

# Session 3: Considering Expenses and Costing Systems in Reviewing Structures



# Organisational structures and costing. Lessons drawn from a number of research projects in this area

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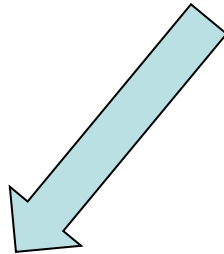
With help from the following researchers:  
Andrew Milne, Carolyn Cordery & John Davies  
Tan Yih Ling  
Nga Cao  
Matt van Kesteren

# Outline

- Costs and Expenses
- Costs in External Reports
  - Discretionary and nondiscretionary
  - Example: New Zealand Rugby Clubs
- Costs within a NFP Organisation
  - Importance of measuring and managing costs
  - Direct and indirect costs
- Costing Systems for NPFs
  - Examples: Four different NPFs + DHBs
  - What determines their use?
- Why Adopt a Costing System in a NFP?
- Concluding Comments

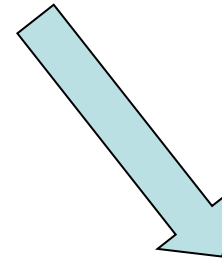
# Costs and expenses

Costs - resources given up to achieve a particular purpose



## **Expense**

Used in the generation of current income

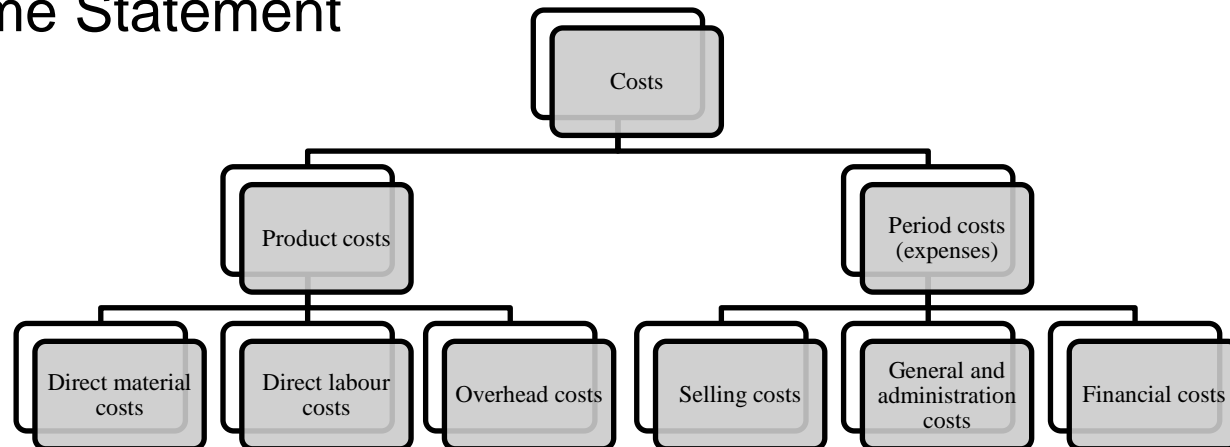


## **Asset**

Used to generate future income

# Costs in external reports

- Traditionally made up of:
  - Inventoriable (product) costs
    - Financial Position Statement
  - Non-inventoriable (period) expenses or costs
    - Income Statement

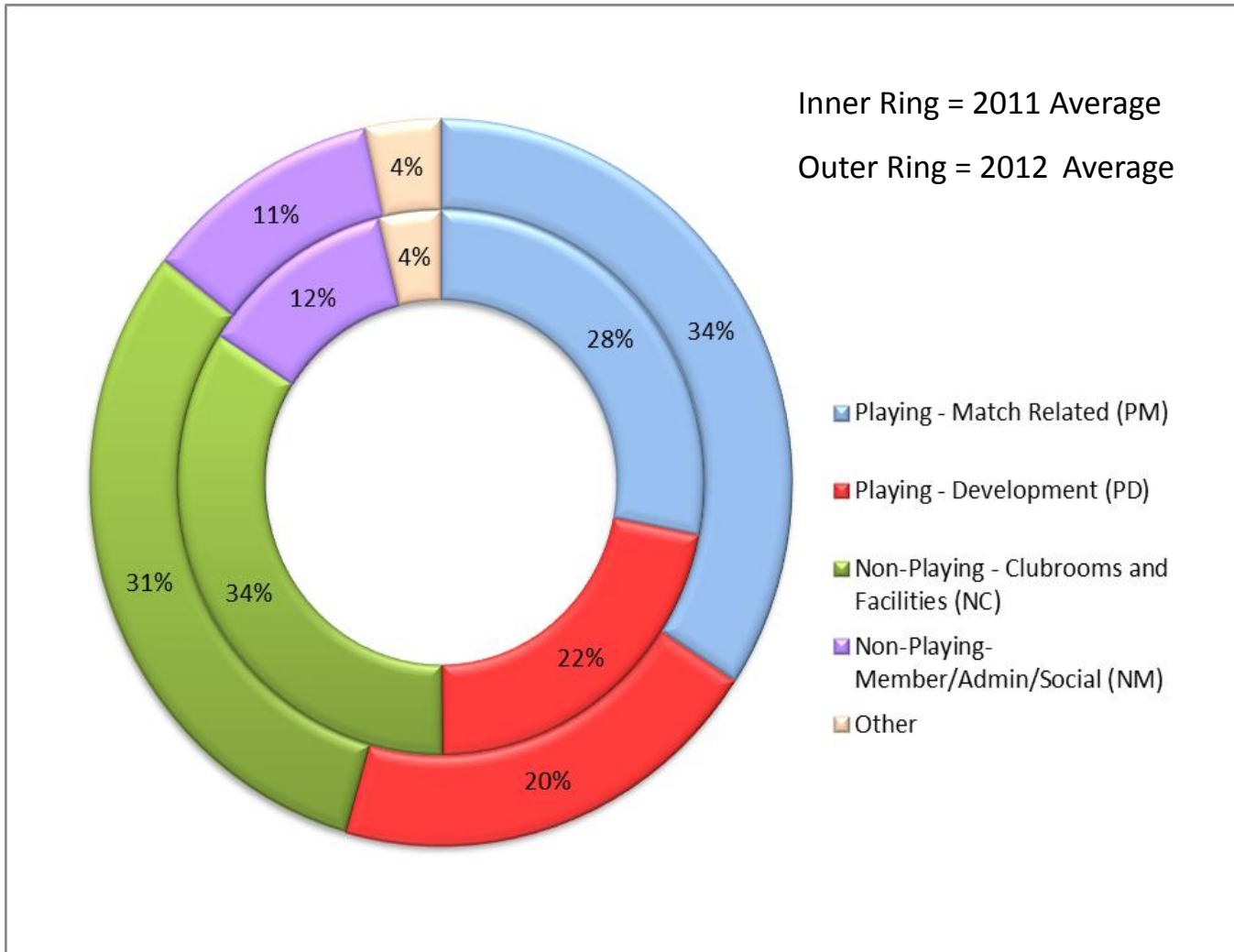


- In NFP unless makes a product or acquires a product for resale then vast majority of “costs” are “expenses”

- Need to understand costs/expenses because:
  - OPEX is the basis on which financial reporting tier structure is determined
  - Income/funding streams diminishing
    - Increase in competition for funds
    - Increase in costs
- Many NFPs think of financial statement expenditure as discretionary and nondiscretionary and analyse and made decisions accordingly
  - Discretionary - something which an organisation would like to spend money on but not essential for its operations.

# Costs in rugby clubs (Milne, Corderly and Davies)

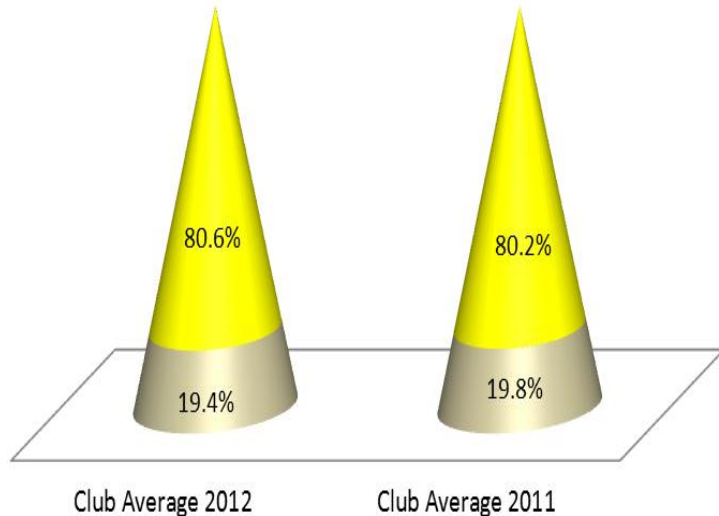
- **Expenditure Breakdown: Major Categories**



# Discretionary and nondiscretionary costs

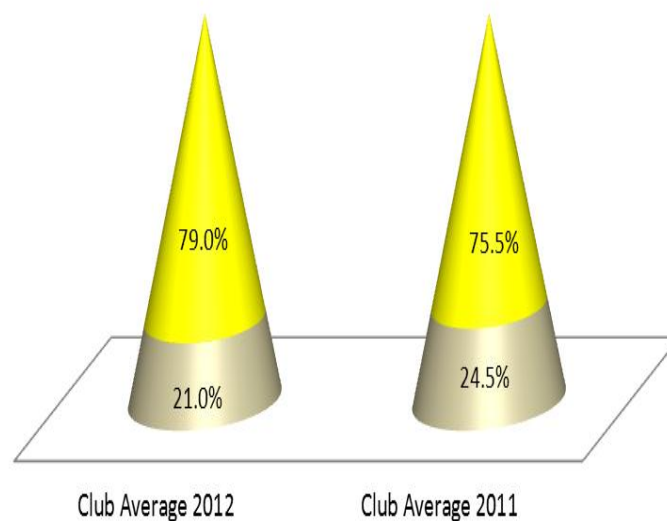
## Small Rugby Clubs

■ Discretionary Expenditure    ■ Non-Discretionary Expenditure



## Large Rugby Clubs

■ Discretionary Expenditure    ■ Non-Discretionary Expenditure



But 80% not discretionary – how are you going to manage these costs?



# Costs within a NFP organisation

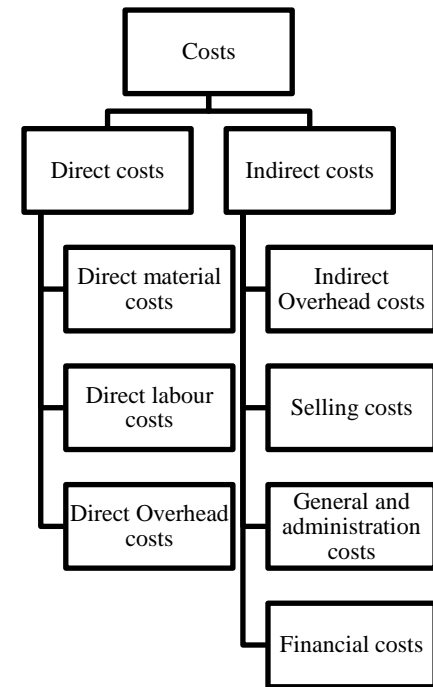
- Importance of measuring and managing costs
  - Assign costs to **cost objects** (cost accounting)
    - Service or programme costing
    - Allocation of indirect costs to determine cost
  - Cost management
    - Cost reduction
    - Budgeting
  - Performance measurement
  - Decision making

## Cost Object

- Anything we wish to know the cost of
- E.G: geographical areas, departments, units, cost centres, programs, contracts, fundraising activity, transfer prices, other prices, services, etc.

# Direct and indirect costs

- Direct: traced to cost object
- Indirect: cannot be traced
  - Incurred for 2 or more cost objects
  - Large portion of some organisation's costs
- In NZ majority of cost systems are
  - Direct cost systems
  - Marginal cost systems
- Public sector biggest user of sophisticated systems



	Non Absorption Cost System	Traditional Absorption Cost System	ABC System
Public Sector and NFP (1)	33.33%	33.33%	33.33%
Private Sector	60.90%	26.10%	13.00%

# Average cost structure by industry

	Total direct costs - mean	Total indirect costs - mean
Manufacturing	66.55%	33.45%
Agriculture, Forestry & Fishing	71.22%	28.78%
Financial & Real Estate	85.00%	15.00%
Education & Health services	67.14%	32.86%
Mining & Construction	79.00%	21.00%
Wholesale & Retail Trade	70.92%	29.08%
Other professional services	62.00%	38.00%
Other	62.50%	37.50%

Survey of New Zealand organisations including Public Sector and NFP (*Nga Cao*)

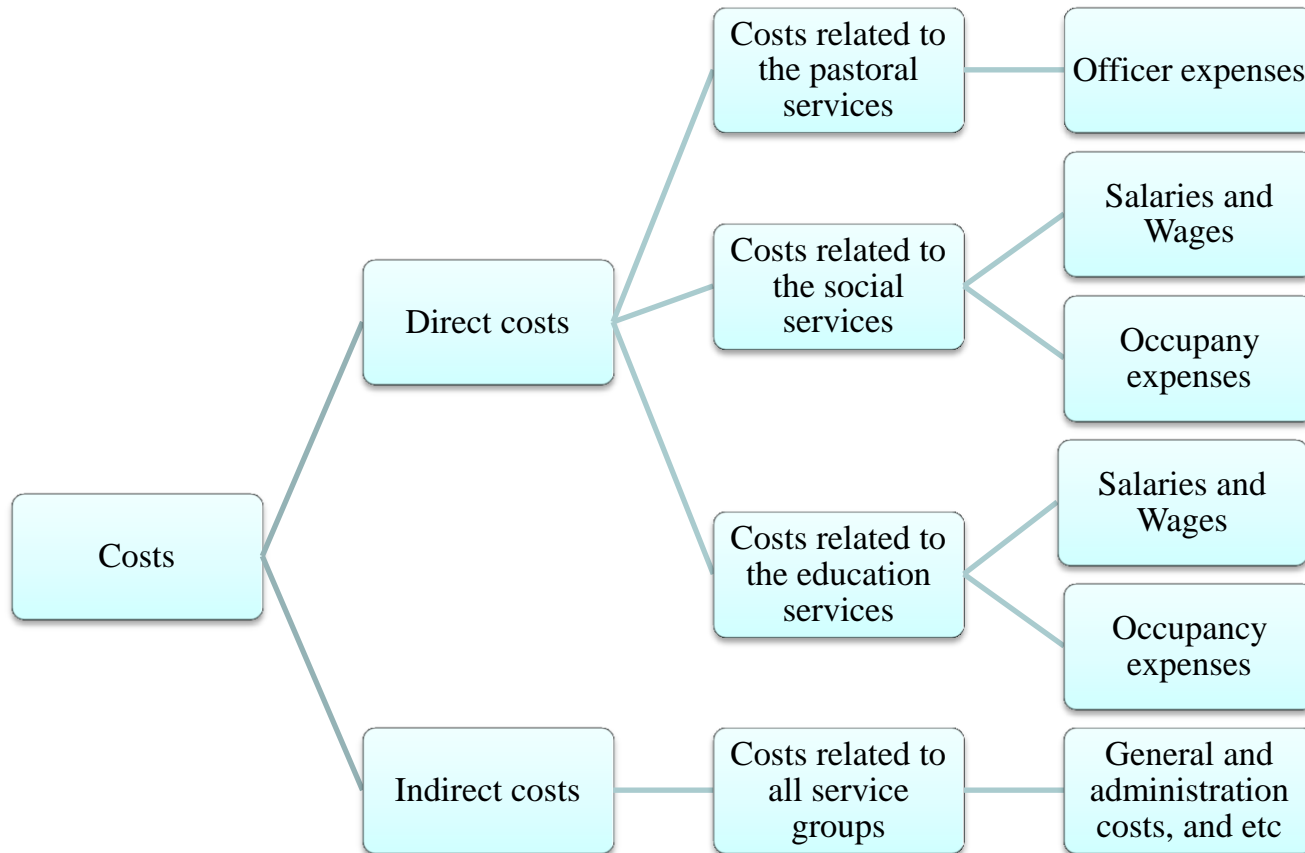
# Problems with using direct and indirect costs

- Direct cost of one cost object, indirect cost of another
- How to allocate/assign the indirect cost (overhead) to the cost object?
  - What is the cost driver?
  - How important is it to be 100% accurate?
- Inappropriate allocation leads to distorted costs

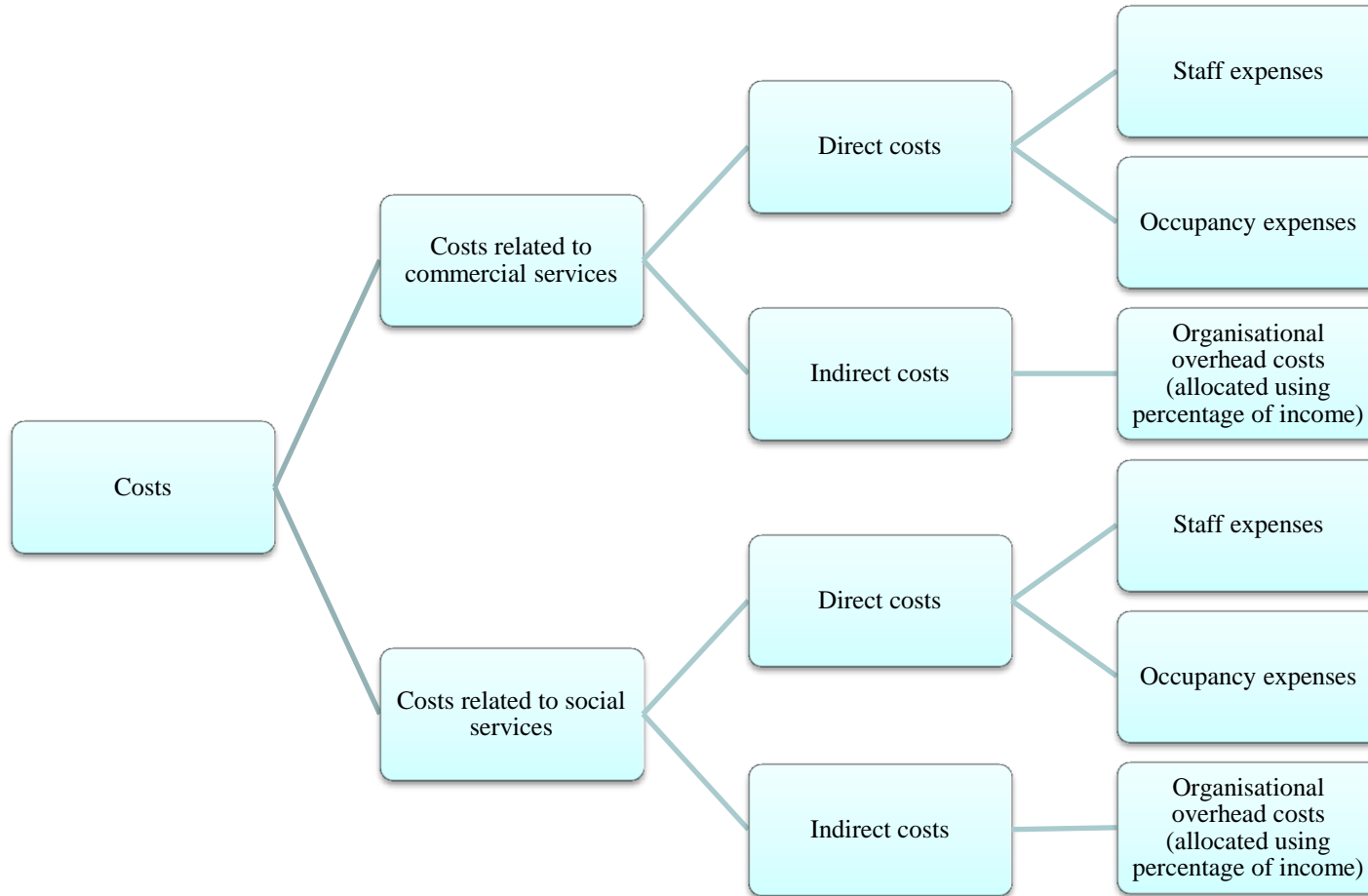
# Costing systems for NFPs

- Different for different organisations
- Many options for developing costing systems to meet the structure of your organisation.
- Case study examples:
  1. Four different NPF's - all use direct-indirect costing (Tan Yih Ling)
    1. Religious
    2. Education
    3. Health
    4. Social services
  2. New Zealand DHBs (Matt van Kesteren)

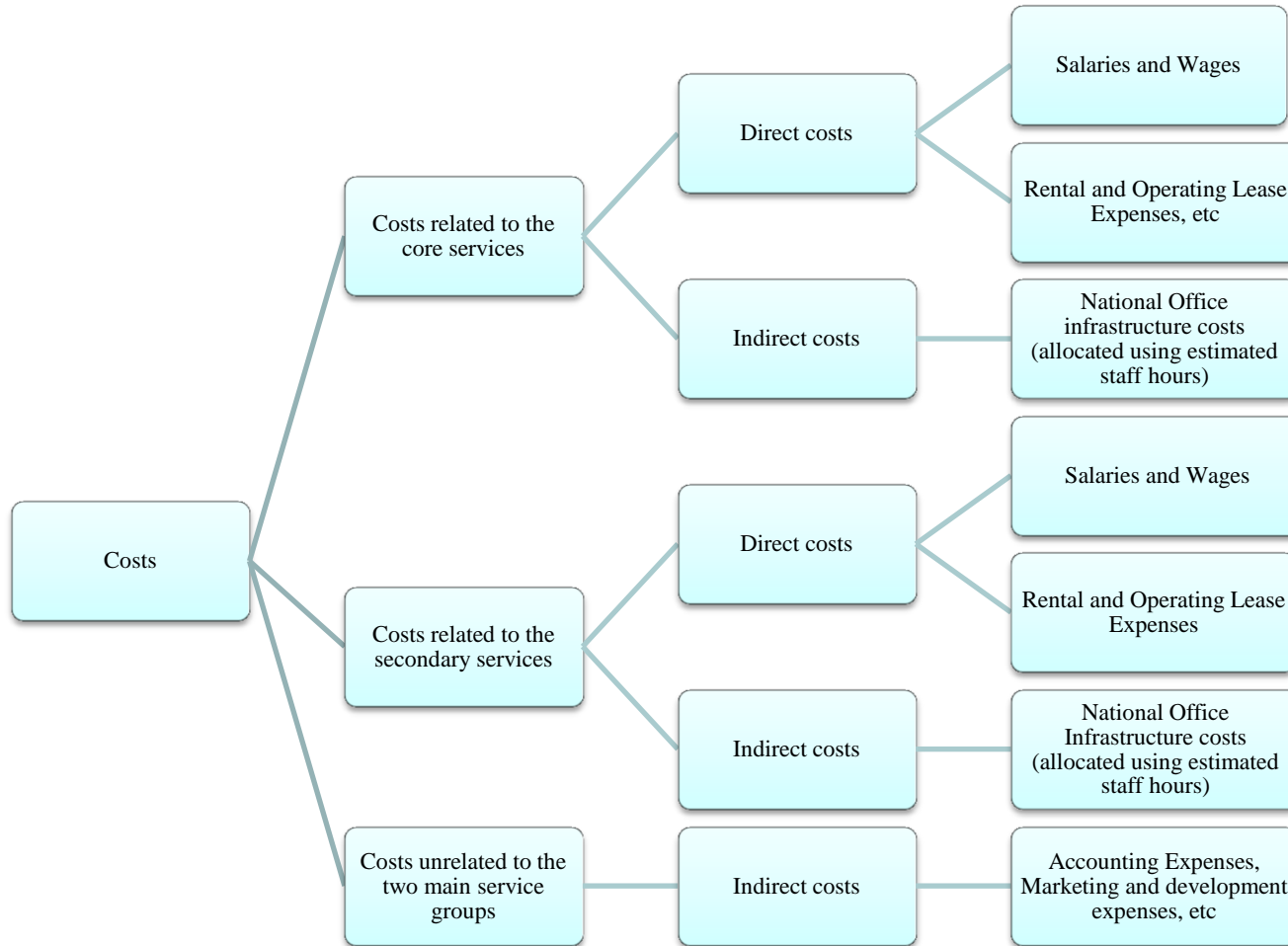
# Costing System – Religious NFP



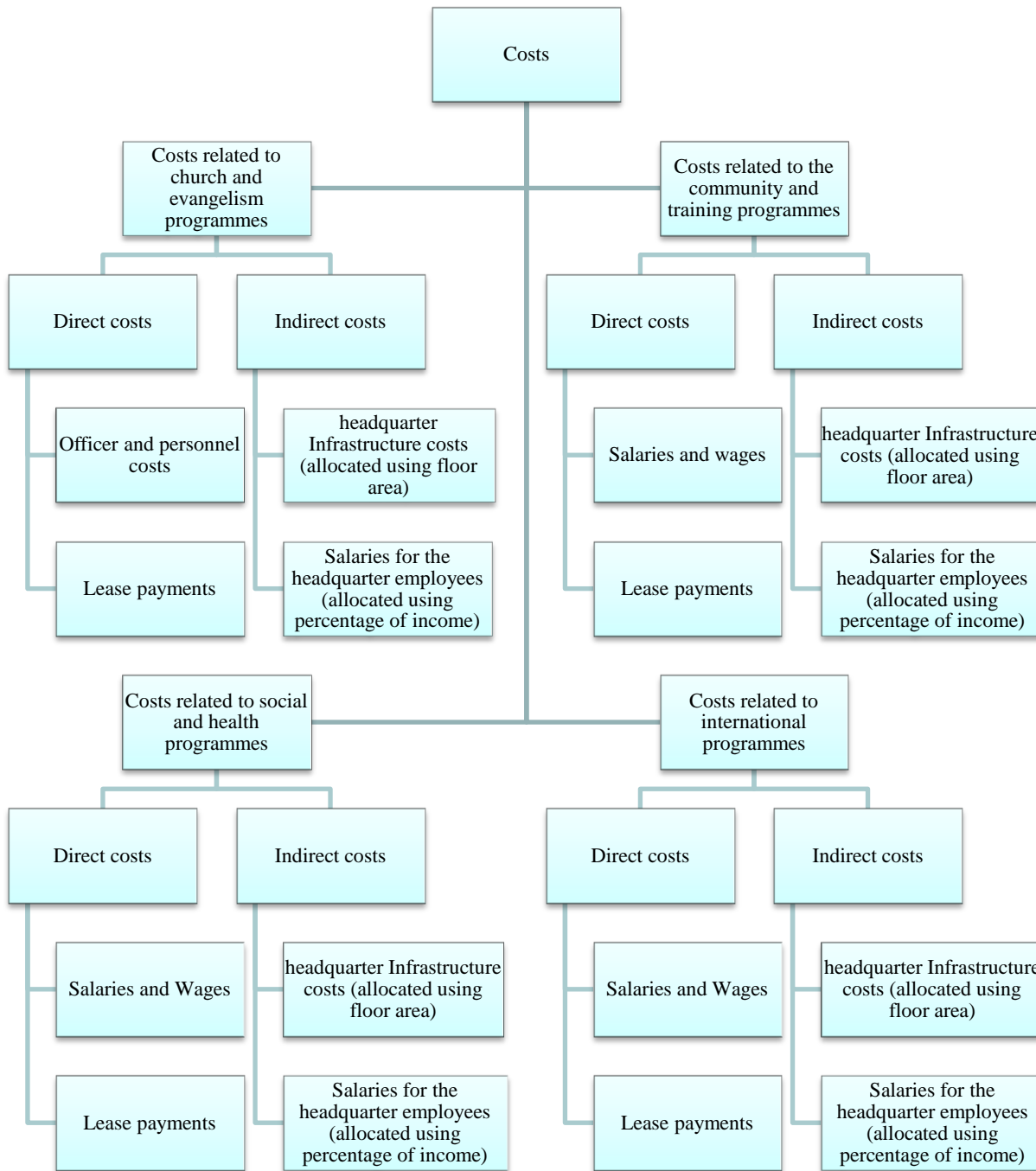
# Costing System – Education NFP



# Costing System – Health NFP

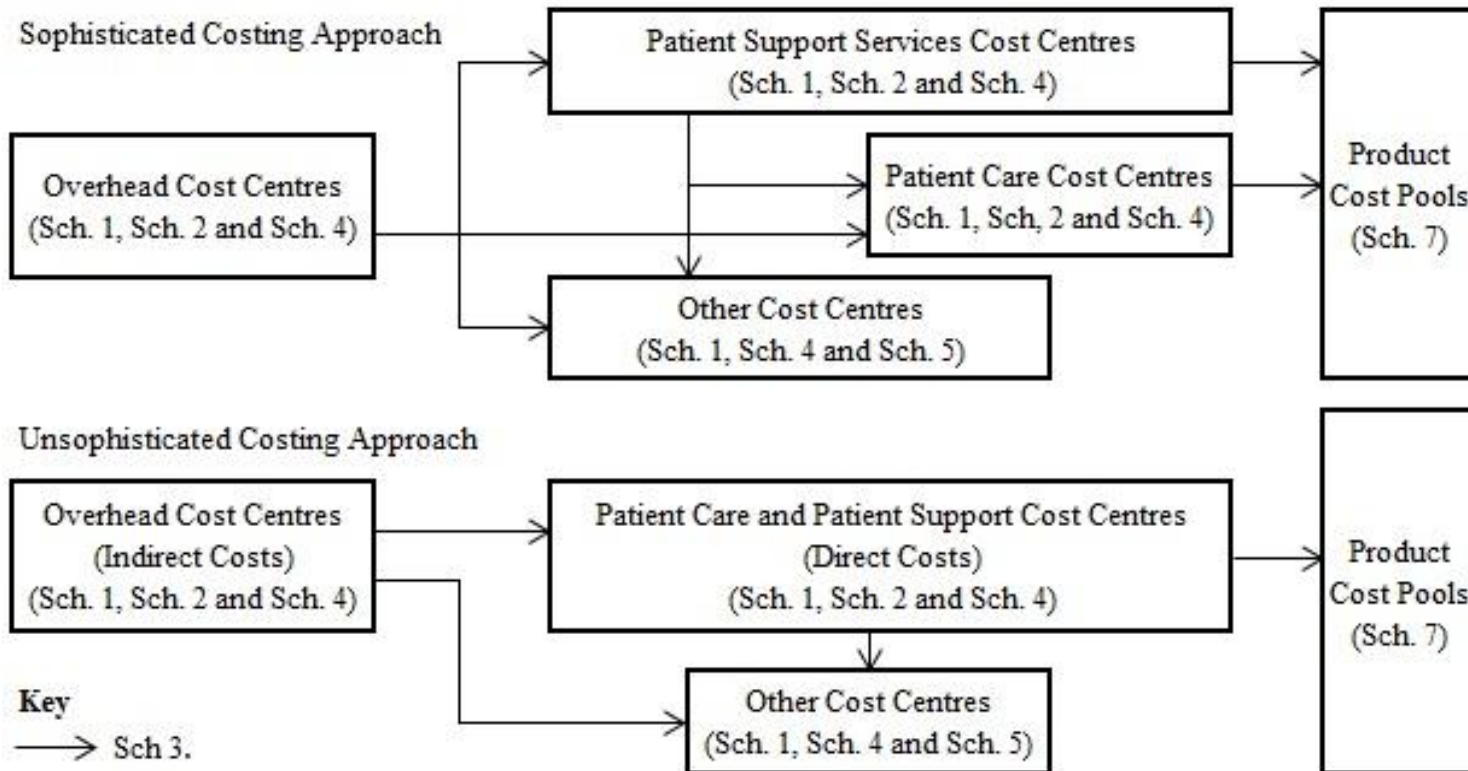






# Costing System – Social Services NFP

# New Zealand DHBs



# What determines their use?

- Type of NFP
  - Expressive versus service function
- When cost information is considered important by the organisation
  - Manage environmental risk to survive
- In a larger organisation
- Organisation has good information technology
  - Reduces costs of collecting and processing cost data
  - Availability of additional cost drivers

# Why adopt a costing system in a NFP?

Applications of cost information provided by the costing system	Religious	Education	Health	Social Services
<b>Service/programme costing and allocation of indirect costs</b>	Uses cost information for service/programme costing but not for allocation of indirect costs	Yes for both service/programme costing and allocation of indirect costs	Yes for both service/programme costing and allocation of indirect costs	Yes for both service/programme costing and allocation of indirect costs
<b>Budgeting</b>	Yes, centralises some of the budgets.	Yes	Yes	Yes
<b>Cost management and cost reduction</b>	Yes	Yes	Yes	Yes
<b>Performance measurement</b>	Yes, it compares and tracks budget to the actual spending and prepares variance reports	Yes, the commercial side measures the business growth rate and the social side compares budgets to the actual spending.	Yes, it compares and tracks budget to the actual spending	Yes, it compares and tracks budget to the actual spending
<b>Decision making</b>	Yes, e.g. government contract bidding decision	Yes, e.g. restructuring decision, pay increase decision, closing service and opening new service decisions	Yes, e.g. purchasing decision (but only part of the information used)	Yes, e.g. purchasing decision

*“We have to understand the costs we incur and relate it to each stream of revenue we get. We have to understand how each programme or contract matches the revenue and costs.”*

*“We would expect each location to be managing its budget. When its income is not what has been budgeted, we would expect them either looking for ways to find more income or ways to cut the costs that they’re incurring.”*

*“Cost information helps us to make decisions on which contract to bid and know the price that we’ll be able to cover our costs. It’s not good for us getting a government contract to do a particular piece of work if we’re not gonna be able to cover the costs of that.”*

*“We have to manage the individual cost centres. If we manage them correctly ... the picture would be fine. So we use cost information for cost centres.”*

*“We’re a service-based organisation. If we don’t manage our costs, funders won’t have confidence that we’re actually a good organisation.”*

# Concluding comments

- You need to think about your internal costs as well as your external reporting expenditures.
- Every NFP organisation should know what their costs are and manage them.
  - Can do this using some form of costing system
  - Provides useful information for costing, budgeting, cost reduction, performance measurement, and decision making
- But need to:
  - Consider both installation and ongoing costs of the system
  - Realize that cost categorization is not a “black and white” exercise.

# Thank You

## Questions and Comments

