

Terms of Reference

Cost Centers and Tariffs

Project:

Business Cases for Improved Waste Collection and Valorisation

Apply Cost Centres & Tariffs
Process in Your Municipality



October 2019

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1 INTRODUCTION

Public Utility Companies (PUCs) that are entrusted with waste management services in the Western Balkans are different not only in terms of capacities and economic strength, but also in structure. As a rule, in addition to the waste management activities, these companies perform other communal services as well. Furthermore, they usually earn part of their revenues from the accompanying services offered on the free market.

The business results of the PUCs are reflected in their official balance sheets that regularly undergo financial audit and can thus be considered as very reliable. However, performing a large number of activities inevitably leads to the overflow of costs within the company. Therefore, in practice it is difficult to pinpoint exactly which part of the cost is related to which activity or service. This leads to the socialization of losses within the company. It is often the case that the profit that a PUC makes on an accumulative activity internally covers losses of another less accumulative service, without any discussion or decision-making at the level of local self-government or the PUC itself.

Inaccurate allocation of costs has direct repercussions to the price of services. Calculations according to which PUCs submit requests to the local authorities for adjustments of the basic communal services prices are not based on sufficiently analytical indicators. Therefore, decision-makers at the local level usually do not have the accurate information needed for evidence-based decision-making. Justified costs are one of the key elements for determining the prices of utility services. However, in practice it is often seen that PUCs do not have a method that would place the costs incurred by one service to that particular activity without mixing and overflowing costs with others.

Cost Centers and Tariffs is a process that has in its core an excel spreadsheet-based tool¹ that aims to support and enable decision-makers to:

- accurately locate justified costs, both planned and actual, for each service/activity performed by the company, and
- based on that, calculate and determine for each service to what extent the existing prices should be adjusted (increased or decreased) in the future.

This process especially focuses on the waste management service, and besides determining the required level of prices, provides recommendations to PUC and the local authority for improvement of the tariff system. The aim of these recommendations is to ensure that the bills received by individual user groups are to a greater extent correlated with the actual amount of municipal waste generated. Existing tariff systems often unnecessarily favor certain groups of customers at the expense of other groups of consumers that are objectively discriminated. In this respect, the main issue is how to choose the "right" billing unit, but also how to set the tariff policy to stimulate users that actively participate in the primary selection or in other similar approaches, which aim to improve the waste management system and achieve high environmental standards.

Ever since the Landfill Directive came into force in 1999, landfilling in the European Union has been substituted by other treatment methods such as recycling, waste to energy, composting and other technologies. With the accession process, the Western Balkan countries will have to

¹ Unique Methodology for Determining Communal Service Prices, developed by Standing Conference of Towns and Municipalities – National Association of Local Authorities in Serbia in 2013

adopt the EU standards, including those in the waste management field, which means that they will also have to transform their waste management systems and PUCs. In order for municipalities to establish sustainable waste management systems in accordance with EU standards, they will have to introduce new business activities (source separation, recycling, composting etc.) and understand and know the costs related to the specific services or activities, categorize customers according to their engagement in the process, and set up fair tariff systems that will be reasonable in the long run.

Still, tariff policy is never an easy political topic at the local level and is always connected to social issues. Therefore, the numerous benefits of the introduction of cost-covering prices for the company, municipality, society and the environment need to be communicated to the political decision-makers and the general population.

The German Development Cooperation implemented by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) aims to provide better and higher quality waste management services. In this context, the Open Regional Fund-Modernization of Municipal services, through the “Business Cases for Improved Waste Collection and Valorization” project, developed the methodological approach (ToR) for the introduction of five (5) business processes: optimization of routes, home composting, cost centers, health & safety, and customer base. Together with the partner organizations, Network of Associations of Local Authorities in SEE (NALAS) and Serbian Solid Waste Association (SeSWA), and in cooperation with the following projects: GIZ Climate Sensitive Waste Management (DKTI) in Serbia and GIZ Sustainable Municipal Services (SMS) in Kosovo, 5 business processes have been piloted in Bosnia and Herzegovina, North Macedonia, Serbia and Kosovo. The Cost Centers and Tariffs process represents 1 out of the 5 piloted business processes. It has been piloted in the municipality of Ugljevik in Bosnia and Herzegovina, the municipality of Lipjan in Kosovo and in the municipality of Brus in Serbia.

The purpose of this document is to describe the methodological steps for application of the Cost Centers and Tariffs process, which can be implemented either by the public utility companies, provided that they possess sufficient internal capacities and expertise or through outsourcing it to advisory services specialized in this kind of tasks. In the case of outsourcing, the documents content and structure provides good understanding of the process, the activities required and the outputs expected from the advisor, thus allowing for easy derivation of the service terms of reference.

2 OBJECTIVE

The objective of these TOR is to provide guidelines for setting up cost-covering and fair tariff systems and contribute to better and more sustainable waste management services.

3 BENEFITS OF INTRODUCING COST-COVERING TARIFF SYSTEMS

In the Western Balkans region, there is an inherited problem of low or inadequate prices of waste management service. With the introduction of new business activities and regionalization of the services, this issue becomes even more acute and the adjustment of tariffs ever so more

important. Therefore, the benefits of cost-covering tariffs need to be clearly stated. The benefits of cost-covering tariffs can be divided in those for the PUC, local authority, customers, society and the environment.

Benefits for the PUC include:

- full cost recovery necessary for covering all operating and running costs as well as ensuring means for system improvements and further development through new investments;
- improved economic and operational efficiency through clear financial flows, defining of cost centers and better control of revenues and spending (funds received from certain activities are directed to further development and functioning of that activity);
- improved liquidity of the PUC.

Benefits for the local authority include:

- reduction of the expenditures from the local budget through the elimination of subsidies for the PUC and freeing resources for other purposes. These can be either investments in environmental protection or for social benefits and subsidies to citizens that can't afford the cost-covering prices of the services;
- creating a more equitable environment in which there is no spillover of costs between different groups of users, thus creating a better business environment for investments and economic development.

Benefits for the customers include:

- improved waste management service in terms of upgraded infrastructure, better, more reliable and diversified services;
- transparency of the tariff system and better understanding of the structure of the service costs;
- possibility to engage in waste separation or home composting and receive benefits for it in terms of reduced bills.

Benefits for the society include:

- ensuring compliance with the polluter pays principle, according to which each polluter bears the cost of its actions to the environment, i.e. there is no socialization of the costs;
- achieving environmental standards and meeting the requirements of the EU accession process.

Benefits for the environment include:

- less pressure to the environment through better treatment of waste, less disposal to the landfills and consequently protection of the ground, air and water.

4 COST CENTERS AND TARIFFS – METHODOLOGICAL APPROACH

In order for the Cost Centers and Tariffs business process to be introduced, local authorities and their public utility companies should be advised and guided to perform the following activities.

4.1 Preparatory Activities

Tariff systems are usually defined by billing units of specific service or activity, tariff zones and prices for different groups of customers and represent one of the main instruments of waste management policy at the local level. However, the issue of communal service prices in the Western Balkans region has always been a very sensitive one in a political context, but also in a social one. Therefore, the introduction of Cost Centers and Tariffing based on the advisory service will take place only if there is substantive level of awareness and clear political will with the decision makers at the local level. In order to obtain political backing and general acceptance for the introduction of Cost Centers and Tariffs process, the benefits of such an approach, but also the consequences of keeping the status quo of the financial state of the PUC, state of the equipment and infrastructure and the environment, need to be clearly communicated to all actors at the local level. Obtaining political backing for this process and ensuring willingness of decision makers at company and local government level to support such an approach should be the first step in the process.

Political support is best obtained through direct contact with decision makers in the local self-government and the PUC and should ideally be documented and provided in the form of a letter of interest signed by the mayor and/or a decision of the PUC Director. Such a letter or decision should clearly state the division of responsibilities and obligations between the PUC, local authority and the other actors in the process. The elements of the letter or decision should come out as result of discussions and meetings with the company and municipal leadership and should be drafted after these meetings, containing, but not limited to elements such as setting up a working group for Cost Centers and Tariffing and identifying the working group members, the responsible person in the local authority and in the PUC for the process, the time frame, etc.

4.1.1 Meeting with the Municipality and the Public Utility Company

The first step after the initial contacts with the political leadership is to organize a meeting. The meeting should be attended by the decision makers and technical teams from both the municipal administration (the council member in charge of communal services and/or finance, administration executive or staff members in charge of communal services and finances, public relations officer) and the utility company (financial director, technical executive, representative of the accountant department, etc.).

The purpose of the meeting is to present the scope of the advisory service and the process to be implemented by the local government authority and the PUC, as well as to inform the main actors at the local level about the steps and activities to be taken. At the meeting, an initiative for setting up a working group for the implementation of the process should be launched and followed by a discussion and an exchange of ideas on the tasks and responsibilities to be performed by the group. In addition, the basic principles and benefits should be discussed, as should be the communication approaches and strategies.

4.1.2 Establishment of a Working Group

As a result of the meeting with PUC and the local authority, a Working Group should be formed upon a decision of the mayor or the PUC director. The decision should specify the responsible executive from the PUC or local authority appointed to oversee the implementation of the process. Furthermore, the decision should specify the composition of the Working Group, which should consist of the municipal administration representative responsible for communal services and local budget and the representatives of PUC from the accounting/financial unit. It is recommended to include representatives of customers in the Working Group, to ensure early acceptance of the adjusted tariffs.

A main task of the Working Group is to develop the action plan for implementation of the process, organize the process and report on the activities to the political decision makers. For all these tasks, the Working Group should have the support of the advisor.

4.1.3 Development of an Action Plan (AP)

The AP should include the responsible persons, and the necessary steps and coordination between different actors. The action plan should include the timeline and dates for all necessary activities. In addition, the action plan should consider other municipal waste management plans and actions if they are applicable and exist in a given municipality. It is developed by the Working Group with support from the advisor.

4.2 Data Collection and Customer Categorization

After the preparatory activities have been conducted, the Working Group formed and AP drafted, the process of data collection should begin. For the Cost Centers and Tariffs process, it is the financial and accounting data kept in PUC's books that are key. These data are used for the development of the baseline, but also in combination with other technical data, such as total waste collected, treated and disposed or number of inhabitants that are shown in the annual financial reports, in order to calculate the performance indicators that will be used to monitor the quality and efficiency of the services. Other relevant information that needs to be collected are the planned revenues and expenditures that are presented in the PUC's annual plans and the budget, as well as some statistical data like population and number of households in the municipality and average income per household.

4.2.1 Data Collection

Together with the working group, the advisor should collect all the financial/accounting sources of data and group them according to the actual and planned revenues and expenditures using the excel spreadsheet, i.e. by using the provided tool. The tool itself consists of four workbooks, out of which two are used for (general and financial) data entry, one for calculation and presentation of findings, and one for benchmarking. The financial data are typically segregated by expenditures, total annual costs, operational costs per ton of waste and inhabitant, revenues structure and collection rate (including annualized investment costs; operational costs, energy

or fuel costs, material and supply, maintenance and repair), differentiated for the service delivery chain collection units: transport, treatment/landfilling, recycling. Other costs to be considered are communication, general administration costs, personal costs and other costs, such as internal costs and depreciation. Collection of data must include transfers from the municipal budget to PUC as well as transfers from other national or international institutions, if such exist. For proper analysis, the financial data needs to be segregated according to the cost centers, i.e. structure of services that the company provides.

4.2.2 Preliminary Data Analysis and Client Categorization

In order to propose adjustments to the tariff system, the advisor needs to collect and analyze the tariff customers. This includes:

- analysis of the current customer categorization scheme;
- scrutiny of the current revenue collection with respect to the customer categories;
- categorization of all financial flows per cost centers.

4.3 Process Implementation

4.3.1 Defining all Financial Flows within PUC

To define the financial flows and to show the expenditures and revenues segregated per activity, the advisor will use the excel-based spreadsheet tool developed for this process and available together with this ToR. The advisor will lead the PUC in using the tool to calculate the full cost accounting for the collection, transportation and disposal of waste. In case costs can't be fully identified and attached to a particular activity, such costs should be allocated by using the appropriate key suggested by the advisor (contained in workbook 2 of the spreadsheet).

The advisor will provide support in the identification of:

- direct waste collection costs;
- operational costs;
- infrastructure costs;
- equipment costs;
- operational (direct) staff costs;
- costs of consumables;
- non-operational (indirect) staff costs;
- other indirect costs.

4.3.2 Determining the Level of Price Correction and Recommendations for Adjustment of Tariffs

The excel tool contains formulas in the cross-sections for each activity individually, which automatically identify the price gaps and calculate the necessary percentage of price increase (or decrease) for individual service.



On the other hand, tariff adjustments need to take in consideration variety of other factors, like affordability, time frame in which full cost recovery need to be achieved, investments, billing units, stimulation of certain behaviors or punishing irrationalities.

The advisor should come up with the set of recommendations for adjustment of prices and tariff policy and present it to the Working Group for discussion. Once tariff policy objectives are agreed upon, the advisor can prepare a draft tariff system for further decision making. These recommendations have to be done according to the best practices in financial management and applicable law in the country.

4.3.3 Training of Staff

Training in using the excel spreadsheet tool for the PUC and local government staff working in financial/accounting departments will be provided in accordance with the recommendations outlined during the process implementation in order to ensure monitoring, optimization and adjustment of tariff policies.

4.4 Promotional Activities

Promotional activities are very important for the acceptance of new prices and tariffs and for the maintenance of the high collection rates. All activities that support the implementation of the process or introduction of new tariffs should be developed within or with guidance of the Working Group. Active involvement of the local government and the PUC, with the support of the adviser is necessary for proper communication with customers. The campaign could include debates, public consultations, promotional flyers, discussion with representatives of PUC, promotional posters, participation of PUC or municipal officials in local TV and radio shows, publication of price adjustments provisions via local media, etc.

4.5 Finalization Phase

4.5.1 Evaluation of Benefits Achieved

The achieved benefits will be evaluated by comparison to the baseline defined prior to the implementation of the process and setting the goals in the action plan. The task is done by the advisor and verified by the Working Group.

For the purpose of evaluating the financial benefits achieved, a tracking model will be developed in the Excel application by the advisor (the model will be further described in chapter 7).

4.5.2 Evaluation and Assessment of the Project Sustainability

Regarding the goals set and benefits achieved, the task includes evaluation of the present and future sustainability of the implemented process. The key weaknesses (if identified) will be assessed, and actions for improvement will be developed. The task is done by the advisor.

4.5.3 Development of the Process Implementation Report

The report on the activities completed is to be developed by the advisor. It should consist of general information on the project, the municipality, the public utility company and the expected outcomes of the engagement. It should also refer to the baseline and provide the main characteristics of the existing state of play. The report needs to also consists of information regarding the parties involved (advisor, working group, dedicated employees) and the activities conducted by them. It needs to show the obstacles that were encountered and the mitigation approaches to overcome them. The report will also include recommendations for the tariff adjustments. Finally, it has to provide information on the results and benefits achieved and any applicable suggestions for the further work and development.

5 ACTION PLAN FOR PROVISION OF THE ADVISORY SERVICE

Activity	Time frame															
	Month 1				Month 2				Month 3				Month 4			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
1. Preparatory activities																
1.1 Meeting with the municipality and Public Utility Company																
1.2 Setting up a working group																
1.3 Development of an action plan																
2. Data collection and planning																
2.1 Data collection																
2.2 Preliminary data analysis and categorization of clients																
3. Process implementation																
3.1 Defining all financial flows within the PUC																
3.2 Determining the level of price correction and recommendations for adjustment of tariffs																
3.3 Training of the staff																
4. Promotional activities																
4.1 Promotional activities																
5. Finalization phase																
5.1 Evaluation of achieved benefits																
5.2 Evaluation and assessment of the project sustainability																
5.3 Development of the report on implementation of the process																

6 KEY DELIVERABLES AND INPUTS BY ADVISOR

For the implementation of the advisory service and the above given tasks, it is recommendable to engage one advisor with the profile as given in Section 8 of this ToR.

The key deliverables and inputs to be provided by the advisor for each stage of the service provision are as follows:

Key tasks and deliverables of Advisor	Number of days	Total
1. Preparatory activities		2 days
1.1 Meeting with the municipality and Public Utility Company	0.5 day	
1.2 Setting up a working group	0.5 day	
Development of an action plan	1 day	
2. Data collection and planning		3 days
2.1 Data collection	1 day	
2.2 Preliminary data analysis and categorization of clients	2 days	
3. Implementation of process		5 days
3.1 Defining all financial flows within the PUC	1 day	
3.2 Determining the level of price correction and recommendations for adjustment of tariffs	3 days	
3.3 Training of the staff	1 day	
4. Promotional activities		2 days
4.1 Promotional activities	2 days	
5. Finalization phase		3 days
4.1 Evaluation of achieved benefits	1.5 days	
4.2 Evaluation and assessment of the project sustainability	0.5 days	
4.3 Development of the report on process implementation	1 days	
TOTAL		15 days

7 SETTING UP THE METHOD AND MONITORING THE FINANCIAL BENEFITS

The development and effect of the implemented process in terms of financial benefits will be monitored through indicators defined in the Action Plan for the implementation of the process.

The financial benefits of the Cost centers and Tariffs will be calculated according to the specific tracking model that will be developed in the Excel application by the advisor. The tracking model should have at least the following interconnected links:

Baseline data

Existing prices of basic utility services - tariffs for households and businesses or other groups of users

Total achieved degree of accumulation at the enterprise level

Accumulation of each activity entrusted to a particular PUC individually

Tracking indicators

Performance indicators (productivity, cost-effectiveness, profitability...)

Affordability of basic communal services prices

Effects on the liquidity and solvency of the company

Revenue increase effects

Cost reduction effects

Effects on the investment ability of the company

The model should be set up in such a way as to produce the report on calculated financial benefits.

It is also important to appoint a responsible person from the local self-government to monitor and deliver data.

7. QUALIFICATIONS OF THE ADVISORS

The key qualifications of the advisor for implementation of the Cost Centers and Tariffs process are:

- 1) A solid waste management or financial expert, with a university degree in environmental sciences, engineering, economics, finance, business administration or related disciplines. The expert shall have a minimum of 5 years' experience in waste management project implementation;
- 2) The expert should possess proven knowledge of the local self-government system;
- 3) Experience in the provision of consultancy and advisory services including capacity development measures;
- 4) Involvement in the development of waste management plans, regional as well as local, waste management modeling and option analysis is an asset;
- 5) Experience in policy support for waste management development;
- 6) Experience of computerized environment; MS Office is a must;
- 7) Strong organizational, interpersonal, moderation, facilitation and communication skills.

This model has been developed by the "Business Cases Development for Improved Waste Collection and Valorization" Project, implemented by the GIZ Open Regional Fund for Southeast Europe - Modernisation of Municipal Services, commissioned by the German Federal Ministry for Economic Cooperation and Development (BMZ). The Project was implemented in Western Balkan partner economies in the period October 2017-October 2019, in partnership with the Serbian Solid Waste Association (SeSWA) and the Network of Associations of Local Authorities of South East Europe (NALAS).



Annex 1 - Regional Working Group Inputs - Lessons Learned through Implementation

During the third meeting of the Regional Working Group on Solid Waste Management held in Belgrade on 21 November 2019, the main focus was dedicated to discussion and presentation of the activities, changes and benefits of the piloted business process. The applied interactive method World Café resulted in outputs regarding three aspects: applicability of the piloted process in other local contexts, possible improvements and way of dissemination of the project products. The content of this Annex is an added value to the ToR by bringing pragmatic reflection and recommendations on the process by the experienced practitioners from the region.

Cost Centres & Tariffs Process



World Café

Applicability of the Process



Having in mind the actions taken during the implementation and the benefits of the process achieved, the general opinion of the participants in the World Café leads towards the conclusion that the process could be beneficial and applicable. In terms of applicability, it is firstly very important to have the methodology (i.e. excel tool) that will be applied and used. By using this methodology, management of the overall costs and expenditures would be easier. This Process is very relevant for public utility companies covering more sectors. Moreover, it is relevant for communication with citizens, because transparency of costs and expenditures is important. On the other hand, the mindset of citizens should be changed. It is emphasized that this Process is very important for regional waste management schemes.

Based on the discussion, the conclusion was that the process is fully adaptable and applicable but usually dependent on political support.

Process Improvement



Consideration should be given to the digitalization of this Process and to the development of a software.

The process should be viewed within a larger picture. Moreover, the awareness of customers should be raised and the communication with them improved.

It is important to maintain transparency in the communication with citizens in order to avoid resistance.





Process Dissemination

Besides the regular institutional channels of dissemination of the local level actors, such as utilization of the capacities of the associations of the PUC and LSG (and their regional networks), the process and its benefits could be achieved through peer-to-peer cooperation and good practices. Furthermore, facilitation of a mindset change should be considered.

It is important to create guidelines for implementation of national level regulation.

