

Victorian Regulatory Change Measurement Manual

Version 2.0

November 2013



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This manual supersedes the Victorian Regulatory Change Measurement Manual (Effective 1 January 2010)

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Abbreviations and roles of DTF and VCEC

Abbreviations

NFP Not-for-Profit

RCM Regulatory Change Measurement

DTF Department of Treasury and Finance

VCEC Victorian Competition and Efficiency Commission

Roles of DTF and VCEC, and their contact details

The Economic Policy Group of the Department of Treasury and Finance (DTF) administers the Victorian Government's Red Tape Reduction Program. DTF provides guidance to departments in conducting a Regulatory Change Measurement (RCM) to measure red tape savings of projects in their red tape reduction plans.

DTF contact details:

Website: www.dtf.vic.gov.au/regulatoryreform Email: regulation@dtf.vic.gov.au

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The Victorian Competition and Efficiency Commission (VCEC) provides independent advice on the adequacy of any measurements of red tape savings in accordance with the Regulatory Change Measurement (RCM) manual.

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1. Introduction

1.1 Purpose

The Victorian Government's Red Tape Reduction Program, which started on 1 January 2011, aims to cut red tape by 25 per cent by July 2014 by minimising the costs associated with regulatory requirements and processes.

This manual provides a consistent and straightforward approach for Victorian agencies to measure the impact of changes in regulatory requirements and processes that contribute to the Government's red tape target.

1.2 What is a regulatory change?

A regulatory change occurs where legally enforceable obligations imposed on business and the community are introduced, amended or removed. Examples of regulatory changes include:

- introducing or removing a requirement for parties to seek permission to undertake an activity;
- changing the monetary threshold from when a regulatory obligation will apply (such as, to supply a certificate of compliance); and
- changing the frequency of reporting to the State Government.

In addition, a regulatory change also includes amendments to government administrative processes that support regulatory obligations. Such changes could include:

- offering information technology or other customer service solutions that make it easier for business and the community to comply with regulatory requirements; and
- streamlining internal approval processes to reduce the time taken for businesses to obtain government approval to undertake a regulated activity.

Changes in administrative processes of government that cannot be linked back to legally enforceable obligations are not considered a regulatory change and do not count towards the Government's red tape target.

A regulatory change takes effect (or is implemented) when businesses or other entities *experience* the regulatory change. This is not necessarily the same date on which the legislation or regulation takes effect.

1.3 What is a Regulatory Change Measurement?

A Regulatory Change Measurement (RCM) is a credible, indicative estimate of the reduction in cost to business and the community from a regulatory change or several related regulatory changes. The estimate of the cost reduction is also known as the red tape saving.

It is mandatory for an RCM to be completed for any red tape savings included as part of the Government's Red Tape Reduction Program.

1.4 The proportionality principle

The analysis for an RCM should be reasonable and proportionate to the magnitude of the red tape savings being measured, ensuring value for money in the measurement process. Measurements are expected to be broadly indicative of the red tape reduction and not the product of statistically robust, resource-intensive calculations.

To ensure that proportionality is applied, the following principles should be considered:

- **Treatment of uncertainty:** Where sufficient information does not exist or is too costly to attain to inform measurements, defensible assumptions should be made about the data. For instance, estimates may rely on proxy data or previous similar studies in other jurisdictions. It may also be appropriate to present savings as a range around a central figure.
- **Transparency of assumptions:** Assumptions used in an RCM (e.g. information based on proxy data) should be appropriately documented and referenced. This will allow the reader of an RCM report to understand the calculations underpinning the red tape reduction measurement.

Table 1 provides an overview of the different requirements for RCMs given the estimated annual red tape savings.

Table 1: Proportional Approach to RCMs

Estimated annual red tape savings	RCM requirements
Less than \$2 million in savings	RCM <u>not</u> required. However, a basic assessment of the impact, including a rough judgement-based estimate, is required to be submitted to DTF. Basic assessment will not be published.
\$2 million up to \$5 million in savings	RCM required. Consultation with the affected sector not required where the department can substantiate the savings measurement, or assumptions underpinning it, with an existing study or resource. RCM should be published.
\$5 million and over in savings	RCM required. Consultation with the affected sector required. RCM should be published.

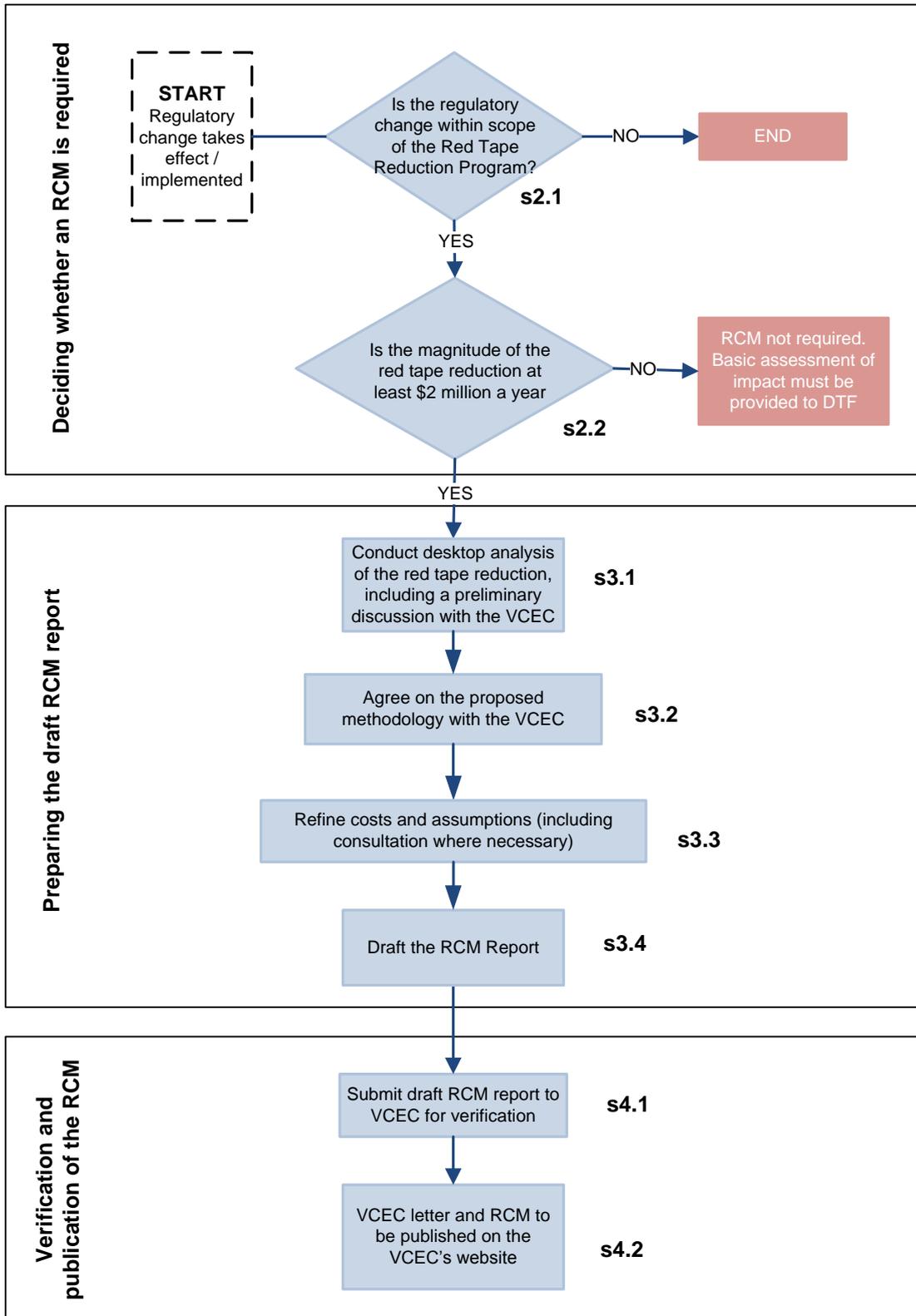
1.5 Step-by-step guide to an RCM

Figure 1 summarises the process for preparing an RCM. It also shows the locations in this manual of guidance on the various steps. For example, s.2.1 (entitled 'Is the regulatory change within scope') refers to section 2.1 in this manual.

For readers familiar with the previous version of the RCM manual (January 2010), the manual has been updated to reflect changes in the Government's policy. Changes in the

approach to RCM's have been highlighted in the 'What's new?' boxes throughout the manual.

Figure 1: Key steps for an RCM



2. Deciding whether an RCM is required

An RCM is required when:

- a) the regulatory change is within scope of the Government's Red Tape Reduction Program; and
- b) the magnitude of the red tape reduction is at least \$2 million a year.

2.1 Is the regulatory change in scope?

Within scope of the Government's Red Tape Reduction Program are costs imposed by legally enforceable obligations from Victorian Government Ministers, departments, regulatory agencies and local governments on:

- business;
- not-for-profit (NFP) organisations;
- government service providers that deliver services comparable to those provided by business or the NFP sector; and
- individuals.

The definition of costs includes:

- compliance costs, including administrative costs and substantive compliance costs;
- delay costs; and
- economic costs of prohibitions¹ (e.g. restrictions on Easter Sunday trading).

The Red Tape Reduction Program scope excludes:

- costs imposed on local governments by the Victorian Government;
- financial costs, involving a direct transfer from a regulated entity to the State Government (e.g. licensing fees); and
- obligations imposed on public sector bodies that deliver services that are not comparable to those provided by business or the NFP sector (e.g. police).

Some of these terms are defined further in Appendix A.

What's new?

The scope of the Government's Red Tape Reduction Program has been broadened to include:

- the impact on individuals, regardless of whether it impacts on the economic activities of individuals or not; and
- the economic costs of prohibitions.

¹The economic costs of prohibitions are included in this manual for completeness. However, to ensure value for money in the RCM process, only a qualitative discussion of these costs is required for an RCM report.

2.2 Is the magnitude of the red tape reduction at least \$2 million?

An RCM is required where there is evidence that the reduction in regulatory costs is at least \$2 million a year. Rough, judgement-based estimates should be used to assess whether the threshold has been met.

Example

A regulatory change that impacts about 4 000 businesses is expected to save them between four and eight hours of administrative work per year. Assuming that the administrative task was previously undertaken by an employee receiving around the Victorian average wage (costing the business \$71.76 per hour, including on-costs and overheads), this change would save businesses between \$1.14 million and \$2.29 million a year. As the upper bound of the estimated savings exceeds \$2 million a year, an RCM is required.

For regulatory changes delivering red tape savings of less than \$2 million a year, an RCM report is not required. However, a basic assessment of the impact is required to be submitted to DTF. The analysis should:

- clearly describe the regulatory change; and
- provide a rough, judgement-based estimate, including the working calculations.

As an indicative guide, the analysis should be approximately one to three pages in length. DTF will review the analysis provided and, where necessary, discuss any concerns regarding the estimate with the relevant Department. Where DTF and the Department do not agree on the estimate, the relevant Department will decide what figure will count towards the Government's red tape target.

What's new?

The threshold for requiring an RCM to be completed has been increased from \$500 000 to \$2 million in savings a year.

For regulatory changes delivering estimated savings of less than \$2 million a year, Departments must submit a basic assessment of the impact to DTF. The estimate provided by the Department will count towards the Government's red tape target.

2.3 When should an RCM be prepared?

For savings to count towards the Government's red tape target, an RCM report for regulatory changes implemented by 1 July 2014 must be completed by 30 September 2014.

An RCM may be conducted before a regulatory change has been fully implemented, if the RCM is undertaken as part of the RIS process or where regulatory obligations have been removed entirely (for example, regulations have been repealed). In these cases, the RCM report can be based on reasonable assumptions and stakeholder input about cost reductions likely to be experienced by affected sectors. It should be noted, however, that to count towards the Government's red tape target the reform must be expected to be fully implemented by 1 July 2014.

3. Preparing the draft RCM report

Once a regulatory change has been determined to be in scope and savings are estimated to be at least \$2 million a year, an RCM report should be drafted following the steps outlined below.

3.1 Conduct desktop analysis of the red tape reduction

Conducting the desktop analysis involves two steps:

1. identifying and documenting the regulatory change; and
2. calculating the costs associated with the regulatory obligations that have changed.

Departments are strongly encouraged to have a preliminary discussion with the VCEC about the regulatory change before commencing the desktop analysis. The VCEC can assist departments with developing the methodology for calculating the cost of the regulatory change.

A preliminary discussion with the VCEC is particularly important where departments are considering engaging an external consultant to undertake the RCM. Departments should contact the VCEC before developing the request for tender documentation.

3.1.1 Identify the regulatory change

To understand the nature of the regulatory change being measured, the following must be identified and documented:

- the regulatory change, by comparing the regulatory obligations imposed under the previous and new regulatory frameworks;
- the sector/s that the obligations are imposed on; and
- the type of costs imposed by those obligations (i.e. compliance costs, delay costs or economic costs of prohibitions).

To ensure a proportional approach to measurement, a top-down approach may be used to determine the changes in obligations experienced by businesses and other entities. For example, rather than identifying each information requirement in an application process, the overall application process requirement may simply be identified.

An RCM should not include business-as-usual costs. In comparing the previous and new regulatory frameworks, it is important to ensure that costs that would have been incurred by the business even in the absence of specific regulation are not included.

For example, in moving from paper based lodgement of annual returns to electronic lodgement, it would be reasonable to assume that most businesses already use a computer and the internet for other business activities so the cost of these would be considered business-as-usual costs and would not be counted as a cost of moving to the new regulatory framework.

3.1.2 Calculate the cost of the regulatory change

The cost calculation is based on:

$$\text{Cost of regulatory obligation} = \text{unit cost} \times \text{quantity}$$

where:

- **unit cost** represents the cost experienced by a particular party in complying with a regulatory obligation; and
- **quantity** represents the number of affected parties and the number or frequency of transactions annually.

Further technical guidance on calculating compliance and delay costs is provided in Appendix B and Appendix C.

Data sources need to be identified for determining the relevant unit costs and quantities. The desktop analysis should primarily use data from the Australian Bureau of Statistics (ABS), internal data sources (such as, synthetic estimates where policy officers fill out forms and search for information to estimate time savings), information from similar studies in other jurisdictions and relevant departmental experts. A list of suitable data sources for unit cost and quantity are provided in Appendix D.

Where there are gaps in the data available or appropriate data is too costly to obtain, assumptions will need to be made. These should be documented and referenced appropriately.

The cost of complying with a regulatory requirement can vary considerably depending on the nature of the regulated entities. The RCM aims to assess the costs experienced by a normally efficient business (i.e. an entity that handles its regulatory tasks neither better nor worse than may be reasonably expected). In some cases, the regulatory costs experienced by small businesses are higher than the costs experienced by larger businesses. Where this is the case, it may be appropriate to segment the affected sector, estimate the costs for each segment and use a weighted average to arrive at a full estimate of the red tape savings.

Measurements of costs should be broadly indicative of the effect of the red tape reduction and need not be the product of exact, resource-intensive calculations. It may be appropriate to present a range around a central point estimate, particularly where any assumptions made impact considerably on the estimated red tape savings of the regulatory change.

The economic costs of prohibitions should be identified but, to ensure value for money in the RCM process, only a qualitative discussion of these costs is required for the RCM.

3.2 Agree on methodology with the VCEC

The proposed methodology for measuring red tape savings should be discussed with the VCEC before drafting the RCM report.

Discussions should focus on identifying:

- issues with the methodology, particularly data sources and any assumptions made;
- what data or assumptions need to be tested through consultation; and
- the level and type of consultation necessary given the estimated savings.

The discussion will provide some certainty to departments that the methodology, when implemented, will be acceptable for verifying the red tape savings.

3.3 Refine costs and assumptions

After an initial desktop estimation and discussion with the VCEC on the methodology, the costs should be refined through further desktop research and/or consultation.

Departments should consult with relevant regulators and departmental experts to confirm whether the data, assumptions and estimated results are plausible.

For RCMs with savings of less than \$5 million a year, consulting with the affected sector may not be required. Consultation is only likely to be required where the department is unable to substantiate the estimate using an existing study or resource. For RCMs with larger savings, consulting with the affected sector is required.

Consultation could involve interviews with individual businesses, relevant experienced consultants working in the sector or industry associations. It may focus on testing particular assumptions and data sources or whether the overall estimated savings are plausible.

What's new?

A proportionate approach to RCMs, where consultation with the affected sector is:

- not required for RCMs of less than \$5 million a year, where the department is able to substantiate the estimate, or assumptions underpinning it, using an existing study or resource; and
- required for RCMs with red tape savings of \$5 million or more a year.

3.4 Draft the RCM report

The RCM report is a technical document that:

- describes the regulatory change;
- details the methodology used to measure the savings, including data sources and assumptions made;
- reports a point estimate or range (with a central estimate) of the dollar value of savings to business and the community from the regulatory change; and
- provides a qualitative discussion of the economic costs associated with removing prohibitions, where appropriate.

Policy justifications for the regulatory change should not be included in the RCM.

In preparing the RCM report, departments are strongly encouraged to adopt the standard RCM report template in Box 1.

Box 1: Recommended standard template for the RCM report

Executive summary

This section should provide a brief summary of the regulatory change and the results of the measurement exercise. It should emphasise that an RCM provides an *indicative estimate* of the red tape savings.

1. The regulatory change

The precise regulatory change should be clearly explained, including:

- the name or description of the regulation or regulatory process (and type, such as legislation, regulation, Ministerial order, etc.);
- the main section number(s) of the regulation or details of the relevant process being measured;
- the date when the regulatory change takes, or took, effect; and
- the duration of the regulatory change (the default duration is 10 years).

2. Methodology for measuring the savings

This section should cover some or all of the following information, as appropriate:

- the methodology used to measure the savings, including:
 - the sources of data, including appropriate references;
 - the assumptions made, with supporting justification;
 - the approach taken to assess how the estimated costs apply to a normally efficient business;
 - the approach taken to determine business-as-usual costs; and
- the approach taken to refine data, assumptions and/or the final estimate. This could discuss the consultation process with the affected sector, such as, the number of interviews conducted (if any), and the range of experts consulted. Businesses or experts interviewed do not need to be identified (unless they gave express permission for such details to be disclosed), however, their views should be reported.

3. Results

This section should outline and report the main quantitative results in a certificate (table) using the template provided below.

Regulatory Change Measurement Certificate

Sector	Business	NFP	Government services	Individuals	Total costs
Costs by Sector	±\$	±\$	±\$	±\$	±\$

Where the regulatory change includes removing prohibitions, this section should provide a qualitative discussion of those economic costs.

Attachments

The attachments to the report should include the underlying detailed spreadsheets and working calculations.

What's new?

A diagrammatical representation of the regulatory change is not required but may be used where departments find it a useful way to explain the regulatory change.

The RCM certificate only needs to report the costs by sector. A breakdown of the costs by cost type is not required.

3.4.1 Check whether the RCM report is adequate

After completing the draft RCM report, departments should check that the report:

- complies with the approach outlined in this manual;
- is written in plain English;
- documents assumptions and cites data sources (subject to privacy limitations);
- calculates the savings accurately; and
- where consultation is undertaken, reports the views of affected parties (subject to privacy limitations).

These are the criteria the VCEC will apply in verifying the RCM report.

The VCEC will not verify the qualitative discussion of the economic benefits of removing prohibitions.

4. Verification and publication of the RCM report

Once satisfied that the RCM report meets the criteria outlined in section 3.4.1, the draft RCM report must be submitted to the VCEC for formal verification.

4.1 Verification by the VCEC

The VCEC will verify the adequacy of the RCM report against the criteria provided in section 3.4.1.

The VCEC's advice will focus on the methodology and quality of analysis. Style, readability and accessibility of the report are secondary considerations.

The VCEC will provide written advice on the quality of the draft RCM assessment within 10 working days of receiving the document.

Once the department has prepared a draft that the VCEC has verified as adequate, the VCEC will provide a letter to the department, which the department should forward to DTF for the reduction to be counted toward's the Government's red tape reduction target.

4.2 Publication of the RCM report

After incorporating any changes that the VCEC requested as part of its advice, the department should submit its final report to the VCEC in an accessible format for publication.

The VCEC will publish the final report, along with the letter, on its website.

The relevant department may also publish the report on its own website.

What's new?

The final RCM report, along with the VCEC's letter, should be published on the VCEC's website.

5. References

The following documents were consulted in preparing this manual:

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[<http://www.treasury.govt.nz/publications/guidance/costbenefitanalysis/primer/cba-primer-v12.pdf>]
- The Treasury (NZ) 2008, Guidelines on the Regulatory Impact Analysis Requirements, Regulatory Impact Analysis Team, November
[<http://www.med.govt.nz/upload/45766/ria-guidelines.pdf>]
- Victorian Competition and Efficiency Commission (Government of Victoria) 2009, A Sustainable Future for Victoria: Getting Environmental Regulation Right, draft report, March [http://tinyurl.com/depylc]

Appendix A: General definitions and concepts

A.1 Legally enforceable obligations

All legally enforceable obligations imposed by Victorian Government Ministers, departments, regulatory agencies and local governments in Victoria are within the scope of the Red Tape Reduction Program, whether through:

- legislation;
- statutory rules;
- legislative instruments;
- mandatory codes and guidelines;
- court rules;
- service agreements; or
- other instruments.

This excludes:

- application of common law that is not specifically co-regulated through state regulation or court rules;
- government imposed contractual conditions of a primarily commercial nature (e.g. purchase of stationery); and
- Commonwealth regulation (with exception of some national harmonisation reforms - see Box 2).

Box 2: National harmonisation

Red tape savings achieved under national harmonisation efforts are within scope of the Red Tape Reduction Program where Victoria's involvement can be demonstrated to achieve a net red tape reduction for the State.

Different types of harmonisation may lead to the need for an RCM, as summarised in Table 3, noting that each change should be assessed for materiality.

Table 3: The need for an RCM under different national harmonisation models

Harmonisation type	RCM needed upon transition?	RCM for subsequent changes?
Victoria refers its powers to the Commonwealth	Yes	No
Victoria introduces mirror (i.e. identical) regulation	Yes	Yes
Victoria introduces inter-jurisdictionally consistent regulation	Yes	Yes
Victoria introduces regulation based on an inter-jurisdictional agreement on consistent principles or frameworks	Yes However, unlikely to have material impact on regulatory burden.	Yes
Adoption of a Victorian regulatory approach by other jurisdictions	No Only if Victoria changes its regulation or regulatory practice in consequence.	No

A.2 Cost categories

The Red Tape Reduction Program includes:

- compliance costs;
- delay costs; and
- the economic costs of prohibitions.

It does not include financial costs.

Detailed guidance, including examples, of the different cost categories follows.

A.2.1 Compliance costs

Compliance costs include:

- costs that directly lead to the regulated outcomes being sought (known as substantive compliance costs) and are often capital and production costs such as the purchase of new equipment, maintenance of equipment, or the undertaking of specified training; and

- costs incurred by regulated entities primarily to demonstrate compliance with the regulation or to allow government to administer the regulation (known as administrative costs).

Examples of compliance costs are provided in Table 4.

Table 4: Examples of compliance costs

Substantive compliance cost examples
<p>Training</p> <ul style="list-style-type: none"> • Providing employees with training to ensure they understand and adhere to the details of a plan or meet regulatory requirements, including fees paid to training provider or institution.
<p>Information for third parties</p> <ul style="list-style-type: none"> • Maintaining signage and warnings required on premises selling alcohol. • Printing statements or providing financial statements to third parties. • Advertising an application. • Preparing disclosure statements, labels and signage to provide information to consumers and workers.
<p>Inputs to comply with a plan or test</p> <ul style="list-style-type: none"> • Undertaking actions set out in a risk management plan. • Undertaking actions and purchasing inputs subsequent to an environment test to follow up on recommendations and ensure compliance.
<p>Purchase and maintenance of plant and equipment</p> <ul style="list-style-type: none"> • Buying and maintaining plant or equipment to meet a regulatory requirement. • Depreciation of plant and equipment. • Building a safety fence around a construction site or scaffolding of appropriate standard (consideration of business-as-usual costs are particularly important for such matters).
<p>Operations</p> <ul style="list-style-type: none"> • Personnel costs – costs of staff, supervision, overseeing, controlling and coordinating costs of internal investigations. • Energy costs, cost of raw materials and auxiliary materials. • Construction of a premise to meet regulatory requirements. • Clean up costs.

Administrative cost examples

Making, keeping or providing records

- Keeping records of training undertaken.
- Collecting and storing records, reports and logs.
- Providing evidence that a product meets labelling requirements.
- Preparing annual financial statements.

Preparing plans

- Preparing risk management plans or updating manuals and emergency plans.

Conducting tests

- Collating and storing information on dates and purpose of an environmental testing program.
- Conducting an environmental test, preparing the test results and storing these results.

Making an application

- Preparing and submitting the documentation for a licence, permission or exemption (e.g. application for a licence to sell alcohol).
- Obtaining expert advice on preparing a licence application.
- Making application for authorisation as an asbestos removalist.

Notifications

- Notifying government about certain activities (e.g. notification of the transportation of dangerous goods).

Conducting internal audits and inspections

- Carrying out internal inspections (e.g. the obligation to carrying out internal inspections of machinery and equipment for health and safety reasons).
- Cost of outsourced activities to directly demonstrate compliance with a regulatory requirement (e.g. payments for services performed by auditors).

Cooperating with Government inspections

- Providing information to, and assisting, official inspectors who visit a business in connection with enforcement of a regulation.

A.2.2 Delay costs

Delays are generally experienced by regulated entities at the point of start-up of a new business project. Delay costs are the expenses and/or loss of income incurred by a regulated entity due to:

- an **application delay**, which is the time that elapses while a regulated entity is going through the process of completing an administrative application requirement that

prevents it from commencing its intended operations (such as an application for a licence, registration, certification, or permit); and

- an **approval delay**, which is the average time taken by between lodgement of an application and a regulator communicating its final decision regarding the administrative application (such as notification, agreement or licence) that prevents the regulated entity from commencing its intended operations. This includes any time taken by the regulated entity to rework the application at the behest of the regulator.

The *direct* costs of preparing an application or re-working it, including time spent on phone calls or meetings as part of an application and approval process is to be counted as an compliance cost.

Examples of delay costs are provided in Table 5.

Table 5: Examples of delay costs

Delay cost examples
<p>Holding costs of land</p> <p>Where a business is forced to buy land earlier than it would otherwise have done (such as for building houses on land) its resource usage (or consumption of capital) has been indirectly affected by the regulatory requirement. These extra costs of holding on to land (not the cost of land itself, which is a business-as-usual cost) comprise:</p> <ul style="list-style-type: none">• higher expenses through interest payments on loans for land; and• capital (equity) locked into an inefficient use, incurring what is known as the opportunity cost of capital, or the loss of income from resources locked into the land.
<p>Standby costs of capital</p> <p>Where physical capital such as plant and machinery is held idle on account of application or approval delays that form part of a regulatory process, the regulated entity incurs:</p> <ul style="list-style-type: none">• higher expenses through interest on loans or rents for such idle physical capital and increased material procurement to maintain physical assets during the delay; and• capital (equity) locked into inefficient use, incurring loss of income from such resources.
<p>Standby costs of labour (or labour downtime)</p> <p>Where human resources are kept idle on account of application or approval delays that form part of a regulatory process, the regulated entity incurs higher operational costs through an extension of its labour contracts or consultancies, or by having to hire additional human resources. These costs include additional overheads and on-costs.</p>
<p>Lost income earning opportunities</p> <p>Regulated entities can experience lost income earning opportunities arising from delays. For example, a restaurant already in operation loses the potential to earn income from the sale of alcohol while waiting for a liquor licence. Any estimates of lost income earning opportunities must take into account any expenses that can be deferred until the approval is obtained.</p>

It is necessary to isolate the impacts of the relevant delay on costs experienced by the regulated entity from other (overlapping) approval processes potentially imposed by multiple regulators. Departments may find it useful to map these overlapping processes in order to identify whether the delay is on the critical path of the investment. Delay costs also need to be carefully distinguished from business-as-usual delays (the time taken by a regulated entity for its own processes). Doing so will avoid the risk of double counting a delay cost.

Box 3 illustrates some issues around the identification of delay costs in a planning application that is made by a property developer.

Box 3: Classifying the costs imposed in a planning process

Purchase of land not a compliance cost

Planning regulations require applicants (often property developers, but sometimes farmers with whom a developer has entered into an agreement to buy land in the future) to own the block of land on which they want to build. Since property developers have to buy the land anyway – as part of their commercial operations – the compliance requirement (to own land) is offset by business-as-usual costs. The net compliance cost is therefore zero.

Delay costs

However, developers can incur delay costs in this process, such as:

Holding costs of land

- Application and approval processes prior to building on a block of land impose a holding cost on property developers who must hold the land for longer (and often for an uncertain period) than they would have otherwise done.

Cost of capital (equity) locked into the project

- In addition, developers experience a loss of returns from their equity that is locked into the project for the duration of the delays.

A.2.3 Economic costs of prohibitions

There are a number of other costs that arise indirectly from the impacts of a regulation or from the way it is administered. Unlike compliance costs, such costs are not incurred as a result of regulatory obligations that directly achieve a regulated outcome. Rather, they limit the ability to create or expand businesses or innovate. These other costs include:

- negative externalities;
- impacts on competition or market structure;
- impacts on innovation; and
- impacts on consumption patterns or resource allocation (those impacts not included in delay costs).

The relevant costs that should be discussed in the RCM report are the economic costs to business or other relevant sectors resulting from prohibitions.

To ensure value for money in the RCM process, the economic costs of prohibitions should be identified but only a qualitative discussion of these costs should be provided in the RCM.

A.2.4 Financial costs

Financial costs arise from an obligation to transfer a sum of money to the Government or the competent authority². Examples include:

- administrative charges;
- fees for applying for a permit;
- taxes;
- premiums payable to Government for mandatory insurance (e.g. WorkCover premiums)³; and
- levies.

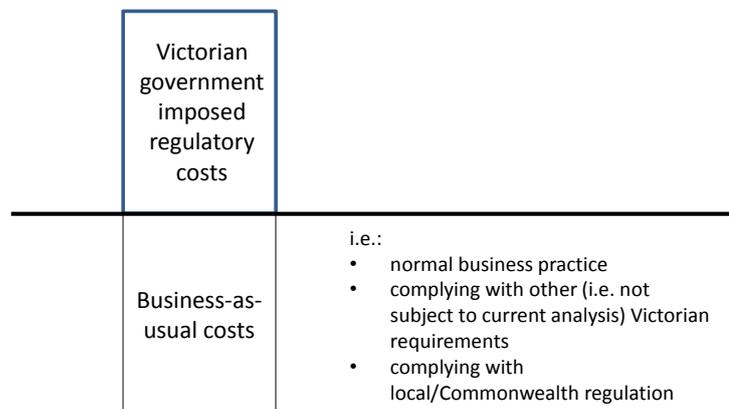
Financial costs are excluded from the Red Tape Reduction Program.

A.3 Business-as-usual costs

Regulated entities often incur a range of costs, including administrative and delay costs, even in the absence of a specific regulation. Such costs incurred by a regulated entity as part of its normal business practice because of other regulatory obligations (such as other Victorian requirements not subject to current analysis or those of the Commonwealth) are known as business-as-usual costs.

The costs of a particular regulatory obligation should be seen as the increment or addition to costs that are incurred by a regulated entity in the absence of that obligation. When identifying regulatory costs, it is therefore crucial to subtract business-as-usual costs. Figure 2 illustrates this concept, with Box 4 providing an example.

Figure 2: Regulatory cost is that part of total costs that exceeds business-as-usual costs



² A competent authority includes a private business that receives money as an agent of the Government.

³ Premiums paid to a commercial insurance provider for mandatory insurance are a compliance cost and as such are within scope of the Government's red tape reduction target.

Box 4: Calculating total remuneration for payroll tax

Businesses paying State payroll tax are required to calculate their total remuneration. However, they also do this:

- for their own purpose (management of staff costs) – being direct BAU costs;
- to determine WorkCover premiums; and
- to meet Commonwealth financial reporting obligations.

In the absence of payroll tax regulation, businesses would still calculate their total remuneration and as such this requirement would be considered a business-as-usual cost and not count towards to the regulatory costs of payroll tax regulation.

It can be difficult to identify business-as-usual costs, in which case, assumptions regarding these costs will need to be made and appropriately disclosed in the RCM report. Rules of thumb can be applied in such cases to assess business-as-usual costs, in consultation with departmental experts or the affected sector (noting that it is not mandatory and in some cases the industry may have never known a 'no regulation' environment and therefore may not be able to provide useful guidance). The key to understanding whether there are any business-as-usual costs is to measure the extent to which business practices or behaviours have actually changed. That is, if there is no or limited changes in behaviour following the regulatory change, then regulatory costs may not have been reduced.

Business-as-usual activities relate to the current regulatory environment and do not require determinations about future business/government behaviour.

A.4 Normally efficient business

The cost of complying with a regulatory requirement can vary considerably depending on the regulated entity. The RCM aims to assess the costs experienced by a normally efficient business, which is a business (or regulated entity) that handles its regulatory tasks neither better nor worse than may be reasonably expected. This cost experience can be deemed to be representative of the experience of similarly regulated entities in that sector.

Note that this should not be taken to mean that the normally efficient business performs its regulatory tasks perfectly. For instance, it is not an expectation (for the purposes of the RCM) that businesses always complete complex application forms perfectly the first time. An average error rate in complying with complex regulatory requirements can therefore be recognised, including some reasonable amount of re-work in response to feedback or advice from regulators.

In some cases, the regulatory costs experienced by small businesses are higher than the costs experienced by larger businesses as they may not have specialist in-house expertise to deal with complex regulatory requirements. It may be appropriate to segment the affected sector in such cases. In general, no more than three segments should be needed for any given sector.

It is not necessary to conduct business interviews to determine these costs.

Appendix B: Calculating compliance costs

This section discusses the formulae for calculating compliance costs.

B.1 Administrative costs

The basic formula for calculating administrative costs is:

$$\begin{aligned} \text{Administrative cost} &= \text{unit cost} \times \text{quantity} \\ &= (\text{tariff} \times \text{time}) \times (\text{population} \times \text{annual frequency}) \text{ OR} \\ &= \{ \text{internal cost (i.e. tariff} \times \text{time)} + \text{external tariff} + \text{other significant costs} \} \times \\ &\quad (\text{population} \times \text{annual frequency}) \end{aligned}$$

Unit cost

The unit cost of an administrative obligation consists of the sum of (a) internal wage tariff (cost of employees who undertake administrative activities), (b) the external tariff (cost of contracting out administrative activities), and (c) other costs necessary to complete the administrative activity. Therefore:

$$\text{Unit cost} = \text{internal cost (tariff} \times \text{time)} + \text{external tariff} + \text{other significant costs}$$

where:

- the **tariff** is labour tariff (see Appendix D, section D.1);
- the **time** refers to the internal time (in minutes or hours) that it takes a normally efficient business to perform an administrative activity;
- the **external tariff** consists of what a regulated entity pays to external service providers for administrative activities undertaken by that service provider to enable the regulated entity to comply with an information obligation. The external tariff includes the cost of accountants, legal workers and the like and is usually expressed as a total cost; and
- **other significant costs** include capital costs incurred by a business directly to comply with a specific information obligation, noting that some capital costs such as internet connections are captured in overheads. Where a capital investment is made specifically for the purpose of meeting an information obligation, e.g. the purchase of a meter, it will generally have a service life of several years. A fixed annual cost, equivalent to the total cost divided by expected service life, should be used in the calculation.⁴

Quantity

The formula for calculating the quantity for an administrative cost calculation is described below:

⁴ This is similar to the straight line depreciation method.

Quantity

$$= \text{population} \times \text{compliance rate} \times \text{annual frequency}$$

where:

- **population**, or the number of regulated entities the information obligation affects, has been defined in Appendix D, section D.2;
- **compliance rate** has been defined in Appendix D, section D.2, noting that the compliance rate for an information obligation may not always be the same as the compliance rate for the overall regulation; and
- the **annual frequency** of the information obligation has been defined in Appendix D, section D.2.

B.2 Substantive compliance costs

In the case of substantive compliance costs it may be useful to distinguish between transition and structural costs, as discussed below:

- **Transition costs** are **one-off** adjustment costs or investments that are incurred in moving to a new regulatory regime or process. In the cost calculation, these costs are spread over the duration of the regulation (the default being 10 years).
- **Structural costs** are **ongoing costs** that recur each year, and are therefore measured on an annual basis.

The general formula for calculating substantive compliance costs is provided below:

Substantive compliance cost

$$\begin{aligned} &= \text{unit cost} \times \text{quantity} \\ &= (\text{tariff} \times \text{time}) \times (\text{population} \times \text{frequency}) \text{ OR} \\ &= (\text{one-off cost of physical asset} \times \text{number of assets}) \times (\text{population} \times \text{frequency}) \text{ OR} \\ &= (\text{annualised depreciation} \times \text{number of assets}) \times (\text{population} \times \text{frequency}) \end{aligned}$$

Unit cost

Substantive compliance costs include labour or capital costs or a combination of these.

Where:

- **labour costs** are involved, the formulae outlined in the administrative costs section (B.2) would be applicable.
- **capital costs** are involved, these are generally of two types:
 - purchase costs, being a one-off purchase cost of a physical asset; and
 - investment costs, being ongoing costs (e.g. annualised depreciation of the relevant asset).

Quantity

The formula for calculating the quantity is the same as that used for administrative costs:

Quantity

$$= \text{population} \times \text{compliance rate} \times \text{annual frequency}$$

B.3 Underlying spreadsheets, working calculations and assumptions

Spreadsheets that show detailed calculations of unit costs and quantity for each regulatory cost obligation should be prepared. To the extent possible these should be published as an attachment to the RCM report. In any event, detailed working calculations and assumptions should be appropriately documented in the report as part of a text-based description.

B.4 Annualised figure for uneven regulatory change

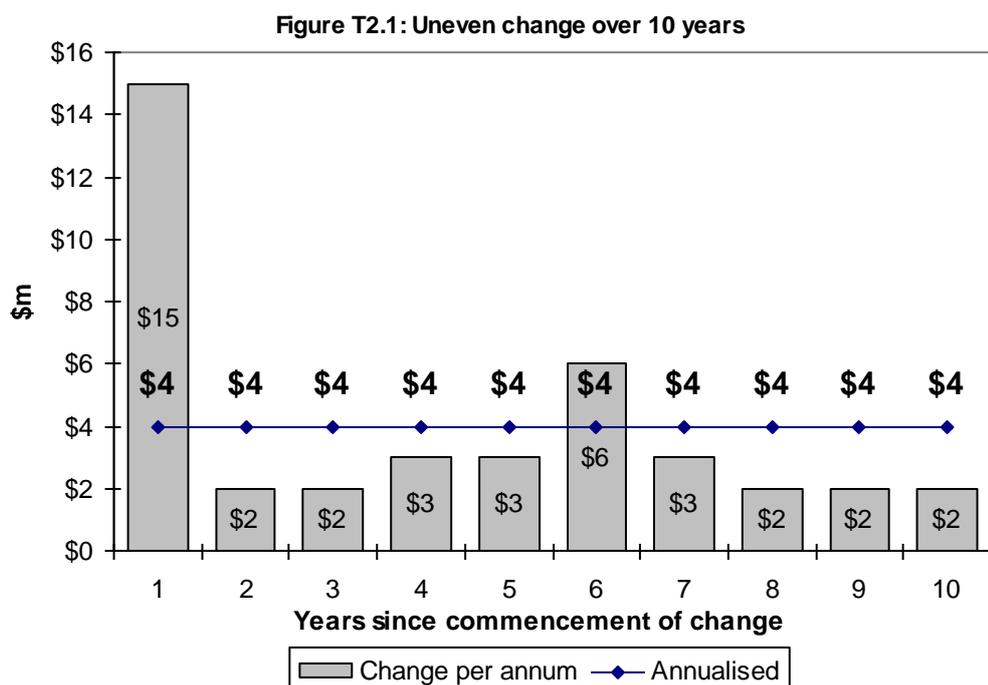
- **Default duration of a regulatory change:** For the purpose of an RCM, the default duration of a regulation or regulatory change should be taken as 10 years except where the change is implemented over a shorter period.
- **Annualising the cost estimates:** For an RCM, an annualised measure of the change (not discounted present value) should be calculated in the following manner:
 - for regulatory change, the uptake of which does not vary over time, the impact of the change in the first year should be treated as the annualised measure of change; or
 - for regulations that impose varying costs over time, the total change over the duration of the regulation or regulatory process should be divided by that duration (section B.4.1 provides more detail).

For regulatory change which does not vary over time, the change in the first year is the relevant annualised measure.

For regulations that impose varying costs over time (uneven regulatory change), the total change over the duration of the regulation or regulatory process should be divided by the relevant number of years. Two cases are illustrated below.

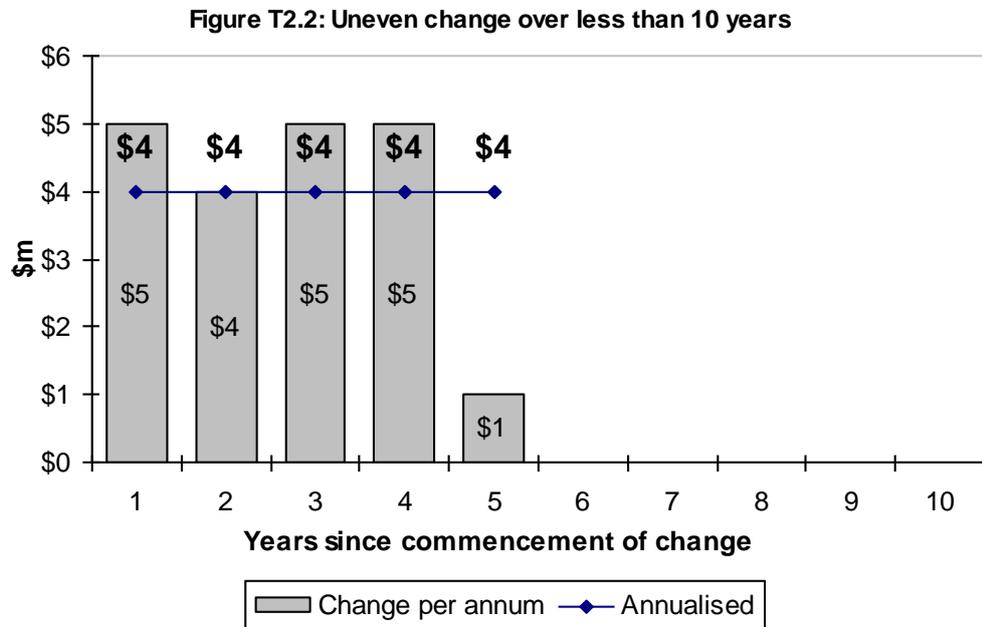
B.4.1 Change distributed unevenly over 10 years

Where the change in regulatory burden is distributed unevenly over 10 years, the average of the change over 10 years yields the relevant annualised figure for an RCM. For instance, in Figure 3, the annual change in burden reported in the RCM report should be \$4 million.



B.4.2 Change distributed unevenly over less than 10 years

Where a change in regulatory burden is distributed unevenly over less than 10 years, the average of the change taken over the relevant duration yields the appropriate figure for an RCM. For instance, in Figure 4, the annual change in burden reported in the RCM report should be \$4 million.



Appendix C: Calculating delay costs

This section discusses the formulae for calculating delay costs.

C.1 Causes of delay

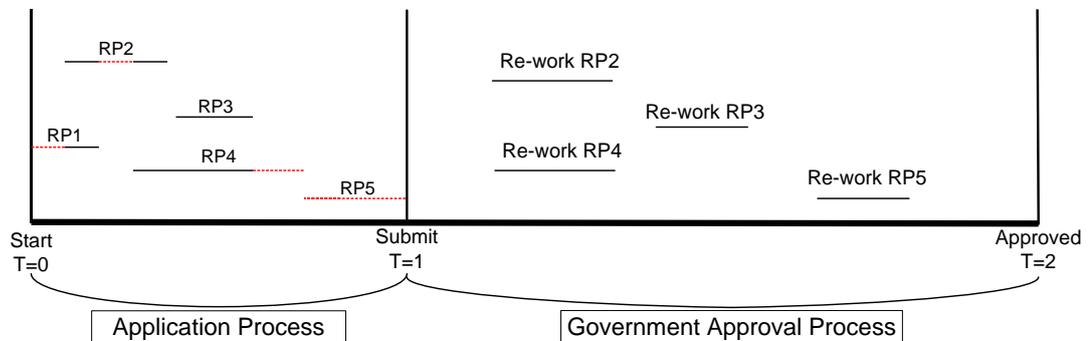
Delay costs are the expenses and loss of income imposed on a regulated entity through an application delay and/or an approval delay. The cause of a delay can accordingly be separated into two main areas:

- the **application process** (e.g. obligation to lodge a planning application); or
- the **approval process** (e.g. requirement to wait for government approval of application).

The direct costs of preparing an application or re-working it, including time spent on phone calls or meetings as part of an approval process should be counted as a compliance cost.

It is important to ensure that business as usual costs are identified clearly and that the delay is attributed only to processes that actually impose a delay, i.e. are on the critical path of the activities of the regulated entity. Removing such regulatory activities should directly expedite business activities. Figure 5 illustrates the two kinds of delays.

Figure 5: Types of delays (RP = Regulatory process)



Identifying application delays

To be counted as a delay, an application delay must meet all of the following criteria:

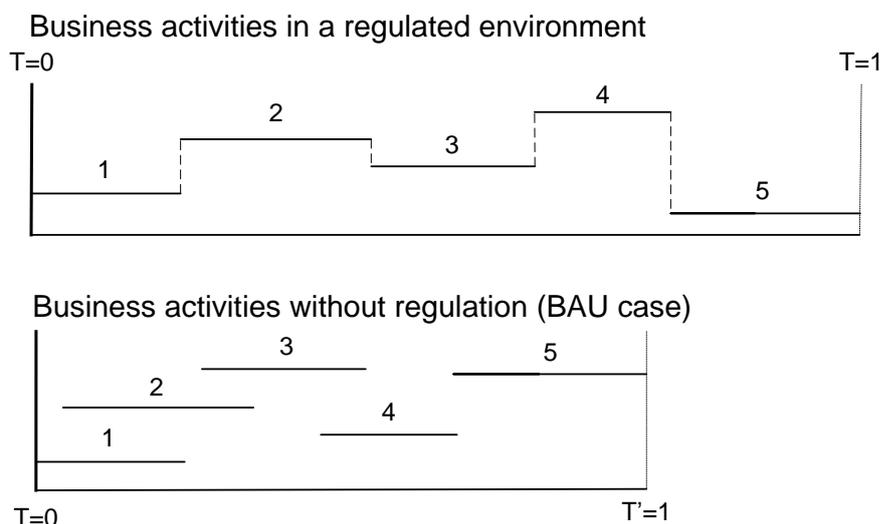
- these delays must prevent the regulated entity from commencing its intended operations;
- reducing the delay should directly impact the critical path (this refers to the widely known Critical Path Method in project management literature⁵). The critical path is shown by the dotted lines in Figure 5. This means that parallel processes during the application process have not been double-counted; and

⁵ The critical path determines the shortest time to complete the project and it is the longest duration path through a network of tasks. Critical tasks are tasks on the critical path. More details on the critical path method are available readily on the internet and in standard project management books.

- business as usual processes that would otherwise have been undertaken as a parallel process during the period of preparation of an application have been excluded or the time spend on these activities subtracted.

In Figure 6, time $T'=1$ under the unregulated situation is theoretically the earliest time a business could conduct its normal operations (lower figure). However, in a regulated situation, business may stagger its necessary activities over a longer duration (upper figure).

Figure 6: The effect of business-as-usual on delays



Identifying and understanding all business and regulatory activities clearly is necessary to identify the precise cost of application delay.

Identifying approval delays

The moment such an application is lodged with a regulator, the time lapsed can be counted (from $T=1$ in Figure 5), subject to a deeper understanding of the overall processes underway. In general, to initiate an approval delay, the application lodged with a regulator should generally conform to regulatory requirements (e.g. by furnishing relevant documentary evidence) to a standard expected of a normally efficient business.

Since normally efficient businesses may be required to put in a moderate amount of re-work despite their best intentions to submit a perfect application (for the regulatory requirements may be too complex or unclear even for the most expert business), a moderate level of re-work should be counted as part of the approval delay. The average time for re-work taken by businesses can be counted towards this purpose.

To be counted as a delay, an approval delay must meet all of the following criteria:

- the delays must actually prevent the regulated entity from commencing its intended operations;
- parallel processes of re-work during the approval process must not have been double counted (thus, in Figure 5, the re-work of processes 2 and 4 must not be double-counted); and
- business as usual processes that would be undertaken in parallel during approval of an application have been subtracted.

The average duration of an approval (difference between $T=2$ and $T=1$ in Figure 5 – including the re-work period), can be determined by considering a normally efficient business and a

normally efficient regulator (a concept similar to normally efficient business, when applied to a regulator).

Underlying causes of delay

Where it is felt necessary to gain a better understanding of underlying costs, the cause of delay can be disaggregated into its underlying causes, such as:

- underlying requirement to pay land taxes and rates during a period of delay; and
- underlying requirement to maintain structures (such as fences) during a period of delay.

Calculating delay costs

A precise calculation of delay costs can potentially require the consideration of:

- complex time values of future costs and returns; and
- difficult to obtain data for the relevant variables.

Given the difficulties inherent in calculating delay costs, **simplifying assumptions** should be made where doing so would be reasonable.

Delays impose both direct costs and opportunity costs.⁶ The general formula for assessing delay costs is, therefore:

Delay costs = unit cost x quantity

$$= (\text{tariff} \times \text{time}) \times (\text{population}) \text{ OR}$$

$$= \{(\text{costs incurred} + \text{opportunity cost}) \times \text{delay period}\} \times (\text{affected units})$$

Businesses often take actions to mitigate the costs imposed by delays. For instance, they may rent out the asset which they are required to hold during an application process. Revenues received from these mitigating actions must be counted, and used to offset some of the costs imposed by regulatory delays. An example of a delay cost calculation that takes into account such a mitigating action is provided in Box 5.

⁶ Opportunity costs are costs imposed through opportunities foregone during the period of delay. For example, the cost of choosing to train as a lawyer is not merely the direct cost (i.e. tuition fees, the price of books, and so on), but also the opportunity cost (e.g. lost income from a salaried job). The total cost incurred is therefore the direct cost plus the opportunity cost, or: the tuition fees plus lost salary.

Box 5: An example of a delay cost calculation

Planning application process

Scenario

Box 3 (in Appendix A, section A.2.2) discussed an example of a delay cost (approval delay) imposed by a planning approvals process. Box 5 calculates the savings delivered to developers if the time for approval is reduced. The quicker approval process saves property developers an amount of time = t . This time saved is over and above various business as usual processes.

Assumptions

Assume that some property developers are able to rent out the land during the approval period, thus minimising idle capital.

Assume that the best alternative use for capital (equity) for the developer is to invest in other property development. The annual value of such alternative use is calculated by considering the return from such equity spread over the duration of the entire property development project.

The calculation

Two types of savings are delivered by reducing the time for approvals by t :

- direct savings (from reduced holding costs of land) during the period t ; and
- savings in opportunity costs (of capital locked into less productive use) during the period t .

The formula for reduced holding costs of land is provided first:

$$\text{Holding costs incurred} = \frac{C \times (+\tau + r) + \theta \times R}{12}$$

where

- C = total land cost, *per hectare*
- i = interest rate, in percent per annum, charged by lenders
- τ = land tax, in percent per annum *per hectare*
- r = Council rates, in percent per annum *per hectare*
- θ = proportion of area rented out (if any) during application process, per annum
- R = rents, in dollars a year per hectare

The opportunity costs reduced can be worked out as follows:

$$\text{Opportunity cost} = \frac{\frac{TC - IT}{D} \times ROI}{12}$$

where:

- TC = total cost of the investment project per hectare, including land, raw material, wages
- IT = total interest and taxes paid out on the investment project, per hectare (excluding interest payments on land which have been separately counted)
- D = originally planned project duration, in years
- ROI = return on investment of the investment project, per cent a year

Combining these two terms, and multiplying them by the total land (in hectares) affected by the more efficient approvals process gives us the estimate for the delay costs reduced.

$$\text{Delay costs reduced} = \frac{K \times (1 + r)^t \times R \times \left[\frac{TC - IT}{D} \times ROI \right]}{12} \times t \times L$$

where:

- t = reduction in time in the approval process, in months *over and above BAU time of acquisition of the asset*
- L = total land affected in hectares

Sources of data

It would be almost always necessary in the case of delays to talk to a few industry experts and, where appropriate, to conduct business interviews, to arrive at data relevant to the calculation. Simplifying assumptions and rules of thumb may need to be used where appropriate.

Appendix D: Cost variables – Definitions and data sources

D.1 Unit cost variables

Labour tariff

The **labour tariff** is the **wage rate** plus **overheads and on-costs** for activities performed internally. It is calculated by multiplying the hourly wage rate with a suitable rate for overheads and on-costs.

- The **hourly wage rate** is the gross wage received by an employee in payment for his/her work. The rate for a paid job with comparable skills is used for volunteers.
- **Overhead costs and on-costs** include the non-wage costs of employees such as fixed administration costs, for example expenses for premises (rent or building depreciation), telephone, heating, electricity, IT equipment, etc, as well as on-costs such as superannuation guarantee payments, payroll tax, WorkCover premiums and fringe benefits tax. The default overhead and on-cost rate is 75 per cent of the wage rate.

Data sources

The **wage rate** can be obtained from a number of sources, including internal accounting systems, detailed Australian Bureau of Statistics (ABS) earning data (for example, broken down by sector) or Victorian public service salary bands. However, an appropriate proxy wage rate that could be used in all RCMs is the rate calculated from the ABS Average Weekly Earnings (catalogue no. 6302.0). The current wage rate based on ABS average weekly earnings data is available from www.dtf.vic.gov.au.

The current wage rate based on ABS average weekly earning data should be used to **value the time for individual's leisure activities** and **volunteering** (no overheads or on-costs should be added).

For **overheads and on-costs** a default rate of 75 per cent of the hourly wage rate should be used, unless circumstances suggest otherwise.

External tariff

An **external tariff** is what a regulated entity pays to an external service provider for activities undertaken by that service provider to enable the regulated entity to comply with a regulatory obligation.

Data sources

Sources of **external tariff** data for regulatory costs could include:

- advertised prices by relevant service providers;
- information in tender documentation received by government (this may provide a good proxy for the price of similar services engaged by the private sector);
- recent relevant RCMs; and
- consultation with departmental staff or industry experts.

One-off cost of a physical asset

The **one-off cost of a physical asset** is its purchase price, such as the market price of a ladder.

Data sources

Market data, such as advertised prices, can be used to determine the **one-off cost of a physical asset**.

Annualised depreciation rate

The **annualised depreciation rate** is the rate by which a physical asset loses value (i.e. depreciates) each year. This rate is normally a proportion of its purchase price (historical cost) distributed over its effective life. In some cases the effective life of an asset could be directly impacted by the duration of regulation. For instance, where a regulation requires the purchase of a durable asset for five years but that asset then has no market value after that period. Such considerations should be taken into account when estimating the depreciation rate.

Data sources

The **depreciation rate** should generally be calculated using the **straight line method**, which allocates the purchase price (historical cost) of the asset over its effective life. If a particular plant has an effective life of five years, 20 per cent of its value is depreciated each year.

The **effective life** of most assets can be obtained from the Australian Taxation Office website (www.ato.gov.au), in particular by referring to Taxation Ruling TR 2000/18.

Departmental finance areas may also be able to provide other potential sources of data on the depreciation rate and effective life.

Interest

Interest is the amount paid out as interest on borrowed capital.

Data sources

The **interest costs** borne by a regulated entity depend on the risk category of that entity (e.g. large and well-established businesses generally pay lower interest costs compared with a newly established small business).

Appropriate market proxies should be identified for the actual interest costs borne by a business or regulated entity.

Where a riskless rate is appropriate (only in very rare cases), the annual rate set by the Treasurer as part of the state budget process can be used (available at www.dtf.vic.gov.au).

Time

Time refers to the internal time (in minutes or hours) that it takes a business to perform a regulatory activity.

Data sources

The **time** taken to complete a regulatory activity can be estimated by departmental officers but may need to be confirmed through consultation with policy and industry experts.

D.2 Quantity variables

Population

Population refers to the number of regulated entities (e.g. businesses, not-for-profit organisations or individuals) affected by a particular regulatory obligation.

The analysis of population may require **segmentation**. Where the affected population is diverse, costs experienced by different parts of the population (sector) may vary significantly. For instance, large businesses may take much less time to complete a particular regulatory task in comparison with smaller businesses. Where the variation in costs is significant, the affected sector can be disaggregated into generally not more than three segments (e.g. small, medium and large⁷).

Data sources

Data regarding the number of affected regulated entities (i.e the **population**) can be obtained from government registers, industry association statistics and the ABS.

Annual frequency

Annual frequency is the number of times an affected business or other entity delivers or complies with a regulatory obligation each year. Therefore where an obligation is required every second year, its frequency becomes 0.5.

⁷ According to ABS, a small business employs less than 20 people, medium between 20 and 200, and large more than 200.

Data sources

The **annual frequency** of an obligation should be derived directly from the regulation. In some cases departmental or agency information, such as the number of inspections or audits, can be a useful source.

Compliance rate

Not all affected sectors comply fully with a given regulatory requirement either due to lack of knowledge, lack of enforcement, or because technological change has made the regulatory requirement redundant. Where evidence exists of less than 100 per cent compliance with a regulatory requirement, the actual rate should be used to avoid overstating the actual regulatory burden. Where no information is available regarding actual compliance, 100 per cent compliance should be assumed.

Data sources

Data on the actual **compliance rate** can be obtained from departmental experts and inspectorates. Where no information is available regarding actual compliance, 100 per cent compliance should be assumed.

Where the uptake of a regulatory change is expected to vary over time (such as is often the case with information technology solutions), there is a need to account for such variation through an appropriate **uptake rate**.

Data sources

Data on the **uptake** of a regulatory processes can be estimated in consultation with departmental or industry experts.

