

Top 7 Trends with Management Accounting

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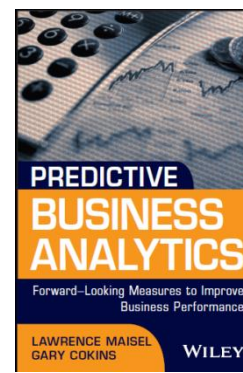
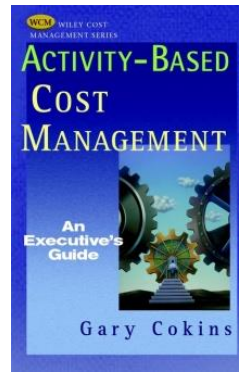
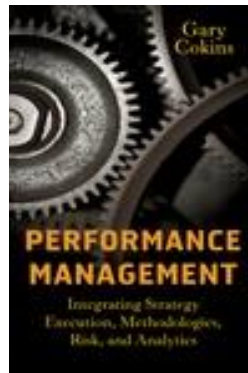
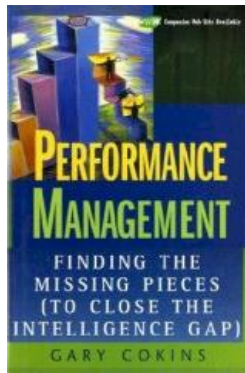
October 20, 2017

About Gary Cokins

Founder, Analytics-Based Performance Management LLC

B.S. Industrial Engineering & Operations Research;
Cornell University, 1971

M.B.A. Finance & Accounting; Northwestern University,
Kellogg School of Management, 1974



Previous Associations:

- FMC Corporation
- Consultant with: Deloitte, KPMG, Electronic Data Systems [EDS, now HP]
- SAS

Who will benefit from this presentation?

Managers who have previously struggled at promoting FP&A, enterprise performance management (EPM) and integrating business analytics (BA) into their decision support systems.

Managers who intend to “champion” any or all EPM and BA improvement techniques and need a compelling call to action.

The Three Key Questions

What? So what? Then what?

Drowning in data but starving for information.



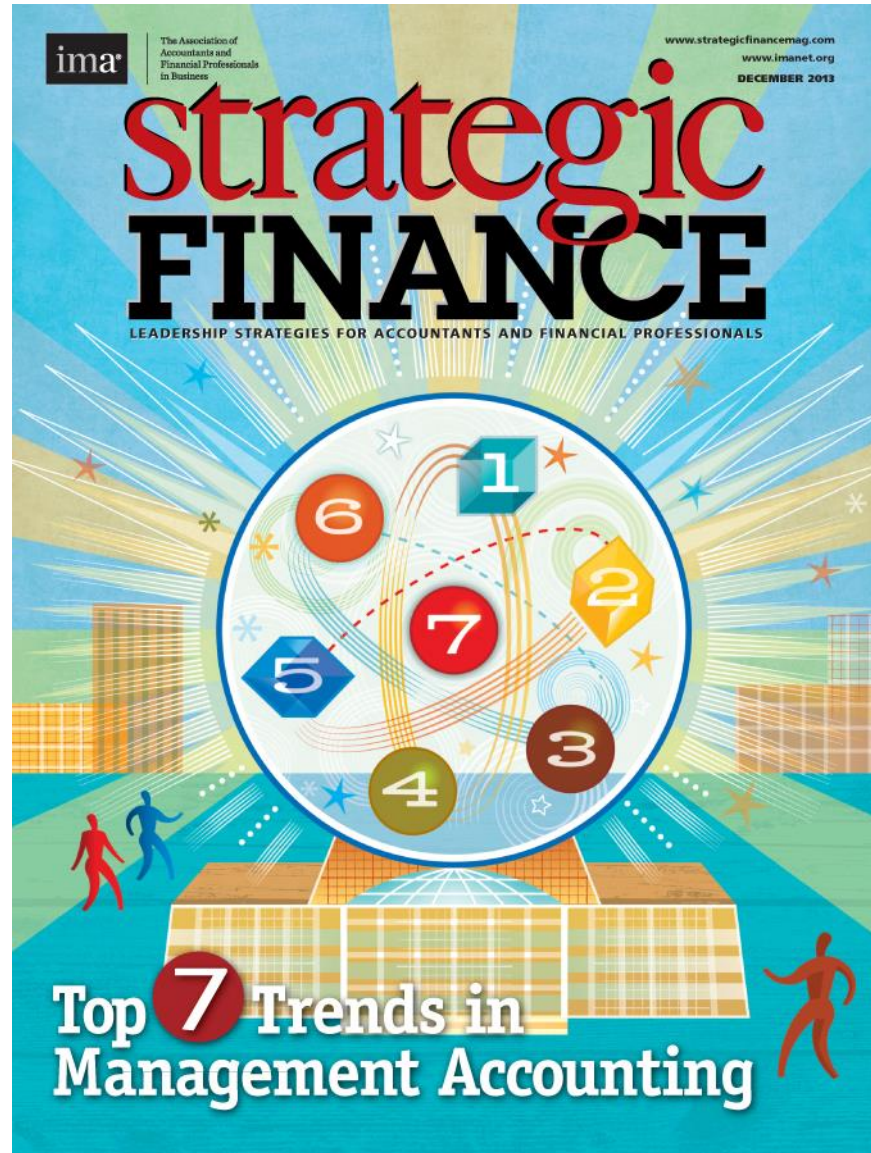
“Looks like you’ve got all the data – what’s the holdup?”

Gary Cokins' part time role as the IMA Executive in Residence

IMA *Strategic Finance* magazine;
December 2014,
January 2017

<http://sfmagazine.com/wp-content/uploads/sfarchive/2013/12/Top-7-Trends-in-Management-Accounting.pdf>

<http://sfmagazine.com/wp-content/uploads/sfarchive/2014/01/Top-7-Trends-in-Management-Accounting-Part-2.pdf>



Top 7 Trends in Management Accounting



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.

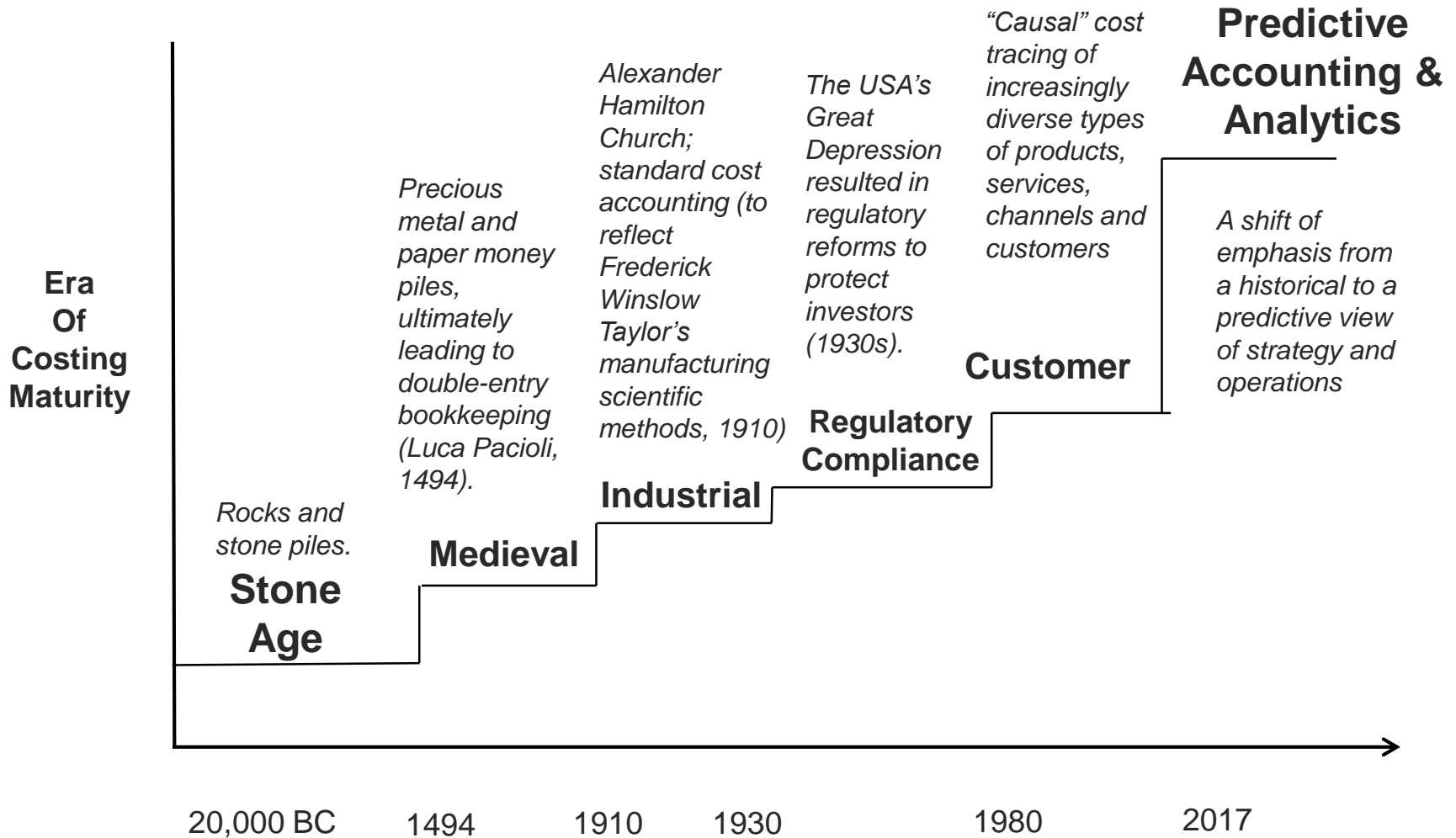
AGENDA

- **Eras of management accounting and cost model stages of maturity**

Top Trends:

1. The expansion from product to channel and customer profitability analysis.
 2. Integration of MA with EPM / CPM.
 3. The shift from historic to predictive accounting.
 4. Imbedding analytics into MA and EPM
 5. Debates over costing methods (e.g., lean, TDABC)
 6. Managing IT as a business (chargebacks, SLAs).
 7. Recognition that “change management” is critical.
- **Why is the adoption rate so slow?**

Six Eras of Managerial Accounting



BIG TREND #1:

The shift from product-centric to customer-centric profitability analysis.

Products and standard service-lines are not the only thing for which accountants should compute costs.

What about costs that have nothing to do with making products and delivering standard service-lines?

The problem with traditional accounting's product gross profit margin reporting is you don't see the bottom half of the picture.

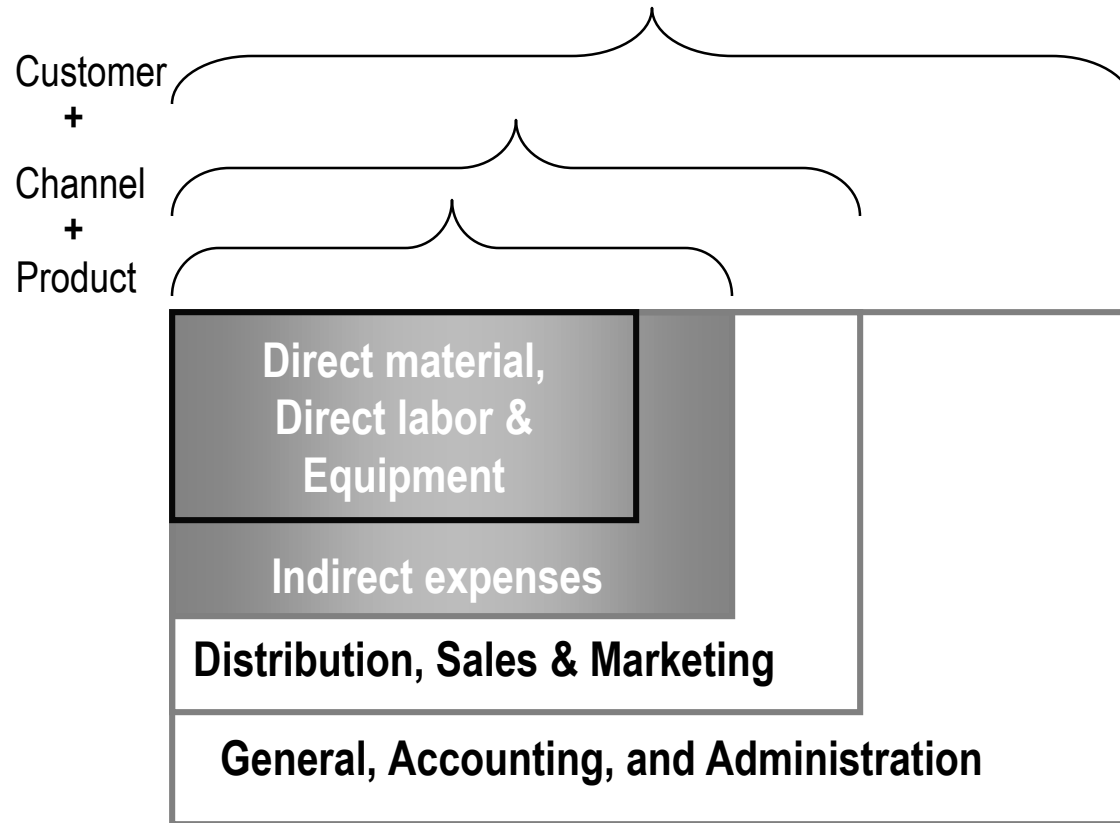
CEO Concerns Confirm this Understanding

Most important

Mean scores



Costs from Sales & Marketing are not Products

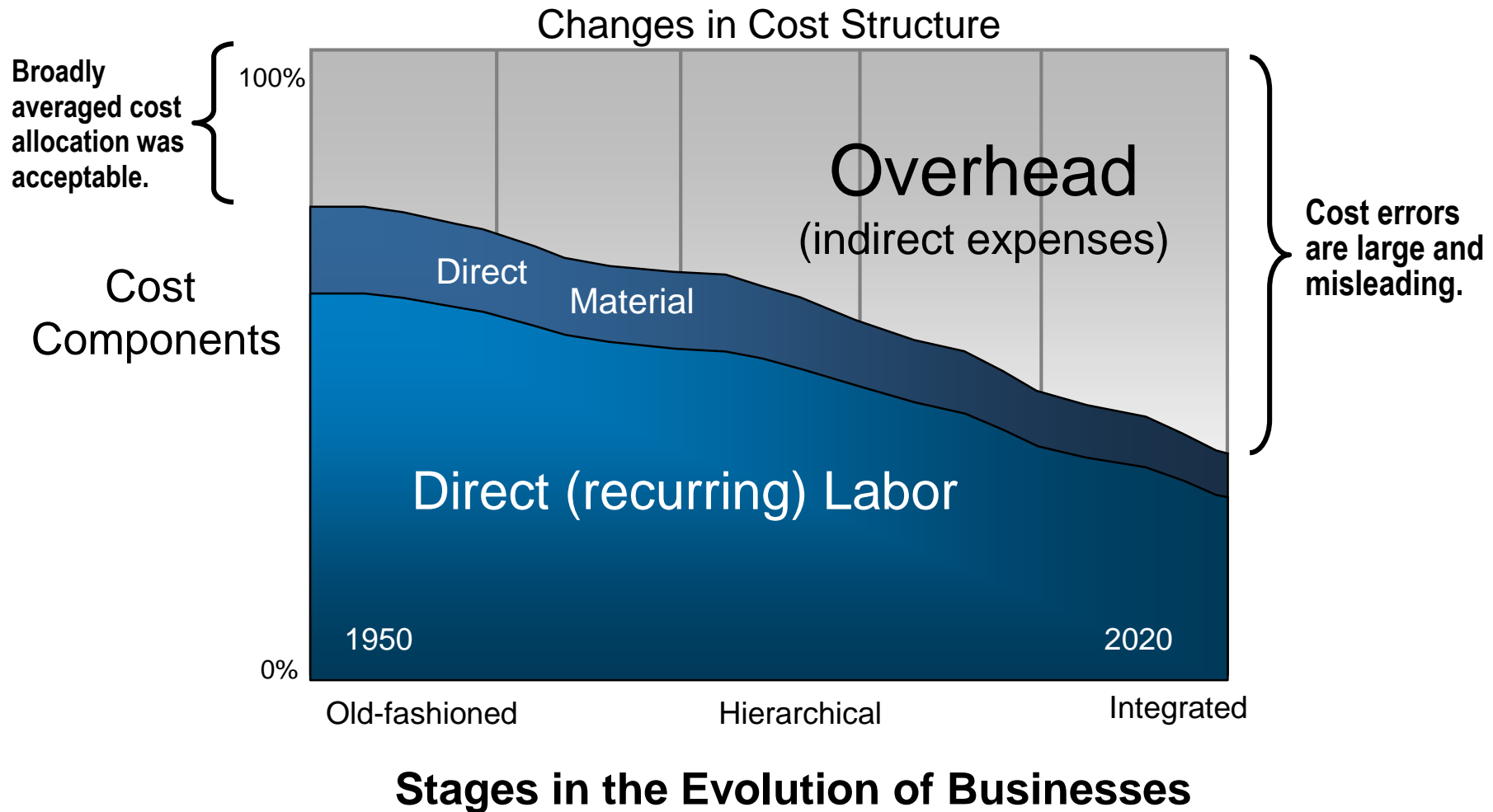


A simple explanation of ABC.

Mistrust of the managerial
accounting system ...

... for accuracy and transparency lead to
applying activity-based costing (ABC).

The Need for Tracing, not Allocating, Costs



The General Ledger View is *Structurally Deficient for Decision Analysis.*

Chart-of-Accounts View			
Insurance Claims Processing Department			
	<u>Actual</u>	<u>Plan</u>	Favorable/ (unfavorable)
Salaries	\$621,400	\$600,000	\$(21,400)
Equipment	161,200	150,000	(11,200)
Travel expense	58,000	60,000	2,000
Supplies	43,900	40,000	(3,900)
Use and occupancy	30,000	30,000	—
Total	<u>\$914,500</u>	<u>\$880,000</u>	<u>\$(34,500)</u>

When managers get this kind of report, they are either happy or sad, but they are rarely any smarter!

Each Activity Has Its Own Cost Driver

From: General Ledger

Chart-of-Accounts View

Claims Processing Department

	<u>Actual</u>	<u>Plan</u>	<u>Favorable/ (unfavorable)</u>
Salaries	\$621,400	\$600,000	\$(21,400)
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Use and occupancy	30,000	30,000	—
Total	\$914,500	\$880,000	\$(34,500)

To: ABC Data Base

Activity-Based View

Claims Processing Dept

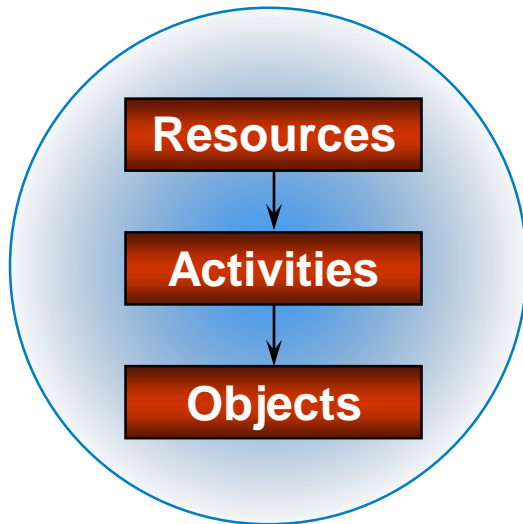
Key/scan claims	\$ 31,500	← #of —
Analyze claims	121,000	← #of —
Suspend claims	32,500	← #of —
Receive provider inquiries	101,500	← #of —
Resolve member problems	83,400	← #of —
Process batches	45,000	← #of —
Determine eligibility	119,000	← #of —
Make copies	145,500	← #of —
Write correspondence	77,100	← #of —
Attend training	158,000	← #of —
Total	\$914,500	

Activity cost drivers

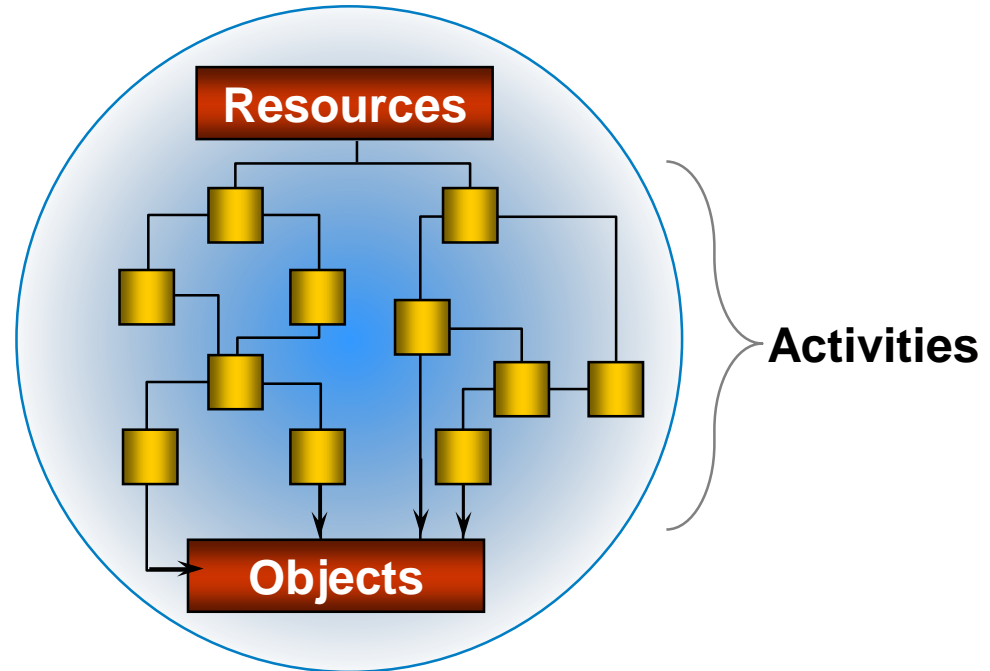
Products / customers

\$914,500

Multiple-Stage Cost Assignment Tracing



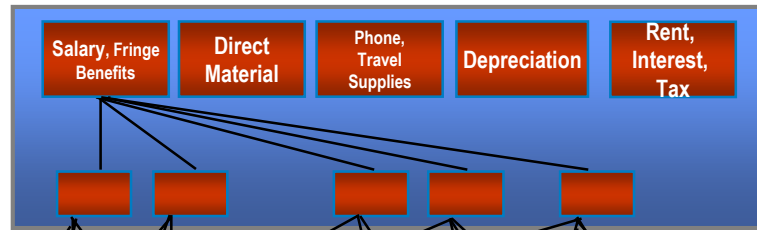
**Simple
ABC**



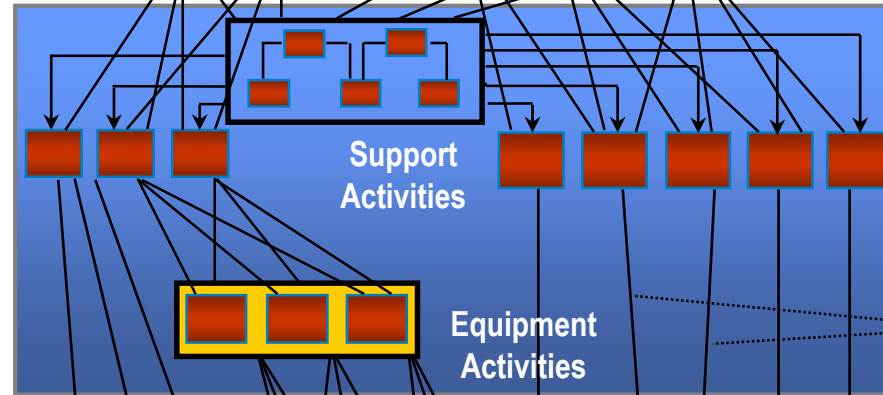
**Expanded
ABC**

ABC Cost Assignment Network

Resources
(general ledger view)



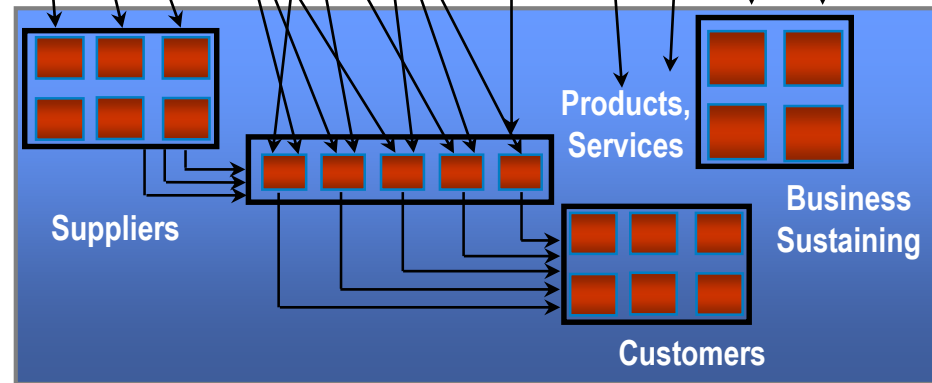
Work Activities
(verb-noun)



People Activities

Final Cost Objects

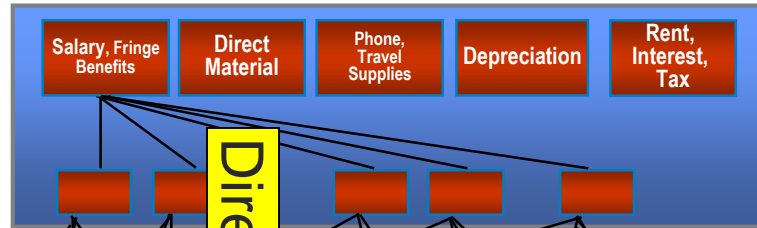
“Costs Measure the Effects”
(1) Demands On Work
Costs (2)



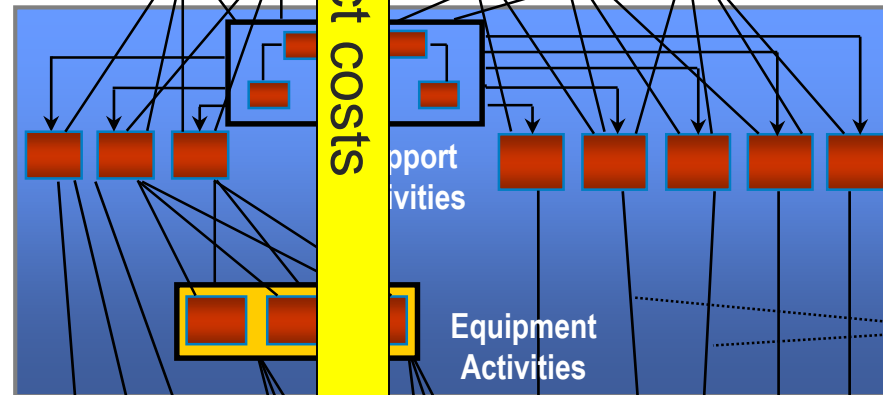
“cost-to-serve” paths

ABC Cost Assignment Network

Resources
(general ledger view)



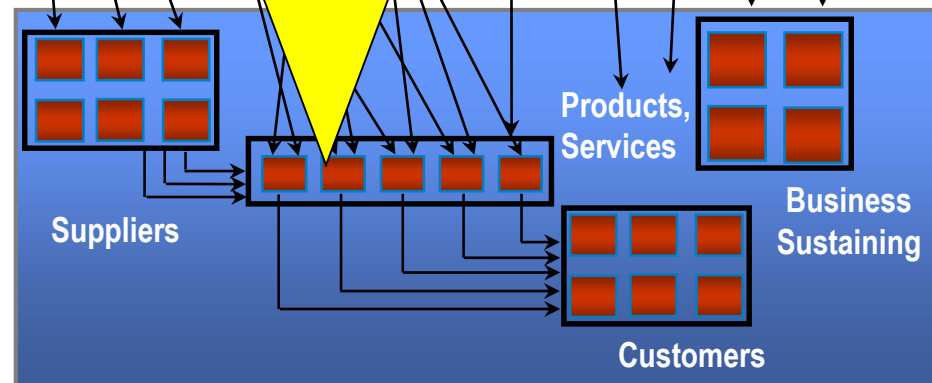
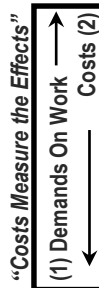
Work Activities
(verb-noun)



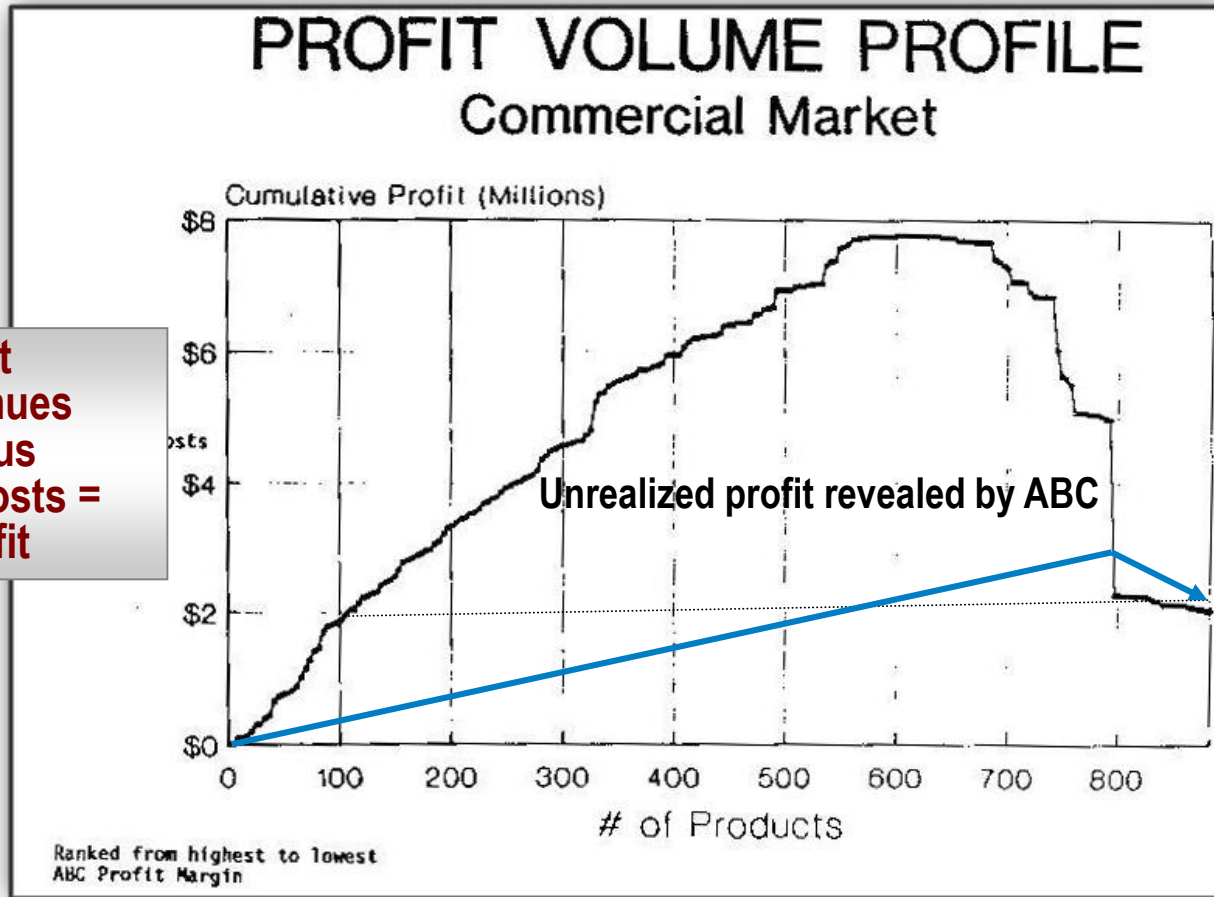
People Activities

"cost-to-serve" paths

Final Cost Objects



More important than a better costing method are its results.



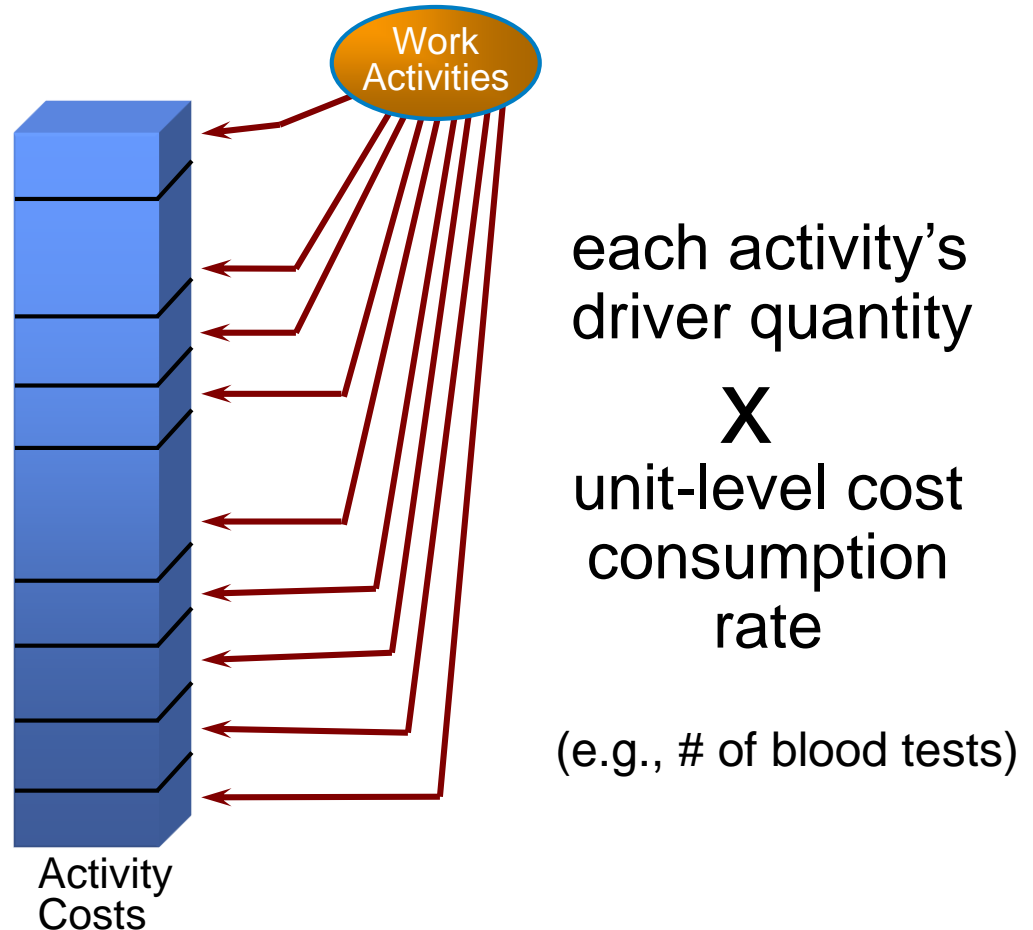
**Net
Revenues
Minus
ABC costs =
profit**

$$\begin{array}{r} \$ 30 \text{ sales} \\ - 28 \text{ expenses} \\ \hline = \$ 2 \text{ profit} \end{array}$$

← \$ 2 profit

Activity Costs “pile up” into outputs

ABC provides insight for the product’s or service’s cost drivers and driver quantities.



Value of Company = f(Value from Customers)

The only value a company will ever create is the value that comes from its customers – the current ones and the new customers acquired in the future.

To remain competitive, one must determine how to keep customers longer, grow them into bigger customers, make them more profitable, serve them more efficiently, and acquire relatively more profitable customers.

What about Costs Below Product Costs ?

INCOME STATEMENT

Sales	\$ 100
- Product direct costs	-20
- Overhead cost	-10

= Gross profit margin	\$ 70
- selling costs	-20
- distribution costs	-10
- marketing costs	-20
- administrative costs	-10

= Total Profit	\$ 10

The accountants report these by each product (but they are wrong without ABC).

?

We have no visibility of these costs by customer (except in total) !

Why Do Customer-related Costs Matter?

The Perfect Storm

1- Customer Retention – It is relatively much more expensive to acquire a new customer than to retain an existing one.

2 – Sources of Competitive Advantage – As products and standard service-lines become commodity-like, then the shift is towards service-differentiation.

Why Do Customer-related Costs Matter?

The Perfect Storm

3 - CRM's "One-to-One" Marketing – Pepper & Rodgers have hailed technology as the enabler to (1) identify customer segments, and (2) tailor marketing offers.

4 - Power Shift – The Internet is shifting power ... irreversibly ... from sellers to buyers.



Angel Customers

&

Demon Customers



**Discover Which Is Which and
TURBO-CHARGE YOUR STOCK**

Larry Selden,

*Professor Emeritus of Finance and Economics at
Columbia University Graduate School of Business*

Geoffrey Colvin,

Senior Editor at Large, Fortune Magazine

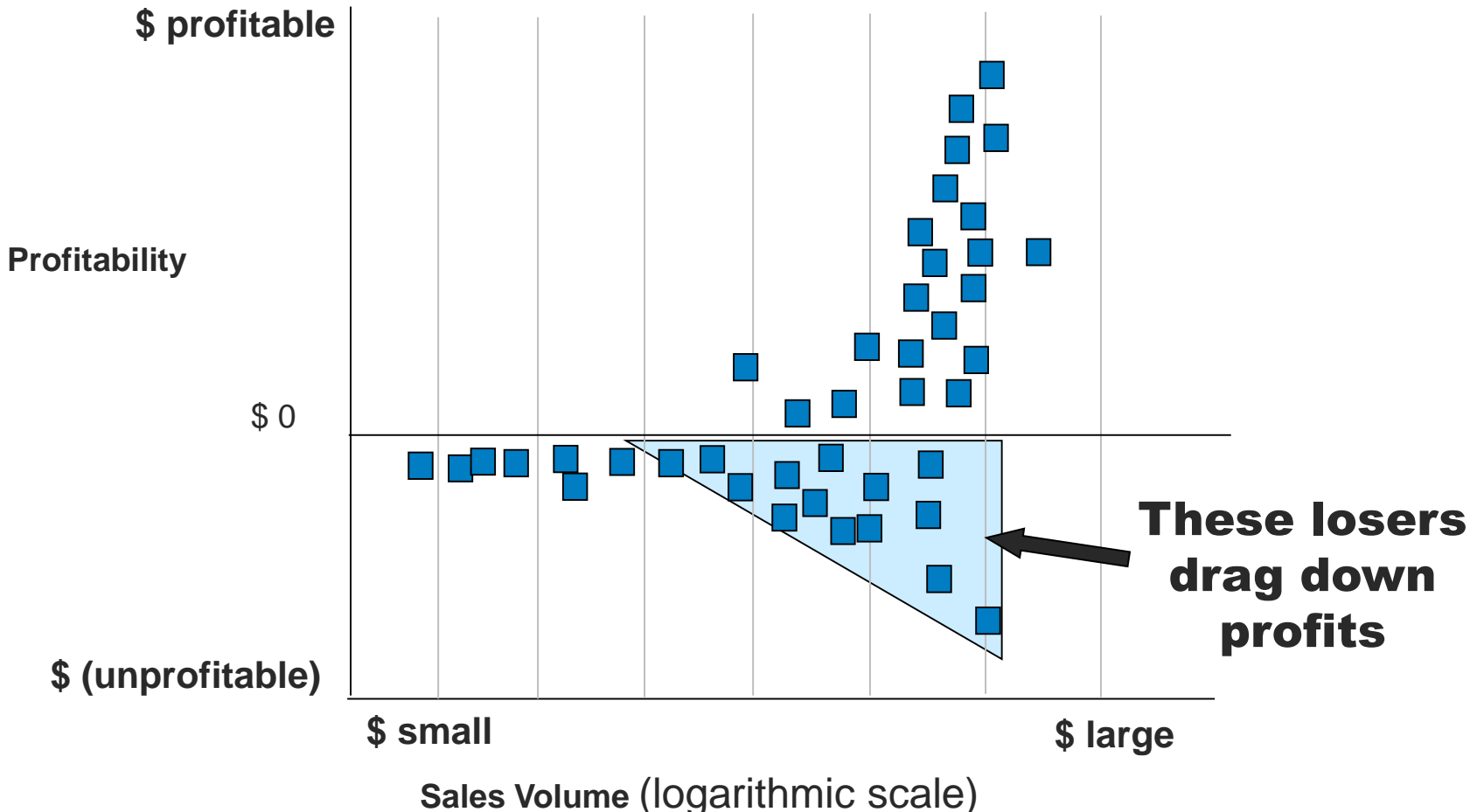
A Customer Profit & Loss Statement

CUSTOMER: XYZ CORPORATION (CUSTOMER #1270)			
Sales	\$\$\$	Margin \$ (Sales - Σ Costs)	Margin % of Sales
Product-Related			
Supplier-Related costs (TCO)	\$ xxx	\$ xxx	98%
Direct Material	xxx	xxx	50%
Brand Sustaining	xxx	xxx	48%
Product Sustaining	xxx	xxx	46%
Unit, Batch*	xxx	xxx	30%
Distribution-Related			
Outbound Freight Type*	xxx	xxx	28%
Order Type*	xxx	xxx	26%
Channel Type*	xxx	xxx	24%
Customer-Related			
Customer-Sustaining	xxx	xxx	22%
Unit-Batch*	xxx	xxx	10%
Business Sustaining	xxx	xxx	8%
Operating Profit		<u>xxx</u>	<u>8%</u>

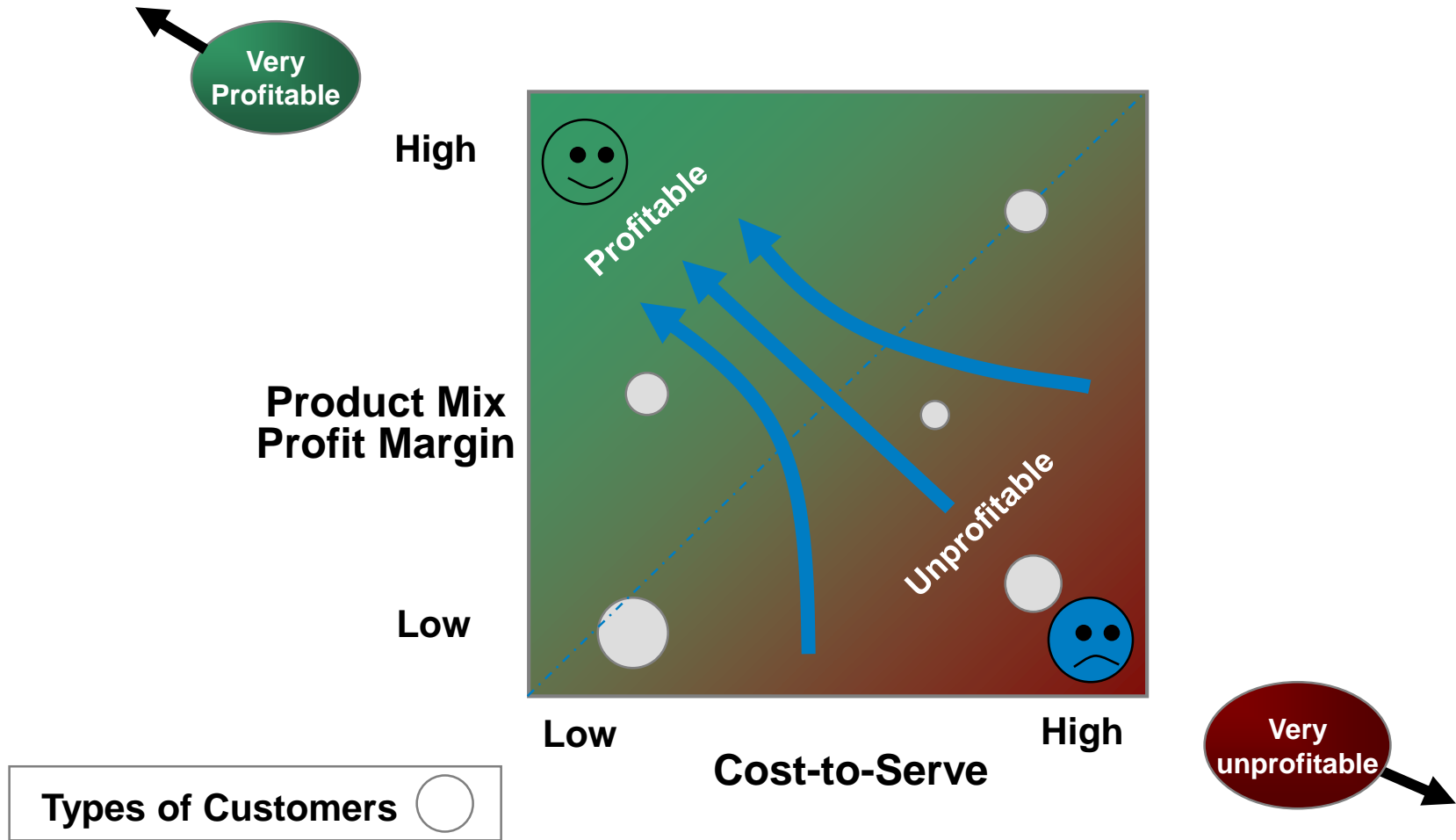
* Activity Cost Driver Assignments use measurable quantity volume of Activity Output (Other Activity Assignments traced based on informed (subjective) %s)

Customer Sales Volume Versus Profits

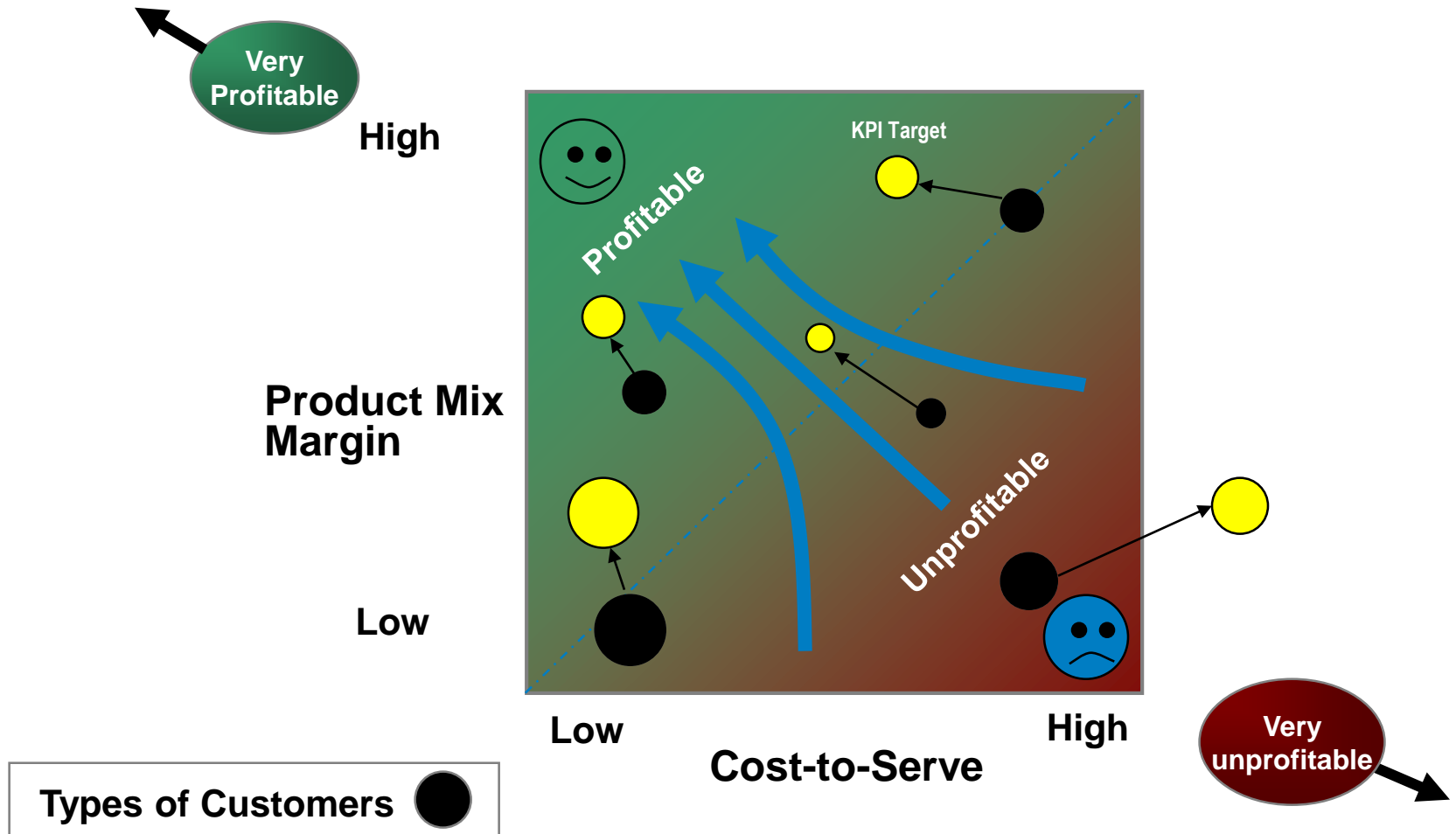
Customers tend to cluster. Medium-volume customers can be much more profitable than large-volume customers!



Migrating Customers to Higher Profitability



KPI Linkage of Customer Profits to the Scorecard



A Shift in the CFO's Emphasis

The CFO must now help Sales and Marketing ... to better target customers.

The spending budget for sales and marketing is critical ... but it should be treated as a preciously scarce resource to be aimed at generating the highest long-term profits.

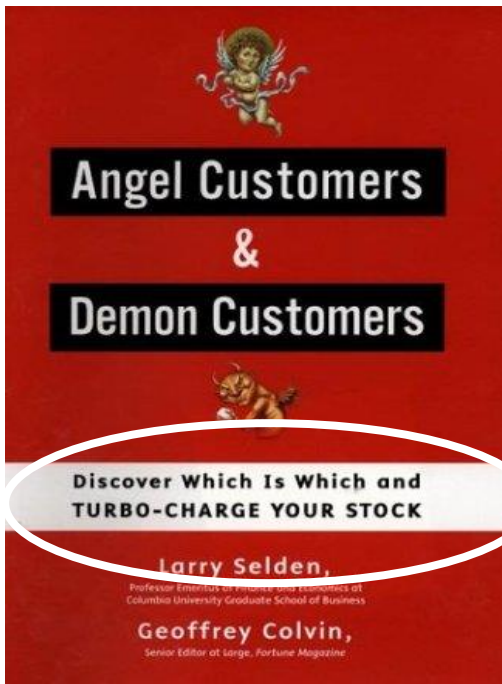
This means answering questions like:

Which type of customer is attractive to newly acquire, retain, grow, or win back? And which types are not?

How much should we *optimally* spend attracting, retaining, growing, or recovering each customer micro-segment?

Optimizing Customer Value ---

“Smart” Sales Growth



You can destroy shareholder wealth creation by ...

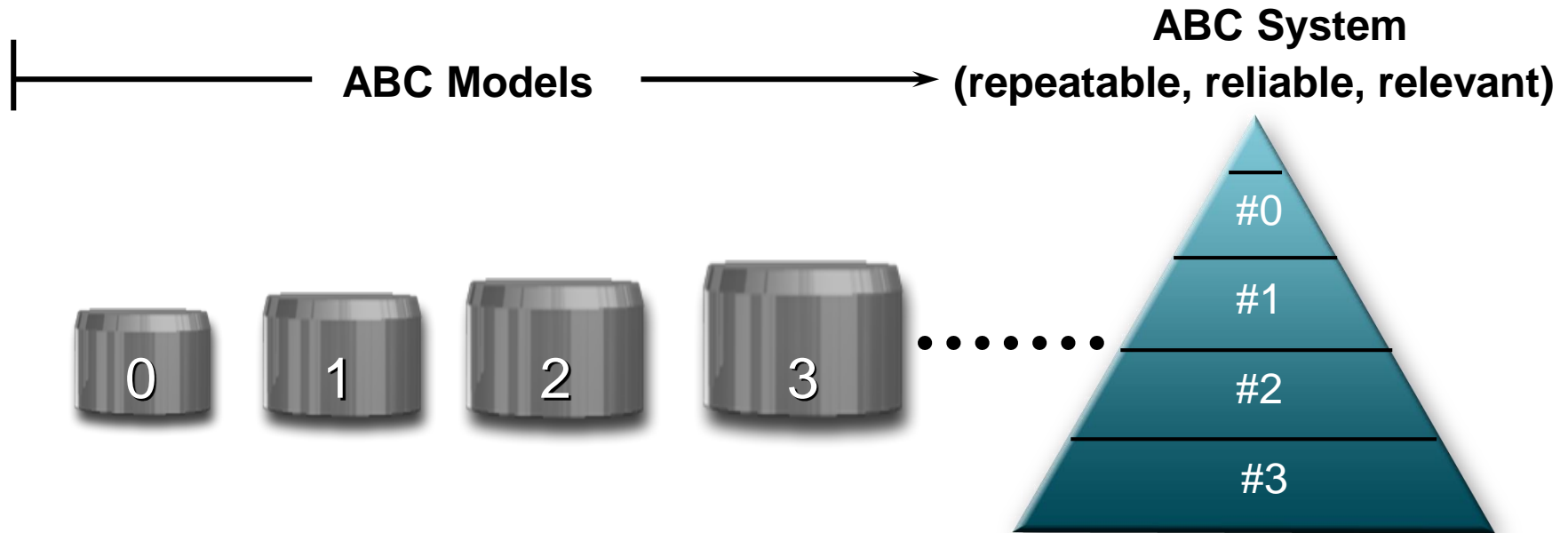
... over-spending unnecessarily on loyal customers for what is needed to retain them.

... under-spending on marginally loyal customers and risk their defection to a competitor.

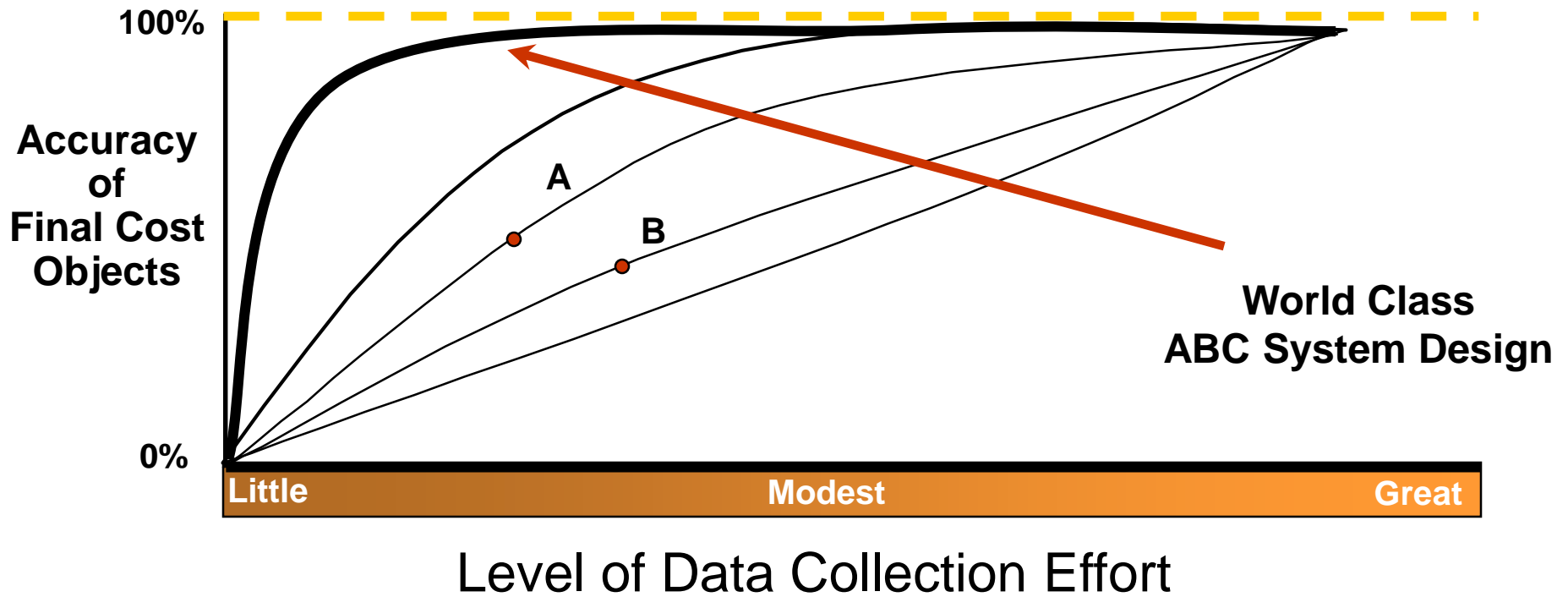
Therefore, what is the optimum spending level for differentiated services to different micro-segments of customers?

Rapid Prototyping with *Iterative Remodeling*

Each iteration enhances the use of the ABC system.



Balancing Levels of Accuracy with Effort

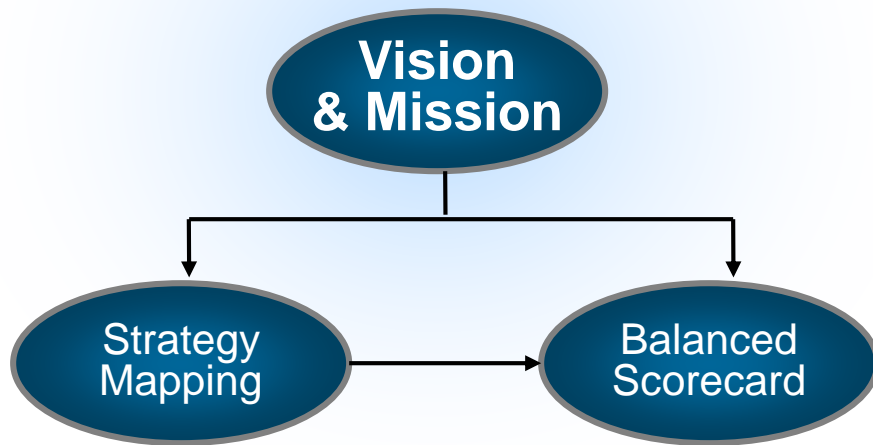


Benefits from ABC Rapid Prototyping

- Accelerated learning
- Solving the thorny “leveling” problem
- Preventing “over-engineering” ABC model size
- Peer group: Pre-determining uses for the information
- Replacing misconceptions with reality.
- Getting ROI from earlier insights and decisions.

BIG TREND #2:

Integration of management accounting with enterprise performance management (EPM)



A Vision statement answers
“where do we want to go?”

Strategy maps and scorecards answer,
“How will we get there?”

The strategy map and scorecard are mechanical.
They help realize the vision and mission.

Generic Strategy Map Architecture

Maximize Shareholder Value

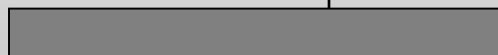
Financial



Customer



Internal Processes



Learning & Innovation



Financial

Customer

Internal Process

Learning

Vision & Mission

Exceed shareholder expectations

Financial

Diversify income stream

Increase sales volume

Improve profit margins

Customer

Diversify customer base

Increase sales to existing customers

Test new products

Internal Process

Target profitable market segments

develop new products

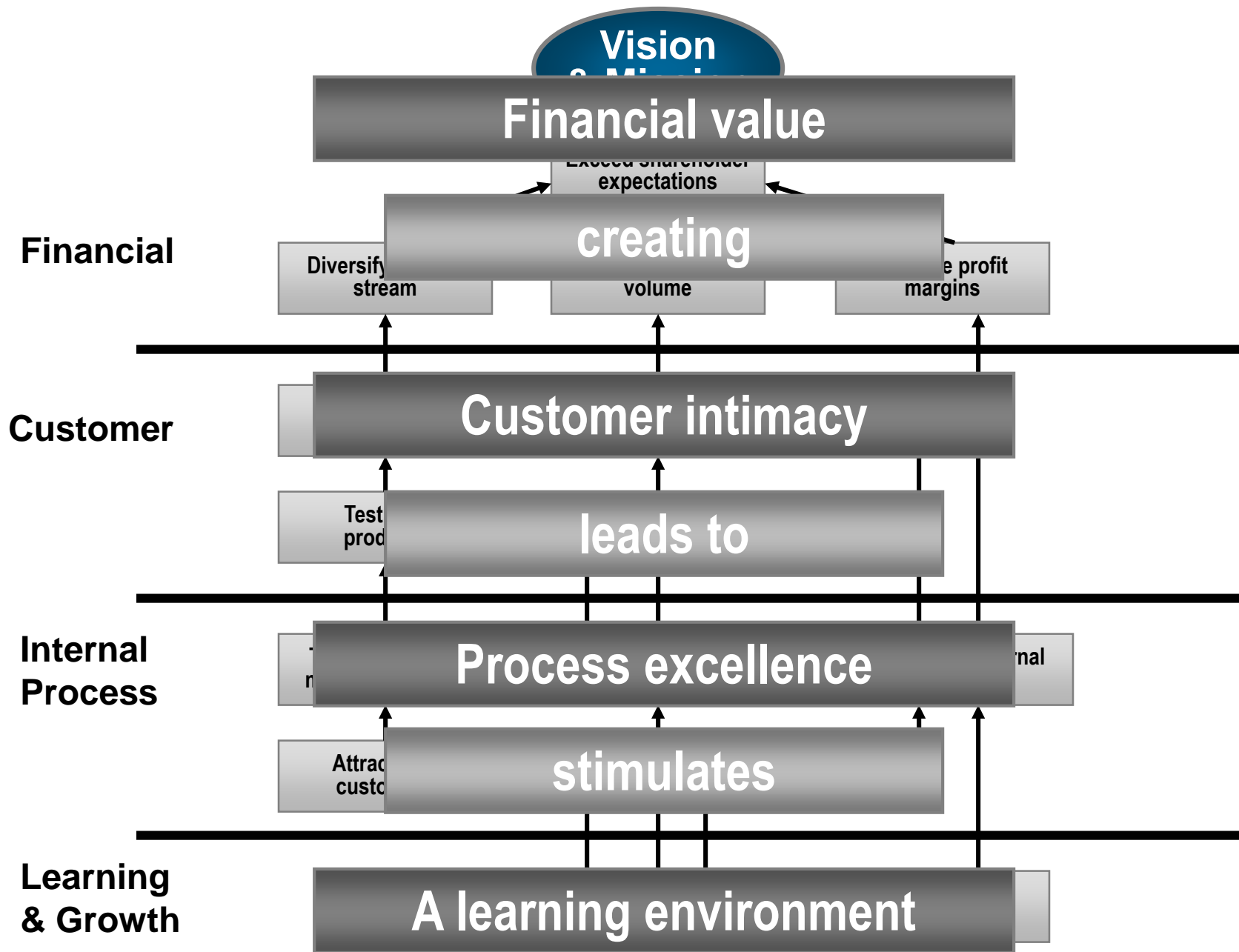
Optimize internal processes

Learning & Growth

Attract new customers

Develop employee skills

Integrate systems



Who Does What?

Measurement Period;	1st Quarter					
	Strategic Objective	Identify Projects, Initiatives, or Processes	KPI Measure	KPI Target	KPI Actual	comments / explanation
Executive Team	X	↕	↕	X		
Managers and Employees		X	X		<i>their score</i>	X
					<----- period results ----->	

A scorecard is more of a social tool than a technical tool.

The Key to Scorecards

How does everyone answer this single question:

“How am I doing on what is important?”

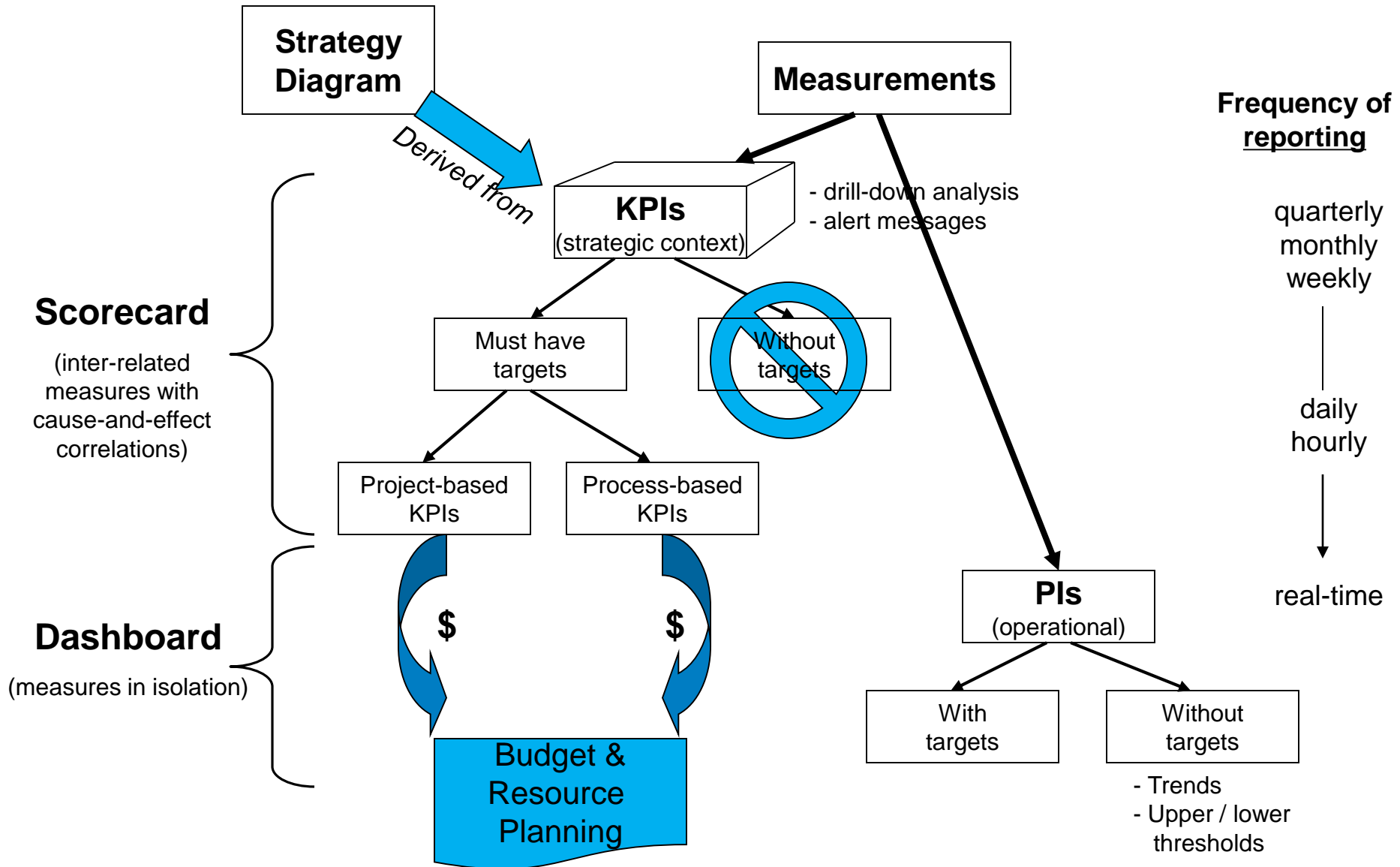
Strategy Maps and Scorecards provide this answer.

The overriding purpose of a strategy map and scorecard system is to make mission and strategy everyone’s job.

Scorecard Lessons Being Painfully Learned

- KPIs or PIs?

What is the difference between KPIs and PIs?



BIG TREND #3: Predictive Accounting Trends

Traditional budgeting

-> EPM-base budgeting

-> Rolling financial forecasts

-> What-if scenario analysis

Why is the budgeting process broken?

The budget is typically a fiscal exercise by the accountants that is:

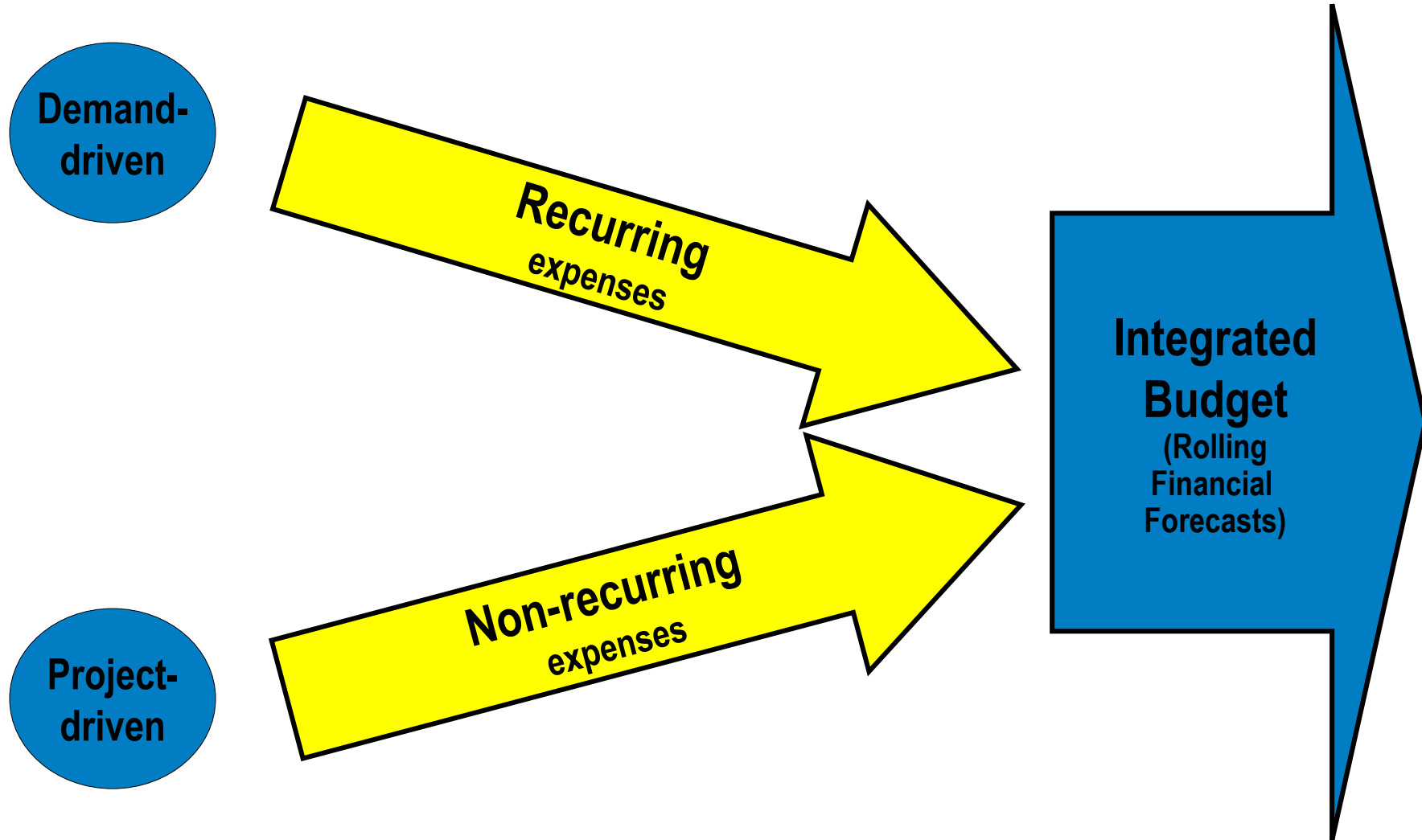
- disconnected from the executive team's strategy.
- not based on future driver volumes.

Spreadsheet Budgeting – It is Incremental !!

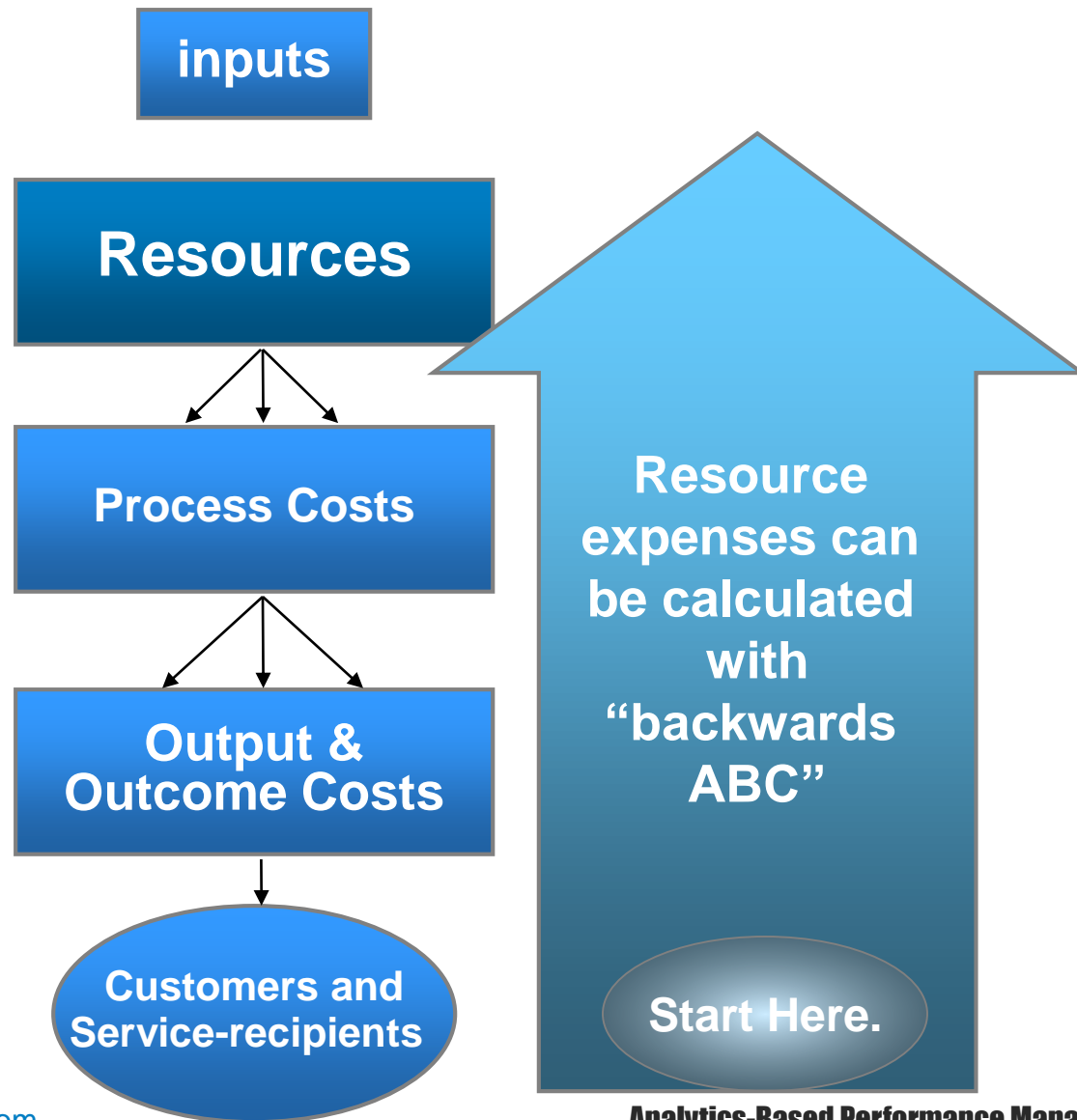
	a	b	c
1		Current Year	Budget Year
2	Wages	\$ 400,000.00	Formula = Column B * 1.05
3	Supplies	\$ 50,000.00	
4	Rent	\$ 20,000.00	Copy down
5	Computer	\$ 40,000.00	
6	Travel	\$ 30,000.00	
7	Phone	\$ 20,000.00	
8	Total	\$ 560,000.00	

Sheet 1

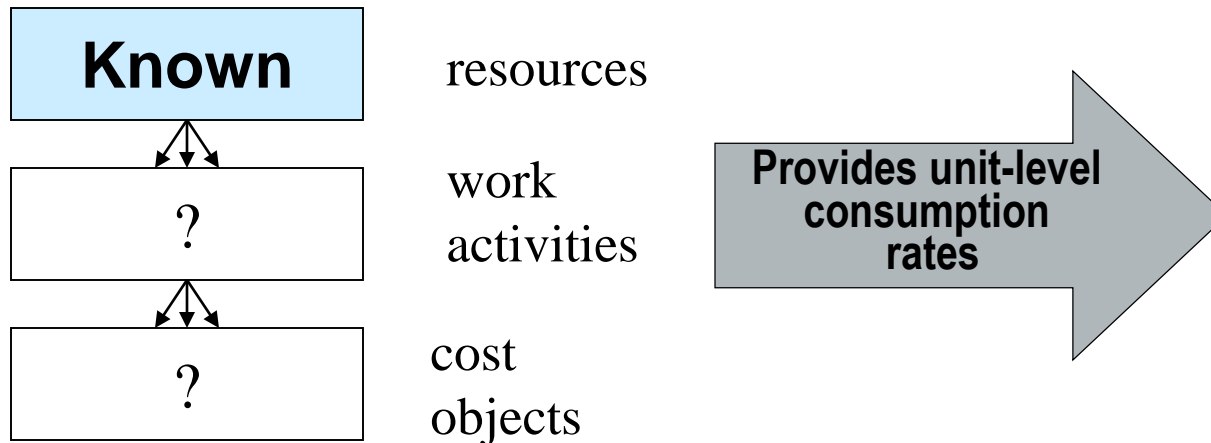
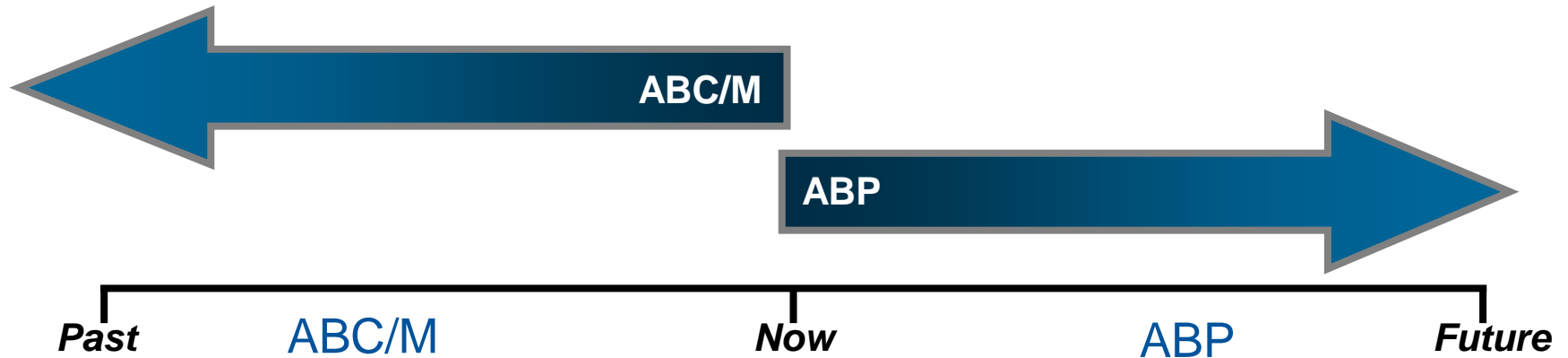
Match the Budget Method to its Category



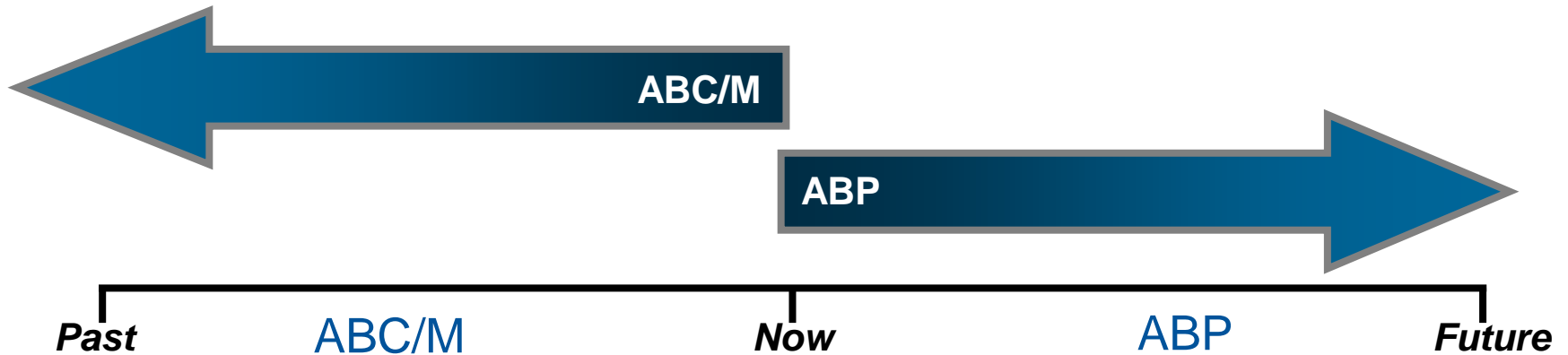
(1) Recurring Expenses // Future Volume & Mix



Predictive Accounting



Predictive Accounting



resources

? calculated

work
activities

?

cost
objects

Estimated

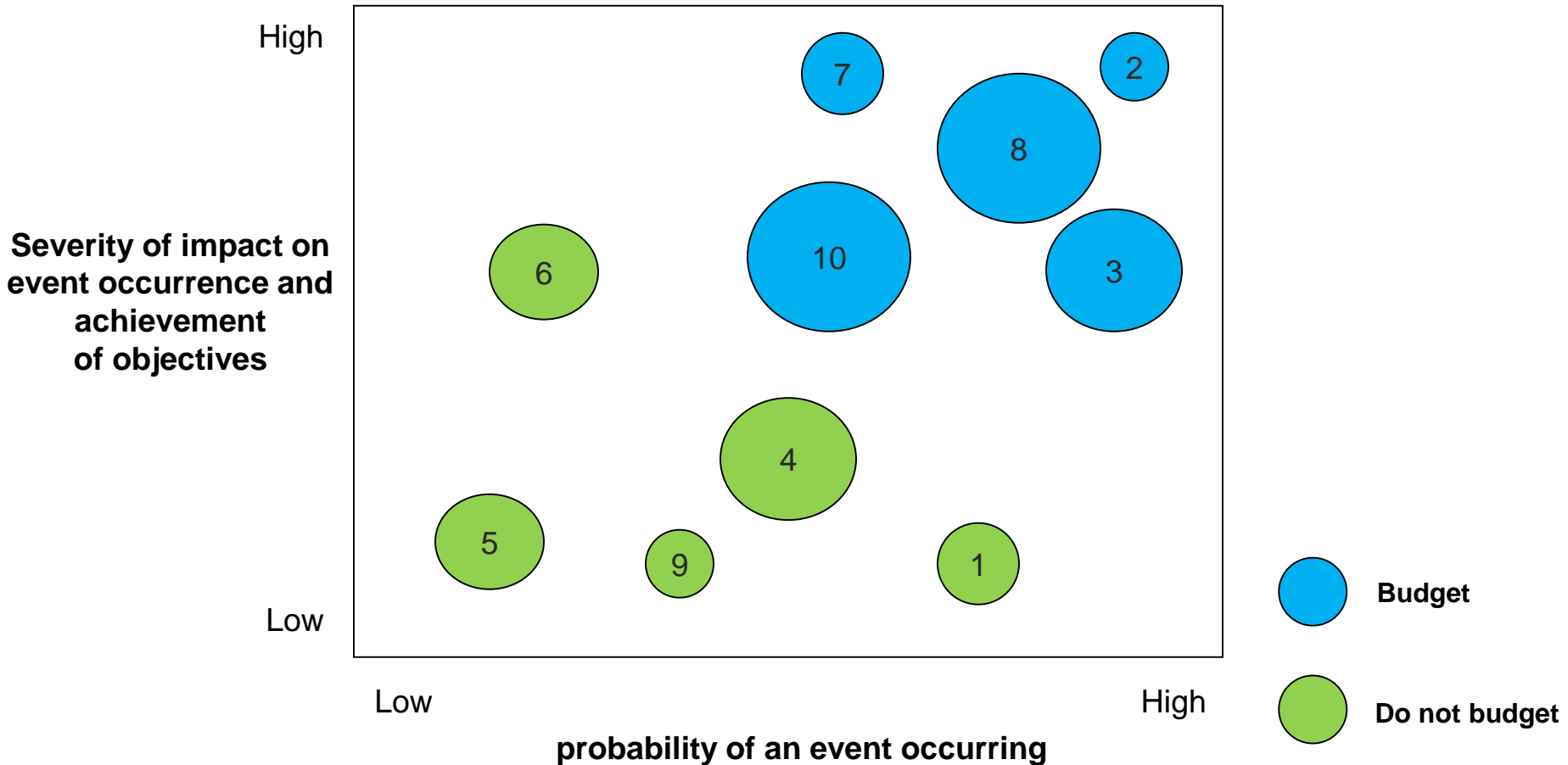
(2) Non-Recurring Expenses // Strategic Initiatives

Measurement Period;	1st Quarter					
	Strategic Objective	Identify Projects, Initiatives, or Processes	KPI Measure	KPI Target	KPI Actual	comments / explanation
Executive Team	X			X		
Managers and Employees		X	X		<i>their score</i>	X
					<----- period results ----->	

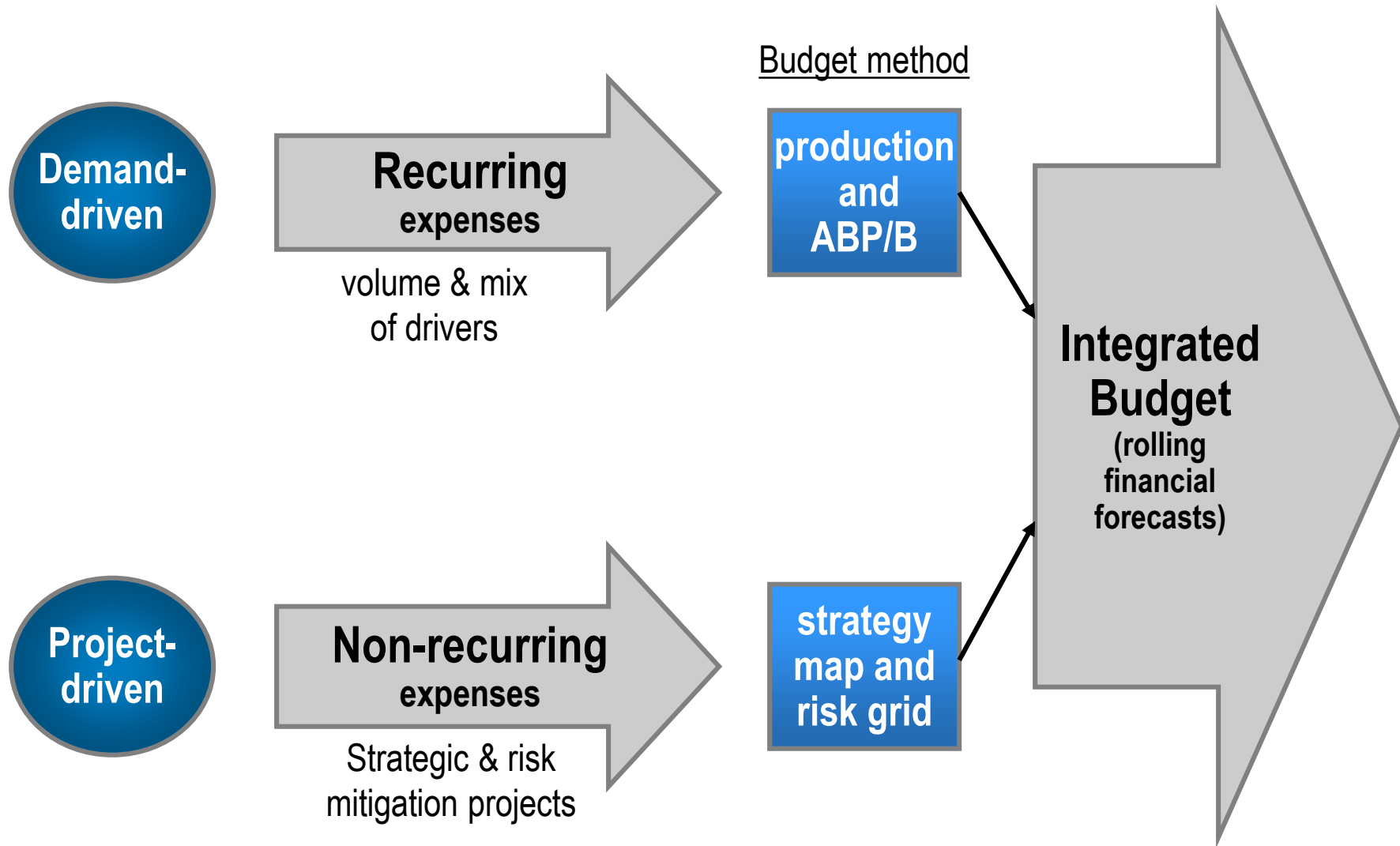
Budgeting is typically disconnected from the strategy. But this problem is solved if management funds the managers' projects.

(3) Risk Assessment Grid

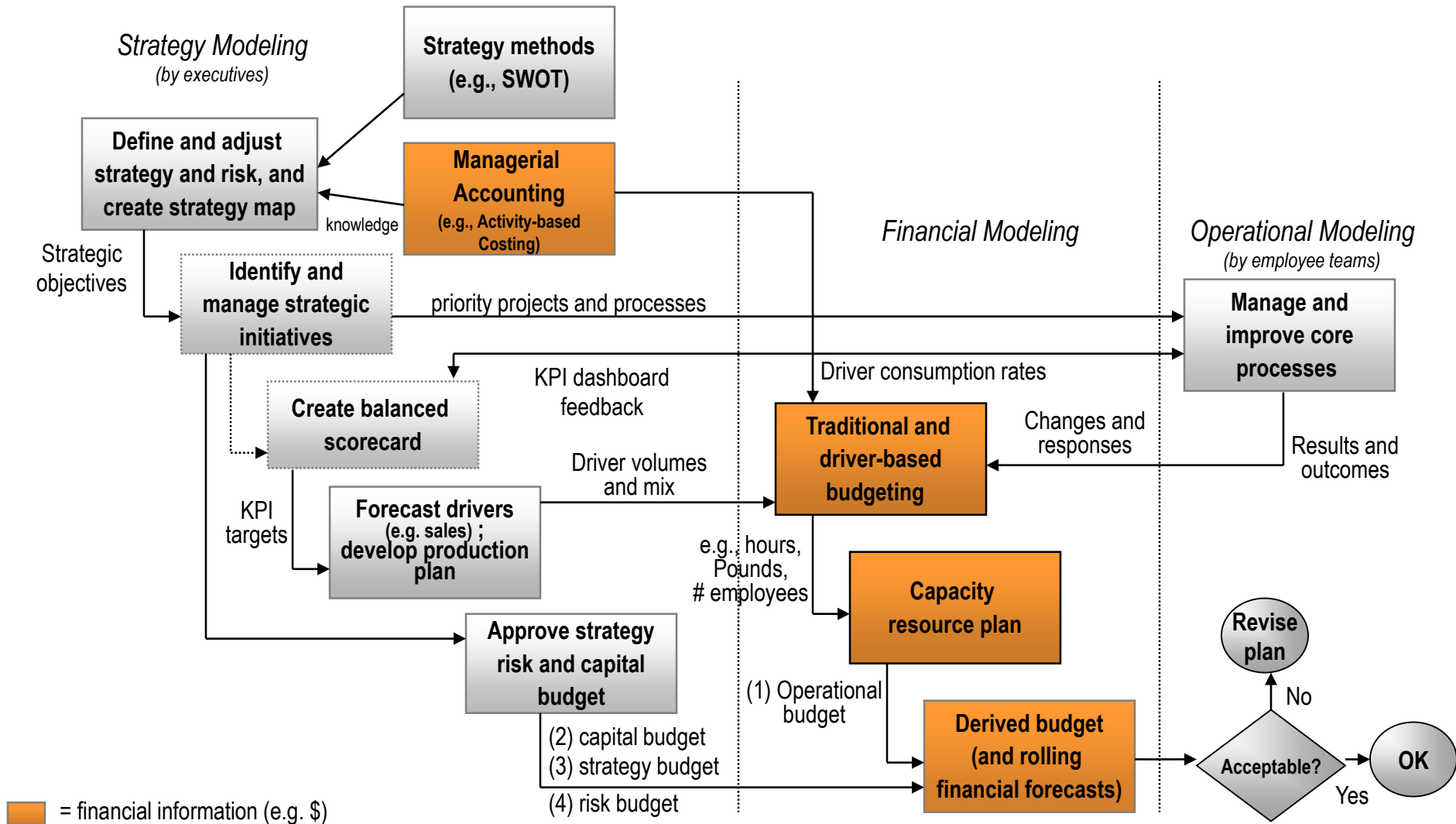
... ERM is not just contingency planning



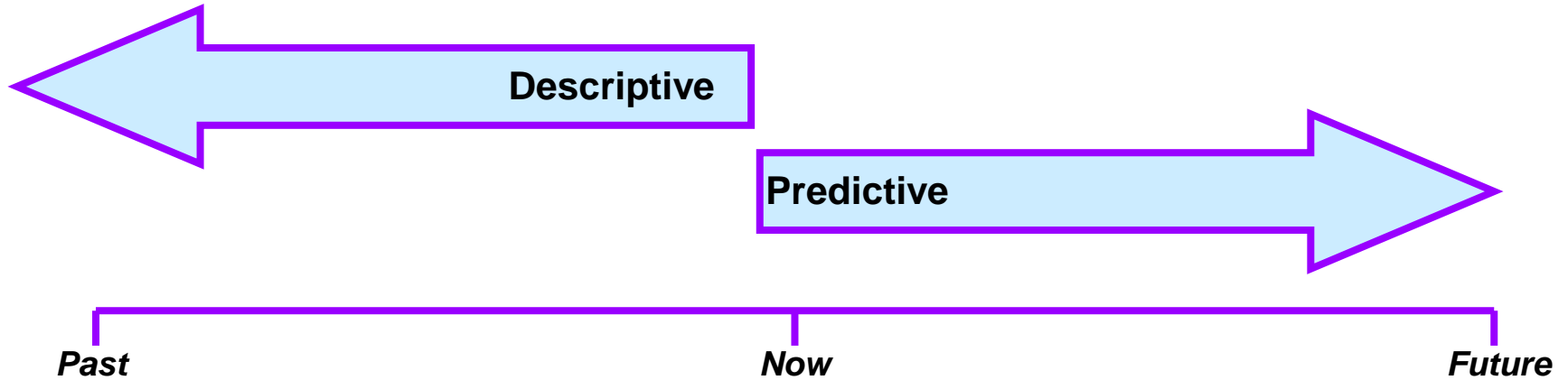
Match the Budget Method to its Category



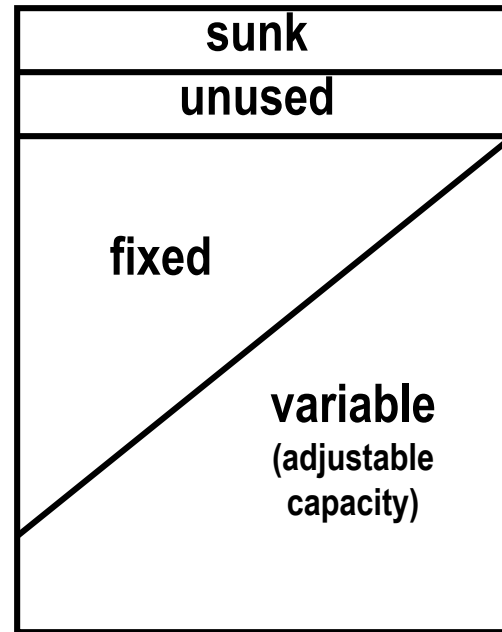
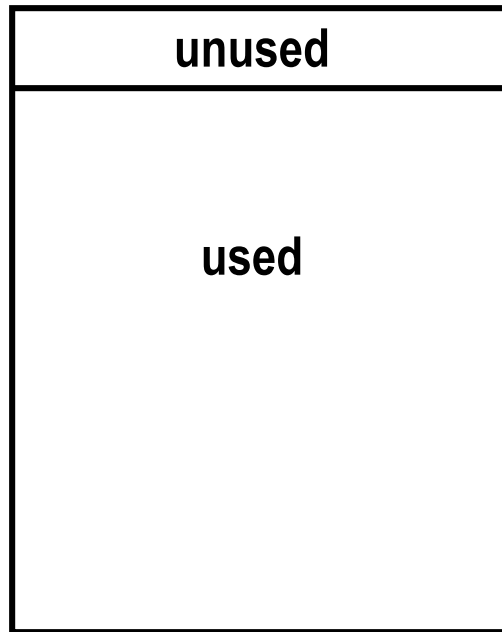
Linking Strategy and Risk to the Budget



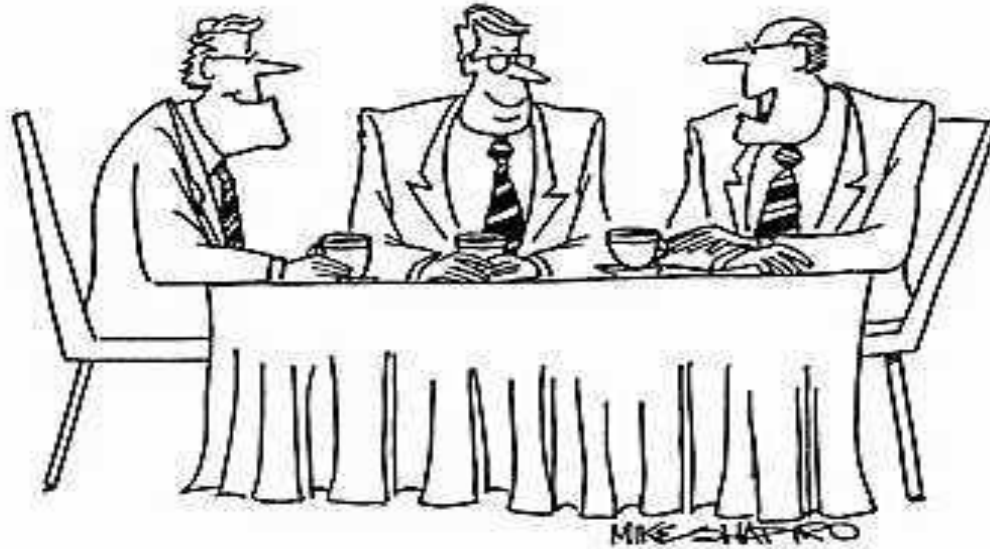
Predictive Accounting



Traceable to products, channels, customers, sustaining



Don't treat forecasting as a "special event."

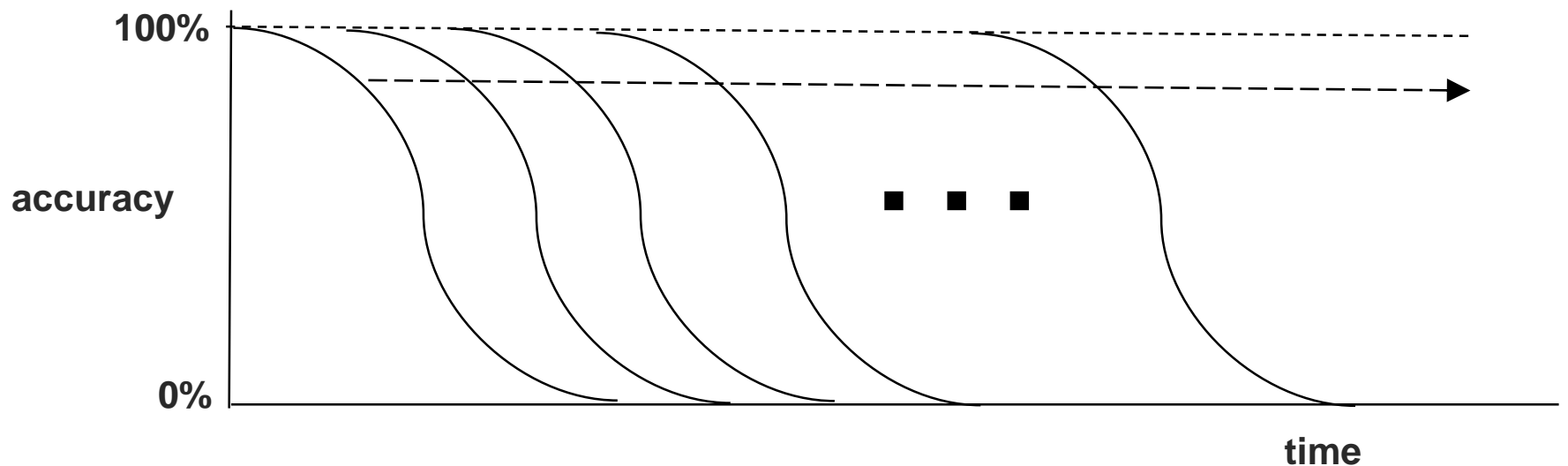


*We haven't forecasted in a while,
maybe we should try that again....*

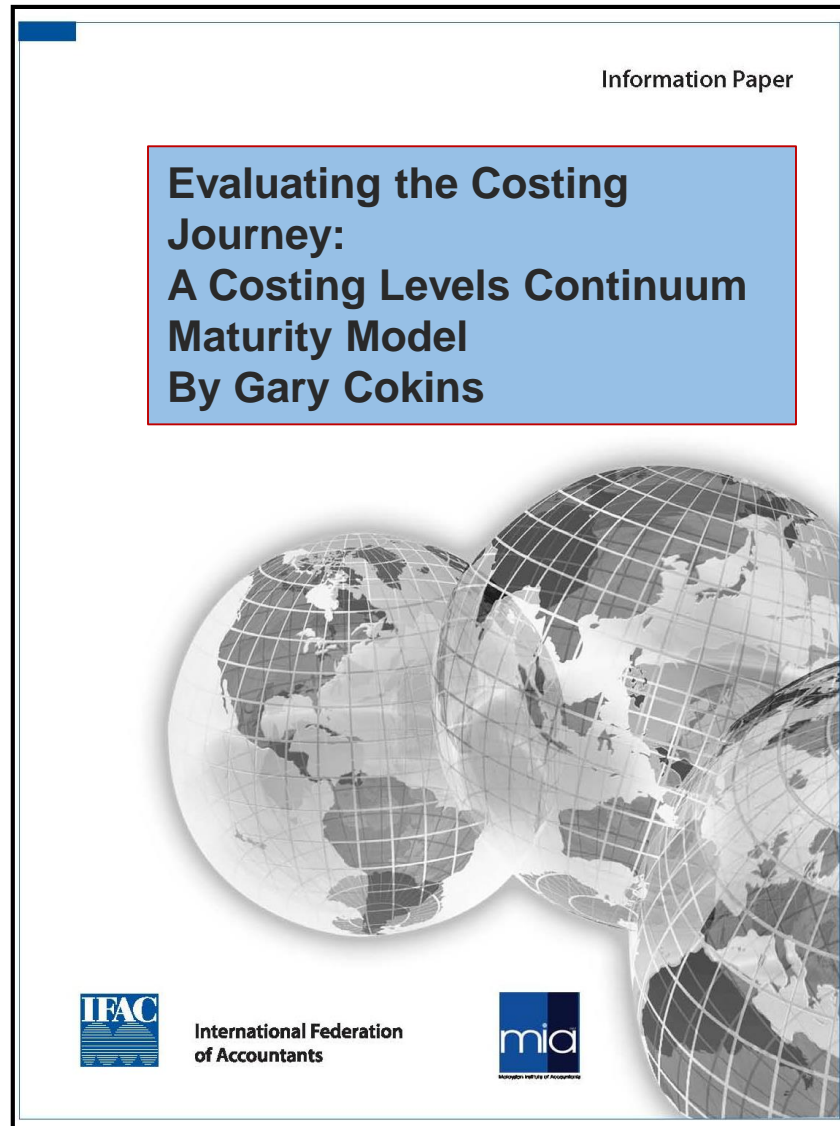
Forecasting should be an on-going part of monitoring the business.

Continuous refreshing the rolling financial forecast

More frequent forecast intervals assure better accuracy.



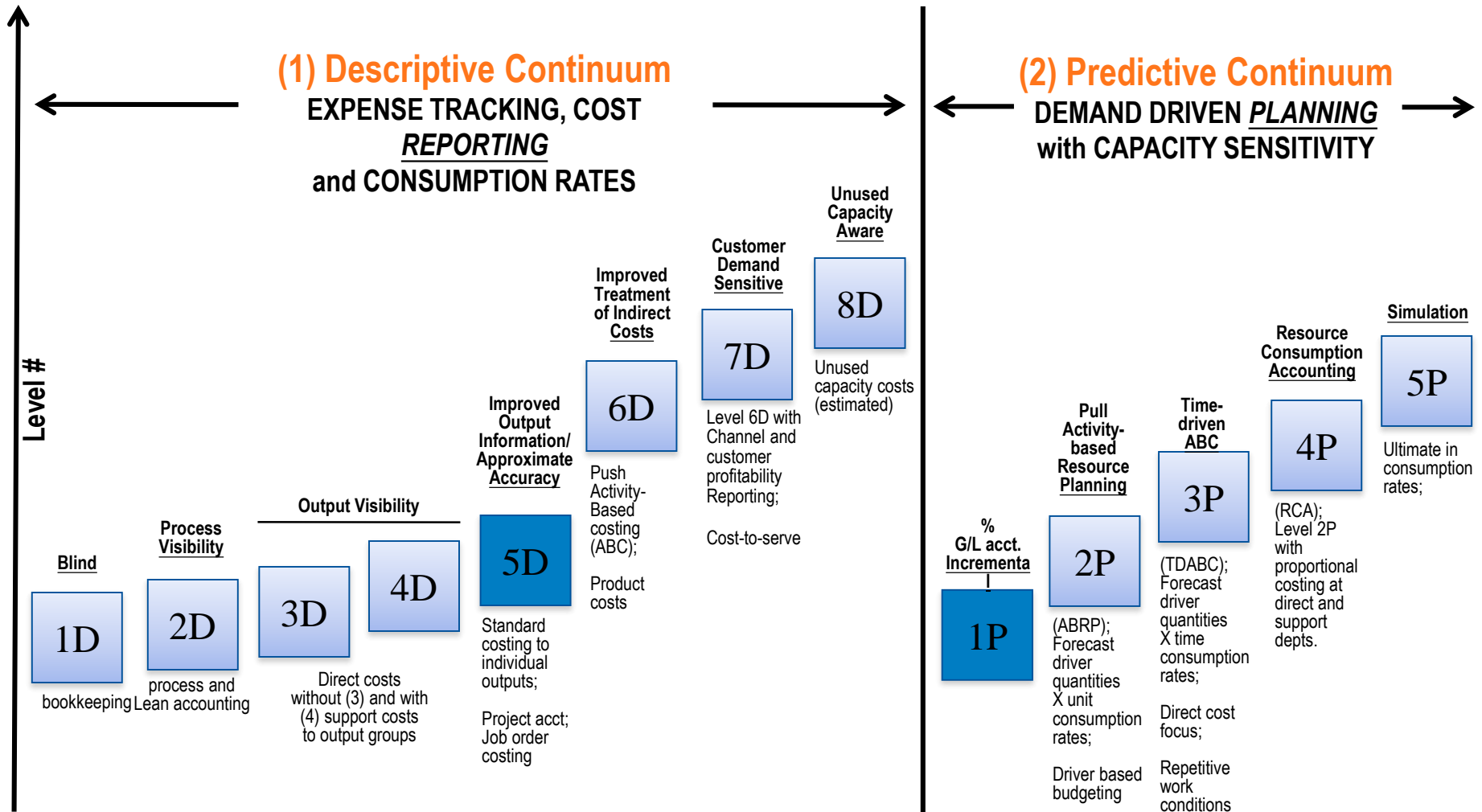
International Federation of Accountants Report



Most organizations are typically at lower levels of maturity in adopting progressive managerial accounting practices, methods and systems.

Costing Continuum / Levels of Maturity

(most companies are Level 5D and 1P)



Source: "A Costing Levels Continuum Maturity Model" by Gary Cokins published by the International Federation of Accountants, 2017

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6. Managing information technology and shared services as a business, and
7. The need for better skills and competency with behavioral cost management.

BIG TREND #4 ... Analytics: Work backwards with the end in mind.

Regardless how Business Analytics should be defined, there should be no argument as to its purpose:

Better decisions. Better actions.

BA's goal should be to gain insights and solve problems, to make better and quicker decisions with more accurate and fact-based data, and to take actions.

Why is business analytics needed?

How does an organization gain a competitive edge?

- by first-to-market (via innovation)?
- by customer loyalty?
- by low-cost and low-price provider?
- Other?

But how sustainable are these long-term?

Isn't competition ultimately about cost leadership, differentiation, or focus?*

- cost leadership strategy – via improving process efficiencies, unique access to low cost inputs, vertical integration, avoiding certain costs, etc.
- differentiation strategy – via developing products and/or services with unique traits valued by customers.
- focus strategy – via concentrating on a narrow segment with entrenched customer loyalty.

But don't each of these have risks today?

* Source: Michael E. Porter's three generic strategies.

Problem: Generic strategies are vulnerable !

- cost leadership strategy – other firms lower their costs.
- differentiation strategy – imitation by competitors; changes in customer tastes.
- focus strategy – broad-market cost leaders or micro-segmenters invade and erode your customers' loyalty.

The best defense is agility with quicker and smarter decision making using statistics, analytics, and operations research.

Business Analytics automates the “shortcuts”

Queries simply answer questions. Business analytics creates questions.

Further, analytics then stimulate more questions, more complex questions, and more interesting questions.

Most importantly, business analytics also has the power to answer the questions.

There are many Business Analytics Domains

Retail sales and merchandising analytics [markdown and assortment planning]

Financial services analytics [risk and loan credit scoring]

Pharmaceutical analytics [drug development and clinical trials]

Marketing analytics [CRM, segmentation, and churn analysis]

Text analytics [sentiment analysis]

Financial control analytics [customer payment collections]

Fraud analytics [insurance and medical claims]

Pricing analytics [price sensitivity analysis]

Telecommunications analytics [customer behavior]

Supply chain and transportation analytics [route optimization]

Manufacturing analytics [warranty claims]

Hospital analytics [patient scheduling]

Human resources analytics [workforce planning]

Banking analytics [anti-money laundering]

Police analytics [crime pattern analytics]

Reactive (Descriptive)

STANDARD REPORTS

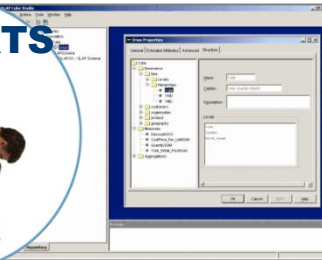
1



Number	Report Date	Expenditures
20-Oct-06		\$739.55
20-Oct-06		\$449.59
20-Sep-06		\$1,031.95
20-Sep-06		\$455.09
13-Sep-06		\$170.88
23-Aug-06		\$1,009.03
21-Aug-06		\$154.96
17-Aug-06		\$812.91
27-Jun-06		\$510.76
24-Jun-06		\$699.14
25-May-06		\$991.20
3-May-06		\$994.25
23-Feb-06		\$789.63
24-Jan-06		\$375.00
19-Dec-05		\$84.00
15-Dec-05		\$599.11
24-Nov-05		\$1,333.94
22-Nov-05		\$200.10
19-Nov-05		\$15.00
13-Nov-05		\$495.00
grand Total		\$11,902.09

AD HOC REPORTS

2



QUERY DRILLDOWN (OR OLAP)

3



ALERTS

4



Reactive (Descriptive)

Proactive (Inferential)

STANDARD REPORTS

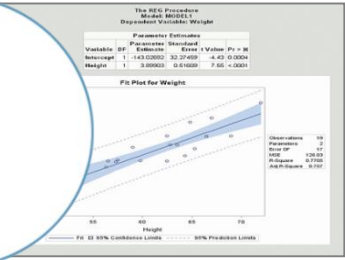
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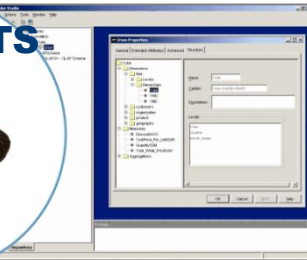
STATISTICAL ANALYSIS

5



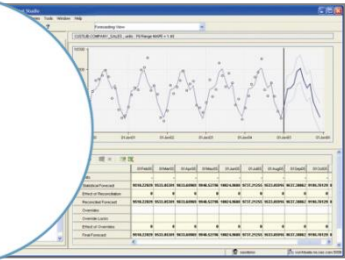
AD HOC REPORTS

2



FORECASTING

6



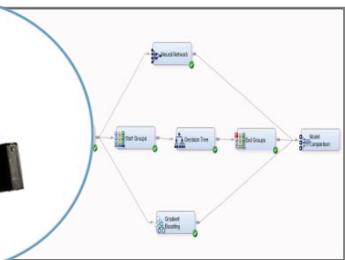
QUERY DRILLDOWN (OR OLAP)

3



PREDICTIVE MODELING

7



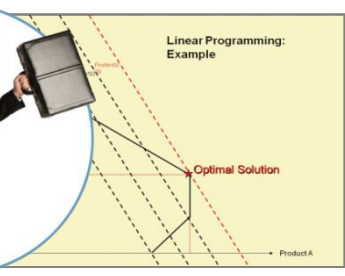
ALERTS

4



OPTIMIZATION

8



BIG TREND #5: Debates about Costing Methods

Time-Driven ABC (TDABC) is an alternative method for activity drivers ... and applies under conditions:

- highly repetitive activities,
- less interest in indirect expenses,
- Multiple resources of varying levels for each “service”,
- concerns about unused capacity costs.

Lean accounting can co-exist with one or more other costing methods. Be wary of its anti-ABC critics.

BIG TREND #6

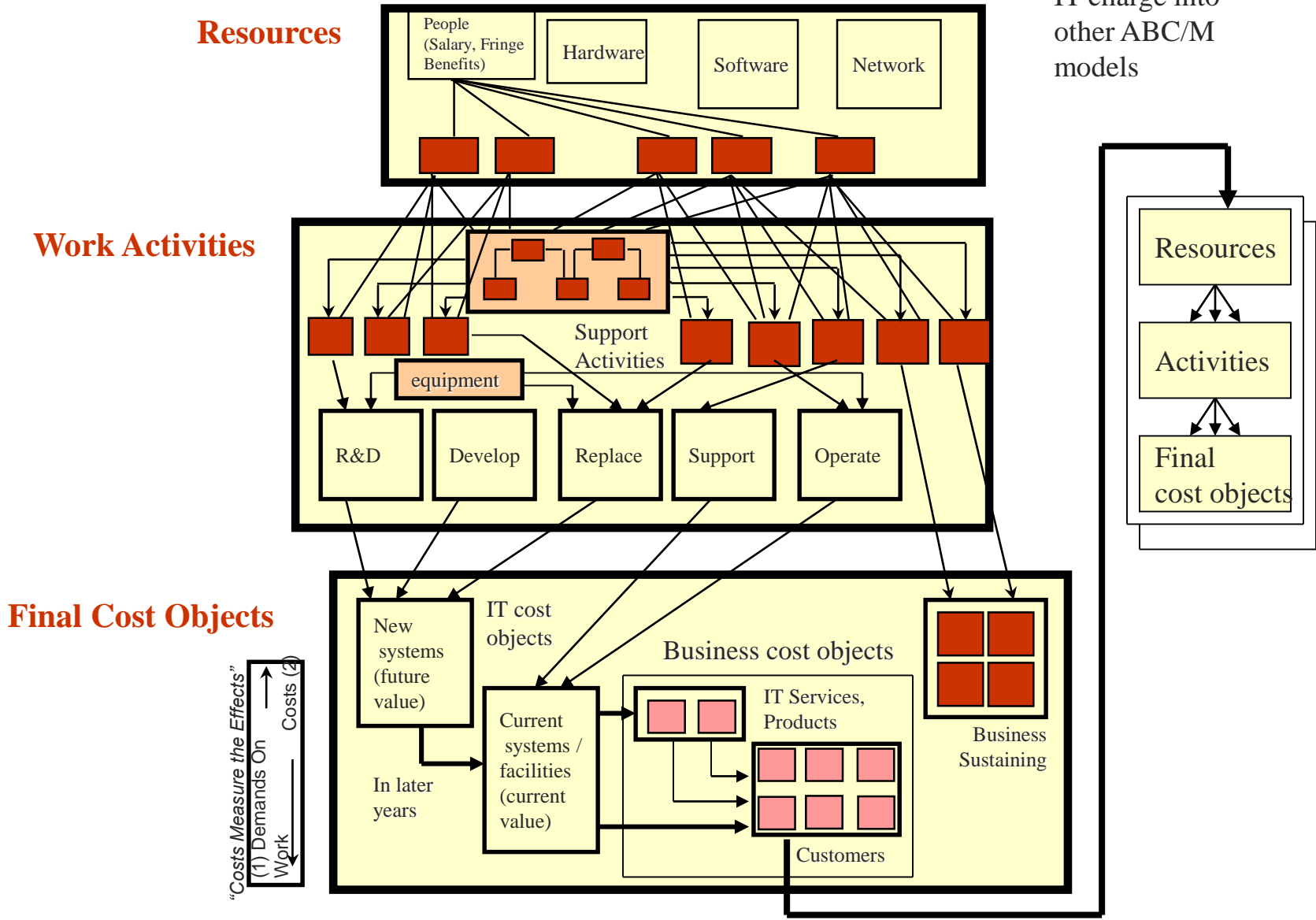
Managing IT as a business

Managing IT as a business is now an imperative. No longer can IT be seen as a technology supplier – it must be seen to be adding value to the organization and providing strategic capability. IT performance management enables IT to become service oriented, aligning itself with the organization to provide internal customer-driven solutions to problems.

But ... it is difficult to maximize returns from IT when the products and services appear to be *free* to internal customers.

IT ABC/M Cost Assignment Network

IT charge into other ABC/M models



AGENDA

- Eras of management accounting and cost model stages of maturity

Top Trends:

1. The expansion from product to channel and customer profitability analysis.
2. Integration of MA with EPM / CPM.
3. The shift from historic to predictive accounting.
4. Imbedding analytics into MA and EPM
5. Debates over costing methods (e.g., lean, TDABC)
6. Managing IT as a business (chargebacks, SLAs).
7. Recognition that “change management” is critical.

- Why is the adoption rate so slow?

BIG TREND #7 – the need for “change management

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) Organizational behavior barriers involve resistance to change, culture, and leadership.

Typical Excuses Preventing Being Progressive

We are profitable, so why does it matter?

We will purchase software that will fix our problems.

We already know our “true” costs from our general ledger financial reporting system.

We have done it this way forever. And we don’t do that here. We already know everything. It is in our heads.

We are a small organization. We’ll worry about better methods when we get larger.

All this hype is just made up stuff from highly paid consultants.

No one looks at the reports I create, so there is no point generating better reports.

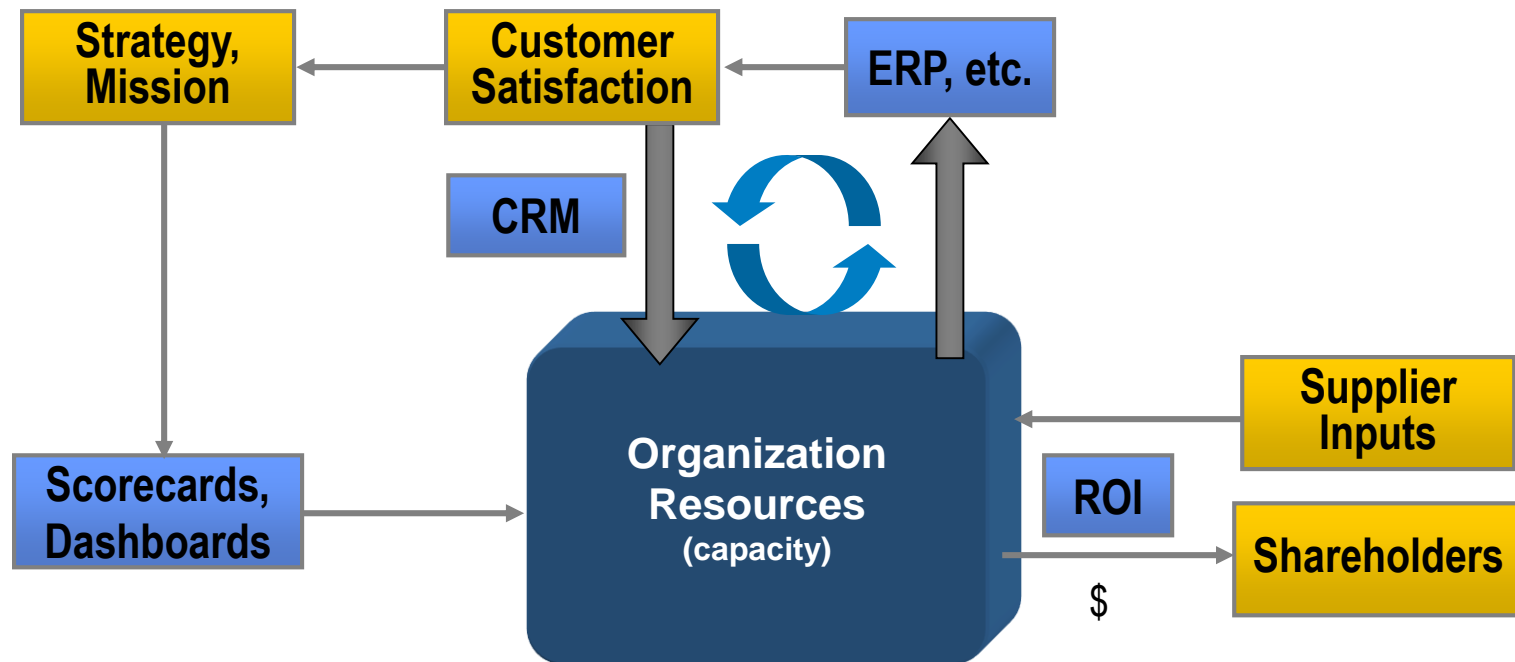
We cannot afford better software to fix our problems.

We are way too busy doing other things.

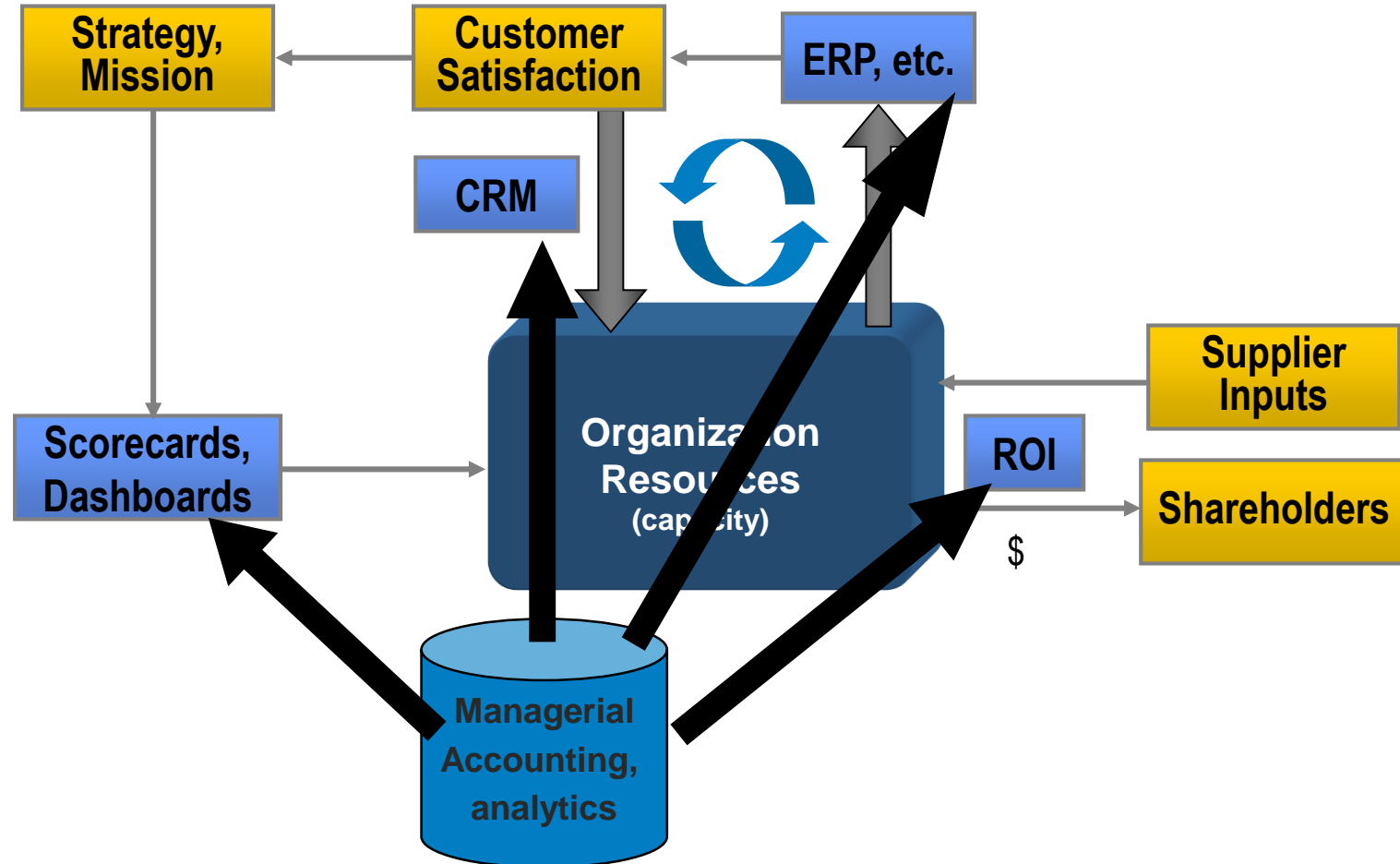
We don’t know where to start or how to get started.

Source: William Vaughn Company CPAs; IMA conference, June 20, 2017

How Does It All Fit Together?

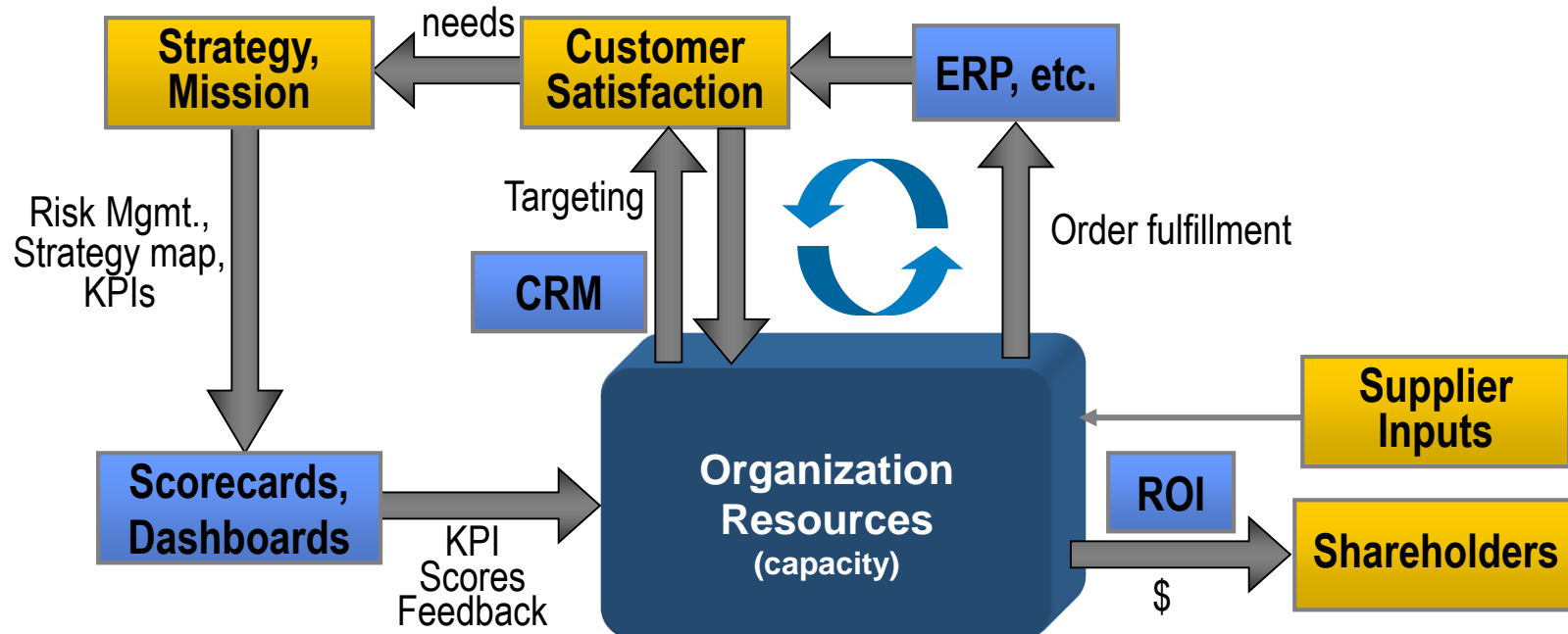


In Summary ... first, we energize *with good managerial accounting.*



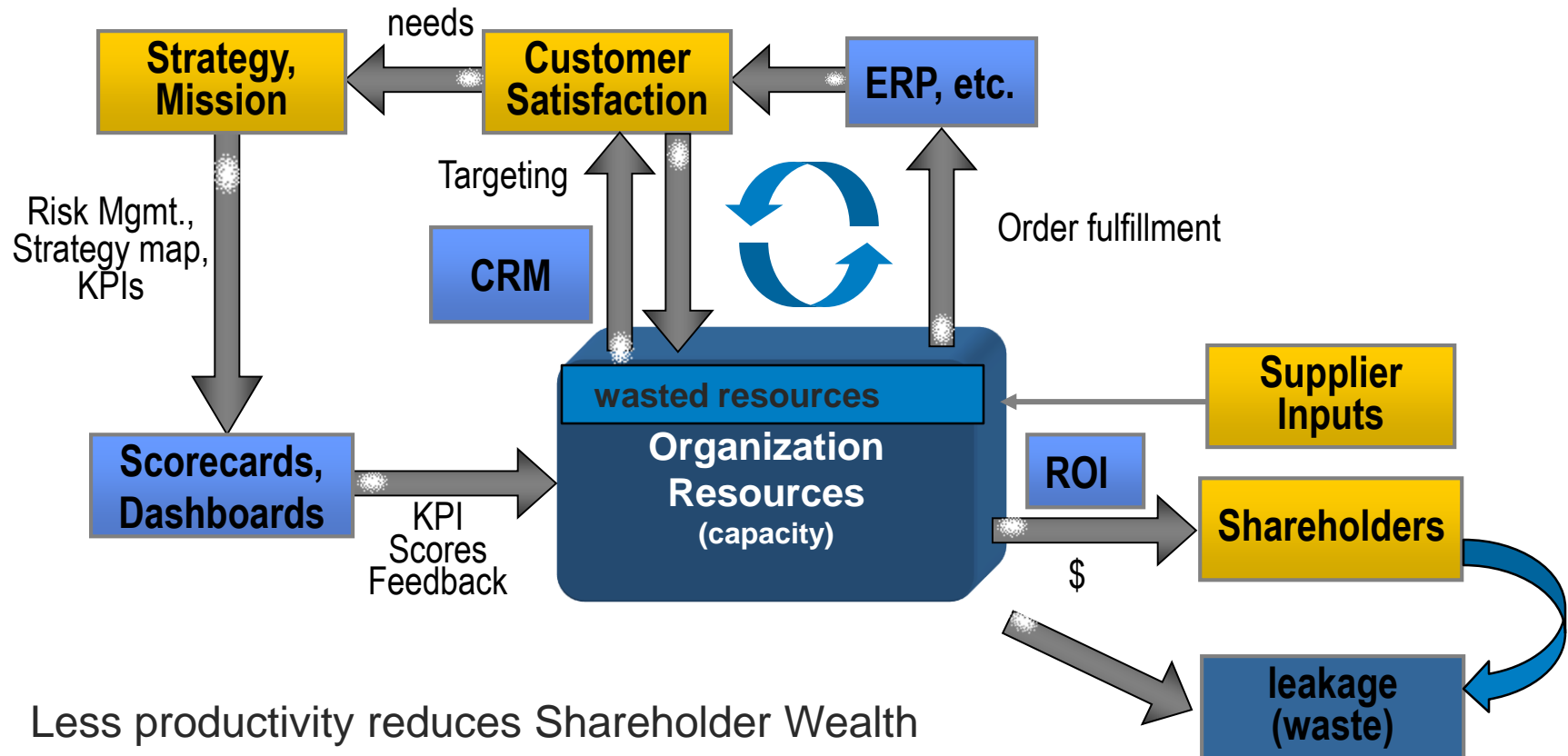
EPM is Circulatory and Simultaneous

Shareholder Wealth Creation is not a goal. It is a result!



EPM is Circulatory and Simultaneous

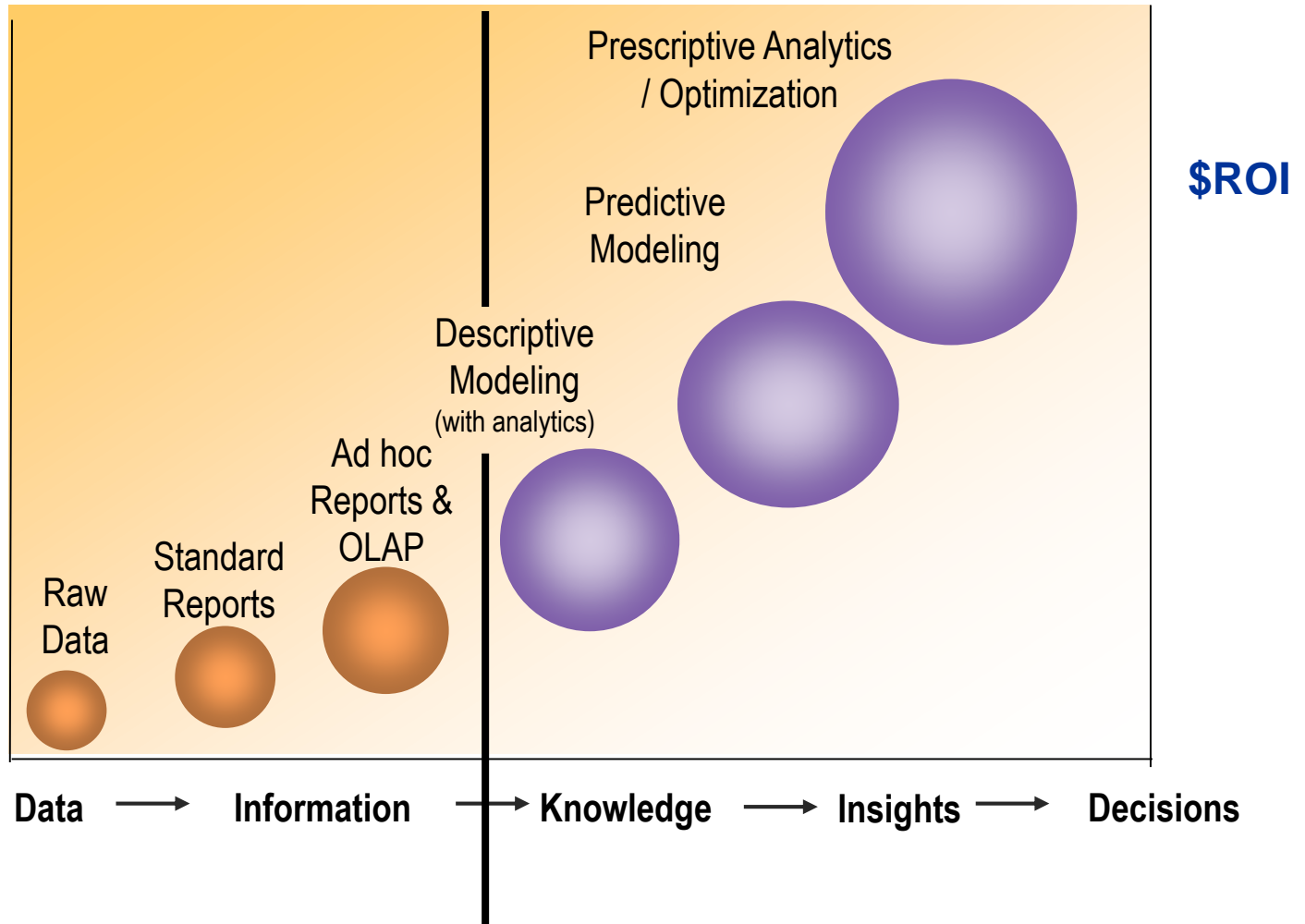
Shareholder Wealth Creation is not a goal. It is a result!



Less productivity reduces Shareholder Wealth

The Intelligence Hierarchy

Power of Information



The Complete Vision of Analytics-based Performance Management



Make the RPM of the PM and BA gears spin ...
... better, faster, cheaper ... and smarter and safer

Getting Started Actions and Resources

Action steps

- **Get educated. Get buy-in.**
- **Rapid prototyping. Start small; think big.**
- **Improve incentives. (Motivational theory)**

Resources:

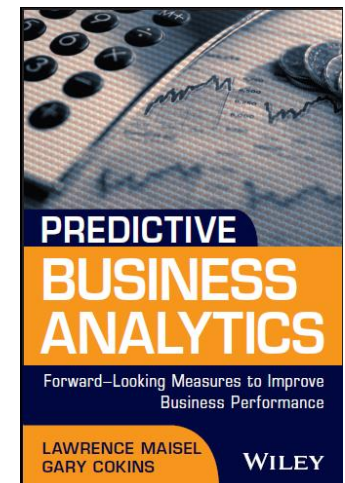
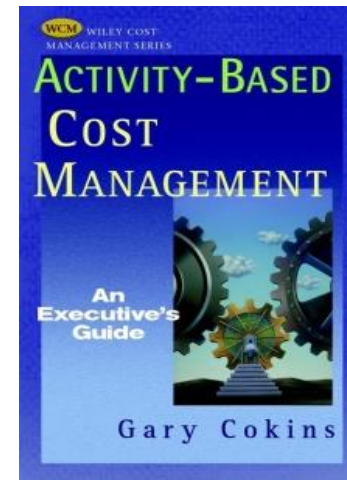
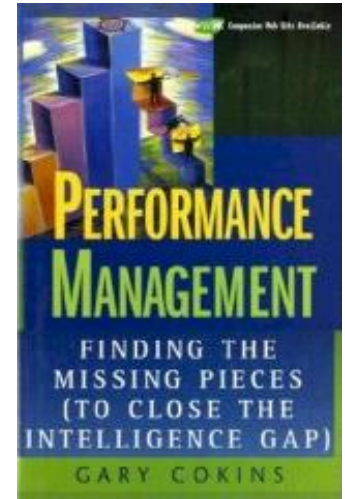
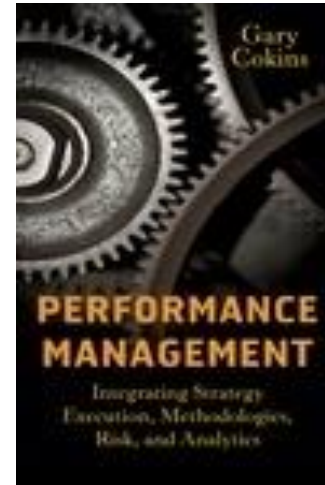
<http://www.epmchannel.com/2013/04/09/exceptional-epm-cpm-systems-are-an-exception/>

<https://opexsociety.org/body-of-knowledge/enterprise-corporate-performance-management/>

A suggestion: Have your management team read either or both of these educational pieces. Then schedule a meeting for discussion. Have each manager answer, “What did I learn? What issues and concerns do I have about EPM?” This will stimulate needed conversations.

From Theory to Practice

Your success depends on how well and how fast the right information and intelligence gets to the right people.



IMA Center for Managing Costing Quality

There are seven seasoned professionals on this IMA task force who share frustration with the slow adoption rate by accountants of progressive management accounting practices, methods, and systems.

The task force's opinion is that most CFOs and accountants continue to use stale and out of date accounting practices from the 1960s !

Here are links to the task force's website. The second link is our "Mission" statement. The task force members are in the third link. Navigate in it a while to see the various "audiences" we are influencing:

<https://www.thecmcq.org/>

<https://www.thecmcq.org/about-us>

<https://www.thecmcq.org/advisory-board>

Our "demand pull" approach is to "partner with 12+ non-financial and accounting institutes (e.g., www.apics.org , www.asq.org , www.cscmp.org) to enlist their members to communicate with their CFO's organization that they are being underserved with flawed, misleading, and incomplete internal management accounting information to support their decision making.

Thank You

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