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"Generally speaking, financial accountants don't have the tools or the overall business knowledge to look beyond the financial statements because all growth looks good from their vantage point. Management accountants, on the other hand, add value by participation in the FP&A process because it takes a long-term view and can prevent the company from betting on a mirage." - Kasthuri Henry [1]

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Dear Executive:

It is often said that England and the United States are "two great nations separated by a common language." A similar situation exists in the world of managerial accounting where knowledgeable and capable accounting professionals appear to be separated by a common language. Popular words and phrases are bandied about that have different meanings for each speaker, writer, listener and reader. Included among these phrases is "Financial Planning and Analysis" (or FP&A). For some it means the budgeting and forecasting processes. For others it means variances, efficiency measures and trend analyses. For still others, it means scorecards, dashboards and other performance measurement devices. Although none of these views of FP&A is wrong, none of them are correct either.

A simple definition of Financial Planning and Analysis is *the provision of economically sound concepts and tools that will enable an organization to formulate an effective business strategy and then translate that strategy into results*. Within that umbrella definition fall many of the individual concepts and tools advocated in the managerial accounting marketplace; most of which are value-enhancing ideas and methodologies, but none of which comprises FP&A on its own. Critical to effective FP&A are the ability to:

1) provide comprehensive and economically sound information,
2) use that information to support the formulation of an effective business strategy, and
3) facilitate the execution of that strategy and generate the desired results.

Much of the information necessary for FP&A to work effectively comes from outside the domain of the financial executive. *Marketing* needs to provide intelligence about customers' likely responses to new products, services, or pricing policies and the resources necessary to promote the company's goods and services. *Operations* and *Engineering* need to provide intelligence about the internal steps and capital investments that will be necessary to perform the services or produce and deliver the products being offered in the marketplace. *Human Resources* needs to provide intelligence about the availability and capability of workers needed to fulfill demand and the compensation required to attract those human resources. Every function within an organization needs to be involved in FP&A. It falls to the financial executive, however, to coordinate the efforts of these individuals and then convert their inputs into accurate, relevant and actionable economic measurements, targets, tools, and plans.

Comprehensive and Economically Sound Information

The first requirement – providing comprehensive and economically sound information – requires that a valid economic cost model of the organization exist. This means not only that a valid structural model that incorporates all of the organization's key processes must exist, but that the model must be populated with economically sound cost information.

To be structurally valid, the cost model must follow the cause-and-effect relationships that are the basis for Activity-Based Costing/Management; not just as a means of assigning costs to the processes, products, services and customers that cause them, but to facilitate the projection of costs when alternative strategies are being considered, possible improvements are being planned, or potential major expenditures – both capital and non-capital – are being evaluated. In short, the model must be bi-directional; it must both assign and project costs effectively.

Without sound economic cost information, however, even a structurally valid cost model will be ineffective. To insure its long-term value creating ability, a company cannot rely solely on cost information as defined by current financial accounting practices. This means that the aberrations in measured costs that occur during specific accounting periods must be normalized. For example:

1) higher or lower spending on repairs and maintenance, research and development, or marketing during a specific period cannot be accepted as representative of the long-term sustainable economics of the business,
2) depreciation expense cannot be relied on as a true measure of the ongoing capital investment required to maintain an organization's existing capabilities and
3) the cost of capital cannot be omitted from an organization's cost structure.

Formulating an Effective Business Strategy

An organization that can provide management with comprehensive and economically sound cost information has a much better chance of formulating an effective business strategy than one whose management must rely on a conglomeration of unrelated data rolled up into averages that are applied with the accuracy of a lead ball fired from a smooth bore shotgun barrel. Without sound cost information, a company cannot accurately measure the value to the organization of its products, product lines, customers or markets. It cannot accurately assess the impact of dropping or adding products or customers or emphasizing one product line over another. It cannot accurately determine the bottom line impact of insourcing, outsourcing or offshoring. Operating in such an environment, management must either rely on flawed information or rely on intuition; both of which tend to result in ineffective, and sometimes fatal, business strategies.

With comprehensive and economically sound cost information, management understands the organization's "profit zones" – the areas where it has advantages over its competitors – and can both formulate and test strategies that exploit those advantages. With an effective strategy formulated, an organization can then facilitate its execution with a well-designed Enterprise Performance Management system – the "missing link" that too often exists between strategy and execution.

Facilitate the Execution of Strategy

Strategies do not implement themselves. Without an effective means of communicating those strategies to the employees that must execute them and a measurement system that monitors, corrects and redirects their efforts, the formulation of strategy is a wasted endeavor. The key to executing strategy is the Enterprise Performance Management (EPM) system.

A simple definition of EPM is “the translation of plans into results – execution.” It is the process of managing the execution of an organization’s strategy. EPM can be summed up by stating it gives an organization the capability to quickly anticipate, react and respond. EPM helps anticipate problems earlier in the time-cycle. In the end, organizations need top-down guidance with bottom-up execution.

Think of EPM as an umbrella concept. EPM integrates operational and financial information into a single decision-support and planning framework. These include strategy mapping, balanced scorecards, costing, budgeting, forecasting and resource capacity requirements planning. These methodologies fuel other core solutions such as customer relationship management, supply chain management, risk management, and human capital management systems, as well as lean management and Six Sigma initiatives. It is quite a stew – a stew that will have a different recipe for each organization – but they all blend together.

Conclusion

It is a tough time for senior managers. Customers increasingly view products and service-lines as commodities and place pressure on prices as a result. Business mergers and employee layoffs are ongoing, and inevitably there is a limit which is forcing management to come to grip with truly managing their resources for maximum yield and internal organic sales growth. A company cannot forever cut costs to increase its prosperity.

It is imperative that financial executives at 21st Century organizations provide management with comprehensive and sound decision support information, guide them in formulating an effective business strategy and provide the means of linking that strategy to execution through an effective Enterprise Performance Management system. That’s what Financial Planning and Analysis means today – the financial arm of an organization adding value by providing it with the information it needs to thrive and grow in a worldwide, hyper-competitive business environment – not simply “doing budgets” and reporting the results after the fact.

IMA Metro Detroit’s 2013 Spring Management Accounting Conference – March 21, 2013

Gary Cokins (http://www.garycokins.com/) and I will explore concepts, tools and techniques that management accountants at 21st Century organizations can use to provide management with comprehensive and sound decision support information, guide them in formulating effective business strategies and provide the means of linking those strategies to execution through an effective, enterprise-wide performance management system at IMA Metro Detroit’s 2013 Spring Management Accounting Conference – ***“21st Century Financial Planning & Analysis: The Difference Between an Accountant and a Management Accountant.”*** The conference will be held on **Thursday, March 21, 2013** at the Sheraton Hotel near Detroit Metropolitan Airport. Topics to be covered during the all-day session include:

- The building blocks of effective financial planning and analysis
    - Structurally valid cost models
    - Accurate, but not necessarily precise, economic and operational data
    - Strategies that compliment strengths, weaknesses and profit zones
    - Strategy maps that translate strategy into action
    - Performance measures that encourage and track the implementation of strategy

    - Formal decision making systems that effectively use financial planning and analysis to enhance the quality of decisions

- Structurally valid cost models
    - The importance of models in decision making
    - Costing's causality principle
    - Designing cost models that match economic reality and that assign past costs and both project and assign future costs
    - Special costing tools and techniques
    - Identifying cost drivers and assignment divisors

- Accurate economic and operating data
    - Precision vs. accuracy
    - Financial costs vs. economic costs
    - The periodicity problem
    - Depreciation expense vs. long-term capital preservation
    - Cost of capital
    - Measuring cost drivers and divisors
    - Time measures
    - Event and transaction measures – weighted and unweighted
    - Input and output measures

- Strategies that compliment strengths, weaknesses and profit zones
    - Product and service profitability
    - Channel, customer and market profitability
    - Customer profit vs. customer future potential value

- Strategy maps that translate strategy into action
    - How to get from present state to future state

- Performance measures that encourage and track the implementation of strategy
    - Traditional financial measures
    - Performance vs. financial budgets, standards and targets
    - Performance vs. non-financial budgets, standards and targets
    - Functional benchmarks, PIs and KPIs
    - Scorecards (strategic) vs. dashboards (operational)

- Formal decision making systems that effectively use financial planning and analysis to enhance the quality of decisions
    - Pricing and quoting
    - Budgeting vs. rolling forecasts
    - Make/buy decisions
    - On/Offshoring decisions
    - Capital expenditure decisions
    - Target costing for new product development
    - Supply chain management
    - Product mix rationalization management

Again this year, the contribution of time and effort by IMA Metro Detroit volunteers and the sponsorship of Greenstone Professional Services (http://www.greenstonepros.com/) will keep the conference's registration fee far below those charged for other such high-quality sessions (not to mention the exorbitant fees charged for all those low-quality sessions). The "early bird" cost for IMA members is $150, non-members $180, retirees and unemployed $105 and students $80. You can learn more and register for the conference at:

https://s08.123signup.com/servlet/SignUp?P=15322661911425770700&PG=1532266182300

Don’t miss this opportunity to sharpen your FP&A skills and add more value to your organization by attending this year’s event.

I hope you had a great holiday season and have embarked on a successful 2013. As always, I look forward to hearing from any of you who have questions or comments regarding the letter and you should feel free to forward a copy to anyone you believe might be interested (or at least amused).

Very truly yours,

Doug

Douglas T. Hicks, CPA
President

[1] Henry, Kasthuri V., “The FP&A Squad: Financial Agents for Change,” *Strategic Finance*, p. 39, April 2012.