

Top Trends in Management Accounting

By Gary Cokins, CPIM

Part 1 of 2

The field of management accounting is experiencing a punctuated shift toward more progressive methods and practices. The cause is reaction to (1) business marketing and sales techniques that are increasingly customer centric and require predictive planning and (2) operational manager needs to improve productivity by removing waste, shortening cycle times, and increasing efficiency and effectiveness. What are the major trends involved? I'll cover the first three trends in this article and the other four in Part 2.

Throughout my career I've observed numerous management fads appear and then fade away as a temporary craze. I've also watched managers excitedly jump onto these new bandwagons only to be disappointed when they haven't lasted. In some cases, though, what begins as a good idea actually sticks and becomes a trend, which is what I'll describe here for management accounting.

Imagine if you reviewed the titles and content of *The New York Times* best-selling business books or of *Harvard Business Review* articles from the last 25 years. How many of them might cause you to react with a chuckle and say, “Oh, that one”? Do you remember any of the items in the following list? (Warning: Some advocates or book authors may be offended.)

- ◆ Quality circles (for total quality management, or TQM)
- ◆ One minute manager
- ◆ Business process reengineering (BPR)
- ◆ Management by objectives (MBOs)
- ◆ Six Sigma
- ◆ Matrix management
- ◆ Core competency
- ◆ Intrapreneuring
- ◆ Search for excellence
- ◆ Best practices
- ◆ Management by walking around (MBWA)

I’m not saying those practices served no purpose. They did introduce useful ideas, but they didn’t live up to their promises as they ascended. Many organizations jump

from one improvement program to another, hoping that each new one will provide that big competitive edge, only to discover with hindsight that it was just a *method du jour*. Most managers would acknowledge that pulling one lever for improvement rarely results in a substantial change—particularly a long-term sustained change. And the business media haven’t helped. They hype what’s fashionable at the time, mostly because that’s their role.

Will the management accounting trends that I describe here take root or be just another fad or fashion?

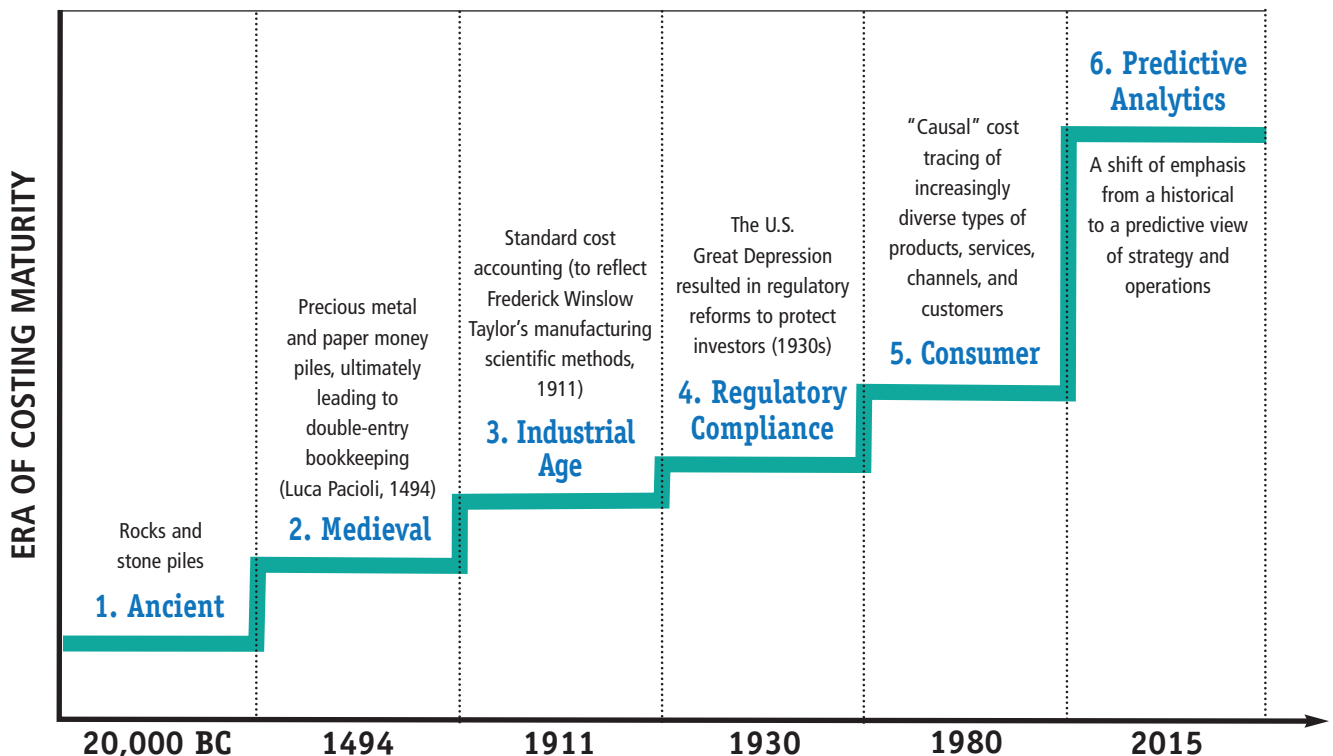
Management Accounting Eras

First let’s look at some history. Figure 1 illustrates a humorous but valid timeline of the shifts in accounting:

1. Ancient Era—Rocks and stone piles.

2. Medieval Era—Piles of precious metal and paper money. This situation ultimately led to the book published in 1494 by Luca Pacioli, an Italian mathematician and Franciscan friar, titled *Summa de arithmetica, geometria, proportioni et proportionalità*. It dealt with Hindu-Arabic arithmetic and its offshoot, algebra, and contained Pacioli’s 27-page treatise on Venetian accounting that described double-entry bookkeeping.

Figure 1: Six Eras of Management Accounting



3. Industrial Age Era—Standard

cost accounting. In the 1860s, Albert Fink, a German-born civil engineer who worked in the United States, developed cost per ton/mile rates for the railroad industry using cost allocations. In the 1890s, to reflect Frederick Winslow Taylor's manufacturing scientific methods, Alexander Hamilton Church developed standard costing methods.

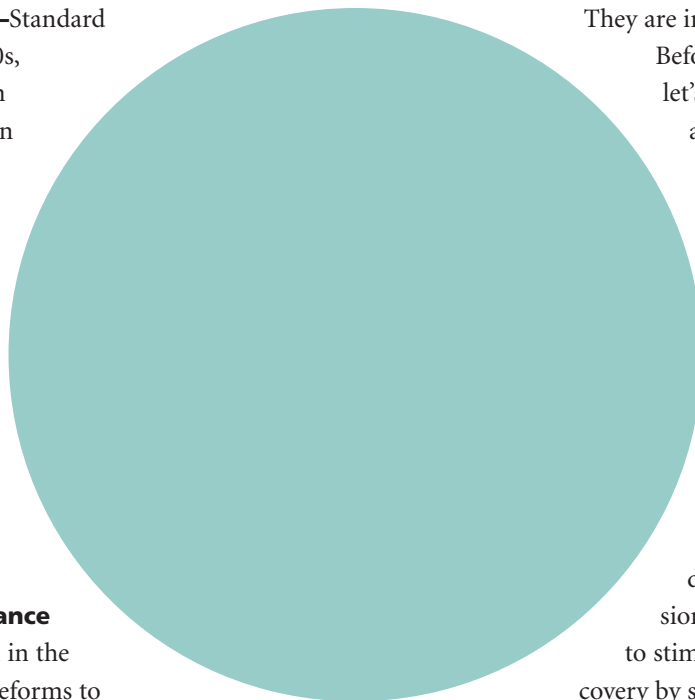
4. Regulatory Compliance

Era—The Great Depression in the U.S. resulted in regulatory reforms to protect investors from shady financial reporting practices (1930s). In one sense, they were a setback to management accounting because the reforms established simplified rules that calculated inventory values and costs of goods sold (COGS), yet the overhead cost allocation methods were misleading because they were based on cost factors that violated costing's *causality principle* (the need for cause-and-effect insights).

5. Consumer Era—The emergence of activity-based costing (ABC). This next era arguably led to a transition from management accounting to managerial economics. ABC reflected "causal" cost tracing of increasingly diverse types of products, services, channels, and customers that resulted in an organization's relatively greater indirect-to-direct expense structure to manage the increase in complexity. In 1987, the book *Relevance Lost: The Rise and Fall of Management Accounting*, by H. Thomas Johnson and Robert S. Kaplan, documented the need for and benefits of upgrading costing practices from a highly aggregated "cost pool" with a single, noncausal cost allocation factor to using multiple disaggregated cost pools with causally related factors.

6. Predictive Analytics Era—Predictive accounting. Today and moving forward, there's a shift in emphasis from a historical to a predictive view of strategy and operations. With cost projections, organizations can translate their plans and actions into monetary terms for decision evaluation and/or validation.

Where are the emerging practices in management accounting that may likely evolve into lasting trends?



They are in steps 5 and 6 in Figure 1.

Before getting to the trends, let's look at the role of management accounting. Contrary to beliefs that the only purpose of management accounting is to collect, transform, and report data, its primary purpose is first and foremost to influence behavior at all levels, from the desk of the CEO down to each employee. It should do this by supporting decisions. A secondary purpose is to stimulate investigation and discovery by signaling relevant information (and, consequently, bringing focus) and

by generating questions.

Here is the IMA® formal definition of management accounting:

Management accounting is a profession that involves partnering in management decision making, devising planning and performance management systems, and providing expertise in financial reporting and control to assist management in the formulation and implementation of an organization's strategy.

My intent isn't to debate or replace IMA's definition but to emphasize the importance of its need to support decision making.

The Seven Major Trends in Management Accounting

The seven major trends in management accounting are:

1. Expansion from product to channel and customer profitability analysis,
2. Management accounting's expanding role with enterprise performance management (EPM),
3. The shift to predictive accounting,
4. Business analytics embedded in EPM methods,
5. Coexisting and improved management accounting methods,
6. Managing information technology and shared services as a business, and
7. The need for better skills and competency with behavioral cost management.

1. Expansion from product to channel and customer profitability analysis

I would like to believe that the reporting of more accurate product and standard service-line cost and profitability information using ABC principles is now common. ABC traces expenses into cost with resource and activity drivers and provides much cost visibility that is traditionally hidden. Sadly, many organizations continue to use a single indirect and shared expense “pool” that allocates resource expenses into costs based on a single cost factor, which violates cost accounting’s causality principle. Hence, compared to ABC’s disaggregating a single cost pool into multiple ones and tracing each pool with an activity cost driver based on a cause-and-effect relationship, the existing costs are flawed and misleading. The products and service lines are simultaneously over- and under-costing because allocations always have a zero sum error. It’s baffling how accountants can accept this deficient practice when ABC is a better alternative.

But let’s put that observation aside and focus on an increasingly more relevant information need: channel and customer profitability reporting. Figure 2 illustrates that the expenses of a company are more than just product-related ones. The white spaces are “costs to serve” incurred through sales and distribution channels and by customers.

In the past, companies focused on developing standard products and standard service lines and then incenting their sales force to push and sell them to existing customers and prospects. But many products or service lines are one-size-fits-all and have become commodity-like. For example, most banks offer similar checking and deposit services. In addition, competitors can quickly replicate a company’s standard products and services. Consequently, the importance of services rises, which results in a shift from product-driven differentiation toward service-driven differentiation to differentiated customer microsegments in order to gain a competitive advantage. That is, as the competitive edge

from product advantages is reduced or neutralized, the customer relationship grows in importance.

To complicate matters, suppliers are aware that they have a broad range of high- and low-demand customers. For example, high-demand customers might regularly change delivery schedules, require special treatment, return goods, or phone the customer service help desk. Low-demand ones do none of these things. The extra consumption of expenses from high-demand customers means they are relatively less profitable than you might assume from the sales volume of their purchases. What this means for the marketing and sales functions is that their objective is no longer solely about increasing market share and growing sales but about growing *profitable* sales. That requires tracing expenses below the product gross profit margin line, including channel distribution, selling, marketing, and customer service costs to serve.

The crucial challenge is to use ABC beyond calculating valid customer profitability data. The benefit comes from identifying the profit-lift potential and then realizing the potential and fulfilling it with smart decisions and actions. Marketing and sales need to view customers as an investment, such as in an individual’s portfolio, rather than as someone to spend money on.

Customer profit and loss (P&L) information quantifies what everyone already may have suspected: Customers who purchase roughly the same volume and mix at similar prices aren’t nearly the same when it comes to profit. As I just described, some customers may be more or less profitable based strictly on how demanding their behav-

Figure 2: Costs from Sales & Marketing Are Not Products

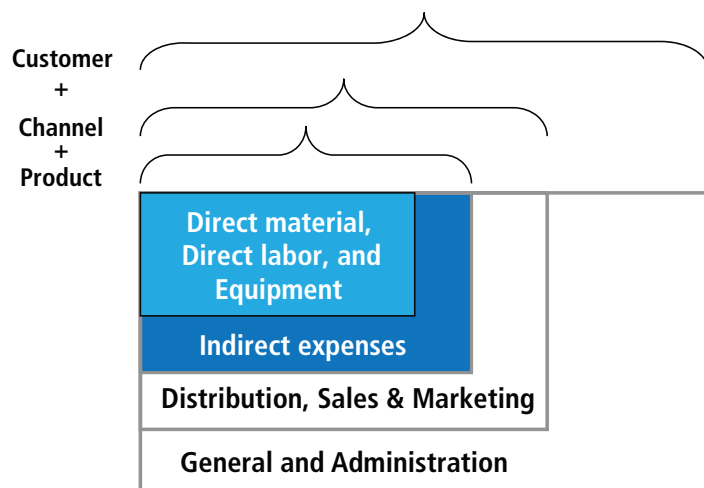
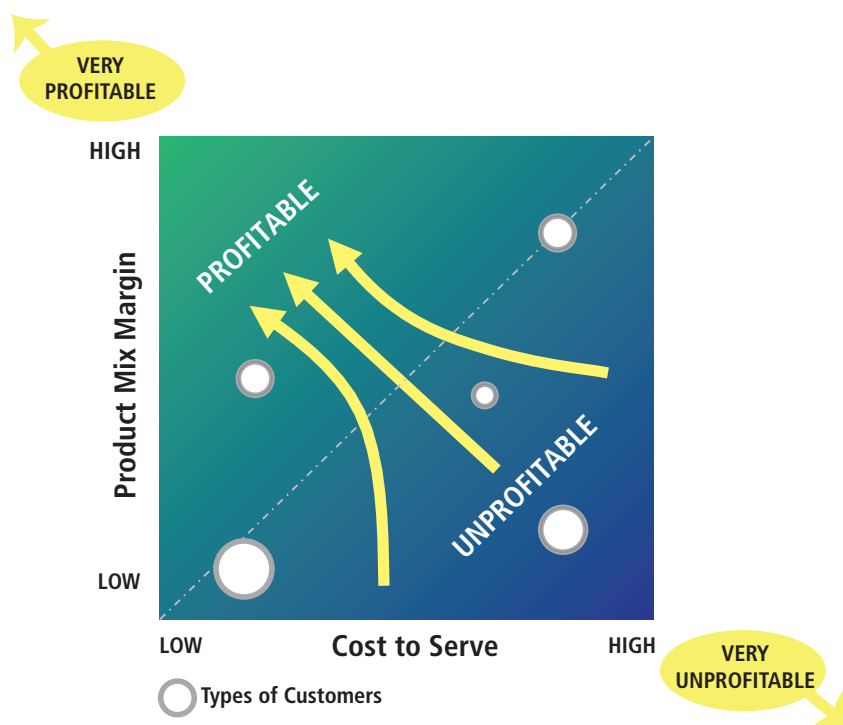


Figure 3: Migrating Customers to Higher Profitability



ior is. The information also provides cost visibility and transparency when it comes to the business processes and work activities that cause the higher or lower costs.

Although customer satisfaction and loyalty are important, a longer-term goal is to increase customer and corporate profitability. There must always be a balance between managing the level of customer service to earn customer loyalty and the impact it will have on increasing owner and shareholder wealth.

There are two major “layers” of profit margin in a company’s P&L:

1. The mix of products and service lines purchased, and
2. The nonproduct “costs to serve” apart from the unique mix of products and service lines purchased.

Figure 3 combines these two layers in a two-axis grid: the composite product gross profit margin of the product mix each customer purchases (reflecting net prices to the customer) and their cost to serve. Any individual customer (or grouped cluster) can be located at an intersection where the circle’s diameter size reflects each customer’s revenues. The figure debunks the myth that customers with the highest sales volume are also generating the highest profits.

The objective is to drive customers with profit-increase potential to the upper-left corner of the grid through a host of actions, such as surcharge pricing, upselling, and

cross-selling. For example, if a customer purchases a set of golf clubs, can they also be sold a golf shirt? And if they purchase the shirt, can they be sold a second shirt at a discounted price? The data could also help suppliers identify customers who are substantially unprofitable: those who reside deep in the bottom-right of the grid. These relationships can be terminated through actions such as increased pricing or reduced service-level tactical actions that might encourage customers to “de-select” themselves. (This is equivalent to “firing” the customer.)

One critical reason for knowing where each customer is located on the profit matrix is to protect your most profitable customers from your competitors.

Again, trend No. 1 is that management accounting must help the sales and marketing functions. A company needs to know the best types of customers to retain, grow, win back, and acquire—and those who aren’t. To maximize shareholder wealth, a company also needs to know how much to *optimally* spend retaining, growing, winning back, and acquiring each type of customer. This is because it’s an optimization problem. A company can unnecessarily spend excessively on loyal customers and therefore destroy shareholder wealth. In contrast, it can spend too little on marginally loyal customers and risk their defection to a competitor. Without this information, financial performance falls short of its full potential.

2. Management accounting's expanding role with enterprise performance management (EPM)

Enterprise performance management can be defined as the integration of multiple methods (such as strategy maps, balanced scorecards, performance measures, driver-based budgeting, lean management, and customer relationship management) to achieve the executive team's strategy, improve control, and increase financial profits—all through making better decisions. A major part of this is that each method is embedded with business analytics, such as segmentation and correlation analysis and especially predictive analytics. The output of a management accounting system is always the input to use in gaining insights and managing activities and operations.

A key example of applying management accounting to EPM is strategy execution. In this area the popular method is a strategy map—used to document and visualize the linkages of strategic objectives that realize the strategy—and the strategy map's companion balanced scorecard. The scorecard's key performance indicators (KPIs) and its cascaded operational performance mea-

The key point in trend No. 2 is integration. The various components of EPM are like gears in a machine—interconnected.

asures (often displayed in dashboards) have become the accepted technique for strategy execution. As we've heard many times, if you can't measure it, you can't easily manage it. And if you can't manage it, you can't improve it. A definition of a strategic KPI is to monitor the progress of accomplishing the strategy map's strategic objectives. Management accounting information provides a subset of KPIs. It translates performance into the language of money, such as unit cost of outputs to monitor favorable improvements or as product and customer profits—with both examples against target amounts.

A second example of applying management accounting

to EPM was in trend No. 1: supporting the marketing and sales functions to view customers as an investment rather than as someone to spend money on.

Other examples will be evident as I describe the remaining trends. The key point in trend No. 2 is integration. The various components of EPM are like gears in a machine—interconnected. Commercial software increasingly provides integration, so, for example, when profitability information is calculated, it is reflected directly in the performance measures of a balanced scorecard or operational dashboards.

3. The shift to predictive accounting

A gap is widening between what management accountants report and what managers and employee teams want. This doesn't mean that information produced by management accountants is of little value. In the last few decades, accountants have made significant strides in improving the utility and accuracy of the costs they calculate and report (such as with ABC). The gap is being caused by a shift in managers' needs—from just needing to know what things cost (such as a product cost) and what happened to a need for detailed information about what their *future* costs will be and why.

Many presentations from consultants and software vendors display an automobile's rearview mirror and humorously proclaim you can't drive the car by looking backward in time and that you should drive looking through the front window. I can make an argument that there's value from historical information. For example, in costing you can calculate highly relevant calibrated cost rates that are essential for projecting future resource requirements expenses.

This example shifts our focus to the future. The past reflects decisions already made. Decisions that *will be made* are the ones that impact the future. We once lived in a more stable world. Today there is increased volatility and uncertainty for a host of reasons, including the dropping of competitive barriers from globalization as well as more rapid changes in customer preferences, technologies, and competitor tactics. Business analytics—especially predictive analytics—and Big Data are popular buzzwords in the media today.

Figure 4: Taxonomy of Accounting

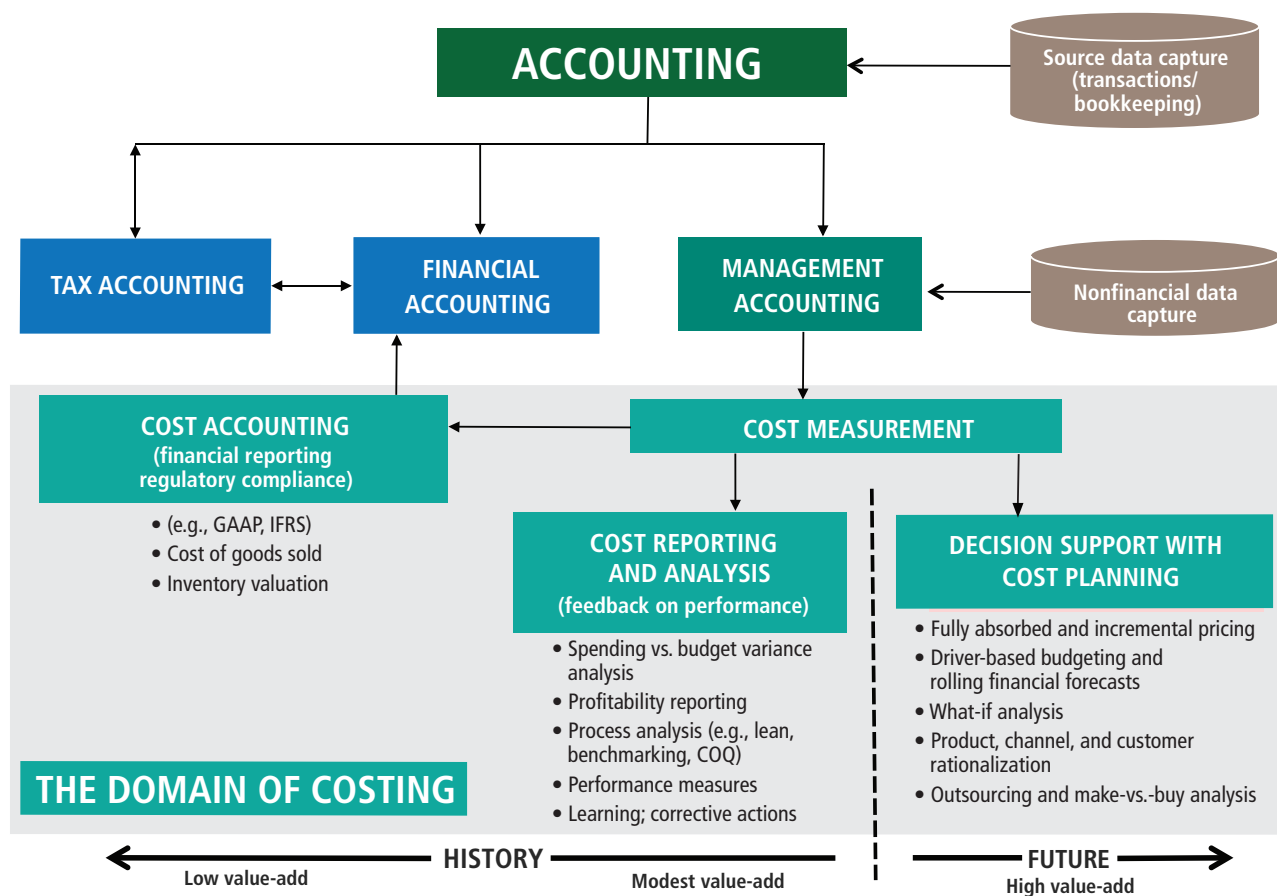


Figure 4 illustrates the large domain of accounting with three components: tax accounting, financial accounting, and management accounting. Two types of data sources are displayed in the upper right. The upper source is from financial transactions and bookkeeping, such as purchases and payroll. The lower source is non-financial measures, such as payroll hours worked, retail items sold, or gallons of liquid produced.

The financial accounting component is intended for external reporting, such as for regulatory agencies, banks, stockholders, and the investment community. Financial accounting follows compliance rules aimed at economic valuation, so it typically isn't adequate or sufficient for decision making. And the tax accounting component is its own world of legislated rules.

Our area of concern—the management accounting component—can be subdivided into three categories: (1) cost accounting, (2) cost reporting and analysis, and (3) decision support with cost planning. To oversimplify a distinction between financial and management

accounting, financial accounting is about valuation, and management accounting is about *value creation* through good decision making.

The three management accounting subcomponents in Figure 4 are recipients of inputs from the “cost measurement” procedure of transforming incurred expenses (or their obligations) into calculated costs:

Cost accounting represents the assignment of expenses into outputs, such as the cost of goods sold and the value of inventories. This box primarily provides external reporting to comply with regulatory agencies.

Cost reporting and analysis represents the insights, inferences, and analysis of what has already taken place in the business in order to track performance.

Decision support with cost planning involves decision making. It also represents using the historical cost reporting information in combination with other economic information, including forecasts and planned changes (such as processes, products, services, channels), in order to make the types of decisions that lead to a

financially successful future.

It will be apparent that the key differentiator between cost accounting and the other two uses of the “Cost Measurement” box is that cost accounting is deeply constrained by regulatory practices and by describing the past in accordance with principles of financial accounting. The other two categories offer diagnostic support to interpret and draw inferences from what has already taken place and what can happen in the future. Cost reporting and analysis is about explanation. Decision support with cost planning is about possibilities. The message at the bottom of the figure is that the value-add, utility, and usefulness of the information increase, arguably at an exponential rate, from the left side to the right side of the diagram.

When the cost reporting and analysis component shifts right to the decision support with cost planning box in Figure 4, analysis shifts to the realm of decision support via economic analysis. For example, we need to understand the impact that changes will have on future expenses, so the focus shifts to resources and their capacities. This involves classifying the behavior of resource expenses as sunk, fixed, step-fixed, semivariable, variable, and discretionary with changes in service offerings, volumes, mix, processes, and the like. The classification is tricky. Here’s a key concept: The “adjustability of capacity” of any individual resource expense depends on both the planning time horizon and the ease or difficulty of adjusting the individual resource’s capacity (its “stickability”). This wanders into the messy area of marginal/incremental cost analysis that textbooks oversimplify but that is complicated to calculate accurately in the real world.

Figure 5 illustrates how a company’s view of its profit and expense structure changes as analysis shifts from the historical *cost reporting* view to a predictive *cost planning* view. The latter is the context from which decisions are considered and evaluated.

The resource expenses in the left-hand side of Figure 5 were incurred during the historical time period. The capacity for which these expenses were incurred was supplied. Then it was either (1) *unused* as idle or protective capacity or (2) the expenses were used to make products, to deliver customer services, or to sustain the organization internally. This is the *cost reporting and analysis* component from Figure 4 that calculates output costs. The money was spent, and costing tells where it was used. This is the *descriptive* view of costs. Accountants refer to it as full absorption costing when all the expenses for a past time period are traced to outputs. It traces expenses

Cost reporting and analysis
is about explanation.
Decision support with cost
planning is about
possibilities.

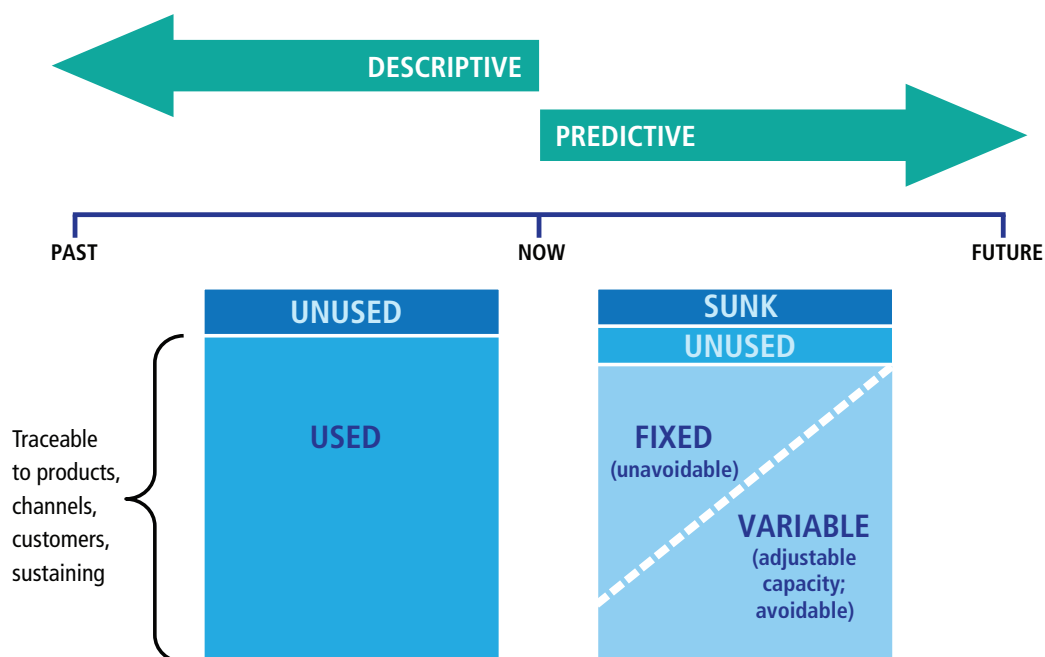
(and, I hope, doesn’t allocate indirect expenses with causal-insensitive, broadly averaged cost allocation factors like the number of direct labor input hours, units produced, head count, or square feet/meters) to measure which outputs uniquely consumed the resources, including individual output costs. The full absorption costing method uses direct costing methods and supplements the reporting with ABC techniques for the indirect and shared expenses.

In contrast, the right-hand side of Figure 5 is the *predictive* view of costs—the *decision support with cost planning* component from Figure 4. Capacity levels and types of resources can be adjusted in the future. Capacity exists only as a resource, not as a process or work activity. The classification of an expense as sunk, fixed, step-fixed, semivariable, or variable depends on the planning time horizon. The diagonal line reveals that most expenses aren’t easily changed in the very short term; hence, they are classified as fixed. As the time horizon extends into the future, capacity becomes adjustable. For example, assets can be leased, not purchased, and future workers can be contracted from a temporary employment agency, not hired as full-time employees. Therefore, these expenses are classified as variable.

The broad decision-making categories for applying management accounting are:

Product, channel, and customer rationalization—Which products, stock keeping units (SKUs), services, channels, routes, customers, and the like are best to retain or improve? And which ones aren’t and should potentially be abandoned or terminated?

Figure 5: Descriptive vs. Predictive Accounting



Customer lifetime value (CLV)—It’s useful to know how profitable a customer has been, but in some cases the future potential profit levels, especially in business-to-consumer (B2C) relationships, is more relevant because customers go through life cycles.

Planning, budgeting, and rolling financial forecasts—Based on forecasts of future demand volume and mix for types of services or products, combined with assumptions of other proposed changes, how much will it cost to match demand with our supplied resources (for example, workforce staffing levels, purchased materials)?

Capital expense justification—Is the return on investment (ROI) of a proposed asset purchase, such as equipment or an information system, justified?

Make vs. buy and general outsourcing decisions—Should we continue to do it ourselves or contract with a third party?

Process and productivity improvement—What can be changed? How can we identify opportunities? How should we compare and differentiate high-impact opportunities from nominal ones?

The term “cost estimating” is a general one and applies in all the previous decision-making categories. You might conclude that the first category, rationalization, focuses

only on historical costs so doesn’t require cost estimates, but the impact on resource expenses from adding or dropping various work-consuming outputs also requires cost estimates to validate the merit of a proposed rationalization decision.

Trend No. 3 reveals a major transition from management accounting for reporting costs and profits to managerial economics for decision support and analysis that impact the future.

As you can see, management accounting is experiencing some interesting shifts. As management accountants, we need to lead the way in helping our organizations understand these changes and how we can help with strategic decision making. **SF**

Gary Cokins, CPIM, is IMA’s executive-in-residence and is founder and owner of the consulting firm Analytics-Based Performance Management LLC in Cary, N.C. (www.garycokins.com). A thought leader in EPM, business analytics, and advanced cost management, he previously was a consultant with Deloitte, KPMG, Electronic Data Systems (EDS), and SAS. He also is the author of numerous books and articles and is a longtime member and active committee member of IMA. You can reach Gary at (919) 720-2718 or gcokins@garycokins.com.

Top Trends in Management Accounting, Part 2

By Gary Cokins, CPIM

Part 2 of 2

The field of management accounting is experiencing a punctuated shift toward more progressive methods and practices. The cause is reaction to (1) business marketing and sales techniques that are increasingly customer centric and require predictive planning and (2) operational manager needs to improve productivity by removing waste, shortening cycle times, and increasing efficiency and effectiveness. What are the major trends involved? I covered the first three trends in Part 1 and will cover the other four in this article.

Last month in Part 1 of this article, I enjoyed listing some of the management fads that didn't last, took you on a journey through the six eras of management accounting, and introduced three of the seven major trends in management accounting. Before we plunge into the last four, let's take a quick look again at all seven:

1. Expansion from product to channel and customer profitability analysis,
2. Management accounting's expanding role with enterprise performance management (EPM),
3. The shift to predictive accounting,
4. Business analytics embedded in EPM methods,
5. Coexisting and improved management accounting methods,
6. Managing information technology and shared services as a business, and
7. The need for better skills and competency with behavioral cost management.

Now on with the next group.

4. Business Analytics Embedded in EPM Methods

Business analytics and Big Data are hot topics. They are here to stay because complexity, uncertainty, and volatility are on the rise. When some managers hear these terms, they react with trepidation and think, “I took a statistics course in school and just wanted a passing grade and be done with it!” Today, the need for analytics may be the only sustainable long-term competitive advantage. Why? Because the traditional generic strategies, such as being the lowest-cost supplier or providing product or customer differentiation, are vulnerable to agile competitors who can quickly match a supplier’s price or invade your customer base.

Analytics is about investigation and discovery. Queries, like drill-downs, simply answer questions. Business analytics creates questions. Further analysis stimulates more questions, more complex questions, and more interesting questions. But most important, business analytics also has the power to answer the questions.

Here are a few examples of emerging applications that will help you get more and deeper insights from EPM methods:

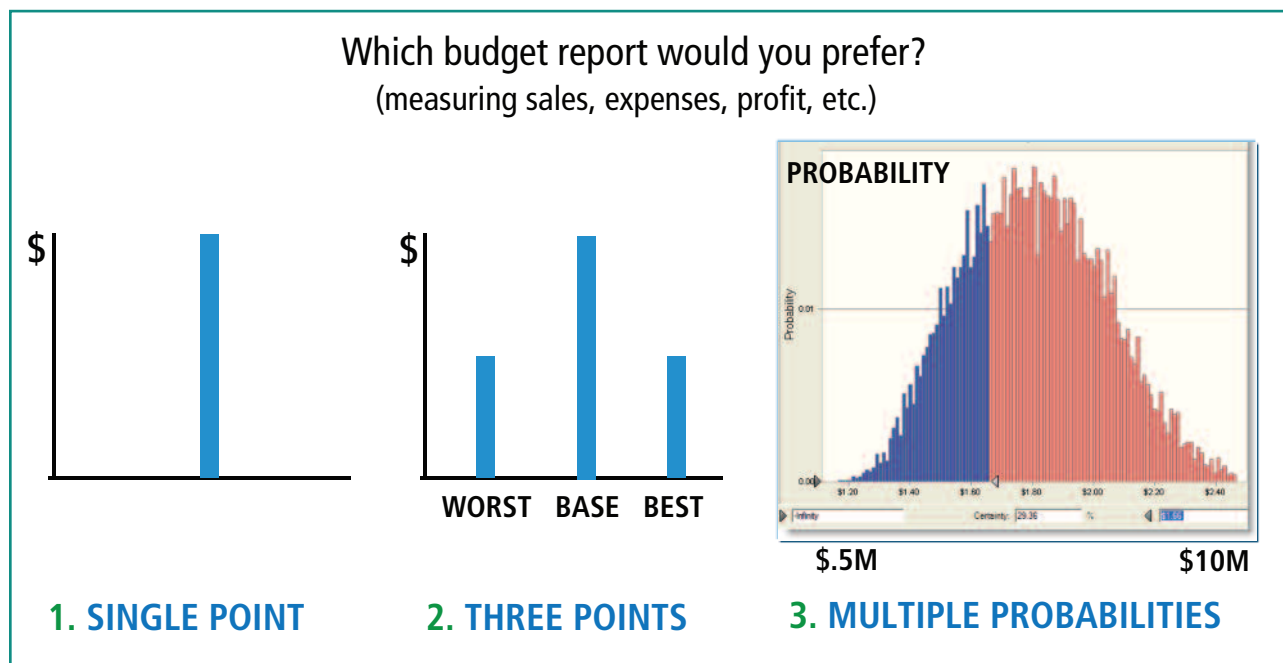
- ◆ Strategy maps typically have 15 to 25 strategic objectives displayed in boxes. They also contain arrows that causally connect the strategic objectives in the traditional four perspectives of a strategy map: (1) learning, growth, and innovation; (2) processes; (3) customer satisfaction and loyalty; and (4) financial. The arrows represent the selected key performance indicators (KPIs) and usually are displayed in a simple PowerPoint diagram that communicates the strategy in a single page. With analytics you can gain rich insights into how actions or projects more or less support the implementation of the strategy. You also can apply correlation analysis

where the thickness of the arrows that connect the strategic objectives reflects the explanatory value, which is the magnitude that a change in one KPI impacts another KPI, that one strategic objective’s KPI has on the dependent KPIs it is presumed to influence in other strategic objectives. The thickness validates the quality of the selected KPIs. With higher correlation (i.e., greater thickness), there is insight to where spending provides a higher return on investment (ROI).

- ◆ The activity drivers in an activity-based costing (ABC) system assign the activity costs to their final cost objects (such as products, services, channels, customers, and business sustaining). Ideally, they should be exactly proportional. That is, if the quantity of an activity driver increases 20%, its activity cost should also increase 20%. This isn’t the case in poorly designed ABC systems. Again, with correlation analysis, the quality of the activity driver can be validated. If there is low correlation, then a new activity driver can replace it and thus increase the cost accuracy of the final cost object. This also provides better insight as to what’s driving the costs.

- ◆ As I described in trend No. 1, there’s an expansion from calculating product profitability to calculating channel and customer profitability using ABC principles. This results in ranking customers from most profitable to least profitable. Some of the reasons that differentiate highly profitable from unprofitable customers can jump off a report’s pages—for example, excessively frequent orders rather than bundled. The “*what* do things cost?” is amplified with the “*why* do things cost?” But the “*why*” question that differentiates highly profitable customers from unprofitable ones isn’t always answered easily. With analytics’ recursive partitioning and decision trees method, a computer can tell you why. Customer profit level is a dependent variable and is a result of many factors. In the customer master file are dozens of independent variables (such as number of sales orders, types of orders, the location of the customer, and special services the customer may demand) that can be compared and interpreted as the key differentiators of profit levels. From that information, companies can take profit-

Figure 1: Analytics: Probabilistic Planning Scenarios



lifting actions.

In trend No. 3, I described the shift from the annual budget to rolling financial forecasts using driver-based resources expense modeling methods that calculate a single-point profit forecast. In some cases, three scenarios may be projected using best-case, baseline, and worst-case assumptions for a few variables, such as sales volume. But why stop with three and just a few variables? Why not estimate on a range of seven estimates for a dozen variables assumptions (such as material prices or labor wages)? With 7×12 , then 84 projections and rank-order can be displayed in a profit distribution graph. An example is in Figure 1, which moves understanding from possibilities to probabilities. With such a distribution curve, analysts can better understand what factors most lead to higher profits (other than the obvious sales volume and product mix) and apply sensitivity analysis to better understand which variables (drivers) might be increased or decreased to improve overall profits.

There are dozens of other examples where analytics can support the management accounting function well beyond simple and primitive ratio analysis, such as sales expense as a percentage of sales, inventory turn ratios, and return on equity (ROE). Analytics is here to stay. The buzz about “data scientists” isn’t hype. Trend No. 4 recognizes that progressive accounting functions now realize that competency and capabilities with analytics provides a competitive edge.

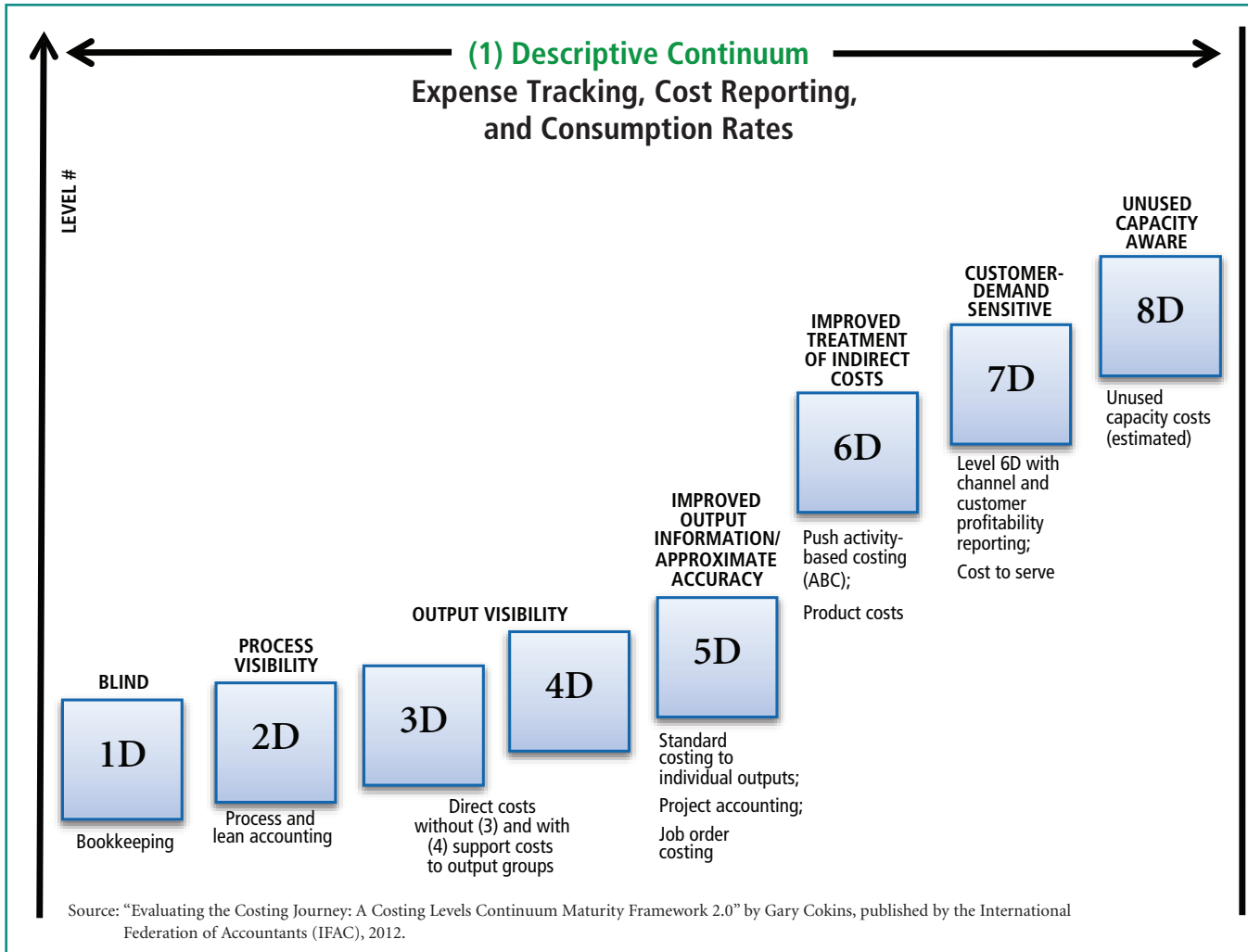
5. Coexisting and Improved Management Accounting Methods

There are debates in the management accounting community about which costing method is the most appropriate. There are rival camps. For example, some lean accounting advocates who create value stream maps criticize ABC (which has passionate advocates). This is surprising because ABC provides much greater cost accuracy and visibility to cost drivers compared to the flawed and misleading costs from traditional and grotesquely cost-distorting, broadly averaging cost allocation methods. Who’s right? (Can you guess which camp I’m in here?)

The trend is to ask a different question that resolves this dilemma. That question is about how to support two or more coexisting management accounting methods. Different types of managers and employee teams can use different costs for different purposes. Operational managers can use lean accounting to focus on removing waste and increasing profitability. They can use ABC strategically to better understand the sources of what drives

Figure 2: Costing Continuum/Levels of Maturity

(Many companies are at Levels 5D and 1P.)



enterprise profitability and the linkages of resource expenses to customers.

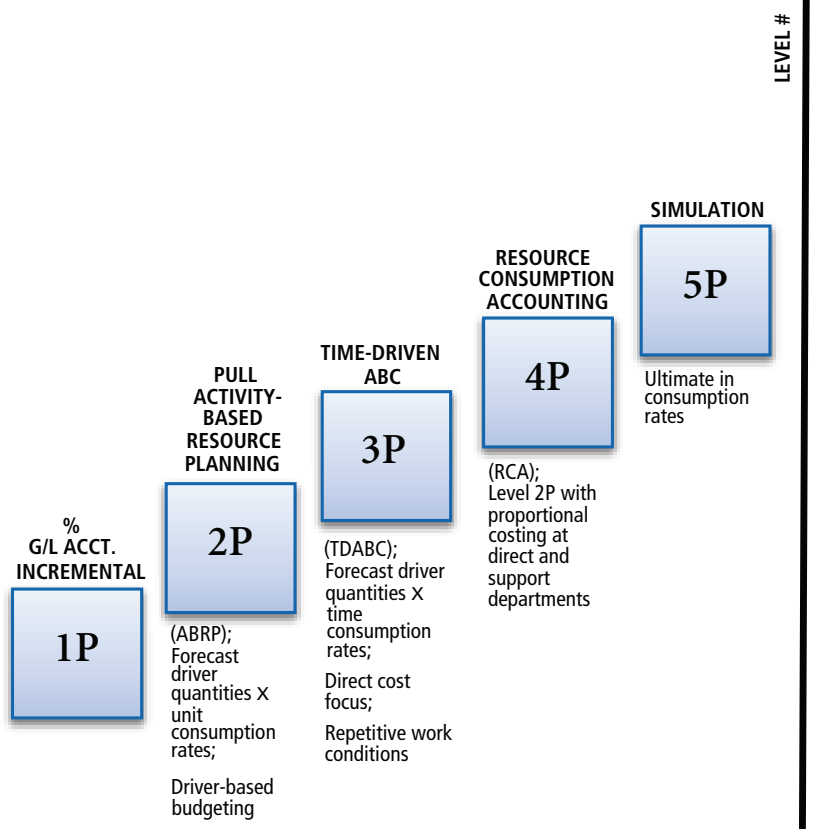
As shown in trend No. 3 and Figure 4 in Part 1, there are three broad categories of accounting: (1) tax accounting, (2) external financial accounting for regulatory compliance and investors, and (3) management accounting. Each calculates different costs of outputs or products. Progressive accounting functions recognize that they can use two or more management accounting methods.

Another trend is a more intelligent way of evaluating which level and type of costing sophistication are required. Under some conditions, an organization may not even need to aspire to advanced methods like resource consumption accounting (RCA) or throughput accounting, the costing method that's a companion to theory of constraints (TOC) advocates. A useful docu-

ment to assess the question "Is the climb worth the higher view?" is my report published by the International Federation of Accountants (IFAC) titled "Evaluating the Costing Journey: A Costing Levels Continuum Maturity Framework 2.0." (You can download it at www.ifac.org/publications-resources/evaluating-costing-journey-costing-levels-continuum-maturity-framework-20.) Figure 2 displays a multiple-stages maturity staircase that organizations can use to judge if the extra benefits from better accuracy and visibility of costs exceed the incremental administrative effort to collect, validate, and report the information.

Trend No. 5 demonstrates that the more progressive CFOs and their management accounting staff are considering the various needs of different types of managers in their organization.

**(2) Predictive Continuum
Demand Driven Planning
with Capacity Sensitivity**



questions: What do some diners do at an “all you can eat” restaurant buffet? They gorge themselves. What might you do if there are free items at an exhibitor booth at a conference? You might take more than one. It’s human nature that when something is free, people don’t care how much they consume—whatever the item or service may be.

How is this different when an organization’s information technology (IT) or shared services are free to internal departments? The substantial growth in IT over the past decade has moved it from a back-office support function to a critical and strategic function. User demands for faster response times, more information, and sophisticated equipment are driving IT spending upward at an ever-increasing rate so that IT now ranks among the top category of expenditures for many organizations. If IT doesn’t in some way internally “charge back” its expenses to its users with an internal invoice itemizing all the service and asset use fees, then the users’ expenses will get out of control.

Not surprisingly, IT spending in some industries that are information intensive, such as financial institutions, has reached 10% of revenue. After Y2K (when there was supposed to be major havoc with computer systems as the year 2000 dawned), the increase in IT spending forced many more organizations to focus cost management and

performance improvement efforts on their information technology groups. Many techniques used in commercial manufacturing and service industries are now being applied specifically to the IT function. Companies are employing activity-based cost management (ABC/M) and IT capacity usage reporting systems to develop cost information used in both cost management and performance improvement efforts. ABC/M and capacity usage information are supporting multidimensional cost analysis, performance measurement and monitoring, creation of internal IT markets, user/customer cost visibility, driver-based planning, and capacity management. Clearly, IT spending no longer can be managed on the back of an envelope.

Thus having an “internal IT market” is important. When internal shared services providers and their users

6. Managing Information Technology and Shared Services as a Business

There’s a trend toward using management accounting for internal chargebacks (like an invoice) from service providers to service users. This information also helps establish what are effectively “transfer prices” based on cost consumption rates for service-level agreements (SLAs).

As background to understand this trend, consider these

interact with an understanding of their mutual relationship using fact-based data, then everyone benefits—IT, the user, and the entire organization. Line-item IT chargeback invoices not only create a service provider/user market for pricing, but the cost calculations also provide the basis, including service-level rates, for SLAs, which formally document what a user should expect from IT.

With increased spending and investment in information technology comes increased scrutiny, and chief information officers (CIOs) are having to demonstrate greater maturity and expertise in IT performance and financial management to reveal how their area's money is being spent, the returns their organization is getting for their spending and investments, and how IT is contributing to overall enterprise performance.

What type of barrier continues to obstruct the adoption rate of management accounting and EPM methodologies? That barrier category is social, behavioral, and cultural.

Users who care about their organization's financial health are demanding greater IT cost transparency, visibility, and financial analysis so everyone can understand the true costs. CIOs often find it difficult to respond to these demands, and they struggle to easily and clearly communicate the cost of services provided and demonstrate the substantial value that IT brings to their organization. To complicate matters for CIOs, chief financial officers (CFOs) are becoming increasingly influential and vigilant in monitoring and even approving IT budgets and purchases.

In the 1990s, there were never enough resources, and organizations couldn't add them fast enough. The needs for IT seemed insatiable. Then shortly after the turn of the century a dramatic shift occurred, and the hunger for these services began to be questioned and challenged. Organizations seemingly had too many IT resources, and they began questioning the value of the money that had been spent. The IT model of the 1990s, "spend first, ask questions later," is gone and is being replaced by "ask questions first, spend later."

An additional problem is that CIOs struggle when they attempt to track and measure the benefits of the technology after it's implemented. They often lack the insight and information they need to understand the implications of investments, accurately forecast demand and costs, and ensure that any investment provides maximum benefit to the business.

The consequences of failing to implement IT business performance management methods, such as ABC/M and KPI scorecard metrics, are often hidden, yet they are substantial. Without performance management methods, IT fights to control its budget, can't maximize its return on investment, suffers from increased complexity and cost, and is unable to make sustainable cost reductions. The result is that organizations make decisions to implement infrastructure or outsource capabilities with inadequate service cost information that doesn't support strategic goals or may even impact them negatively with suboptimal results. Outsourcers prey on IT organizations that don't know their costs, especially those that don't understand the fixed and variable nature of costs.

These pressures are creating a changing role for the CIO to manage IT as a business, to prove its value across its organization, to ensure user-customer satisfaction, and to maximize value from new and existing investments.

IT no longer can be viewed as just a technology supplier. It must be seen to add value to the organization and provide strategic capability. As such, the costs to provide services must be understood and become part of the decision-making process. IT performance management methods allow IT to change its focus from technology and daily "keep the lights on" operations to a focus on its user-customers and services. They also enable IT to become service oriented, aligning itself with the organiza-

Table 1: Barriers to EPM Adoption

Why is the adoption rate so slow? What are the barrier categories?

- 1. Technical** barriers include IT-related issues.
- 2. Perception** barriers are excess complexity and affordability.
- 3. Design deficiencies** include poor measurements or their calculations and weak models and assumptions.
- 4. Organizational behavior** barriers involve resistance to change, culture, and leadership.

tion to provide customer-driven solutions to user problems and opportunities. For example, IT may better understand why a department requires business intelligence software to improve its analysis.

All these reasons show why management accounting needs to support internal IT and why shared services needs to be managed as a business.

7. The Need for Better Skills and Competency with Behavioral Cost Management

Another evolving trend is that activist management accountants—those who are promoting progressive methods as described in the trends already mentioned—are encountering obstacles to buy-in and acceptance of their ideas. They are realizing they need to improve their behavioral change-management skills and capabilities if they want to succeed.

Here's some background. A few years ago, as I concluded my presentations at seminars, I began asking this question: "Since these management methodologies are so logical, proven, and beneficial, why is their adoption rate by organizations so gradual and slow?" Eureka! A flood of replies from people described many diverse barriers and obstacles. I found myself increasingly attracted to these "why not to" and "why to" discussions instead of my "how to" lectures. They filled an emerging void for me—explaining my frustration with why more organizations weren't advancing to a higher level of maturity with management methods.

In hindsight, we now realize that past barriers impeding adoption are easily removable. That is, *technical barriers*, such as disparate data sources or "dirty" data, now have software solutions like extract, transform, and load (ETL), a tool that corrects impure data. *EPM component design deficiency barriers*, such as how to construct a strategy map properly and select its appropriate KPIs, are broken down with experienced consultants and better training courses.

What type of barrier continues to obstruct the adoption rate of management accounting and EPM methodologies? That barrier category is social, behavioral, and cultural. There are many examples of this type of obstacle, including people's natural resistance to change, not

wanting to be measured or held accountable, fear of knowing the truth (or of someone else knowing it), reluctance to share data or information, and "we don't do that here." When you mention these examples to project teams or internal champions tasked to explore, evaluate, implement, or operate enterprise performance management solutions, their heads all nod "yes!"

Table 1 lists the four barriers I've described here. The problem with the final barrier has been that few management accountants have had adequate training or experience as organizational change-management specialists. We aren't sociologists. We aren't psychologists. Yet effective management accountants are learning to become like them. They are learning about motivational theory and how to apply it.

During my seminars and discussions with customers, I'm more routinely citing the need for executive team leadership with the vision and inspiration to drive organizational transformation, not to manage more intensely. Trend No. 7 requires change-agent management accountants to motivate mid-level managers and other "champions" to demonstrate to their coworkers that progressive management accounting and EPM methodologies make sense to implement. There are personal rewards and satisfaction in explaining the importance of overcoming social, behavioral, and cultural barriers so organizations can take next steps.

Future Trends?

This article (Parts 1 and 2) has been a journey describing seven current trends in management accounting. Few organizations are pursuing all seven, but years from now the successful ones will be well along the way with all of them. Will there be future new trends? Of course. If you want to know what my crystal ball is showing me, keep your eye on the role that technology, such as in-memory-chip technology with analytics at the "speed of thought," will bring. **SF**

Gary Cokins, CPIM, is IMA's executive-in-residence and is founder and owner of the consulting firm Analytics-Based Performance Management LLC in Cary, N.C. (www.garycokins.com). A thought leader in EPM, business analytics, and advanced cost management, he previously was a consultant with Deloitte, KPMG, Electronic Data Systems (EDS), and SAS. He also is the author of numerous books and articles and is a longtime member and active committee member of IMA. You can reach Gary at (919) 720-2718 or gcokins@garycokins.com.