Today, one of the most challenging parts of functionally mastering and executing a costing methodology is the allocation of shared services costs across the organization. There are a number of barriers to success, including an effective business case that can be articulated to stakeholders, a lack of transparency across centers, and up-front cost concerns. It is only through effective handling of shared services expenses that an organization can truly understand the efficiency and profitability of the inner workings of the business and be able to hold the appropriate stakeholders accountable.

Whether the goal is to facilitate analysis of organizational profitability, identify areas for increased efficiency, or ensure that business units/owners are properly held accountable for the resources they use, in today’s world, a process must be put into place to determine how shared expenses are spread across the company in support of these goals.

So what are the secrets of costing shared services? Simply put, they are the method of allocation, the software used to calculate the allocations, and the maturity continuum that can help you move forward in costing shared services more effectively.

This article aims to highlight some of the key concepts of building a costing solution and some of the challenges associated specifically with shared services cost allocations and to identify some best practices for tackling those challenges head-on to help get you on the road to optimization. Shared services are all about leveraging efficiencies in the organization on a global scale. These efficiencies will eventually lead to cost savings, ease-of-use improvements, and an optimized modeling approach. Finance, HR, IT, and marketing are all typical shared services cost centers that work in unison to streamline and standardize administration, automation, and infrastructure in an effort to present a single voice to customers.

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As IT solutions continue to improve their ability to provide massive amounts of data with the click of a button, financial analysts are constantly looking for ways for their businesses to improve performance, profitability, and efficiency. At the same time, it is equally (if not more) important to ensure that the methodologies applied are truly effective in producing accurate results.

Analyzing your core financials

When beginning to assess the performance and success of your business, the process often begins with analyzing the core financials of the organization. Ask yourself:

- How much revenue is being generated by each line of business (LOB), product, service offering, and/or customer?
- What are the direct costs to produce those products and/or service offerings and support those LOBs?

While this type of analysis is effective in providing a cursory overview of the organization, it is not possible to fully assess performance and profitability without proper accountability for shared services expenses. However, before diving deep into detail, you must consider two things: the maturity level of the current process and the end-state goals. Consider the following:

- Is there a methodology defined in the organization that is capable of yielding the right results now and is flexible enough to adapt as your company changes over time?
- What is the ultimate goal of improving the shared services model? For example, is the goal to produce a “management reporting” level of detail to facilitate analysis of profitability and efficiency? Or is the goal to garner enough detail about actuals to support the planning and forecasting processes? Or perhaps there is a different goal.

Methodology: Allocation of cost using a multi-stage model

With shared services defined, let us start to cover some of the core building blocks of a costing solution and how that foundation can be built upon to solve some of the challenges associated with allocating shared services costs.

One of the biggest challenges when defining a methodology for allocation of shared services cost is visualizing a way to take expenses from the general ledger (GL) and drive them to a more atomic level of detail across different metadata.
within the organization. This challenge is best portrayed using the example in Exhibit 1. The dimensionality and details of this example may or may not align with the specific needs of the organization, but the concepts that it highlights are relevant and critical in being able to design your own model.

Stage 1 represents the expenses that a cost model would receive from the GL, which is typically stored by an account and cost center. In this particular example, the end goal is to be able to identify what portion of those GL expenses should be charged to each LOB, product, and customer. It is not uncommon for the knee-jerk reaction to be, “Well, the hierarchies in my GL already tell me a lot of information about those expenses.” Although the way the account and cost center hierarchies have been structured in the GL may be able to tell you some additional information about those costs, rarely does it provide the level of detail necessary to truly be able to drive business decisions. Attempting to embed this sort of logic and mapping into your GL is rarely ever a viable option for two main reasons.

1. The expenses in a shared services cost center typically cannot be “mapped” directly to LOBs, products, and customers simply by adding additional levels into a hierarchy or adding new hierarchies, because those expenses should rightfully be split among them. If a bank’s corporate facility houses employees from both the mortgage and commercial banking LOBs, to which LOB would you map your facility’s cost centers?

2. Introducing many new layers into hierarchies could massively increase the amount of maintenance required. If your model aims to only support direct costs, it may be feasible to define how your accounts and cost centers could hierarchically roll up to LOBs, products, and customers. However, this would likely require introducing many new layers into the hierarchies. Not only would this convolute your ledger, but it could also massively increase the amount of maintenance required on a regular basis. Don’t turn your general ledger into a complicated one.

Exhibit 1 shows how we commonly see clients address these problems in their costing model at a high level. The first step in this process would be to allocate cost to LOBs. This allocation is typically accomplished through a combination of direct assignments (mapping a cost center directly to an LOB) and driver-based allocations (used for centers that split costs between LOBs). Once costs have been allocated from Stage 1 to Stage 2, you would be able to identify how much of your total expense should be charged to each LOB.

Stage 3 is the most important stage to understand as it ultimately portrays the bridge between the GL data and the desired results. In this example, we have leveraged the fundamentals of activity-based costing and introduced the activity dimension, which acts as the bridge. The idea is that this intermediary dimension allows you to allocate from cost centers and LOBs to the particular activities that those centers support (either via direct assignments or using drivers). This dimension can be configured at a high level or down to a very granular level of detail, depending on the complexity of the organization and how products and customers are supported.

When you begin thinking about some of the core activities of your organization, it should become clearer how you can map costs from a particular activity to one or more products and customers. Using the activity dimension in this example makes it a two-step process to allocate from the GL data to customers and products. This makes the allocation logic and drivers more straightforward and easier to maintain. Attempting to allocate directly from your GL dimensions to customers and products in one
WITHIN THE REALM OF SHARED SERVICES COSTS, IT IS COMMON FOR DIFFERENT COST CENTERS TO MUTUALLY SUPPORT EACH OTHER.

Within the realm of shared services costs, it is common for different cost centers to mutually support each other. As a result, those centers should be charging (or allocating) costs to each other appropriately. Let us take HR and IT as an example: The HR department helps provide benefits, among other services or activities, to the employees in the IT department. Meanwhile, the IT department supports HR by providing the technological infrastructure needed to carry out everyday business.

Building on this concept, let us imagine we had a similar model to Exhibit 1, but rather than allocating down to the customer and product level, we aimed to allocate expenses from the source cost centers (in Stage 1) to the other centers that those sources support. We would leverage the same concept of allocating from the source cost centers to the activities performed by that center, but then we could allocate from those activities to the other centers that should be charged for those activities. This analysis leads to more detailed questions about how exactly, and in what succession, those shared services cost centers allocate to each other. While the details of waterfall, reciprocal, and recursive costing methodologies are not the focus of this article, it should become apparent how you could leverage the outputs of a certain set of allocations and use them as inputs to an alternative set of allocations.

It is important to do the following:
1. Try to visualize the dimensionality of your costs and how they could potentially flow from source to target.
2. Think about the sets of driver data used to allocate costs between the dimensions.
3. Re-evaluate the short-term and long-term goals of the organization.
4. If the driver data that you deem to be the most accurate is not readily available, choose another driver to use temporarily to get your model up and running. The beauty of this type of model is that it is flexible enough to be able to change your driver selections at a later time without impacting the fundamental design. You are still allocating costs between activities and products/customers — you are just moving those costs in a different way.

Supporting the methodology with a robust IT solution

By now you should have a better understanding of some of the core ideologies of defining a cost model and how those methods can be applied to solve some of the challenges associated with shared services costs. Now let us briefly discuss...
how your methodology can be supported by an IT solution.

In a time when enterprise performance management (EPM) software for budgeting/planning and financial consolidation is becoming a standard for corporations looking to better analyze their financials and drive business decisions, the trend is also becoming increasingly prevalent in the area of costing and profitability. Commercial costing/profitability solutions have become so robust that they are capable of supporting all of the methodological concepts covered in this article, as well as allowing you to customize your solution to the specifics of your organization. For example, the Oracle Hyperion Profitability and Cost Management (HPCM) solution offers different model type templates, each of which are tailored toward different types of cost models. There is a customizable model type, much like we outlined in the earlier methodology section, geared toward (but not limited to) a typical multi-stage allocation model used for activity-based costing.

If your organization has a large amount of data and metadata that you want to allocate to/from, HPCM offers a more detailed model type focused on efficiently processing large data sets across many dimensions. Lastly, if your model applies the concepts of recursive or reciprocal allocations, or if you want to eliminate some of the confines of the tool and define allocations in a more flexible manner, HPCM also offers a more free-form model, which allows you to define many different types of allocations that can occur sequentially or in parallel. In short, there are not many cost-modeling concepts and designs that cannot be supported by modern-day costing software, so start thinking about how to leverage these IT offerings in your business today.

The ability to integrate an IT-enabled costing solution with your GL, data warehouse, planning solution, etc., and to automate the movement of data between these elements is one of the key benefits of building an IT cost model. The ability to execute automated interfaces to load your expenses and driver data into your cost model — and execute allocations with one click of a button — can be a tremendous time-saver for any organization. The “less time consolidating data, more time analyzing results” mantra is a return on investment that in itself is worth considering, not to mention that an IT solution eliminates room for mistakes and produces more accurate numbers.
### EXHIBIT 3 Maturity Level Impact on Methodology, Technology, and Culture

<table>
<thead>
<tr>
<th>Level</th>
<th>Methodology Impact</th>
<th>Technology Impact</th>
<th>Culture Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blind</td>
<td>• Methods are nonexistent.</td>
<td>• Rudimentary spreadsheet models are prevalent at this stage.</td>
<td>• Lines are blurred between various business units within shared services.</td>
</tr>
<tr>
<td></td>
<td>• No clear path from business unit management (e.g., no clear direction on how service centers develop and calculate unit costs for a help desk call within the IT shop).</td>
<td></td>
<td>• The shared centers are not firmly established.</td>
</tr>
<tr>
<td></td>
<td>• Rudi mentary spreadsheet models are prevalent at this stage.</td>
<td></td>
<td>• Communication lines are still being developed, and management is disjointed.</td>
</tr>
<tr>
<td>Siloed</td>
<td>• There exist firm and focused methods for each organization.</td>
<td>• Database or other technology are used to define, track, and report on service level agreements between organizations.</td>
<td>• This level is mature in nature.</td>
</tr>
<tr>
<td></td>
<td>• However, Human Resources and IT might view similar services differently.</td>
<td>• The systems are not consistent and remain disparate between each siloed center.</td>
<td>• This level is Risk-averse.</td>
</tr>
<tr>
<td></td>
<td>• Processes exist and are followed diligently, but they remain nonstandard.</td>
<td>• This technology solution prevents organizations from aggregating and reporting on a holistic level.</td>
<td>• Service centers remain independent from both a delivery and management perspective.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• The economies of scale do allow organizations to gain cost savings by centralizing each center.</td>
</tr>
<tr>
<td>Integrated</td>
<td>• Methods and tool sets are harmonized amongst the centers.</td>
<td>• Utilizes costing/profitability technology, such as HPCM, which focuses on business user transparency.</td>
<td>• Service level agreements are firmly entrenched between shared centers and all receiving centers.</td>
</tr>
<tr>
<td></td>
<td>• For example, if HR is using recursive or reciprocal costing to develop unit costs, IT and Operations will follow suit and provide a consistent approach that is understood and transparent.</td>
<td></td>
<td>• Clear and concise communication exists between all parties.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Globally Optimized</td>
<td>• At this point of maturity, organizations are using the harnessed data to move from a reactionary mindset to a predictive mindset.</td>
<td>• Technology is similar to the Integrated maturity.</td>
<td>• Culturally, we can now integrate the costing solution with the planning/forecasting process.</td>
</tr>
<tr>
<td></td>
<td>• Methods like driver-based planning to foresee high and low level service ranges provide value in staffing and other key management decisions.</td>
<td>• Technology is deployed to the Global team.</td>
<td>• Expanded user base brings budget and forecast individuals into the fold.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Technology has the ability to support the forward-looking methods described above.</td>
<td>• With expansion comes education and training to ensure all users are working toward a singular goal.</td>
</tr>
</tbody>
</table>
So now you may be asking, “How do I take my organization from the point I’m at now to a place and time where I have a fully functioning cost model supported by enterprise software?” Let us get into what we call the maturity continuum and address where you fit in that continuum.

The maturity continuum
Methodologies thrive in theory, not execution. Methods are evoked in a flavor-of-the-month approach, but in order to truly benefit from shared services execution you must understand how mature your organization currently is and how quickly you can accelerate the learning and adoption curve. Remember that question you asked yourself a couple of minutes ago? “Is there truly a defined methodology that is capable of yielding the right results now but is also flexible enough to adapt over time?” Let us think about that.

• Do I have a shared services model deployed today?
• If so, is the methodology applied uniformly throughout the organization?
• Do my methods fit the needs of all stakeholders?
• Are my methods quantifiable, usable, maintainable, and flexible to change?

In order to ace this test, it will be helpful to consider your baseline — where do you fit within the shared services maturity continuum? While implementing projects, some clients attempt to go from zero to 60 too quickly, and these projects fail the majority of the time. Taking baby steps is the cliché, but it is the most effective pace for success.

Exhibit 2 lays out a basic continuum for shared services model maturity that will help you find that pace. As with any maturity model, it can be used as a self-awareness tool to help you determine where you reside in the spectrum today and where you want to be in the future. Your organization should be self-aware and not reach for the highest level if it does not satisfy a specific need from a stakeholder. Stakeholders can take on many forms, including executives, business line managers who receive shared services costs, as well as internal and external reporting customers.

As you move up the continuum, notice two primary goals: (1) increased visibility and (2) increased ability to defend. If your shared services methods contain “black box” components (you can’t see how they were calculated), which lack transparency, they are not likely to be trusted by the receiving organization.

There are four basic levels to the continuum: blind, siloed, integrated, and global optimization. Exhibit 3 outlines how each level of the continuum impacts the method and technology used and the culture of the company. So at what level are you?

Conclusion
Regardless of whether or not you already have a methodology defined and an IT solution supporting the process, there is always room to improve. While reading this article, you may have muttered to yourself, “I get the challenges and the concepts that allow me to overcome my issues, but what are the next steps for me to truly improve my process?” There are many specific factors that influence what the appropriate next steps should be in order to achieve shared services nirvana, but identifying the current maturity level of your shared services model is critical to get you started. If you can identify where your company stands methodologically, technologically, and culturally, and you continue to think back to the questions you asked yourself at the beginning of this article, the direction in which you should move to get on the road toward having a globally optimized shared services solution will become clear.

So now you know the secrets of costing shared services: allocation method, software, and the maturity continuum. Will you keep these secrets and use them to your competitive advantage?