



**by Simon Dekker**

President and CEO – Dekker, Ltd.

A new form of accounting has started to emerge with the general acceptance by the accounting industry which is called Activity Based Costing (ABC). This article covers the four basic modules of the ABC system and the types of information each module captures.

ABC does more than traditional General Ledger accounting. It focuses on the day-to-day operations of a business and directly correlates all of its information to the General Ledger so that there remains only one official book of record. Traditional accounting is used in reporting to stockholders, creditors, and government agencies collecting taxes. It does very little reporting to help internal organizations manage their businesses. ABC provides the ability to track the production costs within a business entity by breaking cost collection points down to activities. In other words, the process flow of raw material conversion to final product is considered to be the actual cost driver. All phases of the product are considered through product R & D, PROTOTYPE, LIMITED FIELDING, MARKETING and FINAL DEPLOYMENT. The information derived from the ABC System is to focus on the internal operation of a business. This information is used by senior management down to technical performing organizations chartered to produce, sell, and maintain the product in the field. The chief purpose of ABC is to provide disciplined strategic planning and tracking, product performance, and profitable pricing information.

Before progressing into the four modules of ABC, it is important to note that the activities of a corporation become a vital link between the General Ledger (GL) and the ABC system. It is quite frequent that accounting and management costing professionals will try to turn these events into a product oriented General Ledger or Work Breakdown Structure (WBS). While such coding can be beneficial, the ABC System is not just another form of cost coding. The focal point of establishing ABC within a business unit is for senior management and technical performing entities to develop events that the business unit must perform to produce product and revenues. Focus is placed on traditional scheduling techniques and correlating those events directly to the general ledger to a level of detail that makes sense. Activities are not a coding structure used for the purpose of summarizing costs from a product oriented point of view. Total emphasis is placed on the defined events to provide insight to the goals and objectives of fielding products to the customer. The ABC system can be used for both manufacturing and service oriented companies.

## **PROCESS FLOW/SCHEDULING (PF/S)**

The first of four modules is Process Flow/Scheduling (PF/S). It focuses on scheduling events, time-phasing activities that consume a company's resource, and establishing objectives for the business unit to complete. The scheduling of events is a process that is important for technical people who tend to be goal oriented. They do not relate well with summary cost reporting because they often do not understand the criteria used to establish summary line items. Technical performing organizations typically have little insight into the General Ledger reporting, or other formats of summary costs reporting because the categories established are sometimes based upon intangibles. They know the steps needed to complete their assignments and the resources necessary to accomplish the work. They require reporting practices that they can understand and have direct correlation to. It is within the PF/S module that technical entities help establish events as cost drivers so that cost collection points can be based upon how work is accomplished within a business unit.

The PF/S module is directly tied to the General Ledger through a traditional job cost module. PF/S makes use of timecards, purchase orders, work orders, and invoice documents as source information to integrate costs to tasks. There is usually a direct relational link between events and traditional job costs data.

## **TPM MODULE**

The second module is called Technical Performance Measurement (TPM). It handles product risk liability, engineering obsolescence, and customer “no choice to modernize” strategies. The purpose of TPM is to provide a formal approach to reporting on desired characteristics of what a product, or service, will be. Product oriented parameters such as size, weight, speed, response times, route length, operating environment, and other data are stored to provide time-phased communication between management and technical staff on how a product functions and how it will evolve. It enables management and marketing to determine which features are necessary for success in the field, end user product performance, and risk analysis during research and development phases. Technical parameters are directly related to the event cost drivers and are measured periodically.

The purpose of TPM is to ensure that the end product will meet expectations of the customer and perform well in the field. It also provides insight into cost effectiveness of delivering a product feature. If a product feature slows production efforts, management will have a better business picture to either continue the expenses to achieve a particular product goal, or to accept what has been delivered and continue refining other aspects of the product. TPM provides a common dialogue between management, marketing, technical organizations, and the customer to focus on the right product target specifications!

The utilization of TPM will typically cause traditional scheduling techniques to become easier. Because actual product or service parameters are measured consistently over time and directly associated to event cost drivers, schedulers find that implementation of TPM will reduce the number of events being tracked in certain applications. This phenomena is caused by the fact that scheduler analysts will often attempt to turn the schedule into TPM and create overly complex schedules resulting in costly, labor intensive scheduling exercises. The objective of TPM integration to the PF/S module is to reduce the scheduling overhead while maintaining a timephased “check-off-list” that is totally oriented on the viability into the risk attributes of product planning and deployment.

## **AR/C MODULE**

The Activity Revenue/Cost Tracking Module (AR/C) provides the mechanism by which to status and forecast costs associated with its respective cost driving activity. The typical attributes of cost data points exist as budgets, actuals, estimates-to-complete, estimates-at-complete, and earned value. One important difference in AR/C is the ability to track Projected Revenues, Revenues Billed To Date, Estimated Revenues Remaining, and Profit versus Loss statements within each project, service or product line. These data points provide a wide array of insight into the financial concerns of product managers, marketing, executive committees, owners, and customers. Data points referring to revenue provide insight into the cash flow and utilization of cash reserves to complete a project, or during times when project startup requires considerable capital investment profiles by the business entity actually performing the work. Managers can determine Return On Investment profiles and better serve the operational requirements of the performing business unit by reviewing these data points.

## **I/OCP PLANNING**

The fourth module is the Input/Output Capacity Planning (I/OCP). I/OCP is Material Resource Planning (MRP), which deals with shop floor management, input/output capacity planning, and materials necessary to process raw materials into product. Inventory control is highly sophisticated and must relate to the individual processes with the manufacturing business

environment. I/OCP is geared entirely toward manufacturing business units and is not used in service oriented companies.

### **In Summary...**

ABC is meant to address internal operating concerns and is an augmentation to the traditional General Ledger based cost management system. It is not a replacement for traditional accounting, but makes use of the source documents provided from standard job costing systems. Instead of being heavily labor based, ABC looks at a business unit's events as cost drivers and ascribes all company resources and accumulated costs against those events in a time-phased fashion. Revenue tracking provides management with a different perspective on the profitability of products and services, providing insight into pricing. Middle management and technical performing organizations understand the line item reporting provided within the ABC system enabling management to achieve more responsibility of reported information within all levels of the organization. ABC is being professed by the accounting industry as the wave of the future and is gaining broad acceptance within larger organizations. This system is intended to serve performing entities and management alike. The key ingredient is integration: True integration, of scheduling and cost management systems.

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