

place, the aggregation of costs at service division level is consistent between local authorities so that comparisons can be made.

THE PRINCIPLE OF TOTAL COST

3.7 The third principle of Best Value accounting requires that total cost is the basis of financial reporting. Total cost is defined in Section 2. The total cost principle applies to each item at the mandatory service division level in the SEA. Specifically, this means that, **in addition to direct costs, each division of service must include an appropriate share of:**

- depreciation
- impairment loss identified on assets used to provide the services of an authority
- revenue expenditure funded from capital under statute
- amortisation of intangible assets
- **support service overheads**
- current service (pensions) costs per IAS 19 *Employee Benefits*.

Key to the comparability of costs between different authorities is the consistent apportionment of these costs across the service divisions. SeRCOP provides good practice guidance, including a set of general principles to apply in accounting for these costs.

STATUS OF THE SERVICE EXPENDITURE ANALYSIS

3.8 The new SEA that follows supersedes all previous versions that apply to England and Wales. The date of application of each part of the SEA is clearly stated in the guidance notes relating to each individual service.

THE SERVICE EXPENDITURE ANALYSIS

3.9 The following individual services are presented, demonstrating the breakdown of the hierarchy of service divisions and subdivisions, followed by guidance notes to further explain the definitions of those service divisions and subdivisions:

- Adult Social Care
- Central Services
- Children's and Education Services
- Cultural and Related Services
- Environmental and Regulatory Services
- Fire and Rescue Services
- Highways and Transport Services
- Housing Services
- National Parks Services
- Planning Services
- Police Services.

allocate services to 'prestige' accommodation is a separate consideration to how the costs should be accounted for.

2.14.7 If an external contractor is making use of an asset at no charge to them, then the amount the authority is paying for their services will be less than would otherwise have been the case. There is, therefore, no justification for not charging depreciation to the client service to which the contractor's work is charged.

2.15 Total cost also includes an appropriate share of all support services and other overheads.

These should be charged, allocated or apportioned across users and other beneficiaries in accordance with the following seven general principles.

1. Complete Recharging of Overheads	All overheads not defined as Non Distributed Costs or Corporate and Democratic Core should be fully recharged to the service expenditure headings as defined by Section 3 of SeRCOP. Note that Corporate and Democratic Core costs should receive an appropriate allocation of overheads.
2. Correct Recipients	The system used must correctly identify who should receive overhead charges.
3. Transparency	Recipients must be clear what each recharge covers and be provided with sufficient information to enable them to challenge the approach being followed.
4. Flexibility	The recharging arrangements must be sufficiently flexible to allow recharges to be made regularly enough and to the level of detail appropriate to meeting both users' and providers' needs.
5. Reality	Recharging arrangements should result in the distribution of actual costs which has the basis of fact. Even if the link cannot be direct, reality should be the main aim.
6. Predictability/ Stability	Recharges should be as predictable as possible, although there will be practical limitations to this.
7. Materiality	It is unlikely that a simple system will be adequate to meet all other requirements noted above. However, due regard should be made to materiality to minimise the costs involved in running the system.

Accounting for Overheads

2.15.1 The guidance on accounting for overheads is intended to consolidate and supersede a range of previous CIPFA guidance, including aspects of *The Management of Overheads in Local Authorities* and *Accounting for Central Services*. Further guidance on detailed overhead apportionment techniques entitled *Fair Shares?* was published by CIPFA in August 2003.

2.15.2 Users of support services expect to know what overheads they carry, how they are calculated and whether they can have any control over the amount charged.

2.15.3 While it is important that total cost includes an appropriate share of all overheads, there are other circumstances where the inclusion of the full range of overheads may not be appropriate. For example, management accounts may exclude from budget holders' reports any overheads for which they are not responsible. There may even be situations where an authority wishes to perform some cost benchmarking exercises, for management purposes, using a definition of cost which excludes specified overheads.

Authorities clearly have discretion to do this, but care should be taken that, whatever alternative definition of cost is chosen, it can be consistently applied.

- 2.15.4 Guidance on Non Distributed Costs (NDC) can be found in paragraph 2.45 of SeRCOP. Costs which fall within the Corporate and Democratic Core (CDC), including both Corporate Management (CM) and Democratic Representation and Management (DRM), are not overheads for this purpose; rather they are represented by their own SEA heading in Section 3.

Principles

- 2.15.5 Administrative overheads arise in service departments as well as in central departments. Service management costs also arise in all departments and these, like all overheads, require apportionment across the range of divisions of service affected. Both the general principles and this guidance apply equally to such service department overheads.
- 2.15.6 This guidance does not cover direct services, such as local tax collection, which in some authorities are managed centrally. Section 3 of SeRCOP identifies all such direct services. A defining feature of overheads is that, for total cost purposes, they end up charged, allocated or apportioned to direct services, as defined in Section 3, rather than having a final service expenditure heading of their own. Accounting for them therefore requires the use of holding accounts.
- 2.15.7 There may be other holding accounts in use; for example, within Adult Social Care, a holding account may record the total costs of the home care service before they are apportioned across client groups. These are not overhead costs and are not covered by this guidance.
- 2.15.8 Nor does this guidance cover depreciation and impairment losses (see the guidance in paragraphs 2.12 and 2.13 of SeRCOP) or direct costs such as for utilities, which are often paid for centrally and then recharged to users.
- 2.15.9 This guidance concentrates on the apportionment of overheads. Allocation, which is a matter of fact, does not give rise to the types of issue addressed in this section. For example, the allocation to operational units of the total costs of outgoing telephone calls can be based on the cost of calls made on the handsets used by each such unit, information on which will be available from the telephone bill.
- 2.15.10 Charging, the third method of recharging available, is based on an agreement between the user and the provider but is otherwise similar, in the bases that can be used and the issues that arise, to apportionment. The general principles that should apply to a charging regime and to the apportionment of overheads are the same.

Complete recharging of overheads

- 2.15.11 The general principle is that all overheads, support service and service management costs should be fully recharged to the service expenditure headings defined in Section 3 of SeRCOP. Also, the costs of CDC and NDC should be allocated to separate objective heads and not allocated to any other head.

- 2.15.12 In this context, CDC costs are not overheads; rather, CM and DRM are service expenditure headings in their own right, to which many overheads will need to be apportioned.
- 2.15.13 Various types of cost may extend across more than one service expenditure heading and require apportionment; not all such costs are overheads. For example, the cost of meals on wheels is a direct service cost but it may require apportioning across different client groups, and thus different service expenditure headings.
- 2.15.14 Two features define apportionable overheads. One is that they end up charged, allocated or apportioned to direct services, as defined in Section 3, rather than having a final service expenditure heading of their own. The second is that they are 'overhead' in nature. In other words, they include service management, support services and certain other costs, such as insurance premiums, but they do not include costs such as grounds maintenance or other direct costs which, for convenience, are initially accounted for within a holding or trading account.
- 2.15.15 Some overhead costs are service specific, eg force command within the Police Service; others are of a more general, administrative nature, eg finance or legal. These latter can arise either in service departments or in central departments.
- 2.15.16 In some authorities, there may be a support activity which relates only to one SEA. For example, committee administration may support only DRM. However, this is still an overhead, albeit 100% allocated to DRM. In other authorities, the committee administration section may support officer-only groups and a more complex apportionment process may be required.

Correct recipients

- 2.15.17 The general principle is that apportionments should be made to each of the services benefiting from the support (or overhead). In Section 3, SeRCOP has deemed that the level of detail for final apportionments must be at division of service level, or lower if required by specific performance indicators. However, because authorities may wish to calculate total cost at lower levels of detail for their own purposes, it may be that apportionments to subdivisions of service, or even to individual cost centres, are required.
- 2.15.18 It is likely to be the case that, as more detailed calculations of total cost are required, more issues will arise concerning precisely who is benefiting from a support service or other overhead. However, even at service level, there may be some areas where apportionments are particularly difficult, for example between General Fund housing and the Housing Revenue Account (HRA). Here, it is important to balance fairly the interests of council tax payers and tenants.
- 2.15.19 Getting the recipients correct can also have a significant impact on trading accounts. For example, if personnel are working for a transport section, they need to be aware of the significance of distinguishing carefully between work involving minibuses (whose costs are met from the General Fund, eg Children's and Education Services or Adult Social Care) and work involving mechanics, whose costs and overheads are charged to a trading operation.

- 2.15.20 Another issue arises as a result of the increasing mismatch between the accounting structure as represented by the SEA and individual authorities' management structures. Support service providers will immediately be clear which part of the management structure is commissioning work, but it may not be so apparent which SEA the cost should be charged to. In this situation, the onus must be on the person commissioning to make it clear to the provider which SEA is to pay. Where work is provider led, the extent of any problem will depend on the apportionment basis used but, in any event, care should be taken to identify the correct division of service to receive the recharge.
- 2.15.21 A specific issue may arise when an external contractor is using a support service at no charge. On the basis that the amount the authority is paying for their services should be less than would otherwise have been the case, the apportionment should be made to the clients of the contractor's service, because it is they who are indirectly benefiting.

Transparency

- 2.15.22 Recipients must be clear what each recharge covers and be provided with sufficient information to enable them to challenge the approach being followed. This requires a number of features to be present in the apportionment system.
- 2.15.23 The first is that information about the bases of apportionments is given in a sufficient level of detail. A lump-sum recharge covering the whole range of financial services is unlikely to be acceptable to users and, from a provider's perspective, more detail than this will be required to calculate apportionments in any event. However, there are levels of detail below which it may not be sensible to go. For example, there are some extremely complex calculation bases for IT services, using a dozen or more sub-headings, including, for example, a specific charge for relocating a computer terminal. It is not good practice to spend undue time or other resources in getting unnecessarily precise figures.
- 2.15.24 Also, although this level of detail may be considered necessary for the initial calculation of apportionments and for the monitoring of costs thereafter, it may be counter-productive to make the actual recharge to users at that same level of detail. On the other hand, any specific recharges where users can influence the amount by their actions will need to be identified separately so that they can see this occur. It is important not only that users are aware of the extent to which they can influence the level of the recharge, but also that they can see this responsiveness in action.
- 2.15.25 The actual level of detail used for the calculation of recharges should be agreed between the user and the provider in each case. However, as a minimum, all elements of the recharge that respond to specific user action should be identified. It will probably also be necessary to identify separately the elements that relate to different outputs (eg training separate from industrial relations work).
- 2.15.26 Users will also need to receive regular information on recharges, since even where they do not control these elements of cost, they will still feature within their total cost and therefore be of concern. Where users have no control over the level of recharges they receive, ie when they are all done by apportionments, they should receive information at least twice a year – once at the year-end as part of the formal total cost reporting

and once at an earlier stage to enable the approach, if not actually the figures, to be challenged.

- 2.15.27 For some authorities, who fix apportionments at budget time and then revisit them only in exceptional cases, this earlier reporting would be part of the budget; for others it may be later in the year, most likely at the revised estimate stage.

Flexibility

- 2.15.28 The recharging arrangements must be sufficiently flexible to allow recharges to be made regularly enough and to a level of detail appropriate to meeting both users' and providers' needs. In other words, as well as routine, regular apportionments, it should be possible to meet the ad hoc requirements of either party.
- 2.15.29 In terms of timing, the main requirement of the apportionment system will be to support the calculation of total costs at least at the end of each financial year for the production of the annual accounts, statistical returns, etc since full apportionments will be required at this time. Calculations will also be required of budgeted and estimated outturn figures to fit in with the timetable for the production of performance indicators and reports.
- 2.15.30 For other purposes, for example a cost benchmarking or activity-based costing exercise, separate total cost calculations will be required. This would entail making apportionments as and when such an exercise requires them to be made. The system should be flexible enough to deliver such apportionments whenever needed.
- 2.15.31 There may also be cases where more detailed apportionments than to division of service level may be required on a regular basis for management reasons, even though they are not required by SeRCOP. For example, where there is any sort of client/contractor or purchaser/provider split in place within a division of service, however informal, it may be that the total costs of each activity is required. A specific example might be within the Adult Social Care client group divisions of service, where the total cost of assessment and care management, on the one hand, and service provision, on the other, may be required. To provide service managers with flexibility, the apportionment system should be capable of meeting this requirement, even if it is identified after the system is established.
- 2.15.32 Clearly, once overheads have been apportioned to any cost centre at or below division of service level, the accounting system will aggregate them automatically to the required level. When regular detailed apportionments are required, therefore, they should be calculated on the same rigorous, top-down basis as is required for the Statement of Accounts, performance indicators, etc and implemented using the main accounting system.
- 2.15.33 However, a distinction should be acknowledged between formal, regular apportionments of this sort and the calculation of total costs for ad hoc management reasons. The former need to be as accurate as possible to comply with SeRCOP, and the comprehensive, top-down, ledger-based approach will help to deliver that accuracy.
- 2.15.34 For the more ad hoc calculations of total cost for management purposes, such as benchmarking or activity-based costing, which are likely to relate to smaller elements

of service, a different approach may be considered acceptable. The intention should still be to bring in the total cost of whatever activity or element of service is being considered, but this could be done on a bottom-up basis, identifying and costing the appropriate overheads only so far as they relate to that activity or element of service. A less than comprehensive approach, which does not apportion overhead costs down across the full range of services, runs the risk of being less accurate, but management discretion should be applied to the balance between the accuracy achieved and the effort required to achieve it.

- 2.15.35 This judgement also needs to take account of the risk of disagreements between figures calculated top-down (eg by Finance) and those calculated bottom-up (eg by service managers). If both calculations are done, they are almost inevitably going to reach different answers and a time-consuming reconciliation exercise may be required. To avoid this, the general guidance is therefore that total cost calculations should be based on a top-down approach wherever possible. This ensures that all costs are included once and only once, since there is a control total to work to. It should also improve the reliability of the results since all users can challenge their own, and other people's, apportionments.

Reality

- 2.15.36 Recharging arrangements should result in a distribution of actual costs that has a basis in fact. For apportionments, such a link clearly cannot be direct, or the apportionment would actually be an allocation. However, since the purpose of total cost is to reflect real cost levels, a main aim of the apportionment process must be to support that.
- 2.15.37 This has a number of consequences. The first is that there should be a link between the cost to a user and the benefit they receive. This link is clearest in an apportionment system that is based on the outputs of the support service and, for that reason, output-based approaches are generally to be preferred. It is acknowledged, however, that this may not be practical in all areas, at least in the short term.
- 2.15.38 A second consequence relates to cross-subsidisation between users. In the past, this has been viewed as unsatisfactory, largely for equity reasons. The concept of total cost precludes any cross-subsidisation between users. This means that, as a matter of principle, the same apportionment basis should be applied for all users (including trading accounts). Where a charging regime is in place, there may be some scope for differential charging, but differential apportionment is not good practice and should be avoided.
- 2.15.39 A particular issue arises if some users are charged for a particular service using a service level agreement (SLA) and others receive their recharge by way of apportionment. In this case, the key requirement is that the two arrangements generally equate; in other words, that there is no advantage to users as a consequence of their being in one regime rather than the other.
- 2.15.40 This common approach to apportionments should apply at least down to division of service level. If apportionments are made below that level, then the same principles should apply, especially that all users should receive a 'fair share' of the apportionment.

However, it may be considered appropriate to leave the detail of how such lower-level apportionments are made to the appropriate service manager.

- 2.15.41 A related issue concerns what could be regarded as cross-subsidy over time and the extent to which the concept of total cost allows the 'lumpiness' of certain costs, ie costs which, for an individual user, can vary a lot from year to year, to be 'smoothed out'. It is clear that such variability in the costs of, for example, internal audit, is not a reason for regarding such costs as 'corporate'.
- 2.15.42 Other areas of support service cost which are potentially 'lumpy' from the perspective of individual users are supporting service departments in reviews, IT developments and the costs of industrial tribunals or legal cases. To a lesser extent, costs such as staff development can vary from year to year in any one department, even if overall, across the authority, they are similar. Variations such as these can arise because of users' demands, eg for systems development, because of corporate or providers' requirements, eg audit investigations or reviews, or as a result of external events, eg insurable risks or legal cases.
- 2.15.43 The principle of 'reality' does not allow for the 'smoothing' of variations such as these. Overhead apportionments should be based on actual costs and reflect actual support levels to each user in the year in question. This means that not only should all overhead costs be written off in the year in which they are incurred, leading to potential fluctuations in the total apportioned, but also that each user's share of the total could, in some circumstances, vary significantly between years.
- 2.15.44 It is acknowledged that any such variations in total costs from year to year may be reflected in performance indicators. However, such variations will be explicable as part of the investigation of differences, whether between years or between authorities. To allow variations to be masked would undermine the credibility of the figures more than would be the case if fluctuations were evident.
- 2.15.45 Also relevant to this issue is the guidance in paragraph 2.11 of SeRCOP as regards exceptional expenditure. This is clear that such expenditure should form part of the relevant total cost even though, by definition, it is 'lumpy'.
- 2.15.46 A related issue concerns the pooling of costs across users. This has most frequently been done in the context of office accommodation where, often for historical reasons, some services are located in offices that cost more than others, even though the quality of the accommodation is similar, and they have no choice about this. Often, property allocation is treated as a corporate issue.
- 2.15.47 It is argued that, in this situation, services occupying more expensive property should not be penalised for this and that costs should be pooled and then apportioned on an equal basis (usually £n per square metre). It is clear that, where users do have choice as to which property they occupy, pooling should not apply, since pooling would obscure the consequences of them exercising this choice. However, it is also the case under the total costing regime that no pooling of property costs should be allowed.
- 2.15.48 Where property differs in quality or where different maintenance standards apply, then under the principle of 'reality', the apportionment system should reflect this. For

example, a charge for property maintenance per square metre could be set at three levels: high for rooms that are required to be expensively decorated (eg members' and public rooms), medium for most normal space and low for 'scruffy' accommodation, such as depots.

- 2.15.49 There are other examples of where an apportionment system should reflect differences in the quality of the support service received. For example, although it will be normal practice to charge all accountants of a similar grade at the same rate, there may be a situation where a user wishes to pay extra for the services of a specified accountant with particularly relevant experience.

Predictability/stability

- 2.15.50 Recharges should be as predictable as possible, although there will be practical limitations to this, not least users' requirement for some flexibility in the amount of a support service they use and therefore pay for. This can have knock-on effects on other users and the apportionment system needs to strike an appropriate balance between providing each user with the flexibility they want to vary their cost by varying their demand, and the requirement of other users not to suffer unpredictable adverse effects as a consequence. Predictability is of particular importance to users who themselves aim to recover their costs.
- 2.15.51 Minimising these adverse consequences is an issue that support service providers need to address by managing their volume of activity because, although there is scope within the definition of Non Distributed Costs for spare IT capacity to be held centrally if no one is using it and it cannot be disposed of, this is not the case for support services.
- 2.15.52 Central support staff will not be left sitting idle. Either support staff numbers will be reduced or they will spend the time freed up by reduced demands from one user working on behalf of other users. This latter course will increase the apportionments made to these other users, without them necessarily being aware of this in advance, to compensate for the reduction in apportionment achieved by the user whose demands reduced.
- 2.15.53 Even without a formal SLA, the solution to issues such as this lies in communication between providers and users. The provider needs to establish whether the other users actually require more service, in which case they should not object to the apportionment increasing. If they do not, then the solution is to manage down the total volume of service provided as soon as is achievable, with all users, including the one (or more) who initiated the decline, carrying a higher cost than they would wish in the interim.
- 2.15.54 In addition to the predictability of the actual recharge, there should also be stability in the method of calculation and apportionment of overheads. Therefore, it is desirable that there is stability in the method of accounting for recharges, with any change in apportionment methods being justified and undertaken in consultation with users.

Materiality

- 2.15.55 It is unlikely that a simple system will be adequate to meet all the other requirements noted in this chapter. However, due regard should be given to materiality to minimise the effort involved in running the system so that the quest for 'accurate' apportionments does not turn the process into a bureaucracy whose costs outweigh the benefits achieved.
- 2.15.56 There are many areas where the issue of materiality is important. For example, in the context of apportionments based on time recording systems, it is often tempting to offer people a large number of different activity codes to collect quite detailed information in case it is required at a later date for some reason. A long list of codes may be important to catch the occasional quarter of an hour spent on a particular activity, but it can also be very daunting and put people off accurate completion of their time record, thus defeating the object, as well as causing resentment about the time it takes to complete.
- 2.15.57 Another would be where support services provide services to each other. If the extent of this is not material, in order to prevent complicated tail-chasing, the recharges between them can be left out of apportionment calculations.
- 2.15.58 Other examples might be where a service manager spends a very small amount of time on corporate or democratic management but, for reasons of materiality, this is not taken into account and they are deemed to be 100% service management. A similar situation may arise if a staff member moves temporarily to another area of work, for example to cover for someone off sick. If this is for a very short period then it may not be considered material enough for any adjustments to be made.
- 2.15.59 There are also materiality issues about how often it is necessary to recalculate the base data used to calculate apportionments, for example proportions of time spent on various activities or floor space occupied. These should be recalculated whenever there is reason to suppose that they may have changed by a material amount, and at least annually.

Impact on Charging Systems

- 2.15.60 Charging systems are a way of spreading the costs of support services between users which, whilst they may use the same bases as equivalent apportionment systems, are founded on an agreement, often called a service level agreement, between the provider and the various users. In principle, charging systems could also apply to other overheads such as office accommodation.
- 2.15.61 A fundamental requirement of a charging system is that all parties are clear that such a system is in operation. There are situations in which an apportionment system may be preferred, and there are situations in which charging may be preferred; but hybrid systems, typified by above-the-line apportionments, are not good practice and should be avoided.
- 2.15.62 It should be noted that the accounting arrangements for charging regimes are not fundamentally different to those required under apportionment arrangements. Charging regimes will be associated with providers' trading accounts, which may have