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# **HIGH LEVEL OVERVIEW ON COST REFLECTIVE TARIFF SETTING GUIDELINES**

## **CFO FORUM UPINGTON**

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# PHOTO



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# INTRODUCTION

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- What do these photo's have in common?
  - Poor water drainage .....
    - Drains blocked due to lack of cleaning
    - Broken pipes due to lack of repairs & maintenance of infrastructure
    - Inadequate infrastructure
    - Inadequate planning
    - Poor quality infrastructure
- In summary **LACK OF GOOD QUALITY SERVICE DELIVERY**

# INTRODUCTION

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- Lack of Service Delivery leads to consumers not wanting to pay for poor quality services and so revenue is reduced
- Demand for services far exceed the ability of municipalities to deliver at an acceptable level
- Imbalances between collected revenues on the one hand and real costs for the provision of services and maintenance of infrastructure on the other hand
- If municipalities do not raise enough revenue, they have to cut expenditure in order to balance budgets. Often cuts on asset maintenance and rehabilitation (provision on depreciation/CRR)

# WILLINGNESS OF COMMUNITIES TO PAY MUNICIPAL ACCOUNTS

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- Determination of the level of services – which services and what level
- Community participation is a MUST
- Create confidence in the service accounts they receive
- Database is complete and accurate – accurate readings, debt collection critical by “cut off” of services (prevent escalation of debtor balances)
- Address large outstanding balances – afford to pay vs cannot pay (assist with payment arrangements, effective indigent system)



# WILLINGNESS OF COMMUNITIES TO PAY MUNICIPAL ACCOUNTS



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- Community to understand how tariffs are calculated  
**COMMUNICATION**
- Tariff determination should be **AFFORDABLE, ACCURATE, COST-REFELECTIVE** and **TRANSPARENT**



PresenterMedia



# NEED FOR COST REFLECTING TARIFFS

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- Service account – communicate with consumers to understand what they are paying for
- By adding an inflation based percentage going create an under-recovery – service may end up operating at a LOSS (not transparent/difficult to explain and understand
- Developing a Tariff Policy is not just a compliance issue – use it to communicate with consumers on how tariffs are established, monitored and reviewed
- Tariff Policy accurately describes the processes followed when setting tariffs.

# PROPOSED PREPARATION

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- Tariff setting is a complex process – keep it basic (simple)
- If loads of data available and a tariff practitioner has lots of experience – **YES** complex tariffs can be designed
- Trading services (electricity, water, sanitation, refuse) - in principle can be run as separate businesses
- Non-trading services (cemeteries, licensing services, libraries, recreational facilities such as sports fields and community halls) – tariffs are not expected to cover the cost of service

# WHAT MUST BE IN PLACE FOR ACCURATE COST REFLECTIVE TARIFFS?



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- Accurate data
  - valuation roll up to date
  - meters are in place and good state – meter master file, accurate readings (consumption figures) recorded, condition of meters, control consumer usage (tampering/ by-passing - losses)
  - data cleansing of accounts - ownership updated, arrear debt collected/written-off, etc
  - chart of account – cost centres per service (employee related costs, general expenses, provisions and capital outlay from own revenue)
  - organogram up to date and reconciled to payroll



# WHAT MUST BE IN PLACE FOR ACCURATE COST REFLECTIVE TARIFFS?



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- FMS to provide accurate statistics information
- determine direct costs – employee related, bulk purchases, repairs & maintenance, contracted services and other expenditure
- determine overheads – not directly attributed to a service, but running the municipality as a whole (council, treasury, user departments) – apportionment by means of:-
  - Activity based costing – identifies activities undertaken by unit and actual cost allocated based on distribution of actions between services
  - Pro-rata allocation of cost – allocated indirect cost on apportionment using measurement such as number of employees or size of budget, etc

# WHAT MUST BE IN PLACE FOR ACCURATE COST REFLECTIVE TARIFFS?



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- Capital financing costs – financing infrastructure expansion and with rehabilitating and/or replacing existing infrastructure at it ages
  - external interest – financing capital expenditure
  - depreciation – cost of “using up” assets (proper depreciation accounting results in a cash surplus on the operating account which can be transferred to a reserve used to finance an asset replacement)
  - provisions to capital reserves – cost item used to create a cash surplus on the operating account which can be transferred to a reserve used to finance asset expansions

# COMMENT ON COST ACCOUNTING

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- It should be clear by now that the cost of providing a service is a key step in setting good tariffs
- Better understanding of costs vs better setting of tariffs
- Different ways of classifying costs
  - bulk vs distribution
  - costs per service level (what community has access to)
  - costs per geographic area (urban vs rural)
- Determine fixed cost vs variable cost (level of consumption of service)  
the municipality to decide



# OTHER FACTORS

- Improving data over time – better data tariffs can be refined/improved
- Work towards a “FULL COST” recovery tariff
- Achieve strategic goals – councils strategic objectives ie
  - affordable services to domestic consumers
  - promoting local economic development by limiting cost of services to commercial or industrial consumers
  - discouraging wasteful use of services by escalating the price of services consumed in large volumes

# OTHER FACTORS

- Ask questions –
  - Do you wish to achieve full cost recovery on this service?
  - Do you plan to give some of this service away free of charge?
  - Do you wish to limit the size of the tariff levied on certain types of consumers?
  - Do you wish to escalate the tariff levied on certain types of consumers?
- Test affordability of the tariff
  - Will the tariff generate sufficient revenue?
  - Will the tariff be affordable to consumers?
  - Revisiting your strategic decisions

# OTHER FACTORS



- Communicate with consumers – explain calculation in setting the tariff
- Tariff Policy - write details of description of services, types of services, levels of service, explanation of costs and strategic decisions
- Tariff schedules – “price list” of tariffs to be levied every year – follow the legislated processes (schedule of key deadlines, user departments inputs/ changes, public participation, advertising, etc)



# OTHER FACTORS



1. Describe the service so that the consumer understands what he or she is receiving in exchange for tariff payments
2. The cost of service provision is provided as a reference against which tariffs can be evaluated. Changes in costs from the previous year are noted
3. Explanations of who the different tariffs apply to are provided
4. A brief description of the tariff structure and its implications are provided. This is particularly important for rising block or seasonal tariffs
5. The tariffs charged this year and last year are stated
6. Reasons for changes in tariffs are noted. If tariffs are adjusted by more or less than the adjustment in costs then the reasons for this should be commented on

# OTHER FACTORS



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7. Some examples of the calculations of actual bills are provided. This helps consumers to understand how the tariffs translate into actual bills
8. The tariff policy is referenced and a channel for feedback provided

***REMEMBER SETTING A COST REFLECTIVE TARIFF IS A VITALE PART OF BUDGETING AND DETERMINES THE FUTURE EXISTENCE OF A MUNICIPALITY***





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