically be recovered, or surpluses identified and returned.

As we progress the cost recovery work programme, we will assess the feasibility of having more flexibility around the time available to adjust for historic deficits or surpluses. For example, in 2018 the levy period defined in the Biosecurity (Border Processing Levy) Order was extended from 12 months to up to 36 months, to provide greater flexibility and align with a similar levy administered by the New Zealand Customs Service.

Review periods

Review periods set the timeframe for revisiting cost recovery charges. For instance a number of Acts have three-year review periods, while several others do not specify timeframes for review.³ Where regulatory change is required to update cost recovery provisions, we consider that a three year review period provides the right balance between regular review and administrative efficiency.

We are committed to an ongoing programme of three-yearly 'rolling reviews' across all of our cost recovered systems. We would seek to undertake an out of cycle review where significant surpluses or deficits are identified.

Design and implementation of cost recovery charges

We assessed the range of provisions in the ten Acts that support the design of charges and implementation of cost recovery. The Acts in the food system provide a wide range of flexibility in the types of charges that can be applied and useful administrative provisions. Several Acts have less flexibility. For example, the Animal Welfare Act does not allow for costs to be recovered through levies, and the NAIT Act does not allow for class-based exemptions or waivers, which presents challenges where MPI needs to suspend charges temporarily.

Given the scope and scale of cost recovery at MPI, we recognise the importance of considering how to support flexibility in the design and implementation of cost recovery arrangements. The newly developed policy guidance will ensure this is fully considered as part of policy development in future.

Key finding 2: Charges are generally targeted appropriately

Fixed fees or hourly rates are generally used for charging where services have private good characteristics and there are direct private benefits. These types of services tend to be more transactional in nature and include a range of approvals, applications, permits, certifications and official assurances provided under the range of Acts MPI administers. For example, fees are charged for the clearing of imported animals at the border.

Levies are used in areas where it is clear that an individual or an industry participant receives a benefit or creates a risk but it is more difficult to establish the level of benefit an individual or industry participant receives, or the level of risk they create. MPI uses levies for a range of services under most of the Acts we administer. This includes standards development and maintenance, certain market access activities, monitoring programmes and some compliance activities (e.g. fisheries observer services), research to support resource management controls, and imported goods and passenger clearance.

The supporting information for this document includes more information about the types of services and activities that MPI provides and illustrates how costs may be recovered based on MPI's cost recovery policy to determine where charges should be directed.

³ Acts with three year review periods include the Animal Products Act 1999, Agricultural Compounds and Veterinary Medicines Act 1997 and Food Act 2014. The Airports (Cost Recovery for Processing of International Travellers) Act 2014, Animal Welfare Act 1999, Biosecurity Act 1993, and Forests Act 1949 are examples with no specified timeframes for review.

Our Review indicated that generally charges are appropriately targeted at beneficiaries and/or those creating risk. We did not find examples where there was a compelling case to change the settings for cost recovery. Two inconsistencies where we do not charge for services were identified. These services are:

- **Compliance activities** –compliance activities are cost recovered in some systems and Crown funded in others. We want to ensure that consistent practice is applied across all of our systems where appropriate.
- **Animal welfare services** - the Animal Welfare Act does not allow us to prescribe levies. Some animal welfare services benefit a specific group of people, making a levy the appropriate way to charge.

Over the next twelve months we plan to investigate possible cost recovery for compliance investigations under the Animal Products Act 1999. In the longer term we will look at other areas where a more consistent approach to charging for compliance activities could be applied.

Providing for levies in the Animal Welfare Act requires legislative change. While this may be considered in the longer term it is not included in the immediate cost recovery work programme.

It is important to use the right type of charge

MPI makes significant use of fixed and variable charges. There is also some use of formula based charges (e.g. for dairy levies). A key feature of MPI's 2015 update of fees and charges was a move towards greater use of hourly rates. This approach can simplify cost analysis, ensure a common approach to charging for services delivered in more than one area and minimise the risks of under-recovery. However, we recognise that using hourly rates can reduce the incentives for MPI to deliver services more efficiently and tends to be less certain for those being charged.

The Review identified a number of examples where hourly rates were essentially operating as fixed rates. In these situations customers are only ever charged the minimum, even when more effort is needed, because the administrative effort required to account for additional time was a barrier to this time being charged. This suggests that these services may be better suited to fixed charges.

Using the MPI cost recovery policy guidance in future reviews will ensure the balance between using hourly rates and fixed charges is appropriate and that efficiency incentives for MPI and users are fully considered.

Over the next two years we plan to consider increased use of fixed charges for appropriate services. We will also look at improving alignment of charges for similar services, taking account of the trade-off between the benefits of hourly rates versus administrative costs.

Full cost recovery is generally appropriate for our services

MPI generally charges those who benefit from the service or create a risk we manage, and fully cost recovers for the service. We do not intend to change this approach.

The Review identified examples where the full costs of providing a service are not recovered (examples of cost sharing for MPI services are included in the supporting information for this document). For example, fisheries stock assessment research may inform management decisions for a shared fishery. While it is easy to identify and charge commercial fishers, under current regulatory settings it is not feasible or efficient to charge recreational fishers, so taxpayers fund a portion of the research on their behalf.

Key finding 3: We are actively managing cost recovery charges across MPI

For most of our charges MPI uses *memorandum accounts* that record expenditure, revenue and the accumulated surpluses or deficits from cost recovered activities. In other words, they help us keep track of the difference between how much money MPI collects and how much the services cost to deliver. We expect the balance of memorandum accounts will vary from year to year but they should trend towards zero over a reasonable time period.

Over the last three years, since the major review and update of charges in 2015, the balances in the majority of our memorandum accounts have largely improved. Deficits in our accounts from that time have now been recovered or written off and many of the accounts are now in surplus. Table 1 gives the closing balance of each memorandum account based on actual and forecast revenue and expenditure data. Some accounts show zero balances in 2014/15 because these are new memorandum accounts commencing from 2015/16. Deficits are shown in red text in brackets.⁴

Table 1: Memorandum account closing balances 2014/15 - 2017/18

Memorandum account	\$000's	2014/15 Actual	2015/16 Actual	2016/17 Actual	2017/18 Forecast
Border Biosecurity Clearance Fees		(4,166)	(641)	1,925	1,249
Food Standards Assurance – Food Act 2014		0	(156)	(142)	(58)
Standards Setting for the Food Industry		2,203	800	665	(819)
Verification of the Food Regulatory Programme		(1,556)	2,142 ⁵	(2,499)	(1,803)
Approvals, Accreditations and Registrations		601	869	1,763	1,917
Border Biosecurity Traveller Clearance Levy		0	1,123	7,746	9,610
Phytosanitary Exports		1,173	952	912	855
Wine Standards Management		0	530	1,285	2,190

To manage these balances, we have progressed a package of changes considered highest priority that came into force from 1 July 2018 in the food safety and biosecurity systems. The changes are to improve the equity of charges and adjust rates driving significant surpluses or deficits in memorandum accounts. The largest change will be to the accumulated surplus in the memorandum account for the Border Biosecurity Traveller Clearance Levy. The rates for this levy have been lowered from 1 July 2018 to address this surplus, while taking into account updated border processing costs, including new investments in this area and forecasts of future traveller volumes.

We are working on a package of regulation amendments for 1 July 2019 implementation that will likely include further rate adjustments. As stated above, we intend to undertake an ongoing programme of 'rolling reviews' to help ensure regulatory settings remain appropriate and significant deficits or surpluses are not accumulating.

Key Finding 4: Our approach to cost recovery is in line with similar countries

We compared our approach to cost recovery with those used by Australia, Canada, the United Kingdom (UK), and the United States of America (USA). We selected these countries based on factors such as relatively similar regulatory environments, comparable systems of government, the safety of food production, and managing biosecurity threats.

⁴ Not all of MPI's cost recovery is managed and recorded via memorandum accounts. MPI also receives revenue from fisheries and conservation levies, fees and charges under the Fisheries (Commercial Fishing) Regulations 2001, the Forestry Act 1949 and other fees for services provided to organic product exporters, which are not set by regulation.

⁵ At June 2016 the Verification of the Food Regulatory Programme memorandum account included an accrual of \$2.24m relating to July 2016 revenue.

These countries all use principles-based approaches to managing cost recovery, which are generally in line with our approach. They also adopt full cost recovery as a starting position for their services, before evaluating whether partial cost recovery may be appropriate.

As outlined in the supporting information for this document, where comparisons were possible, we generally compared favourably with the charges in other countries. That said, comparison of particular charges was difficult. While the services targeted for cost recovery are broadly comparable there are significant differences in the structure of government agencies and responsibilities. For example, Canada and the USA have a wider allocation of responsibilities at the federal, state, regional, and local levels – a more complex system than ours. Each country also has their own priorities and places different emphasis on the primary industries and export markets.

We can improve how we manage cost recovery

In addition to the work outlined above, through the Review we identified a number of areas where we can improve how we manage and apply cost recovery. These are discussed below.

We can improve how we manage information on cost drivers

Having the right information is crucial to accurately forecasting costs, and to setting charges so that memorandum accounts trend to zero. Historically this has required significant work to manually update the models whenever budgets or forecasts are amended and reconcile these back to memorandum accounts. Further, changes to MPI's organisational structure or budget allocations have implications for how we attribute costs and this happens frequently throughout the year.

Through the Review we identified that work is required to improve how we manage costing information used to calculate charges and integrate it with financial and time recording systems. We have already begun this work. The first step was to develop a service catalogue to hold all of our cost information in one place. This will improve alignment of the cost information across all MPI systems and make maintaining and reporting of cost information easier.

There is scope to improve how we allocate costs for some services

Improving how we manage information on cost drivers provides a platform to take a more detailed approach to allocating costs. We consider there may be scope to look at allocating levies differently in some areas. This includes using improved cost information based on actual rather than estimated staff time to apportion levies.

There is also scope to look at whether it is possible to simplify levies in the animal products sector. For instance, some levies are based on volume measures, which may fluctuate between years and therefore not reflect the costs MPI incurs.

Over the next two years we plan to look at the basis for allocating levies in more detail. This work will focus on making sure that the cost drivers reflect the use/benefits of the services and are practical and efficient to implement.

Some charging arrangements could be made simpler for customers

MPI has over 300 fees, charges and levies. The large number and variety of charges drives complexity in regulations and in our costing models. For example, some regulations set out a large number of services that have the same charge. Often these services are for relatively small amounts of revenue, but create significant (and probably unnecessary) complexity in our cost models. Where possible, grouping these charges would simplify the regulations, making them easier for MPI to administer and for users of the services to understand.

Over the next two years, as part of the cost recovery work programme we plan to investigate opportunities to simplify and consolidate MPI's cost recovery arrangements.

We are working to provide transparent and consistent reporting

The Review, including feedback from the IRG, highlighted the importance of transparency in our approach to cost recovery for those who pay. A key part of achieving this is that we should report regularly to fee and levy payers, by sector.

To address this we have been working with the IRG to develop a cost recovery performance reporting framework. The improvements we are making to how MPI manages cost information is critical to this work. The framework will be the basis for a consistent approach to industry reporting and improving the transparency of MPI's service costs. We expect it will also improve understanding of efficiency in our systems.

The framework was finalised in July 2018. This allows the first reports to start being developed consistently across all MPI systems. Regular reporting on the performance of charges will help both MPI and service users to actively monitor where charges may need adjusting.

We will continue to implement the findings of the Review

We are committed to making sure MPI's cost recovery arrangements remain current and fit for purpose. We have begun work to implement the findings of the Review. As stated above, this included the package of changes that came into force from 1 July 2018 in the food safety and biosecurity systems.

In conjunction with the IRG we are developing the next package of proposals targeting implementation from 1 July 2019. These will likely include both updates to charges to address the balances in our memorandum accounts and improvements to the design of our charges. We are aiming to publically consult by late 2018.

All future proposals for changes to cost recovery arrangements (or cost recovery for new services) will be tested against the policy guidance. Continuing to take a principles-based approach will allow flexibility to deal with a range of different and sometimes complex factors in services we deliver, while ensuring a consistent approach across the organisation.

Generally, each cost recovery system will be reviewed once every three years. This will ensure that our charges remain appropriate and that we actively manage memorandum account balances. These regular reviews will be informed by the improvements to how MPI manages cost information and the reporting across all sectors based on the new cost recovery performance reporting framework.