

BBC Efficiency Review

*An update on the BBC's
overheads*

July 2015



Reviewing the BBC's approach to defining and allocating costs as 'overheads'

Following the release of the BBC's Efficiency Review¹, the BBC asked PwC to conduct an objective review of its approach to efficiency. This report focuses on the BBC's approach to general overheads, defined as controllable costs that do not directly support the delivery of public services.



Background

All organisations have costs that are necessary and useful to support and sustain their operations but which do not directly support the delivery of core activities – referred to as 'overheads'. PwC was jointly commissioned by the BBC Executive and BBC Trust to provide an independent review of the BBC's approach in two specific areas. Firstly, to assess how the BBC defines and allocates overheads within its overall cost base and secondly, to develop benchmarks to understand how the BBC's spending on overheads compares with other relevant organisations.

This report

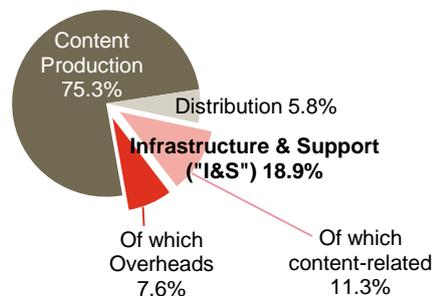
This report outlines our findings in relation to the BBC's general overheads. It contains:

- A summary of our main findings in assessing the BBC's cost base
- The results of benchmarking parts of the BBC's cost base against other relevant organisations

Headline findings

- The BBC's definition and allocation of overheads is in line with other regulated industries and public sector bodies

Breakdown of BBC UK Public Service Broadcasting cost base²: FY14/15



- The BBC's general overheads ratio has reduced to 7.6% for FY14/15. The BBC is targeting a ratio below 7.0% by the end of the current Charter period in FY16/17 through completing delivery of its current efficiency programmes
- These results compare favourably with other organisations – we found the benchmark median overheads ratio for a selection of comparable industries was 10.0% and for the top quartile, 7.2%. Therefore the BBC is forecasting to be within the top quartile of today's benchmark by FY16/17

What we covered

The scope of this review covered the BBC's Infrastructure and Support ("I&S") costs within the UK Public Service Broadcasting cost base².

To assess the BBC's definition and allocation of overheads within these costs, we reviewed a range of documents relating to the BBC's cost base. Our review was supported by consultations with BBC management, as well as regulatory accounting and media specialists within PwC's network.

We conducted a benchmarking analysis to assess how the BBC compares with other organisations. This analysis considered the BBC's unique attributes, such as its public obligations, scale and geographical reach. These attributes can make it challenging to draw meaningful comparisons, which is why we developed tailored benchmarks. This approach to benchmarking provides an indicative position, which outlines how the BBC compares with selected organisations. Further details of our methodology and approach to benchmarking are outlined on the following pages.

¹ Driving efficiency at the BBC, Report published by the BBC, November 2014 http://www.bbc.co.uk/aboutthebbc/insidethebbc/howwework/reports/bbc_efficiency_report_2014

² Total cost base excludes other "non-controllable" costs, e.g. external obligations such as funding for broadband rollout and S4C, group pension deficit recovery payments, licence fee collection costs, lease reclassifications, etc.

The BBC's definition and allocation of general overheads is broadly in line with other regulated industries and public sector bodies

Both the definition and allocation methodology used by the BBC are broadly aligned with management accounting practice, as well as with the approach used by other public sector organisations and some regulated companies. The BBC has accepted and implemented PwC's advice on specific improvements to its overheads definition.

Key consideration

The BBC may also wish to consider:

- Using the term 'general overheads' to make its terminology more aligned with standard naming convention within the industry
- Introducing automation to the process of calculating overheads; for example, embedding into finance systems

Defining overheads

The BBC defines overheads as the proportion of its controllable spend that does not directly support the delivery of public services, or in other words, does not directly support audience-facing activities.

Management accounting definition of 'general overheads'

The BBC's definition is consistent with that used by the Chartered Institute of Management Accountants (CIMA), which defines general overheads as: expenditure on labour, materials or services that cannot be economically identified with a specific saleable cost unit³. The overhead costs that relate to supporting the organisation are commonly referred to as general overheads that exclude production or selling overheads, which is consistent with the BBC's approach.

Commercial or unregulated companies

Commercial or unregulated companies rarely report detailed general overheads unless for specific financial initiatives. Often, they report selling, general and administrative expenses (SG&A) that include all support functions, sales and marketing costs.

Regulated industries

Regulated industries, such as utility distribution and telecoms, are required to identify overheads for cost accounting to demonstrate efficiency, non-discrimination and cost-orientation of their tariffs.

Public sector organisations/charities

Public sector organisations, including Government departments and charities, which are required to outline all spending of public funds and donations, adopt a similar approach to the BBC.

Allocating overheads

The BBC categorises its Public Service spend into a) Content Production costs, b) Distribution costs (to get its services to audiences) and c) Infrastructure & Support ("I&S") costs. Since (a) and (b) relate directly to the delivery of public services, they are not considered as overheads. The remaining I&S costs are further allocated into content-supporting infrastructure costs and other support costs. The latter cannot be directly attributed to audience facing activities and hence these constitute the BBC's overheads. They include HR, Finance, the BBC Trust and related Technology, Property and divisional running costs, among others. This approach to identifying overheads is broadly in line with management accounting practice; however, we recommend the BBC refers to them as 'general overheads', to better align with standard accounting naming conventions and consider introducing some degree of automation to the process of calculating them.

Outcome of our review

We have advised on specific revisions to the way overheads are allocated to make the allocation even more aligned with industry practice, which the BBC has accepted and implemented for FY14/15.

³ Definition from CIMA handbook and refers to indirect cost or general overhead

The BBC's overheads ratio compares favourably with other regulated industries and public sector bodies

The BBC's general overheads ratio of 7.6% indicates that it is more efficient than the average organisation within the benchmark. The BBC expects the impact of completing its efficiency programme 'Delivering Quality First', will be to reduce overheads below 7.0% by FY16/17, indicating that the BBC would be within the top quartile of today's benchmark.

Peer group selection

PwC first sought to compare the BBC's broader SG&A costs, a more widely reported measure of overheads, with private sector media and broadcasting peers. Our high level analysis suggests the BBC is currently better than the median benchmark⁴. The BBC expects it should be closer to the top quartile by the end of the Charter period, once the delivery of its current efficiency programmes has been completed. However, since the vast majority of commercial companies do not publicly report general overheads in the same way as the BBC, a peer group comprising regulated, public sector and charity organisations is more appropriate for specifically benchmarking overheads.

Benchmarking the general overheads ratio

The BBC's general overheads ratio is defined as general overhead costs as a percentage of total (controllable) costs. General overheads are defined as allocations of expenditure on HR, finance, technology, property and divisional running costs which do not relate directly to audience-facing activities.

We drew upon a set of 20 organisations from the public sector, including Government departments and large charities, and companies from regulated industries such as telecoms and utility distribution. This peer group was chosen because each of the organisations operates under similar scrutiny and calculates and reports on general overheads. 75% of peer group organisations are UK-based and 25% are overseas (15% Asia, and 10% in the rest of Europe).

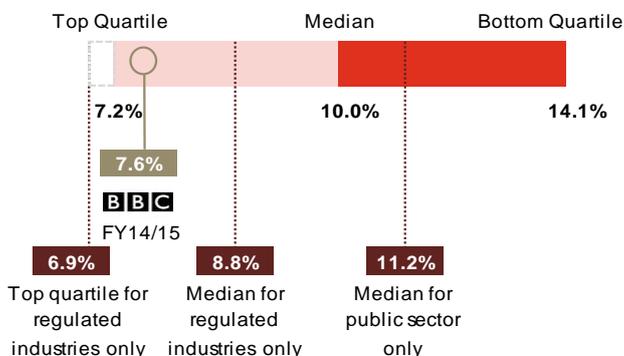
The median general overheads ratio for this benchmark peer group overall is 10.0% and the median for the subset of public sector organisations (Government departments and large charities) alone is 11.2%. The BBC's reported general overheads ratio of 7.6% is therefore 2.4 percentage points lower than the overall median and close to the top quartile benchmark of 7.2%.

The BBC's projected ratio for FY16/17 is below 7.0%, reflecting the completion of the 'Delivering Quality First' efficiency programme, which would place it within the top quartile of today's overall benchmark (7.2%) and very close to that for regulated-sector only peers (6.9%).

Key adjustments

The BBC has adjusted the way in which overheads are allocated to better align with accepted industry standard cost allocation methods. These adjustments are reflected in the ratio for FY14/15 of 7.6%.

General overheads % of total costs



⁴ Based on a composite benchmark of UK and overseas media and broadcasting companies, adjusted to reflect the same mix of operations between TV, Online and Radio as the BBC.



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