

N5 Administration and Overhead Allocation

Ideal Standard

Council has adopted an appropriate method for fully allocating administrative and overhead costs. Cost drivers have been identified.

Outline/Summary

Businesses operating in the market-place need to recover administrative and corporate overheads in their prices, and FCD applies the same principle. However, the cost of governance (including all or most of the CEO's office) in the public sector is unique and not comparable to the private sector. Therefore, the costs of a business need to incorporate administrative and corporate overheads, excluding the cost of governance.

Traditionally, some method of overhead cost allocation has been used to spread overheads over the business activities of many Councils, however this has often been on a high level basis or an arbitrary figure not reflecting a reasonable estimate of relative costs. Depending on the objective of Councils, several methods of cost allocation can be utilized. Since overheads can consume a large part of the Council budget, with no direct service delivery benefit to the community, many Councils have implemented sophisticated methods such as Activity Based Costing or Service Level Agreements to get better control of these overheads, with annual savings of up to 20% being achieved. However, if the objective is simply to reflect the full cost of each activity for decision making purposes, a simplified process can be used based on apportionment by cost-drivers. (A cost driver is the variable which generally governs the cost of administrative overheads, eg. The number of PCs governs the cost of IT). LGAQ's FCP guide provides a useful set of benchmarks and suggested cost drivers.

Ideally, apportionment of corporate overheads should be based on the following principles:

- Exclude governance costs (preferably by having a separate budget item);
- Allocate the costs on the basis of the most applicable cost-driver;
- Apply materiality tests to ensure that the process is as simple as possible (smaller and medium-sized Councils only need to use a few simple cost-drivers);
- Include capital costs for services with significant assets (eg. IT and Buildings);
- Utilise automatic journals to automate the process wherever possible;
- Annually review the apportionment methods and cost driver variables ;
- Maintain separate natural/standard accounts to ensure the ledger is balanced; and
- Ensure that total administrative overheads in the business are in the range of 7 to 15% of total operating costs. Overheads outside this range need to be reviewed.

Key Steps

1. Identify each of the corporate and administrative overheads to be allocated;
2. Exclude Governance costs, and the CEO's costs related to Governance;
3. Modify the accounting records if necessary to distinguish between governance and other corporate and overhead costs;
4. Identify a cost driver for each of the activities to be allocated using Activity Based Costing or the suggested simplified list of cost drivers;
5. Determine the number of units in each cost driver for each Council activity;
6. If possible, set up automatic monthly journals to allocate the actual cost of non-governance corporate and overhead costs to each activity in proportion to the activity's share of costs associated with the each cost driver (Oncost and plant hire systems can be used to allocate costs if the system has no automatic journal process);
7. Implement related budget changes and advise the management in each activity;
8. Review the reasonableness of the resultant overheads in each business; and
9. Review annually as part of the budget process.

Further Information

LGAQ-FCP 4, 5, 6, 14

QCA Documentation Standard

Budget, Chart of accounts or use of Full Cost Pricing software