

Survey on the use of Activity Based Costing (ABC) in Australia

96% find ABC beneficial to their organisation!

A recent survey on the practical application of Activity Based Costing (ABC) in Australia was facilitated by ABM Systems Australia Pty Ltd, in collaboration with the Chartered Institute of Management Accountants in Australia (CIMA). This paper summarises the findings of the survey.

Activity Based Costing is finally living up to its expectations. No longer considered to be a costing methodology just for manufacturing, ABC is bringing substantial cost savings to all sizes of organisations, across most industry sectors. From cost reduction to strategic planning, ABC is supporting a diverse range of performance management initiatives and helping some organisations to gain a competitive edge.

Experience with ABC

ABC is already used widely in Australia, with the majority of respondents (75%) reporting that it was used in at least some capacity within their organisation.

Furthermore, its' use is set to grow, with even more organisations keen to derive the benefits that ABC has been proven to deliver, with over 61% of those organisations who have never used ABC, planning to do so in the near future.

Support of performance management initiatives

Very few enterprises are using ABC for just one reason. It is clearly evident that ABC related information is being used to support a wide range of initiatives across organisations. The most common purpose of these initiatives are:

Initiative	% of respondents
Product Costs & Profitability	65
Performance Measurement	47
Shared Service Costing	41
Planning & Budgeting	40
Customer costing	38
Customer/Channel Costs & Profitability	38
Transfer pricing	25
Outcome / Output based management	25

Not surprisingly, ABC is used for product costing by nearly two thirds of those respondents with experience in ABC. It's accuracy over traditional costing methods is borne out later in the survey with 87% finding that their ABC product costs differed substantially from traditional costing methods, *leading around 50% to reprice their products as a result!*

Validating the views expressed by Kaplan & Norton in their latest book '*Strategy Maps: Converting Intangible Assets into Tangible Outcomes*', which stresses the importance of using ABC and Process perspectives to supporting a Balanced Scorecard, nearly half of all respondents are using their ABC data to support their Performance Management initiatives.

The use of ABC to support Shared Services costing has increased in popularity over the last few years. Now that internal services are represent up to 30% of an organisation's costs, it has become imperative to accurately reflect how those services are consumed by business units. Over 40% of respondents are using ABC to support Shared Service costing, enabling them to understand who and what is driving consumption of their internal services, and thereby increasing the effectiveness of their focus an core business.

These trends are repeated by those who do not yet use ABC, but are planning to. They want to use ABC to support:

Initiative	% of respondents planning to use ABC
Product Costing	55
Shared Service Costing	36
Planning & Budgeting	36
Customer costing	27
Process/Continuous Improvement	27

The most noticeable difference is that only 18% are planning to use the information to support Performance Measurement. This could well be because the ease of which ABC lends itself to Performance Measurement is not evident until an ABC is up and running. Alternatively, the respondents may be looking to introduce ABC to solve a pressing business requirement, and the links between ABC and performance metrics are not immediately apparent.

ABC for Planning

ABC is no longer being used just to analyse historical costs. A massive 94% of those surveyed are already using ABC, or intend using, ABC for planning purposes.

Bottom up methodologies are the preferred means of planning future financial outcomes and/or resource utilisation, with around 27% of respondents using an organisation unit centric view, and a quite surprisingly high 27% adopting a process oriented view, with an, at least, implied internal supplier-customer sign-off.

Some 20% prefer a top down approach, whilst 21% are using a combination of methods.

ABC Planners are looking at all aspects of their organisations in order to identify improvement opportunities. Some 60% are looking to identify process improvements, with 55% looking at activity level improvements via resource planning, and 49% looking to affect strategy formulation. However, only 13% are questioning their organisation's process design in a fundamental way.

Consistent with historic uses of ABC, planning data is being used to support a variety of initiatives, although there is a surprising focus on ABC for goal setting.

Initiative	% of ABC Planners
Shared Service Costing	51
Product Costing	49
Defining team/dept goals	27
Defining organisational goals	13

As with traditional budgeting approaches, the ABC Planning cycle tends to be lengthy, with 66% taking 2 months or longer, despite the majority of budgets being submitted through an automatic process (55%). This seems to be primarily due to delays associated with inter-departmental negotiation (43%), because the bottom up numbers don't reconcile with central top down goals. However, the difficulties inherent in creating an ABC model using a spreadsheet solution (48%) are also evidently a factor.

ABC and Management Reporting

There is an overwhelming tendency not to use ABC to its full potential. Whilst some signs are positive, such as many (46%) are making multiple changes to their models to reflect the changes in their organisations, the vast majority are using small, high level models that are not updated often or regularly.

61% of respondents have models with less than 100 activities, and only 44% update their models on a quarterly, or more frequent, basis. With 40% updating their models periodically as required, it appears a very ad-hoc approach is being taken, with activity based reports not forming a standard part of monthly management reporting.

# activities	%
< 100	59
100 - 500	25
500 - 1000	10
1000 - 3000	2
> 10,000	4

These figures could well be explained by the tools that the respondents are using, and the way that they are being used. As revealed above, 48% are using a spreadsheet solution, but what is astonishing is that, despite the enormous technological advances in Information Technology, a huge 76% are still manually updating their models. It is not surprising, therefore, that models are being kept small, and not updated often, in order to reduce the workload required to produce a new set of ABC results.

Update method	% of ABC users
Centralised manual input	52
Decentralised manual input	24
Imports	26
ODBC	10

Users of ABC specialist software are the happiest with their solution, with 75% saying that it their solution is a good management analysis and reporting tool. They also tend to analyse a higher number of activities (43% have 100-500 activities, and 22% 500-1000), use importing or ODBC links to other databases to update their models (56%), and update more often (44% update quarterly or monthly). Their implementations also tend to be very successful, *with 50% of specialist software users discovering potential cost savings of greater than 5% of their cost base!*

Whilst ABC results may not yet be a mainstream part of *monthly management reports*, they are being used widely to appraise business performance, at corporate, departmental, and individual levels. Around 40% of ABC users are using their results in a Balanced Scorecard, although only 11% have pay or incentives linked to their ABC results, and 15% have ABC results tied into their employee appraisals.

The distribution of reports is also holding organisations back from making the most of their implementations. Over a third (37%) of ABC users are printing off reports and distributing them manually! Only 21% disseminate results via an intranet. This contributes to explaining why, in 73% of cases, less than 10 managers receive ABC data, and why 42% of respondents think the ABC information should be distributed to more managers than currently receive the results.

No respondents distributed ABC reports to more than 100 managers, although 20% thought that they should!

Product/Service Costing and Customer Profitability

By using cause and effect tracing rather than allocations, ABC better reflects the value chain of how organisations consume costs and provides more accurate product, service and customer costings than achieved using traditional costing techniques. The difference in ABC product costs to absorption or other allocation based costings can be dramatic.

The survey shows that 87% of practitioners found that their product and service costs differed from traditional costings markedly. The majority had an average variation of between 5 and 10%, which can be dramatic at a gross or net margin level. However, a surprising number of respondents (11%) experienced variations of over 100%!

Average variation	%	Maximum variation	%
0	13	< 10%	25
1-5%	15	10-25%	17
5-10%	26	25-50%	25
10-15%	13	50-75%	14
15-20%	10	75-100%	8
> 20%	23	> 100%	11

Profitability analysis showed that the majority of organisations found the classic Pareto rule applies, with 64% saying that the *top 20% of products generated 80% of their profits*.

Cost Reduction and Process Improvement

That ABC can improve your bottom line is beyond doubt, with potential cost savings amounting to 25% of cost bases being identified. *Some organisations are yet to find where they can reduce their costs, but it is worth noting that over 70% of those who have not identified cost savings have less than 100 activities in their model.*

Whilst it is important to prevent ABC models become too large and unmanageable (primarily because they can induce analysis paralysis), it is essential that a reasonable level of detail is available, so that there is sufficient information on which to make cost reducing or revenue enhancing decisions. After all, profit outcomes are the result of process design and activity workflow...

Maximum potential cost saving as a % of cost base	%
0%	18
1-5%	21
5-10%	33
10-15%	8
15-20%	13
20-25%	2
>25%	5

A variety of methods are being used to help organisations translate their ABC data into real cost reductions. Cost driver analysis is the most frequently used method for aiding cost reduction and/or process redesign, with 67% of organisations using this technique. Process mapping and benchmarking are also popular, as is repricing of products and/or services, and analysis of the value that an activity adds to an organisation.

Top techniques used to aid cost reduction	%
Cost driver analysis	67
Process mapping & redesign	52
Benchmarking	52
Repricing	50
Value adding analysis	42
Product rationalisation	38
Value chain analysis	32

Conclusions

ABC can, and does, add value to organisations. 96% of respondents have found the experience to be beneficial to their organisations, and 98% are expecting their implementations to deliver even more positive returns on their investment in the future.

Level of benefit delivered by ABC	% achieved	% future
Adverse impact	4	2
Negligible benefit	22	13
Moderate benefit	54	60
Substantial benefit	20	25

Regardless of the benefit analysis above, respondents recommend the use of ABC unanimously!

In particular, practitioners recommend using ABC for product costing and cost reduction, to derive the most benefits, although there is a general belief held by ABC practitioners that the methodology should be broadly used as shown below.

ABC supporting	% of organisations
Product/service costing & profitability	80
Cost reduction	65
Continuous Improvement Program	56
Business Process Re-engineering	55
Shared Services Costing	51
Customer, channel or value chain analysis	44

ABC is generating real benefits for all sorts of organisations across Australia. These benefits can only increase as more organisations are looking to start an ABC project for the first time, but the full potential of ABC will not be realised as so many existing ABC users are still not employing ABC to its full capabilities.

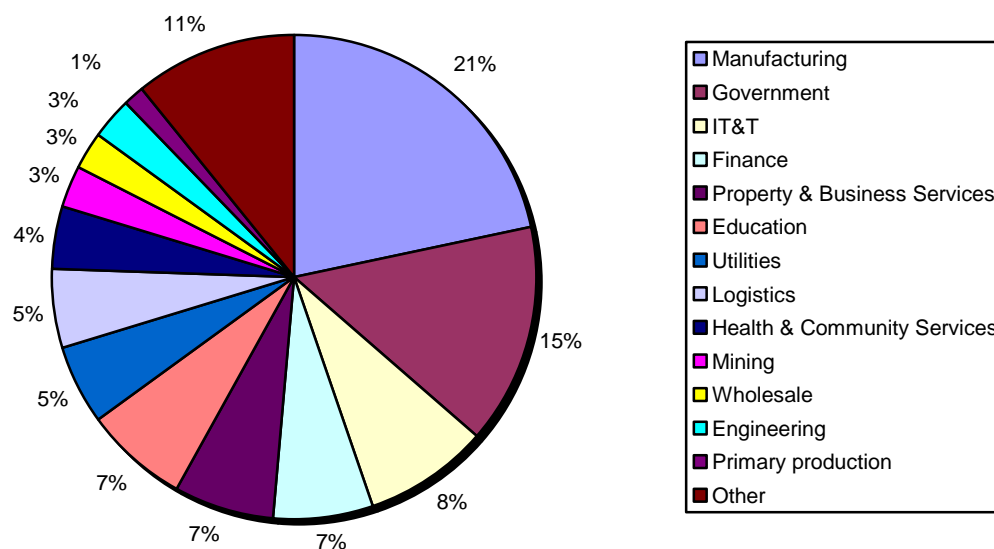
It is important that experienced ABC companies capitalise on their implementations to achieve the maximum possible benefits. Increasing the scale of an ABC project need not be an expensive, time-consuming process. There are cost-effective solutions that combine ABC, Process Mapping and Balanced Scorecard, to produce automated, regular reports with a minimum of manual intervention. With organisation-wide implementations providing much greater cost savings, expanding your ABC project can only be advantageous to your organisation's bottom line.

Appendix

Profile of Survey Respondents

This 2004 survey was conducted online and using hard copy surveys of CIMA Members in Australia, as well as a random sample of other personnel who have attended business training courses facilitated by ABM Systems over the seven years to 2004.

In total, there were 96 companies that participated in the survey, covering a range of industries shown below. The entities involved in the survey ranged in size from small, with under 100 employees, to large with over 10,000 employees.



Invitees to the survey were either CIMA members or financial officers of companies known to ABM Systems. For more information regarding the survey, or ABC in general, please contact:



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