

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:

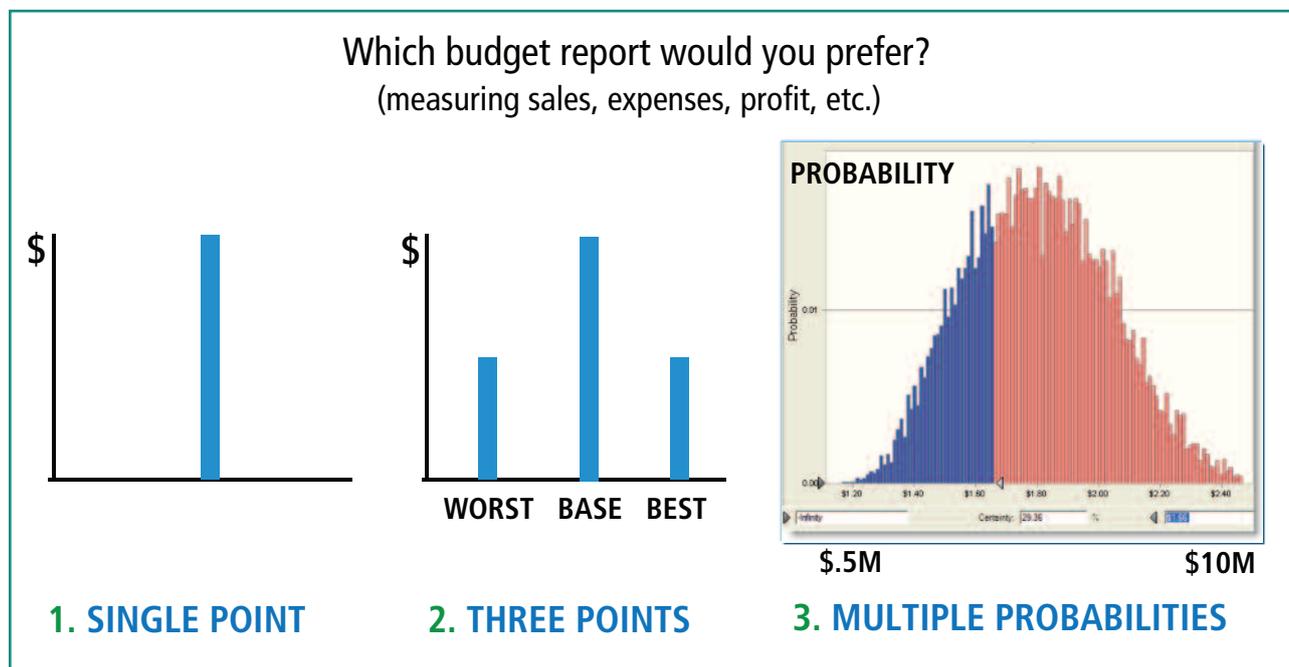
- ◆ Strategy maps typically have 15 to 25 strategic objectives displayed in boxes. They also contain arrows that causally connect the strategic objectives in the traditional four perspectives of a strategy map: (1) learning, growth, and innovation; (2) processes; (3) customer satisfaction and loyalty; 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.

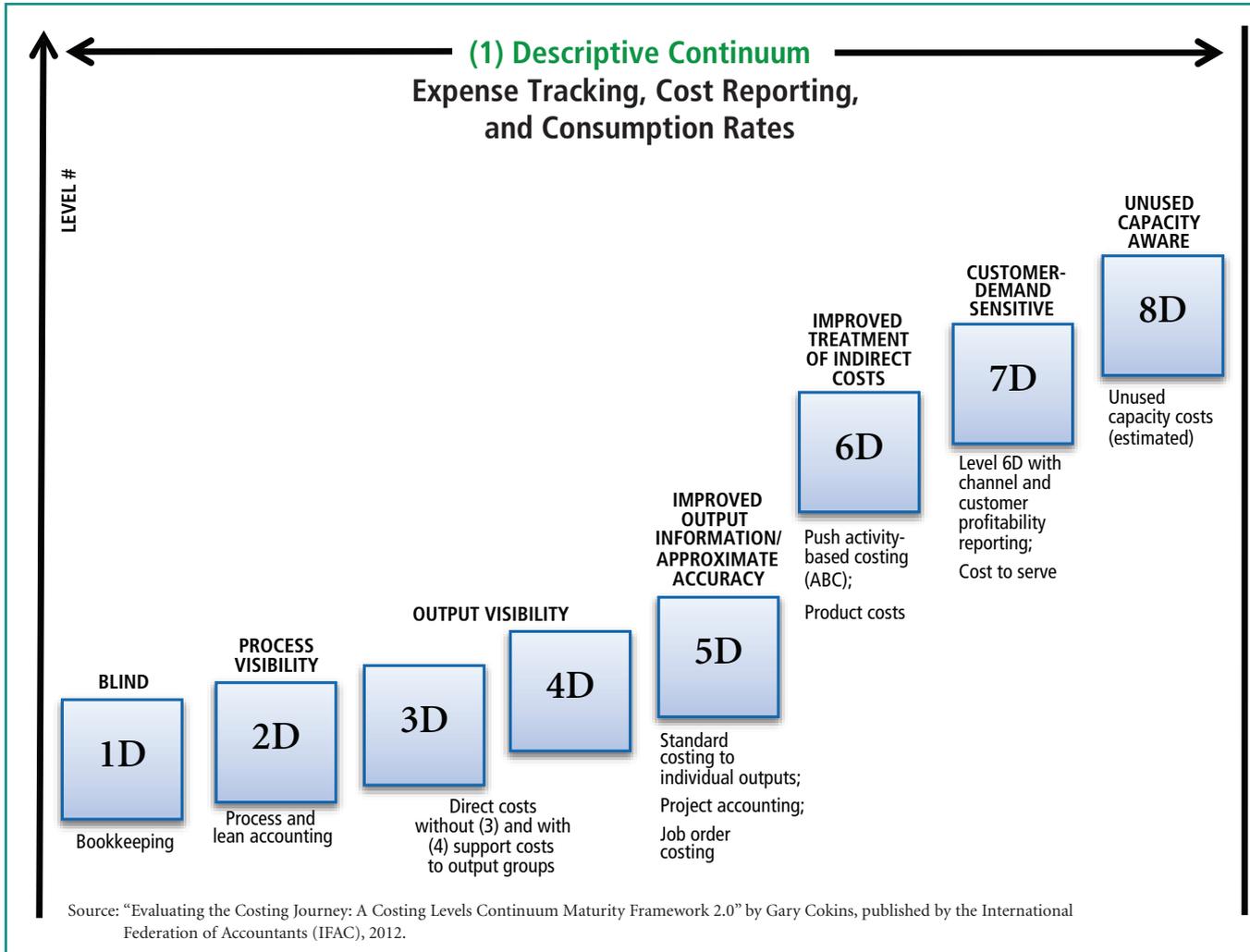
5. Coexisting and Improved Management Accounting Methods

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.

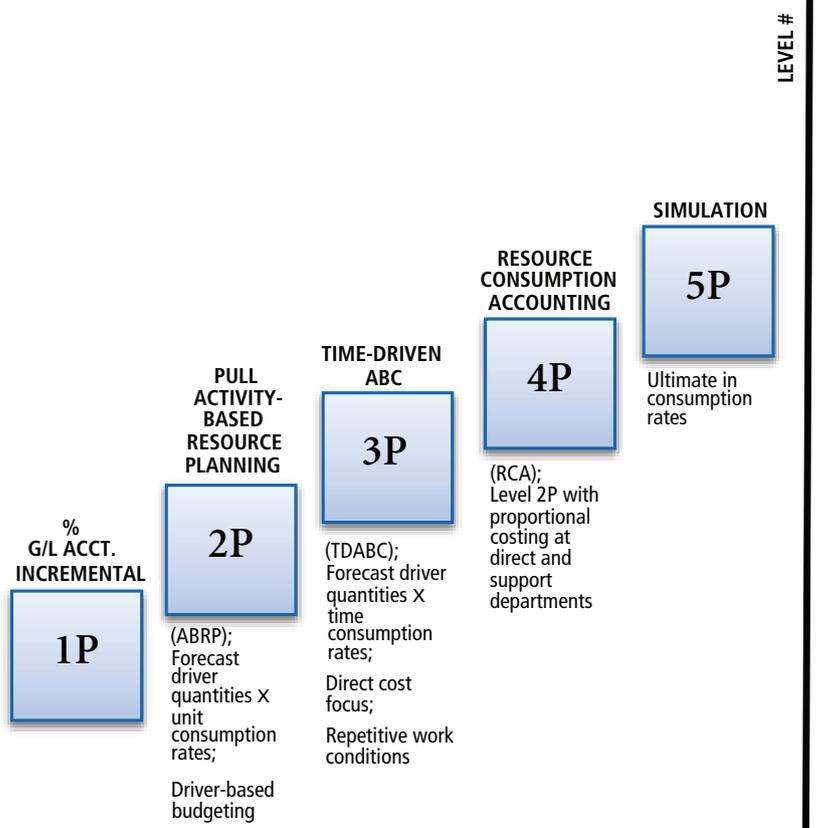
As shown in trend No. 3 and Figure 4 in Part 1, there are three broad categories of accounting: (1) tax accounting, (2) external financial accounting for regulatory compliance and investors, and (3) management accounting. Each calculates different costs of outputs or products. Progressive accounting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

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