

IMPLEMENTING ACTIVITY-BASED COSTING SYSTEMS AS AN EFFECTIVE MANAGEMENT TOOL

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INTRODUCTION

Strategic managers are responsible for providing effective leadership, formulating a strategic vision, and administering the strategic management process. They develop the strategies, structure, and systems that will enable their organization to use its resources most effectively to create value and profit. Today many of these managers realize that using the information produced by traditional cost accounting systems was leading them to make less than optimal business decisions. As managers pursue the quest for more accurate cost information, they are discovering a new tool called Activity Based Costing (ABC).

REVIEW OF THE LITERATURE

A review of the literature reveals an increasing trend for companies to implement ABC. The reported percentages of firms that have implemented ABC range from 16 percent to 63 percent in the studies reviewed. In most cases, the Vice President of Finance or the controller has been shown to play a major role in originating the ABC proposal and spearheading its implementation. Senior management then plays a major role in deciding whether to proceed with the ABC implementation. Most companies that have adopted ABC are satisfied with the results. The benefits often exceed their expectations and the implementation costs. Those who are most satisfied tend to be managers who are the end users of the information. Generally, the least satisfied are the financial accountants who still must generate reports for external users and entities. Firms that are experiencing severe price competition and are under great pressure to reduce costs have the highest level of satisfaction with the operational dimension of their ABC systems.

The majority of companies use ABC information in their budgeting and strategic planning process. In budgeting, ABC acts as a baseline for projecting changes in activity costs. Applications in strategic planning focus primarily on identifying areas for process reengineering or for strategic positioning. Among the companies that chose not to implement ABC, the most common reasons relate to operational and design costs, staff time, the complexity of the system, lack of internal commitment, and organizational politics.

IMPLEMENTING ABC: AN ILLUSTRATION

This paper demonstrates the usefulness of ABC by examining how a large manufacturing firm implemented and benefited from this system. The company's top executives realized that the traditional cost system was inadequate since it masks some important information and could lead to misleading conclusions. While the traditional accounting system might show two customers to be equally profitable on a gross margin basis, some hidden profits and hidden costs could be associated with the orders. This company's experience shows ABC concepts and the associated techniques provide a rich and varied mechanism for vastly improving the management decision making process.