

Briefing Note 2

counting costs

Creating a Cost Conscious Culture



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STATEMENT OF PURPOSE

This briefing is written for the organisation’s leadership, the Board and Cabinet members. With budgets under strain organisations will prioritise making cost control and efficiency part of the mindset of the way they do business. The briefing supplements CIPFA’s *Counting Costs: Understanding and Using Costing Information to Make Better Decisions*. It draws on Audit Commission research and examines elements of a culture that prioritises the better use of costing information in decision taking. Further copies can be downloaded from the CIPFA Financial Management Panel’s webpages and the CIPFA shop.

1 INTRODUCTION

As part of their contribution to reducing the national budget deficit, public sector organisations at all levels have set challenging budgets and financial plans. Having a cost conscious culture will be fundamental to staying on track.

Characteristics of a cost-conscious culture

Audit Commission research and that of others suggests that the public and private sector organisations that excel at cost management have common characteristics. They:

- **Demonstrate visible leadership:** top managers lead by example. This means that they think frequently about cost and talk about cost; it crops up, in formal and informal conversations around the organisation, as well as in management meetings and service reviews (Ref.¹).
- **Build good working relationships:** senior operational managers and finance professionals each recognise the contribution the expertise of each makes to decision-taking processes. Finance staff work closely with other senior managers, to produce timely and accurate cost management information to support evidence-based decision taking (Ref.²).
- **Know their baseline:** organisations have established cost and performance baseline, against which managers can check their progress in driving down costs and driving up productivity.
- **Develop ownership and expert knowledge:** organisations create cost category owners or ‘cost champions’ who build detailed knowledge of categories of cost and have the responsibility, and the authority, to promote value for money vertically within services and horizontally against their ‘cost category’, across service lines or departments.
- **Use comparative data:** senior managers use key performance indicators to benchmark costs internally (and externally wherever possible) and to work out how to get costs down to the target level.
- **Have the right tools in place:** to manage cost information efficiently and effectively and the capacity to use them for information, management and reporting. Having the right tools can be as simple as ensuring that all managers are trained to use simple

1. Accenture (2009) *Unpublished research report for the Audit Commission*

2. Chartered Institute of Management Accountants (2007) *Improving Decision-making in Organisations*

spreadsheets competently, or perhaps providing specialist software and training where this is appropriate.

What gets in the way of effective cost management?

Barriers to understanding costs and managing them effectively include:

- prevailing organisational cultures that do not prioritise cost management
- a lack of clarity on the respective roles and responsibilities of the finance and service departments, and a view that managing costs is difficult
- failure to integrate finance and performance data and to share it across departmental boundaries
- a lack of skills and competencies in the leadership team, managers and finance professionals
- inflexible IT systems which make it difficult to bring together cost information in ways that support decision taking (for example, systems configured solely round traditional hierarchical structures), and
- a lack of ambition for transformational improvement in performance.

‘High performing’ organisations in both the private and the public sector are those that overcome these barriers and manage their costs effectively (Ref.³). Strongly performing private sector firms routinely study their costs because this affects their profit. For public sector managers too, whether they work in front-line services or the back office, understanding and managing down cost is essential to ensure that tight budgets can be met and that every public pound is spent wisely.

Initial responsibility for creating a cost conscious culture lies with top managers in all public organisations; the second section of this guide suggests some steps they can take.

2 CREATING A COST CONSCIOUS CULTURE

There are four main steps to building a cost conscious culture:

- communicating the importance of costs
- making sure roles and responsibilities are clear to all
- creating the environment for dialogue between finance and business managers
- ensuring decisions are based on sound costing information.

Getting started: communicating the message that understanding cost matters

Organisations with a cost conscious culture have communicated successfully the CEO’s message that managing down costs is every manager’s responsibility. There are four important elements in communicating this message:

- the consistency of the message
- using every opportunity to get the message across

3. Accenture (2009) *unpublished research report for the Audit Commission*

- creating supportive organisational systems, and
- sharing good examples of how understanding cost has brought benefits.

When these elements are in place, managers are more likely to understand that cost is one of their most important priorities and that their annual appraisal will include an evaluation of their performance in this area. **The key lever for organisational transformation is the middle manager level** (Ref.⁴). **Staff at this level must understand the importance of understanding costs.**

Being clear about roles and responsibilities in managing cost

There are several reasons for the common opinion among non-financial managers that managing cost is difficult. Some managers lack confidence and are wary of involvement in what they see as a specialist area. Some managers believe costing is solely the province of the finance department and not something for them (Ref.⁵).

Misapprehensions and lack of confidence can be addressed by clarifying roles and responsibilities. Managers' financial responsibility extends beyond checking the monthly printout from the general ledger against the spending profile. Increasingly they have personal responsibility for actively managing their costs. Unless they understand their cost drivers they will be unable to plan services or make savings.

Finance professionals' roles often involve a combination of challenge and support to operational managers. The precise divisions of responsibilities vary in different organisations; they need to be clearly understood by both parties. Managers need to be clear about their own financial responsibilities and on what the finance department can do to support them, for example by carrying out cost analysis, trend analysis and cost scenario modelling for service planning.

There are other models. Some businesses have appointed cost champions; senior managers whose task is to understand the drivers of cost in one category each (IT, say, or premises), set company-wide targets for cost reduction and implement those reductions by negotiating targets with departmental budget holders. They check progress in reducing spending across the company and lead by example in driving down costs.

Getting service and finance departments working well together

Finance departments and service departments can work together to support decision takers with relevant, high-quality cost information. These relationships are effective when characterised by openness and mutual respect for each other's professional expertise. Where that is not in place managers may need to promote better mutual understanding. Service managers need to understand how a finance department works and what services it can provide. Equally, finance professionals need to understand the service departments' needs for financial information and analysis.

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4. RSe Consulting and West Midlands Regional Centre of Excellence (2007) *Transformation, Improvement and Efficiency: What are the Skills Required to Deliver Transformation in Local Government?*
 5. Audit Commission (2004) *Improvement through Better Financial Management*
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Many senior managers are unable to specify what analysis they would like the accountants to do, simply because they do not know what analysis can do for them. Managers need to be able to explain to the accountants what cost information they need to help them weigh up the issues and arrive at a well-founded decision. The finance professionals can then identify what analysis will yield the information the managers want.

Managers need to make effective use of the professional analyst resources to provide cost information for decisions. The amount of work required to produce the cost information will need to be balanced against its importance for their decisions. There will be a trade-off between accuracy and speed of production for an urgent decision. There will be some limitations on what it is possible to do, depending on the availability of time, cost and data. There will be a point at which additional analysis will fail to improve decision taking sufficiently to justify the incremental effort to improve costing, and the cost of so doing (Ref.⁶). All these issues need to be discussed between managers and finance professionals.

Basing decisions on sound costing information

Most of the information needed for operational decisions will either exist within an organisation's financial or other management information systems (see *Making Costing Count* for further analysis of this). Where it does not exist in the form required, analysts may need to conduct analyses or develop models to generate it; for example costing models that help managers understand their costs, what drives those costs and how they behave.

3 CONCLUSION

Changing an organisation's culture such that cost considerations automatically feature in everyone's actions across the organisation is an urgent priority for councils needing to reduce costs. The actions described in this paper are not complicated, but are not easy either. Appendix A summarises the broad themes top managers will need to address. Appendix B provides one example of a short-term programme designed to have an immediate impact on an organisation's costs and change its culture at the same time.

6. International Federation of Accountants (2009) *Evaluating and Improving Costing in Organisations*

APPENDIX A

KEY STEPS

Communication

1. Get the message out that costs matter
2. Create a communications process on costs
3. Use it to share good practice and success

Make sure roles and responsibilities are clear to all

4. Clarify each manager's responsibility to manage costs

Create the environment for dialogue between finance and business managers

5. Encourage each manager to challenge finance to provide the information they want
6. Get finance professionals involved in the business area
7. Jointly find out what information is there
8. Identify knowledge gaps that will give new insights
9. Develop an understanding of cost behaviours and drivers

Ensure decisions are based on sound costing information

10. Know your baseline and benchmarks
11. Set cost targets
12. Know your early warning indicators and limits
13. Ensure all decision reports are based on sound costing information signed off by finance

APPENDIX B

SETTING UP A STRATEGIC APPROACH TO COST MANAGEMENT: A POSSIBLE ROAD MAP

Generate insight including quick win opportunities			Generate insight into efficient use of resources and sustainable savings	
1–2 weeks	4–8 weeks	2–8 weeks	Open ended – depends on budget cycle	
1. Mobilise and Plan	2. Gain Costs Visibility	3. Gain Costs Understanding	4. Negotiate Budgets and KPIs	5. Monitor
<ul style="list-style-type: none"> ■ Agree scope 	<ul style="list-style-type: none"> ■ Explore accounts 	<ul style="list-style-type: none"> ■ Review current analyses and undertake additional analysis with appropriate methods to gain further insight 	<ul style="list-style-type: none"> ■ Recalculate budget based on new baseline and costs targets 	<ul style="list-style-type: none"> ■ Monitor cost targets alongside KPIs
<ul style="list-style-type: none"> ■ Establish Project Team and/or Steering Group 	<ul style="list-style-type: none"> ■ Identify data gaps and inconsistencies 	<ul style="list-style-type: none"> ■ Benchmark appropriate cost levels to set new budget baseline 	<ul style="list-style-type: none"> ■ Consider phased introduction of zero-based budget 	<ul style="list-style-type: none"> ■ Track variance between budget baseline and actuals
<ul style="list-style-type: none"> ■ Obtain leadership and management buy-in 	<ul style="list-style-type: none"> ■ Identify ‘cost categories’ that reflect specific areas of spend 	<ul style="list-style-type: none"> ■ Set top-down cost category targets 	<ul style="list-style-type: none"> ■ Analyse drivers of cost to identify more detailed savings 	<ul style="list-style-type: none"> ■ Monitor trends in drivers of cost
<ul style="list-style-type: none"> ■ Analyse current approach to costs management 	<ul style="list-style-type: none"> ■ Map service/ department costs against cost categories –‘define who spends how much and on what’ 	<ul style="list-style-type: none"> ■ Agree responsibility and policies to support cost targets 	<ul style="list-style-type: none"> ■ Identify early warning indicators and limits 	<ul style="list-style-type: none"> ■ Use early warning indicators to trigger early action to address areas of over- or under-spend
<p>Communicate – start early – report successes widely – provide clarity on each step to employees and stakeholders</p>				
<p>Keep it simple – analysis for each step of the process can be done using simple spreadsheet tools such as Excel</p>				
<p>Assess skills – pinpoint skills gaps for both financial and non-financial staff, eg finance staff understanding of services</p>				

Source: Accenture



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