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# G Approaches to cost allocation in court fees

It is not always straightforward to calculate the cost to the courts of resources used in determining a matter. For instance, what share of the court's corporate services expenses should be attributed to a particular dispute?

There are a number of possible approaches to measuring a court's operating costs, which can have substantially different implications on how costs should be charged to users through court fees. As noted in chapter 16, the Commission has suggested that a fully distributed cost (FDC) method, using differential pricing of indirect costs, may be the most appropriate approach for setting court fees in many matters (in combination with fee relief measures to safeguard access for disadvantaged parties).

This appendix draws on the Commission's previous research on cost recovery to provide background information on approaches to cost recovery (PC 2002). It outlines a number of terms and concepts used to define and measure the costs to be charged (section G.1), before discussing various approaches to allocating costs under the FDC method (section G.2).

## G.1 Defining and measuring costs

The full cost of a unit of product or service is the value of all resources used or consumed in its provision. Definitions of the various types of costs which can comprise this full cost are outlined in box G.1. These costs may include:

- direct labour costs (for example, salaries and associated costs, such as allowances, long service leave and superannuation)
- direct materials and services (for example, paper and photocopying services)
- an appropriate share of indirect labour (for example, executives, office services, personnel, library, audit services, and information technology staff)
- an appropriate share of indirect materials and services (for example, office machinery and insurance). Some materials classified as indirect costs could be direct costs, but attributing them to a specific product may be impractical or costly (for example, stationery)
- property charges, which could be both direct and indirect (for example, rent, repairs and maintenance, cleaning and utility charges)

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- capital costs (for example, depreciation or interest on working capital). Some could be direct costs dedicated to the provision of particular services; others could be indirect costs, such as assets used by corporate services.

### Box G.1 Cost definitions

**Direct costs** are costs that can be directly and unequivocally attributed to an activity or product. They include labour and materials used to deliver products.

**Indirect costs** are costs that are not directly attributable to an activity or product and are often referred to as overheads. They can include 'corporate services' costs, such as those of the chief executive officer's salary, financial services, human resources, records management and information technology.

**Capital costs** comprise the user cost of capital and depreciation. The user cost of capital represents the opportunity cost of funds tied up in the capital used to deliver activities or products. It is the rate of return that must be earned to justify retaining the assets in the medium to long term. Depreciation reflects the portions of assets consumed each period.

**Fixed costs** are costs that do not vary with the amount of activity or product. Rent and capital are usually fixed costs in the short run.

**Variable costs** vary with the volume of activity or product and typically include direct labour and materials.

*Source:* Productivity Commission (2002).

Defining the various parts of a court's operating costs into these categories may be challenging, and a number of approaches could be used. To demonstrate a simplified approach to categorising costs, the Commission has separated the operating costs listed in the Family Court's annual report into direct and indirect costs (though some of the broad descriptions of costs listed in this example as indirect may contain some direct components) (table G.1). The information set out in this example is intended to be illustrative — implementation of the Commission's recommendations would require more detailed analysis to separate direct and non-direct components. For example, distinguishing between information technology services used to directly deliver services to clients (such as video-conferencing) and information technology services used to support corporate services functions.

**Table G.1 Illustrative example of categorising court operating costs<sup>a</sup>**  
Using expenditure figures for the Family Court of Australia

<i>Expense</i>	<i>Share of costs (%)</i>
<i>Direct costs</i>	
Client services	25
Family consultants	8
Registrars	6
Judges and support	21
<b>Total direct costs</b>	<b>60</b>
<i>Indirect costs</i>	
Depreciation	8
Property	15
Corporate support	7
Corporate overheads	2
Information technology services	8
<b>Total indirect costs</b>	<b>40</b>

<sup>a</sup> Assumes that judicial salaries can be entirely attributed as direct costs. As discussed further below, this may not be the case and thus the proportion of direct costs may be smaller.

Source: Family Court of Australia (2013).

## Treatment of judicial salaries

Judicial salaries can comprise a significant share of operating costs for Australian courts. In order to ensure judicial independence, the salaries of judges in the federal courts are subject to specific provisions set out in section 72 of the Australian Constitution:

The Justices of the High Court and of the other courts created by the Parliament:

- shall be appointed by the Governor-General in Council;
- shall not be removed except by the Governor-General in Council, on an address from both Houses of the Parliament in the same session, praying for such removal on the ground of proved misbehaviour or incapacity;
- shall receive such remuneration as the Parliament may fix; but the remuneration shall not be diminished during their continuance in office.

The result is that, unlike most labour costs, the cost to courts of paying judicial salaries cannot be reduced in the short run, even where it may be operationally efficient to do so (for example, in the event of a sudden and substantial decrease in workload). This has significant implications for defining and allocating the cost of judicial salaries through court fees.

Some courts, for example the Family Court of Australia and Federal Court of Australia, characterise judicial officers and their support as a fixed cost in their annual reports. However, it is important to recognise that this inflexibility only applies to reductions in

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cost. In the event that additional judges are appointed in response to an increase in workload, the cost of judicial salaries would rise accordingly. Thus it is not appropriate to characterise judicial salaries purely as fixed costs.

The fact that judicial salaries are fixed at a minimum level in the short run does not mean that their cost cannot be directly attributed to a particular service offered by the courts. Indeed, the Commission believes that the time spent by judges dealing with cases should be included in the direct costs charged through fees for various court activities. For example, the value of a judge's time spent in hearing a case in court could be reflected in hearing fees. The value of time not spent dealing directly with cases can then be treated in the same way as other indirect costs.

## **G.2 Allocating costs to users using the fully distributed cost method**

Many businesses and government agencies use the FDC method as a simple way to distribute indirect costs. The Commission believes that the FDC method may be an appropriate means by which courts can allocate their operating costs to be charged through court fees.

Under an FDC approach, direct costs are allocated to their respective output, while indirect costs are distributed across all outputs. Thus, the cost base for each service will include the direct costs, and those costs incurred indirectly to produce the service. The amount of indirect costs to be reflected in court fees will depend on the specific approach to FDC that is adopted. The Commission has suggested in chapter 16 that a differential pricing approach may be the most appropriate method. The various approaches to allocating these indirect costs, including on a differential basis, are discussed below.

### **Pro-rata basis**

The most simple form of FDC allocates indirect costs on a pro-rata basis. They may, for instance, be allocated as a proportion of:

- staff involved in the activity as a percentage of total staff
- the direct resource use of the activity as a percentage of total resource use, or
- the budget for the activity as a percentage of the total business budget.

Compared with other forms of FDC, simple pro-rata methods are relatively easy to implement and many courts may have the financial data available to attribute direct costs to services and to identify indirect costs separately.

However, allocating the indirect costs of operating courts on a pro-rata basis is unlikely to satisfy the policy objectives of accessibility and affordability in the justice system, since a

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pro-rata system distributes costs evenly across users without any regard to their willingness or capacity to pay.

### Activity-based costing

Activity-based costing (ABC) links an agency's products to the activities undertaken to produce them. Activities are, in turn, linked to the agency's costs. While the form of an ABC system can vary between various bodies, it typically comprises:

- identifying full costs
- identifying products and services, and the agency's user groups
- identifying all activities that the agency performs to produce products and services
- tracing full costs to the activities
- identifying cost drivers that link activities to products to give a cost per unit of product or service.

ABC is a more accurate and sophisticated method of allocating the indirect cost pool. Under the ABC approach, categories of indirect cost are identified, and these costs are allocated to products using criteria (often called 'drivers') that most closely reflect usage by each product. ABC is not only useful from a cost recovery perspective — it can also help an agency understand which of their activities are high cost, and help evaluate whether those activities are worthwhile or if there are more efficient alternatives available.

ABC requires more detailed data to implement than the simple pro-rata system. For example, data would be required to determine which activities contribute to certain court services and how these activities consume resources. These requirements may often be in addition to data already held by courts. Typically, agencies that use ABC collect these data via surveys conducted at regular intervals. They may also use rosters or timesheets.

As a result, new systems may be needed to record items such as staff time spent on activities and services, the numbers of users and indicators of complexity for each service. The increased complexity of ABC, and the greater need for data mean that the costs of implementing and using the system are higher than under simpler approaches to FDC.

A number of courts have explored the use of ABC. The Family Court of Australia and the Federal Circuit Court have updated their resource planning model in recent years to incorporate ABC (Family Court of Australia 2011; FMC 2011). The Commission understands that this has been largely for management purposes to identify savings, rather than for use in determining fees. More recently, the use of ABC to determine court fees has been explored in a regulatory impact study of fees in the Supreme and County Courts of Victoria (Vic DoJ 2012).

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## Differential basis

A third (and the Commission's recommended) approach for allocating indirect costs through court fees is on a differential basis (chapter 16). Rather than averaging indirect and joint costs across all fee amounts, differential pricing allocates a share of indirect costs to users through fees based on the characteristics of the party or the dispute in which they are involved.

While not as simple as a pro-rata approach, differential pricing has the advantage of better fulfilling the broader objective of safeguarding the accessibility of the courts. Allocating indirect costs towards cases with greater private economic value and parties with higher capacity to pay can help balance cost recovery and accessibility objectives, while avoiding the equity and efficiency impacts of cross-subsidisation.

Allocating indirect costs on a differential basis is also likely to require less data and complexity than an ABC approach, and thus may be easier to implement and use. However, for those courts with sufficient resources and access to data to undertake ABC, there may be merit in using ABC as a reference point from which differential amounts can then be set.