



T B M C O U N C I L

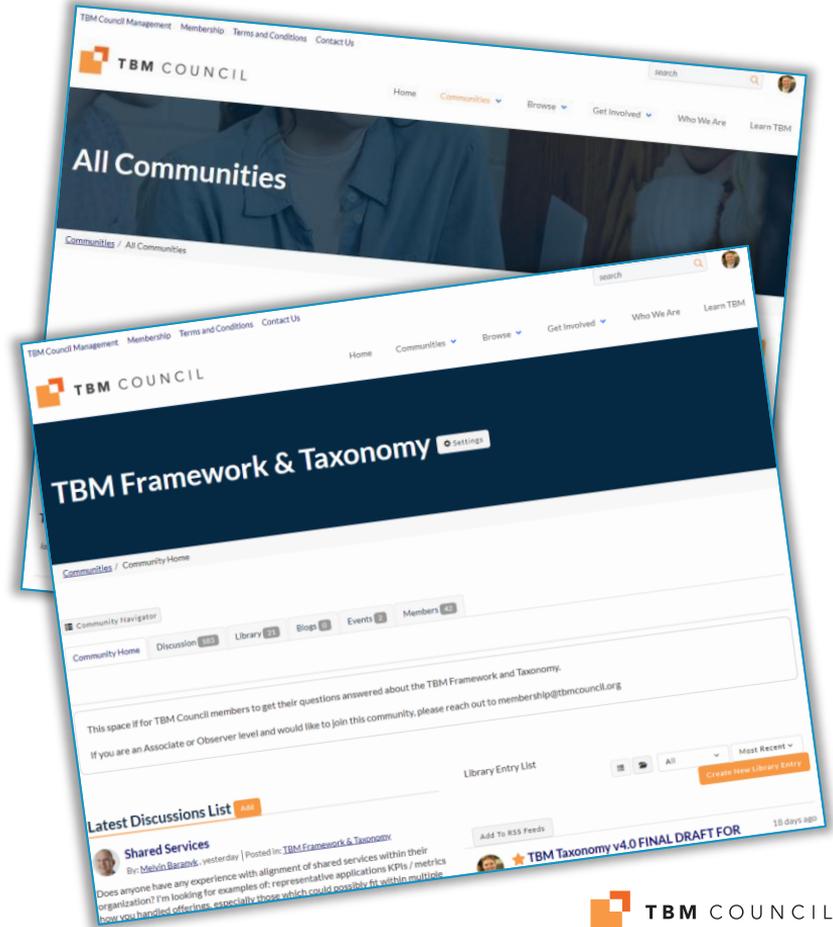
Cost Modelling and Allocation for Business Units

Standards Committee Open Forum

May 2021

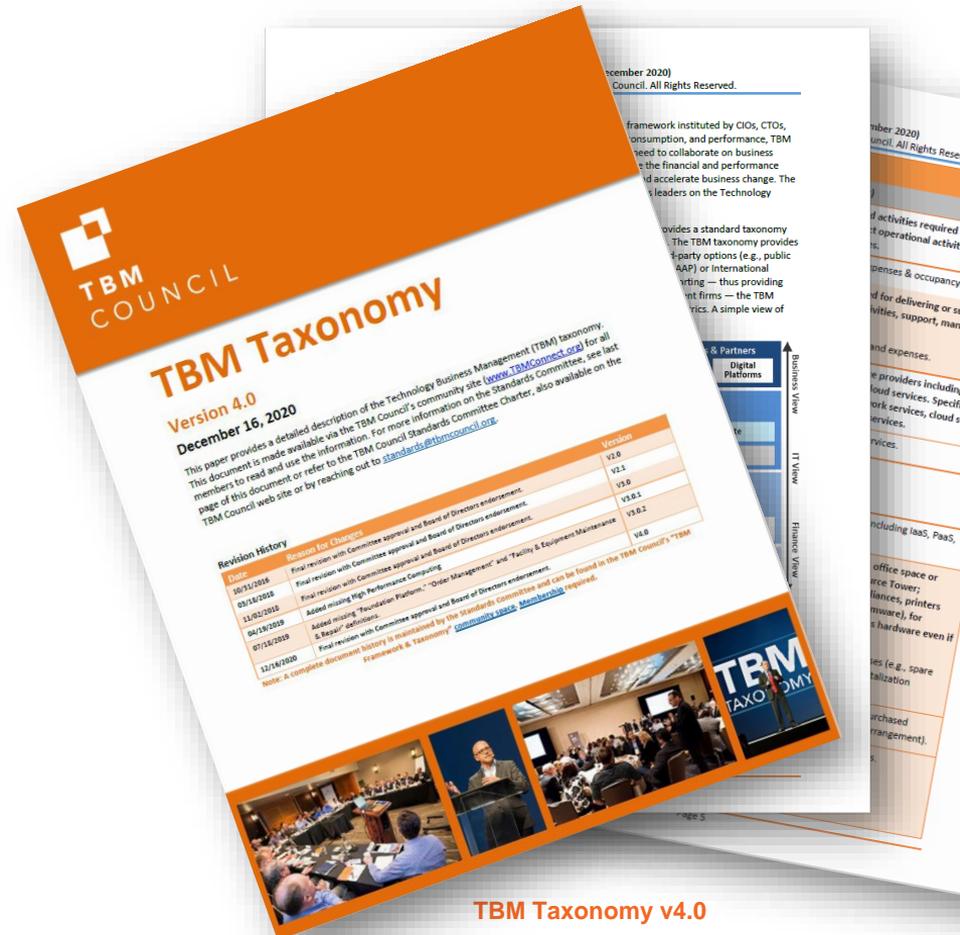
Reminder: Where to Find Content

- ▶ 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

- ▶ Why Allocate IT Costs to Your Business Units
- ▶ Modern vs. Legacy Approaches
- ▶ For What Are You Allocating Costs?
- ▶ Costing vs. Billing vs. Chargeback
- ▶ Considerations when Shaping Demand
- ▶ Introduction to Rates Management
- ▶ Types of Rates
- ▶ Accountability for Rates vs. Volumes
- ▶ How to Set Rates
- ▶ Showback (Billing) and the Bill of IT
- ▶ Cost Recovery and Variances
- ▶ Demand Levers vs Cost Structure
- ▶ Common Data Challenges



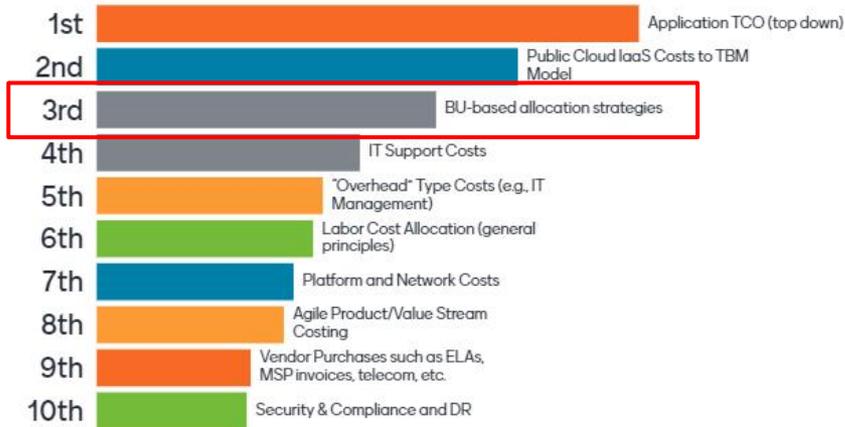
Considerations and Best Practices for Modelling and Allocating Costs to Your Business Units

Todd Tucker

Cost Allocation Topics

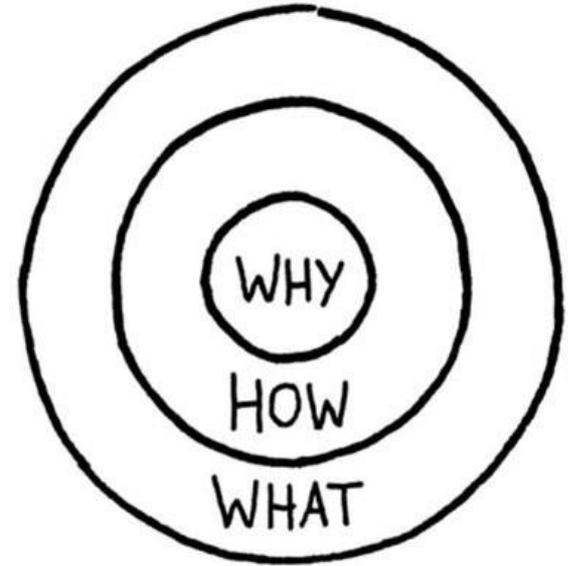
Prioritization from February Open Forum

Which cost allocation topics are most important for you?



Why Allocate IT Costs to Business Units?

- ▶ Shape business unit demand and consumption and align spending with perceived value
- ▶ Support BU-level “P&L” (profit & loss) management
- ▶ Support transfer pricing and tax (income, sales/use, etc.) calculations for multinational companies
- ▶ Support transfer pricing for joint ventures, subsidiary concerns and other legal arrangements
- ▶ Find ways to reduce taxes
- ▶ Satisfy laws (e.g., Reg W in US banking industry)
- ▶ Fund specific programs (e.g., centralized purchasing of public cloud services)



Simon Sinek's Golden Circle

Modern Method of BU Allocations

Legacy Models

- ▶ Not TCO-driven or rates-based
- ▶ Sometimes based on gross denominators such as employees or revenues per BU
- ▶ Line-item based allocations of costs using complicated splits
- ▶ Often includes splitting invoices or individual purchases
- ▶ Often manually intensive processes with little impact on value for money
- ▶ Provides few choices for BUs and gives them little incentive to optimize consumption
- ▶ Usually employed by Expense Center archetypes*

Allocations via TBM Model

- ▶ Uses TCO and/or rates (prices) for solutions (services, products, or apps)
- ▶ Seeks to provide levers for BU partners to shape demand and consumption
- ▶ Encourages fairness and comprehension of the allocations
- ▶ May help you provide cost-effective choices to your BU partners
- ▶ Can facilitate portfolio planning with your BU partners
- ▶ Positions centralized tech departments as Service Providers and/or Business Drivers*
- ▶ Enables/supports Value Partner archetypes*

* See Expense Center, Service Provider, Value Partner and Business Driver archetypes in TBM book or TBM Executive Foundation training.

For WHAT Are You Allocating Costs to BUs?

▶ Applications or Business-Facing Solutions

Do you have apps, products or services that are presented in terms your business partners understand and are able to assess value for the money?

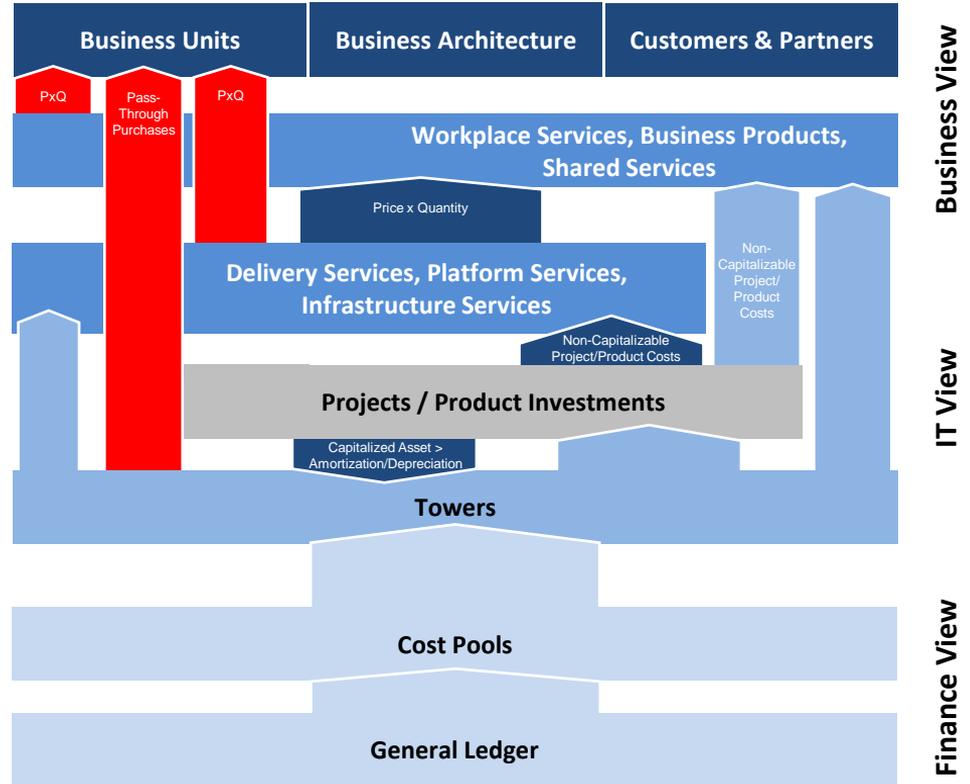
▶ Technical Solutions (Infra/Platform/Delivery)

Do you have stakeholders in your BUs that consume technical solutions such as physical compute, virtual compute/containers, networked storage, development platforms, application hosting, etc.?

▶ Pass-Throughs or Other Allocations

Do you have things that you've agreed to purchase on behalf of your BUs and simply pass through the costs?

Do you have other costs that you've agreed to allocate that aren't solution based (e.g., management overhead)?



Conceptual TBM model only. Actual models vary depending on software used, allocation methods chosen, reporting produced and other factors.

Costing, Billing (Showback) and Chargeback

Optional Approaches to BU Allocations

Costing by BUs

- ▶ Costs of solutions or other objects may be modelled based on actuals
- ▶ Actuals basis may result in “lumpiness” of costs from period-to-period and be difficult to predict
- ▶ Helps determine how BU consumption drove actual costs, regardless of how those costs are billed or charged back
- ▶ Provides a critical component (expense) of a solution-level “P&L” (solution-specific income statement)

Billing the BUs

- ▶ 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”

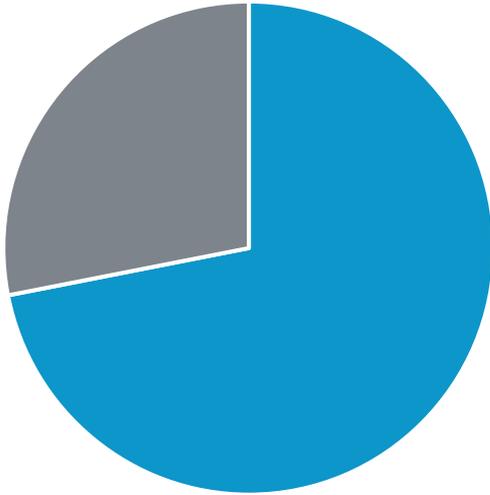
Charging the BUs

- ▶ 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.

Four Considerations when Shaping Demand

Cost



- Directly impacted by business demand
- Indirectly impacted or immaterial



Controllability
(Addressability of Cost)



Optionality
(Discretionary or Mandatory)



Timeline
(Realization of Impact)

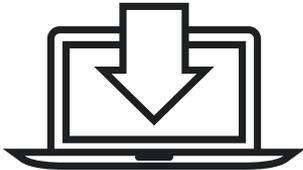


Materiality
(Significance of Impact)

Introduction of Rates Management

Solution Cost Drivers

\$10 Million
in Software



Solution Delivered

Word
Processor
Software



Unit Rates

\$90 per
license



Not actionable by
business

Actionable by
business

Introduction of Rates Management

Rates



are like...

Prices



- ▶ Communicate costs based on solution volumes consumed.
- ▶ Provide predictability of costs.
- ▶ Typically set once or twice a year.

NOTE: Most organizations avoid the term “prices” and prefer the term “rates”. “Price” can be viewed as connoting a profit margin.

Types of Rates (Not Exhaustive)

Type	Description
Named Users	Based on entitled users to a service or application; may vary based on type of user (e.g., “power” users vs. non-power users)
Devices	Based on type and number of devices (e.g., workstations, laptops, mobile) provided and supported for a business unit
Reservations	Based on units of a resource (e.g., storage, virtual servers, user accounts/seats) reserved for a business unit
Transactions	Based on business transactions processed (e.g., orders processed) by a system
Consumption Tiers	Based on a tier of consumption (e.g., 1,000 users)
Metered Usage	Based on a unit of actual usage, such as user logins, bandwidth consumed, minutes of calls made, or CPU utilization

Rates and Volumes



- The **provider** is accountable for rates



- The **consumer** is accountable for volumes

Rates Management

What Do You Do with Rates?

Measure

- ▶ What is the unit cost to deliver a solution (app, product, service) or technology)?
- ▶ What is the appropriate unit of measure?
 - User account
 - Transaction
 - Storage volume
 - Virtual server
 - ...

Communicate

- ▶ What is the “price” (cost) per unit that you will show back or charge your consumers?
- ▶ How often do you adjust your rates?
- ▶ Who is accountable for variances between actual costs and rates?
- ▶ When are true-ups and/or refunds issued?

Optimize

- ▶ What is our target for the unit cost of a solution or technology?
- ▶ How do we set achievable targets?
- ▶ Who is accountable for meeting the targets?
- ▶ What actions can we take to reduce our rates? What are our addressable costs?
- ▶ When do we realize rate reduction benefits?

Rates Management

How Do We Set Rates?

Cost-Based

- Rates are set based on anticipated costs and volumes
- No margin is included

Cost-Plus or Cost-Minus

- Rates are based on anticipated costs and volumes
- Margins are included to accommodate variances or to pay for overhead not included in the underlying unit cost
- Strategic pricing may be used to encourage or discourage consumption

Market-Based

- Rates are set based on industry benchmarks or other comparables
- Consultants are often employed to understand external rates

Strategic Pricing

Strategic pricing means subsidizing or surcharging solutions in order to encourage or discourage consumption, improve fairness of allocations, or enable the adoption of a new solution.

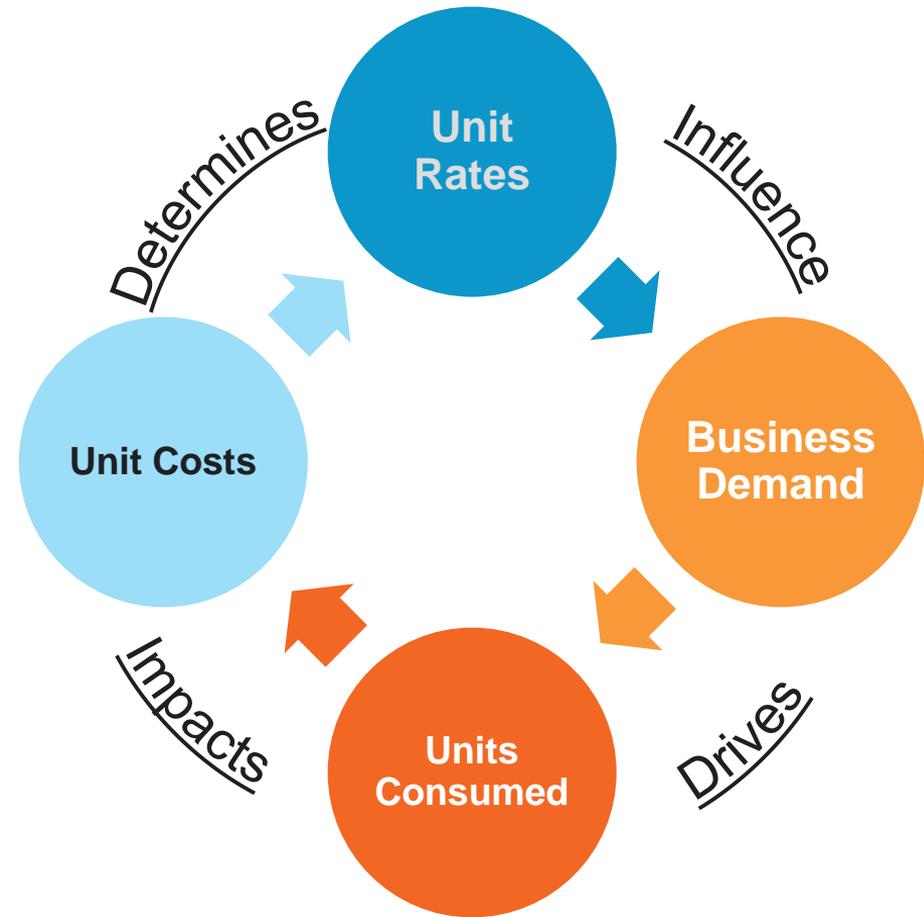
Corporate goals	Pricing approach to achieve goals	
	Subsidize	Surcharge
<ul style="list-style-type: none">• Encourage use of cloud-based infrastructure services to improve agility and refocus staff on core business applications	<ul style="list-style-type: none">• New adoption of strategically important cloud technologies	<ul style="list-style-type: none">• Non-cloud technology when better cloud option is available
<ul style="list-style-type: none">• Foster 2 fledgling business units that have long-term strategic importance	<ul style="list-style-type: none">• Services to strategic new business	<ul style="list-style-type: none">• Cash cows – 4 fully mature business units with shrinking markets
<ul style="list-style-type: none">• Move to virtual desktop infrastructure (VDI) for productivity, reduced costs and improved security	<ul style="list-style-type: none">• VDI instances	<ul style="list-style-type: none">• PCs not designed for optimal VDI use

Rate Setting Process

Rate setting is an iterative process with the business since unit rates impact business demand which, in turn, impacts unit cost.

Often initial rates are published via a “price book” during the planning process and revised through planning iterations.

Going through 3-4 iterations of price books is not uncommon in larger enterprises.

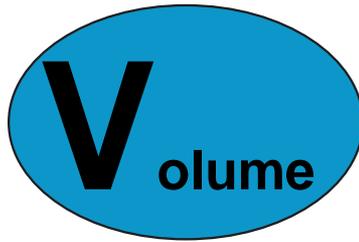


Rate x Volume

aka Price x Quantity ("PxQ")



X



=

**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., percent of revenues, percent of employees)
- Direct charges such as purchases made for a specific business unit
- Projects not delivered as a rate-based service

Consumption Data

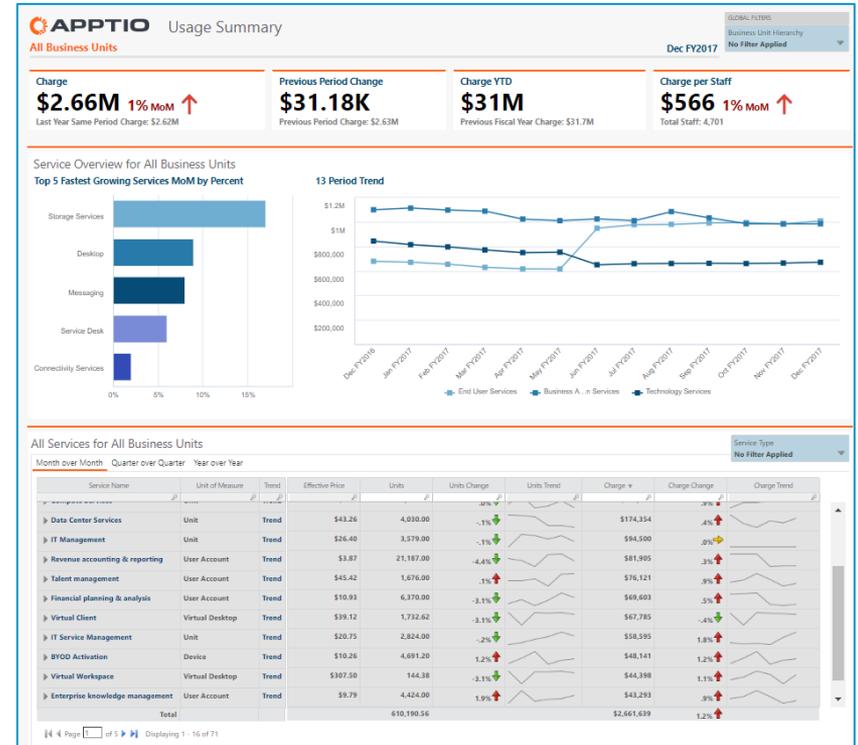
Facts Needed to Understand Volumes

$$\text{Rate} \times \text{Volume} = \text{Consumption-Driven Cost}$$

- ▶ For each solution, where do you get consumption data?
- ▶ Number of potential data sources can be overwhelming
- ▶ Consider packaging of solutions to simplify consumption data? (e.g., including many apps or services in one package)
- ▶ Leverage identity governance solutions (e.g., Azure AD, Okta, Ping Identity, etc.) that manage user entitlements to apps and services
- ▶ Use project/time tracking systems for project-related services
- ▶ Use service catalog and service desk systems for other types of provisioned services

Bill Anatomy

- ▶ What should be in your bill (invoice)? How detailed?
- ▶ Who (from IT) is responsible or accountable for the bills?
- ▶ Who receives the bills?
- ▶ What do they do with them?

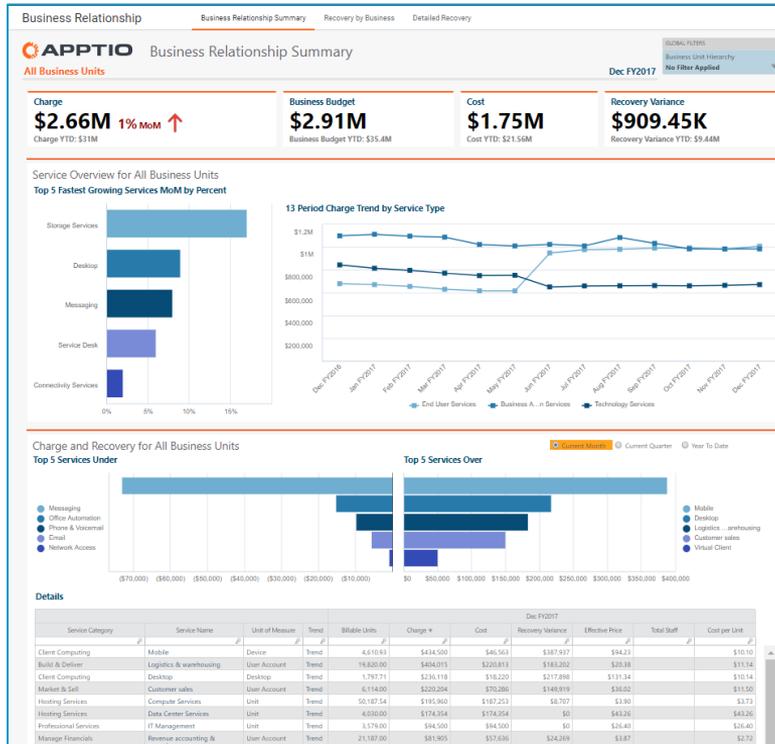


A proper bill of IT should give consumers of IT services or products the info they need to make better decisions about cost, consumption and performance (value tradeoffs).

Bill of IT Best Practices

- ▶ Deliver the bill to your consumers on a regular basis (monthly or quarterly)
- ▶ Provide essential details of cost and related consumption
 - Line items (services) with rates, consumption (volumes) and total costs
 - Other costs and basis for charges (e.g., % of employees)
 - Comparison of billed costs to prior periods
 - Comparison of billed costs to the consumers' budgets (if known)
 - Rate changes (if any) along with reason for changes
- ▶ Have a regular consult between you (e.g., your Business Relationship Managers, or BRMs) and the BU leaders about their bills
 - Explain charges and especially any changes from expectations
 - Share opportunities to alter consumption and costs (including time horizon for changes to be realized)
- ▶ Provide a clear mechanism for reporting errors or omissions
 - Establish a clear policy for handling errors/omissions (including those discovered by IT and by the BUs)
 - You may want to disallow credits for mistakes affecting prior periods unless those amounts are significant (material)

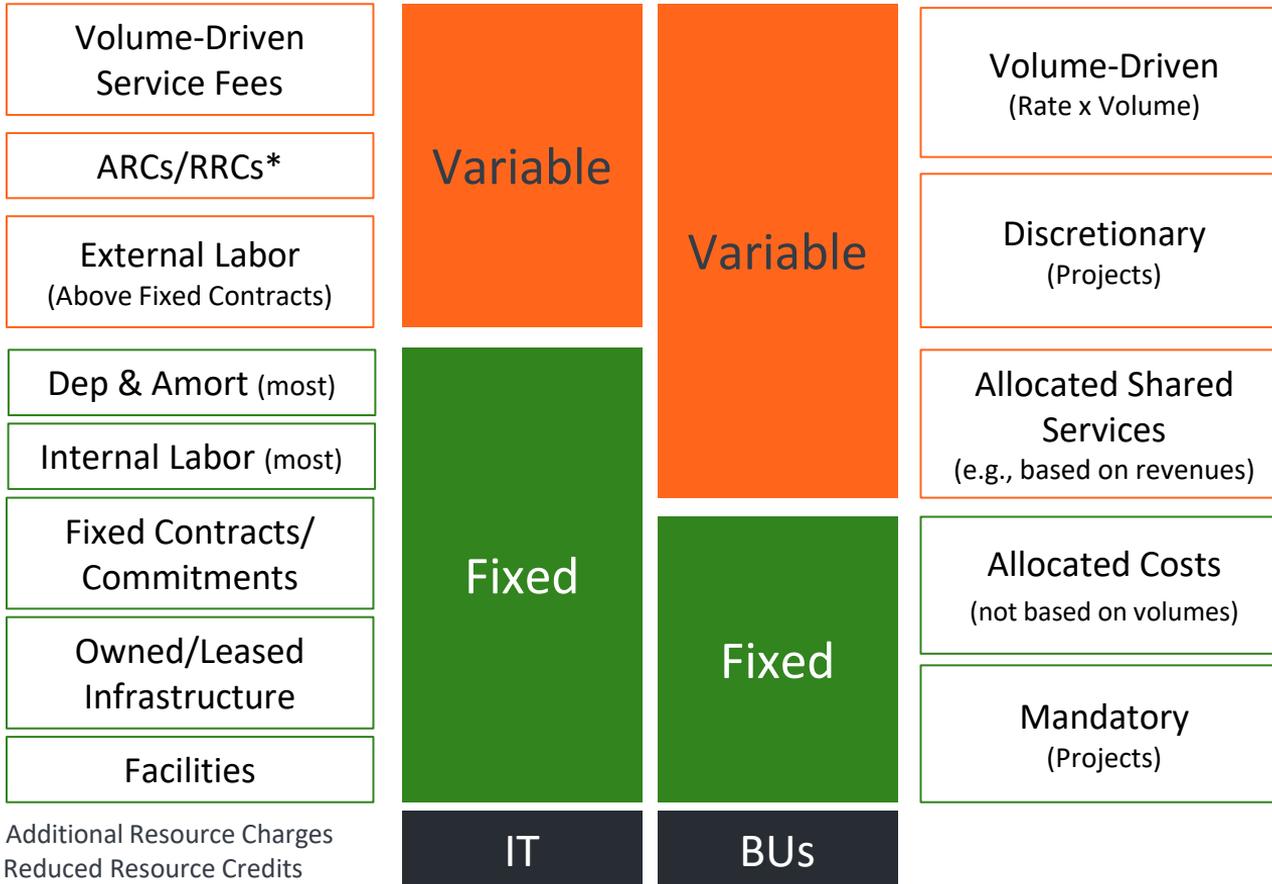
Cost Recovery for IT



IT financial managers need facts about who and what is driving over- or under-recovery of IT costs.

- ▶ If you recover costs based on anything other than actual costs, you have variances
- ▶ How do you know what's causing your variances?
 - Consumption?
 - Price changes?
 - Composition of your services?
 - All three?
- ▶ What do you do about variances?

Demand Levers vs. Cost Structure



IMPORTANT:

If BU variable ratio is different than IT variable ratio, then consumption changes will create a variance.

*ARCs: Additional Resource Charges
RRCs: Reduced Resource Credits

Managing Variances

Under-Recovery of Costs

- ▶ Rates (if used) were insufficient to fully recover the costs incurred in delivering solutions (a deficit)
- ▶ A true-up might be required by your CFO on a monthly, quarterly or annual basis
- ▶ Take care to track and communicate variance to avoid surprising business unit partners

Over-Recovery of Costs

- ▶ Rates (if used) were higher than needed, resulting in recovery of >100% of the costs incurred (a surplus)
- ▶ A refund might be required by your CFO
- ▶ Sometimes, surpluses can be used to fund other investments or to offset deficits elsewhere

Common Data Challenges

Application or Service Entitlements

- ▶ Lack of complete or reliable application or service inventory data
- ▶ Lack of complete or reliable inventories of your desktop and mobile devices
- ▶ Many potential sources of entitlement data, especially if identity governance solutions are not in place
- ▶ Entitlement data must be mapped to business units, which can be frustrated by inconsistent user account naming
- ▶ Sometimes difficult to identify active vs. inactive user accounts (which may dictate different levels of allocations)
- ▶ Contractors or other non-employee users may frustrate allocation process

Common Data Challenges

Infrastructure (non-Public Cloud)

- ▶ Many potential IT asset management systems:
 - Directories, monitoring and config management tools (including CMDBs)
 - Discovery tools (often used for security purposes)
 - Fixed assets systems (usually Finance owned)
 - Enterprise Asset Management tools
- ▶ Poorly maintained infrastructure asset data
 - Asset records not maintained for complete lifecycle
 - Assets recorded in groups and/or improperly classified
 - Asset ownership or accountability (who gets charged) not available
- ▶ Consumption or reservation data varies during each period
 - When do you sample your consumption of infrastructure for purposes of charging and billing?
 - How do you handle reservation data (i.e., terabytes of storage reserved for a specific application owner)?

Common Data Challenges

App Development and Support Data

- ▶ Many potential sources of labor:
 - Project (PPM) management systems and time tracking
 - Agile Lifecycle Management (ALM) or Enterprise Agile Planning (EAP) tools
 - Vendor and contractor invoices (do they track time on your system)
 - Service desk tickets for level 3 / level 4 support
 - Dedicated or semi-dedicated resources who don't track time
- ▶ Inconsistent naming of applications across systems
- ▶ Lack of reliable time details in tickets
- ▶ Outside labor that doesn't record time worked in your systems

Common Data Challenges

Cloud Costs

- ▶ Includes both direct and consumed/indirect costs:
 - Software-as-a-Service (SaaS) charges are mostly direct costs for apps
 - Infrastructure- and Platform-as-a-Service (IaaS/PaaS) are usually consumed and/or indirect costs
 - Treatment of IaaS and PaaS costs are discussed separately (see March 2021 Standards Open Forum presentation)
- ▶ Some infrastructure or platform services don't allow useful tagging
 - Containers and serverless computing, for example, can present unique challenges in linking consumption and cost to BU owners
- ▶ Some cloud vendors don't allow tagging of all products, especially SaaS applications (e.g., IVR from AWS)

Wrap-Up

Wrapping Up

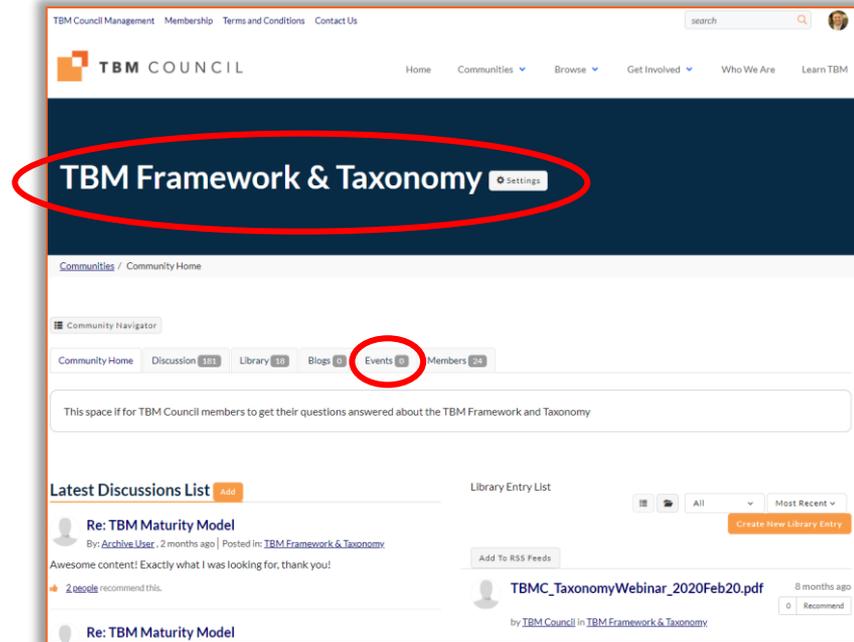
- ▶ Thanks for watching!
- ▶ Please submit questions or comments for this presentation online -- see: **TBM Framework & Taxonomy Community on TBMCouncil.org:**

<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 May 27.

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



Community Space for Taxonomy-Related Content
(see library)

Thank You!