



BEST PRACTICE

Establishing Government Charges and Fees (1996) (BUDGET)

Background. State and local governments use charges and fees to fund the provision of goods and services. Charges are voluntary payments that are used to finance traditional governmental services such as water, sewerage, and mass transit; recreational activities such as golf and swimming; and miscellaneous programs such as libraries, dangerous tree removal, animal shelters, school lunches, and continuing education programs. From a technical standpoint, fees are distinctively different from charges, although the terms may be used interchangeably by some. A fee is imposed as a result of a public need to regulate activities, typically related to health, safety, or other protective purposes. Fees result in the purchase of a privilege or authorization and are applied to such activities as restaurant inspections, landfill use, building permits, and marriage licenses.

According to economic theory, the most efficient use of resources is achieved if the price for a good or service is set at a level that is related to the cost of producing the good or service. In practice, governments set some charges and fees to recover 100 percent of the cost. Other charges and fees are set at levels above or below cost for various reasons, and in some cases, the amount of a charge or fee may be restricted by state or local law.

Recommendation. The Government Finance Officers Association (GFOA) supports the use of charges and fees as a method of financing governmental goods and services. GFOA makes the following recommendations about the charge- and fee- setting process:

1. A formal policy regarding charges and fees should be adopted. The policy should identify what factors are to be taken into account when pricing goods and services. The policy should state whether the jurisdiction intends to recover the full cost of providing goods and services. It also should set forth under what circumstances the jurisdiction might set a charge or fee at more or less than 100 percent of full cost. If the full cost of a good or service is not recovered, then an explanation of the government's rationale for this deviation should be provided. Some considerations that might influence governmental pricing practices are the need to regulate demand, the desire to subsidize a certain product, administrative concerns such as the cost of collection, and the promotion of other goals. For example, mass transit might be subsidized because of environmental concerns.
2. The full cost of providing a service should be calculated in order to provide a basis for setting the charge or fee. Full cost incorporates direct and indirect costs, including operations and maintenance, overhead, and charges for the use of capital facilities. Examples of overhead costs include: payroll processing, accounting services, computer usage, and other central administrative services.
3. Charges and fees should be reviewed and updated periodically based on factors such as the impact of inflation, other cost increases, the adequacy of the coverage of costs, and current competitive rates.
4. Information on charges and fees should be available to the public. This includes the government's policy regarding full cost recovery and information about the amounts of charges and fees, current and proposed, both before and after adoption.

References

- *Cost Analysis and Activity-Based Costing for Government*, GFOA, 2004

Approved by the GFOA's Executive Board, 1996.