

SIMPLE AS ABC? AN EXAMINATION OF ACTIVITY BASED COSTING (ABC) IMPLEMENTATION IN FIJI.

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Introduction

We review the level of Activity Based Costing (ABC) in Fiji in this article. This exercise is important in furthering our understanding of the use of ABC in Fiji. ABC is a popular costing system and strategic tool for organizations in developed countries (Chenhall and Langfield-Smith 1998). However, little is known about the benefits and challenges of implementing ABC in developing countries. Such an understanding could stimulate discussion on the development or modification of ABC to suit developing country circumstances. The article also has a practical objective in informing and education organizations in Fiji regarding the benefits and challenges of ABC implementation in Fiji and also provides practical suggestions for improving and easing the implementation of ABC.

Activity Based Costing (ABC) is a costing system that provides more accurate costs for entities that have a diverse range of products or services (Turney 1996). ABC achieves this by assigning overhead costs in a detailed manner than conventional costing systems. By utilizing a more accurate costing system such as ABC, companies will be able to make better strategic decisions on product pricing, product continuation and product mix (Anderson et al. 2002).

Despite the benefits of ABC, conventional costing systems are still widely used (Cotton et al. 2003). The main reason for this is that implementing ABC is an expensive exercise (Clarke et al. 1999). ABC requires in-depth discussion and analysis of costs to identify activities in the manufacture of the product or delivery of the service. The identification of activities is not conducted only amongst the accountants and management but consultation is also conducted with all employees involved in the production process. This process involves the collection of significant volumes of cost data. This data would then need to be categorized by activity and then allocated to each product or service based on an activity driver. Since companies use the conventional costing systems and so using ABC would require accountants to be trained or for consultants to be engaged to assist in the implementation process. Implementation of ABC thus

can be a complex process that would require significant resources such as time, money and expertise. Thus, organisations perceive that the benefits of ABC do not outweigh the costs.

ABC is not for every entity. The choice of a costing system for an entity is determined by a number of factors such as nature of the entity, level of industry competition, product diversity, to name a few (Anderson et al. 2002). Overall, the choice of costing system depends on the level of information managers require to make decisions. For managers who require detailed cost information, ABC is better than conventional costing systems because ABC provides more detailed information on the consumption of overhead by each product or service.

The Study Approach

Data collected for this article was conducted through a phone survey. The authors called companies and requested to speak to the management accountant. The authors then asked the management accountant if he/she would be willing to participate in the survey and assured him/her complete anonymity. The authors called 112 companies, of which 66 agreed to be interviewed but 16 companies requested more time to prepare or to seek further approval. Due to time limitations, the authors decided to conduct the survey only with the remaining 50 companies.

As the survey and interviews were conducted by telephone, interviews could not be recorded; however, the authors took notes and recorded important quotes for later analysis.

Entities selected for the telephone interview are medium to large entities with a diversified product and service range. These companies are those as stated by the literature that would benefit the most from ABC (Abernethy et al. 2001).

Questions asked to the management accountant related to whether or not they had implemented ABC in their entity. If entities had implemented ABC then questions will be posed regarding the reasons for adopting ABC and the benefits realized. If entities had not implemented ABC, then questions will be asked relating to why ABC was not implemented.

From the 50 companies surveyed 72% were in the manufacturing industry and 28% were in the service industry. This data is presented in figure 1 below:

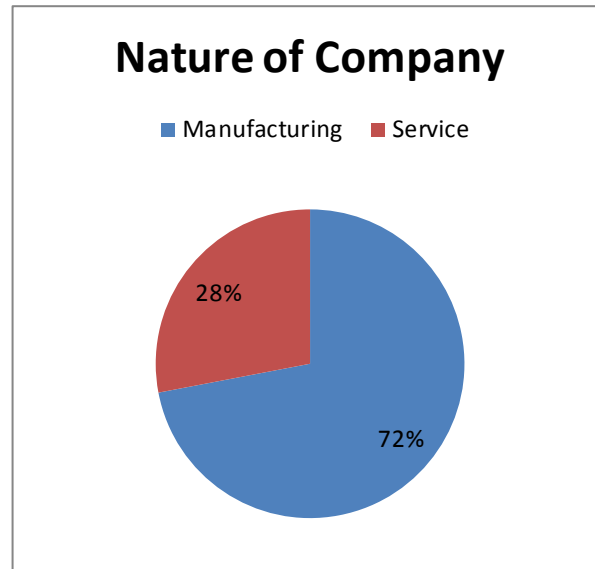


Figure 1: Nature of Company

ABC Implementation Rates

From the 50 companies surveyed, 46 (92%) companies employed conventional costing systems. Only 2 (4%) companies employed “Full ABC”, 1 (2%) company had a unique system which integrated ABC and conventional accounting systems and 1 (2%) company was in the process of transitioning to ABC.

We define full ABC to differentiate it from the hybrid costing system employed by one company from our sample. The development of different costing systems is normal in companies as management accounting systems will evolve based on the nature of the entity and its products or services. The company that we have classified as “Partial ABC” did not actually know that their costing systems had elements of ABC. The company had identified activities and created cost pools but instead of allocating costs to their services by activity drivers, the company had allocated based on only one volume-based driver. The costing system was like ABC in that activities were identified and costs pooled to these activities but was like conventional costing systems in that there was only one drive based on volume. As such we classified this company as “Partial ABC.”

The two companies that employ ABC had similar reasons for using ABC. The reasons were that the two companies had international shareholdings and their overseas branches used ABC. The systems used in the Fiji branch are based on the overseas branch's system.

When asked whether they perceived benefits from ABC, one of the accountants stated the following:

“Using ABC allows us to better measure the costs of producing one product. We use a lot of machines in our production process and thus our overheads are significant. Under traditional costing systems, some of our products would have been underpriced while others would have been overpriced. ABC provides a better reflection of resource consumption in the production process and assists senior management in making more informed decisions.”

Despite, the benefits perceived by these two companies, the results presented in figure 2 below show that an overwhelming majority of companies in Fiji employ conventional accounting systems.

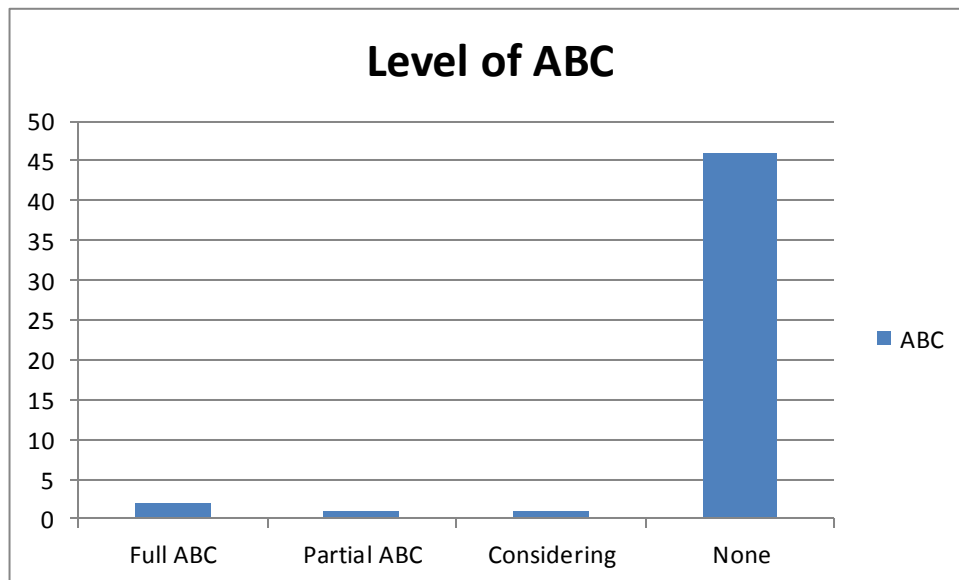


Figure 2: Level of ABC

Reasons for non-adoption

Companies that did not employ ABC were then asked as to the reason for not employing ABC. The four major responses and their frequencies are presented in figure 3 below:

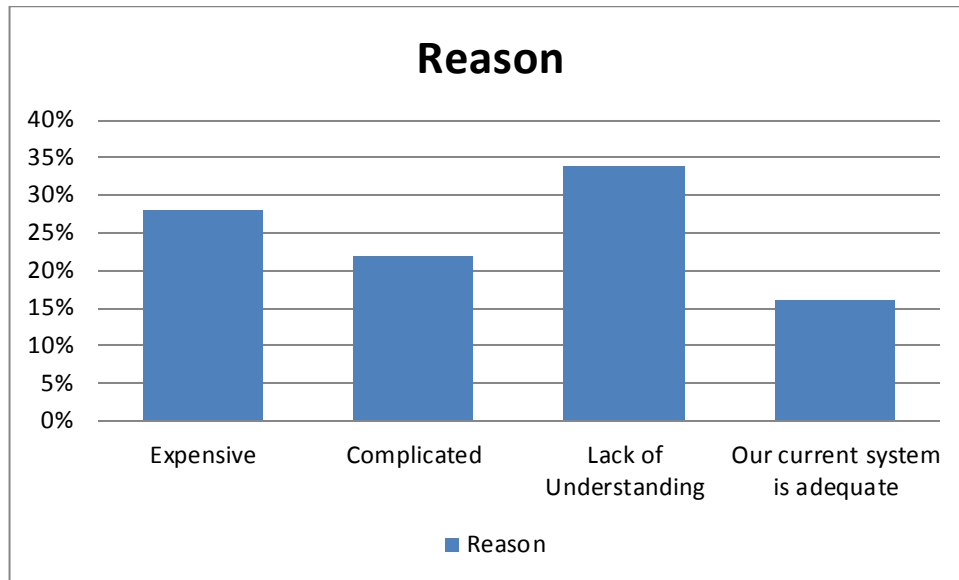


Figure 3 Reasons for non-adoption

The major reason was a lack of understanding of ABC and its potential benefits. One respondent stated:

“The last time I heard of ABC was during my studies. I have even forgotten what it means or how it works.”

Others had not even heard of ABC. The lack of knowledge and understanding, accounts for 34% of companies that have not adopted ABC.

The second major reason relates to cost. 28% of companies stated implementing ABC would require too much time and money. One respondent stated:

“Bringing ABC would be too costly. We have to collect too much data and analyze it. This would take up too much time and might distract workers from their core functions. I then have to verify whether the data collected is accurate as well. This will take too much time for me. Also cost of producing goods keeps on changing, by the time, I have collected all my cost data, the cost of fuel, electricity, etc have increased and all the data I have collected is useless.”

Other reasons included complexity of ABC which accounted for 22% and the remaining 16% had a “if it’s not broken then don’t fix it” approach. This 16% perceived their current costing systems to be working adequately and did not believe that a change in costing system was required.

Suggestions for Companies

From the analysis, we find that companies are still reluctant to adopt ABC even though it could have the potential to provide more meaningful data for informed decision making. By analyzing the responses from companies who have not adopted ABC, we provide the following suggestions for companies who may be contemplating on using ABC in some form:

1.) One of Strategic Decision Making Tool

ABC does not need to replace a company’s cost management system. For most companies, ABC is a supplement to their current costing system. ABC is a strategic tool, which can be used once a year or when there are significant changes in the cost of materials, labour or overhead used in the production process. While it may be costly even to implement infrequently, the cost should be viewed as an asset as it could lead to more informed decisions which could translate to improved profitability in the long run.

2.) Continual Education of Management Accountants

Innovation is crucial in ensuring the long-term success of an organization. Accountants are increasingly being involved in key strategic decisions of the organizations. This is especially so in Fiji, where most senior management comprises of staff who have accounting and finance backgrounds. Accountants need to keep updated with latest accounting standards, regulations and also tools which can improve company performance. ABC is one such tool. Accountants need to keep informed about the available tools such as ABC through taking professional development courses or attending workshops organized by the Fiji Institute of Accountants or tertiary and training institutions. Companies also need to support accountants in continued professional development as these would provide benefits to their organization.

3.) Investment in Specialized Accounting Software

Our analysis shows that a major deterrence to ABC adoption by Fijian companies is the significant amount of data collection and data analysis that needs to take place. This might have been the case 15 years ago when ABC was first introduced but not today. Technology has significantly improved in the last 15 years and there is an abundance of off-the-shelf software designed to automate and simplify the onerous task of collecting cost data for ABC purposes. Making the right IT investments would significantly reduce the burden and ease the transition and use of ABC as a strategic tool and an on-going costing system.

Conclusion

The purpose of this paper was to examine the level of ABC adoption by companies in Fiji. Not surprisingly, the paper found that most companies have yet to embrace ABC. The reasons largely relate to cost, complexity and unfamiliarity. The paper offers three suggestions to companies that may address these issues. These suggestions include using ABC as a one off strategic tool to supplement current costing systems and provide ad-hoc data for better pricing decisions; continual education of management accountants to foster and promote innovation; and the use of specialized accounting software for ABC data collection and analysis.

These suggestions not only relate to ABC but can also be applied to other costing systems such as target costing. While conventional costing systems still prevail in most companies in Fiji, the highly competitive global market requires companies to continually be innovative and strategic if they wish to sustain their competitive advantage. Accountants have an important role to play in achieving this objective. This paper argues that the use of strategic tools such as ABC could provide significant benefits to companies in Fiji through better and more informed decisions.

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