



# **Ministry for Primary Industries Cost Recovery Policy Guidance**

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# 1. Introduction

## About this document

1. The Ministry for Primary Industries (MPI), along with many other government departments, receives a substantial proportion of its revenue by charging third parties for the costs of services it provides. Approximately 40% of MPI's total revenue comes from cost recovery.
2. It is important our fees, levies and charges reflect an appropriate mix between Crown funding and cost recovery. Funding arrangements must balance the need to be fair to the taxpayer with the need to ensure that those that receive direct benefits from our services, or create risks our services are designed to manage, pay for them.
3. At the same time, MPI must also be mindful of the impact that charges have on individuals and businesses, and seek to develop policy that is consistent with our focus on growing and protecting New Zealand, our export growth objectives and wider government policy.
4. We also have a responsibility to our customers and regulated sectors to ensure service delivery is efficient and effective and to be transparent about our costs, and the way we manage the revenue we receive from cost recovered activities.
5. This document sets out the principles and key considerations that should be applied when determining, or developing advice about, cost recovery arrangements. This includes whether to seek to recover costs at all, the types of costs that can be recovered, how to approach allocation of costs, and the charging mechanisms that are available. It also describes features of processes that support good management of cost recovery arrangements on an ongoing basis.
6. This guidance applies to all cost recovery arrangements for services MPI delivers, including services that are not regulated. Some services MPI provides are funded according to specific arrangements such as Government Industry Agreement. These funding mechanisms are different to typical cost recovery arrangements and this guidance does not seek to replace those mechanisms.

## This guidance should not be applied in isolation

7. The scope and diversity of services MPI provides, means it is not practical or useful to be prescriptive or adopt a 'one size fits all' method. Instead, MPI takes a principles-based approach to cost recovery. This document will assist in understanding what the principles mean in practice, and how they can be applied in MPI's context.
8. The principles discussed in this guidance are also included in some of the legislation which authorises MPI to recover costs. This guidance, however, should not be applied in isolation. It is important that we can demonstrate that statutory requirements have been met when determining cost recovery arrangements, and that charges comply with legal requirements.

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9. The Treasury<sup>1</sup> and Office of the Auditor General<sup>2</sup> (OAG) both publish guidance for public sector agencies involved in cost recovery. We have worked to ensure this document aligns to Treasury and OAG guidance, but it's still a good idea to consult those documents when determining a cost recovery approach. Treasury guidance includes specific requirements for assessing the impact of cost recovery proposals<sup>3</sup>.
10. In developing this document we have also considered other published frameworks and guidance documents, for example in other jurisdictions. A summary of useful resources is included in the appendix to this document.
11. This guidance is a living document. The context in which we work will shift over time. As new challenges and opportunities arise, the way we operate will change. This guidance will be periodically reviewed and updated to incorporate new learnings, and continually improve MPI's understanding and management of cost recovery practices.

### How you can support good practice cost recovery

12. The Cost Recovery Directorate maintains most of MPI's charging regulations, and has a responsibility to ensure decision making in relation to service funding is of high quality.
13. It is important that you contact the Cost Recovery Directorate if you are:
  - Reviewing or thinking about changes to charges or charging arrangements.
  - Considering new services, or changes to existing services or operating models.
  - Developing policy that may result in new services or changes to existing services or operating models, whether or not it is intended they be provided by MPI or third parties.
  - Developing or reviewing cost recovery requirements in legislation that contains cost recovery requirements.
14. Consulting with the Cost Recovery Directorate at an early stage to discuss funding implications will assist quality and consistency of decision making. We may also be able to support you with policy development, costing and modelling of charges, and amendments to charging regulations. In particular, we will help you with your drafting cost recovery impact statements if required by Treasury.
15. When designing services to be cost recovered, Treasury guidance recommends agencies first consider whether there are other ways outcomes could be delivered more effectively or efficiently. This includes whether they could be delivered by other agencies or providers, whether production could be outsourced or devolved to industry or other private sector providers, and whether there are ways to introduce contestability to service delivery.

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<sup>1</sup> This guidance draws on the Treasury 2002 guidance and the more recent 2017 update available on <http://www.treasury.govt.nz/publications/guidance/planning/charges>.

<sup>2</sup> <http://www.oag.govt.nz/2008/charging-fees>

<sup>3</sup> This includes development of a Cost Recovery Impact Statement (CRIS) when developing proposals for Ministers to consider (<http://www.treasury.govt.nz/publications/guidance/planning/charges/02.htm>).

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16. Accurate time recording data, particularly once integrated, provides valuable input into the costing of MPI's chargeable services. A new time recording system was implemented during 2016. This has streamlined and simplified business processes for recording those chargeable activities.
17. The Cost Recovery Directorate is working towards a cost recovery system for MPI that is fair, simpler and more transparent. If you have any ideas that may assist, or want to discuss the material outlined in this document and how it is applied, please contact the Cost Recovery Directorate at [costrecovery@mpi.govt.nz](mailto:costrecovery@mpi.govt.nz).

## 2. Objectives of cost recovery

18. Cost recovery involves charges (usually in the form of fees or levies) to recoup the costs of providing services to individuals, businesses or other entities. Cost recovery is only undertaken where there is a lawful authority that is provided for in legislation, or in some cases on a contractual basis.
19. MPI recovers costs associated with activities and services that deliver outputs. Our charges do not generally seek to recover costs or reflect benefits associated with the wider outcomes a service may contribute to. Outcomes are still important when considering cost recovery, and this is discussed further in paragraph 35.
20. Most cost recovery is managed through memorandum accounts, which enable tracking of expenditure and revenue associated with cost recovered services. Memorandum accounts are discussed further in paragraph 100.
21. Cost recovery can also improve the efficiency of resource use, for example, by encouraging users to be prepared before engaging with services, to make good decisions about how much of a service to use, or to take steps to mitigate the risks they create.
22. The main objectives of cost recovery for MPI are to:
  - 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 objectives.
23. Decisions around how a service should be funded also need to consider competition issues and aim to account for wider government objectives. This is not always straightforward; and will often need to be considered on a case by case basis. Situations where cost recovery might not be desirable are discussed in section 4.

### 3. Guiding principles

24. 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.
25. Principles should be the primary criteria against which options for cost recovery are tested, and assist in weighing up the trade-offs about when and who to charge, and how charges should be designed. They are also relevant when thinking about how we engage with our stakeholders, and manage our cost recovery responsibilities in general.
26. Four key principles underpin MPI's approach; **equity, efficiency, transparency and justifiability**. These principles are referred to in Treasury and OAG guidelines<sup>4</sup>, and are common features in most of the legislation that authorises MPI to recover costs. Definitions, and further discussion of these principles is provided in Table 1 on the following page.
27. There are some differences in authorising legislation that are important to be aware of. While legislation almost always refers to equity and efficiency; justifiability and transparency are sometimes not reflected. It is still important to consider these later two principles when considering funding arrangements. Application of these principles support good cost recovery practice and will generally complement equity and efficiency.
28. The National Animal Identification and Tracing Act 2012 also refers to the principles of "administrative efficiency" and "flexibility". These are closely related to and will also complement the principles set out above.
29. The Fisheries Act 1996 is worth highlighting because its cost recovery principles are quite different to most other authorising legislation. While equity and efficiency are underpinning considerations, the principles in the Fisheries Act are more prescriptive and set out in specific terms when costs can be recovered, who costs should be recovered from and in some areas the mechanism that should be used. Principles of equity, efficiency, transparency and justifiability are still relevant considerations –but they will not be determinative. As with all cost recovery decisions, meeting legislative requirements is paramount.

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<sup>4</sup> OAG guidelines also refer to accountability which is an important consideration. Adherence to the principles of transparency and justifiability are a good way to support accountability. New Treasury guidance also refers to other considerations including effectiveness, simplicity and consultation. These considerations are all reflected in various parts of this guidance.

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*Table 1: Guiding principles – definitions*

Principle	Definition set out in law <sup>5</sup>	Discussion
Equity	Funding for a particular function, power, or service, or a particular class of functions, powers, or services, should generally, and to the extent practicable, be sourced from the users or beneficiaries of the relevant function, power, or service at a level commensurate with their use or benefit from the function, power, or service.	<p>This principle is about the fair distribution of resources in the economy. Whether or not it is appropriate to recover the costs of a certain service will often come down to whether this is fairer than taxpayer funding.</p> <p>Discussion of equity can give rise to tensions. For example, when there is geographical cost variation it may sometimes be considered equitable to charge all customers the same, while in others differential pricing may be equitable because people pay in line with the cost of providing the service, regardless of location.</p> <p>This is also a good example of where principles interact – maximising equity might favour differential pricing, but adding an efficiency consideration may favour the same charge for everyone.</p>
Efficiency	Costs should generally be allocated and recovered in order to ensure that maximum benefits are delivered at minimum cost.	<p>This principle is about value for money. There are different types of efficiency that can be relevant:</p> <ul style="list-style-type: none"> <li>• <i>Productive efficiency</i> – maximising outputs at minimum costs.</li> <li>• <i>Allocative efficiency</i> – encouraging users to make the best decisions about whether to use a service, and influence longer term supply.</li> <li>• <i>Dynamic efficiency</i> – improving productive efficiency over time.</li> <li>• <i>Administrative efficiency</i> – this refers to the idea that charges should be easy to understand and implement, in order to minimise transaction costs for all parties.</li> </ul>
Justifiability	Costs should be collected only to meet the reasonable costs (including indirect costs) for the provision or exercise of the relevant function, power, or service.	<p>This is about making sure the costs which are being recovered are appropriate – that they relate to the service being provided and that they are not unreasonable. MPI also has a responsibility to ensure that services are both effective and efficient.</p> <p>Justifiability and transparency work together to ensure that MPI is accountable for the way it manages expenditure and revenue.</p>
Transparency	Costs should be identified and allocated as closely as practicable in relation to tangible service provision for the recovery period in which the service is provided.	The legislated definition is about ensuring that recovered costs are able to be clearly linked to the service provision (including the time period in which they are incurred). However, transparency also means that adequate information is available to ensure that those impacted by charges can understand and have an opportunity to comment on the basis on which charges are calculated and imposed.

<sup>5</sup> This is based on definitions in those statutes MPI administers which include some or all of these as principles, including the: Animal Products Act 1999; Agricultural Compounds and Veterinary Medicines Act 1997; Food Act 2014; Wine Act 2003; Animal Welfare Act 1999; National Animal Identification and Tracing Act 2012; Forests Act 1949; Biosecurity Act 1993.



## 4. When and who to charge for MPI services

30. When deciding when to recover costs, and who should be charged, there are a number of things to consider:
- ***What is the authority to charge?***  
Is the service provided pursuant to legislation<sup>6</sup> and, if so, what is the scope of the authority and are there other requirements to be aware of?
  - ***What is the nature of the service that is being provided?***  
What are the outputs that will be delivered, and what outcomes does the service seek to achieve or contribute to?
  - ***Who are the different parties that could pay, and which option is best?***  
Who uses or receives the benefit of the output? Who creates risks that give rise to the need for the service in the first place? Does the output have public, private, club or merit good characteristics?
  - ***What are the impacts of charges likely to be?***  
Are there good reasons why charges might not be appropriate?
31. These questions are discussed in more detail in this section.

### Authority to charge

32. Where services are provided pursuant to legislation, costs can only be recovered to the extent provided for in the relevant statute<sup>7</sup>.
33. The different legislation that MPI administers generally sets out the authority to charge and principles that should be applied, but may also contain other requirements such as; the types of costs that can be recovered, the types of charges that can be used and process requirements related to consultation and frequency of review. It's important to understand these requirements before developing advice on cost recovery.
34. MPI also provides certain services that are 'non-regulated' or provided by agreement between MPI and third parties. The authority for charging is the contractual arrangement between parties. When entering these types of arrangements, the document should guide how costs are recovered.

### Understanding the nature of the service

35. Treasury guidance emphasises the importance of understanding the outputs and outcomes of services (both in terms of benefits and risks) when considering how a service should be funded.

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<sup>6</sup> MPI must have legal authority to apply cost recovery charges for the services it is legally obliged to provide. Generally legislation includes an empowering provision that authorises the Governor-General to set the amount of cost recovery through the making of cost recovery regulations.

<sup>7</sup> Legislation can be amended if cost recovery is justified but not provided for.

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- Outputs: are the specific things that MPI's services produce, or the immediate and direct result of those services. For instance, an official assurance is an example of an output of MPI's Verification Service, which provides a direct benefit to a specific exporter (e.g. the ability to export a specific consignment).
  - Outcomes: are the wider impacts of MPI's services. For instance, providing official assurances facilitates exports and supports export growth, which in turn has other economic benefits.
36. MPI charges seek to recover the costs of activities and services associated with delivering outputs, because it is at this level that costs are incurred. MPI charges do not seek to recover the costs of delivering wider outcomes. There are a much wider range of activities (and costs) which contribute to the delivery of outcomes. For example other services that MPI provides, which are not cost recovered (such as policy development) also contribute towards the achievement of outcomes. Factors external to MPI also influence or contribute to these outcomes.
37. The extent to which outcomes are realised often depends on the choices made by those that use MPI's services. For example, the extent to which increased export revenue contributes to employment can depend on whether a business chooses to expand its operations domestically or offshore.
38. Understanding outcomes are still important when deciding whether to recover costs. There may be circumstances where implementing cost recovery could materially impact on the delivery of outcomes and it is important that MPI understands these impacts. These types of issues are discussed in paragraph 71.

### Identifying who could pay and choosing the best option

39. There are usually a range of parties that could pay for services; the taxpayer, individuals or groups that use services or receive the benefits of services, and individuals or groups that create risks services are designed to manage.
40. Choosing the best option involves understanding which is the most equitable or fair, what is efficient, and what impact charges are likely to have on the behaviour of parties and the attainment of policy objectives.
41. It's also relevant to consider how practical or expensive it would be to identify and charge parties (administrative efficiency). If for example, in some situations the costs of collection exceed the revenue from charges, it would not be efficient to recover costs. Charges may need to be directed at related parties to overcome practical difficulties. These considerations are discussed in more detail below.

### Who receives the benefits?

42. In most cases, the service user is the direct beneficiary. Identifying and charging the direct beneficiaries of outputs is often the most equitable and efficient approach to directing charges:

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- It is **equitable** because it is usually fairer to charge those who directly benefit from a service output than the taxpayer whose benefits are less tangible, more uncertain and difficult to quantify.
  - It is **efficient** because it can influence the behaviour of service users to only use the service when the benefits they receive outweigh the costs.
43. In general, the stronger the link between the benefit/use of the service and the beneficiary/user of the service the more equitable charging will be.

### Who creates the risk and need for the service?

44. Risk exacerbators are those (individuals or groups) whose actions or inactions present a risk of negative effects or externalities. When a service is designed to manage or mitigate these risks it can often be efficient and equitable to charge risk exacerbators for the cost of those services:
- It is **equitable** because it is usually fairer to charge those whose actions or inactions create the need for a service than the tax payer who does not engage in risky behaviour.
  - It is **efficient** by creating incentives for the risk exacerbator to better manage or mitigate the risks they give rise to.
45. An example of a risk exacerbator is an importer of goods. Goods can have hitchhiker pests and diseases which can damage New Zealand's primary industries and broader society. The act of importing a good directly exacerbates a risk which biosecurity inspections are designed to manage.
46. As with benefits, the stronger the link between the risk and the risk exacerbator, the more equitable charging will be.

### Public, private, club and merit goods

47. Cost recovery guidance often discusses the economic characteristics of services as being helpful in determining where charges should be directed. That is, whether a service or output has the character of a public, private or club good.
48. These terms relate to the **excludability** of, and **rivalry** for benefits:
- Benefits are excludable if it is possible to prevent certain parties from receiving them, for example only a business that meets certain requirements will be issued an export certificate and obtain the benefits of being able to export those goods.
  - Benefits are rival when parties compete for them. For example the export certificate can only be used once and can only be used by the party that made the application and met the requirements.
49. Whether a service or output can be termed a public, private, club or merit good is helpful in identifying which parties it is likely to be practical (and therefore efficient) to charge. While these terms are generally discussed in the context of benefits, they can also be applied to determine who it is feasible to charge when recovering the costs of services designed to manage risk.

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### *Private goods*

50. Services or outputs are private goods when they are both excludable and rival. This means it is possible to identify the beneficiary of the service, so it will usually be both practical and efficient to direct charges at that individual. With private goods there is also a strong relationship between the use of a service and the benefit received, so it will usually be the most equitable charging option as well.
51. Issuing an Export Certificate is a service that has private good characteristics. The certificate is provided to an individual exporter who will receive direct commercial benefits from being able to export goods. No other group or individual is able to benefit from using that particular certificate. The beneficiary can be clearly identified (the exporter) and the link between the use of the service and the benefit is strong. It is therefore efficient and equitable to charge the exporter.

### *Club goods*

52. Services are club goods when benefits are excludable but non-rival (one individual receiving benefits does not prevent another from also receiving benefits).
53. Where benefits are excludable but non-rival, it means that there is a group of individuals who all receive benefits, but it may not be easy to distinguish one member of the group from another or how much benefit they receive compared with another member. While it is always more equitable to charge for services in line with benefits, in this case it is likely to be impossible or costly to distinguish between beneficiaries.
54. In these situations, it could still be efficient to charge the group or 'club' as a whole (for example through a levy). This will also be more equitable than taxpayer funding as there is a strong relationship between the club and the benefit.
55. Fisheries stock assessment to set catch limits may be a service that has club good characteristics. Only those who catch fish from that stock receive the benefits of those catch limits, but one person benefiting does not prevent another from benefiting as well. Another example of a club good service is work undertaken to secure international market access for goods produced in one of the primary industries. The benefits of this are excludable (only exporters of goods produced in that industry can benefit) but non-rival (one exporter in that industry who benefits from market access does not prevent another exporter from doing so).

### *Public goods and merit goods*

56. A public good service is one that is non-excludable and non-rival. In these situations it is unlikely to be practical to determine how much use or benefit any one individual receives compared with any other.
57. In practice, pure public goods are rare. In most cases it will be at least conceptually possible to identify groups or types of individuals that benefit from outputs (and outcomes) more than others. Excluding individuals or groups from the benefits for the purpose of charging however is likely to be costly, and so the most efficient option may be taxpayer funding.
58. A merit good is one that government considers delivers highly desirable benefits to society, is universally available but likely to be under consumed if people have to pay full price. In these

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situations government may choose not to charge, or to subsidise charges, to encourage more consumption of the service and more benefits.

59. It is often assumed that if a service has the characteristics of a public good or merit good, then charging individuals or groups is not appropriate but that is not necessarily the case. For example, if a risk exacerbator (or group of risk exacerbators) can be identified and efficiently charged, this will be a fairer option than taxpayer funding. It is also efficient, because charging aligns incentives for risk exacerbators to take steps to reduce or manage the risks they create.

### Charging related parties

60. In some situations it may be more efficient to charge a related party than to directly charge beneficiaries or risk exacerbators. If many direct beneficiaries use the services of a single company, it could be more efficient to charge that company rather than each beneficiary separately. However, it is only equitable to charge related parties to the extent that there are ways for the person charged to pass on costs to the direct beneficiaries or risk exacerbators.

### Cost sharing

#### *Between different parties*

61. Generally it will be straightforward to identify direct beneficiaries and risk exacerbators as those that use or give rise to the need for the service. The level of service use may be a good indicator of risk or benefit. If there is no clear user, but more than one distinct group of direct beneficiaries or risk exacerbators it can be more difficult to determine how to apportion costs.
62. One option may be to direct charges to one party if there are ways those costs can be passed on to others, for example through the supply chain. The other option generally involves estimating the proportion of benefit each party receives, or how much each party contributes to the risk. This is discussed further in section 6, in relation to apportioning levies.
63. If there are both direct beneficiaries and risk exacerbators, it may also be relevant to consider what impact charges are likely to have on the behaviour of parties. For example, charging the full cost of services that are designed to manage risks to the risk exacerbator can maximise incentives for parties to reduce the risks they create.

#### *To reflect public benefits*

64. It is often argued that where there is wider public benefit, costs should be shared with the taxpayer to reflect this. Wider public benefits, like public health or economic growth or sustainability, are associated with the outcomes of MPI's services. As discussed in paragraphs 35 and 36, there are a much wider range of activities (and costs) which contribute to outcomes, many of which are not cost recovered (such as policy development). The tax-payer does contribute to the delivery of these benefits or outcomes through the Crown funding MPI receives.
65. It is almost always possible to identify groups of individuals that benefit more than others. Even benefits like employment and economic growth benefit some in society more than others.

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The extent to which different groups will benefit is dependent on a range of factors, some of which are highly uncertain.

66. Attempts to apportion costs without an objective measure of benefit or risk can often result in a negotiated agreements between parties, rather than an accurate assessment of costs and benefits.
67. The materiality of costs, and the degree of uncertainty are relevant factors when determining whether developing a framework<sup>8</sup> to apportion costs and benefits is desirable.
68. Often the term 'public benefit' is really used to describe benefits that accrue to different groups of beneficiaries who it is inefficient to identify to charge. For example, if MPI initiates a biosecurity response to a fruit fly incursion, certain industries will receive direct benefits. Home fruit tree growers also receive direct benefits, but it is more difficult to identify and charge them so the taxpayer funds on their behalf. This is also a form of cost sharing.

### Impacts of charges

69. In general, MPI's policy is to recover the full costs of services from direct beneficiaries and risk exacerbators.
70. It is important when considering whether to impose these costs on individuals, business or industries that the implications of this are well understood. This includes consideration of the cumulative impact of different government cost recovery arrangements. In some circumstances, government may choose not to recover costs, to share costs or to phase in cost recovery. This will however need to be considered on a case by case basis.
71. These types of situations may be:
  - To further specific policy objectives; for example in recognition of the desire to maximise the benefits from certain services that might not otherwise occur if costs were fully recovered<sup>9</sup>, to encourage innovation and/or support emerging or marginal markets, or where charges would materially affect the attainment of desired outcomes.
  - To provide funding on behalf of direct beneficiaries or risk exacerbators where it would not be feasible to identify and equitably charge them.
  - Where charging would create perverse incentives (e.g. discourage voluntary reporting) or would not be efficient.
  - Where significant free riding may occur (i.e. where it is only possible to charge one beneficiary or few beneficiaries of a service that provides direct benefits for many others).
  - To avoid impacting competitive neutrality.

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<sup>8</sup> The Government Industry Agreement for Biosecurity Readiness and Response (GIA) is an example of such a framework. The GIA is not a typical cost recovery arrangement. Unlike other service provisions where MPI is the sole service provider, GIAs provide for a partnership approach, which sees both MPI and industry signatories providing readiness and response services, and shared decision-making.

<sup>9</sup> For example, merit goods.

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- To fund where full recovery is prohibited, inconsistent with international obligations or may create technical barriers to trade.
72. These circumstances are **not conclusive or exhaustive**, they are examples of situations where additional factors may need to be considered. In these situations, additional taxpayer funding is likely to be the only alternative. This means that there must be compelling rationale and evidence that outweighs the equity and efficiency considerations which favour cost recovery.
73. If you have identified an area where you think recovering less than full costs may be justified, please consult the Cost Recovery Directorate.

## 5. What types of costs should be recovered

74. Once it is determined who should be charged for a service MPI provides, it is necessary to identify the costs which should be recovered. The principle of justifiability requires that, so far as is possible, only the reasonable costs of providing a service should be recovered.
75. MPI's policy is to seek to recover all direct costs associated with a service (such as staff time, travel costs, systems and equipment used in delivering the specific service), as well as support costs associated with delivery of the service (such as training and development costs for staff, administrative support costs, management costs, project costs and capital costs) and a fair proportion of wider business support or common costs (for example costs associated with corporate functions like finance, human resources management, information technology (IT), and costs of property and utilities). This is in line with Treasury guidelines.
76. Sometimes, MPI will undertake specific projects to improve services, or change business processes. These investments will usually seek to deliver effectiveness or efficiency benefits to service users and are generally recoverable. There may, however, be equity issues associated with recovering significant one-off costs, for example, when existing service users pay for benefits that future service users will receive. It is for this reason, that MPI recovers the costs of relevant capital investments through depreciation and capital charges which are spread over the life of an asset. Recovery of project costs should be considered on a case by case basis, and signalled transparently to affected stakeholders.
77. When recovering indirect costs (service or wider business support costs) it is important to identify and document an appropriate allocation driver to determine a fair proportion. As far as possible the allocation driver should attempt to approximate the actual costs associated with the service. Property costs for example, could be allocated based on floor space per full time employee involved in delivery of the service.
78. The principle of transparency as defined in relevant legislation, requires costs to be allocated as closely as practicable to the service, and the period in which the service was provided. This means that the costs incurred in any given year should be recovered as soon as practical. MPI tries to ensure that when charges are reviewed, cost estimates and forecasts are based on actual and known costs, and clearly documented assumptions (such as growth rates in service demand).
79. The principle of transparency also means that the link between service costs and charges should be clear enough to enable scrutiny by those that pay charges. When setting charges, care should be taken to document the nature and quantum of costs to be recovered at an appropriate level of detail.



## 6. How should charges be designed?

80. The design of charges can encourage efficient service delivery, and should seek to minimise transaction costs for service users and stakeholders wherever possible. This section discusses a range of ways that charges can be designed.
81. Each approach has benefits and drawbacks, and the application of the principles of equity, efficiency, justifiability and transparency should be used to inform decisions about which approach to take in the particular circumstances.
82. Before settling on an approach, it is important to check the options that are available in any authorising legislation. Not all legislation enables the same charging mechanisms.

### Fees

83. Fees are a form of cost recovery that can be used when the level or amount that an individual uses or benefits from a service is clear and there is a strong relationship to the costs of delivering each output or unit of service.
84. The cost of delivering a service can vary based on how complex that service is (e.g. completing a verification audit for a small factory compared to a large factory). Costs can also vary because of other factors – such as the time of day the service is performed (e.g. after-hours), or by geographical location.
85. A central consideration in designing fees is whether we should charge each service user based on actual costs of delivering the service to them, or adopt fixed fees – so everyone pays the same.

### Fixed versus variable fees

86. Depending on the type of service provided, fixed fees can encourage service efficiency. A fixed fee can encourage MPI to provide the service within the cost that is covered by the fee charged. Fixed fees are also likely to be simpler to administer and more predictable for service users.
87. Charging actual costs (for instance, an hourly rate) can also encourage efficiency, as it creates an incentive for service users to take steps to work with MPI to minimise costs, for instance by ensuring all information required is provided in an easily accessible way.
88. Where costs vary it can sometimes be appropriate to use a scale of fixed charges (e.g. having a standard service fee and an after-hours fee or urgent processing fee) or a combined charge (a fixed fee for 90% of cases, but the ability to charge an hourly rate in the 10% of cases which take a significantly longer period of time).
89. In some cases it may be considered more equitable to charge everyone the same – but this is not straightforward. Where costs vary but charges are fixed, there are risks that some parties will pay

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more than their fair share, while others pay less (cross-subsidy, from the first group to the second).

90. In practice, charges will never be perfectly equitable. The extent to which steps should be taken to limit any risk of cross-subsidy will depend on the significance of the risk, how costly alternative mechanisms are likely to be and the likely impact of those paying the charges.

*Table 5: Merits of actual and fixed fees*

Fee type	Advantages	Disadvantages
Actual costs (e.g. hourly rates)	<ul style="list-style-type: none"><li>• Can help to manage peaks in demand as services may be used less when (or where) they are more expensive to deliver.</li><li>• Could be considered more equitable and justifiable as each service user will be charged the true cost of the service.</li></ul>	<ul style="list-style-type: none"><li>• Generally more complex and can be more expensive to administer.</li><li>• May not be seen as equitable as customers could be charged different rates for what they would see as the same service.</li><li>• Service users carry the efficiency risk.</li></ul>
Fixed fees (using averaged costs)	<ul style="list-style-type: none"><li>• Predictable for service users.</li><li>• Simple and inexpensive to administer.</li><li>• MPI carries the efficiency risk.<sup>10</sup></li></ul>	<ul style="list-style-type: none"><li>• May not reflect actual costs.</li><li>• May not be seen as equitable as, depending on variability of costs, some may be charged less than the cost of providing the service and some may be charged more.</li></ul>

## Levies

91. Levies are generally calculated based on actual costs incurred by MPI in delivering the service but spread across all members of an industry or sector. Levies are often used when it is more difficult to establish a direct link between a particular user and their actual or potential level of benefit from the service, but it is possible to make the link to a group of users.
92. Similarly, levies can be imposed on risk exacerbators when it is clear that a particular group creates risks but it is difficult to establish the level of actual or potential risk different members create.
93. Even so, levy design should still aim to reflect, as closely as possible, the level of resources used to provide the service, or the level of benefit received or risk created by each levy payer. For example, levies could be apportioned based on size of a business (where size approximates complexity or effort required by MPI to provide services) or on risk (where objective criteria can be used to approximate risk).
94. Compared with other types of charges, levies are less transparent as it's not always clear how costs compare with benefits or risks of specific parties. This means it is particularly important to provide meaningful information on what activities are being funded using the levy.

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<sup>10</sup> Only to the extent that under-recoveries are foregone. Efficiency incentives may not be as strong when deficits can be recovered through future adjustments to charges.

## Two-part tariffs

95. Two-part tariffs can be useful mechanisms, especially for recovery of fixed costs. This type of fee comprises two components<sup>11</sup>; a *unit fee* for service use and a fixed *entry fee* charged to all users regardless of their use. These types of charges are best suited for situations where:
- Fixed costs are significant.
  - There is uncertainty about how much the service will be used.
  - Service demand is responsive to the level of the charge.
  - There are benefits from encouraging more frequent service use.
96. A two-part tariff can have advantages for the service user and for MPI. The charge per service use (e.g. the charge per inspection) can be lower because it only includes the variable costs (such as staff time, travel). The fixed costs (service and business support costs) are covered by the entry fee.
97. Given the lower unit cost, service users might use more of the service. There may be situations where this is desirable, for example to maximise benefits or wider outcomes that services seek to achieve.

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<sup>11</sup> This is different to a combined charge. A two-part tariff distinguishes between fixed and variable costs. Combined charges distinguish between variability of the services; e.g. charging a fixed fee most of the time, and an hourly rate in exceptional circumstances.

## 7. Management processes

98. This section outlines the different processes that are necessary to keep charges up to date including how stakeholders should be consulted and kept informed of cost recovery matters.

### Frequency of review

99. In determining how frequently charges should be reviewed, it is important to weigh up the administrative and transaction costs associated with more regular reviews against the need to ensure that charges are set at the right levels. Most legislation that authorises cost recovery requires regular review of charges. In general this is three years, but some Acts may require more frequent review and others do not specify a review period.
100. If you are developing advice on whether charges should be updated, it is necessary to consider how charges are performing. MPI tracks expenditure and revenue associated with most charges through memorandum accounts. Memorandum accounts are designed to create transparency about how much is being recovered through charges.
101. Memorandum account balances will fluctuate in any given year, but should trend towards zero over time. A negative balance (deficit) in a memorandum account suggests charges need to be increased, and a positive balance (surplus) suggests charges could be decreased.
102. How quickly charges need to be updated when a deficit or surplus occurs will depend on the size of the balance and the speed with which it is likely to increase or deteriorate. A review may be particularly necessary where there is, for example:
- A significant rise or drop in service volumes.
  - A known upcoming event which could have cost impacts (e.g. an industry re-structuring or re-negotiation of major contract).
  - New services being introduced and/or existing services being altered to reflect changes in government policy or customer need.
103. To the extent practicable, where surplus or deficit arises and there are high levels of ‘churn’ or turnover of industry participants, principles of equity and transparency would favour adjustment as soon as possible. This is to maximise the likelihood that surpluses are returned to the same people that contributed to it, or deficits are recovered from those that incurred it.
104. Much of the legislation that authorises MPI to recover costs also imposes time limits on the ability to recover historic deficits or under-recovery. It is important to understand these constraints when determining how quickly to adjust charges. If a deficit is not recovered within the legislative timeframe it may become unrecoverable.
105. If you want to discuss the frequency of review periods in an area that you are involved with, please contact the Cost Recovery Directorate.

## Involvement of stakeholders in the management of cost recovery

106. Good strategic and operational planning underpins effective budgeting and forecasting, which in turn supports more accuracy in setting of charges. In many cases, our regulated sectors can assist with understanding likely changes in service demand and emerging risks that can have implications for how we prioritise resources.
107. Service users should also have input into planning where services are provided at the request of, or seek to provide a benefit to, specific individuals or groups.
108. It may be less straightforward however for service users to have input where services are designed to manage risks or ensure compliance with regulatory requirements. Care must be taken to ensure MPI maintains regulatory independence from the sectors it regulates.
109. However MPI still has an obligation to ensure stakeholders have confidence in the way cost recovered funding is used and managed. This is achieved in two key ways:
- Consultation when changes are proposed
  - Regular reporting on the performance of cost recovered services.

## Consultation

110. For the most part, legislation includes requirements to consult with the persons or organisations likely to be substantially affected by any proposals for cost recovery changes. MPI is also required to advise the Minister of the results of consultation. The cost recovery principles of transparency and justifiability also support good consultation practices, and this applies to all cost recovery arrangements, including those that are not set in regulation.
111. When consulting on charges, it is important to provide adequate and appropriate notice, a reasonable opportunity for interested persons to make submissions, and be able to demonstrate adequate and appropriate consideration of any such submissions.
112. Stakeholders should be provided with information to ensure they understand:
- Why and how we deliver services we do and how we ensure that our service provision is efficient and effective.
  - The principled basis for charges and the level of cost recovery.
  - The forecast for actual costs of service delivery, including any historic under or over-recovery.
  - The relationship between costs, volumes and service standards.
  - The rationale for how charges have been designed, including whether charges represent average or actual costs.
113. Where possible, the consultation approach should be tailored to the specific stakeholder group, including recognising the particular needs of iwi. MPI recognises these groups may have different interests in and levels of understanding of the MPI's cost recovery arrangements.

### Reporting of cost recovery performance

114. MPI is moving to undertake more regular reporting to stakeholders about the performance of cost recovered services. This will support improved transparency and accountability for delivery of efficient and effective services.
115. Over time it is intended that reporting will include a wider range of information, including actual and forecast breakdowns of the types of costs that are involved in service delivery (both direct and indirect costs), service volumes and achievement of service standards.
116. It is therefore important that when seeking to cost recover for services, business groups also consider whether appropriate performance standards and measures are in place.

## 8. Useful references

Australian Department of Agriculture and Water Resources Charging Guidelines, available at <http://www.agriculture.gov.au/SiteCollectionDocuments/biosecurity/australia/cost-recovery-arrangements/charging-guidelines-2017.pdf>

Australian Government (2014) Australian Government Charging Framework and Cost Recovery guidelines, available at: <https://finance.gov.au/resource-management/charging-framework/>

Canadian Food Inspection Agency (CFIA) Cost Recovery Policy and Framework, available at [http://www.inspection.gc.ca/about-the-cfia/accountability/other-activities/sound-agency-management/service-standards-and-user-fees/cost-recovery-policy/eng/1378073377319/1378073471053#p1\\_2](http://www.inspection.gc.ca/about-the-cfia/accountability/other-activities/sound-agency-management/service-standards-and-user-fees/cost-recovery-policy/eng/1378073377319/1378073471053#p1_2)

CFIA Cost Recovery Initiative: Consultation Document (Chapter 7: CFIA approach to cost recovery), available at <http://www.inspection.gc.ca/about-the-cfia/accountability/consultations-and-engagement/cost-recovery-initiative/consultation-document/eng/1484240043102/1484240189214?chap=0#c7>

HM Treasury: Managing public money, July 2013, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/454191/Managing\\_Public\\_Money\\_AA\\_v2\\_-jan15.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/454191/Managing_Public_Money_AA_v2_-jan15.pdf)

New Zealand Controller and Auditor-General (2008) Good Practice Guide: Charging Fees for Public Sector Goods and Services, available at <http://oag.govt.nz/2008/charging-fees/docs/charging-fees.pdf>

New Zealand Productivity Commission (2014) Productivity Commission report on Regulatory institutions and practices, available at <http://www.productivity.govt.nz/sites/default/files/regulatory-institutions-and-practices-final-report.pdf>

New Zealand Treasury (2017) Guidelines for Setting Charges in the Public Sector, available at: <http://www.treasury.govt.nz/publications/guidance/planning/charges>

OECD (1998) User Charging For Government Services: Best Practice Guidelines and Case Studies, available at: <http://www.oecd.org/gov/budgeting/41213602.pdf>

The Blue Book (collection of UK and EU laws), available at <https://www.gov.uk/government/publications/fishing-regulations-the-blue-book>

The US Government Accountability Office (GAO) reports on *Federal User Fees*

- Federal User Fees: A Design Guide (2008), available at <http://www.gao.gov/products/GAO-08-386SP>
- Federal User Fees: Fee Design Options and Implications for Managing Revenue Instability (2013), available at <http://www.gao.gov/products/GAO-13-820>
- Federal User Fees: Key Considerations for Designing and Implementing Regulatory Fees (2015), available at <https://www.gao.gov/assets/680/672572.pdf>

The US Independent Offices Appropriation Act of 1952 (IOAA) [to be found under the 31 U.S. Code § 9701], available at <http://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title31-section9701&num=0&edition=prelim>