Best Practices for Shared Services Chargeback
Shared Services Chargeback

Introduction

More frequently, corporations move to a shared services organization for functions that are common and corporate-wide in scope.

The synergistic opportunities of consolidation of common functions can no longer be ignored.
Human Resources, Facilities Management, Finance, and other administrative and managerial functions are included.

Information Technology is an important and expensive shared function.

IT is often used as a model for charging other shared services.
Shared Services Chargeback
Introduction

- Shared services organizations have expenses, often times quite substantial.
- Shared services seldom are revenue producing.
- It is important how these expenses are shared among the revenue producing business units.
Shared Services Chargeback Discussion

- Best Practice Considerations
- Alternative Methodologies
- Some Actual Examples
What is the objective?

- Simple Budget Controls
  - Ignore the costs.
  - Consider the costs as general overhead.
- Cost Accounting Exercise
  - Allocate the costs to other functional groups.
What is the objective?

Chargeback Goals
- Provide Business Units with Information
- Identify Services Required
- Control or Influence Costs
- Use Resources More Effectively
- Improve Productivity
Materiality of Shared Services Costs

- Is the expense large enough to justify its own activity center?
- Can the business unit influence or control the expense?
- “Don’t chase dimes with dollars.”
Characteristics of Best Practice Chargeback Systems

- The system must be:
  - Equitable.
  - Repeatable and Accurate.
  - Understandable.
  - Controllable or Predictable.
  - Economical.
Equitable

- Fair to all customers.
- One customer is not subsidizing the cost of another customer.
- The customer pays for the services they consume or the capacity they request.
- Use activity-based costing methodology.
It should not matter when (time of day or day of the month) the job or activity is performed.

The same volume of work should cost the same each month.

Assuming the same input, it should consume the same resources each time.
The customer must understand the chargeback process and methodology.

Service provider (IT or Shared Service) must understand the chargeback process and methodology.

They both must know what is being charged.
Controllable or Predictable

The customer must have the ability to control or predict the cost of performing a particular activity.

If the customer processes more transactions, the cost should increase.

If the customer reduces activities, the cost should decrease.
Economical

The system itself must be relatively inexpensive to run, including:

- Collecting data.
- Processing.
- Reporting on the information.
Activity-based Costing Methodology

The activity consumes resources; therefore, the cost driver is assumed to consume (cause) costs.
Activity-based Costing Methodology

- Establish meaningful activity centers (cost pools).
- Ensure that the cost drivers selected have a strong positive correlation with the resource cost.
Additional Considerations

- Charge for resources that are expensive (material).
- Data is easy and inexpensive to collect.
- Sufficient detail to allow customers to influence the usage (cost).
- Track information by service (application) and customer (company, division, cost center, etc.).
Additional Considerations

- Include flexibility for baseline and incremental (fixed/variable) reporting.
- Charge for different skill sets
  - Junior and senior labor resources
  - Different cost/performance factors with hardware and software.
- Provide for service level agreement charges.
- Prime and non-prime time services.
Shared Services Chargeback Models

- Overhead.
- Charge “revenue generating” business units.
- Sequential charging.
- Simultaneous charging.
Overhead

- Simple process.
- Control through the budget process only.
- Understates the cost of the operating units and the shared service organizations.
- Distorts service or product profitability.
Charge Business Units

- HR
- Facilities
- IT
- Legal
- Business A
- Business C
- Business C
Charge Business Units

- Control through the budget process only.
- Allocation based on revenue generation or other methods.
- Misstates the cost of the operating units and the shared service organizations.
- Distorts service or product profitability.
Sequential Charging

Facilities

Legal

HR

IT

Only Charge Down The Hierarchy
Sequential Charging

- Control through the budget process only.
- Allocation based on a variety of methods.
- Misstates the cost of the operating units and the shared service organizations.
- Distorts service or product profitability.
Sequential Charging

Distorts Functional Costs.
- Legal, HR, and IT have true cost of Facilities.
- IT has true cost of Facilities, Legal, and HR.
- Facilities has no visibility to HR and Legal costs.
- Facilities, Legal, and HR perceive IT as free.
Sequential Charging

- No incentive to use service resources effectively.
- Provides misleading information to management.
- May result in erroneous management decisions.
Simultaneous Charging

HR
Facilities
IT
Legal

Business A
Business C
Business C
Simultaneous Charging

- Perfect world solution.
- Potentially complicated.
- Possibly resource intensive.
Optimized Solution

- Combination of the models.
- Services with immaterial costs
  - Bundle into overhead.
  - Allocate those costs on logical methods (square feet, head count, contracts, etc.)
- Services with materials cost should be charged back to those who consume the resources.
Example:

It is important for HR to understand the cost for IT services to be more effective in using those resources.

While it is important for IT to understand the cost of HR, it is unlikely that IT will alter its staffing decisions based upon those costs. Nor is there a direct correlations of the HR costs to IT staff.
We asked the following questions:
- What are you doing?
- Why are you doing it that way?

The answer to the “Why” question often was, “Because somebody set it up that way”.

Corporate inertia is as immutable as the laws of physics.
Major Telecommunications Company

- Uses separate “service companies” to capture costs in separate legal entities.
- These are very visible and have independent budgets.
- IT has a comprehensive chargeback scheme.
- Corporate, Finance, Legal, and HR are prorated to lines of business based upon share of total operating expenses and taxes.
Each line of business receives a monthly Corporate Prorate bill.

There is some direct billing. For example, Real Estate may bill directly for repairs on a specific building owned by a line of business.

Why…

“Keep in mind that our approach is "shaped" by regulatory requirements, so our methods may appear inconsistent and erratic to the perceptive observer, but we are subject to the whims of the regulators.”
Facilities costs are allocated on square foot usage.

HR costs are allocated on headcount.

All other corporate functions are allocated on a variety of methods.

Why…

Someone said to do it that way. They would prefer to use the method recommended in this presentation.
Major Canadian Bank

Everything is a percentage allocation.

Why…

The contact did not state a specific reason.

It has just always been done that way.
Currently, shares services is only IT. They are implementing a new allocation model that may include additional shared units such as Human Resources and Facilities.
Terry Quinlan, Executive Director reports that in the vast majority of cases, in his experience, companies incorporate their non-IT shared services costs into overhead.

Overhead is then allocated to units using a variety of methods (e.g., FTE, revenue).

Why...

It is the easiest method.
Conclusion

- The most effective use of chargeback in shared services environments should revolve around the optimized solution.
- Materiality, recovery objectives, and the resource intensity of maintaining the systems, are all part of a best practices shared services chargeback system.
Questions…