

A REVIEW OF LOS ANGELES COUNTY'S USER FEE SETTING PROCESS

MAY 31, 2016



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The mission of the Commission is to examine any function of County government at the request of the Board of Supervisors, on its own initiative, or as suggested by others, and to submit recommendations to the Board which will improve local government economy, efficiency, and effectiveness.

**CITIZENS'
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COMMISSION**
LOS ANGELES COUNTY
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May 31, 2016

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To: Supervisor Hilda L. Solis, Chair
Supervisor Mark Ridley-Thomas
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Supervisor Don Knabe
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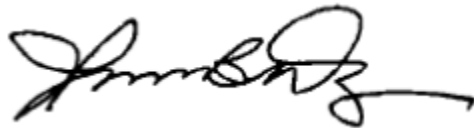
Dear Supervisors:

The Citizens' Economy and Efficiency Commission is pleased to report that it has completed its review of Los Angeles County's Fee Process, as directed by your Board in a motion made by Supervisor Kuehl on June 22, 2015. The attached report entitled, *A Review of Los Angeles County's User Fee Setting Process*, is hereby submitted for the Board's review.

The Commission appreciates the opportunity to present this study to your Board and recommends that the Board consider adopting the report's recommendations in an effort to assist the County in improving the process for fee adjustments. We stand ready to support your Board in the implementation of these recommendations.

The Commission would also like to acknowledge the cooperation and candid feedback from County management. If you or your staff have any questions, please contact the Commission's Executive Director, at (213) 974-1491, or via email at eeng@bos.lacounty.gov.

With Warmest Regards,



Isaac Diaz Barcelona
Chairman, Economy & Efficiency Commission

C: Each Member of the Board
Chief of Staff, Board Offices
Kieu-Anh King, Budget Deputy, 3rd District
Sachi Hamai, Chief Executive Officer
Lori Glasgow, Executive Officer, Board of Supervisors
Economy and Efficiency Commissioners

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I. PREFACE

Local governments are funded from a variety of sources, with the primary sources being taxes, subventions, fees, and fines. In general, “user fee” activities are those services and functions that the County provides to individuals or businesses who receive some direct material benefit from the services.

In most cases, local governments have the ability to impose user fees that reasonably cover the costs of their operations. In some instances, however, State statutes require the establishment of some fees. For example, statutes require a fee for Title Search and for certain Document Recording.

The County of Los Angeles establishes charges for services, user fees, regulatory fees and similar charges for specific services, as allowed under the California constitution and California law. Proposition 26, adopted by California voters in November of 2010, further requires that fees charged must only recover the “reasonable cost” to the County of providing the service or the specific benefit requested and that the County’s cost allocation must also be “fair or reasonable.” The underlying assumption¹ is that costs of services benefiting an individual –and not society as a whole—should be borne by the individual receiving the benefit. Setting user fees, therefore, is equivalent to establishing prices for service, but making a profit is not an objective for local government in providing services to the general public. Fees should be established at a level that will recover the cost of providing each service, no more and no less.

Through the Countywide Fee Database, we identified over 1,200 different user fees² charged by County departments. In the course of this study, with the assistance of County managers, the Citizens’ Economy and Efficiency Commission (CEEC) evaluated the actual cost of providing these services to determine whether the fee revenue being charged or could be charged reflected the full cost of services offered by the County.

II. THE COMMISSION CHARGE AND SCOPE OF WORK

On June 22, 2015, the Board directed CEEC to conduct a detailed cost of service study of departments with the greatest volume of fees, by dollar value that have not been adjusted in five years or longer. In response to the Board’s directive, CEEC delegated this study to a Task Force of seven Commissioners, assisted by the Commission’s Executive Director, to focus on the review of the County fee-setting process, and it builds on the initial part of the motion that was completed by the CEO’s office. That report³ from the CEO to the Board dated August 21, 2015, examined the overall countywide fee revenue statistics and structure for review and compilation. Additionally the report provided a summary of Departments and their total revenues from fees and also total revenues from fees that have not been adjusted in five years or longer. Based on the Statement of

¹ <http://www.caltax.org/UnderstandingProposition26.pdf>.

² These fees do not include billing for contract cities

³ CEO’s report to the Board dated 08/21/2015 at http://file.lacounty.gov/bc/q3_2015/cms1_232672.pdf

Revenue from Various Fees (also known as Schedule EE), the 2015-16 total revenue from fees is \$829,670,600, or 3% of the total County operating budget. The total user fees that have not been adjusted in five years or longer are \$109,236,909, or 13% of total revenues from fees.

Not every department in the County provides fee-related services. Some departments receive so little revenue from fees or their fees are set by outside sources (State mandate/law, etc.) that a comprehensive review would not be cost-effective. Consequently, CEEC restricted the study to Departments having a minimum threshold of unadjusted fee revenue of \$5 million or more.

The stated objective of this study was to originally “provide an analysis of fees and charges which compares County fees, fee structure, and cost recovery at Los Angeles County with those at other peer counties in California” in the context of the development of the Fiscal Year 2016-17 Recommended Budget. While this charge clearly focuses on the comparison of fees to those of other local jurisdictions, efforts by CEEC staff and CEO staff to obtain comparative data from several of these jurisdictions were mostly unsuccessful. Of the data returned, very little information was directly comparable to Los Angeles County departments.

After further consultation and input from the Board motion’s author, CEEC was authorized to move forward with the new objective to evaluate the infrastructure and processes through which fee adjustments are initiated, approved and executed. In conducting this study, CEEC recognized that the County framework for fee adjustments was already in place and sought to identify weaknesses that could practically be addressed in order to achieve more rapid and greater efficiencies for adoption in the development of the Fiscal Year 2016-17 Recommended Budget.

Following the initial discussion of the background information, this report presents the data collection methodology and conceptual issues that guide a fee (cost of service) study in Los Angeles County. The summaries of the actual findings follow this discussion, including specific issues that emerged during the study.

III. DATA COLLECTION

To provide a comprehensive analysis and clear understanding of the County’s process on fees charged, fee structures, and cost recovery calculations, the Commission collected and examined data from a wide range of sources, including:

- Telephone interviews were held with key Departmental finance personnel and various members of their senior staff to evaluate the process of how Departments impose user fees to fund the cost of providing services;
- Departmental fee documents including the voluminous fee schedules, tables and statutes were reviewed wherever possible to determine how user fees levels are established and relied upon as a revenue source to fund services; and

- Finally, outside sources were used as much as possible to learn of practices in other jurisdictions and to gather data for comparison purposes.

In this report, CEEC relied upon estimates and data prepared by knowledgeable staff and managers in Departments studied. They are the preeminent experts on the subject of work requirement and time estimates for completing each service requisite, particularly considering the unique level of service in the County. There are no other sources of information that are currently qualified to reliably contradict or dispute the work and time requirements provided by County staff. Subsequent findings in this study were developed through an extensive process with considerable input from stakeholders.

To encourage candid responses in the interview process, all interviewees were assured that their comments would not be attributed to them individually, although their remarks might be used anonymously for illustrative purposes.

IV. FINDINGS

This section summarizes the findings of the study, presents conceptual information and provides a description of the methodology Departments used to establish fee levels and initiate fee adjustments.

- 1. Since the start of the Great Recession in Fiscal Year 2008-09, many County Departments have been reluctant to initiate any fee increases even in cases when fee levels no longer recover the true cost of providing those services. This prolonged period of inactivity and disinclination has carried on at some Departments well past the end of the recession, resulting in a very passive review process for evaluating those fees needing adjustments.**

The Great Recession⁴ was a period of general economic decline observed in world markets during the late 2000s. During this time of fiscal instability, most County Departments did not raise their fees to recover the cost of providing those services. In addition, no costs of living adjustments were adopted during a five-year period as the County faced a hiring freeze and other curtailments.

- 2. The County's process for determining a full cost of service recovery is complex, burdensomely long, and often takes months for managers to gather information, all of which adversely impacts efficiency. Some Departments have expressed the desire to have the process of calculating and tracking fee adjustments automated.**

⁴ According to the US National Bureau of Economic Research (the official arbiter of US Recessions), the US recession began in December 2007 and ended in June 2009.

The Los Angeles County Fiscal Manual⁵ provides instruction to County Departments on administering departmental revenues, including those generated through user, regulatory and other fees for specific services. However, there are relatively few established rules to follow and there is considerable leeway for judgment. While the basic concepts and process of costing meet the needs of some Departments, more complex approaches to costing require a great amount of effort.

Of the Departments surveyed, CEEC compiled those fees⁶ that made up the majority (50% or more) of each Department's total fee revenues to evaluate the process for calculating the full cost of providing each of the fee-related services. The analysis was based on existing data, when available, and on other actual figures and estimates provided by the County Departments. The study focused on the actual cost of services, as the County currently provides them, and did not examine, or evaluate the effectiveness, efficiency or value of the Departments' programs or services.

In discussion with departmental fee managers, costs related to fee-based services were calculated through a methodology similar to the unit cost "build-up" approach which was used to calculate each cost component for individual fees. For analytical purposes, time estimates for each fee-based service were developed with the help of the Auditor-Controller and assistance of Departmental managers and specialized finance personnel. Based upon these estimates, the direct cost (salaries and benefits) attributed to each fee was calculated. With this information, the cost of services and supplies, as well as other appropriate amount for Countywide and departmental overheads were allocated. The end result of the analysis is a list of full actual costs for individual services. By multiplying the actual cost for each service by the annual volume of the service, the potential annual revenue was estimated. Comparable revenue was calculated by multiplying the same volume by the current fees to determine the "gap" or existing surplus/subsidy cause by under or overcharges within individual fees.

The results of the cost analysis demonstrate the full actual cost of providing each of the fee-related services included in the study. For the specific fee samples studied, CEEC identified an overall current subsidy provided by the County to the services provided, whereby the County was charging less than the full actual cost of providing the services. CEEC recognizes that significant variances in cost inputs, staffing, service demand, and other calculation factors, may cause problems with the validity and usefulness of this type of analysis. However, in these cases, the cost-revenue approach demonstrated some of the current and potential revenue impacts associated with the fees, including the existing gaps between the actual cost of the services and the potential revenues from current fees, which results in a revenue subsidy.

⁵ Section 9.1.3 (Internal Controls Over Revenue) of the Fiscal Manual further directs that "fees charged are reviewed annually and recommendations for adjustments are made when fees no longer recoup costs of the services provided."

⁶ CEEC only evaluated service-based fees; fees mandated by the State were not reviewed.

3. While all of the Departments indicated that they review their fees annually, some do so less thoroughly. Fees that are not reviewed and adjusted regularly run the risk of undercharging or overcharging users, raising equity, efficiency and revenue adequacy concerns.

During this study, County Departments indicated to CEEC that the general policy on recovering rates is to set fees at 100% cost recovery wherever feasible. Of the Departments surveyed, virtually all were Net County Cost Departments⁷, or Departments that require locally-generated revenues as a supplemental funding source to support departmental operations. However, some of the subsidized Departments interviewed believed that they are at 100% cost recovery for their fees charged.

When a fee adjustment is deemed necessary, the associated costs are calculated using the appropriate salaries, employee benefits, services and supplies, overhead rates, and work-load statistics. If the fee requires a County Ordinance revision, the proposed fees are reviewed by the Auditor-Controller and the revised Ordinance is reviewed and approved by County Counsel. Following a public hearing, the proposed fees are submitted to the Board of Supervisors for approval. If the fees are not part of a County Ordinance, the proposed fees may be sent to the Auditor-Controller for review and approval. The review and approval by the Auditor-Controller is not mandatory, but is highly recommended should the fees be disputed. In this case, Board approval is not required. .

All Departments surveyed responded that they have instructions that require a periodic review of user fees, and all indicated that fees are reviewed annually to assess relevance and the amount charged. However, only a limited number of respondents reported that their annual review is an active process used to systematically evaluate the services that the Department provides and whether it wishes to continue the existing fee for these activities and services or to establish new fees. The review process appears to be “pro forma”, lacks deep analysis based on changing conditions, and has little oversight from a single entity.

4. Jurisdictional comparison of fees does not offer any constructive value and may even be misleading, leading to ambiguous evaluation in making cost-based decisions.

In an attempt to compare the County’s fees to those of other peer jurisdictions, CEEC has requested and received partial or inconclusive information. However, CEEC is hesitant to provide any comparative fee levels, in order to avoid the mistaken impression the fees are truly comparable. Our evaluation of data provided by peer jurisdictions did not reveal any objective information or identify the true relationship of what their activities cost to provide.

⁷ Data obtained from the CEO’s office. Net County Cost reflects the amount that is funded by local revenues. Full Cost Recovery is defined by a Department’s percentage of total revenues to the net appropriations.

Since every jurisdiction is different, many specific factors can create differences that affect cost. We also found that fees are defined differently. The same fee with the same name or intent may include or exclude certain activities or sub-services which compromise a direct matchup. For example, direct costs may be very different, due to varying pay scales, benefits and productivity levels; indirect costs may vary greatly due to supervision levels, support structures, organizational structure, cost allocation methodologies, and frequency of allocation updates.

Unless “apples to apples” comparison can be made, any comparative data would most likely be superficial in nature and likely be misleading. As a result, such a comparison has very little constructive analytical value in a cost of service study.

After consultation with the motion’s author, it was determined that obtaining comparison information from other jurisdictions was not feasible. The Board subsequently instructed CEEC to move forward focusing on how to improve and better manage the County fee-setting process.

V. RECOMMENDATIONS

The principal goal of this study was to assist the County’s decision makers to identify weaknesses in the system used to set fee levels and recommend improvements to the County processes or policies for setting fees. As a summary document, the following recommendations are not intended to advocate policies for rate increase or subsidies, but rather, they are intended for use as a tool in understanding fee-related issues and to assist the County in identifying and improving weaknesses in the system. In the final analysis, the actual decision to increase or decrease fees is a responsibility of the Board.

Recommendation 1: That the Board of Supervisors direct the Auditor and Controller and Chief Technology Officer to explore the feasibility of developing an in-house software program or identify any commercial off-the-shelf software modules that would help facilitate the process for conducting fee studies.

Precise calculation of the cost of productive time can be difficult, particularly when accounting for all direct, indirect and other supporting costs associated with the programs and individual services. Recalculating fees based upon new staffing and expenditures numbers each year and estimating an average unit of job costs is a very complex and time consuming process that involves the Auditor-Controller and other finance personnel for significant financial analysis.

Our review of fee schedules indicates that the County charges a wide range of fee amounts in three categories:

- Fees that fund necessary services, such as utilities, trash collection, and recycling are commonly established to fully recover the cost of the activity or service.

These fees can be calculated based on usage, such as the amount of water used or the number of trash container set out each week.

- Fees associated with a broad array of public services that add to the quality of life but that all residents do not require, such as fees for parking and use of County-owned facilities for recreation such as community centers and meeting places.
- Fees that individuals and businesses pay for licenses and permits.

Automating this process would make it easier for Departments to directly track allocations of time and materials used in providing fee-related services. This data could then be used to update, review, implement, and audit data for fee changes.

Recommendations 2: That the Board of Supervisors direct the CEO to emphasize the fee review as an important part of the annual budget process to encourage Departments to review and report on their fees on a regular basis.

Because the costs of providing services change, especially as salaries and other costs increase, it is a best practice for local governments to regularly review the fees they charge. Without a thorough review, the County may not be meeting the goal of full cost recovery for particular services. Combining this review with the budget process allows local governments to better estimate revenue from the fees charged and to incorporate this estimate in the overall budget development.

In addition to the equity issues noted in the report, a cost of service study also assures the County that it is in compliance with state law. By determining the full cost of each fee, the Board can be comfortable in the fact that if it wishes not to subsidize an activity, the full cost fee it sets will be in compliance with the provisions of the law.

Fees that derive their authority from legislation may be triggered in several ways, including a sunset provision, or the maximum and minimum fee which are set in legislation. In this case, there are strict guidelines within which a Department may set fees through a regulatory process that may depend on further legislative action.

Prior to the issuance of this report, the CEO and Auditor-Controller have already initiated several actions consistent with this recommendation. On October 28, 2015, the CEO and Auditor-Controller issued a joint memo to Department Heads and their Administrative Deputies to reinforce compliance of annual fee/rate review policies in order to maintain sustainable levels of funding for ongoing services. In the 2016-17 Recommended Budget phase, revisions to schedule EE enabled departments to record and report the “Date of Last Rate Review” and “Governing Authority” on fee adjustments to provide a clearer picture of their review process. Departments were also instructed to include all revenues from rates and fees, which promoted a more consistent reporting methodology. These

updates were noted in both the Revenue portion of the budget instructions and in the Budget Insider⁸.

Recommendation 3: That the Board of Supervisors direct the CEO and Auditor-Controller to create a committee that has coordinating oversight of all Departments involved in charging user fees for requested services, to help facilitate shared learning, identify issues in the fees study process, and to provide Departments with information they can use to make better management decisions.

This study identified Departments that met the criteria for the greatest volume of fees which have not been adjusted in five years or longer. There are other Departments that the Commission did not survey or interview for this study. Having a committee with coordinating responsibilities would provide support to Departments that may not have the resources or skills to initiate or change their fee structure.

VI. CONCLUSION

The Board of Supervisors engaged CEEC to analyze the process for analyzing the full cost of fee-related services provided to its citizens and businesses. In all departments studied, CEEC identified an overall current subsidy provided by the Departments to the fee-payers as a whole, whereby the County was charging less than the full actual cost of providing the services.

The process of fee analysis is an imperfect endeavor at best, as it normally seeks to standardize charges for services that may have variable inputs, processes, and outputs. With the information gained from this study, we hope County leaders will be in a much better position to understand the current fees structure and its existing subsidy conditions. It is noteworthy to point out that, prior to the formal submission of this report to your Board, the County has already initiated some improvements to the fee review process as stated under Recommendation number two. The County can use this information to make more informed decision and set fees to meet the fiscal and policy goals and objectives of the County.

We leave the decision making policies for determining user benefits and fees versus appropriate taxpayer subsidies to the Board

VII. ACKNOWLEDGEMENT

The Economy and Efficiency Commission appreciates the courtesy, cooperation and substantial contributions extended to us by County Departments involved in this study.

⁸ The Budget Insider is the vehicle by which the CEO highlights important changes to the budget process each year.

These interviewees were truly generous with their time and candor. Their help has been instrumental in our efforts to craft recommendations that we hope will improve County government.

VIII. APPENDIX

- 1a.** Board Motion
- 1b.** Data Request Letter

Appendix 1a- BOARD MOTION

AGN. NO. 5 - C

MOTION BY SUPERVISOR SHEILA KUEHL

June 22, 2015

The County of Los Angeles assigns charges for services, user fees, regulatory fees and similar charges for specific services, as allowed under the California Constitution and California law. Proposition 26, adopted by California voters in November of 2010, further requires that fees charged must only recover the "reasonable cost" to the County of providing the service or the specific benefit requested and that the County's cost allocation must also be "fair or reasonable."

Since the start of the Great Recession in Fiscal Year (FY) 2008-09, many County departments have not raised or have minimized raises to their fee schedules, to reduce the financial burden on County residents and businesses. Over this time period, however, the County's costs of doing business have continued to rise, such that many fees no longer recover the true cost of providing the requested service, which has put greater strain on the County budget.

The Los Angeles County Fiscal Manual provides instruction to County departments on administering departmental revenues, including those generated through user, regulatory and other fees for specific services. Section 9.1.3 (Internal Controls Over Revenue) of the Fiscal Manual further directs that "fees charged are reviewed annually and recommendations for adjustments are made when fees no longer recoup the costs of the services provided."

In the FY 2015-16 Recommended Budget, the Interim Chief Executive Officer instructed each County department to submit Schedule EE: a "Statement of Revenue from Various Fees," which includes a listing of each fee charged, historical revenue collections, the basis for the fee and the most recent adjustment to the fee. A

preliminary analysis of this fee information indicates that some fees have not been adjusted since September of 1996, or earlier.

I, THEREFORE MOVE that the Board of Supervisors instruct the Interim Chief Executive Officer to:

1. Compile the Statements of Revenue from Various Fees for the Fiscal Year 2015-16 Recommended Budget into a centralized database.
2. Produce a report, within 60 days:
 - a. That provides descriptive statistics on fees by department and countywide.
 - b. That provides an analysis of all fees that have not been adjusted in five years or longer.
 - c. The report should identify the three-to-six departments with the greatest volume of fees, by dollar value or by number of fee payments, which have not been adjusted in the last five years, and should include recommendations and a timeline to comprehensively review each department's fee structure, including fee levels, cost recovery, departmental cost allocation and potential new fees, in the context of the development of the Fiscal Year 2016-17

Recommended Budget.

I FURTHER MOVE that the Board of Supervisors instruct the Citizens' Economy and Efficiency Commission to provide a report to the Board in 120 days that, relative to the departments identified in Item 2(c) above, provides an analysis of fees and charges which compares the types of fees, fee levels, services provided and cost recovery at Los Angeles County with those at other peer counties in California.

KK: Fee Study Motion – v. 1

Appendix 1b DATA REQUEST LETTER

The Economy & Efficiency Commission is currently working on a Comparative Fee Study as directed by Supervisor Kuehl's motion (attached) dated June 22, 2015. As part of this motion, Mr. Sid Kikkawa of the CEO's office has provided descriptive statistics (attached) on revenues from various fees by departments that have not been adjusted in five years or longer.

We will also follow up with your office to meet with you and your staff to review the data. Once we have all the data back, we will then ask for similar data from local jurisdictions for comparative purposes.

Questions for the Departments:

1. Please identify the top 4-6 fees that make up the majority (50% or more) of the total revenue, either by function or by revenue source. Please also specify what is included in the fees, so that we will have fees that cover similar services when we survey other jurisdictions.
2. Of the fees identified in (1) above, which fees are mandated by the State or other Government agencies? Which of the fees are discretionary?
3. Of the fees identified in (1) above, when was the last time these fees were changed?
4. What is your Department's process for evaluating, initiating, and approving a fee change?
5. How is the cost recovery factor calculated, how often?
6. How is the CPI (in light of the recession 2008) factored in when calculating fee rates and cost recovery factor?

Task Force

Chair-Becca Doten-3rd District
Commissioner Ed Munoz-1st District
Commissioner Ron Ikejiri-2nd District
Commissioner Ben Reznik-3rd District
Commissioner Tom DeSimone-3rd District
Commissioner Matt Kinley-4th District
Commissioner Paul Jhin-5th District

Please don't hesitate to contact me if you have any questions, (213) 974-1491, or email eeng@bos.lacounty.gov. Thank you!

***Edward Eng
Executive Director
Economy & Efficiency Commission
Executive Office, Board of Supervisors***