STRATEGIC (FINANCE) PARTNERS SAGEBUSH

Managing a fall in Fees or Levies

Purpose

In a crisis such as the COVID-19 pandemic demand for some services may drop. If a public sector organisation charges fees or levies for those services, it may find itself short of funds. This guide sets out a high-level framework to help public sector organisations which rely on fees or levies to manage a funding shortfall.

Funding from Fees or Levies

Government services are largely funded from taxation, but they may also be funded through fees or levies.

A fee is charged for the provision of a good or service – fees aim to recover the cost of providing the good or service. A levy is set for a specific purpose, but not necessarily for provision of goods or services – therefore levies do not necessarily reflect the cost of service provision. The key similarity between fees and levies is that they are both non-Crown funding sources[1]. Funding from fees and levies may vary over time while Crown funding is largely fixed from year to year.

Fees or levies can be beneficial to public sector organisations when demand for services rises (because revenue will rise), but they may create funding issues when demand for services falls (because revenue will drop). A drop in revenue may be particularly difficult to manage if costs are fixed.

Steps

The following sections set out 5 steps to help resolve a funding shortfall resulting from a drop in fee or levy revenue.

Step 1: Understand & size the problem

The first step is to confirm whether there really is a funding issue and how big it is. To do this, we need to understand how the organisation is funded, how the external event will affect fee or levy receipts, the potential loss of revenue and the size of the funding issue.

- **How is the organisation funded?** – an understanding of how the organisation is funded and the mix of fee, levy and Crown funding will enable us to identify the areas

[1] Fees and Levies are often referred to as “third party funding”.

 © 2020 SageBush www.sagebush.co.nz

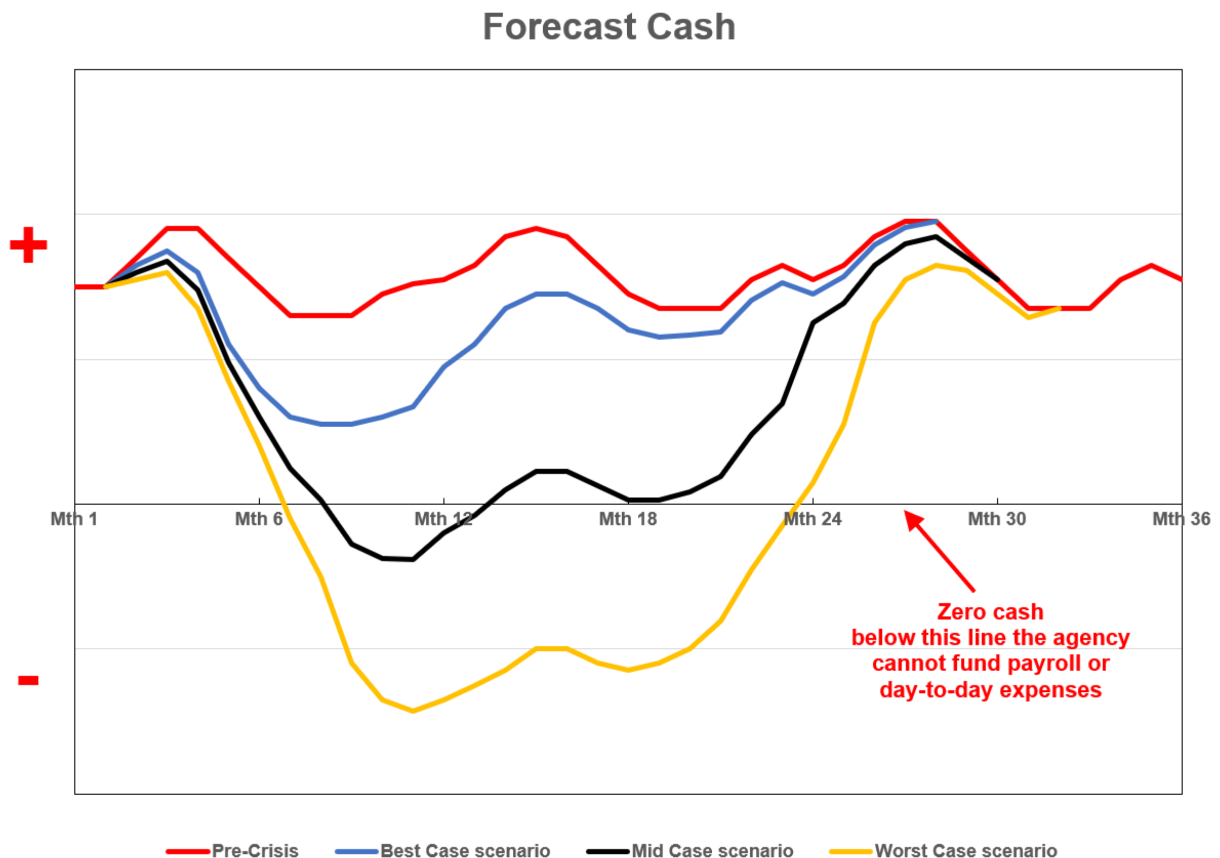
likely to be affected by changes in demand for services, and where response activities need to happen. This requires fee or levy revenue to be tracked back to the business areas and activities which are being cost-recovered. Some business groups will have a higher proportion of fee or levy funding than others and will be more impacted by a reduction in revenue. Corporate groups will be indirectly funded from fees or levies and will also be impacted by a reduction in revenue.

- **Will external events affect fee or levy receipts?** – whether you are facing a funding issue will depend on whether the event will cause a drop in demand for services and therefore a reduction in fee or levy receipts. So we need to understand what drives the demand for fee or levy funded services, whether the external event will change these demand drivers, whether the changes will be significant, and how long they might last.

- **What is the potential loss in revenue?** – estimating the potential loss in revenue in a crisis situation will be difficult due to the number of unknowns. To deal with this we should model the impact on revenue using a range of scenarios which reflect the Leadership Team's view of the Best, Mid and Worst case outcomes. Forecasts should be developed over a time period which is long enough to include both the end of the event and the recovery phase – typically this would be 3 to 5 years.

- **How big is the funding issue?** – to size the potential funding issue we need to compare forecast revenue with costs under each scenario and estimate the impact on cash holdings. If cash is forecast to drop close to, or below zero at any point on the forecasting horison the organisation will have a funding issue – it may be unable to fund its payroll or other day-to-day expenses. Cash forecasts should include any memorandum account balances if they are operated by the agency.

The above analysis will enable us to graph forecast cash under each scenario. This will identify the size of the funding shortfall and when it is likely to occur.



Step 2: Identify the options

The second step is to identify options to manage the forecast funding shortfall. The most effective way to do this is to hold a series of workshops which include operational managers and staff from the affected business groups – they will be the ones who know where savings might be found and what changes are possible.

There are four general approaches to managing a funding shortfall:

1. Reduce Costs

- **Prioritise spend.** Existing activities and services should be reviewed and prioritised to identify low-value spend. Costs can be reduced by cutting back or stopping low-value spend. If your agency has a large number of projects we could consider cutting back, deferring or stopping non-critical projects. This option does have its issues – for example, stopping and (possibly restarting) activities or services may incur additional costs which will reduce short term savings and may affect viability in the long term. There may also be difficulties extricating the agency from existing supplier agreements or employee commitments.
- **Reduce capacity.** A reduction in demand for services may mean that there is surplus staffing in some areas. It may be possible to reduce staffing levels by actively managing workloads across the agency to match with available capacity and skills. Potential

savings will depend on the number of positions cut, whether these can be managed through attrition, and whether redundancy payments are required.

- **Reduce communications and marketing**. A reduction in demand for services may mean less need for communication and marketing activities. An immediate response to the crisis might be to cancel advertising or marketing campaigns, particularly if they are about rationing services, or informing the public how to access services.
- **Reduce Corporate costs**. A reduction in front-line activities or staffing should reduce the need for back-office support which should translate into reduced corporate charges. However a large portion of corporate costs will be fixed and Corporate groups may resist reducing corporate charges because of difficulties in reducing costs in the short-term. Options to reduce corporate charges will need to be discussed with the Corporate DCE and a realistic approach and level of savings agreed.
- **Cost cutting**. The fall-back option is often to undertake a general cost-cutting exercise aimed at reducing "discretionary" expenditure, which typically includes: photocopying; courier/postage; travel; training; contractors and consultants; and conferences and seminars. Although this is seen as an easy option, the gains are usually at the margins and are unlikely to be sustainable into the future. Cost cutting may impact on the efficiency and effectiveness of the business, in particular management effectiveness, staff capability, and morale. These risks need to be managed by prioritising cuts, re-implementing expenditure at the earliest opportunity and developing a communication strategy to manage staff morale and expectations.

2. Realise Efficiencies

- **Centralise processing**. If the volume of activity slows or declines, there may be surplus staffing and office space in some locations. In this situation savings may be realised by centralising processing onto fewer sites. Changes may generate processing efficiencies and lead to further savings.
- **Close high cost offices**. All organisations with dispersed operations have a range of cost profiles across different sites. Savings may be realised by closing high cost offices and moving processing activities to lower cost offices. This may also increase overall cost efficiency and reduce the average cost of providing services. Of course closing offices and realising the savings will take time, and this option would need to be part of a longer-term response.

3. Change Services

- **Reduce services**. It may be possible to realise savings by reducing the range or quality of services offered, although this will have limited impact on costs when demand is low. It also has potential downsides, including reduced customer satisfaction and a reduction in business process efficiency. Decisions on reducing services would need to be carefully considered, consulted and communicated.
- **Move on-line**. It may be possible to reduce costs by reducing face-2-face services and moving as many activities as possible on-line. Whether this option is viable in the short-term will depend on the nature of services provided, whether some of these services are already e-delivery and the ease of transferring more services to the e-delivery channel.

4. Increase funding

Seeking to increase funding in a crisis situation may be a long shot. However, there are a few options:

- **Increase fees or levies.** Fee or levy changes require consultation with customers and other key stakeholders, and approval by Cabinet. These processes can be long and may outlive the crisis you are trying to solve. Moreover, in a crisis situation Treasury and Ministers may not support fee or levy increases because they impose further burden on the general public.
- **Use the Memorandum Account**[2]. The purpose of the memorandum account is to record the accumulated balances of surpluses and deficits incurred in providing goods and services on a cost-recovery basis so that fees can be set in line with costs over time. If your organisation operates a memorandum account and the balance for a particular fee or levy is in surplus, this may offset any related funding deficits (although this should be taken into account in the above cash forecasts). Conversely, a deficit memorandum account balance will exacerbate any funding shortfalls.
- **New funding.** As a last resort you might consider requesting new Crown funding. This is likely to be in the form of a loan which would be repaid when demand for services and revenue picks up, and/or fees or levies are increased. This option requires the support of Treasury and approval of joint Ministers.

Step 3: Assess the options and develop a plan

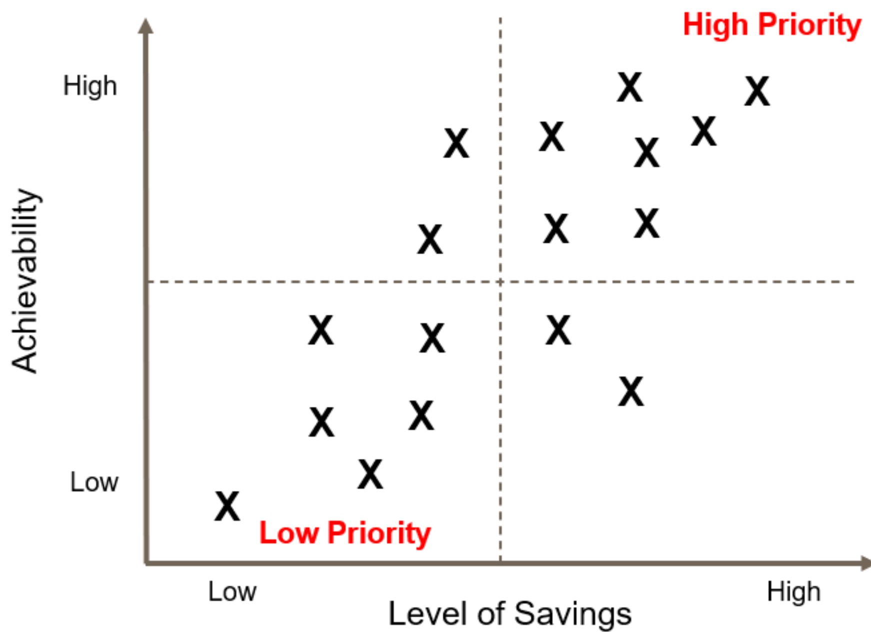
Step 2 will result in a long list of options with descriptions of how they would work and expected impacts. In step 3 the long list should be assessed against criteria such as:

- **Achievability**
  - how difficult will it be to implement?
  - what will be the impact on the quantity, quality or scope of services?
  - will the organisation be able to meet its service delivery targets, government policy expectations and/or international commitments?
  - what will be the impacts on business operations and can these be managed?
  - what are the potential risks of adverse unintended impacts and can these be mitigated?
- **Level of savings or funding increase**
  - how large are the potential cost savings and/or funding increases?
  - are the potential savings sufficient to resolve the funding shortfall?
  - what are the risks of adverse unintended impacts and can these be mitigated?

---

[2] Refer to SageBush starter series: Understanding Memorandum Accounts, https://www.sagebush.co.nz/starter-series.

Once the options are scored against these criteria, they should be plotted on a graph as shown below:



The assessment process will result in a short list that will need to be analysed in more detail. We should look at the cost and revenue impacts, and develop cash forecasts of each option, both before and after the option is implemented. This will enable us to determine the options which will be most effective in addressing each of the scenarios identified in step 1.

Business groups should be consulted on the feasibility and potential impact on outputs of each option and a preferred option should be agreed. A high-level project plan should then be developed which specifies the tasks, how they will be achieved, resources required, deliverables and timeframes.

Step 4: Approve the plan

A paper should be prepared for the leadership team requesting approval of the project plan. The paper should outline forecast costs, expenditure and revenue appropriations and resulting funding shortfalls. It should then set out the identification and assessment of options, leading to the preferred options, why these would resolve the funding shortfall and how these would be jointly implemented.

The paper will also need to clearly identify any risks to the delivery of services and the achievement of organisational goals. Significant changes to outputs, deliverables or the agency’s strategy may require discussion with key stakeholders such as the Responsible Minister, Treasury, State Services Commission and other interested agencies.

The leadership team should make a decision on the proposed plan and allocate responsibility for implementation.

Step 5: Implement the plan

The key steps in implementing the plan are:

1. **Assign responsibilities.**

   Every manager should be expected to take responsibility for their part of the project plan and to deliver their share of savings.

2. **Set targets.**

   Clear targets should be set for cost savings and/or funding increases. This will ensure that managers know what is expected and increase the likelihood of success.

3. **Ensure buy-in.**

   Understanding and buy-in is required from all parts of the organisation which are funded in part by fees or levies.

4. **Manage the Risks**

   Critical to the success of any project aiming to reduce costs is to identify and mitigate the risks. In this type of project, the key risks are:

   - **Degradation of services**. Staff changes and reduced staffing levels may adversely impact on services. This could be mitigated by building staff capability, knowledge and capacity across the network.
   - **Negative impacts of cost cutting**. Cost cutting may impact on the efficiency and effectiveness of the business, in particular management effectiveness, staff capability, and morale. This could be managed by prioritising cuts, re-implementing expenditure at the earliest opportunity and developing a communication plan to manage staff morale and expectations.
   - **Loss of skills, knowledge and IP**. Reducing staff may lead to a loss of skills, knowledge and IP which will be difficult and take time to build up again when demand for services starts to pick up. This could be mitigated by ensuring knowledge is transferred as staff leave and building staff capability, knowledge and capacity across the network.
   - **Lack of buy-in from other groups.** Other business groups which are part funded by fees or levies may resist or be unable to reduce costs in the short-term. This could be mitigated by discussing and agreeing a realistic approach with the relevant DCEs.

5. **Monitor and Review.**

   As the implementation progresses it is important to monitor progress, review how external events are developing, reassess the most likely scenario tracks and the effectiveness of your responses. You may need to adjust your response.