



A Report
to the
Board of
Supervisors

Maricopa County
Internal Audit
Department

Ross L. Tate
County Auditor

Licenses, Fees, & Permits

*Ineffective Fee Reviews Could Cost
County Millions in Lost Revenues*

August ■ 2009

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The mission of Maricopa County is to provide regional leadership and fiscally responsible, necessary public services so that residents can enjoy living in a healthy and safe community.

The mission of the Internal Audit Department is to provide assistance to the Board of Supervisors so they can ensure Maricopa County government is accountable to its citizens.

The County Auditor reports directly to the Maricopa County Board of Supervisors, with an advisory reporting relationship to the Citizen's Audit Advisory Committee.

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"Do the Right Things Right!"



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August 11, 2009

Max Wilson, Chairman, Board of Supervisors
Fulton Brock, Supervisor, District I
Don Stapley, Supervisor, District II
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We completed our Fiscal Year (FY) 2008-2009 Countywide review of Licenses, Fees, and Permits. This audit was performed in accordance with the annual audit plan approved by the Board of Supervisors. The specific areas reviewed were selected through a formal risk-assessment process.

Highlights of this report include:

- A Countywide user fee study has not been conducted since 1995
- Agency user fee reviews are generally not timely or effective

This report contains an executive summary, specific information on the areas reviewed, and County management's response to our recommendations. We reviewed this information with County management and appreciate the excellent cooperation provided by management and staff. If you have any questions, or wish to discuss the information presented in this report, please contact Richard Chard at (602) 506-7539.

Sincerely,

A handwritten signature in cursive script that reads "Ross L. Tate".

Ross L. Tate
County Auditor

Executive Summary

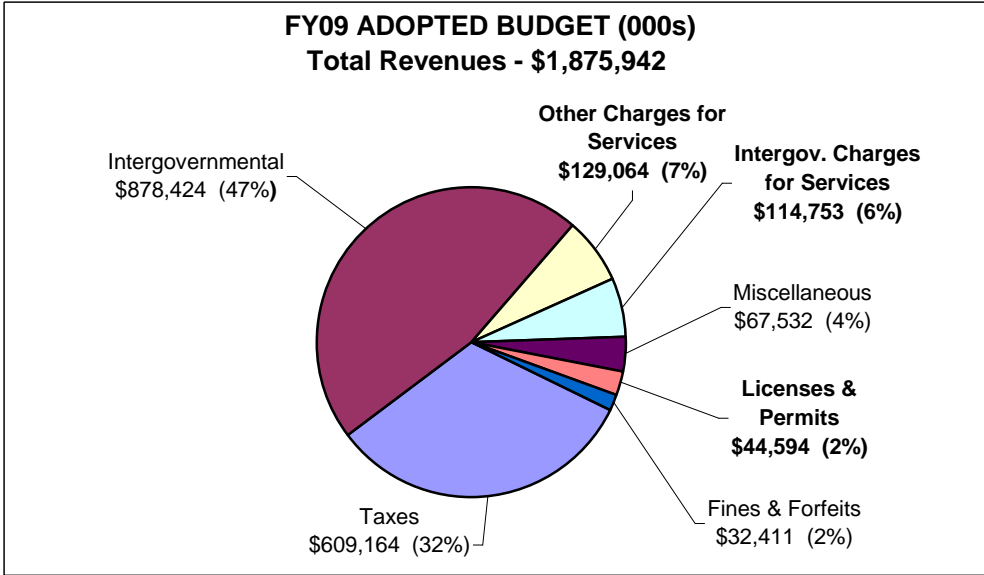
Fee Reviews are Generally Not Timely or Effective (Page 5)

Fee review practices vary greatly among County agencies and are generally not timely or effective due largely to the lack of Countywide policies and procedures. Most County agencies do not review fees annually or have a reliable system in place to determine the full cost of providing fee-based goods and services, which greatly inhibits management's ability to ensure (a) collections cover the intended share of program costs; and (b) compliance with Arizona Revised Statutes and County policy. County management should establish a "policy framework" for County agencies charged with conducting fee reviews by establishing minimum requirements and developing needed guidance, and consider requiring agencies to establish fee cost models.

Introduction

Background

User financing can be a fair and effective way to fund a variety of County programs. With user financing, all or part of the costs associated with providing certain goods and services are paid by the beneficiaries who receive the services. User financing can be achieved through user fees, charges for services, or targeted excise taxes. For FY09, the County budget included \$288 million in charges for services (intergovernmental and other) and regulatory fees (licenses & permits), or 15% of total revenues, as shown in bold below.



Source: FY09 Annual Business Strategies

Budgeted Charges for Services & Regulatory Fees total \$288 million

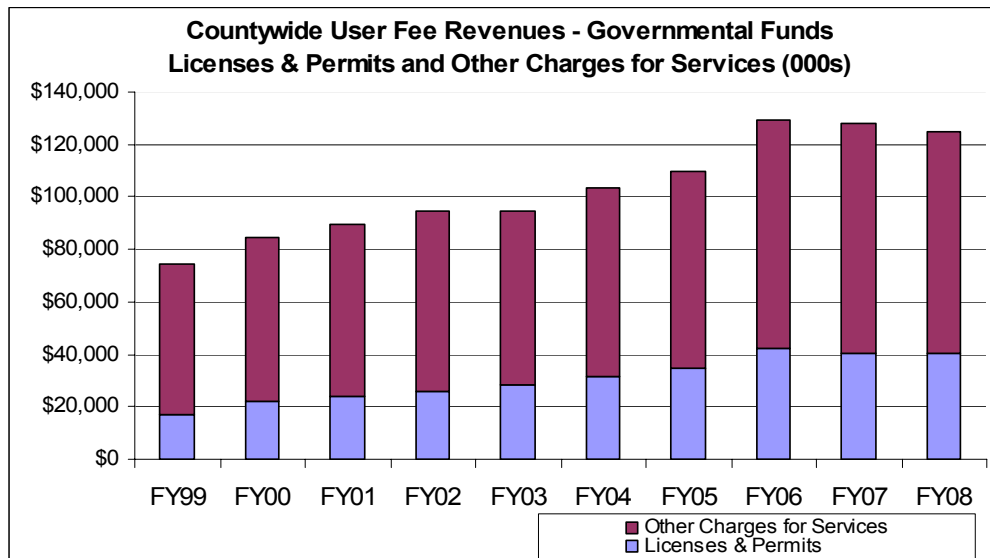
Through user financing, the County can reduce the burden on taxpayers and promote greater economic efficiency and equity. To be effective, however, fees must be substantively reviewed regularly and reliable information on the full cost of providing the goods or services must be available. The full cost is defined as the total cost of all resources consumed in providing the service, including direct and indirect costs. Direct costs are those that can be traced directly to a specific process or product. Indirect costs are those that are incurred for common or joint purposes and cannot be specifically traced to a particular process.

User Fee Revenues Defined

Our audit focused specifically on regulatory fees assessed for “Licenses and Permits” (object code 610) and “Other Charges for Services” (object code 635). All other revenue sources were outside the scope of our review. All references to “fee revenues” or “user fee revenues” in this report refer to “Licenses and Permits” and “Other Charges for Services” only.

User Fee Revenue Trends

Total fee revenues (governmental funds) increased by \$51 million, or 68%, from FY99 to FY08, as shown below.



Source: FY08 Comprehensive Annual Financial Report

User fee revenues begin to decline in FY07

Authority to Establish User Fees

In 1988, the State Legislature enacted House Bill 602, which modified A.R.S. § 11-251.08 to allow county boards of supervisors to establish fee schedules. This enabled counties to establish new fees to recover the costs of services for activities suitable for user fees where no authority previously existed and adjust certain fees currently authorized by statute in the event the amounts authorized by statute were not sufficient to recover costs. The intent of this legislation was to enable counties to improve the level of cost recovery for fee-based services without having to seek legislative approval. However, there are numerous instances where A.R.S. § 11-251.08 does not apply and legislative action is required. Fees generally fall into one of the following categories:

- Fees established by the Board of Supervisors (BOS) pursuant to A.R.S. § 11-251.08 or other specific statutory authority
- Fees established or adjusted through enabling legislation
- Fees permitted by statute but assessed by judicial discretion
- Fees imposed or adjusted through intergovernmental agreements (IGAs) authorized by the BOS

Scope and Methodology

Audit Objectives

Our audit objective was to determine if user fee reviews conducted by County agencies are timely and effective. To meet this objective, audit work was focused on determining if user fee reviews are (1) conducted annually, and (2) effective in determining the full cost of providing fee-based goods and/or services.

To gain a better understanding of agency fee review practices, we conducted a Countywide fee revenue survey as of September 2008. As part of the survey, agencies were requested to provide information for all fees charged. We selected a random sample of 100 fees for detailed test work. Survey responses were validated and fee review practices were examined at the agencies with fees selected for review, which encompassed 14 County agencies with FY08 fee revenues totaling \$113.5 million. The 14 agencies provided detailed information for each fee selected (FY03 – FY08), as well as all fee revisions (FY05 – FY08). We also performed various trend analyses (FY99 – FY08) and reviewed relevant policy and economic literature.

Our audit work focused specifically on fees assessed by County agencies for “Licenses and Permits” (object code 610) and “Other Charges for Services” (object code 635). All other revenue sources were outside the scope of our review and are excluded from all references to “user fees” and “fee revenues” for purposes of this report.

Auditing Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Issue 1 Fee Reviews are Generally Not Timely or Effective

Summary

Fee review practices vary greatly among County agencies and are generally not timely or effective due largely to the lack of Countywide policies and procedures. Most County agencies do not review fees annually or have a reliable system in place to determine the full cost of providing fee-based goods and services, which greatly inhibits management's ability to ensure (a) collections cover the intended share of program costs; and (b) compliance with Arizona Revised Statutes and County policy. County management should establish a "policy framework" for County agencies charged with conducting fee reviews by establishing minimum requirements and developing needed guidance, and consider requiring agencies to establish fee cost models.

Criteria

Arizona Revised Statutes (A.R.S.) § 11-251.08:

County fee for service authority; alternate fee schedule; fee limits; adoption procedures

- A. In addition to any other county power or authority the board of supervisors may adopt fee schedules for any specific products and services the county provides to the public. Notwithstanding fee schedules or individual charges in statute, a board of supervisors may adopt an additional charge or separate individual charge.
- B. Any fee or charge established pursuant to this section must be attributable to and defray or cover the expense of the product or service for which the fee or charge is assessed. A fee or charge ***shall not exceed the full cost*** of the product or service. ***(Emphasis added.)***

There is no Countywide user fee policy. However, the Budgeting for Results Policy #B1006 states the following:

Where appropriate, services and programs will be supported by user fees. User fees will recover the County's full direct and indirect costs, unless market considerations dictate otherwise. ***All user fees will be reviewed annually*** in conjunction with the budget development process. Because expenditures supported by user fees are generally subject to the constitutional expenditure limitation, such expenditures must be carefully reviewed, and user fee rates should be reduced if they can no longer be justified by actual expenditures.

Condition

Our findings are presented in the following four sections in the order shown below.

1. Countywide User Fee Studies
2. Trend Analyses in 14 Agencies

3. Fee Survey Results
4. Agency Test Results

SECTION 1 - Countywide User Fee Studies

The last Countywide user fee study was conducted by an external consultant in September 1995. That study was requested by the Office of Management and Budget (OMB) to recommend fees based on the full cost of providing various services and to provide OMB with the necessary tools to conduct annual user fee reviews.

A Countywide fee study has not been conducted in the intervening 14 years and responsibility for conducting fee reviews is now assigned to County agencies. However, there is no substantive Countywide user fee policy, and very limited guidance or oversight exists to assist agencies in performing this essential but often challenging task.

Recommended Interval for Fee Studies

Typically, a detailed fee study is undertaken every three-to-five years with Consumer Price Index (CPI) adjustments in the intervening years, according to a leading cost consulting firm that provided cost consulting services to more than 400 government entities.

We found that federal agencies are required to review user fees biennially according to the U.S. Chief Financial Officers Act and the U.S. Office of Management and Budget (USOMB) Circular No. A-25. The Circular provides that these reviews will include (1) assuring that existing charges are adjusted to reflect unanticipated changes in costs or market values, and (2) a review of other programs within the agency to determine whether fees should be initiated for government services or goods for which it is not currently charging fees. It also states that if imposing such fees is prohibited or restricted by law, agencies will recommend legislative changes as appropriate.

Recommended Policy Considerations

In 1996, the Government Finance Officers Association published the following recommendations for setting government fees:

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.

We acknowledge that it would be very challenging to establish a comprehensive Countywide user fee policy due to unique circumstances that exist at various County agencies. However, a Countywide “policy framework” could be developed to (a) set forth certain minimum requirements at the agency level, (b) provide essential guidance, and (c) improve oversight and accountability for agencies charged with conducting user fee reviews.

Cost Accounting Standards

The process of conducting a fee review is complex and requires at least a basic understanding of managerial cost accounting concepts. To ensure that fees are aligned with program costs and activities, agencies generally must track direct and indirect costs at the fee level, determine a proper methodology for allocating indirect costs, identify an appropriate unit of measure for establishing the “per-unit fee,” project future program costs and fee collections, etc., and reassess these and other variables routinely. It can quickly become a challenging process, particularly for staff with limited exposure to cost accounting. Despite this, very limited guidance or oversight exists at the County.

In contrast, in 1995, the USOMB issued “Managerial Cost Accounting Concepts and Standards for the Federal Government (Statement of Federal Accounting Standards No. 4),” which consists of 105 pages aimed at assisting staff at federal agencies in providing reliable and timely information on the full cost of federal programs, their activities, and outputs. The five primary concepts of managerial cost accounting contained in this statement describe the relationship among cost accounting, financial reporting, and budgeting, and help demonstrate the overwhelming need for additional guidance in this area at the County.

SECTION 2 - Trend Analyses in 14 Agencies

We analyzed fee revenue trends at 14 County agencies with FY08 fee revenues of \$1 million or more, as shown below. Fee revenues generated by these agencies totaled \$111.2 million in FY08, or 72% of Countywide fee revenues.

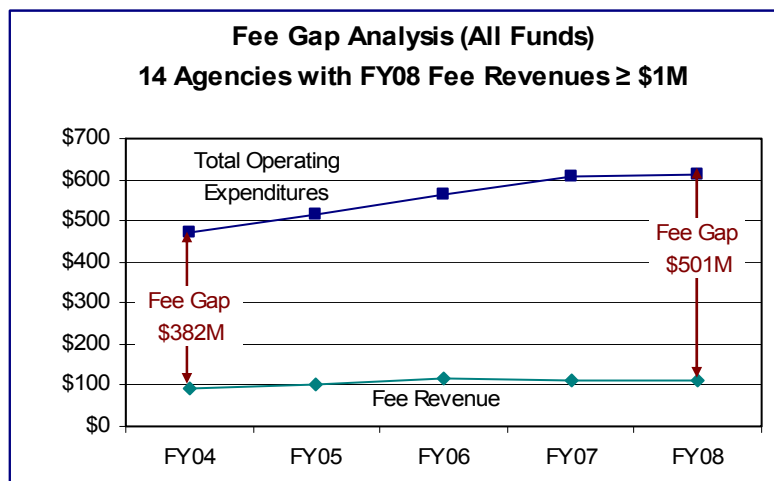
1. Adult Probation	6. Environmental Services	11. Public Health
2. Air Quality	7. Flood Control District	12. Recorder
3. Animal Care & Control	8. Parks & Recreation	13. Transportation
4. Clerk of the Superior Ct.	9. Planning & Development	14. Trial Courts
5. Constables	10. Public Defender	(Nondepartmental excluded)

Highlights for these 14 agencies are summarized below:

1. **Fee Gap Analysis** – The fee gap (difference between fee revenues and total operating expenditures) increased by \$119 million (31%) from FY04 to FY08, to \$501 million.
2. **Growth Rates** – Fee revenues grew by 23% and total expenditures grew by 31% at these 14 agencies (FY04 – FY08), while Countywide expenditures decreased by 15%.
3. **Cost Recovery Ratio** – User fees recovered an estimated 48% of direct costs, leaving 52%, or \$133.4 million (*plus undetermined indirect costs*) to be funded by other sources.

Fee Gap Analysis

We performed a fee gap analysis to determine the dollar difference between fee revenues and total operating expenditures from FY04 – FY08. As shown below, the fee gap increased by 31% (\$119 million). Although there are many factors and variables, including other funding sources, that could account for the spread between fee revenues and total operating expenditure in the listed agencies, the increasing spread between revenues and expenditures between FY04 and FY08 suggests potential benefits might be realized from updating fee models.



Source: Advantage Financial System

The fee gap grew by \$119 million (31%) over four years

Total operating expenditures include *all* County expenditures, exclusive of debt service and capital expenditures. Although the fee gap can be attributed in part to factors not directly related to user financing, we did not have the resources to determine the potential for fee revisions to narrow the gap.

Growth Rates

Collectively, fee revenues at the 14 agencies increased by 23% from FY04 – FY08 and expenditures grew by 31%, compared to a 15% decrease in expenditures Countywide.

Cost Recovery Ratio

Most County agencies do not have a reliable system in place to determine the full cost of providing fee-based goods or services. Being able to determine full cost is important for many reasons, including ensuring (1) collections cover the intended share of program costs, and (2) compliance with A.R.S. and County policy (as specified in the Criteria section).

Given the lack of reliable cost information, it is difficult to definitively determine the County's cost recovery ratio for fee-based services. However, we estimate that 48% of direct costs were recovered in FY08, leaving 52%, or \$133.4 million (*plus undetermined indirect costs*) to be funded by other sources. To arrive at this estimate, we identified all Managing for Results activity codes used to record fee revenues by agency and then queried Advantage for total expenditures booked to these activities.

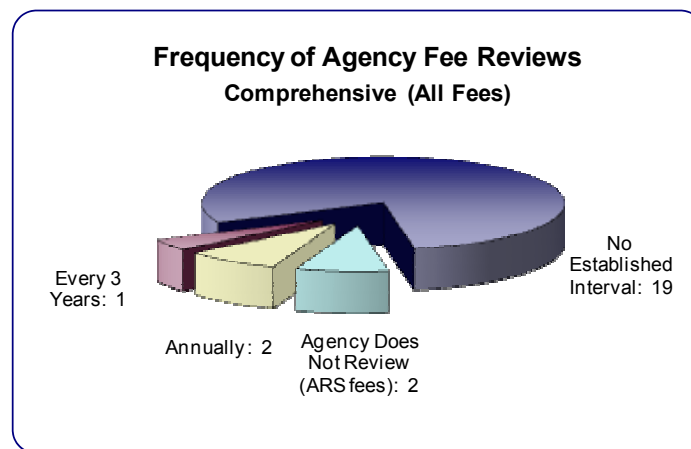
SECTION 3 - Fee Survey Results

To gain a better understanding of agency fee review practices, we surveyed all agencies with FY08 fee revenues. A total of 40 surveys were sent and 38 were returned, for a 95% response rate. The 24 agencies listed below reported fees that are subject to routine review.

- | | | |
|------------------------------|----------------------------|-----------------------|
| 1. Adult Probation | 9. Environmental Svcs. | 17. Planning & Dev. |
| 2. Air Quality | 10. Finance | 18. Public Fiduciary |
| 3. Animal Care & Control | 11. Flood Control District | 19. Public Health |
| 4. Assessor | 12. Justice Courts | 20. Recorder |
| 5. Clerk of the Superior Ct. | 13. Juvenile Probation | 21. Solid Waste |
| 6. Constables | 14. Library District | 22. Super. of Schools |
| 7. Correctional Health | 15. Medical Examiner | 23. Transportation |
| 8. County Attorney | 16. Parks & Recreation | 24. Trial Courts |

Key Survey Findings

According to our survey, all fees are generally not reviewed annually as required by County policy, as shown below.



Most agencies report that fees are not reviewed annually

Key survey results are shown below:

- 22 of 24 agencies (92%) report that all fees are not reviewed annually
- 19 agencies (79%) have no prescribed interval for conducting fee reviews
- 2 agencies (8%) do not review fees “because they are set in statute”
- 19 agencies (79%) do not have written policies or procedures for fee reviews
- 18 agencies (75%) do not have cost models for user fees
- 8 agencies (33%) do not document fee reviews

SECTION 4 - Agency Test Results

A total of 1,255 fees were reported by the agencies in response to our survey or were identified by reviewing agency websites. We randomly selected 100 fees (8%) for test work. The number of fees selected for review is shown on the following table by agency. Nine items were ultimately eliminated from our sample because they were obsolete or merely guidelines.

Number of Sampled Fees Randomly Selected by Agency (000s)

NO.	AGENCY	FY08 FEE REVENUES (610, 635)	# FEES SELECTED
1	Adult Probation	\$ 10,057	1
2	Air Quality	8,440	10
3	Animal Care & Control	8,826	2
4	Clerk of the Superior Court (COSC)	11,637	5
5	Constables	1,603	1
6	Environmental Services	16,081	24
7	Flood Control District	2,759	14
8	Office of Enterprise Technology	1,570	1
9	Parks & Recreation	3,653	7
10	Planning & Development	10,744	16
11	Public Health	3,303	10
12	Recorder	13,186	1
13	Transportation	1,814	8
14	Trial Courts	18,073	Incl w/COSC
	TOTAL	\$ 111,746	100

Random Sample Results

Data provided by the agencies was analyzed to determine the following:

1. *Time Interval Since Fee was Last Revised (increased or decreased)*
2. *Number of Sampled Fees Revised (FY03 – FY08)*
3. *Total Number of Agency Fees Revised (FY05 – FY08)*

1. *Time Interval Since Fee was Last Revised (increased or decreased)*: As shown below, only 25% of the fees sampled have been revised within the past two years (including two decreased fees), based on information provided by the agencies. Over 40% have either not been revised in over four years (since September 2004) or the agency did not know when the fee was last revised.

Time Interval Since Selected Fees were Last Revised

INTERVAL	# OF FEES REVISED
< 2 Years	25% (23 of 91 fees)
2 - 4 Years	31% (28 of 91)
> 4 Years	21% (19 of 91)
No Data	23% (21 of 91)

2. *Number of Sampled Fees Revised (FY03 – FY08)*: The agencies were asked to provide the date and amount of the last revision for the 91 selected fees. We analyzed this data to determine the total number and percentage of fees that were revised during FY03 – FY08. Twenty fees were excluded from this analysis because the fee was not implemented until after FY03, and six fees were excluded because the agency was unable to determine the amount of the fee in FY03. For the 65 remaining fees, fewer than half (46%) were increased during the six-year period, as shown below:

Number of Sampled Fees Revised FY03 – FY08

Description	#	%	% Change (Average)
# of Fees Increased	30	46%	139%
# of Fees Decreased	4	6%	(49%)
# of Fees Unchanged	31	48%	N/A

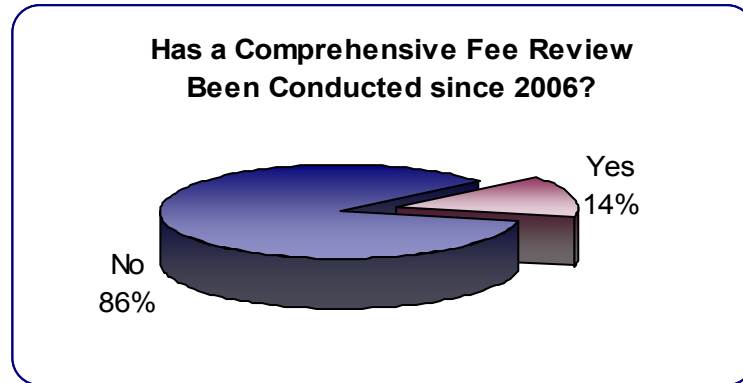
3. *Total Number of Agency Fees Revised (FY05 – FY08)*: We asked the 14 agencies to provide a list of *all* fees revised between FY05 – FY08. Of 1,024 fees identified within these agencies, the agencies reported that 503 (49%) had been revised within the last four years.

Summary of Agency Fee Review Practices

In order to gain a better understanding of agency fee review practices, we conducted interviews at the 14 agencies included in our random sample. A summary appears below.

- 14 of 14 agencies (100%) do not review all fees annually
- 11 agencies (79%) do not have a reliable system in place to determine full costs (agencies with a reliable system are: Air Quality, Animal Care & Control, and Environmental Services)

- 9 agencies (64%) have not documented a fee review since prior to 2006 (agencies with a documented review are: Air Quality, Animal Care & Control, Parks & Recreation, Planning & Development, and Public Health)
- 12 agencies (86%) did not conduct a comprehensive review of all fees from 2006 – 2008 (agencies with a comprehensive review are: Parks & Recreation and Clerk of the Superior Court)



Five agency user fee studies have been conducted by outside consultants since FY03, as shown below.

Agencies with External Fee Studies Since FY03

Agency	Last External Fee Study
Air Quality	FY05
Animal Care & Control	FY05
Environmental Services	FY05
Flood Control	FY05
Public Health	FY03

At Air Quality, Animal Care & Control, and Environmental Services, the external consultants developed Excel-based “fee cost models” designed to determine (1) the full cost of service for activities that charge user fees, and (2) current cost recovery rates for these activities. It was reported that many of the cost models required significant modifications to produce reliable results; however, actual cost models were outside the scope of our review.

A similar tool is needed at other County agencies, although the process of developing and maintaining fee cost models can be a time consuming and tedious process. Nevertheless, reliable information on full costs, collections, outputs, etc., is essential to properly manage fee-based activities and ensure compliance with A.R.S. and County policy. County management should consider requiring agencies to develop “fee cost models.” The cost models could be reviewed periodically by OMB, Internal Audit, or another party to help provide the oversight needed to improve fee review practices Countywide.

Effect

Ineffective fee reviews could cost the County millions in lost revenues. Without regular, substantive fee reviews, management lacks complete information about whether authorized fees cover the intended share of program costs. In addition, the lack of complete, transparent cost and collections data can prevent management from addressing existing issues, including possible misalignments between fee collections and program costs and unnecessary general fund support. In addition, County policy requires that such expenditures be carefully reviewed, and user fee rates be reduced if they can no longer be justified by actual expenditures. Without accurate, reliable cost data, County management is unable to ensure compliance with A.R.S. and County policy.

Cause

- Lack of substantive Countywide policies and procedures for user fees
- Lack of proper guidance and oversight
- Ineffective cost accounting system

Recommendations

County management should:

- A.** Establish a “policy framework” for County agencies charged with conducting fee reviews by establishing minimum requirements and developing needed guidance.
- B.** Consider requiring agencies to establish fee cost models.

Management Response

**MARICOPA COUNTY DEPARTMENT OF FINANCE
AUDIT RESPONSE
LICENSES, FEES, PERMITS**

August 4, 2009

Issue #1: Fee Reviews are Generally Not Timely or Effective

Recommendation A: County management should establish a “policy framework” for County agencies charged with conducting fee reviews by establishing minimum requirements and developing needed guidance.

Response: Concur – in process. A “FY10 Special Improvement Project” was recently established by the County Manager to address many of the issues discussed in this audit report. As project leader, I have assembled a team of many of the County’s top financial managers to review, make recommendations, and implement policies and procedures for non-tax revenues.

In conjunction with this, my office has prepared a Scope of Work (SOW) to engage the services of an expert in the field of cost accounting. The SOW will focus on: (1) Licenses, Fees, and Permits; (2) Internal Service Funds charges for services; and (3) the Central Service Cost Allocation, which all relate to developing cost rates for services provided. SOW objectives specific to Licenses, Fees and Permits are to:

- Conduct a limited Countywide user fee study and determine if all appropriate costs, including overhead administration and indirect costs, are included in the fees and that the full cost of providing the various services are included in the fee calculation. This limited user fee study will be for those departments who regularly charge for their services through the license, fees, and permit process.
- Review and/or determine a methodology for determining fee amounts to be charged including cost pools and allocation methodology and provide recommendations to improve the methodology.
- Develop a “policy framework” for county departments who charge for license, fee, and permits, and establish the minimum requirements and develop departmental guidance.
- Develop a fee cost model to be used in future years that can be used as a template for departments who charge licenses, fees, and permits.

Team goals are to provide County departments with policies and procedures that will potentially increase non-tax revenues, and develop and recommend methodologies and/or costing models for departments to utilize to review or develop fees in order to maximize recovery of the costs of services. Project completion success measures include BOS or County Manager approval of Non-Tax Revenue policies and procedures, and 100% of all departmental License, Fee, and Permit schedules reviewed in accordance with approved policies and procedures methodologies.

Target Completion Date: 6/30/10

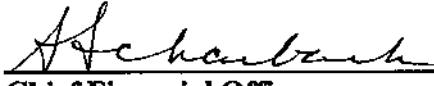
Benefits/Costs: Potential for increasing non-tax revenues through user financing; improved guidance and oversight for conducting fee reviews; improved ability to determine full costs for fee-based services to ensure that fees cover the intended share of program costs. Cost for consultant is not known at this time.


Recommendation B: County management should consider requiring agencies to establish fee cost models.

Response: Concur – in process. Refer to response above.

Target Completion Date: Reflected above.

Benefits/Costs: Reflected above.

Approved By :  8/4/09
Chief Financial Officer Date

 8/9/09
County Manager Date