



National Audit Office



## The BBC's definition of overheads

NAO review presented to the BBC Governors' Audit Committee,  
June 2006, by the Comptroller and Auditor General, and a response  
to the review from the BBC

# The BBC's definition of overheads



## BBC response to the National Audit Office Value for Money study

At the request of the Governors' Audit Committee, the BBC's definition of overheads has been subject to a value for money study by the National Audit Office (NAO) to assess whether the definition is a useful measure to demonstrate whether the BBC achieves best value for the licence fee payers. This study is part of a programme of studies, commissioned by the Governors, to be undertaken by the NAO and other external agencies, assessing value for money across the BBC.

The BBC is currently undergoing significant change as an organisation. Targets and measures introduced in previous years may not be as relevant and effective for the corporation looking forward into the next Charter period, which begins in 2007.

One of the BBC's objectives set in 2000 was to reduce overheads, as defined in the body of the following report, and to increase programme spend. This has been successfully achieved through major initiatives in areas such as procurement, technology and finance. By targeting the individual line items that make up overheads, the BBC has been able to identify areas where savings can be made.

The Governors commissioned the following NAO study into the BBC's definition of overheads to provide recommendations for the BBC to adopt going forward that ensure overhead targets and measures support the BBC in achieving best value for the licence fee payers. The review assessed whether there was scope for the BBC to strengthen its approach to defining and measuring overheads for the future, enhancing its management and control of overheads.

The Board of Governors thanks the NAO for undertaking this review and accepts the report's conclusions and recommendations.

The Governors welcome the independent review's confirmation that the overhead definition has been useful to the BBC and that, since the Governors approved the overheads reduction target in 2000, the percentage of overhead, as a proportion of 'output spend', has reduced from 24% to 12%.

The NAO's study acknowledges that the BBC, following its own internal value for money reviews has, in recent years, sought to benchmark particular activities, such as HR and Finance, rather than use the overhead measure as a single tool.

The Governors have committed the BBC to a process of open scrutiny with assistance from the NAO. The Governors will ensure that the recommendations from the NAO concerning the clearer reporting to stakeholders will be reflected in the 2005/2006 Annual Report and Accounts.

The attached statement from BBC Management outlines what action is being taken to address the report's conclusions. It has been considered and approved by the Board of Governors.

**Board of Governors  
June 2006**

## BBC management response

The NAO's study acknowledges that there is no universal and standard classification of the costs that make up overheads. The BBC therefore developed a high-level classification system which BBC divisions use to split expenditure between 'content' (programme related) and 'non content' (non-programming) costs. This measure is used for external reporting, and is complemented by a range of detailed targets for specific cost lines for internal management purposes. In 2000 the Board of Governors endorsed the BBC's management target to increase expenditure on programme content and services as a proportion of 'output spend' from 76% to 85% over five years, with overhead costs reducing from 24% to 15%. The BBC achieved this target in 2002/2003, and by 2004/2005 the BBC had exceeded this target, with overhead costs being 12% of output spend.

The NAO's review concluded that, in seeking to differentiate between these costs, the BBC's overhead measure goes some way to demonstrate that the BBC is putting its resource into front-line services. The NAO's review concluded that the BBC would derive greater value internally if the method the BBC used to report performance on overhead costs externally was more closely linked to how performance is managed internally.

The BBC therefore welcomes:

- the NAO's recognition that this measure has been useful to the BBC in providing a clear focus on reducing 'non-content' costs
- the NAO's recognition that this has provided assurance to stakeholders that a greater proportion of resources is going into programming
- the NAO's recognition that the BBC's efforts in breaking down overheads into particular functions and conducting exercises to benchmark these has been a practical way forward

## Action taken to address the NAO's recommendations

The NAO has made some valuable observations and recommendations within the report that the BBC is already taking steps to address. Specifically:

### 1. Linking overheads measurement with the BBC's wider performance measurement framework for public service broadcasting

The BBC has developed a framework for performance measurement which measures audience reach, quality, impact, and value (RQIV framework). This will give BBC Governors, licence fee payers and other stakeholders assurance that BBC services are delivering public value. This RQIV framework will include cost-based measures for programming spend, and the next step is to develop overhead measures for external reporting, for inclusion within this suite of performance measures.

The BBC has found the NAO's framework for performance measurement ('FABRIC') particularly useful in developing this.

### 2. Clearer reporting to stakeholders

The BBC strives to achieve the highest standards in corporate reporting and already discloses more information than many other public companies. However, the BBC accepts the recommendation that the basis on which costs are categorised into either programming costs or overheads should be explained further, and the 2005/2006 Annual Report and Accounts will include an explanation of this categorisation process. The inclusion of a clearer definition will provide further clarity to the Governors, licence fee payers and our stakeholders.

The BBC has adopted the approach recommended within the report to break down overhead expenditure to

show its individual components, and this was used in presenting budgeted expenditure plans for 2006/2007 as part of the Governors approval of the Budget.

The BBC feels it is important to continue to report overheads in a consistent manner, and for the remainder of this charter feels reporting of overheads as 'programming' or 'non programming' should continue. This measure is used to target improved performance, and the reporting of this measure enables stakeholders to monitor progress against this objective. For the new charter the BBC Trust will issue service licences, which will include the budget of each service. In addition the BBC will continue to develop spend by function reporting to ensure transparency of costs for stakeholders.

### 3. Aligning overheads to business needs

The BBC uses the current measure for overheads for external reporting purposes only and overlays this measure with more specific targets for each category of spend for internal management of costs. The measures reported externally are designed as a simple and clear measure for stakeholders, but naturally the management of costs within the BBC is targeted at a much lower level of detail to enable detailed evaluation and management. Therefore, externally reported measures were not designed to be in alignment with internal performance management.

The BBC has embarked on a large-scale change and re-engineering programme for the finance function. The centralisation of strategic cost management will lead to a greater degree of transparency on performance and enable the BBC to continue its drive to reduce costs further. The implementation of new financial policies has begun and the rollout of the change

programme will continue throughout 2006. A fundamental principle of this change programme is to simplify performance management reporting, which will enable the alignment between internal performance management techniques and externally reported measures.

#### *4. Comparing performance with others*

The NAO review acknowledges that meaningful benchmarking of overhead costs at a summary level is difficult in practice, as other organisations will use a variety of different measures to report overheads.

The report does acknowledge that the BBC has made progress in external benchmarking by breaking down costs into particular functions and benchmarking these.

The BBC will continue to progress this, and recent benchmarking has driven large-scale change programmes in many overhead areas, including finance, human resources, property costs, technology and other support services. These programmes are cornerstones of the BBC's value for money programme and have already delivered significant savings.

## The BBC's definition of overheads



This report has been prepared under Clause 10B of the amendment to the Agreement between the Secretary of State for Culture, Media and Sport and the BBC dated 4 December 2003.

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**National Audit Office**

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This report can be found on the National Audit Office web site at [www.nao.org.uk](http://www.nao.org.uk)

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# EXECUTIVE SUMMARY

**1** The BBC is the United Kingdom’s largest public service broadcaster and is funded by income from television licence fees. In 2004-05 the BBC’s total spending on broadcasting was £3.1 billion (Figure 1). In reporting its expenditure, the BBC refers to:

- ‘programme spend’ (also referred to as ‘content’) – costs which the BBC identifies as directly related to its television, radio and online services;
- ‘overheads’ (also referred to as ‘non-content’) – costs which the BBC classes as unrelated to its broadcasting output.

**2** In 2000 the Board of Governors endorsed BBC Management’s target to increase expenditure on programme content and services as a proportion of ‘output spend’, which is total expenditure less transmission and licence fee collection costs, from 76 per cent to 85 per cent within five years. Correspondingly, the proportion spent on overheads was to fall from 24 per cent to 15 per cent. The BBC reported that it had achieved the target in 2001-02, and since then has reported further reductions in overheads, which in 2004-05 accounted for 12 per cent of output spend. The BBC attributes most of the reduction in overheads to central initiatives targeting areas such as procurement, technology and finance.

**3** Defining overheads as spending on ‘non-content’ has been useful to the BBC in providing a clear focus on reducing this category of costs and assurance to stakeholders that a greater proportion of resources is going into programming. However, the BBC has now come to the view that there may be scope to improve its approach

to defining and measuring overheads for the future, and it is currently considering alternative definitions with the aim of enhancing its management and control of overheads. Against this background, we reviewed the BBC’s existing arrangements for defining and measuring overheads, focusing on the top level measure, and considered whether there are ways in which the BBC’s approach might be strengthened.

**4** This report focuses on the BBC’s approach to overheads in the context of its top level objective to increase expenditure on programme content and services as a percentage of output spend, thereby reducing the proportion spent on non-content. Our work was not about the BBC’s approach to cost management generally or the budgeting processes and other ways in which it monitors and measures its costs.

**1** The BBC’s broadcasting expenditure in 2004-05

	£ million
Programme spend	2,466.1
<b>Overheads</b>	<b>332.3</b>
Transmission costs	157.3
Licence fee collection costs	152.0
<b>Total</b>	<b>3,107.7</b>

Source: BBC annual report and accounts for 2004-05

**NOTE**

A breakdown of the overheads total is shown in Figure 7.

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## Our main findings

### 5 Our main findings are:

- Overheads are those costs, such as general administration and support services, which cannot easily be associated with particular products or services. There is, however, no standard classification of the costs that make up 'overheads'. Although overheads tend to be seen as a 'bad' cost, some level of overheads is needed to run an organisation and spending on overheads does not necessarily represent a poor use of resources.
- In targeting reductions in overheads, the BBC's approach is similar to that of some other organisations we looked at. All of the seven overseas public service broadcasters we consulted have targets to reduce overhead costs and three report on this externally, like the BBC. And in the United Kingdom, some organisations in the public and third sectors seek to measure and reduce spending on 'administration' or similar categories of costs.
- To implement its overheads measure, the BBC developed a high level cost classification system which divisions use to split their expenditure between content and non-content. Splitting expenditure is essentially a manual exercise since the BBC's financial systems do not generate this information automatically. With some 14,000 account codes, the BBC would need to weigh up carefully the costs and benefits of automating the generation of overheads data.
- BBC staff consider they have a clear understanding of how costs should be split between content and non-content, and assurance that costs have been consistently treated is provided by work by the BBC's internal and external auditors.
- Since 1999-2000 the BBC has provided information about its performance against the overheads measure in its annual report and accounts. However, as there is only a limited explanation of the measure and which costs are included within it, readers have to make their own assumptions about the distinction between programme spend and overheads.
- In its published annual report, the BBC has reported on overheads as a percentage of 'output spend', which excludes licence fee collection costs and transmission costs. However, in the annual report, the overheads objective itself was expressed as a percentage of licence fee income, which is a larger figure.
- The BBC's current overheads measure stems from the objective set in 2000 to increase expenditure on programme content and services. However, as the BBC recognises, the measure is now less relevant as the Governors' top level financial objectives no longer refer explicitly to the overheads ratio. The BBC's overall aim is to achieve value for money across all its activities and, in line with this broader focus, the Governors' objectives are now framed in terms of value for money generally.
- The overheads measure was not designed to be a single tool for managing overheads. BBC divisions do not directly use the measure to manage their activities, but manage costs, including overheads, against budgets which incorporate reductions in spending on particular areas. At a corporate level, outturn against budgets is reported monthly, but complete information about overheads is not available until the end of the financial year.
- The BBC's summary expression of overheads as a percentage ratio does not provide a clear basis for benchmarking against other organisations in the United Kingdom because other organisations tend not to measure overheads. While overseas public service broadcasters told us that they do measure overheads, it is clear there is no consistent approach to which costs are to be classified as overheads. A more fruitful approach is to benchmark particular activities, as the BBC has sought to do in recent years.



## CONCLUDING COMMENTS AND RECOMMENDATIONS

**6** In common with other public bodies, the BBC is under pressure to show that it is putting its resources into front line services. In seeking to differentiate between costs which are programme related (content) and costs which are not (non-content), the BBC's overheads measure goes some way to achieving this.

**7** The overheads measure would have greater value externally if it were part of a wider range of measures giving greater insight to whether value for money is being achieved across the BBC's activities. And, although its budgeting processes include a focus on overhead costs, the BBC could derive greater value internally if performance measurement and performance management arrangements were more closely integrated. In considering the way forward, there are four areas on which the BBC should focus.

**a** **Linking overheads measurement with its wider performance measurement framework for public service broadcasting**

In 2004 the BBC introduced a new performance measurement framework which aims to give BBC Governors, licence fee payers and other stakeholders assurance that BBC services are delivering public value. The framework incorporates measures of value for money which include cost-based indicators such as cost per viewer or listener, but not the current overheads measure. The BBC is continuing to develop the framework and has yet to set a timetable for external reporting of the results. Any measure of overheads would logically sit within that framework.

**b** **Clearer reporting to stakeholders**

Performance should be reported more clearly to Governors, licence fee payers and other stakeholders so that they have a common understanding of what the information is telling them and of how performance has changed from one year to the next. One approach could be to break down overhead

expenditure to show the components of the measure (for example by function, such as IT and finance, or by theme, such as governance and support services) and how particular components have changed over time. The BBC should also explain the basis on which those categories of costs (such as accommodation) which are split between programme spend and overheads have been apportioned.

**c** **Aligning overheads measurement with business needs**

The BBC would get most value from an externally reported measure if it were aligned with its objectives and financial systems, and therefore used to drive management decisions. A strong relationship between performance information and management systems brings benefits in terms of embedding performance measures within the organisation so that they are 'owned' by staff, making performance improvements more likely. Integrating performance measurement and management would also have the benefit that the data collection and analysis required for reporting performance would also be needed to run the business.

**d** **Comparing performance with others**

Meaningful benchmarking of overhead costs at a summary level is difficult in practice since other organisations either do not measure overheads or use different definitions. To establish a basis for routine benchmarking at this level, the BBC would need to identify partner organisations which share its aim and with whom it could develop a consistent approach to definition and measurement. This could involve a significant commitment of time and effort to develop appropriate protocols and build the confidence needed for organisations to share information. Breaking down overheads into particular functions and conducting exercises to benchmark these, as the BBC has been doing, is a practical way forward.

# MAIN REPORT

## What is this report about?

**8** The BBC is the United Kingdom's largest public service broadcaster, providing eight television channels; ten radio networks, and local and national radio stations; and new media – an online site and interactive services.

**9** The BBC is responsible for collecting television licence fees, which it passes to the Department for Culture, Media and Sport which, in turn, surrenders them to the Exchequer. The BBC receives an annual grant (£2.9 billion in 2004-05), equal to the sum of the licence fees collected less costs incurred by the Department. **Figure 2** outlines the BBC's current governance arrangements, which are being reviewed as part of the ongoing review of the BBC's Royal Charter.

**10** This report examines the BBC's approach to defining and measuring overheads, and considers whether there are ways in which the approach might be strengthened. The report is about the effectiveness of the BBC's measure of overheads, rather than the efficiency of the particular activities it defines as overheads. Our approach to the exercise is summarised in **Figure 3 overleaf**, with more detail in the Appendix. In doing our work, we were guided by the good practice principles set out in the publication 'Choosing the right FABRIC – a framework for performance information'<sup>1</sup>.

## 2 The BBC's governance arrangements

- **The Royal Charter** – the BBC is established by a Royal Charter which sets out the BBC's role, structure and funding. The Charter runs for a fixed term, usually 10 years, and is renewable. The current Charter ends in December 2006.
- **The Agreement** – further rights and obligations relating to the provision and funding of public service broadcasting are set out in an Agreement between the BBC and the Secretary of State for Culture, Media and Sport, which accompanies the Charter.
- **Governance** – the BBC is overseen by a Board of 12 Governors, appointed by The Queen on advice from Ministers. The Governors are responsible for ensuring that the BBC meets its statutory and other obligations, and that it is managed in the public interest.
- **Management** – the Board of Governors appoints the BBC's Director-General and the nine other members of the Executive Board, which is responsible for managing the BBC. The BBC is organised into 16 divisions – nine broadcasting divisions which manage the BBC networks and their programme commissioning and production; five divisions which provide professional support; and two commercial divisions which sell goods and services around the world.
- **Reporting to Parliament** – the Royal Charter requires the Chair of the Board of Governors to submit an annual report and an account of the BBC's income and expenditure to the Secretary of State for Culture, Media and Sport for presentation to Parliament. The Charter does not specify in detail the content of the BBC's accounts, and the BBC has opted to prepare its financial statements in a way that is consistent with United Kingdom public limited companies.

Source: National Audit Office

<sup>1</sup> *Choosing the right FABRIC – a framework for performance information* (HM Treasury, Cabinet Office, National Audit Office, Audit Commission and Office for National Statistics).

### 3

#### Summary of the main methods we used

- Interviews with BBC staff.
- Analysis of the BBC's financial data.
- Consultation with experts in cost and management accounting.
- Interviews with other broadcasters and stakeholders in the United Kingdom.
- Research on the approach to defining and measuring overheads adopted by public service broadcasters overseas.

Source: National Audit Office

## What are overheads?

**11** The costs of an organisation can be broadly divided into direct and indirect costs. Direct costs are those which can be specifically and exclusively identified with a particular product or service, for example the cost of paper used to produce a magazine or artist fees in a television drama. Indirect costs, such as general administration and support services, cannot easily be associated with products or services, and are often referred to as overheads. Although overheads tend to be seen as a 'bad' cost, some level of overheads is needed to run an organisation and spending on overheads does not necessarily represent a poor use of resources.

**12** The Chartered Institute of Management Accountants defines overheads as "expenditure on labour, materials or services that cannot be economically identified with a specific saleable cost unit"<sup>2</sup>. There is, however, no standard classification of the costs that make up 'overheads'. As a result, overheads may mean different things to different people, with organisations using different definitions to suit their particular needs. Neither the Companies Act 1985 nor UK GAAP (generally accepted accounting practice) require separate disclosure of overheads.

## Why are organisations interested in overheads?

**13** In general terms, identifying overhead costs can help organisations to:

- **calculate the full cost of outputs or activities.** This information is needed to manage the cost and mix of products, services, locations and customers. In commercial terms, information on overheads can help with distinguishing between profitable and unprofitable activities; setting prices; and judging whether, for example, to contract out a service or keep it in-house. In the broadcasting sector specifically, full cost information is needed to inform comparisons between in-house and independent productions;
- **manage and control costs** by devolving responsibility and holding people responsible for the costs incurred within their sphere of influence. This may involve pre-specifying costs or setting standard costs, and subsequently analysing variances from these;
- **report to internal and external stakeholders** on how resources have been used at an aggregate level, and provide assurance about the level of resources which have been spent on an organisation's core products or services.

## Why does the BBC measure overheads?

**14** The BBC has a range of cost measures and its performance measurement framework for assessing whether BBC services are delivering public value includes cost-based indicators such as 'cost per viewer and listener' and 'cost per viewer and listener hour'. However, in recent years the BBC's top level financial objective set by the Governors has focused on overheads, with a view to providing assurance to stakeholders about how it has used licence fee payers' money.

<sup>2</sup> Reprinted from *Official Terminology, The Chartered Institute of Management Accountants*, page 15, Copyright 2005, with permission from Elsevier.

15 As there is no standard classification, it is open to organisations to define overheads as they see fit to meet their particular needs. The BBC's measure was developed to focus attention on reducing certain costs and demonstrate that resources were being freed up for programme budgets. In reporting its expenditure in its annual report and accounts, the BBC refers to:

- **programme spend** (also referred to as '**content**' spend) – costs which the BBC identifies as directly related to its television, radio and online services, such as the salaries of actors and presenters, the cost of studio space, and the cost of producing content for its website;
- **overheads** (also referred to as '**non-content**' spend) – costs which the BBC classes as unrelated to its broadcasting output, such as the central costs of accommodation, technology, finance and human resources. However, broadcasting divisions' spending on items such as accommodation, computers and stationery is treated by the BBC as programme spending rather than overheads, on the grounds that these costs are necessarily incurred when making and commissioning programmes and services.

## Is the BBC's approach consistent with that of other organisations?

- 16 As part of our work to review the BBC's approach to defining and measuring overheads, we considered the approaches of other organisations. In general terms we found that there were similar approaches, although none was fully comparable to the BBC (consistent with there being no standard classification of overheads).
- 17 Private sector companies focus on profitability and return to shareholders, rather than overheads, as measures of financial performance. While profit-making organisations might look at overhead ratios internally, particularly in times of financial difficulty, they tend not to report such information externally. Similarly, other United Kingdom broadcasters, both private sector and public corporations, tend to focus on overall financial performance, rather than targeting any particular category of costs.

18 However, some organisations in the public and third sectors do seek to measure and reduce 'administration costs', with the aim of placing an emphasis on resources being used for front line services. The precise category of costs measured varies but:

- Public Expenditure statistics<sup>3</sup> show administration budgets (which are set for most government departments and comprise mainly civil service pay and associated expenditure such as accommodation, travel and training) as a percentage of total managed expenditure. And as part of the Government's Efficiency Programme, departments are being encouraged to benchmark the cost of administrative functions against other organisations in the public and private sectors to highlight resources which could be released for front line service delivery;
- charities have reported externally on the proportion of their spending going on management and administration, in part to demonstrate to supporters that their contributions are going to support the cause in question. In future, however, recommended accounting practice for charities is to report on 'governance costs', which will include items such as the costs of internal and external audit and spending associated with meeting statutory requirements<sup>4</sup>.

19 Among other public service broadcasters in the United Kingdom, only S4C has a target relating to overheads. In 2004 S4C revised its measure of overheads to remove the costs of marketing and audience research in an effort to bring the measure more into line with that of the BBC.

20 Looking overseas, all of the seven public service broadcasters we consulted told us they had targets to reduce overhead costs, and three reported on overhead costs externally (**Figure 4 overleaf**). For example, Publieke Omroep, the central management board for public service broadcasting in the Netherlands has agreed targets with individual public service broadcasters for the maximum level of overhead costs, with progress against the targets reported to the Government every six months.

3 *Public Expenditure Statistical Analyses 2005* (Cm 6521, April 2005).

4 *Accounting and reporting by charities: Statement of Recommended Practice* (revised 2005).

#### 4 Overseas public service broadcasters' approach to overhead costs

Country	Finland	France	Ireland	Netherlands	Norway	Portugal	Sweden
Broadcaster	Yleisradio Oy	France Télévisions	Radio Telefís Éireann	Publieke Omroep	Norsk Rikskringkasting	Rádio e Televisão de Portugal	Sveriges Television
Has targets to reduce overhead costs?	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Reports on overhead costs externally?	No	Yes	No	Yes	No	Yes	No

Source: National Audit Office

### What has the BBC reported?

**21** In 2000 the Board of Governors endorsed BBC Management's target to increase expenditure on programme content and services as a proportion of output spend (which excludes licence fee collection costs and transmission costs) from 76 per cent to 85 per cent. Correspondingly, overheads were to reduce from 24 per cent to 15 per cent of output spend. The BBC aimed to achieve the target within five years, but in the event reported that it had been met in 2001-02.

**22** The BBC has reported on the overheads measure in its annual report for the last six years. **Figure 5** shows that since 1999-2000 overheads have fallen from 24 per cent to 12 per cent of output spend, although prior to the 2002-03 annual report the objective was expressed in terms of licence fee income. This is discussed further in paragraphs 34 to 36.

**23** The cut in the ratio of overheads to output spend equates to a total cost reduction for 2004-05 compared with 1999-2000 of £239 million in real terms (**Figure 6**), giving a cumulative saving over five years of £1 billion. The BBC attributes most of the reduction in spending on overheads to central initiatives targeting areas such as procurement, technology and finance. For example, the introduction of a new accounting system during 2000-01 enabled the BBC to replace 11 separate systems, reduce the volume of internal trading by three-quarters, and cut the cost of financial management by half.

### Has there been clear and consistent measurement and external reporting by the BBC against the overheads measure?

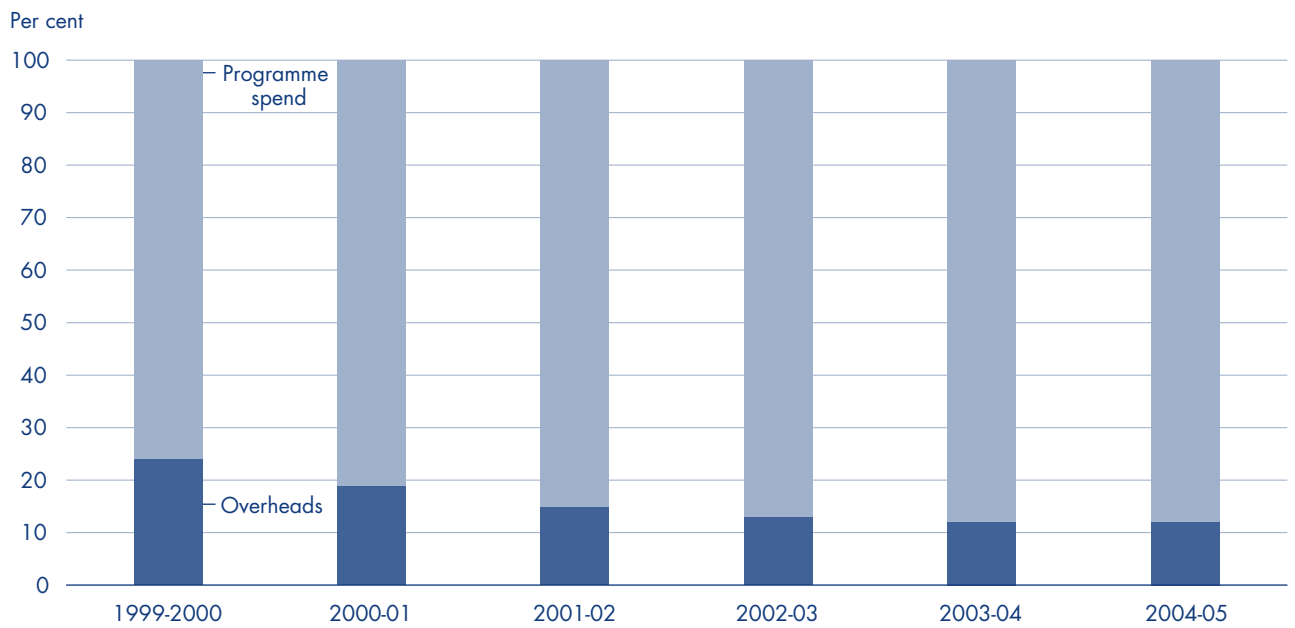
**24** We looked at the arrangements underpinning the BBC's reported performance. In doing this, we drew on the work of the BBC's internal and external auditors, interviewed BBC financial controllers and staff in the central finance team, and reviewed the BBC's internal guidance and the performance information published in the BBC's annual reports and accounts.

### Have overhead costs been consistently measured?

**25** Performance measures need to be clearly and unambiguously defined so that data is collected, and performance measured, consistently. As far as possible, standard definitions should be used and changes to definitions minimised.

**26** With the aim of achieving accuracy and consistency in its measurement of overheads, the BBC developed a high level cost classification system, which BBC divisions use to split their expenditure between programme spending (content) and overheads (non-content). The classification is supported by a guidance note to help staff in BBC divisions split their costs. The financial controllers we interviewed felt they had a clear understanding of what costs counted as 'non-content' for the purpose of calculating the measure of overheads.

**5** The BBC's expenditure split between programme spend and overheads, 1999-2000 to 2004-05

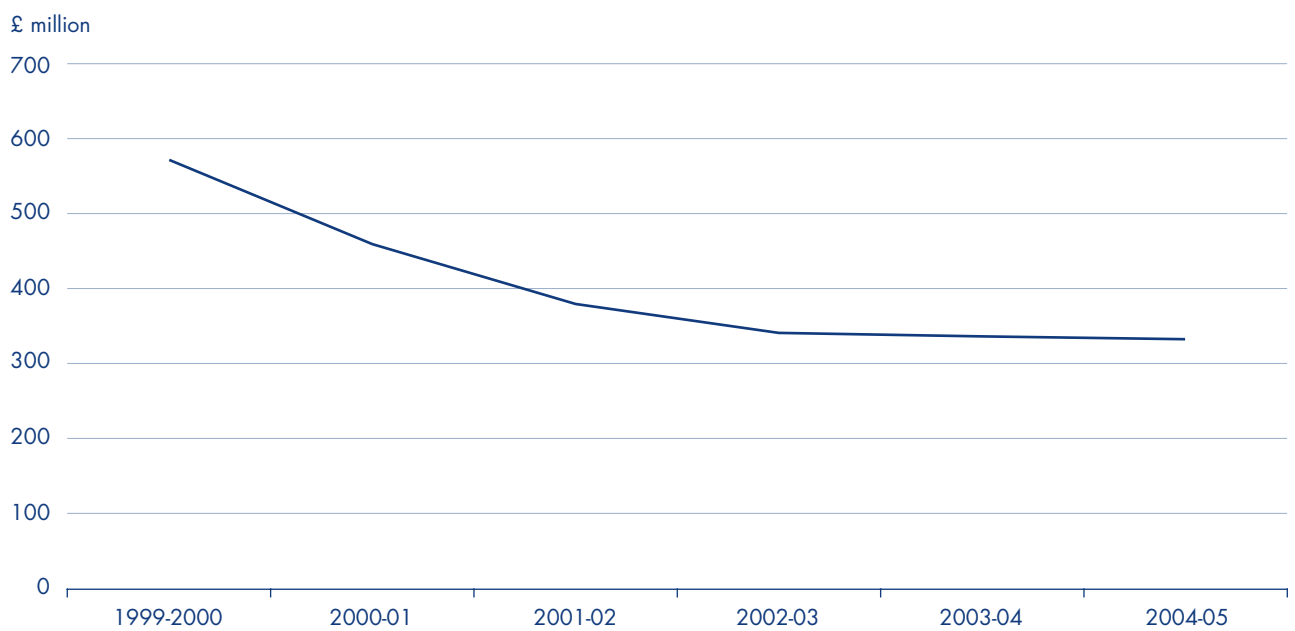


Source: National Audit Office analysis of the BBC's annual report and accounts for 1999-2000 to 2004-05

**NOTE**

The ratio of programme spend and overheads is discussed further in paragraphs 34 to 36.

**6** The BBC's expenditure on overheads in real terms between 1999-2000 and 2004-05 (constant prices, March 2005)



Source: National Audit Office analysis of BBC figures using RPI data from the Office for National Statistics

27 Since 2002-03 the BBC's published financial statements have included a figure for total overhead costs and in terms of its reliability we noted that:

- as part of their annual audit, the BBC's external auditors, KPMG LLP, seek assurance that the approach to calculating overheads has been consistent both across the BBC and compared with previous years. KPMG confirmed to us that their work had not revealed any material issues relating to the measurement of overheads<sup>5</sup> in the context of the BBC's definition;
- in 2004 the BBC's internal audit team reviewed the allocation of costs between content and non-content. They concluded that the cost classification had generally been applied appropriately and the methods used by BBC divisions appeared to give consistent results, given that information is reported at a summary level for the BBC as a whole.

28 The financial statements for 2004-05 reported total overhead costs of £332.3 million. A breakdown of this figure is shown in **Figure 7**.

<b>7 The BBC's overheads in 2004-05</b>	
<b>Type of cost</b>	<b>Cost (£ million)</b>
<b>Overheads in programming divisions</b>	<b>76.8</b>
Includes local finance teams, human resource management and divisional direction and general management.	
<b>Infrastructure and support services</b>	
■ Human resources and central training	51.8
■ Research, development and technology	48.3
■ Central finance	47.1
■ Property division	29.9
■ Executive support group	21.1
■ Policy and legal	16.0
■ Strategy division	6.1
■ Procurement staff	3.6
■ Rights and business affairs management	1.7
■ Marketing management	<u>1.0</u>
<b>Sub-total</b>	<b>226.6</b>
<b>Central balances</b>	
■ Provisions for future liabilities	10.3
■ Restatement of provisions for future liabilities	(4.2)
■ Sale of BBC Technology Ltd	(7.3)
■ National Insurance Contribution rebate	<u>(20.6)</u>
<b>Sub-total</b>	<b>(21.8)</b>
<b>Restructuring</b>	<b>50.7</b>
<b>Total</b>	<b><u>332.3</u></b>

Source: BBC

5 With the exception of 2002-03 when £24 million was misallocated to overheads. A revised figure for overheads for 2002-03 correcting the misallocation was included in the 2003-04 financial statements.

## Is the overheads measure clearly explained?

**29** Clear explanations of the purpose of the overheads measure and what costs are included in it are needed if users are to have a proper understanding of the performance reported by the BBC. Definitions should be easy to understand and supported by sufficient explanation to help ensure that different people understand them in the same way.

**30** The BBC's annual reports and accounts, however, have provided limited explanation of the overheads measure. In the first three years of reporting progress in reducing expenditure on overheads, the BBC did not define overheads in its annual report or explain how the reduction had been achieved. For 2002-03 and 2003-04, the BBC provided a summary description of overheads as costs which "include the central costs of accommodation, technology, finance and human resources" but with no explanation about how costs had been apportioned between programme spend and overheads. For 2004-05 there was no description or explanation of overheads.

**31** Without clear explanations, the BBC's figures could be misinterpreted with readers making assumptions about the distinction between programme spend and overheads (see paragraph 15). The experts and stakeholders we interviewed, including other United Kingdom broadcasters and the Producers Alliance for Cinema and Television (a trade association in the United Kingdom representing independent television, feature film, animation and new media companies), said that the absence of a clear description meant they were uncertain what the BBC's measure of overheads included, and observed that the published information did not show how particular elements of overhead expenditure had changed over time.

**32** The importance of providing explanations was also illustrated by our work within the BBC which highlighted a distinction between what the BBC corporately counts as overheads for the purpose of the published measure, and what individual BBC divisions regard as overheads at local level. When we asked financial controllers in two BBC divisions involved in the making, commissioning and acquisition of programmes – Television, and Drama, Entertainment and CBBC – to provide us with details of the items which they regarded as overheads from the perspective of their divisions but which were not included in the BBC's non-content measure, along with a **broad estimate** of the associated cost, their significantly differing estimates were:

- for Television, widening the definition of overheads to include costs such as telephones and some agency staff would have put overheads in the region of £13.3 million, compared with the £9.7 million calculated using the definition underpinning the BBC's published measure;
- for Drama, Entertainment and CBBC, the costs it would regard as overheads at local level but which were not covered by the corporate overheads measure included expenditure on, for example, accommodation including studios and production offices on location, the computers used by script writers, production insurance and local management teams. Drama, Entertainment and CBBC estimated its total divisional overheads for 2004-05 to be broadly in the region of £36 million, compared to just under £3 million using the definition underpinning the published measure.

## Has performance against the overheads measure been consistently reported?

**33** We reviewed the overheads information published in the BBC's annual reports: first in terms of consistency with the Governors' objective, and then in terms of consistency of the data provided in the BBC's annual reports.

### **34** Consistency with the Governors' objective.

The costs of the BBC's public service broadcasting are funded by the licence fee. When the objective to reduce overheads (non-content) was adopted by the Governors in 2000, it was based on overheads as a proportion of what the BBC terms 'output spend', which is the total cost of its public service broadcasting less transmission costs and the costs of collecting the licence fee.

**35** The BBC has used 'output spend' as the basis for calculating the overheads ratio from the outset so the information reported is consistent from one year to the next. However, in the BBC's annual reports from 1999-2000 to 2001-02, the Governors' objective itself was expressed in terms of reducing overheads as a percentage of licence fee income, a larger figure. The annual reports did not show until 2002-03 that the overheads ratio was based on output spend rather than licence fee income, and the reports have not explained why the costs of licence fee collection and transmission are not relevant to the calculation of the ratio.

**36** We used data from 2004-05 to review how the figures differ according to whether performance is assessed on the basis of output spend or licence fee income (**Figure 8**). This showed that the overheads ratio was 11.9 per cent as a proportion of output spend or 11.3 per cent of licence fee income. Programme spend changed more significantly, accounting for 88.1 per cent of output spend compared with 83.9 per cent of licence fee income.

**37 Consistency of the data in the BBC's annual reports.** For 2001-02 the BBC reported that it had reduced overheads to 15 per cent from 24 per cent in 1999-2000. We calculated that this equated to a reduction of £158 million over the two years but, in its annual report, the BBC stated that overheads were £67 million lower than two years previously. A reconciliation of this figure to the overheads ratio was not provided in the annual report. (The BBC told us that the £67 million related to the savings arising from one initiative and did not in fact cover all overhead reductions.) For the last three years, however, the BBC has provided fuller information in its annual report, showing how much has been spent on overheads in absolute terms and as a percentage of output spend.

**8** Analysis of the BBC's expenditure for 2004-05

	£ million	Percentage of output spend	Percentage of licence fee income
Programme spend	2,466.1	88.1	83.9
Overheads	332.3	11.9	11.3
Transmission costs	157.3	–	5.3
Licence fee collection costs	152.0	–	5.2
<b>Total</b>	<b>3,107.7</b>	<b>100.0</b>	<b>105.7<sup>1</sup></b>

Source: National Audit Office analysis, using figures from the BBC's annual report and accounts for 2004-05

**NOTE**

<sup>1</sup> Expenditure (£3.1 billion) exceeded licence fee income for the year (£2.9 billion) so the figures sum to more than 100 per cent.

## How useful is the measure to the BBC?

**38** We considered whether the overheads measure is relevant to what the BBC is trying to achieve and a practical cost management tool.

### Is the overheads measure relevant to the BBC's objectives?

**39** An organisation's performance measures should aim to measure what the organisation is seeking to achieve. As an organisation's objectives are likely to change over time, its performance measures should periodically be reviewed to ensure they remain relevant. In addition, for performance measures to be an effective management tool, they need to be embedded in the organisation through a clear link with the objectives of the organisation and those of divisions and teams.

**40** The BBC's current approach to defining and measuring overheads stems from the objective endorsed by the Board of Governors in 2000 to increase expenditure on programme content and services rather than overheads. However, as the BBC recognises, a number of factors are now limiting the value being derived from this measure in terms of its impact and relevance to the BBC's objectives.

- Since 2003-04 the Governors' top level financial objectives have not referred explicitly to the overheads ratio. The BBC's overall aim is to achieve value for money across all its activities, including programme content and services as well as overheads, and in line with this broader focus the Governors' objectives are now framed in terms of value for money generally.
- Although the BBC has continued to measure and report on overhead costs, using the definition developed in 2000, overheads as a proportion of spending have remained more or less constant since 2002-03. (The BBC intends to reduce overheads from the current 12 per cent to 10 per cent of output spend by early in the next Charter period, which starts in 2007.)

- The overheads measure does not form part of the BBC's new performance measurement framework, on which we reported in 2005<sup>6</sup>. The framework, which is designed to give Governors, licence fee payers and other stakeholders assurance that BBC services are delivering public value, uses other cost-based measures such as cost per viewer and listener.
- The way in which the BBC is providing some overhead functions is changing through the increasing use of outsourcing. Activities such as the provision of IT, licence fee collection and some finance services have been contracted out, some for a number of years. While the aim is to improve value for money, with contracts lasting a number of years this change is taking the day to day management and control of some costs beyond the BBC, meaning that costs are less variable in the short term.

### Is the overheads measure of practical value in managing the BBC?

**41** From our interviews with BBC staff, our sense was that the overheads measure had raised awareness of non-content costs and the need to move resources into programme spending. However, on its own the measure does not indicate whether resources have been used efficiently. And taken in isolation, there is a risk that the measure could create a perverse incentive for the BBC to increase its spending on programmes without due attention being paid to output quality.

**42** The non-content measure was not designed as a single tool for managing overheads and the BBC's corporate target to reduce non-content costs is not cascaded to individual divisions. Divisions manage costs, including overheads, against line items in divisional budgets which incorporate reductions in spending on particular areas. While divisional financial controllers thought that the non-content measure may have a value in terms of external reporting, they see the distinction between content and non-content as having limited operational value at their level and do not use it to manage their activities.

**43** In addition, some costs currently charged to individual BBC divisions and treated as programme costs are costs over which divisions have little control. As part of its work on alternative overhead definitions (see paragraph 3), the BBC is currently developing proposals to centralise the management of these 'infrastructure costs', such as property and IT, with the aim of ensuring that responsibility for costs rests with the people that control them.

**44** The fact that the overheads measure is not integral to business management within BBC divisions is reinforced by the fact that the BBC's financial systems do not automatically categorise costs as content or non-content so divisions have to carry out a specific exercise each month to split their expenditure between the two categories. This is essentially a manual exercise, which takes around half a day a month.

**45** At a corporate level, the overheads measure is not being used to inform the in-year management of the BBC. While the monthly financial reports provided to BBC Senior Management and the Board of Governors show the variance between budgeted and actual expenditure on overheads, they do not present the ratio of overheads to total expenditure. In addition the information on overheads presented in the monthly reports does not include some expenditure on divisional and financial management, personnel and strategy, which is reclassified as overhead spend only at the end of the financial year. The total of these costs amounted to £43 million in 2004-05.

**46** At the end of the financial year for external reporting purposes a more detailed exercise is carried out to produce the information required to show performance against the overheads measure in the BBC's annual report and accounts. This more detailed work can take each BBC division up to a week to complete.

<sup>6</sup> *Public service broadcasting: the BBC's performance measurement framework*, National Audit Office review presented to the BBC Governors' Audit Committee (May 2005).

**47** Attaching a content/non-content classification to the BBC's existing cost codes would remove the need for divisions to calculate information on overheads manually, although to date the BBC has found this unfeasible. Five of the seven overseas public service broadcasters we consulted told us that data on overhead costs was generated automatically by their financial systems. For example, the Norwegian broadcaster, Norsk Rikskringkasting, told us that its account codes show whether costs are counted as programmes or overheads and, where appropriate, the type of overhead. The BBC currently has some 14,000 cost codes so the costs and benefits of such a change would need to be carefully weighed up.

### Does the overheads measure allow meaningful benchmarking against other organisations?

**48** Performance measures can be useful in helping organisations to compare their performance with others, and the BBC considers external comparisons to be an important tool in managing its overheads.

**49** However, our work indicated that the BBC's summary expression of overheads as a percentage ratio does not provide a basis for benchmarking against other organisations. In the United Kingdom other organisations either do not focus on particular blocks of costs or they look at administration costs, rather than overheads (paragraph 18). In addition, the experts we consulted observed that there is no reason why overheads as a proportion of expenditure should necessarily be similar in different organisations, and that organisations with differing ratios may be equally efficient in delivering value.

**50** While some overseas public service broadcasters told us they do measure overheads (paragraph 20), it is clear there is no consistent approach to classifying costs as overheads. For example, the Norwegian public service broadcaster, Norsk Rikskringkasting, treats the cost of its licence fee department as an overhead whereas the BBC excludes the costs of licence fee collection from its calculation. To get any value from benchmarking against other broadcasters, the BBC would need to satisfy itself about the definitions used and the systems of measurement to be sure that it was comparing like with like.

**51** The experts we spoke to also observed that in considering overheads as one block of costs, the BBC could risk losing sight of particular areas of inefficiency. A more fruitful approach is to benchmark particular activities, as the BBC has sought to do in recent years. For example in 2004 it commissioned consultants to compare the costs of the BBC's finance function with those of public limited companies, and is restructuring its Finance division in the light of the results. Other broadcasters, both in the United Kingdom and overseas, also benchmark individual support services and confirmed that they were less interested in whether, for example, finance costs were attached to programme or corporate activity than with how much was being spent on the particular activity in question.

# APPENDIX

## Study methods

1 The aim of our study was to review the BBC's existing arrangements for defining and measuring overheads (focusing on the top level measure of 'non-content' expenditure), and to consider whether there are ways in which the BBC's approach might be strengthened. Our work was designed around three questions:

- Does the measure of overheads meet the BBC's needs?
- Does the measure provide stakeholders with a clear and consistent picture of the BBC's overheads?
- Does the measure help the BBC to manage its overheads effectively?

2 In doing our work, we were guided by the good practice principles set out in *Choosing the right FABRIC – a framework for performance information*<sup>7</sup>, produced jointly by HM Treasury, the Cabinet Office, the National Audit Office, the Audit Commission and the Office for National Statistics. The publication identifies the key features of an effective performance information system and of individual performance measures.

### What makes an effective performance information system?

- **Focused** – the performance information system should focus on the organisation's aims and objectives.
- **Appropriate** – the information being collected should be appropriate to, and useful for, the stakeholders who are likely to use it.
- **Balanced** – the performance measures should give a balanced overall picture of what the organisation is doing, covering all significant areas of work.
- **Robust** – the performance information system should be able to withstand organisational changes or individuals leaving.
- **Integrated** – the performance information system should be integrated into the organisation, being part of the business planning and management processes.
- **Cost-effective** – the resources put into collecting performance information should be proportionate to the benefit which the information brings.

### What makes a good performance measure?

- **Relevant** – the measure should be relevant to what the organisation is aiming to achieve.
- **Avoids perverse incentives** – the measure should not encourage unwanted or wasteful behaviour.
- **Attributable** – the activity measured must be capable of being influenced by actions which can be attributed to the organisation. It should be clear where accountability lies.
- **Well defined** – the measure should have a clear, unambiguous definition so that data will be collected consistently, and the measure is easy to understand and use.
- **Timely** – data should be produced frequently enough to track progress and quickly enough for the data still to be useful.
- **Reliable** – the measure should be accurate enough for its intended use and responsive to change.
- **Comparable** – the measure should be capable of being compared with either past periods or similar programmes elsewhere.
- **Verifiable** – the measure should have clear documentation behind it so that the processes which produce the measure can be validated.

3 We collected and analysed a range of quantitative and qualitative data using the following methods.

## Work at the BBC

### Interviews with BBC staff

4 We carried out interviews with the Finance Director of the BBC and other staff from the Finance division. The interviews covered the background to the BBC's current approach to defining and measuring overheads, how the non-content measure is compiled and reported, and how the BBC's approach might be strengthened. We also reviewed the BBC's internal guidance, which divisions use to split their expenditure between content and non-content.

7 Available at [www.nao.org.uk/guidance/focus/fabric.pdf](http://www.nao.org.uk/guidance/focus/fabric.pdf).

5 We interviewed financial controllers in six BBC divisions (which together accounted for over 70 per cent of the BBC's expenditure on public service broadcasting in 2004-05) to get their views on how the overheads measure is used by divisions, and on how the BBC's approach to defining and measuring overheads might be improved from their perspective.

#### The BBC divisions we interviewed

- Drama, Entertainment and CBBC
- Marketing, Communications and Audiences
- Nations and Regions
- Property and Business Affairs
- Radio and Music
- Television

6 We met with staff from the BBC's internal audit team to discuss the review they carried out in 2004 to examine the allocation of costs between content and non-content. We also met with staff from KPMG LLP, the BBC's external auditors, to discuss the work they do to seek assurance about the overheads figure reported in the BBC's financial statements.

7 We interviewed staff from the BBC's Governance Unit, which supports the Board of Governors in its work, to get their views on the BBC's current approach to defining and measuring overheads, and on how the approach might be strengthened from the perspective of the Governors.

### Analysis of the BBC's financial data

8 We analysed financial information contained in the BBC's annual report and accounts for the six years from 1999-2000 to 2004-05. We also reviewed the schedules for 2004-05 submitted by each of the BBC's 16 divisions, which formed the basis for the information reported in the BBC's annual report and accounts.

9 We carried out more detailed analysis on two BBC divisions – Drama, Entertainment and CBBC, and Television. Working with the divisional financial controllers, we identified items of expenditure they regarded as overheads but which are not included in the BBC's non-content measure, along with a broad estimate of the associated cost. This work was designed to illustrate the scope for alternative definitions of overheads and the associated financial implications, and to highlight the importance of transparency in reporting.

## Consultation with experts in cost and management accounting

10 Following discussions with the Chartered Institute of Management Accountants (CIMA), we consulted a number of experts in cost and management accounting to discuss good practice in the field and to seek views on the BBC's approach to defining and measuring overheads.

#### The experts we consulted

- Professor Thomas Ahrens (Professor of Accounting, Warwick Business School, The University of Warwick)
- Professor Michael Bromwich (CIMA Professor of Accounting and Financial Management, London School of Economics and Political Science)
- Professor Bernard Pierce (Dean and Professor of Accounting, Dublin City University Business School)
- Professor Michael Tayles (Director, Centre for International Accounting and Finance, Hull University Business School)

11 We liaised with the Institute of Chartered Accountants in England and Wales, who consulted on our behalf a number of academics and Chartered Accountants working in commercial businesses.

12 We also commissioned Professor Michael Tayles from the Centre for International Accounting and Finance at Hull University Business School to provide advice on defining, measuring and reporting on overheads, and on why different approaches may be appropriate in different circumstances and to meet different requirements for information about costs.

## Interviews with other broadcasters and stakeholders in the United Kingdom

13 We carried out interviews with three other United Kingdom public service broadcasters – ITV plc, Channel 4 and Five – to discuss how they define, measure and report on overheads, and get their views on the BBC's approach. We also consulted S4C about its measure of overheads. And we sought the views of the Producers Alliance for Cinema and Television (a trade association in the United Kingdom representing independent television, feature film, animation and new media companies) about the BBC's approach.

**14** We met with staff from the Association of Chief Executives of Voluntary Organisations to identify how bodies in the third sector approach overhead costs, and to discuss guidance the Association has sponsored to help such organisations better understand their costs.

**15** To review the cost information that other organisations report to external stakeholders, we examined the annual reports and accounts of a number of major publicly listed companies (including BP plc, BT Group plc, HSBC Holdings plc, Tesco plc and Unilever Group) and of a selection of government departments.

**16** We met officials from the Department for Culture, Media and Sport with responsibility for broadcasting policy to discuss the BBC's approach to defining and measuring overheads, and wider matters relating to public service broadcasting.

## Liaison with overseas public service broadcasters

**17** We looked at how public service broadcasters in other countries define and measure overheads. Although comparing public service broadcasting in different countries is problematic because structures, funding systems and remits vary from one country to the next, we wanted to see in general terms how the BBC's approach to overheads measurement compared with arrangements overseas.

### The overseas public service broadcasters who provided information

- Yleisradio Oy (Finland)
- France Télévisions (France)
- Radio Telefís Éireann (Ireland)
- Publieke Omroep (Netherlands)
- Norsk Rikskringkasting (Norway)
- Rádio e Televisão de Portugal (Portugal)
- Sveriges Television (Sweden)