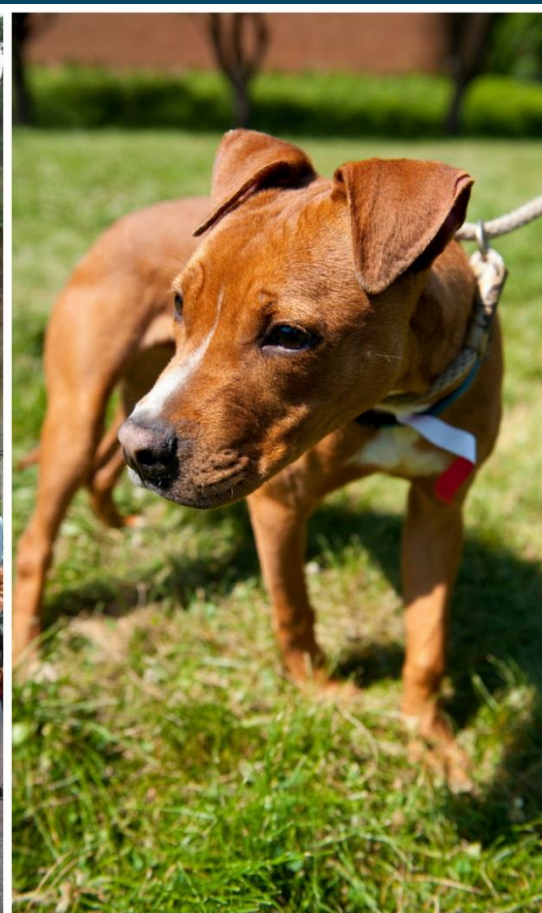
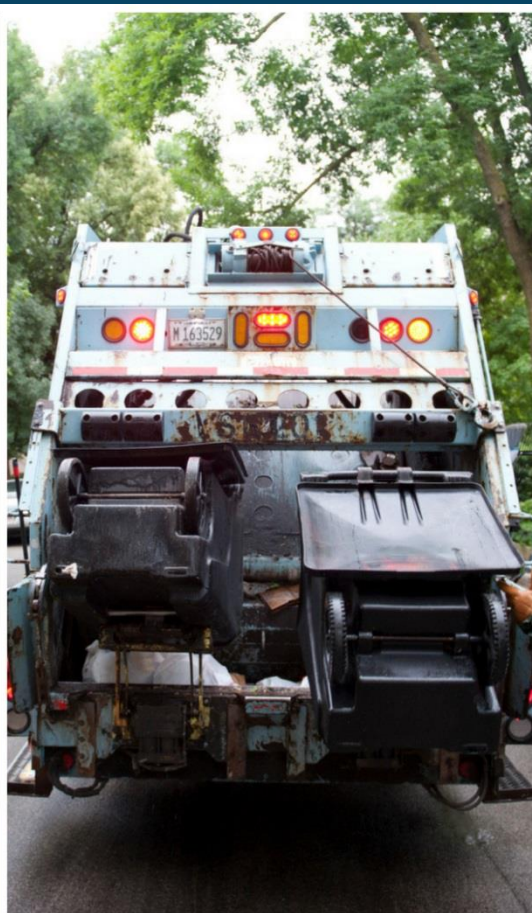


JUNE 2018

CITY OF CHICAGO OFFICE OF INSPECTOR GENERAL

AUDIT OF THE CITY'S PROCESS FOR EVALUATING AND SETTING USER FEES



REPORT OF THE OFFICE OF INSPECTOR GENERAL



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JUNE 21, 2018

**TO THE MAYOR, MEMBERS OF THE CITY COUNCIL, CITY CLERK,
CITY TREASURER, AND RESIDENTS OF THE CITY OF CHICAGO:**

The City of Chicago Office of Inspector General (OIG) has completed an audit of the City's process for evaluating and setting user fees. User fees, which are a significant source of City revenue, include charges for water usage, inspections, permits, and licenses. Although the Mayor and City Council are ultimately responsible for approving user fees, the Office of Budget and Management (OBM)—a subdivision of the Mayor's Office—manages the City's process for evaluating and setting fees. The audit compared the process for evaluating and setting user fees to the City's Financial and Budgetary Policies and to national best practices embodied in the recommendations of the Government Finance Officers Association (GFOA).

OIG found that the City does not periodically review all fees to determine whether they are set at levels designed to support City policy goals, including covering the cost of providing the services related to the fees. Also, while OBM reviewed 91 unique fee proposals submitted during the 2013 through 2017 budget cycles, the City conducted a full-cost analysis for only 3 of the proposals. Accurate analysis of the full cost of delivering a City service provides crucial information for the Mayor and City Council to consider in determining whether to approve fees. Moreover, OIG's review of two of the City's three full-cost analyses discovered several inaccuracies, resulting in a potential \$45.2 million overestimation of the cost of collecting residential refuse and a \$1.0 million underestimation of the cost of the City's vehicle booting program.

OIG concluded that the City does not evaluate user fees in accordance with its Financial and Budgetary Policies or GFOA recommendations, which may result in revenue shortfalls, unintended subsidies of private beneficiaries by taxpayers, overcharging, lack of transparency, and public perception that fees are set arbitrarily. In addition, the lack of accurate full-cost analyses may prevent departments from identifying future operational efficiencies, because department leadership and City Council have no basis for knowing the actual cost of providing services to the public.

To address these concerns, OIG recommends that OBM develop a user fee policy and accompanying procedures that adhere to GFOA recommendations, including periodic review of all City fees, full-cost analyses to support consideration of fee changes, and more opportunities for transparency and public feedback regarding fees. We further recommend that OBM develop procedures to ensure that future full-cost analyses accurately account for all direct and indirect costs.

OBM agreed with our recommendations to develop a user fee policy, create a complete list of all City fees, and establish a schedule for periodic review of fees. Specifically, OBM stated it is drafting a policy “based on current practices and GFOA’s recommendations.” Furthermore, OBM stated it intends to “provide a more uniform definition” of user fees and require departments to “conduct a thorough review” to ensure that the City identifies “all existing fees and the current fee structures.” Once it has a complete list of fees, OBM will develop a multi-year review schedule to provide “more frequent reviews of citywide fees[.]”

OBM disagreed with OIG’s recommendations to enhance public transparency, support fee proposals with full-cost analyses, and consider developing an alternative cost allocation plan (CAP) to support future full-cost analyses.

We thank OBM and the Department of Finance for their cooperation during this audit.

Respectfully,



Joseph M. Ferguson
Inspector General
City of Chicago

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ACRONYMS

| | |
|------|--|
| BOS | Department of Streets and Sanitation, Bureau of Sanitation |
| CAFR | Comprehensive Annual Financial Report |
| CAP | Cost Allocation Plan |
| CDPH | Chicago Department of Public Health |
| DOF | Department of Finance |
| DOL | Department of Law |
| DSS | Department of Streets and Sanitation |
| GAO | Government Accountability Office |
| GFOA | Government Finance Officers Association |
| OBM | Office of Budget and Management |
| OIG | Office of Inspector General |
| RRC | Residential Refuse Collection |

I. EXECUTIVE SUMMARY

The Office of Inspector General (OIG) conducted an audit of the City's process for evaluating and setting user fees. User fees, which are a significant source of City revenue, include charges for water usage, inspections, permits, and licenses.¹ Although the Mayor and City Council are ultimately responsible for approving user fees, the Office of Budget and Management (OBM)—a subdivision of the Mayor's Office—manages the City's process for evaluating and setting fees. The objective of the audit was to determine whether the City's process for evaluating and setting user fees adhered to the City's Financial and Budgetary Policies and to national best practices embodied in the recommendations of the Government Finance Officers Association (GFOA).²

OIG found that the City does not regularly review all fees to determine whether they are set at levels designed to recover the cost of providing the services related to the fees, or to achieve other policy goals. In fact, the City is unable to state with certainty how many fees exist because it lacks a comprehensive list. As a result of this audit, OBM created a list of 301 fees, and OIG identified an additional 20 fees referenced in fee proposals submitted to OBM by other City departments, for a sum of 321 identified fees. However, it is likely that the actual number of City fees is much larger. For comparison, the City of Houston imposes approximately 1,600 fees.³ According to documentation provided by OBM, during the 5 budget cycles from 2013 through 2017,⁴ the City reviewed only 172 (or 53.6%) of the 321 identified fees. Moreover, for most of those 172 fees, the City conducted only a preliminary review to determine if changes to an existing fee would align with City policy or departmental missions.⁵ The City rarely conducted additional analyses, such as a full-cost analysis to determine the total direct and indirect cost of providing the service. Accurate analysis of the full cost of delivering a City service provides crucial information for the Mayor and City Council to consider in determining whether to approve related fees. Furthermore, the City does not document its rationale when a fee is intentionally set below the full cost of the service, resulting in inconsistent records supporting its fee-setting decisions. The lack of clear criteria and documentation of the rationales for these decisions may create the appearance of biased, unfair, or arbitrary decision-making.

OBM stated that the City's irregular review results in many fee levels remaining well below the cost of service, and that, as time passes without incremental adjustments, such fees eventually

¹ The City is unable to calculate the exact proportion of total revenue generated by fees because it does not maintain a comprehensive list of all fees.

² Founded in 1906, the GFOA is an association of public finance officials in the United States and Canada who seek to "promote excellence in state and local government financial management." Government Finance Officers Association, "About GFOA," accessed February 22, 2018, <http://www.gfoa.org/about-gfoa>.

³ City of Houston, "City Fee Schedule," accessed February 22, 2018, http://cohweb.houstontx.gov/FIN_FeeSchedule/default.aspx.

⁴ For the purposes of this report, the term "budget cycle" refers to the annual budget development process which occurs prior to budget adoption. Therefore, the "2013 budget cycle" refers to the budget development process that occurred in 2012.

⁵ An example of a fee aligning with a departmental mission would be animal adoption fees. Rather than generating additional revenue by increasing the fees, the City may choose to subsidize adoption as a means of furthering Animal Care and Control's mission of protecting public safety and promoting the humane care of animals.

require large increases that are difficult to justify to fee payers. For example, during the 2017 budget cycle the City increased the Vacations of the Public Way application fee from \$50 to \$1,025.⁶ Although OBM had previously told OIG that cost recovery alone was an insufficient basis for increasing a fee, OBM said that the primary rationale for this increase was that the City last adjusted the application fee in 2003, and it was clearly far below the cost of service. However, OBM did not conduct a full-cost analysis to determine the actual cost of service. And, in contrast, OBM rejected proposals from the Chicago Department of Public Health (CDPH) to raise environmental and food inspection fees, even though CDPH submitted that the fees had not been updated since the mid-1990s and were below the cost of service. In this instance, OBM told CDPH that it was “not the right time” to adjust the fees, taking into consideration the other fee and tax increases imposed by the City that year. Maintaining fees well below the cost of service may have the unintentional result of non-users subsidizing the services, in addition to causing the City to forgo revenue. GFOA notes that regular fee reviews allow governments to assess service demands, consider cost-reduction alternatives, and make comparisons to private competition.

While OBM reviewed 91 unique fee proposals submitted during the 2013 through 2017 budget cycles proposals—61 fee modification proposals and 30 proposals for new fees—the City conducted a full-cost analysis for only 3, (or 3.3%), of them. OIG’s review of two of the City’s three full-cost analyses discovered several inaccuracies, resulting in a potential \$45.2 million overestimation of the cost of collecting residential refuse and a \$1.0 million underestimation of the cost of the City’s vehicle booting program.

OIG also found that the City provides limited opportunities for public engagement regarding fees, contrary to GFOA recommendations. OBM stated that the City primarily provides information to the public, and solicits feedback regarding fees, through City Council budget hearings. However, the City Council process does not provide detailed information regarding fees in a timeframe sufficient for fully informed public feedback. OBM explained that individual aldermen have the opportunity to request briefings from OBM and may then hold public meetings to inform their constituents and receive feedback on fees.

OIG concluded that the City does not evaluate user fees in accordance with its Financial and Budgetary Policies or GFOA recommendations, which may result in revenue shortfalls, unintended subsidies of private beneficiaries by taxpayers, overcharging, lack of transparency, and public perception that fees are set arbitrarily. In addition, the lack of accurate full-cost analyses may prevent departments from identifying future operational efficiencies, because department leadership and City Council have no basis for knowing the actual cost of providing services to the public.

⁶ The City’s Street and Alley Vacation Program allows commercial and residential entities to apply for the City to vacate little-used and/or unimproved streets and alleys. Upon review and approval, the City confers ownership of the property to the applicant. An applicant’s property must be appropriately zoned for commercial or residential use, and must border the property proposed to be vacated.

OIG recommends that OBM develop a user fee policy and accompanying procedures that adhere to GFOA recommendations, including periodic review of all City fees, full-cost analyses to support consideration of fee changes, and more opportunities for transparency and public feedback regarding fees. We further recommend that OBM develop procedures to ensure that future full-cost analyses accurately account for all direct and indirect costs.

OBM agreed with our recommendations to develop a user fee policy, create a complete list of all City fees, and establish a schedule for periodic review of fees. Specifically, OBM stated it is drafting a policy “based on current practices and GFOA’s recommendations.” Furthermore, OBM stated it intends to “provide a more uniform definition” of user fees and require departments to “conduct a thorough review” to ensure that the City identifies “all existing fees and the current fee structures.” Once it has a complete list of fees, OBM will develop a multi-year review schedule to provide “more frequent reviews of citywide fees[.]”

OBM disagreed with OIG’s recommendations to enhance public transparency, support fee proposals with full-cost analyses, and consider developing an alternative cost allocation plan (CAP) to support future full-cost analyses.

The specific recommendations related to each finding, and OBM’s response, are described in the “Audit Finding and Recommendations” section of this report.

II. BACKGROUND

A. THE DEFINITION AND ROLE OF USER FEES

Although no universal definition exists, user fees are commonly understood to be voluntary transactions that provide individuals and organizations access to government services and benefits beyond those generally provided to the public.⁷ The characteristics that distinguish fees from fines and taxes are outlined in Figure 1.

FIGURE 1: Differences between fees, fines, and taxes

| Fees | Fines | Taxes |
|---|---|--|
| <ul style="list-style-type: none">• Relate to a voluntary transaction• Benefit identifiable individuals• Relate to the cost of providing a good or service• Support a business-type activity or serve a regulatory purpose | <ul style="list-style-type: none">• Punitive in nature• Designed to deter behavior• Revenue is not the primary goal• Payment is not optional | <ul style="list-style-type: none">• Support broad-based public services• No relation to cost or benefits of specific services• Payment is not optional |

Sources: United States Office of Management and Budget,⁸ Government Accountability Office,⁹ and Congressional Budget Office.¹⁰

Some government charges are easily identifiable as fees, fines, or taxes, while others are more difficult to categorize. For example, the City's Wheel Tax, an excise tax collected through the sale of City Vehicle Stickers, could be categorized as a fee.¹¹ Wheel Tax revenue supports the repair and maintenance of City streets, and the primary beneficiaries of such maintenance (i.e., motorists) pay the Wheel Tax. Other fees exhibit characteristics of fines. For example, the City uses wheel clamps ("boots") to immobilize vehicles with unpaid parking, red light, or speed enforcement tickets. The booting program serves to encourage payment of previously issued fines. However, the City's fee to remove a boot is designed to recoup the cost of the

⁷ Some organizations use the term "user charge." We use the terms "user fee" and "fee" to be consistent with the City's Financial and Budgetary Policies.

⁸ United States Office of Management and Budget, "Circular No. A-11," July 2016, Section 20, accessed February 22, 2018, https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/a11_current_year/a11_2016.pdf.

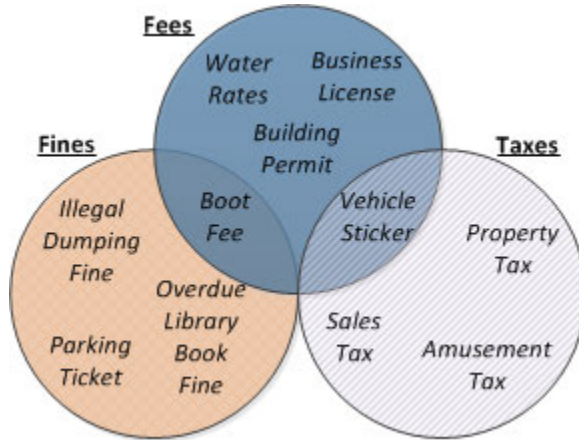
⁹ United States Government Accountability Office, "Federal User Fees: A Design Guide," May 2008, 1-4, accessed February 22, 2018, <http://www.gao.gov/assets/210/203357.pdf>.

¹⁰ Congressional Budget Office, "The Growth of Federal User Charges," August 1993, 3-7, accessed February 22, 2018, https://www.cbo.gov/sites/default/files/103rd-congress-1993-1994/reports/1993_08_growthofuserchargesa%29taxes.pdf.

¹¹ City of Chicago, Office of the City Clerk, "Chicago City Vehicle Sticker FAQs," accessed February 22, 2018, <http://www.chicityclerk.com/city-stickers-parking/about-city-stickers>.

enforcement program while punishing non-compliance. Figure 2 illustrates how various charges may be characterized as fees, fines, and/or taxes.

FIGURE 2: Examples of fees, fines, and taxes



Source: OIG review of Municipal Code of Chicago and City webpages.

Depending on the nature of the relevant service, there are advantages and disadvantages to implementing a particular charge as a fee as opposed to a tax. According to the Government Accountability Office (GAO), fees have the advantage of providing an equitable and efficient source of revenue with the potential to reduce burdens on taxpayers, but the disadvantage of excluding individuals who are unable to pay for the service.¹² Figure 3 summarizes the primary advantages and disadvantages of fees.

¹² United States Government Accountability Office, "Federal User Fees: A Design Guide," May 2008, 1, 11, accessed February 22, 2018, <http://www.gao.gov/assets/210/203357.pdf>.

FIGURE 3: Potential advantages and disadvantages of fees

| Advantages | Disadvantages |
|--|--|
| <ul style="list-style-type: none">• Encourage economic efficiency by charging individual beneficiaries• Encourage operational efficiency by revealing to decision makers the cost of service• Encourage one form of equity by ensuring only beneficiaries pay• Can create dedicated revenue stream to cover cost of service | <ul style="list-style-type: none">• Administrative cost of collecting fees may be higher than tax administration• May reduce equity by excluding individuals with less ability to pay for service |

Source: GAO.¹³

When imposing fees, policymakers must consider whether it is permissible and advisable to exclude potential users from the relevant service. For example, the government cannot charge a fee for basic police services, because it would be impractical, and possibly illegal, to exclude non-payers from such services. In addition, charging transactional fees for police-related services could discourage people from reporting crimes.

According to GAO, even when governmental entities are able to identify specific beneficiaries of particular services, they often elect to set the corresponding fees below the full cost of providing the services in order to avoid harming vulnerable people or to achieve another policy goal.¹⁴ The Government Finance Officers Association (GFOA) states, “The full cost of a service encompasses all direct and indirect costs related to that service.”¹⁵ Figure 4 identifies common direct and indirect costs that should be considered when determining the full cost of providing service.

¹³ Government Accountability Office, “Federal User Fees: A Design Guide,” May 2008, 1-2, 11, accessed February 22, 2018, <http://www.gao.gov/assets/210/203357.pdf>.

¹⁴ Government Accountability Office, “Federal User Fees: A Design Guide,” May 2008, 10, accessed February 22, 2018, <http://www.gao.gov/assets/210/203357.pdf>.

¹⁵ Government Finance Officers Association, “Full Cost Accounting for Government Services,” January 2002, accessed February 22, 2018, <http://www.gfoa.org/full-cost-accounting-government-services>.

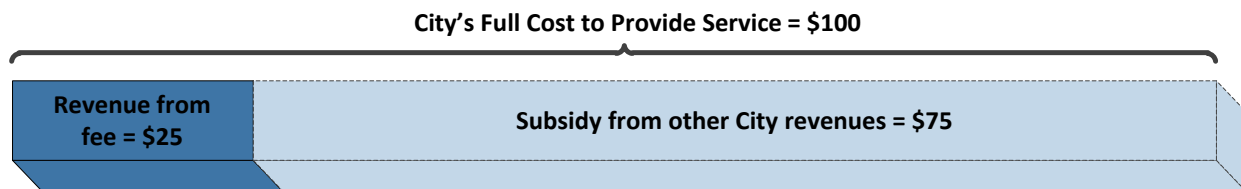
FIGURE 4: Direct and indirect costs constituting the full cost of a service

| Direct Costs | Indirect Costs |
|--|---|
| <ul style="list-style-type: none">• Salaries & Benefits• Equipment• Repair & Maintenance• Contracts | <ul style="list-style-type: none">• Citywide Overhead• Depreciation Expenses |

Source: OIG review of GFOA Recommendations for Measuring the Full Cost of Government Service.¹⁶

For example, although charging only a small fee for animal adoption does not recover the full cost of housing, feeding, and caring for impounded animals, it advances the City's goal of increasing animal adoptions. Setting a fee below the full cost of service requires subsidization of the service from other City revenues. Figure 5 illustrates such a situation, assuming a \$25 fee for a service that costs the City \$100 to provide.

FIGURE 5: Relationship of fee and subsidy to the full cost of providing service



Source: OIG depiction of fee cost recovery.

GFOA provides recommendations to help state and local governments set fees that maximize the advantages, and minimize the potential disadvantages, of fees.¹⁷ The following list summarizes GFOA's six recommendations for setting fees.¹⁸

1. Consider applicable laws and statutes.
2. Adopt formal policies that include factors pertinent to setting fees (such as policy goals and affordability), guidelines on what services should recover the full cost of service, and a requirement to document the government's rationale when fees are set below cost.
3. Calculate the full cost of service, including direct costs, such as personnel and equipment, as well as indirect costs, such as payroll processing or administrative services.
4. Review and update fees on a regular basis to avoid large, sudden increases that may

¹⁶ Government Finance Officers Association, "Full Cost Accounting for Government Services," January 2002, accessed February 22, 2018, <http://www.gfoa.org/full-cost-accounting-government-services>.

¹⁷ Government Finance Officers Association, "Establishing Government Charges and Fees," February 2014, accessed February 22, 2018, <http://www.gfoa.org/establishing-government-charges-and-fees>.

¹⁸ See Appendix A for the full text of GFOA's recommendations for "Establishing Government Charges and Fees."

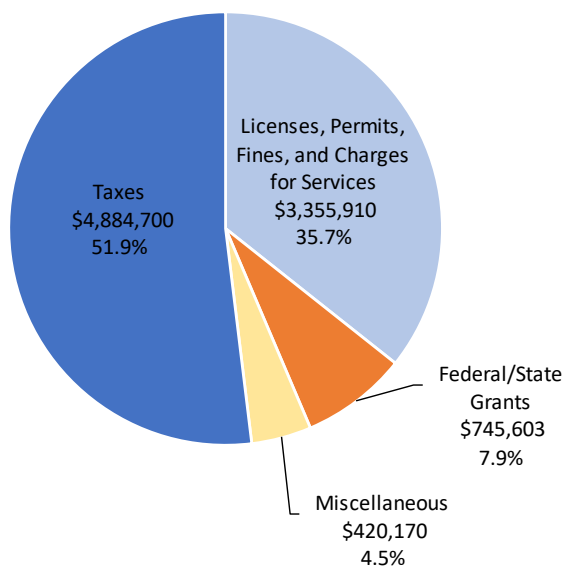
negatively impact users.

5. Use long-term forecasting to ensure that fees anticipate future costs.
6. Provide information on fees to the public, and create opportunities for public feedback before and after the creation or amendment of fees and fee-related policies.

B. CITY FEE REVENUE

The City cannot calculate the exact proportion of total revenue generated by fees because it lacks a complete list of fees. Currently, the Comprehensive Annual Financial Report (CAFR) is the best resource for approximating annual fee revenues. Figure 6 shows the City's \$9.4 billion total revenue by category for 2016. Most of the fee revenue is included in the "Licenses, Permits, Fines, and Charges for Services" category.¹⁹ Although the majority of the \$3.4 billion in this category is derived from fees, the total also includes non-fee revenues.²⁰

FIGURE 6: 2016 City revenues, totaling \$9.4 billion (amounts in thousands)



Source: OIG Analysis of 2016 CAFR.

¹⁹ The category "Licenses, Permits, Fines, and Charges for Services" includes fee revenue from the City's Corporate and Enterprise Funds. The Corporate Fund is the City's primary operating fund that supports basic City operations and services, including public safety and public health. Enterprise Funds support the operation and maintenance costs of the City's water and sewer systems, as well as the O'Hare and Midway International Airports. Enterprise Funds operate as commercial enterprises and pay expenses with revenue derived from charges and fees associated with their service.

²⁰ The CAFR combines individual revenue streams into broader categories, such as Fines, Charges for Services, Licenses and Permits, and Miscellaneous. While most fees are included in the Licenses and Permits and Charges for Services categories, the Miscellaneous category also includes some fees. In addition, the Licenses and Permits and Charges for Services categories include a small amount of non-fee revenue, such as fines.

C. THE CITY'S PROCESS OF PROPOSING, EVALUATING, AND SETTING FEES

Although OBM manages the City's process of proposing and evaluating fees, numerous City departments, as well as City Council and non-OBM personnel in the Mayor's Office, are involved in setting fees. OBM's mission is to "develop annual budgets that constantly improve efficiency, protect taxpayers, and make the best use of resources while providing critical City services to residents."²¹ This annual budget development process—which typically spans from June to October—serves as the primary avenue for submitting fee proposals, allowing OBM to evaluate multiple proposals at one time.²²

During the 2013 through 2017 budget cycles, OBM requested, but did not require, that departments submit written proposals to create new fees or change existing fees.²³ As submitted, the proposals included general information, such as the rationale for creating or changing the fee, applicable legal considerations, estimated revenue impact, and rate comparisons to peer jurisdictions. OBM did not require, nor did departments provide, full-cost analyses in support of departmental proposals. Typically, the submissions were evaluated, and approved or rejected, through the following process:

1. OBM senior management assigned fee proposals to staff in portfolios within OBM. Each portfolio covered several departments. For example, the Public Safety portfolio included the Chicago Police Department, Chicago Fire Department, Office of Emergency Management and Communications, and Department of Innovation and Technology.
2. OBM identified fee proposals that merited further review and submitted them to a working group composed primarily of staff from OBM, Department of Finance (DOF), and Department of Law (DOL).
3. The working group developed a list of fee proposals for potential inclusion in either the Management or Revenue Ordinance.²⁴ OBM finalized the list and circulated it within the Mayor's Office.

²¹ City of Chicago, Office of Budget and Management, "Mission," accessed February 22, 2018, https://www.cityofchicago.org/city/en/depts/obm/auto_generated/obm_mission.html.

²² Fees are occasionally created and amended outside the budget process. In May 2014, for example, the City passed the Transportation Network Providers Ordinance to regulate ride share companies. The ordinance created annual issuance and renewal fees for transportation network provider licensees.

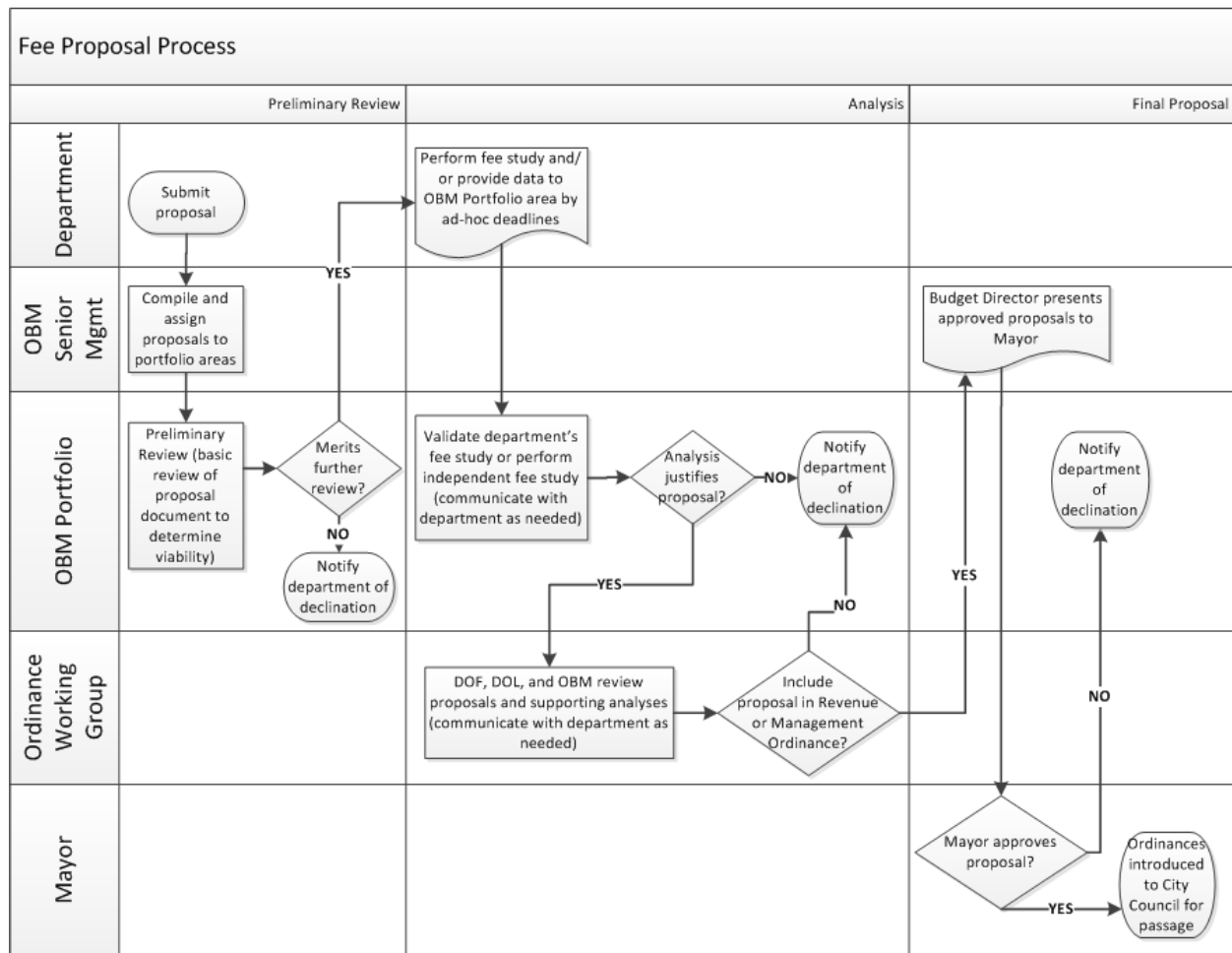
²³ The City's 2018 Budget Manual stated that OBM would not solicit departmental fee proposals for the 2018 budget. Instead, OBM deputies and analysts would develop a list of fee proposals for each department, giving the departments the opportunity to add or delete items from the list.

²⁴ The Management and Revenue Ordinances are omnibus ordinances introduced on an annual basis to modify multiple sections of the Municipal Code of Chicago. City Council typically passes the ordinances in November, after passing the Annual Appropriation Ordinance. The Management Ordinance is generally oriented towards operational and administrative issues, while the Revenue Ordinance covers fees, fines, and taxes. Typically, fee proposals are in the Revenue Ordinance, but could be in the Management Ordinance if the fee change relates to a larger operational modification.

4. Each fee proposal on the list was either approved or rejected, and DOL prepared drafts of the Revenue and Management Ordinances incorporating the approved proposals.
5. The Mayor's Office of Legislative Counsel and Government Affairs provided the City Council with briefings on the proposed ordinances, including the provisions related to fees.
6. The Committee on Finance voted on the proposed ordinances.
7. After approval by the Committee on Finance, the entire City Council voted on the Revenue and Management Ordinances.

Figure 7 illustrates the fee proposal process.

FIGURE 7: Fee proposal process



Source: OIG summary of process as described by OBM, DOF, and DOL.

III. OBJECTIVE, SCOPE, AND METHODOLOGY

A. OBJECTIVE

The objective of this audit was to determine whether the City evaluated and set fees in accordance with its Financial and Budgetary Policies and GFOA recommendations.

B. SCOPE

The audit focused on the process the City used during the 2013 through 2017 budget cycles to evaluate and set fees, including the submission and review of fee proposals.

The audit did not assess the City's processes for collecting fee revenue, nor the City's process for setting taxes or fines.

C. METHODOLOGY

To understand the City's process for evaluating fees, we interviewed OBM and DOF management, as well as individuals from DOL, CDPH, the Chicago Fire Department, the Department of Buildings, the Chicago Department of Transportation, the Department of Water Management, and the Office of the City Clerk (Clerk's Office). We also reviewed the proposals and full-cost analyses of the boot fee and residential refuse collection (RRC) fee. City Council voted in October 2015 to enact these fees, and they went into effect on January 1, 2016.

To determine whether the City's full-cost analyses accurately accounted for all direct and indirect costs, we reviewed two of the three analyses conducted during the 2013 through 2017 budget cycles and interviewed staff from OBM, DOF, and the Department of Streets and Sanitation (DSS). Whenever possible, we calculated the actual cost of service using the City's expenditure data.²⁵ We also interviewed personnel from Maximus, the City contractor responsible for creating the Cost Allocation Plan (CAP), to better understand how the City uses, or should use, the CAP to calculate indirect costs.

To determine whether the City periodically reviewed fees, we first attempted to obtain an inventory of all fees. The City, however, does not maintain, and thus could not provide, an inventory. Upon our request, OBM created a partial list of fees. We also interviewed OBM management and reviewed fee proposal documentation submitted by departments during the 2013 through 2017 budget cycles. Through that process, we identified additional fees. To determine the number of fee proposals enacted into ordinance during this time period, we compared the fee proposal documentation to annual Revenue and Management Ordinances. Ultimately, however, we were not able to identify all City fees.

²⁵ As part of a separate, unrelated engagement, OIG assessed the reliability of the query used to extract actual expenditure data from the City's financial system. We determined the query and resulting data were sufficiently reliable for further analysis.

To determine whether the City's process for evaluating and setting fees adhered to GFOA recommendations, we interviewed OBM management, as well as individuals from the GFOA committee responsible for drafting GFOA's recommendations for Establishing Government Charges and Fees. We also interviewed representatives and reviewed documentation from several peer jurisdictions, including New York City, Los Angeles, Houston, and San Diego.

D. STANDARDS

We conducted this audit in accordance with generally accepted Government Auditing Standards issued by the Comptroller General of the United States. 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.

E. AUTHORITY AND ROLE

The authority to perform this audit is established in the City of Chicago Municipal Code § 2-56-030 which states that OIG has the power and duty to review the programs of City government in order to identify any inefficiencies, waste, and potential for misconduct, and to promote economy, efficiency, effectiveness, and integrity in the administration of City programs and operations.

The role of OIG is to review City operations and make recommendations for improvement.

City management is responsible for establishing and maintaining processes to ensure that City programs operate economically, efficiently, effectively, and with integrity.

IV. FINDINGS AND RECOMMENDATIONS

FINDING 1: The City does not evaluate and set user fees in accordance with its Financial and Budgetary Policies or GFOA recommendations.

The City does not evaluate and set user fees in accordance with its Financial and Budgetary Policies or national best practices embodied in GFOA recommendations, which may result in revenue shortfalls, unintended taxpayer subsidization of private beneficiaries, overcharging, lack of transparency, and public perception that fees are set arbitrarily. In addition, the lack of regular full-cost analyses may prevent departments from identifying future operational efficiencies, because department leadership and City Council have no basis for knowing the actual cost of providing services to the public.

The City's 2017 Financial and Budgetary Policies²⁶ related to user fees consist of one sentence: "User fees will be regularly evaluated and set at levels designed to support the full cost of the service."²⁷ However, OBM stated that the City does not regularly evaluate all fees, nor does it intend to set all fees to support the full cost of service because doing so would conflict with the City's other policy goals. For example, the City purposefully charges less than the full cost of service for daycare licensing and inspections in order to encourage daycare providers to comply with City requirements and provide services safely. As described in Figure 8, OIG found that the City's process for evaluating and setting fees adheres to only one of six GFOA recommendations.²⁸

²⁶ City of Chicago, Office of Budget and Management, "2017 Budget Overview," 2017, 40, accessed February 22, 2018, https://www.cityofchicago.org/content/dam/city/depts/obm/supp_info/2017%20Budget/2017BudgetOverviewFinal.pdf. The City's Financial and Budgetary Policies, which we provide in full in Appendix B, are written and reviewed by OBM, DOF, and the Chief Financial Officer. In the 2018 Budget Overview, the City slightly changed the wording of the policy; it now reads "User fees are regularly evaluated and set at levels designed to support the cost of the service."

²⁷ As a point of comparison to the City's one-sentence policy, we provide in Appendix C San Diego's six-page policy, which incorporates recommendations from GFOA, the National Advisory Council on State and Local Budgeting, and the Federal Government Office of Management and Budget.

²⁸ The majority of these GFOA recommendations are also included in the United States Government Accountability Office and Office of Management and Budget's guidelines for fees, which we describe in the Background section.

FIGURE 8: GFOA recommendations for establishing government charges and fees

| GFOA Recommendation | Included in the City's process? |
|---|---------------------------------|
| 1. Consider applicable laws and statutes | Yes |
| 2. Adopt formal fee policies | No |
| 3. Calculate the full cost of service | No |
| 4. Review and update fees regularly | No |
| 5. Utilize long-term forecasting to anticipate future costs | No |
| 6. Provide information on fees to the public and create opportunities for public feedback | No |

Source: OIG comparison of City's process to GFOA recommendations. See Appendix A for the full text of GFOA's recommendations for "Establishing Government Charges and Fees."

As described in the Background section, DOL is involved in the City's process for evaluating fee proposals. DOL is responsible for drafting ordinance language for potential changes, in addition to ensuring that fee proposals comply with applicable laws and regulations and do not exceed the City's legal authority. Therefore, we determined that the City follows GFOA's first recommendation. As discussed below, however, the City did not follow any of the other five GFOA recommendations.

A. THE CITY'S FEE POLICY DOES NOT INCORPORATE GFOA'S RECOMMENDED ELEMENTS

While the City's Financial and Budgetary Policies includes one sentence regarding user fees, OBM informed OIG that it does not have a formal user fee policy. Rather, it follows a standard fee review practice that takes numerous factors into account, including service delivery costs, policy and regulatory decisions, and the logistics of how fees will be levied and collected. GFOA recommends that a user fee policy include five specific elements. We determined that the one sentence of the City's Financial and Budgetary Policies that relates to user fees includes only one of the elements, and that, in any event, the policy language does not describe the City's actual practice. Figure 9 compares the City's user fee policy, noted above, to the GFOA-recommended fee policy elements.

FIGURE 9: GFOA-recommended elements of a fee policy

| Recommended elements of a fee policy | Included in the City's policy? |
|---|---|
| Identify the factors to consider when pricing goods and services | No |
| State whether the jurisdiction intends to recover the full cost of service | Yes, but does not reflect actual practice |
| Identify the circumstances under which the City would set a fee below the cost of service | No |
| Require a documented rationale for subsidizing fees | No |
| Address how fees and charges will be levied and collected | No |

Source: OIG comparison of City policy to GFOA recommendations.

OBM's inadequate policies resulted in the formulation of inconsistent rationales supporting decisions about fee adjustments. Further, the lack of clear criteria and documentation of these rationales may create the appearance of biased, unfair, or arbitrary decision-making. For example, during the 2017 budget cycle the City increased the Vacations of the Public Way application fee from \$50 to \$1,025.²⁹ Although OBM had previously told OIG that cost recovery alone was an insufficient basis for increasing a fee, OBM said that the primary rationale for this increase was that the City last adjusted the application fee in 2003, and it was clearly far below the cost of service. However, OBM did not conduct a full-cost analysis to determine the actual cost. And, in contrast, OBM rejected CDPH proposals to raise environmental and food inspection fees, even though the Department stated that the fees had not been updated since the mid-1990s and were below the cost of service. According to CDPH, OBM stated that it was "not the right time" to adjust the fees, taking into consideration the other fee and tax increases imposed by the City that year.

OBM management acknowledged that there are many services for which the City does not seek to recover the full cost of service. OBM stated that the City has never adhered to its user fee policy, and that the policy should be changed to reflect the City's actual practices.

B. THE CITY CONDUCTED FULL-COST ANALYSES FOR ONLY 3, OR 3.3%, OF 91 FEE PROPOSALS SUBMITTED IN THE PREVIOUS 5 BUDGET CYCLES

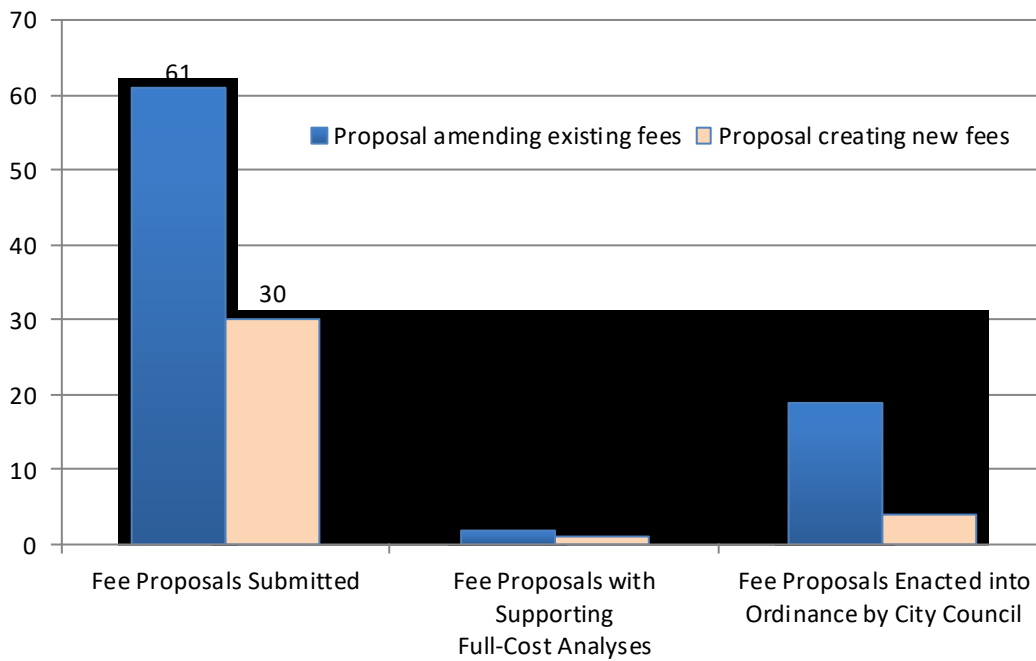
The City conducted full-cost analyses to support only 3, or 3.3%, of the 91 unique fee proposals submitted during the 2013 through 2017 budget cycles.³⁰ Figure 10 summarizes the number of fee proposals submitted by departments, the number of proposals that received full-cost analyses, and the number of proposals passed into ordinance by City Council during the 2013 through 2017 budget cycles.³¹

²⁹ The City's Street and Alley Vacation Program allows commercial and residential entities to apply for ownership of little-used or unimproved streets and alleys from the City. After review and approval, the City may vacate the street or alley, conferring ownership to the applicant. The applicant's property must border the property proposed to be vacated, and must be appropriately zoned for commercial or residential use.

³⁰ The 91 unique fee proposals included 61 proposals to modify existing fees and 30 proposals to create new fees.

³¹ The numbers in Figure 10 may not reflect all fee proposals submitted to OBM. OBM did not provide OIG with sufficient documentation to identify every fee proposed during the 2013 through 2017 budget cycles. In addition, the chart represents unique fee proposals. If a department submitted the same proposal in multiple successive cycles, OIG counted the proposal only once.

FIGURE 10: Fee proposals with full-cost analyses submitted during 2013 through 2017 budget cycles



Source: OIG review of fee proposals.

Without an accurate full-cost analysis, the City may unintentionally set a fee substantially above or below the actual cost of service. If fees are set too low, there may be excessive demand for the service that can create backlogs and lead to customer dissatisfaction. In addition, low fees may result in the subsidization of private beneficiaries by the public via taxes or other fees. Fees that are set too high, on the other hand, may deter potential users, or may result in individuals or industries unintentionally paying more than the cost of the service, thus subsidizing other public benefits or City operations. Moreover, GFOA states that full-cost analyses should incorporate all direct and indirect costs and that the “associated costs of collection” should also be considered. OIG reviewed two of the three full-cost analyses conducted and found errors, which we discuss in Finding 2 of this report.

OBM stated that rather than performing full-cost analyses for all fee-based services in order to inform which fees should be raised, OBM first decides which fees should be raised and then performs the analyses. OBM acknowledged that its process is likely the inverse of best practices, but stated that, due to limited resources, it prioritizes fees that City Council will likely approve and enact.

C. THE CITY DOES NOT REGULARLY REVIEW AND UPDATE ALL FEES

During the 2013 through 2017 budget cycles, the City did not regularly review all user fees. In fact, the City is unable even to state with certainty how many fees exist, because it lacks a

comprehensive list. As a result of this audit, OBM created a list of 301 fees, and OIG identified an additional 20 fees referenced in proposals, for a sum of 321 identified fees.³² However, it is likely that the actual number of City fees is much larger. For comparison, the City of Houston has approximately 1,600 fees.³³ According to documentation provided by OBM, during the 5 budget cycles between 2013 and 2017, the City reviewed only 172, (or 53.6%), of the 321 identified fees.³⁴ Moreover, for most fees, OBM said that it conducted only a preliminary review to determine if changes to an existing fee would align with City policy or departmental missions.³⁵ The City rarely conducted additional analyses, such as full-cost analyses, despite the fact that the City's 2017 Financial and Budgetary Policies state that "the City should evaluate each department's direct costs, as well as any indirect costs" every year.³⁶

OBM stated that the City's irregular review results in many fee levels remaining well below the cost of service, and that, as time passes without incremental adjustments, such fees eventually require large increases that are difficult to justify to fee payers. Maintaining fees well below the cost of service may also have the unintentional result of non-users subsidizing the services, in addition to causing the City to forgo revenue. GFOA notes that regular fee reviews allow governments to assess service demands, consider cost reduction alternatives, and make comparisons to private competition.

OBM stated that it prioritized its consideration of other forms of revenue over fees, because fees brought in less revenue. In addition, OBM stated that it lacked sufficient resources to review all City fees on a regular basis, especially if the review included a full-cost analysis. To conserve

³² OBM provided OIG with spreadsheets listing identified fees. In some cases, a single line described a fee with multiple rates, while in other cases what appeared to be a single fee with multiple rates was broken up into one line per rate. For example, OBM listed the "Plumber's and Apprentice Plumber's License" as one fee with three rates (the apprentice plumber's license is \$15, the plumber's license is \$30, and the plumbers examination fee is \$149), but listed the "General Contractor's License" as five fees, each with a different rate, based on the maximum project size allowed. For purposes of this audit, OIG did not modify the manner in which OBM presented the list of fees; we counted each row in the spreadsheets as accounting for one fee.

³³ City of Houston, "City Fee Schedule," accessed February 22, 2018, <http://cohweb.houstontx.gov/FIN/FeeSchedule/default.aspx>.

³⁴ The documentation provided by OBM did not include affirmative evidence of review for all 172 fees. However, where OBM's list indicated that a fee was changed during the period 2012-2017, OIG made the conservative assumption that OBM had reviewed the fee in some manner prior to the change. We did not verify the fee change dates provided by OBM, however, and fees with automatic annual increases, such as water rates, may have changed without receiving any additional review. Furthermore, of the 321 identified fees, OBM did not know when 122, or 38.0%, were last changed, and identified that 48, or 24.1% of the 199 remaining fees had not changed since at least 2008.

³⁵ As discussed in the Background section of this report, one example of a fee aligning with a departmental mission would be animal adoption fees. Rather than generating additional revenue by increasing the fees, the City may choose to subsidize adoption as a means of furthering Animal Care and Control's mission of protecting public safety and promoting the humane care of animals.

³⁶ Under the heading "Balanced and Comprehensive Budgeting," the City's 2017 Financial and Budgetary Policies states: "As part of the annual budget process, the City should evaluate each department's direct costs, as well as any indirect costs that are necessary to conduct that department's function. Accurately assessing these costs across City government will provide a useful measure of the full cost of City services." See Appendix B for the City's full 2017 Financial and Budgetary Policies.

resources, OBM stated that it first determined which fees should be modified or created, and then performed the supporting analyses. However, these analyses rarely included full-cost analyses. OBM rejects most fee proposals after a preliminary review, without conducting full-cost analyses or other in-depth evaluations.³⁷ For example, OIG identified 12 proposals rejected by OBM at this stage relating to fees that had not been updated in at least 15 years and were likely at levels far below the cost of service.

Despite its stated lack of resources, OBM is reluctant to train other departments to conduct full-cost analyses and has not provided instructions or templates to assist departments with such analysis. OBM stated that departments should focus on their core operational missions rather than conducting detailed fee analyses.³⁸ In contrast, many peer jurisdictions require departments to evaluate fees periodically, as well as to perform detailed full-cost analyses in support of proposals to modify existing fees or create new fees. Figure 11 shows five peer jurisdictions that rely upon departments to conduct full-cost analyses, three of which also provide instructions or templates to assist departments.

FIGURE 11: Other cities' delegation of full-cost analysis

| | Departments conduct full-cost analyses ³⁹ | Detailed instructions or templates provided to departments |
|-------------------|--|--|
| New York City, NY | ✓ | ✓ |
| San Diego, CA | ✓ | ✓ |
| Los Angeles, CA | ✓ | ✓ |
| Portland, OR | ✓ | |
| Houston, TX | ✓ | |

Source: OIG interviews with peer jurisdiction representatives.

D. THE CITY DOES NOT ENGAGE IN LONG-TERM FORECASTING WHEN EVALUATING FEES

None of the 91 unique fee proposals submitted during the 2013 through 2017 budget cycles considered long-term costs, such as capital expenses and related debt service costs, or expected future changes in operational costs. OBM stated that it considered this GFOA recommendation as primarily applicable to fees that recover the costs of capital planning, a description that fits few City fees. However, accurate forecasting could help the City avoid situations where fee rates fall significantly below intended cost recovery levels, thereby necessitating sudden and sharp

³⁷ For example, OBM rejected several DWM proposals after a preliminary review because the City had recently increased utility taxes.

³⁸ OBM relied on departments to propose new or modified fees, although departments were not required to submit fee proposals or regularly review all fees. It appears, however, that in some cases departments were unable to provide supporting documentation during the limited time period of the budget cycle, resulting in some fee proposals being declined or saved for a later date.

³⁹ New York City, Houston, and Los Angeles require departmental cost analyses to be reviewed by a third party, such as the budget or finance office.

increases. In addition, forecasting could prevent revenue shortfalls by anticipating future changes to service costs, including those associated with labor.

E. THE CITY PROVIDES LIMITED OPPORTUNITIES FOR PUBLIC FEEDBACK AND DOES LITTLE TO PROMOTE PUBLIC AWARENESS REGARDING FEES

The City provides limited opportunities for public engagement regarding fees. OBM stated that the City primarily provides information to the public, and solicits feedback regarding fees, through City Council budget hearings. However, the City Council process does not provide detailed information regarding fees in a timeframe sufficient for informed public feedback. OBM explained that individual aldermen have the opportunity to request briefings from OBM and may then hold public meetings to inform their constituents and receive feedback on fees.

New and modified fees are typically enacted through the omnibus legislation of the Revenue and Management Ordinances after passage of the Annual Appropriation Ordinance. During the 2017 budget cycle, the Office of the City Clerk posted the hearing notice for the Revenue Ordinance three days in advance of the hearing. The agenda, which we provide in Appendix D, did not include any details regarding the fees included in the Revenue Ordinance. Moreover, as mentioned previously, the City does not maintain a list of all fees and, therefore, does not promote awareness of fees by providing such a list to the public. Houston⁴⁰ and San Diego⁴¹ are examples of municipalities that make fee lists publicly available. Some municipalities require public notification of fees prior to establishment or modification. New York City requires agencies to post “in a prominent location on such agency’s website” information regarding the establishment or modification of fees “at least seven days prior to the date set for [the related] hearing.”⁴² San Diego’s Council Policy requires, “When fees are revised, data indicating the proposed fee, the estimated cost required for providing the service, and the estimated amount of revenue shall be available to the public prior to the City Council meeting[.]”

OBM stated that the City’s secondary source for feedback on fees is meetings with key stakeholders, including business organizations. For example, when evaluating business license fees, OBM and the Department of Business Affairs and Consumer Protection reportedly sought input from small business owners and related associations, including the Small Business Advocacy Council and the Business Owners and Managers Association of Chicago. Similarly, OBM solicited feedback from building developers when evaluating the possibility of raising building permit fees. This combination of reliance on City Council hearings as the primary source of public input while meeting separately with other stakeholders may result in decisions that prioritize, or

⁴⁰ City of Houston, “City Fee Schedule,” accessed February 26, 2018, http://cohweb.houstontx.gov/FIN_FeeSchedule/.

⁴¹ City of San Diego, “City of San Diego Fiscal Year 2017 User Fee Schedule,” accessed February 26, 2018, https://www.sandiego.gov/sites/default/files/fy17feeschedule_5.pdf.

⁴² City of New York, “City Administrative Procedure Act,” accessed March 2, 2018, <http://rules.cityofnewyork.us/content/city-administrative-procedure-act-capa>.

at least appear to prioritize, the perspective of interest groups over that of the general public. In particular, the lack of transparency may exacerbate the perception that local government caters to special interests.

RECOMMENDATIONS

1. OBM should develop a fee policy and accompanying practices that adhere to GFOA recommendations. Specifically, OBM should develop a fee policy that identifies the factors, including policy considerations, included in the evaluation of a fee. The policy should provide guidance on what types of fees are candidates for being set at more or less than the full cost of their related services, and should require an explanation of the rationale for subsidizing services when a fee is set below full cost.
2. To aid the City in accomplishing the timely review of its fees, OBM should create a complete list of all City fees and establish a schedule for periodic review. OBM should also identify the parties within OBM and the various departments who will be responsible for ensuring that fee proposals and supporting documentation are submitted on schedule.
3. OBM should further ensure that fee proposals are supported by full-cost analyses. To overcome its stated resource limitations, OBM should follow the lead of peer cities by asking departments to perform these analyses for OBM's review and validation. To assist departments in this task, OBM should develop full-cost analysis templates and instructions that provide guidance, including how to account for indirect costs. OBM should identify those departments that may need additional support and provide them with training.
4. To account for cost of service adjustments and price increases, OBM should consider incorporating long-term forecasting in its process for evaluating and setting fees.
5. In implementing the aforementioned recommendations for full-cost analyses, OBM may wish to begin with a pilot program with an individual or a small subset of departments. If OBM launches such a program, it should document the results of the pilot, identify lessons learned, and design any changes needed to implement the practices City-wide. When selecting a department or subset of departments, OBM should consider,
 - the number of fees levied by the department(s);
 - the capacity of department staff to perform financial analyses;
 - the complexity of cost accounting in the department(s); and
 - the expected level of fee subsidization.
6. OBM should provide more information regarding fees to the public and present more opportunities for public feedback regarding fees. Based on the GFOA recommendations, and a review of other jurisdictions, we recommend that OBM,

- publish and maintain a complete list of fees on its website;
- develop and implement procedures to solicit public feedback regarding the establishment of new fees or the modification of existing fees; and
- consider providing both the estimated cost required for providing the service and the estimated amount of revenue for each proposed new fee and fee modification.

MANAGEMENT RESPONSE⁴³

1. *"The OBM is drafting a policy that establishes a review process of the City's user fees and charges based on current practice and using guidance from resources developed by the Government Finance Officers Association ("GFOA"). We intend to work with our budget analysts, departments, and members of our revenue and management ordinance working group⁴⁴ throughout the 2019 budget process to codify the policy and establish a review schedule to be implemented beginning with the 2020 budget. The framework of the policy will be based on existing practice with input from departments to ensure we develop an easy-to-follow format that provides for a suitable review schedule and will clarify that fee adjustments are based on various policy and service goal considerations, not solely based on full cost recovery.*
2. *"OBM first intends to provide a more uniform definition as to what is classified as a user fee and subsequently ask departments during the 2019 budget process to conduct a thorough review of our current list of user fees to ensure it includes all existing fees and the current fee structures.*
"The review schedule we intend to establish will be a multi-year process and will be structured by order of magnitude. We will provide for more frequent reviews of citywide fees and fees with significant revenues and establish periodic reviews for more nominal or specialized fees. This review schedule will be implemented beginning with the 2020 budget.
3. *"As it relates to determining factors to increase or reduce a fee, we plan to continue utilizing the factors discussed [in the response] and follow our existing practice of performing a preliminary review to determine which fees should be modified or created before conducting an in-depth evaluation. This allows OBM to efficiently utilize our limited resources without burdening other City departments with full-cost analyses – which are not part of their core operational functions – on fees that will not be adjusted in a given year. As part of this preliminary review, OBM will develop and provide a template for the data OBM needs from departments to perform a preliminary review. If the preliminary*

⁴³ OBM provided a response in the form of a letter, which is included as Appendix E to this report. OIG excerpted the portions directly responsive to the OIG recommendations and quoted them in the Management Response section for each finding. After receiving the response, OIG sought clarification. OBM provided clarifying edits which have been incorporated into the Management Response section.

⁴⁴ "Members of the revenue and management working group include OBM deputy budget directors and assistant budget directors, Department of Law employees, Mayor's Office staff, and senior management from the Department of Finance."

analysis determines that a fee adjustment warrants further review, the OBM budget analysts and the revenue and management working group will work with the impacted departments to perform a more in-depth cost analysis. As part of this analysis, cost recovery will be a factor, but consistent with GFOA guidance, it will not be the sole reason for increasing a fee.

4. *"Our process for evaluating and determining user fees is not a linear process, as described in the audit and discussed with your staff. This process involves the input of many parties who evaluate the following items:*

- *[...]*
- *Current and future revenue from a user fee and how it will be collected;*

"As part of our existing practice, which we intend to formalize, we do assess current and future revenue from a user fee as well as future costs associated with the service. Additionally, given the fact that our proposed review schedule will incorporate more regular reviews of revenue and costs, especially for fees that with significant revenue, the analysis of future long-term forecasting is redundant and unnecessary.

5. *"OBM does not intend to implement a pilot, because, as we discussed throughout our letter, we will begin with the 2019 budget process of first developing a uniform definition of user fees and then ask departments to verify that our current list of user fees comports with what qualifies as a user fee and update the list accordingly. Following the completion of a verified user fee list, OBM will establish a review schedule to begin implementation during the 2020 budget. Additionally, it is not the core function of operating departments to conduct full-cost analyses.*
6. *"The OBM recognizes that public participation makes government more accountable and responsive to its residents and can positively impact the public's understanding of governmental performance. This office heavily relies on the City's departments and its elected officials, all of whom interact regularly with residents and various stakeholders to convey the interests of those groups. The current structure allows for public engagement in coordination with members of City Council, through public hearings, Town Hall meetings, as well as other stakeholder meetings."*

FINDING 2: The City inaccurately conducted full-cost analyses, resulting in a potential overestimation of net annual residential refuse costs by \$45.2 million and underestimation of net annual vehicle booting operations costs by \$1.0 million.

OIG reviewed the City's full-cost analyses for the residential refuse collection (RRC) fee and the boot fee, two of the three analyses performed during the 2013 through 2017 budget cycles. Neither analysis accurately accounted for all direct and indirect costs, thus potentially overestimating RRC net costs by \$45.2 million, and underestimating vehicle booting net costs by \$1.0 million.⁴⁵

A. OBM POTENTIALLY OVERESTIMATED THE NET ANNUAL COST OF RESIDENTIAL REFUSE COLLECTION BY \$45.2 MILLION, OR 18.5%

During the 2016 budget cycle, OBM proposed creating a new fee to partially offset the cost of RRC. OBM conducted a full-cost analysis in support of the proposal and estimated that providing RRC service costs the City \$244.4 million annually, or \$33 per month per dwelling unit served by DSS. However, City Council ultimately approved a fee of \$9.50 per month per dwelling unit, well below the City's estimated full cost of the service.⁴⁶ The City stated, in a related "Frequently Asked Questions" document, that "the fee will cover approximately one-quarter of the City's garbage collection costs."⁴⁷ Prior to the RRC fee, the City provided refuse collection free-of-charge for residences with fewer than five dwelling units.

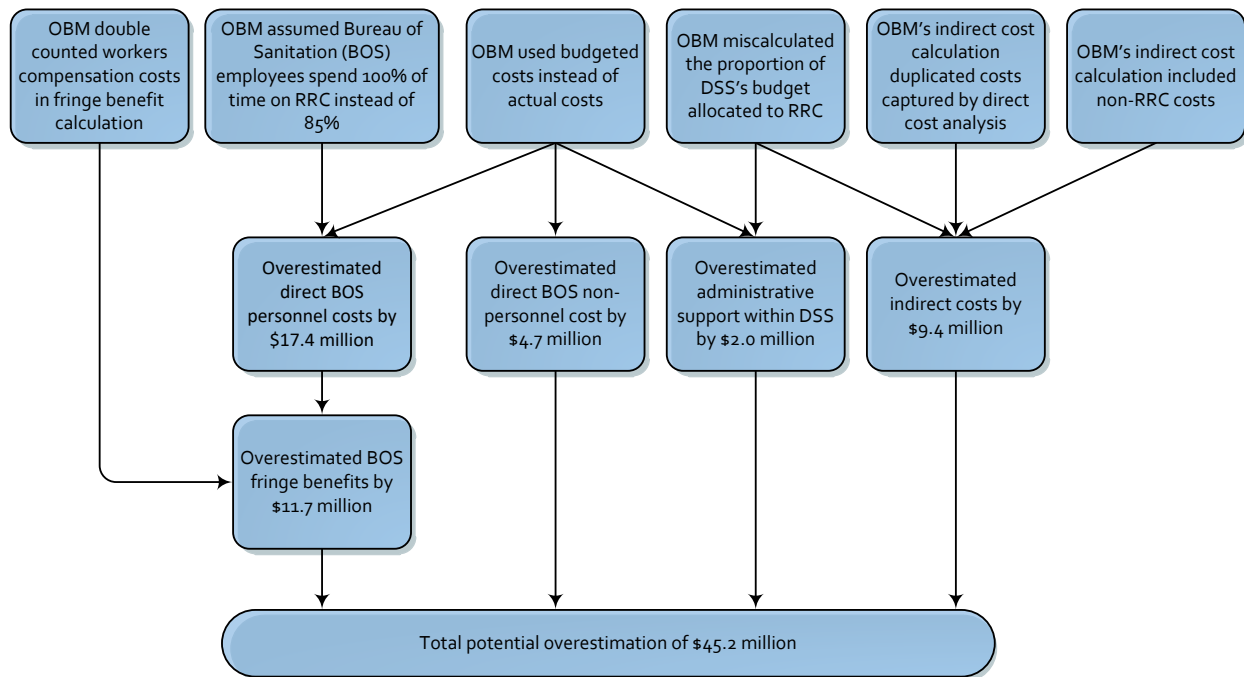
OIG reviewed portions of OBM's full-cost analysis and determined that OBM potentially overestimated RRC costs by \$45.2 million, or 18.5%. OBM could not provide sufficient documentation or explanation for OIG to evaluate all parts of the analysis. Recognizing that such documentation or explanation may have resulted in portions being underestimated, we can only project a potential net overestimation. OBM stated that a) it did not maintain detailed records of its methodology and b) the last employees involved in the analysis left City employment during the audit. Figure 12 illustrates the ways OBM overestimated RRC costs.

⁴⁵ Examples of direct and indirect costs are provided above in Figure 4.

⁴⁶ A 50% discount is provided to senior citizens eligible for the Cook County Assessor's Senior Freeze Program. For more information regarding that program see: <https://www.cookcountytreasurer.com/seniorcitizenassessmentfreezeexemption.aspx>.

⁴⁷ City of Chicago, Department of Finance, "Garbage Fee FAQ," accessed February 22, 2018, https://www.cityofchicago.org/city/en/depts/fin/supp_info/garbage-fee-faq.html.

FIGURE 12: Components of RRC cost overestimation



Source: OIG analysis of OBM’s 2015 RRC full-cost analysis.

OBM overestimated both personnel and non-personnel costs by relying on budgeted costs instead of actual costs. While budgeted cost data is readily available to departments, it often does not reflect the true cost of service and can differ significantly from actual costs. OBM acknowledged the shortcomings of budgeted costs and explained that a number of factors went into the decision to use them, including the ready availability of data, the level of detail included, and the fact that budgeted costs constitute the most current information available. OBM also assumed that that DSS Bureau of Sanitation staff dedicated 100% of their working hours to RRC. However, Bureau of Sanitation management stated that employees spent closer to 85% of working hours on RRC.

OBM made an arithmetical error that resulted in an overestimation of DSS administrative support costs. It attempted to allocate administrative support from other DSS sections based on the ratio of budgeted RRC costs to the total DSS budget. However, OBM used the Bureau of Sanitation budget rather than the RRC budget in the numerator, thereby overstating the proportion of DSS administrative support costs that should be allocated to RRC.

OBM overestimated Citywide indirect RRC costs by \$9.4 million by applying the same incorrect cost ratio and misusing the City’s full cost allocation plan (CAP). A CAP is a tool for estimating the full cost of service by allocating costs across City departments to determine the amount of Citywide overhead costs attributable to a specific department or section. Although OBM was familiar with the CAP, it lacked the level of expertise necessary to accurately apply it to the RRC

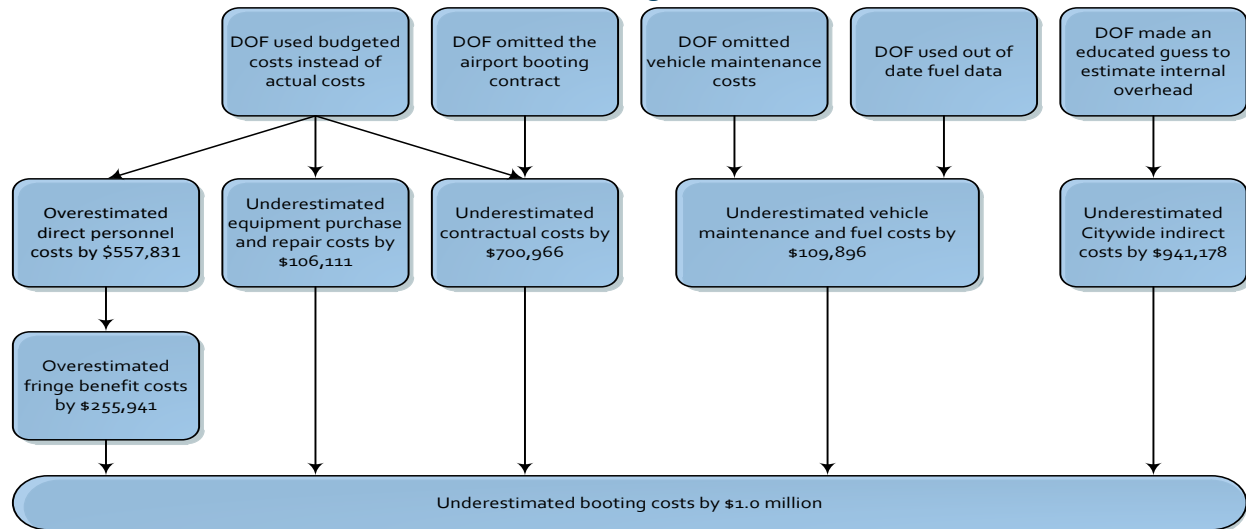
full-cost analysis. The CAP is highly complex, and without specialized knowledge necessary to determine indirect costs, it is easy to make mistakes.

Furthermore, the City's CAP is not designed to be used for full-cost analyses. At the City's request, the vendor designed the CAP to achieve the primary purpose of allocating indirect costs to Enterprise Funds. As a result, some costs are not captured in the CAP. For instance, while the CAP allocates building depreciation expenses to City departments, it includes only six City-owned buildings. In addition, there are certain sections of the CAP that capture all relevant costs, but do not fully allocate them to departments. For example, the 2015 CAP captures the City's \$134.8 million in fleet operations costs, but does not allocate \$71.2 million, or 52.8%, to user departments. Because it does not allocate all City costs, the CAP as currently designed cannot be used as an accurate tool for calculating the full cost of service.

B. THE CITY UNDERESTIMATED THE NET ANNUAL COST OF VEHICLE BOOTING BY \$1.0 MILLION, OR 18.3%

During the 2014 budget cycle, DOF conducted a full-cost analysis of the City's vehicle boot fee and proposed a \$48 increase, from \$60 to \$108.⁴⁸ Two years later, following the 2016 budget cycle, City Council raised the fee to \$100. OIG reviewed DOF's 2014 analysis and determined that it miscalculated the annual cost of booting operations. Figure 13 illustrates the ways DOF both under- and overestimated booting costs, resulting in a net underestimation of \$1.0 million, or 18.3%.

FIGURE 13: Sources of underestimation of booting costs



Source: OIG analysis of DOF's original full-cost analysis and City cost data.

⁴⁸ A boot is an immobilization device attached to a vehicle that has accumulated three or more unpaid parking, red light, and/or automated speed enforcement tickets in final determination status, or two if both are over one year old. To remove the boot and regain use of their vehicle, an individual must pay the boot fee, in addition to any unpaid tickets, plus towing and storage costs. Whether the boot fee should be considered a fee or a fine is debatable. The City elected to treat it as a fee, relating the charged amount to the cost of service.

Similar to OBM's RRC analysis, DOF relied on budgeted costs instead of actual costs. DOF acknowledged that the 2012 actual cost data were available at the time of the analysis, but stated it was easier to use 2013 budgeted costs.

As discussed previously, the City's CAP is an imperfect tool for conducting full-cost analyses for City services or departments. We opted to use it to calculate indirect booting costs because it is the only tool currently available for such calculation. DOF management, however, was unaware that the CAP was available for consideration when calculating indirect costs and, therefore, arbitrarily estimated indirect costs, resulting in an underestimate of \$941,178. While OBM is responsible for vetting the accuracy of departmental fee proposals, OBM either did not identify, or chose not to include, the omitted direct and indirect costs we outline above.

RECOMMENDATIONS

7. OBM should ensure that future full-cost analyses accurately account for all direct and indirect costs, as recommended by GFOA. To avoid the specific errors found in the boot and RRC fee analyses, OBM should use, and direct departments to use, actual cost data whenever possible. Use of budgeted costs should be limited to situations where actual cost data is unavailable, such as first-time purchases of new equipment. Further, departments should make a reasonable effort to estimate the time allocated to a program or service. Many City employees devote less than 100% of their time to a single program or activity. While it may be overly cumbersome to track employee time on a project-by-project basis, managers should be able to make reasonable estimates of the amount of time employees spend on specific programs or services.
8. OBM should also consider developing an alternative CAP, or revising the current CAP, to support future full-cost analyses. The purpose of the new or updated CAP would be to allocate all City costs across departments and thereby facilitate accurate full-cost analyses. As part of this endeavor, OBM should seek to simplify the CAP in order to aid City departments' understanding and facilitate the CAP's use for full-cost analyses.

Alternatively, OBM could work with DOF and/or its vendor to develop indirect cost rates for each department based on the CAP. If indirect costs vary significantly within departments, separate rates could be calculated for departmental sub-elements, such as bureaus. The development of indirect cost rates would eliminate the need for individual departments to gain the necessary expertise to use the CAP.

MANAGEMENT RESPONSE

7. *"While we agree in part as it relates to performing an analysis of cost associated with performing services, OBM balances accuracy to the penny and the amount of work required to achieve that balance.*


"Specifically, OBM stated in our letter that "[a]s it relates to determining factors to increase or reduce a fee, we plan to continue utilizing the factors discussed above and follow our existing practice of performing a preliminary review to determine which fees

should be modified or created before conducting an in-depth evaluation. This allows OBM to efficiently utilize our limited resources without burdening other City departments with full-cost analyses – which are not part of their core operational functions – on fees that will not be adjusted in a given year. As part of this preliminary review, OBM will develop and provide a uniform template for the data OBM needs from departments to perform a preliminary review. OBM intends to seek actual cost data associated with a given service that will also include a reasonable estimation of the time devoted to a given service or operation by employees. If the preliminary analysis determines that a fee adjustment warrants further review, the OBM budget analysts and the revenue and management working group will work with the impacted departments to perform a more in-depth cost analysis. As part of this analysis, cost recovery will be a factor, but consistent with GFOA guidance, it will not be the sole reason for increasing a fee.

8. *“Any alternative cost allocation plan [“CAP”] implemented for the City will be just as complex as our current CAP and would also require mirroring the same assumptions used in the existing CAP, so the validity of one plan over another is not called into question. The City of Chicago’s budget is \$8.6 billion and funds operations in over thirty different departments. The current CAP is a complex set of calculations that produces over 600 pages of tables used to determine proper allocation of general service costs (such as facility costs, 311 services, etc.) that should be reimbursed from other funds and city departments to the corporate fund or directly to certain departments. We believe our current methodology for determining indirect costs applies logic to utilizing the City’s CAP and pulls from significant experience with department budgets and costs of services. The indirect rate and cost allocation methodology are reviewed and calculated annually with external public cost allocation experts by applying actual historical data and utilizing best practices, and OBM continues to work with our vendor to review this process and ensure our CAP is providing an accurate calculation.”*

APPENDIX A: GFOA RECOMMENDATIONS FOR ESTABLISHING GOVERNMENT CHARGES AND FEES

The following is the full text of GFOA's recommendations for "Establishing Government Charges and Fees."⁴⁹



Government Finance Officers Association

BEST PRACTICE

Establishing Government Charges and Fees

BACKGROUND:

State and local governments use charges and fees to help fund services. When certain services provided especially benefit a particular group, then governments should consider charges and fees on the direct recipients of those that receive benefits from such services. However, many governments provide subsidies to various users for policy reasons, including the ability of residents or businesses to pay. Well-designed charges and fees not only reduce the need for additional revenue sources, but promote service efficiency.

Setting user charges and fees can be difficult. Items to consider when developing charges and fees should include:

1. What are applicable laws and statutes regarding charges and fees?
2. Are formal policies in place articulating pricing factors or rationale for any subsidies?
3. What is the full cost of providing the service (both direct and indirect)?
4. Are rates periodically reviewed and updated?
5. Are long-term forecasts and plans consistent with the decision-making in the rate setting process?
6. How will the public be involved in the fee-setting process, and how will the public be informed of the result?

RECOMMENDATION:

The Government Finance Officers Association (GFOA) supports the use of charges and fees as a method of financing governmental goods and services. Concerning the charge and fee setting process, GFOA makes the following recommendations that governments should:

1. *Consider applicable laws and statutes before the implementation of specific fees and charges.*
2. *Adopt formal policies regarding charges and fees. The policy should:*
 - Identify the factors (affordability, pricing history, inflation, service delivery alternatives, and available efficiencies) to be taken into account when pricing goods and services.
 - State whether the jurisdiction intends to recover the full cost of providing goods and services. 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

⁴⁹ Government Finance Officers Association, "Establishing Government Charges and Fees," February 2014, accessed February 22, 2018, <http://www.gfoa.org/establishing-government-charges-and-fees>.

recovered, then an explanation of the government's rationale for this deviation should be provided.

- Outline the considerations that might influence governmental pricing decisions. Such policy concerns might include the need to regulate demand, the desire to subsidize a certain product, competition with private businesses, economic development, elasticity of demand for the particular service, and visibility of the service to the community.
- The specifics of how the fees and charges will be levied and collected should be a consideration when developing policy.

3. Calculate the full cost of providing a service 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.
- One useful tool for calculating service costs is Activity Based Costing (ABC). ABC assigns costs to the activities required to deliver a service and can be more accurate than traditional costing methods.
- The associated costs of collection need to be addressed.

4. Review and update charges and fees periodically based on factors such as the impact of inflation, other cost increases, adequacy of cost recovery, use of services, and the competitiveness of current rates.

- By updating fees on a periodic basis, this may help smooth charges and fees over several years rather than having uneven impacts. Periodic review of the service demand and competition is also recommended to ensure that the appropriate quality and price point of the service continues to meet actual demand. The review should be performed in conjunction with a look at alternatives for cost reduction.
- Benchmarking individual fees and charges with those charged by comparable or neighboring jurisdictions can guide a governing body when setting rates; it can also differentiate service levels to reveal service or pricing options.

5. Utilize long-term forecasting in ensuring that charges and fees anticipate future costs in providing the service.

- If the charges will recover costs associated with other long-term plans, such as a multi-year capital

plan, a longer-term service fee plan should be consistent, recognizing the plan may be amended to reflect changing conditions in the future.

6. *Provide information on charges and fees to the public.*

- There should be opportunities for citizen feedback, particularly when new rates are introduced or when existing rates are changed. This includes the government's policy regarding full cost recovery, subsidies, and information about the amounts of charges and fees (current and proposed), both before and after adoption, and the anticipated impact of the new fee on providing the service in future years.

References:

- *Best Practice: Measuring the Cost of Government Service* (2002).
- *Best Practice: Managed Competition as a Service Delivery Option* (2006).
- *Best Practice: Alternative Service Delivery: Examining the Benefits of Shared Services* (2007).
- *Best Practice: Long-Term Financial Planning* (2008).
- *Best Practice: Public Participation in Planning, Budgeting, and Performance Management* (2009).

APPENDIX B: CITY FINANCIAL AND BUDGETARY POLICIES

The City's 2017 Financial and Budgetary Policies are reproduced below.⁵⁰ The fee policy follows the third bullet on the second page.

2 0 1 7 B U D G E T O V E R V I E W

FINANCIAL AND BUDGETARY POLICIES

FINANCIAL AND BUDGETARY POLICIES

The City's financial policies provide a framework for overall fiscal management across all levels of City government, outline standards for consistent and transparent budgetary practices, and provide a roadmap for assuring long term financial stability. These fiscal policies are intended to secure the City's fiscal integrity and health, encourage equitable allocation of costs and resources, and allow sufficient flexibility to consider new fiscal and budgetary strategies. The City consistently evaluates these policies to determine if they should be modified to accommodate changing circumstances and conditions.

Fund Stabilization

The City will maintain sufficient fund balance to mitigate current and future risks, emergencies, or unanticipated revenue shortfalls. Due to improved financial and budget practices, the City has established and maintains three sources as unrestricted budgetary fund balance, also referred to as Budget Stabilization Fund or fund balance:

- Asset Lease and Concession Reserves: Revenues from the long-term lease of the Chicago Skyway and the concession agreement for the metered parking system comprise the City's Asset Lease and Concession Reserves.
- Operating Liquidity Fund: The City created this fund in 2016 and each year a portion of the unassigned fund balance will be assigned to it. This fund will provide reoccurring short-term funding solutions for City operations that are funded from a dedicated revenue source (e.g. Chicago Public Library property tax revenue), allowing the City to manage liquidity issues associated with timing of revenue collection.
- Unassigned Fund Balance: Surplus resources identified through the annual financial audit process make up the unassigned fund balance. However, the City's unassigned fund balance has grown annually since 2013 due in part to the improving economy, enhancements in revenue systems, including debt collection and investment strategies, and ongoing savings and efficiencies.

As part of its budget stabilization policy, the City will adhere to the GFOA recommendation that governments maintain an unrestricted budgetary fund balance in their general fund

of no less than two months of operating expenses. Further, the City does not appropriate more than one percent of the value of the annual corporate budget from the prior year's audited unassigned fund balance in the current year's budget.

Balanced and Comprehensive Budgeting

- The City will base its annual budget on a reliable assessment of the available resources for that year and a meaningful understanding of the City's service priorities, and will adopt a balanced budget in accordance with the Illinois Municipal Code (65 ILCS 5/8-2-6).
- Members of the public will be provided with an opportunity to submit comments on the annual budget through City Council hearings, community forums, written or electronic submissions, or other appropriate means, and at any public hearings required by the Illinois Municipal Code (65 ILCS 5/8-2-6).
- As part of the annual budget process, the City should evaluate each department's direct costs, as well as any indirect costs that are necessary to conduct that department's function. Accurately assessing these costs across City government will provide a useful measure of the full cost of City services.
- Enterprise funds should be charged the full cost of services provided by other City funds.
- Long term debt will not be used to finance ongoing operating expenditures.

Financial Report and Long Term Financial Planning

Pursuant to Executive Order No. 2011-7, the Office of Budget and Management will issue by July 31 of each year a long-term budget and financial analysis which will include a historical expense and revenue trend analysis and a long-term financial forecast.

Grants Management

Anticipated grants will be appropriated annually as part of the Appropriation Ordinance passed by the City Council. Before applying for or accepting any grant, the City will evaluate whether the grant is consistent with the City's mission and priorities and assess the costs, responsibilities, and risks associated with the grant.

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⁵⁰ City of Chicago, Office of Budget and Management, "2017 Budget Overview," 2017, 40, accessed February 22, 2018, https://www.cityofchicago.org/content/dam/city/depts/obm/supp_info/2017%20Budget/2017BudgetOverviewFinal.pdf.

2 0 1 7 B U D G E T O V E R V I E W

FINANCIAL AND BUDGETARY POLICIES (CONTINUED)

Capital Investments and Maintenance

The City will strive to consistently maintain capital assets and prioritize capital projects in a manner that minimizes future maintenance and replacement costs, and meets Chicago's infrastructure needs.

Diverse Revenue System and Evaluation of Costs

- The City will maintain a diversified and stable revenue system that is responsive to the changing economy and designed to protect the City from short-term fluctuations in any individual revenue source.
- The City will not use revenue from volatile sources in an amount that exceeds normal growth rates for ongoing operating costs.
- User fees will be regularly evaluated and set at levels designed to support the full cost of the service.
- The City will critically evaluate tax and fee reductions and waivers to determine their value and impact on City services and finances.
- Where appropriate, the cost of City services will be benchmarked against similar providers of such services so that the City is able to accurately evaluate opportunities to improve efficiency and reduce costs associated with service delivery.

Declaring a TIF Surplus

Pursuant to Executive Order No. 2013-3, the City declares a surplus from TIF districts in an amount that is at least 25 percent of the available cash balance in the TIF, subject to the restrictions set forth in the Executive Order, after accounting for current and future project commitments and contingencies, revenue volatilities, tax collection losses, and tax liabilities.

APPENDIX C: CITY OF SAN DIEGO, CALIFORNIA USER FEE POLICY

The following is the City of San Diego's User Fee Policy, which incorporates recommendations from the GFOA, the National Advisory Council on State and Local Budgeting, and the United States Office of Management and Budget.⁵¹

**CITY OF SAN DIEGO, CALIFORNIA
COUNCIL POLICY**

CURRENT

SUBJECT: USER FEE POLICY
POLICY NO.: 100-05
EFFECTIVE DATE: March 10, 2009

BACKGROUND:

The following presents a comprehensive User Fee Policy for the City of San Diego that includes guidelines for establishing and maintaining a comprehensive user fee schedule. The user fee policy establishes the method for setting up fees and the extent to which they cover the cost of the service provided, as recommended by the Government Finance Officers Association (GFOA), National Advisory Council on State and Local Budgeting (NACSLB), and Federal Government Office of Management and Budget (Circular A-87).

The City charges a range of fees for services provided to residents and businesses. These fees are imposed as a result of a public need, such as recreational services, rental uses, and other types of services.

According to the standards established by GFOA and NACSLB and their best practice guidelines, governments should calculate the full cost of the different services they provide. For instance, GFOA recommends a formal fee policy that should identify factors to be considered when pricing services.

Many cities have implemented user fee policies to comply with the regulations set by their jurisdictions. Best practices indicate that several components are essential in developing a User Fee Policy that are described below and included in the User Fee Policy:

1. Provide specific requirements for frequency of fee review.
2. Identify how fees are set and what factors are considered.
3. Develop a cost recovery rationale which will allow revenue enhancement through full cost accounting, thereby improving government efficiency, and which will maintain equity considerations in regard to provision of government services.
4. State the government agency's intent to set fees to recover the full cost of service. Determining cost recovery rates necessitates an accurate calculation of the cost of providing government services, both direct and indirect, regardless of whether all services are deemed to be fully cost recoverable. Direct costs consist of costs that are incurred directly by providing the service, such as staff time spent on service-related activities in addition to salary and benefit expenses. Indirect costs consist of departmental overhead such as operating expenses and internal administrative costs as well as citywide overhead costs. Failure to include indirect costs results in inadvertent subsidization of government services that benefit individuals rather than the overall public.

CP-100-05

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⁵¹ City of San Diego, City Council, "User Fee Policy," March 2009, accessed March 2, 2018, <https://www.sandiego.gov/sites/default/files/legacy/fm/pdf/userfeepolicy.pdf>.

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5. Provide rationale in cases where a government agency sets a fee lower than the full cost of a service. The concept behind a user fee is that the fee charged for a service should equal the cost of providing that service. Examples of programs and services with low to moderate cost recovery levels include recreational activities for youth and seniors, other community services, and library fees.

6. Set a frequency for undertaking cost of service studies. In-depth user fee studies should be undertaken every two to five years, with annual adjustments based on certain economic inflators or changes in budget allocations. While some cities determine annual fee changes by evaluating the impact of inflation, others also evaluate the impact of changes in budget allocations for each department to determine whether the cost of providing specific services has changed. In addition, while an annual review is necessary to determine whether fees should be updated according to the policy, a comprehensive annual user fee study may not be cost-effective because of its labor and time-intensive nature, particularly due to the large number of fees that must be reviewed. Therefore, a schedule of increases based on Consumer Price Index (CPI) or other annually adjusted inflator should be included in the policy.

7. Allow stakeholder input and make the policy available to the public. GFOA recommends that stakeholders be given an opportunity to provide input during the User Fee Policy formulation process. This User Fee Policy includes: a) provisions for allowing the public to be part of the discussion of the proposed fees; and b) the requirement to make a schedule of all fees available and ensure its easy access for the public.

PURPOSE:

Identify the full cost of services for activities that charge user fees in order to develop target cost recovery rates.

Bring existing fee levels in-line with service costs to ensure that all reasonable costs incurred in providing these services are being recovered.

POLICY:

Definitions:

“User Fee” is a fee charged by a government agency to recipients of its services. User fees generally apply to activities that provide special benefits to members of the public, and the amount of the fee is usually related to the cost of the service provided. Examples of user fees are pool fees, park room rental fees, fire inspection fees, and others.

“Cost Recovery” is recouping a portion of or all costs associated with a particular service provided by the government agency to the public. The user fees determine the percentage of a service that is recovered. Cost recovery has two important rationales: (a) revenue enhancement through full cost accounting, thereby improving government efficiency; and (b) maintaining equity considerations in regard to the provision of public services.

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“Direct Costs” are the costs incurred directly by providing a specified service. These costs are associated with staff time spent performing service related duties and include employee salary and benefits. In general, direct costs are any costs that can be traced directly to the production of a given service or product.

“Indirect Costs” are the costs not directly accountable or associated with the production of a service, such as a fixed cost. Indirect costs include departmental overhead (operating expenses and internal administrative costs), as well as citywide overhead, including all those costs that support City programs and services.

Annual Review Process:

Regular annual changes to user fees in the General Fund shall be first reviewed by the Budget and Finance Committee and proposed to the City Council during the annual budget process. All approved changes shall be published in the City’s user fee rate book and on the City’s website, both of which shall be maintained by the Office of the City Clerk.

Changes to user fees in enterprise fund departments (Water, Wastewater, Airports, Golf Course, Recycling, and Refuse Disposal funds) shall be proposed to the City Council as recommended by each responsible enterprise fund department.

Requirements:

A. Levels of Cost Recovery

Category I – Full Recovery (100 Percent)

User fees that are determined to have a 100 percent cost recovery goal shall be updated annually based on the costs incurred for providing services using actual data from the prior fiscal year. All user fees are assumed to be at 100 percent cost recovery unless they meet the criteria for Categories II and III.

Category II – Partial Recovery (Below 100 Percent)

User fees that are below the 100 percent cost recovery goal shall be adjusted annually by a standardized escalator based on the most recent Consumer Price Index. Alternatively, these fees may be changed at any point in time upon recommendation by the responsible department, approval by the Chief Operating Officer and final approval by the City Council.

Fees are generally less than 100 percent cost recovery in cases where: (a) the collection of fees is not cost-effective; (b) the collection of fees would not comply with regulatory requirements; (c) the purpose of the fee is not to generate revenue but rather provide benefits to the recipients (e.g. recreational activities).

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Category III – Fees (Fines and Penalties)

User fees that fall into this category are in most cases penalties, fines or deterrents to the public (library fines, penalties for uncollected money or public safety response for disturbances). User fees in Category III shall be reviewed annually relative to the reasonableness of the fee and the fiscal effect as it relates to deterrence.

In summary, the following economic and policy considerations shall be considered when setting cost recovery levels as follows:

- Public use of government services shall be considered (potential to use fees as a means of encouraging or discouraging activities, for instance, library book fines).
- Constitutional or other types of limitations on charging more or less than the actual cost of providing the service.
- Subsidization (not full cost recovery) of activities for groups who cannot afford access to services if fees are set at full cost recovery (e.g. pool fees). In these cases, the City shall subsidize a portion of the cost of the service.
- The fee amount and its affect on the demand of the service shall be considered. Increasing a fee amount might not always raise revenues, but instead may have the opposite impact. A fee set above what the public is generally willing to pay will lessen the demand for the service, and, as a result, a sensitivity analysis of consumer demand shall be considered when setting fees.
- The nature of the facilities or services shall be considered when setting fees (e.g. fees for facilities may warrant full cost recovery while fees for youth recreation programs may warrant less than full cost recovery).
- The nature and extent of the benefit to the fee-payers. The recipients that benefit from the service provided shall be identified. The fee review shall consider whether the service is beneficial to the public as a whole or the individual fee-payer.
- Fee amounts shall be proportional to the costs associated with providing the service or program. The full cost should consist of both direct and indirect costs and should be included within the fee amount. Indirect costs shall be captured through overhead rates for each department.

B. Cost Recovery Calculation

City departments with user fees shall determine cost recovery rates based on direct and indirect costs for all fees in order to accurately calculate the cost of providing services regardless of whether all services are deemed to be fully cost recoverable. Indirect costs shall include allocated central support services costs (IT, risk management, fleet assignment and usage fees, etc.).

Fees shall be annually adjusted to maintain the cost recovery level. Departments with user fees shall be responsible for developing cost recovery rates for their respective user fees in accordance with the cost

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recovery levels described in this policy. User fees that do not meet the criteria for Categories II and III shall be developed to achieve full cost recovery (Category I). Where appropriate, departments may initiate a multi-phase approach to achieve a targeted cost recovery rate.

Different methods of adjustment are acceptable such as using a Consumer Price Index (CPI), State and Local Implicit Price Deflator, Municipal Cost Index, or other inflators. It is recommended that, if applicable, a CPI inflator be used for setting or revising the City's user fees.

C. Frequency of User Fees Cost Studies

User fees shall be updated annually as a part of the budget process based on CPI inflation estimates or other annually adjusted inflators until the next comprehensive user fee study is undertaken.

A comprehensive user fee study and a review of this proposed User Fee Policy shall be conducted every three years. The user fee study should include the extent and scope of study as well as the level of participation of responsible departments. Any major changes to fees shall be implemented prior to the adoption of the annual budget for the following fiscal year.

The following factors shall be taken into account during a comprehensive user fee study:

- Whether service costs are covered by revenues received.
- Whether fees cover costs and generate excess revenue that supplement other services.
- A comparison of fee levels for similar services provided in other jurisdictions.
- An analysis of all relevant costs involved including direct and indirect costs.

Any proposals for new or revised fees shall be first approved by the Chief Operating Officer. The fee proposals then shall be reviewed by the Budget and Finance Committee with subsequent approval by the City Council. Any such proposals shall include the purpose of the fee (if new); justification for implementation or revision; the fee amount and annual revenue; annual cost; the methodology and level of cost recovery; the nature and extent of the benefit to the fee-payers; and other relevant information.

The City's Administrative Regulations related to user fee charges shall be revised by including all the requirements of this User Fee Policy and shall include procedures for implementing new fees or revising existing fees.

D. Public Input and Availability of Fee Information

When fees are revised, data indicating the proposed fee, the estimated cost required for providing the service, and the estimated amount of revenue shall be available to the public prior to the City Council meetings through the docketing of the report for the Council agenda. The City Clerk shall post an updated schedule of all fees on the City's internet site on July 1st of each year. The City Clerk shall also make available to the public a fee rate book that shall be located in the Office of the City Clerk.

**CITY OF SAN DIEGO, CALIFORNIA
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This policy shall replace Council Policy 100-05 (“Fees - Public Notification”) adopted by the City Council in April 1979.

CONCLUSION:

The purpose of this policy is to provide general guidelines and to incorporate best practices in establishing user fees to ensure that the City adequately recovers costs for services it provides to the public. The User Fee Policy identifies factors that need to be considered in setting fees, the level of cost recovery, and the frequency of comprehensive user fee studies. The key factor of the User Fee Policy is to review and update fees on an ongoing basis to ensure that they keep pace with changes in the cost-of-living as well as changes in methods or levels of service delivery.

HISTORY:

Fees – Public Notification”
Adopted by Resolution R-223244 04/09/1979
Retitled to “User Fee Policy”
Amended by Resolution R-304723 03/20/2009

APPENDIX D: REVENUE ORDINANCE HEARING AGENDA

The 2017 Revenue Ordinance Hearing Agenda from the Office of the City Clerk is reproduced below.⁵²

| AGENDA COMMITTEE ON FINANCE NOVEMBER 7, 2016 10:00 A.M. CITY COUNCIL CHAMBER | | RECEIVED #3 NOV 4 AM 8:09 OFFICE OF THE CITY CLERK |
|--|---|--|
| <u>CITY COUNCIL</u> | | |
| 1. | A proposed ordinance concerning the authority to amend Chapter 4-64 of the <u>Municipal Code of Chicago</u> . | |
| | Direct Introduction | |
| <u>OFFICE OF BUDGET AND MANAGEMENT</u> | | |
| 2. | A communication recommending a proposed ordinance concerning the authority to approve the supplemental levy of real estate taxes for the City of Chicago for the year 2017. | |
| | O2016-7989 | |
| | Amount of Tax Levy: | \$1,357,834,000 |
| 3. | A communication recommending a proposed ordinance authorizing amendments to various sections of the <u>Municipal Code of Chicago</u> , which relate to revenue derived from certain taxes, fines, and fees. | |
| | O2016-7981 | |
| <u>OFFICE OF THE CITY COMPTROLLER</u> | | |
| 4. | A communication recommending a proposed ordinance concerning the authority to approve the abatement of 2016 property taxes for the payment of City of Chicago General Obligation Bonds, Library Series 2008D. | |
| | O2016-7958 | |
| 5. | A communication recommending a proposed ordinance concerning the authority to approve the abatement of 2016 property taxes for the payment of City of Chicago General Obligation Bonds (Emergency Telephone System), Refunding Series 1999. | |
| | O2016-7960 | |
| 6. | A communication recommending a proposed ordinance concerning the authority to approve the abatement of 2016 property taxes for the payment of City of Chicago General Obligation Bonds (Emergency Telephone System), Series 2004. | |
| | O2016-7959 | |

⁵² City of Chicago, Office of the City Clerk, "Agenda," November 4, 2016, accessed February 22, 2018, http://media.legistar.com/chic/meetings/D38D0FD6-EA17-4931-A98E-94889B8E4CC9/agdfin_20161104081225.pdf.

7. A communication recommending a proposed ordinance concerning the authority to approve the abatement of 2016 property taxes for the payment of City of Chicago General Obligation Bonds, (City Colleges of Chicago Capital Improvement Project), Series 1999.

O2016-7957

MISCELLANEOUS

8. Four (4) orders authorizing the payment of hospital and medical expenses of Police Officers and Fire Fighters injured in the line of duty.

APPENDIX E: OBM'S RESPONSE LETTER



OFFICE OF BUDGET AND MANAGEMENT
CITY OF CHICAGO

May 25, 2018

Joseph M. Ferguson
Inspector General, Office of the Inspector General
740 N. Sedgwick St., Suite 200
Chicago, IL 60654

Sent Via E-Mail

Dear Mr. Ferguson:

In September 2016, the Office of the Inspector General ("OIG") notified the Office of Budget and Management ("OBM") of your Office's intent to review the City's and OBM's process for "establishing and evaluating user fees and charges." I want to thank you and your staff for your review of the City's processes related to user fees and charges and appreciate the overall direction your Office suggested for future reviews of user fees and to enhance our existing protocol.

This letter is in response to your findings outlined in the audit of "The City's Process for Evaluating and Setting User Fees." Since many of the findings presented by the OIG are interconnected, we believe they should be addressed simultaneously, recognizing that a discussion about any specific recommendation in isolation from the entire process may result in an incomplete response.

The City's current process for establishing and evaluating user fees is performed as part of the annual budget process. This allows OBM, the Mayor's Office, all other City departments, and the Chicago City Council to review any user fee changes in relation to proposed modifications to taxes, fines, and other fees as well as proposed operational savings, reforms, and investments in services. Our process for evaluating and determining user fees is not a linear process, as described in the audit and discussed with your staff. This process involves the input of many parties who evaluate the following items:

- All applicable laws, rules and regulations;
- A history of user fee or charge adjustments;
- Current and future revenue from a user fee and how it will be collected;
- The cost associated with performing the service funded in full or in part by the user fee;

- Potential service reforms or efficiencies that can be implemented to reduce the cost of a service without increasing the fee or charge;
- Benchmarking fees and charges with those of comparable or neighboring jurisdictions;
- Constituencies (residents and businesses) impacted by any adjustment, and various factors such as affordability, inflation, demand for services, market fluctuations, etc.;
- Policy goals achieved or forfeited by any adjustment; and
- Public concern or support for an adjustment.

When OBM is reviewing and analyzing any fee change, there are multiple layers of evaluation, including: OBM, Department of Law, Department of Finance, and Mayor's Office staff. This review and analysis ultimately culminates with the review and approval by the Aldermen of Chicago's City Council. Any fee change goes through multiple iterations before a charge is finalized to ensure the final adjustments reflect the City's overall policy and budget goals. We believe this process provides the checks and balances necessary to ensure any user fee adjustments comport with the City's overall budget and policy goals and do not disproportionately impact certain residents or businesses. While we believe our current process provides necessary checks and balances, we do agree with the OIG regarding codifying our process for analyzing and determining user fees and formalizing a review schedule.

The OBM is drafting a policy that establishes a review process of the City's user fees and charges based on current practice and using guidance from resources developed by the Government Finance Officers Association ("GFOA"). We intend to work with our budget analysts, departments, and members of our revenue and management ordinance working group¹ throughout the 2019 budget process to codify the policy and establish a review schedule to be implemented beginning with the 2020 budget. The framework of the policy will be based on existing practice with input from departments to ensure we develop an easy-to-follow format that provides for a suitable review schedule and will clarify that fee adjustments are based on various policy and service goal considerations, not solely based on full cost recovery. This is consistent with GFOA guidance provided in "Full Cost Accounting for Government Service," which states that "cost should not be the sole factor used to determine how a government will provide services."

Please note that OBM has a current list of more than 300 user fees, which differs slightly from the OIG's list as we excluded certain charges that we classify as fines, such as storage fees for impounded vehicles. Further, OBM's user fee list does not list every fee individually; rather, our list groups many fees together by category with fee ranges. For example, in our user fee list, we couple the electrical contractor's license fee with the supervising electrician's license fee as both are electrician licenses and both license fees should be analyzed and adjusted simultaneously.

As a point of clarification, the OIG often pointed to the City of Houston and its fee structure and fee list as a comparison to the City of Chicago. It should be noted that Houston's list is larger than our list

¹ Members of the revenue and management working group include OBM deputy budget directors and assistant budget directors, Department of Law employees, Mayor's Office staff, and senior management from the Department of Finance.

because Houston lists fees individually and includes fees for services that the City does not provide, such as more than 400 fees related to Parks and Recreation.

In response to the OIG's recommendation that the City develop a "complete list of all City fees" and implement a schedule for reviewing all user fees and charges, OBM first intends to provide a more uniform definition as to what is classified as a user fee and subsequently ask departments during the 2019 budget process to conduct a thorough review of our current list of user fees to ensure it includes all existing fees and the current fee structures.

The review schedule we intend to establish will be a multi-year process and will be structured by order of magnitude. We will provide for more frequent reviews of citywide fees and fees with significant revenues and establish periodic reviews for more nominal or specialized fees. This review schedule will be implemented beginning with the 2020 budget.

As it relates to determining factors to increase or reduce a fee, we plan to continue utilizing the factors discussed above and follow our existing practice of performing a preliminary review to determine which fees should be modified or created before conducting an in-depth evaluation. This allows OBM to efficiently utilize our limited resources without burdening other City departments with full-cost analyses – which are not part of their core operational functions – on fees that will not be adjusted in a given year. As part of this preliminary review, OBM will develop and provide a uniform template for the data OBM needs from departments to perform a preliminary review. If the preliminary analysis determines that a fee adjustment warrants further review, the OBM budget analysts and the revenue and management working group will work with the impacted departments to perform a more in-depth cost analysis. As part of this analysis, cost recovery will be a factor, but consistent with GFOA guidance, it will not be the sole reason for increasing a fee.

The OBM recognizes that public participation makes government more accountable and responsive to its residents and can positively impact the public's understanding of governmental performance. This office heavily relies on the City's departments and its elected officials, all of whom interact regularly with residents and various stakeholders to convey the interests of those groups. The current structure allows for public engagement in coordination with members of City Council, through public hearings, Town Hall meetings, as well as other stakeholder meetings.

The final portion of the OIG recommendation discussed Cost Allocation Plans ("CAP") and the City's methodology for determining the full cost of certain services. As noted in the OIG's report, the primary purpose of the CAP is to allocate indirect costs² to the City's Enterprise Funds, Emergency Communications Fund and Vehicle Tax Fund as part of the annual budget process. Regarding residential refuse collections, the CAP is the best tool available for OBM to determine the net annual cost. Similarly, the OIG used the same CAP to review the annual cost of vehicle booting in the determination that the City underestimated costs. On page 25 of the audit, the OIG states, "the City's CAP is an

² The Government Finance Officers Association defines indirect costs to include shared administrative expenses where a department or agency incurs costs for support that it provides to other departments/agencies (e.g. legal, finance, human resources, facilities, maintenance, technology). <http://www.gfoa.org/indirect-cost-allocation>

imperfect tool for conducting full-cost analyses for City services or departments. We opted to use it to calculate indirect booting costs because it is the only tool currently available for such calculation.”

There are methodological choices in how the OIG believes the indirect costs should be determined and how indirect costs should be calculated. The OIG recommends OBM simplify the CAP when performing full-cost analyses as it relates to user fees and charges. Any alternative cost allocation plan implemented for the City will be just as complex as our current CAP and would also require mirroring the same assumptions used in the existing CAP, so the validity of one plan over another is not called into question. The City of Chicago’s budget is \$8.6 billion and funds operations in over thirty different departments. The current CAP is a complex set of calculations that produces over 600-pages of tables used to determine proper allocation of general service costs (such as facility costs, 311 services, etc.) that should be reimbursed from other funds and city departments to the corporate fund or directly to certain departments. We believe our current methodology for determining indirect costs applies logic to utilizing the City’s CAP and pulls from significant experience with department budgets and costs of services. The indirect rate and cost allocation methodology are reviewed and calculated annually with external public cost allocation experts by applying actual historical data and utilizing best practices, and OBM continues to work with our vendor to review this process and ensure our CAP is providing an accurate calculation.

User fees and charges are important to the City’s overall mission of providing high quality services to residents, but they are not our sole funding source for operations and services. We rely on a broad variety of revenue sources to ensure we are not over-reliant on one source of funding, with no one source accounting for more than nineteen percent of the City’s overall revenues. We appreciate the OIG’s recommendations and are moving forward with developing a user fee policy that reflects our existing practice and the role user fees serve in the City’s overall budget process and policy goals.

Sincerely,



Samantha S. Fields
Budget Director

MISSION

The City of Chicago Office of Inspector General (OIG) is an independent, nonpartisan oversight agency whose mission is to promote economy, efficiency, effectiveness, and integrity in the administration of programs and operations of City government. OIG achieves this mission through,

- administrative and criminal investigations by its Investigations Section;
- performance audits of City programs and operations by its Audit and Program Review Section;
- inspections, evaluations and reviews of City police and police accountability programs, operations, and policies by its Public Safety Section; and
- compliance audit and monitoring of City hiring and employment activities by its Hiring Oversight Unit.

From these activities, OIG issues reports of findings and disciplinary and other recommendations to assure that City officials, employees, and vendors are held accountable for violations of laws and policies; to improve the efficiency, cost-effectiveness government operations and further to prevent, detect, identify, expose and eliminate waste, inefficiency, misconduct, fraud, corruption, and abuse of public authority and resources.

AUTHORITY

OIG's authority to produce reports of its findings and recommendations is established in the City of Chicago Municipal Code §§ 2-56-030(d), -035(c), -110, -230, and 240.

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