

Reallocation of costs in information technology

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Reallocation of Costs in Information Technology Introduction With the rapid technological advances in the information technology sector, businesses have gotten confused as to how costs for IT can be allocated in their books. Would IT costs be operational or fixed, or would these costs be allocated in a lump sum or on a granular level. This essay aims to evaluate the processes in allocation of IT costs and the purpose why it is required. The paper will also evaluate the benefits and how organizational decisions can affect cost allocation.

Process of Allocation of IT Costs When information technology is implemented within organizations, it is important to identify how the costs of this investment will be allocated within the books. Costs for any other investment for instance, physical assets (land, building, furniture, etc.) are easy to understand and allocate. However, allocation for information technology assets and expenses is more difficult to decide because information technology transcends departmental boundaries. Generally, the process used to classify information technology costs is a flat fee mechanism. So, the IT department sets out a specific standard rate for a project, irrespective what the length of the project would be, and who would be the team members within the project, as well as ignoring the level of experience and expertise involved in the project. So in each instance, whether it is project costs or expenses based on running of information technology within the organization, all are allocated as an average based on the number of employees within the organization. In most organizations, this is the method followed and is considered one of the easiest to use and implement. (Branton, 2010; Apptio, 2010; McCann, 2010)

Purpose of Cost Allocation The primary reason why organizations allocate costs for information technology to various departments is to ensure that IT

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costs are accounted for. IT costs are not as easy to calculate and allocate like any other cost. For example, cost of using furniture is easy to calculate (depreciation), but cost of using a computer is not as easy to evaluate. Further, cost of investing in a piece of land is easier to comprehend, however, cost for investing in software may not be as easy to understand and allocate in the organization. Therefore, the purpose of allocation of IT costs is primarily to identify where information technology is being used, and to what extent. As a result, cost is then spread out in the organization based on the allocation mechanism that is in place. (Branton, 2010) Benefits of Cost Allocation There are various benefits of the right cost allocation system for information technology. IT helps the entire organization through various levels and in several ways. The costs incurred need to be charged back based on the usage of IT facilities and systems. With the right system, cost allocation is accurate and efficient indicating the extent of usage of IT across departments. Cost allocation is also helps in identifying the cost and business centers within organizations, which in turn helps determine where costs need to be curtailed and which areas are generating better business, in terms of information technology. (Branton, 2010) Comparison of ABC Costing against Lean Manufacturing Activity based costing specifically in the IT sector involves charging the actual costs resulting from information technology, in order determine the actual profit of the organization. As the name suggests, activity based costing involves calculating the actual costs that are incurred on each business activity, and then allocating them to the business or specific department from where the cost originated. In lean manufacturing, costs are based on indirect expenses as well as the actual, direct expenses. As a result, lean manufacturing involved a more detailed <https://assignbuster.com/reallocation-of-costs-in-information-technology/>

analysis of the cost structure, especially when it comes to information technology and costs incurred in this sector. (Apptio, 2010) Organization's Decision Affecting Cost Allocation An organization defines its cost structure and allocation of costs on the basis of various factors. These factors may include the type of industry in which the company operates; the types of costs that it incurs the type of cost structure currently functional in the industry; amongst other factors. Once the organization decides the types of costs it needs to allocate and how, the business's finances are affected. For example, if the company decides on the ABC method of costing, then costs are allocated in actual, to each department where information technology costs have been incurred. For instance, these costs might include usage of computers, usage of a specific software, and some allocated benefits may include sales earned through software (leads generated through CRM) etc. (Apptio, 2010) References: 1. Apptio. (2010). Activity based costing is the best allocation methodology [Web log message]. Retrieved from <https://community.apptio.com/blog/b/it-financial-transparency/archive/2010/03/16/activity-based-costing-is-the-best-allocation-methodology.aspx> 2. Branton, D. (2010). How to create a system for charging back it services. Retrieved from <http://www.cio.co.uk/article/3217465/how-to-create-a-system-for-charging-back-it-services/> 3. McCann, D. (2010). The New Star of IT Cost Allocation. CIO Magazine. Retrieved from <http://www.cfo.com/article.cfm/14494101>

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