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ANNEX 6.2 HOW TO CALCULATE FEES

This annex discusses how to calculate the cost of public services for which fees are charged.

A.6.2.1 With some exceptions, it is government policy that fees for services should generally be charged at cost, sometimes with an explicit additional element to match the returns of commercial competitors. So to set many fees for public services it is essential to calculate the cost of providing them accurately.

A.6.2.2 The main features to be taken into account in measuring the annual cost of a service are set out in box A.6.2A. Not everything in the list will apply to every service and the list may not be exhaustive. It is important that the calculation is comprehensive, including all relevant overheads and non-cash items.

box A.6.2A elements to cost in measuring fees

- accommodation, including capital charges for freehold properties
- fixtures and fittings
- maintenance, including cleaning
- utilities
- office equipment, including IT systems
- postage, printing, telecommunications
- total employment costs of those providing the service, including training
- overheads, eg (shares of) payroll, audit, top management costs, legal services, etc
- raw materials and stocks
- research and development
- depreciation of start up and one-off capital items
- taxes: VAT, council tax, stamp duty, etc
- capital charges (if they were not met separately when the service was established)
- notional or actual insurance premiums
- fees to sub-contractors
- distribution costs, including transport
- advertising
- bad debts
- provisions

but not

- enforcement costs
- replacement costs of items notionally insured
- start up costs (those which can be capitalised in the accounts)

A.6.2.3 So far as possible the calculation should use actual costs, where they are known. For services just starting, there may be no alternative to using estimates, geared to estimated consumption patterns. Start up costs and the cost of fixed capital items should be scored in resource accounts (or their equivalent) in full, attributing to the cost of the service just the depreciated value each year.

A.6.2.4 For services which are charged at different rates, the same procedure should be used to set the different rates. That is, the cost of any premium service should be objectively justifiable by its additional cost (eg where faster shipping is offered); or conversely any discount should be justifiable by the saving to the supplier (eg using the internet rather than over the counter). Note, however, that sometimes the legislation permits differential pricing unrelated to the relative underlying costs – though even then there should be good policy reason for the difference.

Financial objectives

A.6.2.5 The standard approach to setting charges for public services (including services supplied by one public sector organisation to another) is full cost recovery. It normally means recovering a 3.5% real charge for the cost of capital. Some exceptions are noted in box 6.1.

A.6.2.6 One such exception is commercial services, ie those sold into competitive markets. These should aim to recover full costs plus a real rate of return in line with the rates achieved by comparable businesses facing a similar level of risk. The normal range of rates is 5-10% but rates as high as 15% may be appropriate for the very highest risk businesses.

A.6.2.7 Great care should be taken in pricing competitive services where public sector suppliers have a natural dominant position. The market prices of competitors will often be a good guide to the appropriate rate of return if there is genuine competition in the market. Where there are limited numbers of buyers and sellers in a market, it may be better to take other factors into account as well. These might include past performance, the degree of risk in the underlying activity and issues bearing on future performance.

A.6.2.8 Despite every effort to measure and forecast costs, surpluses and deficits are bound to arise from time to time. Causes may include variations in demand, in year cost changes, and so on. It is good practice to consider mid year adjustment to fee levels if this is feasible.

A.6.2.9 It is also good practice to set fees to recover accumulated past deficits. This may require statutory backing through a s102 order (see paragraph 6.2.3).