


SHARED SERVICES TEAM

Document Name: Shared Service Charging Rules and Guidelines

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Charging Special Interest Group (SIG) **Shared Service Charging Rules and Guidelines**

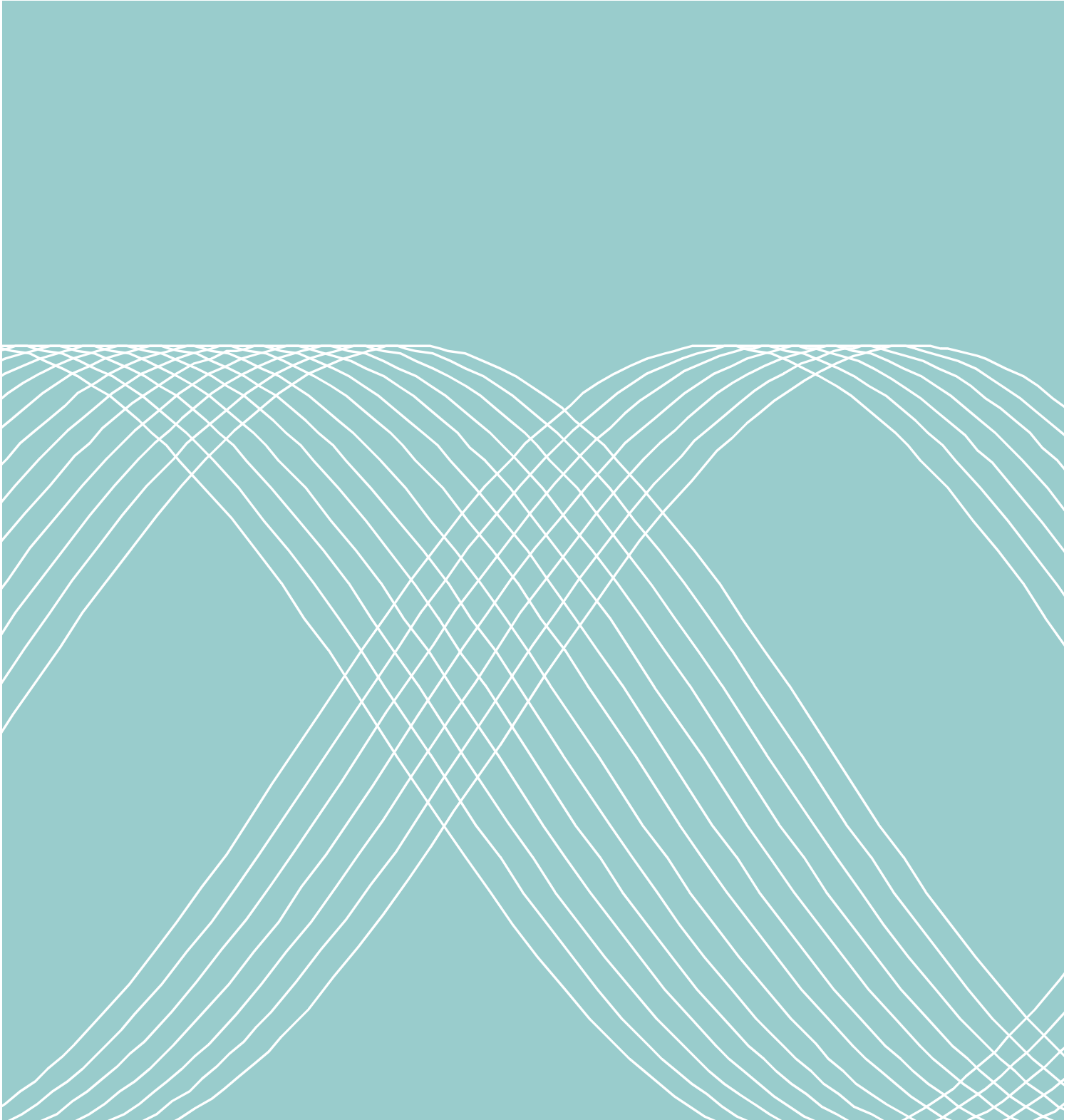


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This material has been developed to reflect a shared understanding of good practice in the areas specified. It is intended to provide guidance to Public Sector shared service practitioners, rather than to document formal government policy. The Cabinet Office cannot accept any liability for the accuracy or content of this material.

1 Introduction

1.1 Objectives

- This material provides guidance on developing charging mechanisms for shared services in the public sector. It applies to all bodies that are government departments (including executive agencies or trading funds), non-departmental public bodies (NDPBs) most public corporations (including NHS trusts or other NHS bodies) in England and, in respect of non-devolved services, in Scotland, Wales and Northern Ireland. It is intended to give guidance to all such bodies planning to provide or receive shared services. The precise applicability of individual points will vary according to the size and nature of the shared service, and the exact form and status of the body delivering the services.
- This document contains two principal sections:
 - The **first part** of this document ('Government Accounting Rules Relating to Shared Services'), outlines the government rules that determine the parameters of what charging approaches are possible for public sector organisations.
 - The **second part** of this document ('Developing a Charging Model'), looks in more detail at the approach to constructing a charging model.

1.2 Background

- This document has been developed using input from the Shared Service Team Special Interest Group on Charging. The group consisted of practitioners from the public sector, using input from external and private sector sources. SIG Contributors included:
 - Defra
 - DfT
 - DVLA
 - DWP Finance
 - HM Treasury
 - Home Office
 - ODPM
 - Scottish Executive
 - Input from the Government of Queensland
- Any updates, corrections or queries regarding this material should be sent to the Shared Services Team via sharedservices@cabinet-office.x.gsi.gov.uk.

2 Government Accounting Rules Relating to Shared Services

- This material is intended to identify the key information sources relating to shared services charging, and to document the discussion points that were raised during the Charging Special Interest Group meetings held August – November 2005.
- This section has been reviewed by HM Treasury Fees and Charges Policy Team to ensure that it is consistent with the key requirements of charging in the public sector, and is in line with the Treasury Fees and Charges Guide (which is currently under review)
- However, this material does not replace the detailed guidance on charging provided in the Treasury Fees and Charges Guide or in the various Government Accounting documents specified below. Accounting Officers and other responsible parties need to ensure they develop their charging plans in accordance with all appropriate requirements.

2.1 Primary sources

- The principal documentation providing guidance on the setting of service charges in the public sector is the 'Treasury Fees and Charges Guide' (1992), which is currently in the process of being redrafted. The current draft is not available for general circulation, although the Fees and Charges Policy Team can be contacted with specific queries (sue.warrington@hm-treasury.x.gsi.gov.uk / tel 020 7270 5314)
- Treasury Guidance as set out in the Fees and Charges Guide focuses primarily on the basic statutory and legal parameters relating to charging. These parameters are often high level, and the details of any charging strategy will be determined in part by the specifics of the services in question and the policy context.

2.2 Additional sources

- Government Accounting 2000 manual, incorporating Amendment 4/05 (<http://www.government-accounting.gov.uk/current/frames.htm>)
- Resource Accounting Manual, HM Treasury
- FrEM (Financial Reporting Manual) for accounts from 2005-06 onwards (see <http://www.financial-reporting.gov.uk/>)
- Improving Financial Management High Level Requirements and Outline Plan Milestones

2.3 Key Charging Considerations

2.3.1 Types of service

- There are four different types of chargeable service, depending on the type of provider and customer organisation:
 - a) **Statutory service** – where there is a provision in statute to recover a fee for a service and where the fee is, or would be, set or approved by a Minister or one of the bodies described in paragraph 1.1.
 - b) **Interdepartmental service** – a discretionary service provided by one of the bodies described in paragraph 1.1 to one of the other bodies.
 - c) **Intradepartmental service** – where one part of a government department provides a discretionary service to another part of the same department (either the provider or recipient, or both, may be an agency or part of an agency)
 - d) **Commercial service** – where, in the absence of a specific fee-setting power, a department, agency, NDPB or NHS body sells discretionary services to the wider public sector or to the private sector
- The category of service will have implications for the financial objective of charging, and legal and policy considerations. Most shared service provision will fall under categories B, C or D.

2.3.2 Financial objectives for shared services

- **Statutory services** - Shared services are not likely to fall within this category. If they are, their charging approach will be defined by legislation. Full cost recovery is normally applicable. A clear justification (usually by the responsible minister) is required where it is proposed deliberately to recover less than full costs.
- Where the intention is to recover more than the full costs this needs to be set out in the legislation. Where the proposed charging structure involves charging different fees to different users for the same form and quality of service, and this is not wholly related to differences in the cost of providing the service, the power to do this should also be set out in the legislation.
- **Interdepartmental services** - Full cost recovery is the default charging policy. There are some exceptions to this rule but in most cases charging mechanisms that return more than full cost recovery and result in a deliberate and significant surplus are not appropriate, and are likely to be classified as taxation.
- Goods and services should only be provided free of charge interdepartmentally if the cost of payment transactions (e.g. raising invoices

and paying bills) would outweigh the benefits of payment, or if there are other exceptional considerations.

- **Intradepartmental services** - Charging for intra-departmental services should be introduced selectively. It is appropriate where it is useful for control purposes, assessing value for money or market testing, giving customers the freedom to choose different sources of supply and place work where best value dictates.
- Where charging is used for intradepartmental services, full cost recovery considerations apply as for interdepartmental services.
- **Commercial services** - Commercial services will usually need to charge at a market rate, which may be higher than a full cost recovery level. Above all this applies where there is or may be potential or actual competition with private sector suppliers, in which case including a profit element where appropriate would avoid unfair competition by the public sector.

2.3.3 Treatment of costs

- Where full cost recovery is the financial objective, all costs incurred should be charged, even notional charges for sunk costs. There should be no 'free' overheads. The full cost should be calculated on an accruals basis. The end goal is to charge for the total cost of all the resources used in providing the service (direct and indirect costs, including a full proportional share of overhead costs and any selling and distribution expenses, insurance, depreciation and cost of capital, etc, both cash and "non-cash" costs).
- Startup and capital refresh costs should be included in full cost recovery. The amortisation profile for shared service capital items should be spread over the expected life of the capital asset, for which an annual depreciation charge can be passed on to the customer.
- Full cost recovery should include recovery of the cost of capital, at the rate of 3.5 per cent in real terms for statutory, inter-departmental and intra-departmental services; a higher indicative rate may be appropriate for commercial services
- All capital expenditure related to service provision should be funded up front out of departmental voted finance, from trading funds' or NDPB's internal resources or through other means (PFI etc).

2.3.4 Apportionment of costs

- The general principle is that the same fee should be charged to all customers of the same service or form of the service. Where services are provided on an inter-departmental basis and where there are multiple customers, costs should normally be split in line with the relative levels of consumption of each customer (for which an allocation or transaction – based charging mechanism may be appropriate).
- The Service Agreement between supplier and customer needs to clearly state how overheads and other costs will be allocated so that they can be apportioned consistently.

2.3.5 Estimates v. actuals

- The Treasury guide requires use of actual costs as the basis for charging where possible, based on initial estimates for planning purposes. Significant variances from estimates should be rectified through payment or receipt of balancing charges. The thresholds and process for making such balancing charges should be articulated in the service level agreement.
- Estimates (e.g. based on periodic surveys) should be used only when actual information is not available (or only available at disproportionate cost). Whenever possible, the method of assessing costs should be that used for the operating cost statement of departments' resource accounts (or other public bodies' annual accounts).
- A full review of costs should be undertaken periodically to ensure that the service provides value for money. Charges should be adjusted accordingly following reviews.

2.3.6 Accounting periods

- The key accounting period for service charging is 1 year, and costs incurred within any year should be recovered within the same accounting period. If a service provider generates a surplus or deficit through providing a service, this must be balanced within the accounting period.

2.3.7 Variances

- In practice, a degree of tolerance is applicable when balancing variances between forecast and actual costs. Although it is not normally legitimate for a service to deliberately recover more than full costs, it is legitimate in the interests of administrative efficiency to apply a degree of tolerance.
- For example, a fee may be rounded even though this may produce a small surplus or deficit; and in some cases the rates to be used to determine a particular cost may be provided centrally on an averaged basis and may not be recalculated each year.

2.3.8 Differential pricing

- Price differentials where there is no difference in the underlying service represent a 'cross subsidy' (ie some customers paying more than full cost so that others can pay less). This should normally be avoided, but may be appropriate if it is explicitly provided for in statute (more appropriate for statutory services).
- In other cases where, exceptionally, Ministers agree that a service should recover less than its full cost, i.e. that the service should be subsidised from public funds, there should be either a target date for moving to full cost recovery or clear justification for continuing with less than full cost recovery.

2.3.9 Income retention exceptions

- **Trading funds** – All income collected in the course of a trading fund's business should normally be credited to the trading fund.
- **NDPBs** – Some NDPBs are required to pass their income to their sponsor department for surrender to the Consolidated Fund as CFERs. Other NDPBs are permitted to retain their income, which may be used to meet expenditure and is in some cases offset against the level of grant in aid. The treatment of an NDPB's income should be specified in the NDPB's financial memorandum (or equivalent document).
- **Wider markets initiative** - There is an automatic right to retain income from those commercial services which come within the definition of wider markets activities, subject to a number of technical points on retention of income set out in the policy note and to the requirement to consult the Treasury. However, the WMI applies only to services that represent the sale of existing excess capacity, which does not apply to shared services provision.

2.3.10 Responsibilities

- In most service provision scenarios, it is assumed that one department or organisation will take the lead for managing the service, for which there will be a responsible lead accounting officer. Responsibility for the sound financial management of a service lies with the Accounting Officer of the supplier. The Finance Director (FD) should exercise oversight of all chargeable services in Government Department on the Accounting Officer's behalf. The equivalent officer in a NDPB or a NHS body should exercise similar oversight.
- However, it is also possible for a number of other governance models to work effectively to provide a platform for common services, including taking some corporate form (e.g. an agency with several parent departments, an NDPB or even a Companies Act company) and the departments using it could buy services from it.
- The detailed organisation of fees and charges work will vary from service to service, depending on local requirements, the nature of the service and the resources available to support it. In the case of a Government Department, it will normally be appropriate for a Finance Director to appoint a Fees and Charges Co-ordinator to provide guidance on fees and charges matters and to check that service managers are fulfilling their responsibilities. Executive Agencies and Trading Funds may organise the work differently, but the same functions need to be performed.

2.3.11 New joiners

- Government accounting rules do not make specific requirements for treatment of new joiners to an ongoing shared service – the same full cost recovery rules apply. The Service Agreement documentation between supplier and customer should clarify how all costs will be split and allocated if new parties join the shared service operation.

2.3.12 VAT

- Public bodies are required to provide HM Revenue and Customs with a full description of any new service (other than intra-departmental services) for which a charge is to be made so that the question of liability for Value Added Tax can be considered. Generally, VAT is chargeable on shared services, which is then recoverable by most customer organisations, with the exception NDPBs. Shared Service VAT procedures are currently being assessed by an HMT/SST working group.
- All government organisations with the exception of NDPBs can reclaim VAT on the provision of Corporate Services. The SST is exploring channels for enabling the exemption of NDPBs.

3 Developing a Charging Model

3.1 Overview

The charging mechanism is an approach agreed between provider and supplier, and may require several iterations before agreement. The final charging mechanism should be documented in the Service Level Agreement or a related Charging Schedule, which sets out the charges, costing method and objectives, as well as the roles and responsibilities of the various parties .

The nature of the relationship and the spirit behind it is a key factor in the development of a sustainable charging mechanism. Limited trust between the parties will result in a sub-optimal agreement. The clear communication of the financial objectives of all parties is an important part of this process, including the sharing of financial information (before, during and after negotiation e.g. through an open book agreement).

In addition, both parties should aim to keep the mechanism as simple as possible, whilst still retaining sufficient detail to ensure proper accountability. Too much detail can generate a charging 'cottage industry', so any aspect of charging strategy needs to be justified in terms of the objectives and responsibilities of the parties.

There are four main steps in the development of a shared services charging model:

- **STEP 1 - Clarify objectives & context** – Why is charging being considered? What does it need to accomplish, by what mechanism is it to be delivered and what are the rules that need to be observed?
- **STEP 2 - Determine cost model** – What are the underlying costs of providing the service? How should the component costs be allocated?
- **STEP 3 - Determine charging approach** – Given the objectives and costs of providing a service, how should they be reflected in the price the customer sees? Is the charge 'soft' (nominal) or 'hard' (real)?
- **STEP 4 - Manage charging** – How should the charging mechanism be negotiated, agreed and reviewed?

A key distinction in the process is the difference between costing and charging – understanding the underlying cost of the service, and determining the price for the customer. The following sections will explore each step in detail.

3.2 STEP 1 - Clarify objectives & context

Clarify objectives: A successful charging approach must fulfil a range of objectives, depending on the type of the organisations involved in the shared service and the allocation of roles and responsibilities between them. The objectives will have implications for the approach required in subsequent steps:

- **Government rules:** The primary financial objective of the organisation, and each individual service it provides, will be determined by Government accounting rules (see Section 2). This will have fundamental implications for the charging strategy, e.g. for the treatment of costs, cost recovery, admissibility of surpluses.
- **Additional criteria:** In addition, there are a range of additional criteria need to be considered in the design of a charging mechanism:
 1. Be perceived as transparent and fair by both supplier and customer
 2. Promote positive behaviours by supplier and customer
 3. Identify and communicate the underlying cost drivers
 4. Be easy to use, to implement and transparent
 5. Be predictable and stable over time
 6. Promote comparability of prices

Service scope: The charging strategy also requires a clear statement of the services to be charged for.

3.3 STEP 2 - Determine cost model

Running a shared services operation incurs costs, and 'costing' is the term for allocation that cost to the various processes and customers of the service. Costing is not an exact science, and can be approached with a range of accounting techniques.

As the starting point in most charging strategies, determining the true cost of a service by cost allocation can be a complex task. There is a variety of methods of allocating costs, and the right method depends on the degree of sophistication required by the customer / supplier relationship and the extent to which there is a desire to influence behaviour.

Determining the cost structure of a shared service operation is the primary basis for calculating charging in almost all public sector contexts, as most charging will be conducted on a cost recovery basis. Even where the charging strategy of an organisation is not cost-driven (e.g. market-based pricing), an understanding of underlying costs is essential in order to estimate margins and to drive continuous improvement.

Where there are multiple customers, a common basis for sharing costs between customers should be agreed. Similarly, where services are provided in more than one form (eg a premium as opposed to a standard service) a common basis for charging for each form of the service should be agreed.

3.3.1 Types of costing model

In practice, there are a limited number of types of costing approach, ranging from simple allocation to more complex transactional models:

1. Simple Allocation

- The cost of a service can be recovered by allocating it between customers on a consistent basis - such as in proportion to the number of FTEs in each customer's organisation (but this may lead to arbitrary outcomes unless the pricing mechanism reflects costs).
- This approach requires developing a view of the costs of the service as a whole, or of individual processes, including all fixed and variable costs. Assumptions need to be made about which costs can be allocated to the service, and which are part of the day to day activities of the supplier organisation.
- The total costs of the service are then divided between customers (including all in-house customers) according to a high level allocation metric, such as the number of FTEs (or terminals) working on each sub-process.
- Private sector perspective: "If it all boils down to FTEs anyway, then you have to ask why go to all the trouble to devise a complex transaction or activity pricing mechanism. On the other hand, activity based costing can play a key role in understanding and reducing the cost of the SSC-but so can a lot of other techniques, such as six sigma or benchmarking"
- See sections 4.2, 4.3 and 4.4 for illustrations.

2. Transactional Allocation

- Transactional allocation goes a step beyond simple allocation by using historic volumes data to calculate a standard unit cost per transaction (e.g. processing an invoice: £x m Accounts Payable cost / y m invoices => 1 invoice costs £z). Using forecast volumes for a forthcoming service period, this method produces an estimated volumes-based costing.
- By understanding the unit cost per transaction the customer can be encouraged to shift behaviour to minimise expensive transactions (e.g. manual processing) and maximise more unit-cost effective transactions (e.g. automated processing). This is only effective where 'hard' charging is in place (i.e. real financial charges are paid).
- This method relies on making assumptions about which transactions drive costs for each process of the service. In addition, calculating the unit cost will also require the same high level allocation assumptions about which costs are in scope, as used in simple allocation.
- More complex approaches such as Activity Based Costing can also be used to develop a transactional cost model, although this is usually too complex to be warranted purely for the purposes of developing a charging mechanism.
- Transactional cost allocation is most useful where there is a high level of variable / volume based costs in a service. Where there is a high level of fixed overhead, the approach is less useful and simple allocation may be more appropriate.
- See sections 4.2, 4.3 and 4.4 for illustrations.

3. Resource based

- The charge for a shared service may include components where the costs are entirely linked to use of retainer or on demand third party resources e.g. In Accounts Receivable, collections may require legal advisory input.
- In such cases, the estimated number of hours / days to be worked can be calculated, or a fixed retainer negotiated

4. Hybrid

- In practice, service costing will usually calculate different components of a service using different methods. See sections 4.3 and **Error! Reference source not found.** for illustrations.

3.3.2 Cost categories

The cost model should include all costs incurred for the provision of the service, including set-up and ongoing costs. During the set up of new shared service operations, large investment costs may need to be incurred (e.g. transition costs such as TUPE; new technology costs). In line with government accounting rules, they should be included in cost calculations and taken into account in charging either through the element of the charge for depreciation (for capital expenditure) or by spreading them over the first few years of service provision (for costs that cannot be capitalised). A list of key cost categories to assess is included in section 4.1.

3.3.3 Lack of cost data

At the start of a shared service process, organisations often have limited information

on what their real costs are. Many operations do not know the number of people involved, the transaction numbers or the current levels of accuracy. In these circumstances, it is important to recognise that the development of a costing (and charging) model is an iterative process and that more sophisticated modelling may not be possible at the outset.

3.3.4 Variance from forecasts

The costing methods above are driven initially by budgeted / estimated costs, however actual costs may deviate significantly from these forecasts. If the financial objective of the service is full cost recovery, any significant shortfalls or surpluses need to be rectified with balancing payments between provider and customer.

Where the financial objective is 'commercial' (i.e. other than full cost recovery) and the final service charge is not based on transactional models, the charging may entail a 'volume risk' that can be borne by the provider or the customer (e.g. the provider pays for higher than expected transaction volumes / the provider benefits from lower than expected transaction volumes).

These transaction volume risks can be managed through the use of agreed range of volumes or 'deadbands' (e.g. 100k invoices processed, +/- 10%). Where actual volumes are significantly higher or lower than predicted, agreed pricing modifications are applied.

3.4 STEP 3 - Determine charging approach

Setting a price for services is a central element of most customer-provider relationships. Defining the charging strategy can be a complex task because there are many alternative models, options and implications. Different strategies can lead to different charges; they can also lead to different behaviours by the supplier and customer. In addition to agreeing the type of charging mechanism, the customer and provider need to confirm secondary charging questions such as billing frequency and invoicing approach.

3.4.1 Hard and soft charging

Hard charging describes where actual funds are transferred between a customer and a supplier. Under soft charging, the charge is nominal, and funds are typically retained under central management. Under government public expenditure rules, all inter-departmental services should be provided under hard charging arrangements.

Unless public sector customers employ hard charging and have a direct responsibility for paying for the services they use, charging remains nominal. Under a soft charging regime, cost overruns or savings are not recharged and have no significance to customers, and there is no incentive to seek out and maintain a good supplier relationship. The move from soft to hard charging has a major impact on how customers procure and manage services.

3.4.2 Types of charging approach

There are several types of charging model in shared services. Each option should be assessed based on the financial objectives of the shared service (see section 3.2):

I. (No charge)

- Many internal shared service centres do not charge – particularly where flows of money are nominal (e.g. between two parts of the same organisation), or where the cost of administering collection outweighs the charge.

II. Cost recovery

- Cost recovery sets the charge to exactly meet the level of costs incurred in providing the service. Full (rather than marginal) cost recovery is the default charging requirement in the public sector. In cost recovery, costs effectively 'pass through' the provider - with the exception of a 3.5% cost of capital charge, and other non-cash costs.

III. 'Cost plus'

- A 'cost plus' charge applies a margin on top of the costs of recovery. This is often the default charging approach of private sector providers. Private sector 'cost plus' models can come in two forms - a 'fixed price' basis where original estimates are final, or a 'time and materials' basis which varies according to the actual level of input.

IV. Market based

- A market-based charge is not directly based on the underlying costs of provision. It is based on typical charges available from comparable service providers in the marketplace. It is applicable primarily to private sector providers and public sector organisations providing 'Commercial' services.

V. Performance based

- Cost plus and market-based pricing approaches can also be linked to performance levels. The charge is modified by service credits or bonuses based on actual performance of the supplier or customer (e.g. as measured against SLAs). For example:
 - 20% payment reduction for achieving 80-90% of performance target
 - 10% payment reduction for achieving 90-97.5% of performance target
 - Full payment for achieving 97.5-102.5% of performance target
 - 10% payment increase for achieving 105-110% of performance target
- Without hard charging, performance-based charging has no financial consequence for the provider or customer (e.g. charges are nominal), and therefore has no impact on behaviour.

3.4.3 Example Charging Scenarios

Depending on the type of organisation supplying the service, different charging models will be most appropriate in a public sector context. The following table provides a few examples:

Provider	Considerations	Relevant Charging Options
Inhouse – Intra department	<p><i>A shared service with customers in the same organisation:</i></p> <ul style="list-style-type: none"> • No external supplier • No cross-dept funding issue • Simpler governance • No competition 	<ol style="list-style-type: none"> 1. Simple cost recovery 2. Transaction cost recovery
Inhouse – Inter department	<p><i>Inter department provision from a 'lead department':</i></p> <ul style="list-style-type: none"> • Cross dept movement of funds • Governance more complex • Requires detailed service definition and contractual agreements • Competition from alternative suppliers 	<ol style="list-style-type: none"> 1. Simple cost recovery 2. Transaction cost recovery
Outsourced	<p><i>Outsourced shared services:</i></p> <ul style="list-style-type: none"> • Commercial shareholder considerations • Risk transfer (e.g. TUPE) • Potentially higher set-up costs • Formal contracts & legal governance 	<ol style="list-style-type: none"> 1. Simple cost recovery 2. Transaction cost recovery 3. Performance based 4. Cost Plus

3.5 STEP 4 - Manage charging

3.5.1 Reviewing the charging mechanism

A charging mechanism should not be static. The scope, objectives, and knowledge of the customer-supplier relationship will change with time, and different strategies may be appropriate in the future. As parties in a shared service relationship get more experienced, more sophisticated charging techniques may become possible (e.g. based on more extensive costing data, new systems).

Most organisations find that a simple allocation of costs (e.g. by FTE) is most practical when launching a new shared service centre, moving to more sophisticated models as the service matures. The SLA should therefore include scope for a regular review of the charging mechanism and charges, typically on an annual basis.

3.5.2 Changing the charging mechanism

The charging mechanism should also be able to accommodate major changes in the structure of the service. For example, the SLA / Charging Schedule should outline the procedure for admitting an additional customer onto the service, and describe how costs and charges will be updated to reflect this. The SLA / Charging Schedule should also describe the charging implications of the premature termination of a service agreement, the effects of any changes in domestic or EC law, taxation or other initiatives that could impact on the cost or structure of the service.

4 Appendices

4.1 Cost components

The following types of cost should be considered for inclusion within a shared service costing model (Source: SST and HM Treasury):

Types of cost	Examples
Accommodation costs	<ul style="list-style-type: none"> • Capital charges for freehold property; • Charges for other rented properties; • Depreciation of freehold and leasehold properties (where treated as fixed assets of the body); • Furniture and fittings (cost of purchase if treated as current expenditure, or depreciated if treated as fixed assets); • Maintenance; • Utilities.
Amortised costs	<ul style="list-style-type: none"> • Expenditure that satisfies the definition of an asset and is capitalised and written off over a number of accounting periods.
Bad debts	<ul style="list-style-type: none"> • Debts written off or provided for.
Common services	<ul style="list-style-type: none"> • Finance and accounting; • Fire and security; • Legal; • Human resources; • Reprographics; • Top management; • Transport (cleaning, maintenance, running); • Continuous improvements; • Quality assurance / compliance
Depreciation	<ul style="list-style-type: none"> • The value of fixed assets written off over a number of accounting periods (eg information technology and other office equipment, plant and machinery, vehicles). Also, the depreciation of freehold and leasehold properties. See “accommodation costs” above.
Disposal of fixed assets	<ul style="list-style-type: none"> • The surplus or loss incurred on disposal.
Equipment rentals	
IT	<ul style="list-style-type: none"> • Technology hardware, networking • Systems development • Software acquisition • Software / ERP licences and maintenance • Technology hardware and software refresh • Disaster recovery
Insurance	<ul style="list-style-type: none"> • Premiums paid for commercial insurance cover. (Insurance is a “non-cash” cost when no premiums are paid. See “non-cash” costs below).
“Non-cash” costs	<ul style="list-style-type: none"> • Any costs incurred by other departments or by e.g. the National Audit Office on auditing accounts, which are not charged out to the service provider;

	<ul style="list-style-type: none"> • Cost of capital. (This may take account of costs met elsewhere in government but not charged out to the body. But where a body is required, as part of its financial objectives, to earn a specified rate of return on capital employed, there will be a cash costs to the body to the extent that it meets interest charges on borrowings and dividends on public dividend capital from the return); • Insurance (This is a cash cost where the body takes commercial insurance cover. See “insurance” above); • Intra-departmental services received without charge.
Offices services	<ul style="list-style-type: none"> • Maintenance of office equipment; • Postage; • Printing; • Telecommunications.
Pay costs	<ul style="list-style-type: none"> • Employers’ National Insurance contributions; • Employers’ superannuation. (This is a notional cost where the body does not make payments to a superannuation fund). • Gross salaries and wages; • Overtime.
People transition	<ul style="list-style-type: none"> • Recruitment of new staff • , Relocation, redeployment payments
Personnel overheads	<ul style="list-style-type: none"> • Travel and subsistence.
Stocks and raw materials	<ul style="list-style-type: none"> • Consumables; • Items issued from store for sale or use; • Items purchased for immediate sale or use; • Change in the level of work in progress.
Sub-contracted items	<ul style="list-style-type: none"> • Services bought from external suppliers, including consultancy and professional services.
Value-Added Tax	<ul style="list-style-type: none"> • Irrecoverable tax only.

4.2 Example transactional approaches

Illustration of 3 alternative cost allocation approaches, for Accounts Payable and Accounts Receivable processes:

Service	1. Simple allocation (process level)	2. Simple allocation (sub-process level)	3. Transactional allocation
Accounts Payable			
Process Invoices	<ul style="list-style-type: none"> (# AP FTEs for customer A / total # AP FTEs) * total budgeted AP cost 	<ul style="list-style-type: none"> Total Budgeted Cost of the Accounts Payable area * (total Process Invoices FTEs / total Accounts Payable FTEs) 	<ul style="list-style-type: none"> # of invoices [/line items] * unit cost
Process Payments		<ul style="list-style-type: none"> Total Budgeted Cost of the Accounts Payable area * (total Process Payments FTEs / total Accounts Payable FTEs) 	<ul style="list-style-type: none"> # of payments * unit cost [Electronic Funds Transfer v. Cheque]
Manage Vendors Master Data		<ul style="list-style-type: none"> Total Budgeted Cost of the Accounts Payable area * (total Manage Vendor Master Data FTEs + the total Manage AP Accounts FTEs / total Accounts Payable FTEs) 	<ul style="list-style-type: none"> # of active vendors * unit cost
Manage AP Accounts			
Accounts Receivable			
Remittance Processing	<ul style="list-style-type: none"> (# AR FTEs for customer A / total # AR FTEs) * total budgeted AR cost 	<ul style="list-style-type: none"> Total Budgeted Cost of the Accounts Receivable area * (total Remittance Processing FTEs / total Accounts Receivable FTEs) 	<ul style="list-style-type: none"> # of remittances * unit cost
Credit Control		<ul style="list-style-type: none"> Total Accounts Receivable FTEs * Total Budgeted Cost of the Accounts Receivable area * (total Credit Control FTEs + total Collections FTEs + total Manage Customer Master Data FTEs) 	<ul style="list-style-type: none"> # of active customers * unit cost
Collections			
Manage Customer Master Data			

4.3 Example hybrid costing approach 1

Example charging mechanism, illustrating the allocation of HR and Finance operating costs between multiple customers, using FTE and transactional approaches:

Annual Running Cost Allocation [Dummy data]

	£m
• Cost of Finance	0.714
• Cost of HR	1.326

Finance Cost Apportionment (based on transaction volumes)

Based on:

- Annual PO invoice volumes (*1 weighting)
- Non PO invoice volumes (*1.5 weighting)
- Sales Ledger invoice volumes (*1 weighting)

Agency x	=	10k + 50k (1.5) + 2k = 87k	£0.183m
Agency A	=	0 + 50k (1.5) + 0 = 75k	£0.158m
Agency B	=	10k + 30k (1.5) + 1k = 56k	£0.118m
Agency C	=	60k + 0 + 2k = 62k	£0.131m
Agency D	=	2k + 38k (1.5) + 0 = 59k	£0.124m
		339k	£0.714m

HR Cost Apportionment (based on FTEs)

Agency x	=	3500 * X = 3500	<u>£0.243m</u>
Agency B	=	7000 * X = 7000	<u>£0.486m</u>
Agency A	=	2000 * X = 2000	<u>£0.139m</u>
Agency C	=	2000 * 1.2X = 2400	<u>£0.167m</u>
Agency D	=	<u>3000 * 1.4X = 4200</u>	<u>£0.291m</u>
		17500 19100	<u>£1.326m</u>

4.4 Example hybrid costing approach 2

Example charging mechanism using a mix of FTE, transaction, and ABC allocation methods:

Level 1 Function	Level 2 Service	Level 3 Service Item	Sub Price Elements	Allocation Driver	
FINANCE Includes providing client advice and support	Policy and Procedures	Policy		FTEs / hours of effort	
		Financial procedures			
		Delegations			
	Expenses	Accounts Payable	Manual Accounts Payable Events		Number of Documents
			Electronic Accounts Payable Events		Number of Line Items
			Non Standard Transactions		Per Non Standard Transaction
		Corporate purchasing card		Cardholder	
	Revenue	Accounts receivable		Accounts Receivable Events	
		Collection of revenue		Receipts	
		Debt management		Accounts Managed	
	Assets	Asset register management		Assets in Register	
		Asset valuations			
		Stocktakes			
	Taxation	Returns		FTEs / hours of effort	
		Liaison with ATO			
	General Ledger	Processing	Manual Journal Processing		Number of Journal Lines
			Electronic Journal Processing		Number of Electronic Journal Docs
		Maintenance	Reconciliations, Reviews and Maintenance	Projected Hours of Effort	
		Account reconciliations			
	Statutory Reporting	Financial accounting		FTEs / hours of effort	
		General purpose financial statements			
		Financial reporting			
		TRIDATA input			
Management Accounting	Budget, cash and liability management		FTEs / hours of effort		
	Internal budget processes				
	Budget cycle reporting				
	Trend analysis and forecasting				
	Financial costing and analysis				
Finance function	Management of entire finance function		ABC		

	management	Note that 'function management' is a category for MOHRI purposes to cover general positions and might not be considered as a 'service' as such. May also be used by service deliverers as a cost collector for further attribution.		ABC
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Level 1 Function	Level 2 Service	Level 3 Service Item	Sub Price Elements	Recovery Drivers
HUMAN RESOURCES Includes providing client advice and support and business unit resource management	Workforce Management (inc Organisational Capability)	Policy and planning		FTEs / hours of effort
		Establishment management		
		Industrial and employee relations		
		Workplace change		
		Learning and development		
	HR and Payroll Services	Payment of personnel <ul style="list-style-type: none"> Standard Non-Standard 	Payment of Personnel <ul style="list-style-type: none"> Standard Non-Standard 	# of Payments (Standard and Non-standard)
			Workforce Information	FTEs / hours of effort
	Recruitment Services	Recruitment planning	Job Applications	Number of Applications
		Applicants	Advertised and Non-Advertised Processes	Number of Jobs Advertised plus Non-advertised Events
		Selection and appointment	Recruitment and Selection Advice	FTEs / hours of effort
	Workplace Health and Safety	Workplace environment		FTEs / hours of effort
		Incident response		
		Claims management		
		Rehabilitation case management		
	Performance Management	Individual performance management		FTEs / hours of effort
Performance maintenance and support				
Reward and recognition				
Human Resources management and information	HR analysis and information		ABC	
	Management of entire human resources function		ABC	

4.5 Charging Considerations Checklist

1. What is the service, and the rationale for providing it?
2. Who is/will be using it?
3. In what mediums should the service be provided – on line, telephone, application in person, by post, etc?
4. What happens if there is a machinery of government change?
5. How it is to be delivered and charged for? Should there be an investment appraisal of alternative options?
6. Who should run it – the department, an agency, trading fund, NDPB, public corporation, the private sector?
7. Any public expenditure issues?
8. Is there a departmental Fees and Charges Co-ordinator with whom this could be discussed? Or have the proposals been discussed with your body's finance team (and accountants or other specialist advisers where appropriate)?
9. The proposed charging structure? Will there be one service, or several sub-services and forms of service? If, for example, companies are to be licenced or registered for an activity, should there be one level of charge, or a scale of charges for different sizes of company?
10. Any necessary legal powers to charge are in place or is new legislation needed?
11. An appropriate mechanism to collect charges, set targets, monitor performance and account for the service?
12. If there is a need for HM Treasury to be consulted/give approval?
13. For commercial services, any implications of Competition Law
14. For inter- or intra-departmental charging, agreed the responsibilities of the supplier and user?
15. Is there a need for consultation with potential users during the development of the fee setting process? If there is an appropriate body with which to consult?
16. The timescale for introducing the new service?

Source: HMT and SST