



T B M C O U N C I L

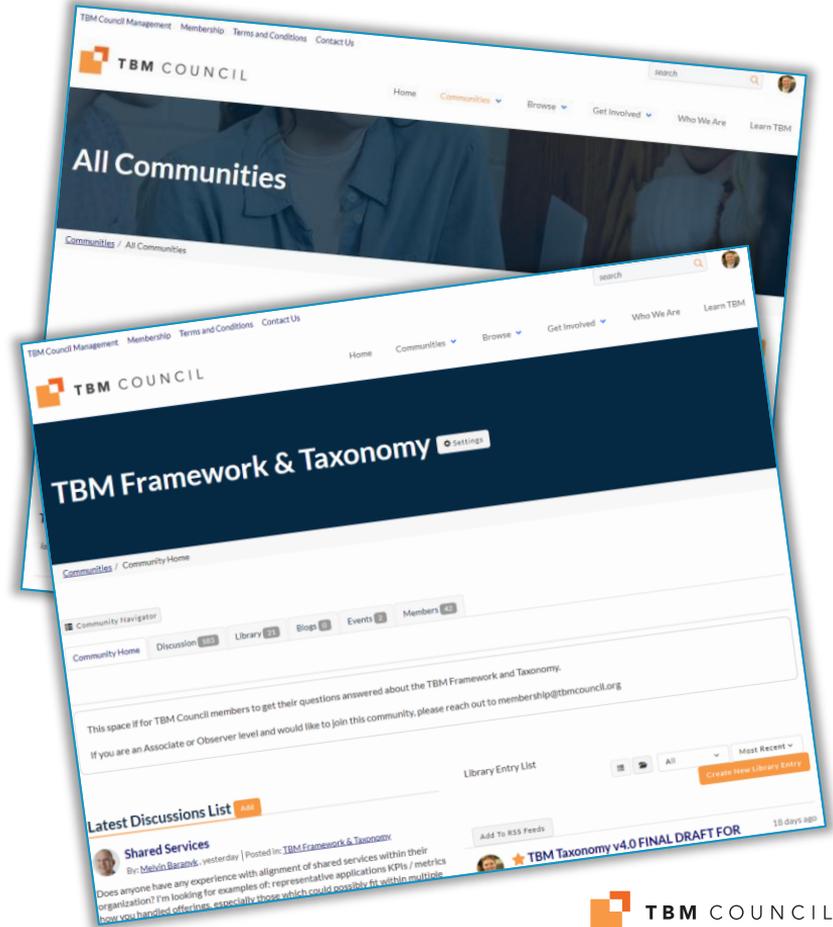
Cost Modelling and Allocations for Indirect Costs

Standards Committee Open Forum

July 2021

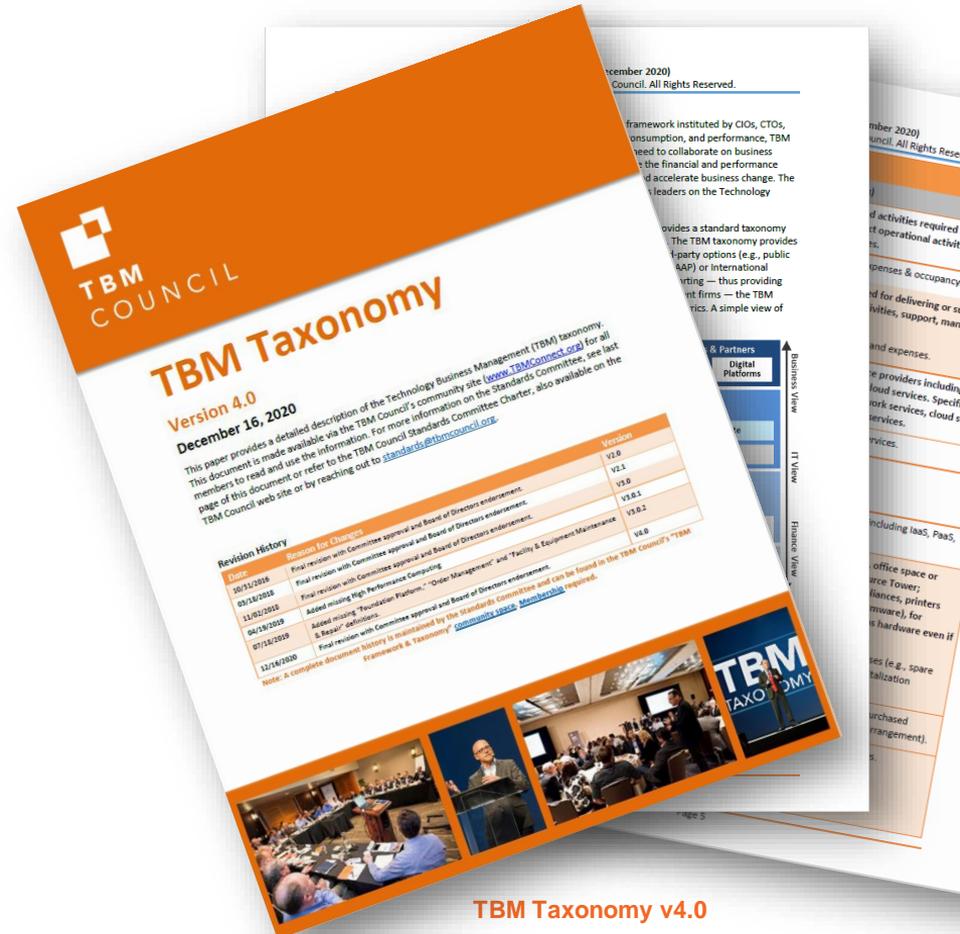
Reminder: Where to Find Content

- ▶ You can find the Taxonomy documents (PDF and PowerPoint slides) in the “**TBM Framework & Taxonomy**” community at community.tbmcouncil.org
- ▶ You must join the community and then you can access the library.



Today's Topics

- ▶ What are indirect costs?
- ▶ Where do we find them?
- ▶ To allocate or not to allocate...
- ▶ Main methods for handling indirect costs
- ▶ Best practices for specific types of indirect costs



TBM Taxonomy v4.0

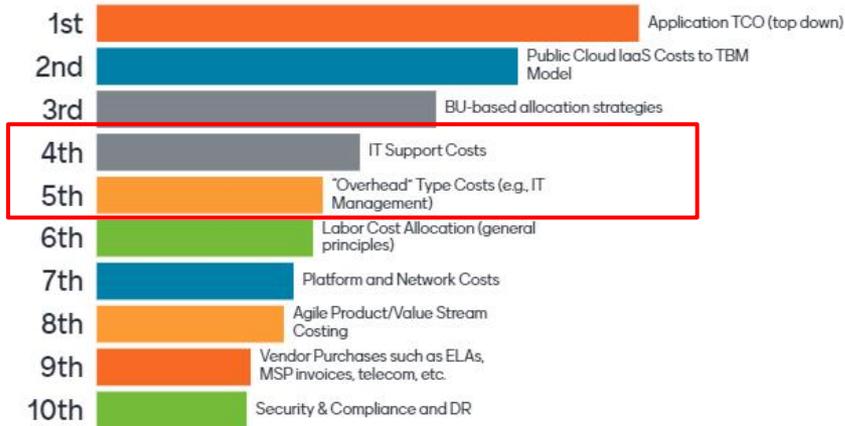
Considerations and Best Practices for Modelling and Allocating Indirect Costs

Todd Tucker

Cost Allocation Topics

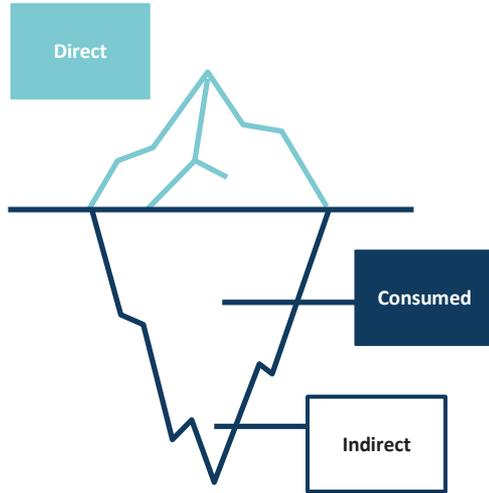
Prioritization from February Open Forum

Which cost allocation topics are most important for you?



What Are Indirect Costs?

Definitions Introduced with TBM Taxonomy v4.0



Direct costs are resources in the budget or span of control of the costed object's owner. For example, an application owner might have app developer labor, tier 3 support labor, and some software licenses (e.g., software development tools) in their budget. These resources drive the direct costs of the application. The application owner has control over those resources and therefore over their costs to the business.

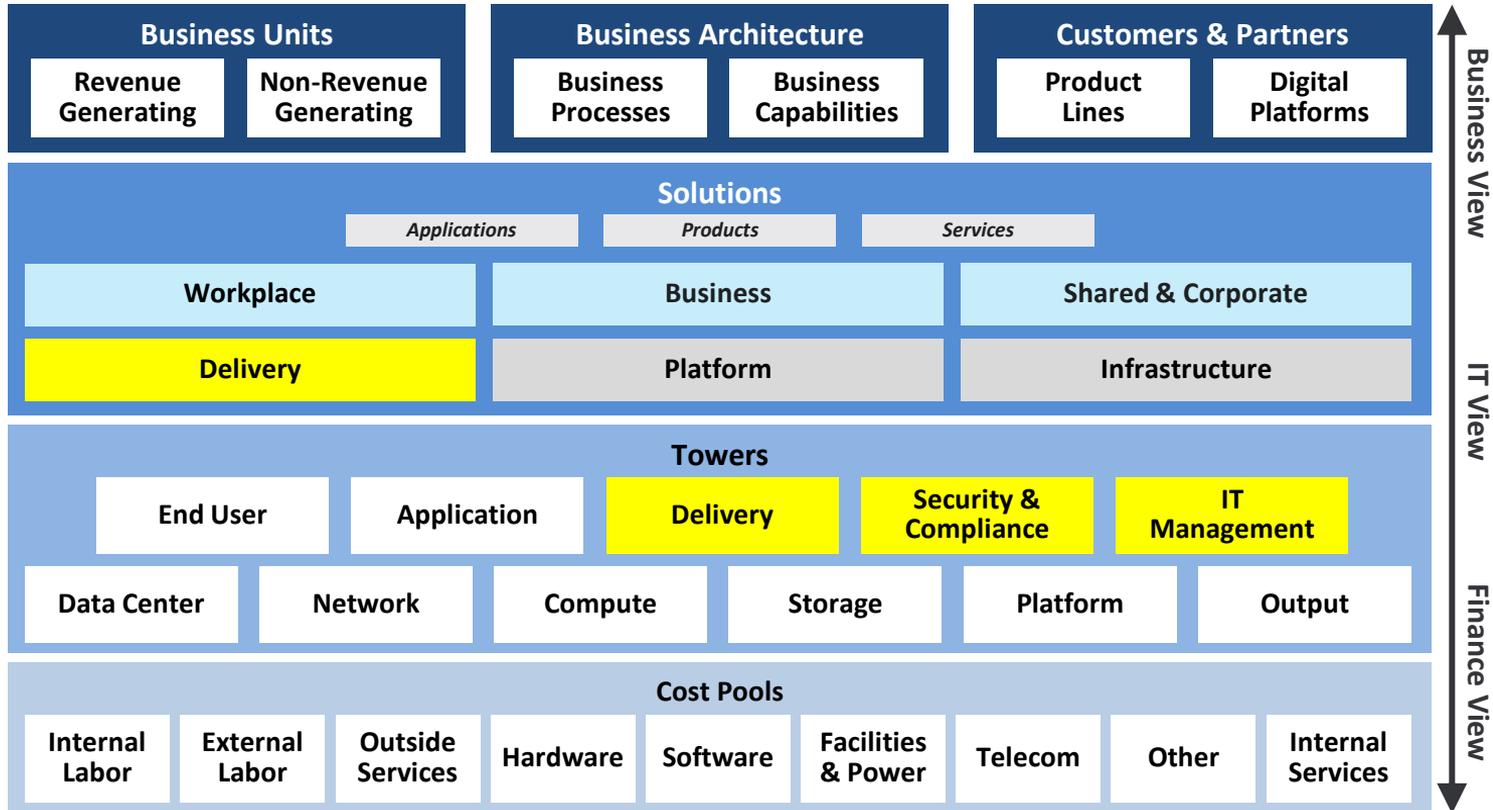
Consumed costs are resources that are used to support or deliver the costed object but are owned by another resource owner. Consumed costs do not appear in the budget (e.g., cost center) of the costed object. However, the consumption of those costs is clearly reflected in a data source, meaning their consumption is controllable (to some degree) by the costed object's owner.

Indirect costs are resources that are owned by another resource owner where the consumption is not attributable to a costed object using a data source. These indirect costs may be considered overhead. For example, an application may depend upon the help desk, but the help desk tickets may not provide sufficient information to show the relationship of help desk resources to the applications they support. In some cases, it is defensible to allocate indirect costs to an object using an agreed upon method, especially where a fully-burden cost is needed for cost recovery, tax purposes, contractual obligations, or other requirements.

Why does it matter for IT professionals?

As more and more IT resources are delivered as shared services, more costs are indirect. As a result, you must be able to trace the indirect costs to what's driving them in order to understand the Total Cost of Ownership of applications, services, infrastructure and other things that are build, managed and supported by IT.

Where Do We Find Most Indirect Costs?



TOWERS (v4.0)

DATA CENTER	COMPUTE	STORAGE	NETWORK	PLATFORM	OUTPUT	END USER	APPLICATION	DELIVERY	SECURITY & COMPLIANCE	IT MANAGEMENT
Enterprise Data Center	Servers	Online Storage	LAN/WAN	Database	Central Print	Workspace	Application Development	IT Service Management	Security	IT Management & Strategic Planning
Other Facilities	Unix	Offline Storage	Voice	Middleware		Mobile Devices	Application Support & Operations	Operations Center	Compliance	Enterprise Architecture
	Midrange	Mainframe Online Storage	Transport	Mainframe Database		End User Software	Business Software	Program, Product & Project Management	Disaster Recovery	IT Finance
	Converged Infrastructure	Mainframe Offline Storage		Mainframe Middleware		Network Printers		Client Management		IT Vendor Management
	Mainframe			Container Orchestration		Conferencing & AV				
	High Performance Computing			Big Data		IT Help Desk				
						Deskside Support				

SOLUTIONS (v4.0)

Delivery

Strategy & Planning	Development	Support	Operations	Security & Compliance
<ul style="list-style-type: none"> • Technology Business Management <ul style="list-style-type: none"> • <i>IT Planning</i> • <i>IT Finance & Costing</i> • <i>IT Billing</i> • <i>Business Value</i> • <i>Metrics & Benchmarking</i> • <i>Strategy Management (new)</i> • <i>Service Portfolio management</i> • <i>Service Catalog management</i> • <i>Service Level management</i> • <i>Availability management</i> • Innovation & Ideation <ul style="list-style-type: none"> • <i>New technology solutions</i> • <i>Incubation services</i> • Enterprise Architecture <ul style="list-style-type: none"> • <i>Business architecture</i> • <i>Information architecture</i> • <i>Application architecture</i> • <i>Infrastructure architecture</i> • Program, Product & Project Management <ul style="list-style-type: none"> • <i>Portfolio investment planning</i> • <i>Project planning & delivery</i> • <i>Continuous planning & delivery</i> • Business Solution Consulting <ul style="list-style-type: none"> • <i>Business Relationship management</i> • <i>Business Process analysis</i> • <i>Technology solution analysis</i> • <i>Demand management</i> • IT Vendor Management <ul style="list-style-type: none"> • <i>Vendor Selection / Negotiation</i> • <i>Procurement</i> 	<ul style="list-style-type: none"> • Design & Development <ul style="list-style-type: none"> • <i>Custom build</i> • <i>Package configuration</i> • <i>SaaS configuration</i> • System Integration <ul style="list-style-type: none"> • <i>On-prem application integration</i> • <i>SaaS integration</i> • Modernization & Migration <ul style="list-style-type: none"> • <i>App re-architecture</i> • <i>Data migration</i> • <i>Infra re-architecture</i> • Testing <ul style="list-style-type: none"> • <i>Functional testing</i> • <i>Integration testing</i> • <i>Performance testing</i> • <i>Usability testing</i> <div data-bbox="421 663 755 896" style="border: 1px solid red; padding: 5px; margin-top: 10px;"> <p>For Development costs, much will be Direct or Consumed, relying on project codes, team assignments or work assignments, etc.</p> </div>	<ul style="list-style-type: none"> • Service Desk <ul style="list-style-type: none"> • <i>Central help desk</i> • <i>Deskside support</i> • <i>Tech bar support</i> • <i>IT knowledge management</i> • <i>Request fulfillment</i> • Application Support <ul style="list-style-type: none"> • <i>Tier 2 app support (by app)</i> • <i>Tier 3 app support</i> • IT Training <ul style="list-style-type: none"> • <i>Off-the-shelf productivity training</i> • <i>Business application training</i> • Central Print <ul style="list-style-type: none"> • <i>Bill/invoice print</i> • <i>Publications</i> • <i>Automated post processing</i> 	<ul style="list-style-type: none"> • IT Service Management <ul style="list-style-type: none"> • <i>Incident management</i> • <i>Problem management</i> • <i>Change management</i> • <i>Asset management (CMDB)</i> • Event Management <ul style="list-style-type: none"> • <i>Network monitoring</i> • <i>System monitoring</i> • <i>Application monitoring</i> • <i>Usage analytics</i> • <i>Logging analytics</i> • Scheduling <ul style="list-style-type: none"> • <i>Batch processing</i> • Capacity Management <ul style="list-style-type: none"> • <i>Storage capacity</i> • <i>Compute capacity</i> • <i>Data Center capacity</i> • Deployment & Administration <ul style="list-style-type: none"> • <i>Software distribution</i> • <i>Config administration</i> • <i>Patch management</i> 	<ul style="list-style-type: none"> • <i>Identity & Access Management</i> <ul style="list-style-type: none"> • <i>Authentication/Authorization</i> • <i>Identity Management</i> • <i>Identity Governance & Administration</i> • <i>Privileged Access Management</i> • <i>Certificate Management</i> • <i>Security Awareness</i> <ul style="list-style-type: none"> • <i>Security Training</i> • <i>Security Advisory</i> • <i>Security Policies and procedures</i> • <i>Cyber Security & Incident Response</i> <ul style="list-style-type: none"> • <i>Cyber Security Monitoring</i> • <i>Security Incident Response</i> • <i>Threat & Vulnerability Management</i> <ul style="list-style-type: none"> • <i>Application Vulnerability Management</i> • <i>Infrastructure Vulnerability Management</i> • <i>Network/Endpoint Security</i> • <i>Data Privacy & Security</i> <ul style="list-style-type: none"> • <i>Data Classification & identification</i> • <i>Data loss prevention</i> • <i>Data encryption</i> • <i>Database security</i> • <i>Governance, Risk & Compliance</i> <ul style="list-style-type: none"> • <i>Risk management</i> • <i>Policy management</i> • <i>Policy tracking</i> • <i>Data governance</i> • <i>Business Continuity & Disaster Recovery</i> <ul style="list-style-type: none"> • <i>Business continuity policies</i> • <i>Business resiliency plans</i> • <i>DR procedures & exercises</i> • <i>DR facilities</i> • <i>Office continuity facilities</i>

NOTE: Italicized sub-entries under Solution names are representative (example) offerings. They are not to be considered standard offerings. They are used to illustrate the types of offerings or commercial products that often comprise a specific Solution.

Indirect Costs: To Allocate or Not to Allocate...

Why Allocate?

- ▶ To measure a fully-burdened TCO of your solutions (even though indirect costs are difficult to control from a solution perspective!)
- ▶ To support tax or transfer pricing requirements (i.e., because your tax people say you must)
- ▶ To bolster trust by not appearing to hide a big part of your spending (i.e., for “full transparency”)
- ▶ To help articulate the value of solutions that are not easily rate-based or for which you do not want to discourage consumption (e.g., Security & Compliance services)

Why NOT Allocate?

- ▶ To avoid burdening solutions with costs that aren't easily controlled from a solution perspective
- ▶ To focus consumers on the costs that they can control or influence via their consumption
- ▶ To avoid creating disincentives for important services such as Security & Compliance
- ▶ Because the allocation is unnecessary (e.g., if you use rates that include a margin that covers your indirect costs)

Reminder: Costing vs. Billing vs. Charging

Optional Approaches to BU Allocations

Costing of Solutions

- ▶ Costs of solutions or other objects may be modelled based on actuals
- ▶ Solution costs may be burdened with indirect costs, but generally solution TCO focused on direct and consumed
- ▶ Provides a critical component (expense) of a solution-level “P&L” (solution-specific income statement)

Billing (Showback)

- ▶ A bill of IT may be produced showing BUs their consumption and the costs they drove
- ▶ Costs may be based on actuals, rates (prices) or budget
- ▶ Rates are often preferred but requires extra planning and discipline
- ▶ If chargeback is employed, bills should match charges
- ▶ Provides the other (income) component of a solution-level “P&L”

Charging

- ▶ Chargeback can be done without any bill of IT or showback (not recommended)
- ▶ Variances between chargebacks and actual costs must be managed (typically quarterly or annually)
- ▶ Clear business rules must be established up front for what costs are charged, the basis for those charges, and how variances are handled

NOTE: Costing vs. Billing often necessitates two different TBM models, one for each.

Main Methods for Handling Indirect Costs

(A) Cost Them as Distinct Services and Showback

- ▶ Define major buckets of costs as administrative, professional and other non-consumptive types of services (Solutions layer)
- ▶ Use Delivery solutions as a guide to defining those services
- ▶ Allocate tower/sub-tower costs to those services for showback (reporting, transparency)

(B) Cost Them as Distinct Services and Chargeback

- ▶ Same as option (A), plus...
- ▶ If they must be allocated to BUs, do so based on number of employees, revenues and/or direct/consumed costs for each BU (next 4 slides)
- ▶ Consider use of benchmarking (internal or peer-based) to justify indirect spending
- ▶ Report them “below the line” if possible (i.e., avoid impacting incentive comp for BU leaders)

(C) Allocate to Solutions as a “Tax”

- ▶ In rare circumstances and where rates (prices) are used for solutions, include indirect costs as overhead for each solution
- ▶ Base overhead burdening rate on the percentage of costs for each solution (i.e., the total direct and consumed costs before overhead)
- ▶ Use the overhead-burdened cost of each solution to determine a rate that fully recovered the burdened cost (similar to including a “margin” in your rate)

Delivery Solutions / Strategy & Planning

Name	Brief Description	Consumed Costs	Indirect Allocations
Enterprise Architecture	Guides organizations through the business, information, process, and technology changes necessary to execute their business and IT strategies.	Where possible and material, allocate EA team costs to major projects or initiatives based on data. Important to include in WIP/capitalization.	Allocate all else to BUs based on % of IT consumption (dollars).
Business Solution Consulting	Helps the enterprise improve their performance, primarily through the analysis of existing business problems and development of plans for improvement.	Majority of BSC team costs should be allocated to major projects or initiatives using time tracking or other tools.	Allocate all else to BUs based on % of IT consumption (dollars).
Technology Business Management	Enables the disciplines and value conversations for improving the business outcomes enabled by the technology portfolio. Enables technology leaders and their business partners to collaborate on business-aligned decisions.	Consider allocating large, requested TBM services (e.g., custom reporting) to BUs based on consumption. <i>Avoid discouraging use of TBM!</i>	Allocate all else to BUs based on % of IT consumption (dollars).
Innovation & Ideation	The investment, development, and incubation of new technologies to create new or better solutions which meet unarticulated or existing market needs.	If program works on discernible BU-oriented opportunities, allocate accordingly.	Allocate all else to BUs based on % of IT consumption (dollars).
IT Vendor Management	The management of technology suppliers who provide, deliver and support technology products and services.	Not applicable.	Allocate to BUs based on % of IT consumption (dollars).
Program, Product & Project Management	The process of managing software development-focused projects, programs, and products with the intention of improving an organization's performance.	Where possible and material, allocate team costs to major projects or initiatives. Important to include in WIP/capitalization.	Allocate all else to BUs based on % of IT consumption (dollars).

Delivery Solutions / Operations

Name	Brief Description	Consumed Costs	Indirect Allocations
Deployment & Administration	Includes release management and software distribution to deploy new and/or the most recent software version to the host servers or client computing devices. Includes ongoing operating system (OS) support and patch management.	Where possible and material, costs should be allocated to end user devices and servers based on number of endpoints.	Allocate all else to BUs based on % of IT consumption (dollars).
IT Service Management	Provides the incident, problem, and change management capabilities necessary for IT to plan, deliver, operate, and control the IT services offered to its customers.	Where possible and material, costs should be allocated to other solutions based on tickets, change requests or project codes.	Allocate all else to BUs based on % of IT consumption (dollars) or number of BU users.
Capacity Management	Ensures IT resources are right-sized to meet current and future business requirements in a cost-effective manner.	Where possible and material, costs should be allocated to other solutions based on change requests or project codes.	Allocate all else to BUs based on % of IT consumption (dollars).
Event Management	Monitors resources and applications. Records API calls and delivers logs and insights. Provides log data consolidation, reporting and analysis.	Where possible and material, costs should be allocated to other solutions based on volume of events.	Allocate all else to BUs based on % of IT consumption (dollars).
Scheduling	Executes the tasks required to operate an IT solution and using software tools that run batch or online tasks at specific times of the day, week, month, or year.	Where possible and material, costs should be allocated to other solutions based on defined scheduling support.	Allocate all else to BUs based on % of IT consumption (dollars).

Delivery Solutions / Support

Name	Brief Description	Consumed Costs	Indirect Allocations
Application Support	Provides the ongoing operational activities required to keep the application or service up and running, provide Tier 2 and Tier 3 technical support to more complex or difficulty user questions and requests.	Where possible, costs should be allocated to other solutions based on tickets, change requests or project codes.	Allocate all else to BUs based on % of IT consumption (dollars).
Central Print	Provides high-volume and advanced printing for invoices, product literature or other complex documents for mass distribution. May also include folding, envelope stuffing, postage and bundling to expedite distribution.	Where possible, costs should be allocated to other solutions based on central print volumes or directly to BUs as central print services.	Allocate all else to BUs based on % of IT consumption (dollars).
IT Training	Provides educational services to the organization's users on how the access and effectively use the organization's business application services, as well as common productivity software and tools.	Where possible, costs should be allocated to other solutions based on change requests or project codes.	Allocate all else to BUs based on % of IT consumption (dollars).
Service Desk	Provides a single point of contact to meet the support needs of users and the IT organization. Provides end users with information and support related to IT products and services, usually to troubleshoot problems or provide guidance about products such as computers, electronic equipment, or software.	Where possible and material, costs should be allocated to other solutions based on tickets or change requests processed by the service desk.	Allocate all else to BUs based on % of IT consumption (dollars).

Delivery Solutions / Security & Compliance

Name	Brief Description	Consumed Costs	Indirect Allocations
Identity & Access Management	Sets policy, business processes, establishes controls, and provide technologies to facilitate the management of digital identities and access privileges.	Not applicable.	Allocate to BUs based on % of IT consumption (dollars), revenues or employees.
Security Awareness	Sets policy, procedures and provides corporate knowledge training to members of an organization to promote good security practices and culture by all individuals.	Not applicable.	Allocate to BUs based on % of IT consumption (dollars), revenues or employees.
Cyber Security & Incident Response	Provides policies, procedures, and technologies to recognize threats and ensure the organization has the appropriate defense and responses to each incident.	Not applicable.	Allocate to BUs based on % of IT consumption (dollars), revenues or employees.
Threat & Vulnerability Management	Ensures an organization's applications and infrastructure vulnerabilities are proactively identified, classified, and corrected or mitigated.	Not applicable.	Allocate to BUs based on % of IT consumption (dollars), revenues or employees.
Data Privacy & Security	Ensures corporate and user data is not used or accessed by unauthorized individuals or entities.	Not applicable.	Allocate to BUs based on % of IT consumption (dollars), revenues or employees.
Governance, Risk & Compliance	Provides strategy, policies, and processes for managing an overall governance, enterprise risk management and compliance with regulations, with regards to IT.	Not applicable.	Allocate to BUs based on % of IT consumption (dollars), revenues or employees.
Business Continuity & Disaster Recovery	Ensures the continuous operation of the enterprise. Includes business impact assessments, business resiliency plans, disaster recovery capabilities and more.	Not applicable.	Allocate to BUs based on % of IT consumption (dollars), revenues or employees.

Other Types of Indirect Costs

Examples

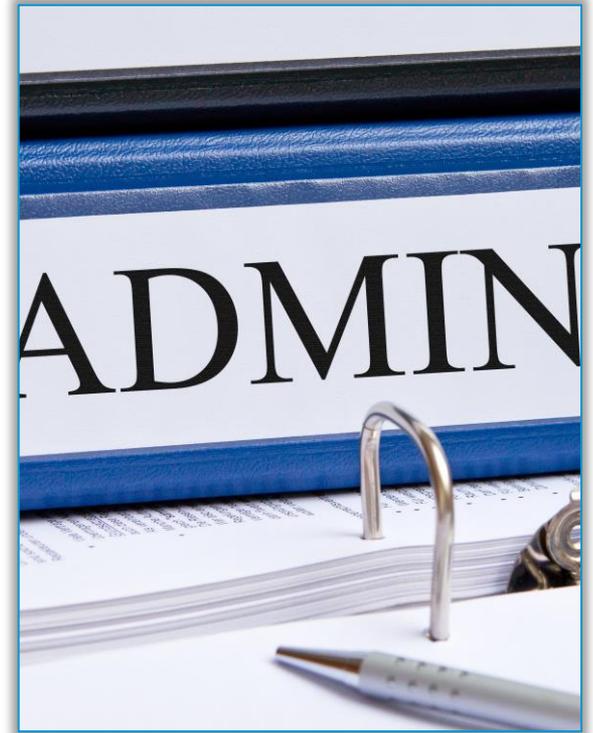
- ▶ Infrastructure that can't be allocated to applications or solutions
- ▶ Cloud services that can't be tagged and easily allocated
- ▶ Situations where cost of allocation data (drivers) is not justified by the benefit (“juice is not worth the squeeze”)
- ▶ IT Management & Strategic Planning (sub-tower), not associated with specific solutions

Considerations

- ▶ Are the amounts material?
- ▶ Can gross allocation rules (e.g., peanut-butter spread, t-shirt sizing) result in *good enough* costing?
- ▶ Can you just report as other costs? Include towers/sub-towers as reporting dimensions?
- ▶ How are you working to resolve those examples?

What About Administrative Time?

- ▶ Employees spend time each month on training, meetings, PTO, and more.
- ▶ Should this time be treated as indirect cost?
 - As a best practice, no...
 - Labor costs are generally allocated using rates established by HR/HCM and may be burdened with other costs (PTO, facilities, etc.)
 - Standard TBM models use those standard labor rates and drivers (allocation data such as time tracking) to allocate actual labor costs from the general ledger
 - Therefore, administrative time is included in the cost of each employee



Where Do Indirect Costs Show Up In a Bill?

Price x Quantity ("PxQ") Bill + Other Costs

$$\mathbf{R}_{\text{ate}} \times \mathbf{V}_{\text{olume}} = \mathbf{Consumption-Driven Cost}$$

The rate for each thing you consumed (**R**)

What and how many IT solutions you consumed (**V**)

The total cost of your consumption (**Bill of IT**)

Other Costs Reported in a Bill of IT:

- Shared solutions reported by a non-consumption factor (e.g., % of revenues, % of employees)
- Direct charges such as purchases made for a specific business unit
- Projects not delivered as a rate-based service

Using a “Margin” to Recover Indirect Costs

- ▶ If you’re using rates, you might consider using a margin to cover your indirect costs. (After all, this is what IT service vendors do!)
- ▶ Many caveats with this approach, including:
 - This requires the blessing of CFO/Finance, especially where different legal entities are involved, or transfer pricing is a concern.
 - This method may appear to “hide” or obfuscate costs and impair the trust of your business partners.
 - Your business partners must see that your rates your rates are competitive and/or cost-effective.
 - Also, this approach may unfairly burden some BUs with indirect costs. Consider if there are more equitable ways to allocate those costs to BUs.



Wrap-Up



Wrapping Up

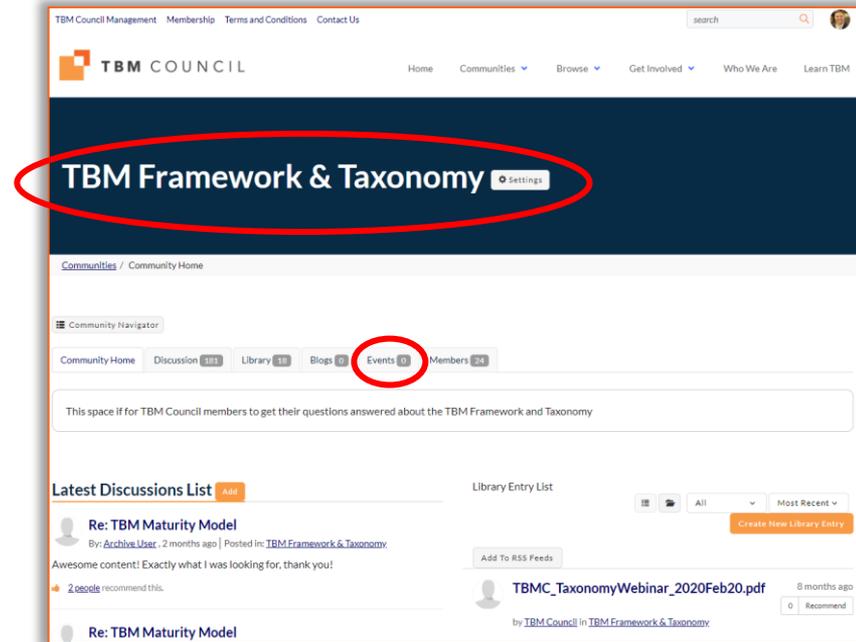
- ▶ Thanks for watching!
- ▶ Please submit questions or comments for this presentation online -- see: **TBM Framework & Taxonomy Community on TBMCouncil.org:**

<https://community.tbmcouncil.org/communities/allcommunities>

NOTE: TBM Council membership required. Sign-up at: <https://community.tbmcouncil.org/membership>

- ▶ Please join us for our Open Forum for discussion on July 15!

Meetings (events) can be found in the same community space.



Community Space for Taxonomy-Related Content (see library)

Thank You!