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Best Practices in IT Costing & Chargeback Solutions:

Towards a Customer-Focused Internal Marketplace

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OVERVIEW

Over the last year, we have talked with a multitude of Information Technology leaders and employees through IQPC-sponsored workshops and via visits to potential IT client offices. We always ask a series of questions (resulting in answers) during these visits concerning best practices in IT costing and chargeback:

- Do your internal clients get the kind of cost transparency they want about your service portfolio? No!
- Do you have what you would consider a "best-practice" costing/chargeback solution? No!
- Have you talked with anyone who has successfully done so? No!
- Would you like one? YES!

We recently talked with the IT group of a State government who had done an informal survey of 200 IT organizations to see if they could find a "best-practice" solution. They did not! So, based on what we know from the experience of our own consultants, our discussions with various IT managers and CIOS and our recent "IT Cost Management" implementations, we have documented what we think is a best-practice design methodology for IT Costing & Chargeback.

In this paper, we propose an IT Cost Management and charge back methodology for efficiently manage IT costs through a combination of detailed unit cost calculations and a process where the internal client (customer) and provider (the IT department) are jointly accountability for service consumption and service unit costs. In other words, IT service providers become responsible for providing the demanded services at a competitive price, while IT service consumers are more accountable for the types and quantities of services that they demand. This we believe will create a customer-focused internal market place.

In our opinion, the best way for any internal IT business to add financial value has two key components:

- deliver services at a unit cost that is equal to or less than market price, with
- Equal or greater quality than the market.

STRATEGY

To become a customer-focused internal service provider requires answers:

- Do we have a strategic plan for your IT Business? If so,
- Is it well documented and communicated to the staff and internal clients? And,
- Does it portray positioning the IT organization as the most preferred supplier of IT services?

If not, we suggest that you begin that process immediately with your key internal and external stake holders and determine your IT Business strategy.

The typical "vision" statements and strategies we have seen normally contain phrases and key phrases such as strategic partner, maximize value, customer-focused, low-cost provider while maintaining high quality, high degree of technical competency, ability to keep most qualified employees, etc.

The Strategy is a very important part of the "best practice" solution. It sets the stage for IT Service delivery. It creates an ending point, a strategic target.

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CUSTOMERS – INTERNAL CLIENTS

A key theme in our best practice implementation is a clear understanding of the customer.

Since most strategic plans include something about being customer-focused, it becomes important to understand who is the IT customer. Every employee is an internal consumer of IT, since every employee consumes one or more IT services. However, not every employee has/owns a budget with which to "pay for" IT services. Therefore, the lowest level IT customer in the Company would be a cost/budget manager. This assumes that volumes of IT services delivered could be captured at the cost/budget manager level. If this is not feasible, then we must find the organization level where it is feasible to collect volume consumption data – another key element in our best practice methodology.

Furthermore, IT organizations (Cost/Budget Centers) consume many of their own Services. The cost/chargeback model should include the assignment of IT Services to IT Cost/Budget Centers. Keep in mind that the goal of the cost model is to assign 100% of IT costs to its customers, thus creating a full cost recovery model.

"CUSTOMER-FOCUSED" SERVICES

There is no better way to begin achieving a customer-focused strategic goal than to develop a list of services that our customers can understand. It is important that the Services be comparable to what our customers could "buy" in the external market place. We realize that the IT business is a very technical, complicated business, but let's not impose the complexity on our internal customers.

Below is an example of a bundled list of IT Services that are understandable and comparable. Even with this short list, there is still opportunity for additional bundling.

For example, if we cannot differentiate the cost between supporting desktops and laptops, then we could combine those into a single service. Furthermore, this list does not include any "premium" services. These can be added once we reach a certain level of sophistication within the cost model. ***It is extremely important to start out as simply as possible or the entire effort will fail.***

Again, the objective of this approach is that customers will be able to affect the volumes of Services they are demanding, if they can understand the volume. By customers actively managing their consumption and IT actively managing the cost to deliver, unit costs will begin to decrease.

Service Description	Unit of Sale
Application Development Service	# of hours
Application Maintenance Service	# of hours
Mainframe Processing Service	# of CPU Units
Distributed Processing Service	# of Servers
Network Service	# of Network Ports
Adhoc Data Requests	# of hours
Desktop Equipment Leasing	# of Desktops
Laptop Equipment Leasing	# of Laptops
On-Line Report Viewing	# of On-line Reporting log-ins
Remote Access Service	# of subscriptions
Intranet Support Service	# of hours of support
Email Service	# of accounts
Imaging Service	# of seats
Basic Telephone Service	# of extensions
LD Telephone Service	Pass through actual cost

We have talked with IT groups that have defined 100 to 300+ services to be included in their chargeback solution. The client does not understand many of these services, as

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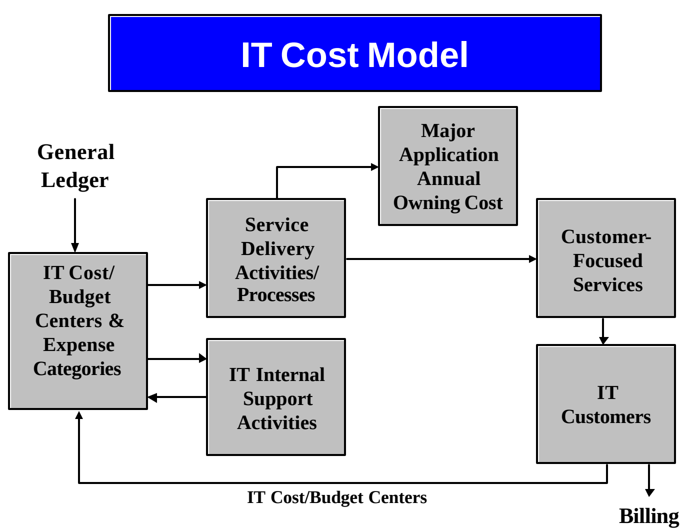
they bear no resemblance to what they need to know so they can run their business. We agree that IT directors/companies want to know the cost of these "activities" and that we need to design a model that will not only calculate the unit cost of the bundled set of services, but also calculate the unit cost of many activity or process outputs that support the bundled set of services.

ACTIVITIES/PROCESSES

We chargeback Services but we manage Activities/Processes. IT Services are delivered to customers via work activities, and a series of activities define a process. We are passionate about using an Activity-Based Management (ABM) approach to enable the cost management of IT activities, processes and Services. ABM methodology will allow IT management to understand better the "drivers" of cost at all levels and be able to better benchmark their processes and services to external providers. It is critical that we define our IT activities/processes as those that directly support IT Service offerings, versus those that support other IT groups. The cost of IT internal support activities are reassigned to the IT Service-supporting activities within the cost model, thus creating a fully assigned cost at both the activity and service dimensions.

Remember, the work activity/process dimension is where we will manage our IT business, so activities/processes can be defined in as much detail as required. A word of caution: 20% of our work activities will consume 80% of our resources (cost). "Simple is better" when starting the cost modeling – more detail and sophistication can be added later. Also, if a particular activity consumes less than 5% of resources, treat it as a "task" and bundle it with another activity.

Most IT organizations have implemented work management and/or project management applications to enable better resource management. If we take a closer look at the various management applications (work, project, activity-based), they all define the basic work unit, but for different reasons. *Work Management* defines "work" at a very low level, normally a task. *Project Management* usually uses a work breakdown structure (WBS) to define the work involved in a specific project. And *Activity-based Management* defines work related to the delivery of IT Services. A best practice in costing is to integrate these different management objectives at some level. For example, tasks can be "rolled-up" into higher-level activities (as those used in ABM) and a certain level of standard project WBS can match these activities. After all, it is all the same work.



The basic activity-based costing methodology

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Additionally, by using a multi-dimensional cost model, ***we can capture the annual ownership-cost of major applications*** and use this information to support replacement decisions. This is an added benefit of an activity-based cost model.

We usually begin our cost modeling with summarized cost categories within organizational cost centers found in the general ledger. In a recent engagement, our IT client was preparing a forward-looking budget every quarter, which we used to calculate a forward-looking unit cost. In our opinion, this is a better practice than using historical actual cost transactions to begin the unit costing effort. ***For management purposes, we would rather be looking into the future than the past.***

More detail about constructing these unit cost management models is discussed in a white paper about cost modeling on our website, ***www.crgroup.com***. We always use volume-based, cause-and-effect data to assign costs all the way from the resources (cost centers and accounts) to customers, so this ends up being a full absorption "cost-to-serve" model for IT.

CHARGEBACK

Once we have a good volume-based unit cost calculation at the IT Service/customer level in the model, we already have the information for a chargeback/billing (quantity x price). In this case, the price equals the calculated unit cost. For those IT organizations that prepare Service Level Agreements that include Price, our solution can be used to calculate a budgeted or forward-looking unit cost, which could be used to establish the SLA price. We recommend that the SLA price remain constant for a period longer than a month (quarterly, semi-annually, or annually). This affords the opportunity to simplify the monthly chargeback/billing. The result is an invoice to each customer detailing the quantity of IT Service consumed (for each billable service) during the billing period times the established Price.

This way, we do not have to calculate unit cost every month in order to invoice our customers. In fact, since the management of unit cost is more about improving cost trends rather than monthly transaction results, the cost management model really doesn't need to be updated any more than quarterly. Even then, we would recommend using twelve months of volume and GL cost information each quarter. This produces an annualized unit cost trend. Obviously, the important thing is to manage the cost such that the unit cost is decreasing over time.

It is also clear that the actual costs may differ from forecasted costs and that there will be variance arising from either the overall costs going up (e.g. due to higher than anticipated salary increases) or unit cost will go up due to lower than anticipated demand and thus higher un-utilized capacity. In that case, there will be a need for the residual settlement or a true-up. Depending on the culture of the organization, we have designed relatively easy way to handle these situations – it can be done.

A very important consideration concerning chargeback! We may not have to implement a formal chargeback/billing in order to accomplish our strategic cost management goals. An invoice is nothing more than a MIS report detailing customer consumption times a price (usually based on unit cost). If the culture is such that that a formal billing will create internal negative consequences, then do not formalize billing. We can still use the information to educate customers concerning their consumption patterns and our unit cost of the services we provide. Once customers are comfortable with the information and agree to be formally invoiced, then we just use our existing chargeback process.

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CONCLUSION

We believe that in order to make the efforts of constructing a value-added unit cost model worthwhile the organization must design and build it with a strategic focus. The cost model should be designed to capture IT Service costs at a customer-focused level and activities at a level that leaders need to effectively manage the business. By designing and constructing the cost model at this level, the IT organization can attain an understanding of the continued achievement and effectiveness of its strategy, as well as leave the flexibility within the cost model to “drill-down” into areas where more detail may be required for decision analysis.

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Ron has extensive experience in implementing shared services along with his expertise in performance management, financial accountability, process redesign, business system design and strategic cost and profitability models. Mr. Bradley has extensive experience in developing business driven solutions, was Director of Activity-based Costing and Performance Management for a large utility prior to his consulting career, and has hands-on knowledge of process redesign methodologies. Ron has a B.A. in economics with an MBA and holds a CPA designation.

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Vijay consults extensively to many organizations and assists them in improving financial and operational performance. He has been active in both costing and shared services area for last fifteen years. He is a frequent speaker at many executive development seminars on enterprise performance improvement. He has implemented many shared services solutions across the world. Vijay is a Chemical engineer with an MBA and Ph.D. in management.

About CRG

Established in 1989, CRG is a global provider of innovative solutions and services that drive better business management and performance. With expertise in shared services, corporate finance, business intelligence and value-based management, CRG has established itself as a leading provider of solutions that transform financial performance and operational effectiveness.

CRG is headquartered in Ottawa, Canada, with offices in the United States, South Africa and India. It is strategically aligned with technology partners Microsoft and Cognos. Products include a suite of Financial Systems (ERP), Shared Services, Activity-Based Costing, Performance Measurement, Business Management and Personnel Performance applications which are sold directly and are also available through a global network of more than 600 partners and resellers.

For additional information on CRG and our solutions, visit www.crgroup.com.

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