

Gaining Control of Overheads

Overhead Costs are Rising in Relation to Other Costs...

How cost structures have changed:

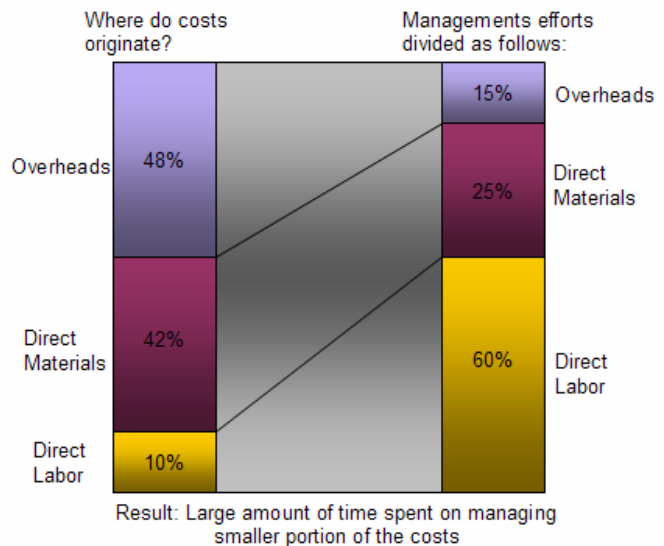
| Cost Category | 1960 | 1986 | 1996 | 2004 |
|------------------|------|------|------|------|
| Overheads | 15% | 30% | 35% | 48% |
| Direct Labor | 25% | 12% | 10% | 10% |
| Direct Materials | 60% | 58% | 55% | 42% |

Currently between **40% to 50%** of companies' expenses are **Overhead Cost** related, costs other than purchased materials. **Overhead cost management has become critical.**

Understanding the sensitivity and dynamics of cost in terms what is controllable (variable) and what is fixed is a key element to Business Success...

...but where has management been spending their time?

- Work Study Departments have been actively measuring and controlling Direct Labor
- Purchasing Departments have been effective in sourcing direct materials from lower cost suppliers...
- Very little effort has gone into Controlling Overhead Costs...



You can not manage what you do not understand
You can not understand what you do not measure
What you do not measure you can not control...

So, what is the Solution? How do organizations Gain better Control of their Overheads?

A definitive start is understanding the three key areas of overhead management:

- Cost Accountability
- Accurate Cost Centre Activity rates
- Deep Understanding of your Cost Base

Cost Accountability is defined as assigning responsibility to individuals within the organization responsible for the expenditures incurred over which they have control. Cost Center Accounting provides the ability to assign Cost Centers to departments and /or Managers responsible for certain areas of the business as well as functional areas within your organization. Cost Centers can be created for functional areas such as Marketing, Purchasing, Human Resources, Finance, Facilities, Information Systems, Administrative Support, Legal, Shipping/Receiving, or even Quality. The owners of the cost centers would be responsible for basing their cost planning on good performance standards. Measuring actual performance by comparing actual cost against a dynamic plan as opposed to a static budget is a fundamental key to improving performance.

Accurate Cost Centre Activity Rates are the result of cost centre managers understanding the cost drivers and their sensitivity to cost. Variable and Fixed components of cost are determined by making use of cost engineering techniques. Measuring the actual cost against dynamic standards then becomes not only meaningful, but also a tool for quality control of the standards. The result is a continuous improvement process of cost centre activity rates and cost savings through productivity improvements.

Gaining a deep understanding of your Cost Base provides the base data for continuous improvement campaigns in many areas:

- Capital feasibility studies on new technology for energy savings in energy intensive processes
- Immediately able to evaluate impact on profitability of any product mix changes
- Evaluation of in-house production vs. external/3rd party processing
- Evaluation of capital feasibility studies like introducing new technology or analyzing alternative production methods.



Activity Dependent Cost Planning on a Cost Center

| *CEL.No. | *CEL.Descr. | *Res.No. | U | IQ | Q/P | Q/Va | SC | Full | Prop | Fixed | Remark |
|----------|--------------------------------|---------------------------------|-------|---------|--------|------|-----|--------------|------------|------------|--------|
| 95410 | Depreciation Plant & Machinery | | | 0 | 0.00 | 0 | | 124,856.50 | 0.00 | 124,856.50 | |
| 93310 | Maint. Plant & machinery | | | 0 | 0.00 | 70 | HY1 | 161,321.23 | 112,924.06 | 48,396.37 | |
| 980565 | Calc. Employee Benefits | | | 347,154 | 0.20 | 100 | | 69,430.71 | 69,430.71 | 0.00 | |
| 980566 | Calc. Non-attendance Pay | | | 347,154 | 0.13 | 100 | | 45,129.96 | 45,129.96 | 0.00 | |
| 980567 | Calc. Annual Bonus | | | 347,154 | 0.09 | 100 | | 31,243.82 | 31,243.82 | 0.00 | |
| 980568 | Calc. Shift Allowance | | | 347,154 | 0.15 | 100 | | 52,073.03 | 52,073.03 | 0.00 | |
| 980571 | Calc. Skills Development Levy | | | 347,154 | 0.02 | 100 | | 6,943.07 | 6,943.07 | 0.00 | |
| 190310 | Calc. Electricity Cost | 2111.1 / Electricity Supply | KWH | 144,178 | 0.30 | 100 | | 43,843.41 | 34,460.11 | 9,383.30 | |
| 190340 | Calc. Compressed Air Cost | 2113.1 / Compressed Air Supply | TNCBM | 206 | 67.47 | 100 | | 13,843.10 | 8,972.67 | 4,870.43 | |
| 190410 | Calc. Mechanical Maintenance | 2121.1 / Mechanical Maintenance | Hrs | 650 | 193.34 | 70 | | 127,504.87 | 56,741.02 | 70,763.85 | |
| 190420 | Calc. Electrical Maintenance | 2122.1 / Electrical Maintenance | Hrs | 87 | 72.20 | 70 | | 6,405.57 | 2,986.06 | 3,419.51 | |
| | Total | | | | | | | 1,260,645.49 | 815,587.22 | 445,058.28 | |
| | Activity rate | | | | | | | 566.33 | 366.39 | 199.94 | |

Cost Center Accounting (CCA) at a glance:

- Cost Center Owners set a budget for their cost center for which they have responsibility
- Budgets are split between fixed and variable costs
- Variable portion of budget “flexes” with activity output
- Cost Centers can be aligned to functional areas of the organization
- CCA provides dynamic capabilities for planning both direct(variable) as well as indirect (fixed) costs
- CCA Activity rates are automatically calculated with the rate split between fixed and variable portion
- Cost can be allocated between cost centers using allocation methods.
- Costs can be assessed/distributed to other types of cost objects – for example production orders.

Technical Requirements

- Server: Pentium Processor: > 2GHz, RAM 2GB
All relational DB's e.g. SQL Server, Oracle, Informix
Operating systems: Windows NT or Unix
- Client: Pentium Processor: >1GHz, RAM 1GB
Operating systems: Windows NT, Windows 200X, Windows XP



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