

Briefing Note 1

counting costs

Making Costing Count: Improvement
Actions for Council Managers



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STATEMENT OF PURPOSE

This briefing is written for managers in the public sector, and Board and Cabinet members. It supplements CIPFA's *Counting Costs: Understanding and Using Costing Information to Make Better Decisions*. It draws on the research of the Audit Commission to give practical examples of ways managers can take action to improve the use of costing information in councils. It includes case studies, largely from the private sector, as examples to help promote better understanding of costs by local public bodies and better use of cost information to support decision taking. The case studies offer managers valuable learning points that can be directly transferred to the public sector. The full content of case studies is accessible from the CIPFA Financial Management Panel webpages. Further copies of this briefing can be downloaded from the CIPFA FM Panel's webpages and the CIPFA shop.

1 INTRODUCTION

Understanding cost is an essential part of sound financial management for all organisations. Companies in the private sector need to understand costs to control them, to stay financially viable and deliver returns to their shareholders. Similarly, in the public sector, understanding costs helps managers see and assess the relationship between spending and performance and hence improve value for money for the taxpayer.

The current state of the public finances means that local public bodies will need to reduce their spending. In this climate relevant, high-quality cost information needs to be the basis for decisions on where and how to cut spending.

Audit Commission research shows that many local public bodies fail to understand the costs of their various activities in a way that will help them make good decisions.

This briefing is designed to help senior managers and Board and Cabinet members understand the importance and the potential in understanding costs. It includes case studies from the private sector which illustrate how understanding cost information can help drive down costs and improve performance and these have been selected because there are parallels for public bodies. Fuller versions of these case studies can be downloaded from the CIPFA website. In addition, a second briefing looks at how organisations can build a more cost conscious culture that affords cost information a higher priority.

2 WHERE ARE THE PROBLEMS?

Audit Commission research shows that local government understands how important it is to gather the right information and use it well for decision taking. Ninety-four per cent of councils said that information has become an increased strategic priority. The cost implications of a decision, alongside the context and the expected outcomes, are significant relevant information for most decisions.

There are examples of good practice. But Audit Commission research has often found understanding of costs to be an area of weakness:

- Work on competition and contestability found that few councils understood the costs of their own services well enough to form sound judgements about the relative merits of in-house and contracted service delivery (Ref.¹).
- Research on strategic service delivery partnerships found that some councils had entered partnerships without a formal business case, or with an inadequate one, and that few councils had a good grip on the costs of the procurement process (Ref.²).
- Research into the financial challenge for councils of an ageing population found that most councils do not know enough about the costs they risk incurring because their population is ageing. They do not know about the potential savings from preventive and collaborative action (Ref.³).
- Research on fees and charges found that councils do not understand the cost of services well enough to know who they are subsidising and when. Managers often present spending information to councillors net of charging income, which obscures the true cost of the service (Ref.⁴).
- More generally, research in financial management found lack of the right information to be a significant barrier to effective cost management. Some councils are not collecting and analysing cost information for decision taking. Other councils do collect the data, but fail to turn it into usable information or to share it across departmental boundaries (Ref.⁵).

3 DECISION POINTS IN THE BUSINESS CYCLE

Board and Cabinet members and senior managers make different kinds of decisions at different points in the business cycle. Some decisions are made regularly in the business cycle; others fall within no particular time horizon or are ongoing. Common decisions that should be supported by a good understanding of costs include:

- planning the future, for example strategic budget-planning decisions
- deciding whether to proceed with strategic projects, for example investments in public assets
- deciding whether to implement new policies and services or withdraw from activities
- monitoring and control of activity and budgets in year
- choosing between alternative ways of providing services, including whether to outsource or provide in-house

1. Audit Commission (2000) *Healthy Competition: How Councils Can Use Competition and Contestability to Improve Services*

2. Audit Commission (2008) *For Better, For Worse: Value for Money in Strategic Service Delivery Partnerships*

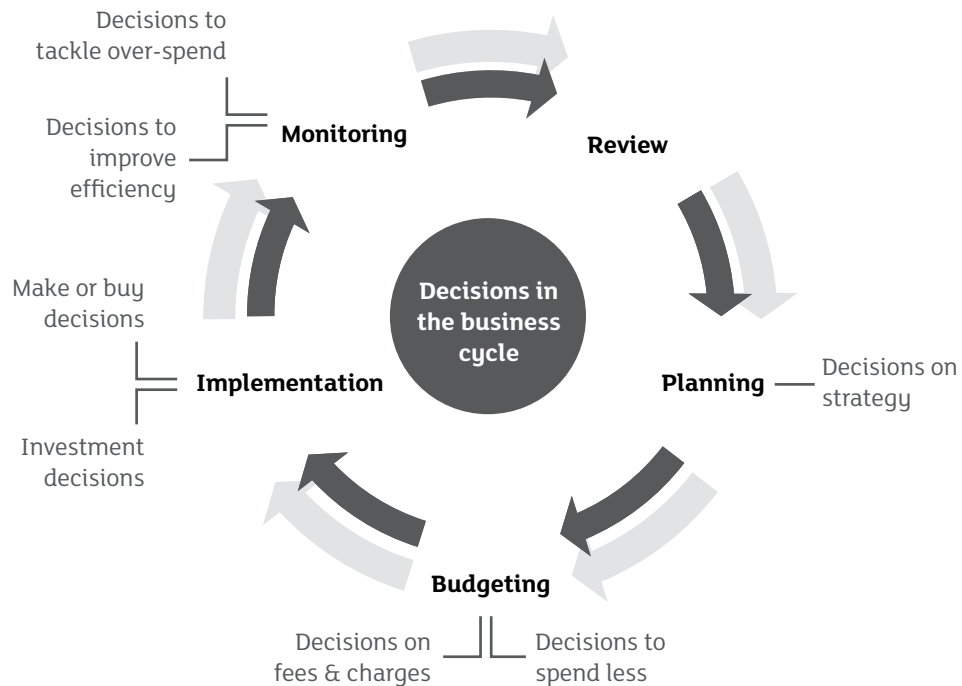
3. Audit Commission (2010) *Under Pressure: Tackling the Financial Challenge for Councils of an Ageing Population*

4. Audit Commission (2008) *Positively Charged: Maximising the Benefits of Local Public Service Charges*

5. Audit Commission (2004) *Improvement Through Better Financial Management*

- deciding on activity levels, the mix and design of services or how to improve efficiency and productivity
- reviewing and setting charges for services to users and customers, and
- responding to unexpected events, for example severe weather.

Figure 1: Decision points in the business management cycle



For any of these decisions to be well-founded, the information to support them has to be relevant, of high quality and well presented (RQP) (Ref.⁶).

Relevance: Decision takers need cost information that covers all the significant cost factors that might influence the decision. Relevant cost information will have the right level of aggregation for the decision (for example geography time or type of cost information).

Quality: Cost information needs to be transparent in its accuracy validity reliability timeliness and completeness.

Presentation: Managers should present information to decision takers clearly so they can understand both the information itself and the story it tells. They need to tailor the presentation to the particular preferences of a decision taker.

What RQP means in practice varies both by decision and by decision taker. Clearly, the same cost information is not relevant to all decisions, nor is the same presentation of cost data right for a financial analyst and a Board member. The first step in providing the right cost information is to understand what decision it is to support.

The table overleaf summarises the cost information managers are likely to need for some of these decisions. The table shows that it is impossible to make a well-founded decision without understanding some aspects of cost. It also illustrates how the cost information needed to support decisions at each point in the business management cycle differs.

6. Audit Commission (2009) *In the Know: Using Information to Make Better Decisions*

Type of decision	Taken by	Example decisions	Relevant cost information
Strategic	Priority setting	Board members	<p>Should we change entitlement for a service?</p> <ul style="list-style-type: none"> ■ <i>What is the full cost of providing the current service?</i> ■ <i>How does it vary by service user?</i> ■ <i>What does each part of the current service cost?</i> ■ <i>What are the cost drivers for this service?</i> ■ <i>How would costs change if ... ?</i>
	Investment	Board members	<p>Should we invest to save?</p> <ul style="list-style-type: none"> ■ <i>What are the costs and benefits attributable to the investment through its life?</i> ■ <i>Do we understand the impact on costs and benefits of changes in the timeline?</i> ■ <i>Do we understand the forecasting assumptions for the movement of cost elements and accuracy limits on forecasts?</i> ■ <i>Are any residual costs clear?</i> ■ <i>Will there be cost impacts on other departments, or partner organisations?</i>
	Alternative service provision	Board members	<p>Should we outsource or deliver in-house?</p> <ul style="list-style-type: none"> ■ <i>What are the relevant stand-alone costs of the service?</i> ■ <i>Which costs are saveable? Which will remain with the organisation?</i> ■ <i>What are the contract management costs?</i> ■ <i>What is the impact on fixed asset/estates costs?</i>
Operational	Efficiency improvements	Senior managers	<p>Where and how should we seek to reduce costs?</p> <ul style="list-style-type: none"> ■ <i>How do our cost profiles compare with other organisations?</i> ■ <i>What are the cost drivers in our high cost areas?</i> ■ <i>What costs do we incur on each activity and how do they break down by category (staffing, contracted spend etc)?</i> ■ <i>How do costs in different areas of the organisation relate to one another?</i>
	Managing budgets	Senior managers	<p>How can we react to unexpected overspends?</p> <ul style="list-style-type: none"> ■ <i>What drives cost in relevant areas?</i> ■ <i>What external changes might be giving rise to overspends? Are they likely to continue?</i> ■ <i>Will reductions in activity in one area increase costs in another?</i>

Type of decision	Taken by	Example decisions	Relevant cost information
Procurement	Senior managers	What can we do to reduce our spend on procured goods and services?	<ul style="list-style-type: none"> ■ <i>How does what we pay compare with other similar organisations?</i> ■ <i>Are we getting volume discounts?</i> ■ <i>Is there a range of prices paid for similar goods or services across the organisation?</i> ■ <i>Do we have good market intelligence on supplier input prices?</i> ■ <i>What difference would changes to what we specify make to prices?</i> ■ <i>What does our procurement function cost?</i> ■ <i>Would joint buying arrangements increase our buying power and reduce our unit costs?</i>

4 USING COSTING INFORMATION TO MAKE GOOD DECISIONS

Learning from the private sector

The current financial climate challenges senior managers in local public bodies to probe costs more deeply than ever before. A good understanding and depth of knowledge on costs is as important for them as it is in highly competitive markets. So the approaches of private companies and how they tackle cost investigations can offer useful lessons for public bodies.

Many of the most successful private sector companies routinely study their costs in detail. It is this meticulous analysis that allows them to pinpoint areas where they can improve cost control, drive out savings and redirect expenditure to invest in priority areas. The case studies that follow show how some companies made considerable savings, by thinking differently about their costs. Senior managers in local government need to take a similarly detailed approach to studying cost.

The case studies illustrate how, by looking at cost from different angles and using different costing techniques and thus understanding different facets of cost, the senior managers were able to take firm decisions, with proven benefits, on:

- strategic budgeting
- strategic choices
- provide or buy-in
- procurement of goods and services.

Councils could secure benefits from adopting some of these approaches and we have indicated after each case study where there are parallels.

Strategic budgeting and planning decisions

CASE STUDY 1

New Look's understanding of the cost implications of different store upgrades, from analysis and trials, enabled the company to improve services in a way that increased sales revenue more than the increase in cost.

New Look is a high street clothing retailer that provides affordable clothing across a broad market. New Look senior managers wanted to make improvements in a way that enabled them to provide a consistent service across the chain, but also to meet local needs.

Customer preferences on products, affordability, and types of service vary with location and therefore the kinds of store improvements that managers wanted to make also varied.

To understand the costs and benefits, New Look's senior managers grouped the stores according to similarities in customer preferences and explored the potential improvements needed for each category of store.

They used existing cost information to estimate how each initiative might affect their main cost categories. These were IT (updating tills with new prices), employees (more sales staff), processes (more analysis to select the right product mix for the store) and supply chain (more frequent deliveries to refresh stock).

The managers compared these cost estimates with information drawn from internal sales and account data, and from free external data from the Office of National Statistics. They also used paid-for market reports such as ACORN, MOSAIC and MINTEL to understand the clothes retailing industry. They then carried out a trial, to ensure that they had fully understood all the costs of the proposed improvements. The trial confirmed their calculations.

The improvements achieved their aim of improving customer satisfaction and meeting demand. Although costs increased by 5%, a 10% increase in sales more than covered this. In the financial year 2008/2009, New Look reversed the high street trend of falling sales and reported a 16% sales increase.

Source: Accenture

This case study illustrates the importance of supporting the aim of increased customer satisfaction and meeting local needs and demand, with relevant information. This includes using internal cost data and external data sources to supplement management information from different locations. This combination allowed managers to assess their options and to pilot proposed changes. Councils too deliver the same services, for example leisure complexes or libraries, to customers in different localities. They need to meet local needs that vary, and maintain customer satisfaction whilst controlling costs.

CASE STUDY 2

When the Tate Gallery invested in new picture frames to improve public access to the collection, senior managers' grasp of the cost enabled them to provide the decision takers with the full cost implications of the whole project.

The Tate Gallery used an innovation grant from the Public Sector Research Exploitation Fund (PSRE) for the initial development of a more robust picture frame. This would improve public access to the collection by allowing the gallery to display fragile artworks continuously for a year at a time, compared to the current limit of just six months in every two years. The gallery needed to prove the new frames would deliver business benefits, to justify further development work.

Using accounting data from previous exhibitions, they calculated a standard cost of creating and loaning out an exhibition, divided into fixed and variable elements. They found the fixed cost made up the major part of the outlay; there would be little increase in costs if they extended the duration of exhibitions or the number of venues.

The analysis showed that not only would the new frames allow increased access to the Tate collection, but that it would be possible to make cost savings. The analysis also provided information to help senior managers to decide on pricing exhibitions and tickets. The Tate Gallery decided to go ahead with further research to develop the new frames and it has secured the £500,000 funding needed.

Source: Accenture

By having a good understanding of fixed and variable costs of activities, managers could calculate the marginal costs of extending a service. Because the extension generated opportunities to increase revenues, the additional investment was justified.

Council managers will also want to examine where small capital investments now can make a service more efficient and save money in the future. Capital investment (in self-service terminals in public libraries, or in new information technology channels to give the public a choice of access, for example) can either directly reduce costs or enable a service to be maintained or extended without additional net cost.

CASE STUDY 3

A leading global investment bank's analysis of the cost of serving different customers allowed it to decide which customers' business it wanted to keep.

Because the handling costs were not transparent in the management accounts, senior managers could only guess the true costs of setting up and servicing a new account. Analysts used time-driven activity based costing to look at the time staff spent on particular client accounts, and at what they were doing.

The analysis found the cost of setting up and servicing accounts ranged from £600 for UK financial institutions to as much as £120,000 for emerging market hedge fund clients from overseas, because these accounts needed extra due diligence checks. Stopping work on idle or unprofitable accounts saved the bank around £1.2 million. The bank has rolled out this costing approach across its other divisions and estimates that future cost savings opportunities will exceed £300 million.

Source: Accenture

Councils serve ranges of customer types. Though they are less likely than private companies to be able to stop serving high cost customer groups, they can still benefit from understanding who their high cost customers are and how to better manage these customers to bring costs down.

Provide or buy-in decisions

CASE STUDY 4

Understanding the costs of activities in a recruitment process enabled Accenture to make savings through outsourcing transactional processes.

Accenture is a management consulting, technology services and outsourcing company. Accenture must carry out security checks on all new employees before hiring them out to clients. With just under 10,000 UK employees, the company must keep the costs of these processes to a minimum; even a slight cost increase multiplies up to a significant amount.

When Accenture's internal human resources team examined the options for contracting out HR processes, they used process-costing techniques to give managers an understanding of the overall processing times and staffing needs, and activity based costing to understand the costs of particular parts of the process.

Some sub-processes were 'transactional' activities that did not need much staff experience, for example checking someone's university degree. However, higher-paid senior employees were doing this, when it would be cheaper to use junior staff. There were also 'non-transactional' activities that needed an element of judgement because of unusual circumstances.

Understanding cost fully enabled Accenture to split the tasks into high and low value activities. The company contracted out the latter to a supplier who could process a high volume of these activities at low cost. However, the company kept final responsibility for the activity and for those unusual cases needing an experienced, more senior eye. Accenture achieved up to 15% cost savings while preserving their quality target across the new joiner process.

Source: Accenture

An analysis of a process into high value added activities and routine transactional activity can help councils in developing the potential for shared and outsourcing options.

It is also relevant to areas where there is substantial professional staff input to service delivery, for example: educational psychologists, adult and children's social care services, some technical environmental services, and legal services. In addition to informing budget planning, it can help senior managers carry out service reviews: reconfigure service teams, compare productivity across teams and evaluate alternative service delivery options.

Time-driven activity based costing can reveal the proportions of simple, medium and complex cases in a typical caseload and the costs for each category of case. This can help ensure that the most costly professional staff are deployed on the most complex cases, and deploy the less experienced and cheaper professional staff on the simpler, straightforward cases. The point at which additional demand would exceed the capacity of the current staff resources can also be calculated and how waiting times will be affected.

Procurement of goods and services

CASE STUDY 5

When an international logistic company understood how different approaches to buying temporary labour were driving its running costs, the company reduced both the overall cost of temporary staff and variation in those costs, by standardising how it bought labour.

The company learned that buying labour in different ways driven by local business needs meant that it had about 20 different locally determined pay rates for the same type and grade of job. Because the company did not know the cost of a single worker, it was difficult to budget for variations in demand and any temporary rise in labour needs.

The company decided to set up a single, central set of labour rates across the organisation. It first defined the individual roles that temporary labour covered and then benchmarked data across the company and across the logistics industry. Internal and external benchmarking allowed senior managers to understand the 'going rate' for each defined role where they used temporary staff, to get better prices and to estimate changes in cost with greater certainty.

Setting up one temporary labour rate card across the organisation was one of several initiatives that contributed to savings. The company saw a 10% drop in the costs of temporary labour across all its non-transportation functions: head office, administrative work and packaging.

Source: Accenture

Staff costs are the significant part of councils' cost base and in managing staff costs the intelligent use of temporary staff is an important part of the mix. It is more likely to be manageable if the level and variability of costs is understood.

CASE STUDY 6

Virgin Media analysed the total cost of ownership of its most important categories of IT component, to help it achieve £250 million of cost savings.

The company identified the largest categories of cost where reductions would have the greatest impact and assessed the potential for savings in each one. They assessed whether the cost category was strategically important to the business (whether it influenced the final product for the customer), the balance between low costs and risk to supply, and where there was and was not scope for tolerance on component quality.

The managers analysed the total cost of ownership for each cost category: how the company used goods, and the cost of buying and handling them, as well as the price. This analysis gave managers a clearer understanding of cost and a better basis for comparing goods of different quality or from different suppliers. The analysis of costs allowed senior managers to decide the best method of specifying and sourcing goods, whether to buy locally, put out to tender or to develop items in-house.

Virgin Media estimated the savings they achieved through this approach would be over 60% of the original £250 million target.

Source: Accenture

Input costs for consumables and components is an area where councils may be able to use buying power either alone or jointly to achieve economies. Joint work by the Audit

Commission and the National Audit Office (Ref.⁷) has identified that councils are not yet securing all the benefits of collaboration in procurement of basic items. Good information on cost and usage of items used across the organisation is essential to understand the potential for improvement.

Learning from the public sector

The benefits of good cost analysis are not confined to private companies. Public bodies can demonstrate effective cost analysis to inform decision takers.

CASE STUDY 7

Hammersmith and Fulham Council found unexpected benefits from improving its understanding of unit costs.

The council was concerned that the budget for children's social care (around £35 million yearly) was volatile and hard to control. Members could see variations in actual spending compared to the original estimates and they found it hard to understand this or to challenge it.

The council was considering merging its children's services department with that of Westminster City Council.* Leading members were concerned that they would not be able to identify where the merger would produce savings, or how to allocate the savings between the councils.

With the help of a small team from the Audit Commission, Hammersmith and Fulham Council matched the costs of its children's services department to the activities it undertook. The council then set those alongside the numbers of children involved, to produce an estimate of the unit cost of individual activities within children's social care. This helped the council to understand not only the cost of one assessment, on foster care placement, and one package of post care support, but also what it costs to support one child right through the system to age 25.

This process produced more benefits for financial management than the council had anticipated. As expected, understanding unit costs helped members to understand and challenge variations in spending. This understanding also informed the merger discussions. Members were able to start a process of questioning where the costs of high performance might be higher than the costs of comparable councils. Managers were able to discuss with frontline staff the direct financial consequences of the decisions the staff had to take. The financial data provided a basis for understanding the potential savings, if effective interventions could prevent children entering the social care system in the first place.

* *This merger proposal was later overtaken by a proposal for a broader merger to include the Royal Borough of Kensington and Chelsea.*

5 WHAT A COST INVESTIGATION CAN TELL MANAGERS

The case studies reveal two lessons:

- that the analysis conducted needs to be tailored to the decision it is designed to support, and
- that the information required for the right cost analysis does not necessarily need to be laboriously or expensively collected; it is often available to decision takers or analysts.

7. Audit Commission/National Audit Office (2010) *A Review of Collaborative Procurement across the Public Sector*

Specifying and using the right information for a decision is not always straightforward. Costs can be analysed in a variety of ways. Table 1 shows two examples of how different analyses can provide different insights to help managers answer different questions.

Just as much of the information the case study companies needed was available to them within their organisation, the information councils' managers require to conduct effective cost analysis is likely to be found in corporate information resources. These include:

- Customer databases, which can provide information on different customer groups, often by age, gender, disability, ethnicity, location, etc. Where councils operate 'Smartcards' or similar systems the information gathered from them can be useful for cost or market analysis, or to understand the cost implications of providing concessions to selected groups of users.
- HR databases, which hold information on staff numbers and grades and information on staff turnover and sickness absence. This information can help cost service delivery.
- Land and property databases, which hold information on the age and condition of properties, the running costs, market value, and opportunities to share under-occupied premises. Comparative benchmarking data on property costs may also be available.
- The general financial ledger is the basic source of data on past spending; finance managers can run high-level reports from this. At a lower level, an examination of cost centre data and subjective codes helps to track and control costs by department or across departments for comparisons.

Most councils do not exploit fully all the cost data they already hold. Although the necessary data exists, senior managers may be unaware of its existence, or its potential to support cost management (Ref.⁸).

Case Study 7 shows that there is generally enough information in the general financial ledger to support relevant analysis. Managers do not always know what analysis to do on the data and they may be unable to do it themselves. Finance professionals with a good understanding of cost centres and cost category codes can advise on how to manipulate the data in different ways to answer specific questions. Discussion between service managers and finance professionals should tease out what would be the right analysis for the particular decision.

8. Audit Commission (2009) *Is There Something I Should Know? Making the Most of Your Information to Improve Services*

Table 1: How different cost analyses can help reduce the costs of waste management

Question for management	Insights into costs	Supporting analyses
Can we change the balance of fixed and variable costs of the service?	<ul style="list-style-type: none"> ■ What is the time frame for fixed costs? ■ What is driving the variable costs? 	<ul style="list-style-type: none"> ■ How does the balance of fixed and variable costs change with different patterns of in-house or contracted delivery? ■ Procurement options for trucks; whether to lease or buy, capacity, reliability, fuel efficiency ■ Identify the events that drive the variable costs, eg service demand, fuel costs, frequency of collection, etc, projections of service demand growth from new housing and economic developments
Can we reduce costs by changing the routes or timing of rounds?	<ul style="list-style-type: none"> ■ How do local geographical variations affect the costs? ■ How does the time of day affect the speed of collection? ■ How does route choice affect speed and cost of collection? 	<ul style="list-style-type: none"> ■ Understanding of drivers of cost (mileage, speed) ■ Modelling of costs associated with different route planning and time of day/week
Can we reduce the costs of components (people, trucks, fuel, and landfill) or change the balance of them to reduce overall costs?	<ul style="list-style-type: none"> ■ What can we do to reduce the costs of each component, eg increasing fuel efficiency or buying it more cheaply, changing maintenance schedules, etc? ■ Can spending more in one area give rise to greater savings in another? 	<ul style="list-style-type: none"> ■ Analysis of drivers of staff costs – staffing levels and structures, absence, shift patterns, etc ■ Analysis of fuel buying options ■ Analysis of maintenance, fuel efficiency and repair costs and the links between them ■ Projections of landfill taxes and volumes
What is the most cost effective way of collecting different types of waste (general domestic waste, food, garden waste, glass, paper, plastics, etc)?	<ul style="list-style-type: none"> ■ What do different approaches to collection cost in different areas? ■ How do different approaches to collection affect recycling levels? ■ How do recycling volumes affect landfill costs? 	<ul style="list-style-type: none"> ■ Analysis of costs of collection of different types of waste by geography and premises type ■ Analysis of impact of different approaches to collection on recycling rates ■ Analysis of drivers of costs of landfill – availability, tax regime, etc

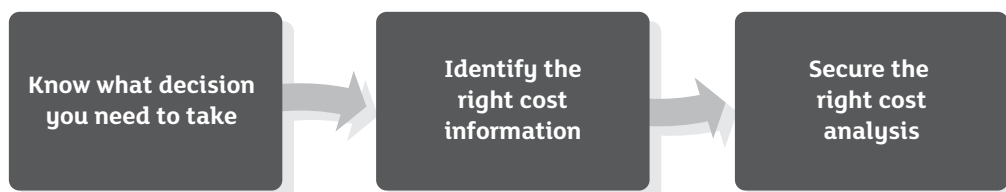
Table 2: How different analyses can help contain costs of preparing Statements of Special Educational Need

Question for management	Insights into costs	Supporting analyses
<p>What is the cost of producing one SEN Statement?</p> <ul style="list-style-type: none"> ■ Standard cost ■ Average cost and range of variation 	<ul style="list-style-type: none"> ■ What is the balance between different components of cost? ■ What does it cost per hour, for an educational psychologist's time? ■ What does the administrative support cost for processing one statement? 	<ul style="list-style-type: none"> ■ Time-driven activity based costing to analyse the educational psychologist input to each statement ■ Process analysis and costs to identify the cost of the administrative support input to each statement ■ Analysis of what drives variation in each component of cost (case mix, skills profile, etc)
<p>How and why have costs changed over time? What have we done or can we do about it?</p>	<ul style="list-style-type: none"> ■ How has the average cost of producing one statement changed in recent years? ■ What do we spend on appeals? How has this changed over time? How does it relate to the costs of preparing a statement? ■ Which components of costs have changed and why (increased volumes, increased unit costs)? ■ What options have we for reducing costs or avoiding cost increases? 	<ul style="list-style-type: none"> ■ Analysis of the historic financial records to identify trends in costs ■ Analysis of the components of cost to identify the causes of those trends ■ Analysis of the links between the costs of different processes (eg statements and appeals) ■ Modelling the cost implications of different approaches to staffing and delivery
<p>What is the marginal cost of producing one extra statement?</p>	<ul style="list-style-type: none"> ■ At what point is it necessary to employ more psychologist resources? ■ What other options are there? 	<ul style="list-style-type: none"> ■ Analysis of past changes in workload and capacity ■ Analysis of the cost of different options for managing workload peaks and growth

6 BEGIN WITH THE END IN MIND

Cost analysis is not an end in itself; it simply serves a purpose, in providing information to influence decision taking. Taking time to study and understand cost allows people to make better decisions. Senior managers need to bring relevant, high-quality cost and performance information together for decision takers and present this in an easy-to-understand form.

Senior managers should begin by being clear about what decision they want to take, identify the cost information they will need to know for this decision, and then take steps to secure it, through an appropriate analysis.



Organisations that invest time and effort to understand their costs fully can achieve tighter financial control, secure greater choice in allocating money and make better decisions. Every manager in the public service should recognise that understanding and controlling costs is part of their responsibility. The case studies presented earlier in this briefing show how understanding cost has helped private organisations to manage their money effectively and make savings. The challenge for public bodies is to create the conditions where costing information is afforded a high priority and is seen as an integral part of driving performance and operational management.

Supplementary detail of case studies

STATEMENT OF PURPOSE

The case studies in the briefing *Making Costing Count: Improvement Actions for Council Managers* are expanded in this supplementary material. The case studies offer managers valuable learning points that can be directly transferred to the public sector.

Each is ordered by the decision type it supports.

STRATEGIC BUDGETING AND PLANNING DECISIONS

Case Study 1: New Look

Balancing cost and service quality

New Look's key performance indicator was to meet customer demand and ensure that the clothing range was affordable for all. Market research had shown that customers wanted a consistent quality of service, regardless of whether they were shopping in a 'flagship' store or a small town store. However, customer preferences on products, affordability, and types of service varied with location. The challenge was to provide a consistent service and meet local needs simultaneously.

The senior managers realised that it would be challenging to cover the increased costs in the smaller stores. They needed to understand their costs in order to ensure that the proposed improvements were affordable, because simply raising prices was not a viable option.

In order to understand the scale and type of improvements that the company would need to make, New Look's senior managers categorised the stores according to similarities in customer preferences. They used internal sales and account data, free external data from the Office of National Statistics and paid-for market reports such as ACORN, MOSAIC and MINTEL. The company explored the potential improvements required for each category of store. This case study focuses on the 'Neighbourhood' category.

'Neighbourhood' stores were located in small towns with a strong sense of local community, such as Windsor and Stockport. Customers here placed importance on a 'new' feel to the shopping environment (ie new fittings, frequently refreshed product ranges), value (ie affordable prices), getting more for their money, and importantly, the personal touch in customer service.

The management team estimated the impact of improvements on their core cost categories: IT systems (eg updating tills with new price structures); employees (eg increased numbers of sales assistants in shops), processes (eg increased analysis and selection of the right product mix for the store) and supply chain (eg increased deliveries to refresh stock more often). They used existing cost information from stores that were already offering this level of service, to put the high-level estimate together.

'Neighbourhood' store customers particularly valued personal customer service; recommendations travelled fast in local communities. The company needed to ensure that sales assistants had time to talk to customers and to be helpful with difficult or unusual requests. This would mean re-training existing staff and hiring more staff to increase the presence on the shop floor. The company calculated these costs based on staff salary levels and the cost of developing and delivering their current new sales assistants. By comparing these costs with the current sales data from the tills, senior managers could work out the size of any gaps between expenditure and income.

Source: Accenture

Case Study 2: The Tate Gallery

Understanding costs for investment appraisal

The Tate Gallery senior managers used a simple 'standard costing' method to analyse their organisation's costs. This method used existing information and required minimal additional analysis. They used accounting data from previous exhibitions to calculate the fixed and variable costs of creating and loaning out an exhibition. The fixed costs are the overhead expenses (curation and conservation); the variable costs are the transport and marketing costs for each destination. Each receiving gallery pays the Tate Gallery a hiring fee for the opportunity to show the exhibition.

By analysing their costs, the Tate senior managers found that the fixed and up-front costs made up the major part of the expenditure; there would be little increase in costs if they extended the duration of exhibitions or the number of venues.

The senior managers calculated that using the new, more robust frames could allow them to extend the duration of exhibitions and tour the exhibitions to more destinations than at present. When other galleries share the costs of curating and touring an exhibition, the overall costs of the exhibition to the Tate Gallery reduce by up to 50%. The analysis also allowed senior managers to make informed decisions on pricing exhibitions and tickets. The Tate Gallery decided to go ahead with further research on the development of the new frames and it has secured the £500,000 funding required.

Source: Accenture

Case Study 3: A Global Investment Bank

A leading global investment bank wanted to understand the cost of setting up and maintaining new accounts within their investment division. Senior managers believed that the cost of setting up a new investment fund client was approximately £11,000. However, the costs were not transparent so they could do little to test this hypothesis. Without this knowledge, senior managers were unable to bring down the budget costs either by changing processes or by ceasing to maintain accounts that were not profitable to run.

Making costs transparent

The bank used a time driven activity based costing method over an initial eight-week period. This method focuses on outputs rather than just cost allocations; it looks at the volume and type of work that staff can complete in a given business unit, taking capacity and efficiency into account. This method is more accurate than simple cost allocation and many service-based industries now use it.

The first stage of the analysis was to understand the current position. The analysts identified the cost of running a department, using data from the finance system (including overhead charges) and they checked on staff numbers. In this example, the costs of a particular department were approximately £1.9 million.

The analysts determined the time available by making assumptions on contractual hours. In this example, the average monthly head count for the department was 8.7 full time equivalent staff: 8.7 FTE, 8 hours per day, less 1.5 hours for non-productive time such as breaks, training and meetings. The total of 19 days per month equals 773,604 hours of staff time available in this department per year.

In the second stage of the analysis, the study team interviewed the managers responsible for the various processes in account maintenance (such as setting up, amending or closing an account), in order to understand the processes and the time required to complete them. They also looked at the volume of activity and the resource requirements for the processes.

Once the analysts understood the high-level cost of running the department, they were able to calculate the cost per process activity: £1.9 million divided by 773,604 minutes works out at £2.45 per minute. Therefore, the cost of completing an activity that took 100 minutes was £245. The analyst added each activity cost together to obtain the total cost per process.

The final stage of the project was validation and analysis. The study team sense-checked their calculations by reconciling them back to the finance system and validated the figures against the available time for a department team.

The study established that the cost of setting up and maintaining accounts varied from £600 for UK financial institutions to as much as £120,000 for emerging market hedge fund clients. The primary reason for the difference in cost was the additional due diligence that the bank had to undertake for customers from countries with less rigorous regulation than the UK. This additional work could add up to six months to the process, compared to two to three weeks in the UK.

Understanding costs allowed the bank to decide which accounts it wanted to maintain. The bank identified approximately £1.2 million cost savings, by ceasing reviews of inactive or unprofitable client accounts. The bank has rolled out this approach across its entire £1.5 billion cost base and estimates that there will be future cost saving opportunities in excess of £300 million.

Source: Accenture

PROVIDE OR BUY-IN DECISIONS

Case Study 4: Accenture UK

Understanding where contracting out is worthwhile

Accenture's HR department faced a growing volume of processing activities, due partly to the requirement for a greater range of background security checks on new employees. The HR team needed to manage the growing demand in the volume and complexity of 'new joiner' checks without increasing their costs.

The analysts' first step was to cost each of the end-to-end sub-processes that comprise the new joiner process. They broke down the task into key processing activities and worked with a sample group of processing staff to check the actual time required, when a member of staff is actually working on a case (excluding delays). The analysts also noted the level of staff seniority needed for each part of the process. They calculated the average time required and the typical salaries of the processing employees involved in each part. The analysts added these costs together to arrive at the cost of dealing with one case.

Process costing provided managers with a simple way to obtain a sound understanding of the new joiner process and its sub-processes, in order to identify the parts of the process that might be suitable for contracting out. However, some steps in the process are more labour-intensive and costly than others, so the managers needed some additional analysis to pinpoint where out-sourcing might generate savings and an increase in value for money.

The analysts used activity based costing to examine the transactional sub-processes in more detail, in order to understand the cost impact of each one. They interviewed processing staff and analysed existing process descriptions, to build up a picture of these sub-processes and their costs. Some sub-processes were 'transactional' activities that did not require much staff experience; for example, checking someone's university degree. However, they found that higher-paid senior employees were doing this, when it would be cheaper to use junior staff. There were also 'non-transactional' activities that required an element of judgement because of unusual circumstances. Management needed to build in steps to the process to ensure that such cases would come back in-house for decision.

Understanding cost fully enabled HR management to make a compelling case for contracting out the majority of processes. They also based the decision to outsource on the supplier's ability to process a high volume of these activities at low cost and to the required quality standard. The management team decided to contract out the new joiner processes where it was easy for a relatively junior person to document the processes, but Accenture retained ultimate responsibility for the activity and for those unusual cases requiring an experienced eye.

Accenture achieved up to 15% cost savings while maintaining their quality target across the new joiner process.

Source: Accenture

PROCUREMENT OF GOODS AND SERVICES

Case Study 5: An International Logistic Company

Improving procurement: controlling the costs of temporary labour

The company had about 20 different locally determined pay rates, for the same type and level of job. Because the company did not know the cost of a single resource, it was difficult to budget at national level for fluctuations in demand and any temporary increases in labour requirements.

The company decided to establish a single, central set of labour rates. It did so by first defining the individual roles that temporary labour covered and then benchmarking data from across the company and across the logistics industry. This allowed the company to understand the 'going rate' for each defined role where they used temporary labour, and to estimate changes in cost with greater certainty.

Implementing a temporary labour rate card was one of several initiatives that contributed to savings. The company saw a 10% reduction in the costs of temporary labour across all its non-transportation activities – head office, administrative functions and packaging.

Source: Accenture

Case Study 6: Virgin Media

Virgin Media ran an 18-month project to identify savings across different cost categories. This case study looks at how improving the understanding of costs helped Virgin Media to identify savings in procurement.

Using cost categories to find savings

Senior managers' first step was to identify levels of expenditure across the organisation. They categorised costs into consistent groups, based on current information. This provided a baseline against which to measure cost reduction.

In the second phase, the company carried out further analysis, categorising costs according to significance, risk to supply, quality and strategy, to identify areas in which to focus on cost reduction.

Under the first category: '*significance*', senior managers considered the proportion of expenditure in each cost category and focused on the largest areas of expenditure where cost reduction would have the greatest impact; for example, the cost of IT equipment rather than office cleaning costs.

Under the second category: '*risk to supply*', they asked themselves whether they needed a guaranteed supply. The company might decide to pay more for a given item to guarantee supply, rather than procure at a lower price from a less reliable source; for example, when procuring specialist components for cable-based television services.

Under the third category: '*quality*', senior managers considered the extent to which the tolerance on quality can vary and how critical this is to the business. Some components may be relatively expensive to replace and be critical to the business; for example, specialised computer server technology, where paying a higher price may ensure robustness and reduce the risk of failure.

Under the final category: '*strategy*', the senior managers considered whether the cost category was strategically important to the business, ie whether it influenced the final product to the customer.

As an example, the transportation cost category would be of less strategic importance than business critical computer systems such as customer account management systems. This would suggest that senior managers should direct the focus of cost reduction onto transportation costs rather than the business critical systems.

Next, the senior managers analysed the three elements that comprise the total cost of ownership for each cost category: price, how the company uses goods, and the cost of acquiring and handling them.

Understanding what drives price was critical to senior managers' determination of how to reduce costs. They considered what volume discounts were available; whether there were incentive structures that offered a cheaper price for buying a greater volume; and what determined the price for one item – was it an agreed level of business with a particular supplier? For example, 'we will charge you 10% less for stationery if you spend over £X,000 with us each year'.

Understanding how Virgin Media uses the goods it buys provided senior managers with further insights into what materials offered the greatest value for money. Considerations included: what is the expected life of an item and how did the company use it? Was there a scrap or sell-on value for the item at the end of its useful life in the company?

The senior managers also examined the costs of buying and handling the goods:

- Was it possible to purchase the goods electronically?
- Could they pay invoices electronically or were manual processes involved?
- Did they have to pay separate invoices for each item as they ordered it, or was it possible to pay on a single invoice issued monthly or quarterly, etc? and

- Were they incurring storage costs because they needed to hold stocks?

Understanding these four elements gave the company a clearer understanding of its true costs and gave it a better basis for comparing goods of different quality or from different suppliers.

This full life costing approach was important in informing decisions on the best approach to source an item. When senior managers take into account the full life costs, a more expensive item may have lower overall costs to the company. For example, the cost of a computer system will include long-term maintenance and support costs and the costs of obsolescence, as well as the initial outlay; decision-takers need to consider whether the computer will last three or five years.

Cost category analysis enabled management to understand the importance of each cost category, and its *real* cost to the organisation. This understanding allowed senior managers to decide the most appropriate method of sourcing goods; whether to buy locally, put out to tender or to develop items in-house.

The final phase of the project involved planning and implementing each of the purchasing approaches according to the priority and level of impact on Virgin Media and its customers. Virgin Media estimated that the purchasing savings they secured through this approach would be over 60% of the original £250 million target.

Source: Accenture



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