

Audit Report No. 10, 2000–2001

AQIS Cost Recovery Systems

Australian Quarantine and Inspection Service

Introduction

- 4.1 The Australian Quarantine and Inspection Service (AQIS) is part of the Department of Agriculture, Fisheries and Forestry—Australia (AFFA). It was established in October 1986 by amalgamation of the Animal and Plant Quarantine branches of the Australian Agricultural Health and Quarantine Service, the Export Inspection Service (both within the then Department of Primary Industry), and the general quarantine function of the then Department of Health.¹
- 4.2 AQIS's primary role is to contribute to and administer Australia's quarantine, agriculture and food export laws. AQIS's core services are quarantine, inspection and export certification and food safety standards activities.²
- 4.3 AQIS and its predecessor bodies have provided a mix of cost-recovered and non-cost-recovered services through a range of programs delivered in Australia and overseas. AQIS managed

1 ANAO, Report No. 10, 1999-2000, AQIS Cost-Recovery Systems, 15 September 2000, p. 29.

2 ANAO, Report No. 10, 1999-2000, p. 29.

twelve cost-recovered programs during 1998-99. AQIS staff in recoverable programs numbered 1741 (or 85 per cent of all staff) in 1998-99.³

- 4.4 In 1998-99, AQIS's activities were funded through a combination of government appropriations for Community Service Obligations, and the fees and charges imposed on users.⁴ Under various policy decisions, AQIS has been required to recover the costs for most of its activities from users, beginning with 50 per cent cost-recovery from 1979, 60 per cent from 1 July 1988 and 100 per cent cost-recovery for recoverable programs from 1 January 1991.
- 4.5 In *Audit Report No. 10, AQIS Cost-Recovery Systems*, an audit initiated at the request of this Committee, the Australian National Audit Office (ANAO) sought to assess the efficiency and effectiveness of the management of AQIS's cost-recovery systems and to provide assurance to the Parliament that the AQIS cost-recoverable programs were identifying and recovering the full costs of services provided, without cross-subsidisation.⁵
- 4.6 The ANAO concluded that overall, AQIS's cost-recovery systems were mature and stable and, with some exceptions, had delivered near cost-recovery for the AQIS recoverable programs. However, the audit found that AQIS's cost-recovery systems contained a number of inherent weaknesses that potentially impaired the efficiency and effectiveness of the management of those systems.
- [AQIS] is not able to sufficiently assure itself, or stakeholders, that the programs are identifying and recovering the full costs of each type of service provided, without not insubstantial cross-subsidisation for some services.⁶
- 4.7 The ANAO made six recommendations aimed at improving AQIS's cost-recovery documentation, cost identification, performance reporting and management of cross-subsidisation. AQIS agreed to five of the six recommendations and disagreed with one.⁷

3 ANAO, Report No. 10, 1999-2000, p. 30.

4 ANAO, Report No. 10, 1999-2000, p. 30.

5 ANAO, Report No. 10, 1999-2000, pp. 31, 37.

6 ANAO, Report No. 10, 1999-2000, p. 16.

7 ANAO, Report No. 10, 1999-2000, pp. 25-6.

4.8 At its hearing on 2 March 2001, the Committee took evidence from AQIS and the ANAO on the following issues:

- identifying and attributing costs;
- recovering costs;
- setting fees and charges;
- managing cross-subsidisation, and
- consulting with industry.

Identifying and attributing costs

4.9 An essential element of an effective cost-recovery system is to be able to identify readily and accurately the costs to be recovered. The ANAO found that AQIS identified its costs through a customised costing methodology that traced costs to programs rather than to the range of activities performed by the programs in delivering services:

AQIS collects costing information at a cost centre level within programs, but does not have accurate information on the costs involved in performing each type of service within programs.⁸

4.10 The Committee sought from AQIS an explanation as to why it was resisting activity based costing to strengthen the accuracy of its calculated costs and provide enhanced information for management.⁹

4.11 AQIS replied that it had the cost measurement systems it considered necessary, and, though they might not be ideal, AQIS had reservations about moving towards 'very tight time charging processes'. However AQIS noted that the cost-effectiveness of introducing an alternate system is currently under review:

We have asked KPMG to look for us at what the possibilities are for our moving down a more sophisticated time measurement system. They have recently done a similar exercise in Customs.¹⁰

8 ANAO, Report No. 10, 1999-2000, pp. 18-19, 46.

9 *Transcript*, 2 March 2001, p. 4.

10 Stanton, *Transcript*, 2 March 2001, p. 4; AQIS, Submission No.1, p. 5.

- 4.12 While AQIS agreed that it needed to increase the sophistication of its cost measurement systems, it wished to understand how it would be assisted by adopting a very fine level of activity-based costing:

Certainly industry is very reluctant to make the system more complex. They say they do not need it, and they are very concerned to keep their charges low. They are concerned that it will add to their charges.¹¹

- 4.13 The Committee expressed some doubt that the cost of implementing an accurate cost measuring system would outweigh the benefits derived from such a system:

...those activities for which you undercharge might well exceed those for which you overcharge and would put you at great risk in the market place. [The Committee] just cannot imagine that you could exist as a private sector organisation with the way that you are measuring costs, or attempting to measure costs, at the moment.¹²

- 4.14 In reply, AQIS stated that it did have fairly comprehensive cost measuring procedures. It further stated that while at times fees were not matched up to costs, it was because industry had decided that they wanted a simple system that was uniform across Australia.¹³

- 4.15 The Committee made the point that what AQIS had agreed with industry was not the issue:

The issue is whether or not you can accurately measure your costs and therefore manage your own business as well as apportion costs to industry for cost recovery accurately.¹⁴

- 4.16 The Committee sought information from the ANAO on the cost of developing and maintaining a sophisticated cost measurement system versus the potential benefits to be derived from such a system.¹⁵

11 Stanton, *Transcript*, 2 March 2001, p. 5.

12 *Transcript*, 2 March 2001, p. 5.

13 Macdonald, *Transcript*, 2 March 2001, p. 5.

14 *Transcript*, 2 March 2001, p. 6.

15 *Transcript*, 2 March 2001, p. 16.

- 4.17 In reply, the ANAO advised the Committee that the Therapeutic Goods Administration (TGA) charged fees for particular services and wanted to assess the value of refining their costing information:

[The TGA] started off with a method by which they asked their staff to record how they spend their time against a set of predetermined activities for a set period of six to eight weeks. They did that on spreadsheets – a very low-cost approach to seeing what it provided them with and whether there were benefits in it. They have since moved to a commercially based off-the-shelf time recording costing system. I think that is a very sensible way to go, particularly if there are concerns or doubts in the organisation about the value of it.¹⁶

- 4.18 AQIS claimed during the hearing that the ANAO's assessment of its cost recovery systems in the current audit was inconsistent with its findings in the Audit Report No.21, 1998–1999, *The Costing of Services, Financial Control and Administration Audit*. However, the ANAO made the point that the two audits were quite different in focus. While the ANAO agreed that AQIS's performance on cost recovery at the program level was quite good, it noted that the issue in the current audit was the costing of the particular service or fee level.¹⁷

Committee comment

- 4.19 Cost recovery is a central part of AQIS's business. AQIS has been involved in cost recovery for over two decades and has been recovering 100 per cent of costs for the last 10 years.
- 4.20 The Committee notes AQIS's claim that it was still in a continuum—from no cost recovery to full cost recovery—and that considerable effort had been put in over the years.¹⁸ However, it appears to the Committee that AQIS is taking a long time to reach an appropriate level of sophistication in its cost measurement processes.
- 4.21 While the Committee heard from AQIS that it considered it had gone as far as it could in assigning costs to each of the services that

16 McPhee, *Transcript*, 2 March 2001, p. 16.

17 AQIS, Submission No.1, pp. 3-4, McPhee, *Transcript*, 2 March 2001, p. 7.

18 *Transcript*, 2 March 2001, pp. 5, 7.

it delivered to industry,¹⁹ the Committee agrees with the ANAO that it is not possible to assess with any confidence how well AQIS's fees and charges reflect the actual costs incurred.²⁰

- 4.22 The Committee is concerned that AQIS has held a largely unsubstantiated view that a more sophisticated costing system would not be viable. However, it notes the comment from AQIS that to date, internal AQIS calculations and considerations on the viability of such a system may not have been disciplined enough in their approach.²¹
- 4.23 The Committee notes the example of the TGA and considers that there would be value in AQIS's trialing something similar. While the Committee does not want to increase industry costs, it considers it important for both management and equity reasons that AQIS explore what options and value there might be, in proceeding along the path suggested in the audit.

Recovering costs

- 4.24 AQIS has been required to recover from industry the full costs of its recoverable programs since 1 January 1991. In any system of full cost recovery, individual programs will generate revenue recovery that exceeds or falls short of the amount required to deliver services. Under-recoveries are expected by AQIS to be recouped through future revenue collection within the program. Over-recoveries are placed in reserve accounts.²²
- 4.25 The audit report noted that the administrative costs involved in returning over-recovered funds through Revenue Rebates or Industry Initiatives and by using over-recoveries to offset previous under-recoveries can be significant and depend on the method used.

These costs are borne by industry, but have not been quantified by AQIS. The cost of managing over-recoveries highlights the importance of AQIS regularly monitoring fee levels and promptly adjusting these where necessary,

19 Macdonald, *Transcript*, 2 March 2001, p. 5.

20 *Transcript*, 2 March 2001, p. 6.

21 Stanton, *Transcript*, 2 March 2001, p. 13.

22 ANAO, Report No. 10, 1999-2000, pp. 33, 62.

to minimise the likelihood of program over-recoveries. There are also difficulties in ensuring that those clients who contributed to any surplus receive an equitable share of the proceeds.²³

- 4.26 The ANAO noted that although AQIS has a policy that a maximum of 10 per cent of annual program expenditure can be held in an Income Equalisation Reserve account, there are no limits on the amount of funds that could be held in the Revenue Rebate and Industry Initiative accounts. The ANAO noted that for some industries, the total held in reserves was significant.

... Revenue Rebate balances are often retained for a number of years rather than being paid out promptly by means of fee discount following over-recovery, which should be a matter of concern in a fully cost-recovered situation.²⁴

- 4.27 The Committee noted that of the six programs that had revenue rebate balances at 30 June 1997, only grains had paid out rebates over the following two years. The Committee asked AQIS to comment on the timeliness and effectiveness of its over-recovery rebates.²⁵

- 4.28 In reply, AQIS stated that the Revenue Rebate balance of about \$2 million at the end of the audit had been reduced to \$151,000.

...a lot of work has been done on that since the audit. The amounts ... are reasonably small. The largest amount is in the dairy program where there is \$69,000, fish has \$28,000 and international mail has \$54,000.²⁶

- 4.29 The Committee asked about over-recoveries in the animal quarantine stations program which at the time of the audit had accumulated funds totalling 46 per cent of the program's annual expenditure.²⁷

- 4.30 AQIS stated that at the end of the financial year 1999–2000, the accumulated surplus was \$360 000.

23 ANAO, Report No. 10, 1999-2000, p. 67.

24 ANAO, Report No. 10, 1999-2000, pp. 67, 69.

25 *Transcript*, 2 March 2001, p. 12.

26 Carlton, *Transcript*, 2 March 2001, p. 12.

27 *Transcript*, 2 March 2001, p. 12; ANAO, Report No. 10, 1999-2000, p. 72.

The program is showing a surplus at the moment of an additional \$82,000. The fees for the animal quarantine stations went to our business and financial committee just before Christmas. It was decided that, because the program has a possible major restructure which may take a fair bit of capital to fund, we should let that surplus deficit sit there at the moment to see more detail about what money is going to be required for any restructure.²⁸

- 4.31 When asked by the Committee whether AQIS agreed that it could be more timely in making decisions about rebates, AQIS acknowledged that, at the time of the audit, there had been a lot of money sitting in the rebate account.

One of the reasons was a bookkeeping problem in that one of the larger programs which had a lot of money had agreed for that money to be transferred into the income equalisation reserve. That had been agreed with industry but the accounting within AQIS had not caught up. Some of the [other programs' rebates] had been quite slow in going out. There has been a push since then to get the money out.²⁹

- 4.32 The Committee drew attention to the sale of a financially troubled business, where a significant issue in the sale became the quantum of unpaid fees to AQIS. This had been allowed to accumulate over a period of years and had reached extraordinary levels.³⁰

- 4.33 In response, AQIS's CEO indicated that she was considering how AQIS could move towards up-front fees to avoid getting into situations of debt recovery.

As to debt recovery itself, which does happen from time to time, I am also looking at those processes because, to put it in a positive way, I think we can do better at drawing attention to debt early and not continuing to provide service which increases the debt.³¹

28 Carlton, *Transcript*, 2 March 2001, p. 12.

29 Carlton, *Transcript*, 2 March 2001, p. 12.

30 *Transcript*, 2 March 2001, p. 11.

31 Stanton, *Transcript*, 2 March 2001, p. 11.

Committee comment

- 4.34 AQIS notes in its submission that it has developed, in conjunction with industry, low cost arrangements to return to clients any funds recovered in excess of requirements. However, it is clear that Revenue Rebate balances have often been retained for a considerable time rather than being paid out promptly by means of fee discount following over-recovery.
- 4.35 In particular, the Committee notes the audit report conclusion that clients using the animal quarantine stations, mainly dog and cat importers, have paid fees well in excess of costs for a number of years.
- 4.36 AQIS has agreed to the audit recommendation to provide more information on the status of over-recovered funds in the annual *Report to Clients*. AQIS has also agreed to review more regularly its fees in relation to the costs incurred for the Animal Quarantine Stations program. However, it appears to the Committee that AQIS has been very slow to make improvements in this area. It needs to improve its risk management strategies and its fee setting policies so as to reduce over-recoveries.

Recommendation 2

- 4.37 **The Committee recommends that the Australian Quarantine and Inspection Service (AQIS) improve risk management in its fee-setting activities with the aim of significantly reducing over-recoveries.**

Setting fees and charges

- 4.38 About 90 per cent of AQIS's trading revenue is collected from fees-for-services. In the main, the remainder is collected from registration and quantity charges that are raised under taxing legislation.³²
- 4.39 In most program areas, fees and charges are determined in consultation with relevant industry representatives, by taking into consideration existing fee and charge levels, the expected volume

32 ANAO, Report No. 10, 1999-2000, p. 75.

of chargeable transactions and expected costs for the forthcoming year.³³

- 4.40 AQIS seeks to set fees-for-service at levels considered appropriate by AQIS and industry; they are not necessarily set with a view to match closely the cost of each type of service provided by a program. The cost of providing one service may be offset by revenue generated by another service within the same program.

Accordingly, AQIS collects costing information on a program basis and by location (through a total of 430 cost centres). Consequently, it does not have readily available data at an activity level within many of its programs that would enable assessment of the alignment between AQIS' costs and the many different fees it imposes.³⁴

- 4.41 The audit found that AQIS systems' provision of limited costing information below program level resulted in AQIS using estimates of its costs, often based on staff utilisation, to discuss and agree fees and charges with Industry Consultative Committees.³⁵

- 4.42 The audit report stated that:

...AQIS' systems provide limited assurance of the apportionment of the staffing costs for the 15 per cent of AQIS employees, and the majority of State/Territory employees working for AQIS, that share their time either across recoverable programs or between recoverable and non-recoverable programs. The ANAO therefore concludes that, as presently operating, AQIS' systems do not provide assurance of the apportionment of staffing costs to the recoverable programs, as the subjective staffing attributions are not supported by a satisfactory assurance mechanism which monitors the sensitivity of estimates against cost outcomes.³⁶

- 4.43 AQIS stated at the hearing that it was committed to continued refinement and improvement of all its functions, including those related to setting and recovering fees within the cost recovery framework the government had set.³⁷

33 ANAO, Report No. 10, 1999-2000, p. 77.

34 ANAO, Report No. 10, 1999-2000, p. 81.

35 ANAO, Report No. 10, 1999-2000, p. 42.

36 ANAO, Report No. 10, 1999-2000, p. 54.

37 Stanton, *Transcript*, 2 March 2001, p. 3.

- 4.44 AQIS's CEO acknowledged that AQIS needed to look in more detail at the 15 per cent of its staff working across different programs and across different groups.

I have been in this position for four months and I certainly think there are changes to be made. I am not satisfied that we have a good enough system.³⁸

- 4.45 The Committee sought information on AQIS's priorities for change and the expected timing of them.³⁹

- 4.46 The AQIS CEO advised that her priorities were to look at those programs where she believed there was still improvement to be made.

Horticulture has been a good example. That review is nearing completion now. We are hoping to have a new fee structure for horticulture in the near future which will be more transparent, more equitable and so on. The vision beyond that really is a matter of, once we believe that these programs are pretty much up to speed in terms of their basic costing information and so on, trying to work towards a simpler set of fees – which I do not for a minute believe means that you do not need more detailed information; you do. The more detailed the information, the better able you are to set a simpler fee structure in the end.⁴⁰

Committee comment

- 4.47 The Committee notes that an independent client satisfaction survey conducted in early 1999 revealed that 69 per cent of AQIS's clients considered its charges were too high.⁴¹ The audit report makes it clear that information at a detailed level is generally not available to see whether there is a good match between fees and costs. The Committee considers that AQIS needs to collect information at a more detailed level to better align fees and for the services it provides.

38 Stanton, *Transcript*, 2 March 2001, pp. 4, 11.

39 *Transcript*, 2 March 2001, p. 11.

40 Stanton, *Transcript*, 2 March 2001, p. 11.

41 ANAO, Report No. 10, 1999-2000, pp. 94-5.

Managing cross-subsidisation

- 4.48 Under full cost-recovery, revenue raised from fees and charges should offset fully the costs of service provision. Cross-subsidisation occurs when one group of users pays for more than the cost of the services they receive, and the surplus is used to offset the cost of services provided to other users (who pay less than the cost of the services they receive).⁴²
- 4.49 AQIS noted at the hearing that it operated under the fundamental principle that there be no cross-subsidisation between industry groups (programs). AQIS maintains that cross-subsidisation within user groups is legitimate provided there is a rational basis for discrimination between users in the group.⁴³
- 4.50 AQIS told the Committee that it seeks to operate on a system of nationally uniform fees and charges and that fees and charges set and collected should be consistent between locations. The audit concluded that there was minor cross-subsidisation between AQIS's programs, but that there was some cross-subsidisation between clients and between locations.

The risk of cross-subsidisation is inevitably a matter of considerable interest to clients. Any suspicion of cross-subsidisation may undermine client perceptions of the fairness of the fees and charges. AQIS' practice of limited measurement of the costs of its services and not aligning its fees and charges with its costs at this level means that it is only able to provide limited assurance to clients regarding cross-subsidisation.⁴⁴

- 4.51 The audit found that AQIS's approach to setting fees-for-service means that costs borne by individual clients are not necessarily the same as the cost to AQIS for providing the service.

Misalignment between activity costs and revenue sources can result in inequitable fees and charges ...[as] illustrated in the [June 1999] report of the Quarantine and Exports Advisory Council.⁴⁵

42 ANAO, Report No. 10, 1999-2000, p. 84.

43 Stanton, *Transcript*, 2 March 2001, p. 2; AQIS, Submission No. 1, p. 21.

44 ANAO, Report No. 10, 1999-2000, p. 91.

45 ANAO, Report No. 10, 1999-2000, p. 81.

Committee comment

- 4.52 The Committee notes the Quarantine and Exports Advisory Council's Review and Evaluation of the AQIS Horticulture Exports program found that some clients were paying very high proportional costs associated with AQIS's fees and charges while others did not contribute at all to the program's cost. The Committee is also aware that AQIS has responded to the review.⁴⁶
- 4.53 It is apparent to the Committee that more transparent costing information would assist AQIS to explain the basis for its fees and charges. Moreover, the Committee considers that until AQIS has a better knowledge of the costs associated with servicing its clients, it cannot consider management options such as the contracting out of some remote services.

Recommendation 3

- 4.54 **The Committee recommends that the Australian Quarantine and Inspection Service implement the Australian National Audit Office's recommendation No. 6 of Audit Report No. 10, 2000-2001, namely that the Australian Quarantine and Inspection Service align fees charged to particular clients with the costs associated with servicing those clients where it is cost-effective to do so. Where this is not feasible, the reasons should be made transparent to relevant stakeholders and kept under review.**

Consulting with industry

- 4.55 AQIS places considerable emphasis on developing and strengthening its relationship with its clients and has operated a client feedback program since 1994 that enables industry to report directly to senior management, with guaranteed confidentiality, about how AQIS performs its role. AQIS has also been surveying its fee-paying clients since 1995.⁴⁷

46 ANAO, Report No. 10, 1999-2000, p. 129.

47 ANAO, Report No. 10, 1999-2000, p. 93.

- 4.56 AQIS now has industry consultative committees⁴⁸ for all but one of its recoverable programs and considers that it works in close collaboration with industry. All committees have had their terms of reference, scope and membership reviewed. Each committee now has representation from AQIS, the major client groups and industry peak bodies and is the principal advisory forum for policy, strategic issues, costs of the program and fees and charges.⁴⁹
- 4.57 The ANAO concluded that the revised consultative mechanisms were generally appropriate.
- Overall, they appeared to be working well and provide a sound framework for the continuous improvement of open communications between AQIS and its clients.⁵⁰
- 4.58 However, in reviewing the effectiveness of AQIS's consultation with its clients, the ANAO noted that a number of affected industries expressed some dissatisfaction with AQIS's handling of the introduction of the non-meat EXDOC system.⁵¹

Non-meat EXDOC

- 4.59 EXDOC is the AQIS Electronic Export Documentation System. It is designed to replace a number of manual transactions with electronic processing for documents and certificates. The system has been in place in the Meat Industry since 1992. In 1997, the decision was taken by AQIS to extend EXDOC to a number of non-meat programs, to commence by the end of 1998. The audit report noted that AQIS considers this initiative to be an important element in giving effect to the Government's commitment to implementing electronic commerce initiatives.⁵²
- 4.60 The ANAO noted some issues covering the management of the project and the adequacy of industry consultation, which have implications for cost-recovery.

48 Industry Consultative Committees have been established for all programs except Animal Quarantine Stations because there is no easily identifiable industry for this program.

49 ANAO, Report No. 10, 1999-2000, p. 95.

50 ANAO, Report No. 10, 1999-2000, p. 95.

51 ANAO, Report No. 10, 1999-2000, pp. 95-6.

52 ANAO, Report No. 10, 1999-2000, pp. 95-6.

Estimates of the cost of the EXDOC non-meat development have escalated considerably from \$0.75 million at initial planning in 1996, to \$1.2 million in September 1997 and \$4 million in January 1999. Some \$2.7 million of this had been spent to 30 June 1999. There has been no cost-benefit study for the extension of EXDOC to non-meat industries since a report completed in December 1997. The report of the study did not clearly show the costs of developing, maintaining and operating the system over its intended life. The capital cost used in the calculations appears to be \$1.2 million. The report showed (for an undefined 12-month period only), negative net benefits to industry of \$0.3 million, offset by projected benefits to AQIS of \$0.68 million. It is not clear whether industry was informed of the findings of the report at the time. Given the increase in the capital cost of the project since then, the costs would now appear to outweigh considerably the benefits.⁵³

Committee comment

- 4.61 The Committee notes that the Industry Consultative Committee minutes record concerns raised by industry about the huge increase in costs of the non-meat EXDOC project without consultation by AQIS. One industry representative was quoted as saying that the redevelopment was an 'extreme embarrassment' and that it was not a partnership, but a costly program that had been imposed on industry.⁵⁴
- 4.62 The Committee notes ANAO's comment that even at this stage in the non-meat EXDOC system project, the conduct of a thorough cost-benefit analysis would be beneficial, to provide full transparency and accountability to industry.⁵⁵
- 4.63 The Committee is aware that EXDOC costs are major recovery costs for industry. The Committee is particularly concerned about ANAO's statement about EXDOC that 'the costs now appear to outweigh considerably the benefits' and makes the following recommendation:

53 ANAO, Report No. 10, 1999-2000, p. 96.

54 ANAO, Report No. 10, 1999-2000, p. 96.

55 ANAO, Report No. 10, 1999-2000, p. 97.

Recommendation 4

- 4.64 **The Committee recommends that the Australian Quarantine and Inspection Service conduct a thorough cost-benefit analysis of the non-meat EXDOC system project.**