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How to Produce an Effective Bill of IT Using Showback or Chargeback



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Who this eBook is for...

This eBook is for IT Finance practitioners, leaders, and CIOs interested in learning about showback and chargeback from the ground up. Whether you have experience using a showback or chargeback – or if you're starting from scratch – this eBook serves as a comprehensive reference of best practices, implementation options, and keys to success.

After reading this eBook, you should understand:

- The definition and purpose of an IT showback or chargeback
- The distinct differences between showback and chargeback
- The key business outcomes a successful showback or chargeback enables
- The steps and requirements to implement a new showback or chargeback
- How to choose the execution strategy to calculate your bill of IT
- Six keys to long-term showback or chargeback success

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Introduction



As organizations increasingly rely on technology to drive growth and transformation, it's critical that IT and business leaders work together to maximize the value of tech spend and ensure it stays closely aligned with enterprise objectives.

But in the absence of clearly defined allocation and consumption metrics, business leaders often can't understand IT costs or value – causing needless frustration, doubt, misguided consumption, and wasted resources.

A showback or chargeback model remedies this problem by joining the threads of IT spend, customer consumption, and business capabilities – enabling a more intelligent conversation around how technology resources are distributed and the value they provide.

That said, let's take a deeper look at the anatomy of a showback or chargeback, how they both work, and what makes them different.



The Tactical Difference Between Showback and Chargeback

Showbacks and chargebacks are more alike than they are different. From a mathematics and content perspective, they share the exact same structure.

The only tactical difference between showback and chargeback is what each delivers to consumers in the bill of IT – either a report “showing back” costs and consumption, or the same information delivered as an invoice for payment.

- In a showback model, there are no bills or invoices paid by consumers. IT reports out costs and usage, while also maintaining ownership of budget funds – meaning no cost recovery is needed and no money ever changes hands within the organization. Since IT is a cost center, costs still must be allocated to business units, but these allocations are often disconnected from a showback.
- In a chargeback model, departments or agencies own and manage their own budget funds. IT buys the resources to deliver services, but each consumer department must then submit internal payment back to IT based on usage. This payment can take the form of actual cash changing hands (common in the case of public entities) or in the form of a journal entry charging the consuming department. Then, there may be a true-up to manage the over/under between the amount of expense truly incurred and the amount charged to consumers. In other words, a chargeback is essentially a showback with more teeth.





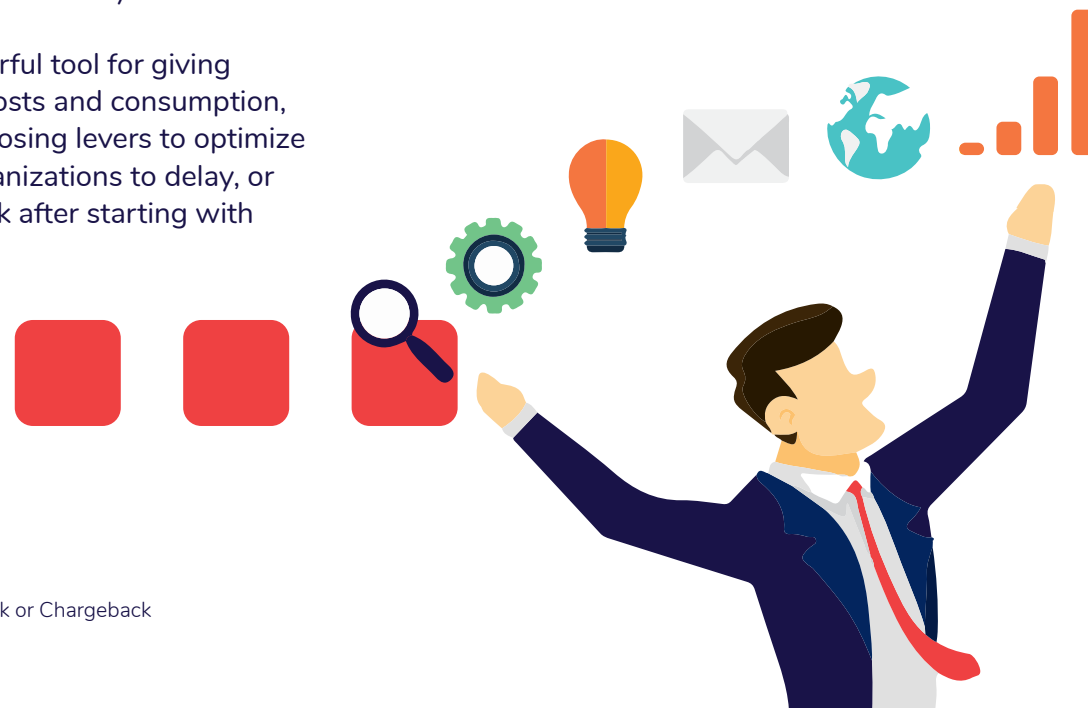
The Strategic Difference Between Showback and Chargeback

Despite the similarity between showback and chargeback on a tactical level, each is quite different in terms of capabilities. From a strategic perspective, the key differentiator is the degree to which each enables accountability and the ability to guide usage behavior.

Since a showback doesn't invoice consumers and collect payment, it lacks an enforcement mechanism to encourage consumers to pay attention and be proactive. Unless consumers are exceptionally thoughtful and conscientious – even when there's no financial incentive – a chargeback is likely the only way to stimulate positive change.

As a result, most organizations use showback as a stepping-stone to chargeback. And it's a smart approach: testing the bill of IT as a showback to work out any kinks, giving consumers time to raise questions and get familiar with the process, and then moving to a chargeback once everything is running smoothly.

Keep in mind, showback is still a powerful tool for giving business leaders better visibility into costs and consumption, demonstrating the value of IT, and exposing levers to optimize spend. And it's not uncommon for organizations to delay, or entirely forego, moving to a chargeback after starting with showback and finding it sufficient.





Showback vs. Chargeback: Pros and Cons

Now that you know the differences between showback and chargeback, and what each model can help accomplish, here's a simple list of pros and cons to recap what we've discussed – and to note a few other important points to consider:

SHOWBACK PROS:

- ✓ Exposes levers for consumers to impact costs and optimize usage
- ✓ Establishes a firm connection between IT spend and business capabilities (demonstrates value)
- ✓ Enables fair cost comparisons against outside suppliers
- ✓ Implements more rapidly than chargeback
- ✓ Requires no changes to existing financial systems
- ✓ Carries a lower consequence of error
- ✓ Offers the chance to refine cost distributions and allocations (especially useful if planning to move toward a chargeback)

CHARGEBACK PROS:

- ✓ Captures all the benefits of a showback-only model
- ✓ Promotes total accountability by financially incentivizing consumers
- ✓ Helps guide adoption or discontinuation of services through strategic pricing
- ✓ Allows IT to collect payment and recover costs across multiple departments or agencies

SHOWBACK CONS:

- ✗ Gives the visibility to spot problematic spend, but no mechanism to enforce accountability and fix it
- ✗ Offers no functionality to collect payment and recover costs
- ✗ Requires more education and socialization to solicit action from consumers

CHARGEBACK CONS:

- ✗ Brings higher risk of conflict regarding equitability of cost distribution and allocations
- ✗ Requires a monthly or yearly true-up that may need to be accounted for using a fixed rate methodology
- ✗ Carries a higher consequence of error
- ✗ Requires all the same setup work as a showback, plus new process creation and integration with existing financial systems
- ✗ Presents a higher risk of failure and abandonment without thorough preparation prior to launch and strong support from leadership

Just to reiterate, a chargeback is simply a showback plus invoicing. That means a chargeback can drive all the same outcomes as a showback, but it adds the ability to enforce accountability with real invoices and guide usage behavior through strategic pricing.



Navigating Initial Requirements: Service Catalog & Cost Model

Every facet of the showback or chargeback process is driven by an effective service catalog and cost model – setting and monitoring rates, processing actuals to calculate over/under, and the list goes on.

Consequently, the success of every new showback or chargeback comes down to the accuracy and defensibility of its cost model.

But for the purposes of this eBook, we'll cover the process of building out the service catalog and cost model from a high level only – keeping our focus on the work that comes after the cost model is complete.

However, you can learn more about service catalog and cost model best practices by downloading our eBook dedicated to the topic: “A Practitioner’s Guide to Cost Modeling.”

For now, here’s an abbreviated explanation of the process.

Define and Catalog IT Services

Before building out the cost model itself, assemble a catalog of each IT service to be included in the showback or chargeback. This could take some time, depending on your starting point, but don’t be too intimidated. It’s perfectly fine to use a handful of core services to get started, then continue to build out the catalog over time.

Analyze Cost Components for Each IT Service

After deciding what to include in the catalog, it’s time to look at each service and compile all the different cost components required to deliver it. Diligence and thoroughness are key here; failing to account for all the cost components behind each service will impact the accuracy and reliability of the model.

Determine Usage Metrics to Track Consumption

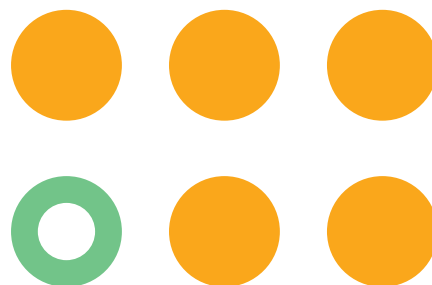
Once all direct and indirect cost components are identified for each service, it's time to determine the metrics to track usage and bill consumers. Keep in mind, these tracking metrics can vary significantly depending on the nature of the service in question and knowing where to find them isn't always easy. To ensure maximum accuracy, the best course of action is to seek guidance from the specific cost center managers and resource owners responsible for the cost components of each service.

Gather Necessary Data

Once the service catalog is defined – along with cost components and usage metrics for each service – the crucial next step is getting the right data.

There are really two sub-steps to this:

- 1) Finding the right data sources** – the data needed is likely spread across several areas of the organization. Coordinate with data source owners to ensure availability, as well as quality and completeness. A word of warning: data source owners aren't always forthcoming when it comes to giving their numbers to an outsider (especially from Finance). Don't be discouraged though. Stay friendly; explain their importance to the process; and reassure them that they won't necessarily be judged by what the data ultimately reveals.
- 2) Building solid business processes to pull the data at regular intervals** – every time the model runs, it needs to be fed fresh data. Establish processes to pull that data at regular intervals. In the beginning, it's best to simply do this manually, delaying automation until there is confidence in both the calculations the data is being used for and the process being used to pull the data itself.





Using an Established Cost Model to Deliver a Showback or Chargeback

Once the service catalog and cost model are complete, it's time to start using the newly established consumption metrics and fully burdened rates to produce a monthly bill of IT.

Here's a brief overview of the five steps required to start leveraging the cost model to drive a transparent showback or chargeback process.

→ STEP 1

Select an Execution Strategy (How the Bill of IT Will Be Calculated)

To process actuals and allocate them across consumers, first create business processes to govern how the bill of IT is calculated and reconciled each month. There are three common strategies to accomplish this – Percentage of Use, Fixed Rate with Under/Over, and Fixed Rate without Under/Over – and we'll break those down in the next chapter.

→ STEP 2

Test & Evaluate as a Showback (Even if Working Toward Chargeback)

After selecting the execution strategy, it's time to test the model by running it through several iterations as a showback. Even if chargeback is the ultimate long-term goal, starting with a showback offers a safe way to catch any major problems before the model starts producing real invoices, while giving the business time to gain confidence in the process. Depending on the validity of starting data, and the soundness of service definitions and cost model, most major challenges are overcome within 4-6 months.

→ STEP 3

Socialize, Defend, & Educate

As you launch the model and start dialing it in, continually socialize it throughout the organization, defending its outputs and educating consumers on how it works. Frankly, this is less of a step and more of a rule for the entire lifecycle; even months or years down the road after the model is more mature, customers must remain familiar and comfortable with its outputs.

→ STEP 4

Merge with Accounting Stream (for Chargeback)

After sufficient testing and socialization, the process of transitioning to a chargeback can begin. The specifics of what this entails can vary greatly between organizations, depending on existing financial tools and systems. But assuming the model is thoroughly validated and adopted, this step should be relatively painless.

→ STEP 5

Iterate & Improve to Refine the Model

Now, we can focus on iterating and improving the model over time. There are many ways to do that – and we'll discuss them in detail in Section 8 of this eBook – but the three keys to long-term success are:

- 1) Close contact with consumers and business leaders.
- 2) Stay focused on value and actionability of insight.
- 3) Educate customers and socialize the model.



Calculating the Bill of IT: A Closer Look at Execution Strategies

Now that we've discussed a high-level view of the process to launch a new showback or chargeback, let's revisit the critical step of selecting an execution strategy.

The execution strategy governs two key processes:

- 1) How actuals flow through the cost model and out to the bill of IT
- 2) How monthly variance is managed and allocated across consumers

Although there's room for customization, most execution strategies fall into three major categories:

- 1) Percentage of Use
- 2) Fixed Rate – Option A (with Under/Over)
- 3) Fixed Rate – Option B (without Under/Over)

***Note:** If your organization is not pursuing a chargeback in the foreseeable future – or if there's no need for the bill of IT to tie back to the GL on a regular basis – then the inclusion of over/under or true-up processes is optional.

Let's dive into each strategy to understand its mechanics, key benefits, and potential drawbacks.

PERCENTAGE OF USE

The first, most basic way to structure the bill of IT is by allocating to consumers based on their individual responsibility for total service costs. The two main advantages of this strategy are its simplicity and the fact that it results in 100% of incurred costs being allocated monthly.

It works like this:

- 1) Run monthly actuals through the cost model to find:
 - Current effective rates.
 - Total cost of each service.
- 2) Calculate each consumer's usage as a percentage of the total service cost.
- 3) Charge or report on that percentage and show the full breakdown in each consumer's bill of IT.





For example, let's say there's one service with three consumers in a given month. Using cost model actuals and consumption data, we find the first consumer holds responsibility for 25% of the monthly total, the second 15%, and the third 60%.

In the bill of IT, each consumer will see actual consumption, the total cost for the service in question, and the percentage of that total tied to usage (what would be billed in a chargeback scenario).

Key Benefits

- **Low complexity** – compared to other strategies, Percentage of Use has the fewest components, which means less confusion and opportunity for error.
- **Ease of implementation and maintainability** – again, due to its simplicity, this strategy requires the least effort to launch and maintain.
- **100% monthly allocation without over/under** – for organizations who must allocate and/or recover the entirety of IT service costs each month – tying billing reports to the GL without needing a true-up or monthly over/under recovery – Percentage of Use is the most straightforward strategy to achieve that goal.

Potential Drawbacks

- **Not predictable** – considerable fluctuations can occur in response to changes in demand or one-time expenses and credits.
- **Raises questions of fairness** – depending on fixed vs. variable cost components for a given service, when consumers stop or dramatically reduce usage, it can cause other consumers' bills to spike – regardless of their usage staying the same.

FIXED RATE – OPTION A (WITH UNDER/OVER)

For organizations wishing to bill on actual consumption more accurately than Percentage of Use will allow, while still allocating 100% of service costs monthly, a Fixed Rate with Under/Over strategy is the ideal choice.

Here's a step-by-step summary of the process:

- 1) Create fixed annual rates by running the full year budget through the cost model.
- 2) Run actuals through the cost model monthly to obtain true cost of service for the month.
- 3) Determine each consumer's service cost obligation using monthly usage data and fixed annual rates.
- 4) Calculate the under/over recovery amount (Actual monthly cost of service – (Fixed Annual Rate * Actual Service Consumption))
- 5) Populate the bill of IT and include a separate line item charge or credit for the under/over (This can be spread across consumers using a basic percentage, usage by service, or any other agreed upon metric).



Key Benefits

- **Offers the fairest way to achieve full monthly cost recovery** – out of all three strategies outlined in this eBook, only the first two result in 100% of costs being allocated out each month. Between those two, Fixed Rate with Under/Over bills on actual usage to minimize the impact of expense seasonality, making it the fairest choice if 100% monthly allocation is required.
- **Ensures the bill of IT matches actual expenditures** – by managing variance between plan and actuals each month, this strategy produces a bill of IT that always ties back to the GL.

Potential Drawbacks

- Still lacks consistency – although this strategy produces a somewhat steadier cost of service than Percentage of Use, it's still inherently unpredictable due to the variance between annual and effective rates charged monthly (the under/over).
- Requires more effort to launch and maintain – out of all three strategies, this one tends to require the most time and effort. It also has more moving parts, which can make integration with existing systems difficult.
- Potential conflict on under/over allocation – collaboration across the business is required to establish a reasonable method for allocating the monthly over/under across consumers, but reaching a final agreement can be challenging.

FIXED RATE – OPTION B (WITHOUT UNDER/OVER)

In situations where 100% of costs don't need to be allocated to consumers monthly – maybe because the bill of IT is being delivered as a showback only, or in an attempt to reduce the administrative burden of a chargeback – organizations often utilize the same core Fixed Rate strategy but without an under/over charge in the bill of IT.

Instead of using a monthly under/over like Option A, Option B monitors monthly effective rates, adjusts them when needed, and uses periodical true-ups to reconcile back to the GL.

In other words, Option A and Option B are essentially two sides of the same methodological coin for Fixed Rate. The only difference is how each option manages variance between plan and actuals.

Neither option is right or wrong, but there are some important trade-offs between the two. Keeping in mind what we've already discussed about Option A, let's investigate the benefits and drawbacks of Option B.

Key Benefits

- **Provides the most consistent and predictable bills** – by excluding the over/under and keeping costs tied directly to monthly usage, consumers can more easily anticipate charges.
- **Prevents confusion and dispute** – consumers pay for only what they use, nothing more and nothing less, which encourages prompt and complete payment.

Potential Drawbacks

- **Produces a bill of IT that doesn't match actual expenditures** – since variances between plan and actuals aren't addressed monthly, the bill of IT won't reflect true costs by tying back to the GL.
- **Needs periodic monitoring and possible rate adjustments** – chargeback models operating without a monthly over/under will require users to monitor rates on a monthly or quarterly basis. If the fixed rate is materially off from the actual rate, your organization may need to introduce some mid-year rate adjustments. However, this is a non-issue for showback models; since no money is changing hands, a true-up would just be an accounting entry.





Words of Wisdom: 6 Keys to Success Now and in the Future

Now that we've covered the mechanics of launching a showback or chargeback, let's talk about a few high-level strategic points to keep in mind throughout the process.

Key #1: Assemble an Advisory Board at the Beginning

It's important to stay in close contact with every stakeholder group who interacts with your showback or chargeback – to ensure value is being realized, document feedback for potential enhancements, and identify problems in need of immediate attention.

That said, the best way to ensure clear communication across the business is to establish a showback/chargeback advisory board on day 1, before work to build and launch the model even begins.

The board should meet regularly and include, at a minimum, constituents from each of the following core groups:

- Business unit consumers
- Service and app owners
- Cost center managers
- Change management staff

Key #2: Don't Wait for Perfect Data

Organizations frequently cite problems with data quality, completeness, and availability as the main hurdle to launching a new showback or chargeback. However, these fears are often unfounded.

Very few organizations start with perfect data. Most start with “good enough” and improve over time. Only after sufficient testing, iterating, and refining does the data get better.

In truth, the pursuit of perfect data is a catch 22: organizations delay new projects like showback or chargeback due to data concerns, but the only way to improve bad data is by taking the plunge and creating the impetus to fix it. You don't know what you're missing until you start looking for it; and there's less incentive to get things right when dollars aren't at stake.



So don't wait for perfect data to take the first step.

There's almost always enough good data to get started. And simply getting started is what matters most.

Key #3: Avoid Runaway Complexity

It's always a challenge to balance simplicity and complexity in the service catalog and cost model. There's continual pressure to create new, more granular service definitions to match consumer demand. But with each new definition, the service catalog and cost model become more burdensome to maintain.

Furthermore, stakeholders often don't realize that maximizing technical accuracy isn't always the best choice from a financial perspective, e.g. adding a new service might not result in a material cost difference for the business or IT.

Here are three simple tips to manage the conversation and prevent complexity from spiraling out of control:

- **Break out new services using a phased approach.** Once a service is defined and in-use, discontinuing it can be a battle. In other words, it's far easier to add specificity than it is to subtract complexity, so always err on the side of simplicity and only break out new services as needed.
- **Understand stakeholder motivations.** Business units want detail to track consumption, finance wants granularity for billing, and internal IT stakeholders want technical accuracy. Be ready to defend the balance of simplicity vs. complexity with all this in mind – showing stakeholders how the desire for more granularity doesn't always trump the practical utility of existing definitions.
- **Establish materiality thresholds.** Work with stakeholders to agree on what warrants a "material" cost difference for changes to the service catalog. Afterward, every request should be judged against that threshold.

Key #4: Map the Bill of IT to Business Capabilities

After the model is dialed in to produce reliable, accurate results on a monthly basis, the next step in maturity is to start mapping costed services to business capabilities. In other words, the goal is to add another dimension to analyze costs and align them with value.

So, instead of consumers only seeing how much they spent on each service or app, they'll also see the tangible business functions that spend enables.

Granted, this might sound like a complex task, but all it requires is time and collaboration.

Here are three high-level steps to categorize services and applications into business capabilities:





- 1) Meet with consumers to clearly define business capabilities.
- 2) Consult service and application owners to determine the business capabilities they support.
- 3) Based on the information gleaned from both stakeholder groups, determine a reasonable allocation of service/app costs to each previously established business capability.

Key #5: Educate, Educate, Educate...

A perfectly executed showback or chargeback isn't worth much if no one knows what it means or how to use it. What's more, stakeholders are far more likely to resist, criticize, or, worst of all, abandon the model if they don't understand what it's capable of doing for them.

Here are four tips for keeping stakeholders informed on the functionality of the model and the value it can deliver:

- **Utilize a variety of mediums.** Everyone consumes information differently. Accommodate stakeholders' learning styles and preferences by delivering information in a variety of formats like lunch and learns, a monthly newsletter, etc.
- **Teach functionality by topic and stakeholder group.** Make it easy for stakeholders to learn what's most relevant to them by focusing on one topic or set of capabilities at a time.
- **Develop intro packets for brand new users.** Succinct training materials will be needed to get new hires up to speed quickly.
- **Be detailed and transparent about changes.** Anytime there's an alteration to the service catalog, cost model, or bill of IT, give stakeholders an in-depth explanation as early as possible.

Key #6: Build Firm Processes for Reacting to Change

When it comes to technology, the only constant is change. As a result, it's always a balancing act to maximize the technologies your organization uses today while planning for the technologies it will use tomorrow.

Keep these three tips in mind to stay ahead of the curve:

- **Communicate early and often.** To guarantee everyone knows what's on the horizon, stay in close communication with decision-makers, be aware of the changes they're considering, and share that information out on a regular basis.
- **Ensure collaboration between IT and Finance.** Before making any changes, it's crucial to check that metrics are in place so consumption can still be properly measured by IT and billed by Finance.
- **Manage expectations.** Business leaders and consumers may not always have a clear understanding of what's required to alter the service catalog and cost model. To avoid conflict, make sure everyone understands the time, effort, and material threshold required for changes.

Simplify Your Showback or Chargeback with Nicus

The task of building a new showback or chargeback model from scratch can feel insurmountable. With the help of an experienced guide, the process becomes far simpler.

Nicus has partnered with organizations across the private and public sector to develop defensible showback and chargeback models that drive an effective, value-focused bill of IT.

If you're ready to use showback or chargeback to drive a smarter internal economy for IT services, Nicus is ready to lead the way.





Elevate IT. Ignite Possibility.

At Nicus, we empower organizations to realize their full potential by elevating IT. We're passionate advocates, providing financial management solutions that expand what's possible. We believe what we do with technology defines what we can do in the world.

Contact us to learn more.

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