

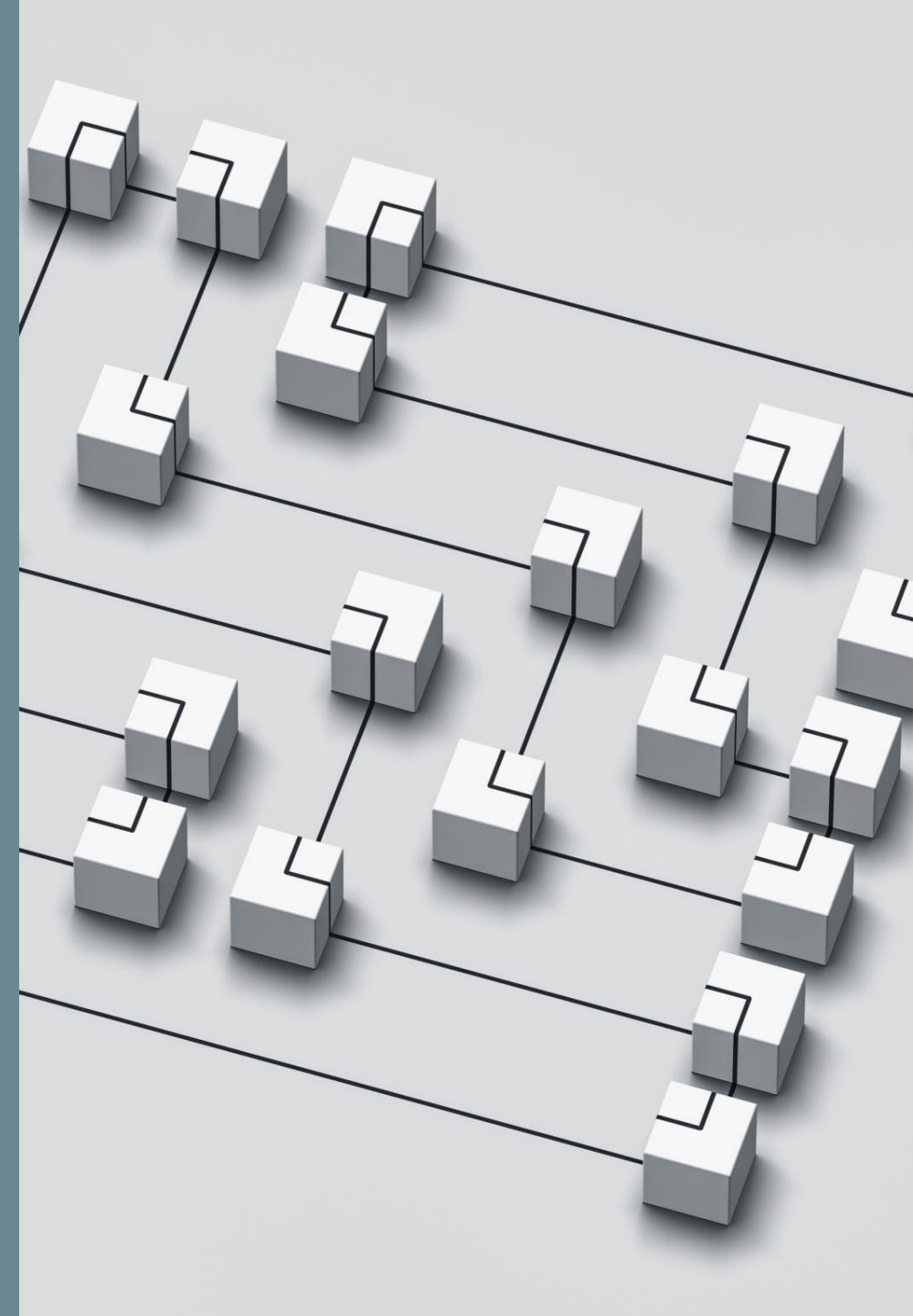
# **WHAT IS ACTIVITY BASED COSTING AND IS IT STILL RELEVANT?**

Financial World of Information Technologies

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# ABSTRACT

Activity Based costing is an accounting method with an emphasis on assigning costs to activities. Using this methodology provides a more accurate picture of what it costs to deliver a service within IT. ABC expands cost management from the traditional categories of salaries, hardware, or training. ABC is a powerful tool in understanding IT costs and increasing cost transparency, However, adding new dimensions adds to the complexity of Financial management and requires capturing volume information about services.



# ABC IS AN ALLOCATION METHODOLOGY

What is ABC?

ABC



ABM

A methodology that assigns costs to activities based on the use of resources, and assigns costs to cost objects based on their use of activities.

A discipline that focuses on achieving customer value through the continuous management of the activities. ABM draws on ABC cost information and performance measurements as a major (but not only) source of information.

ABM is not “advanced ABC”

# WEAKNESSES OF TRADITIONAL COST ACCOUNTING...

## What is ABC?

- Does not help understand how work activities consume resources and then convert to services
- Does not provide adequate information to make decisions in a competitive environment
- May not support business insights into controlling costs
- Lacks details to define work performed while focusing on inputs and outputs

## BACKGROUND OF ACTIVITY BASED COSTING

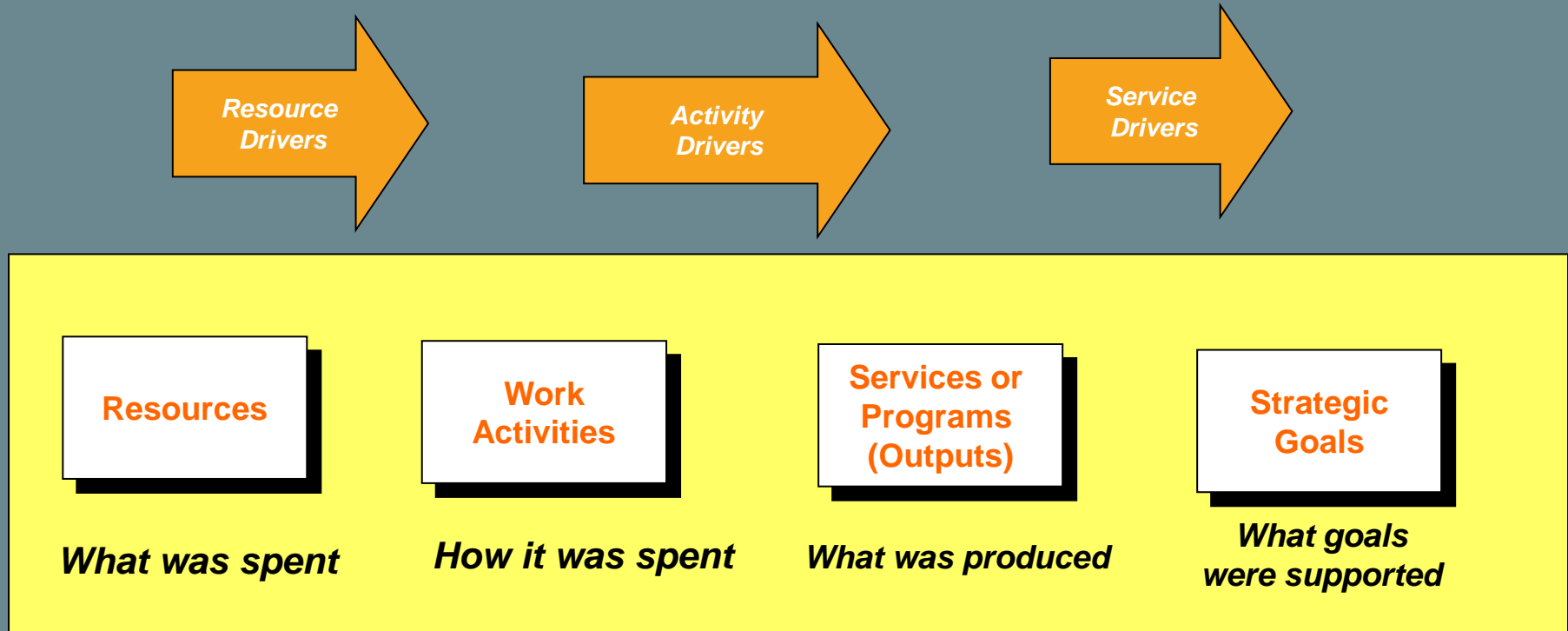
- Methodology developed in the manufacturing sector of the US during the 1970s and 1980s
- Was first clearly defined in 1987 by Robert Kaplan
- “Managerial” cost accounting methodology
- Result of broad acceptance that traditional cost accounting weightings were not allocating costs appropriately across outputs

## WHY ACTIVITIES?

- **Activities:**
  - Consume resources
  - Represent what is done within an organization
  - Are the focus of what is being managed
  - Provide the basis for continuous improvement
  - Highlight department interdependencies

# What is ABC?

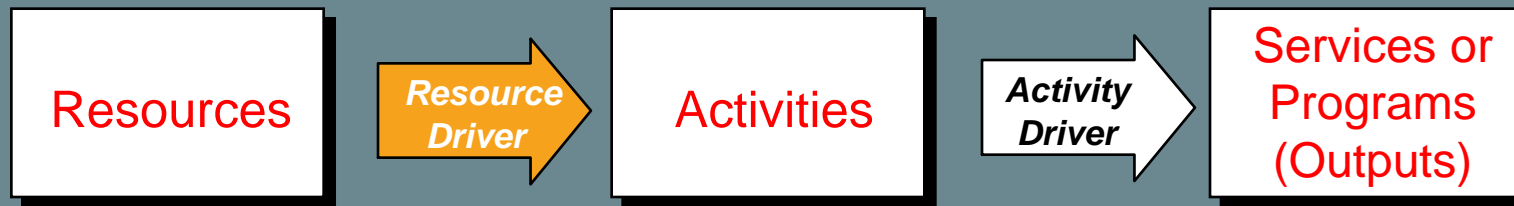
## ABC VOLUMES SUPPORT VALUE EXPLANATIONS



# RESOURCE DRIVERS

A Driver is a method for distributing costs

What is ABC?



## Resource Driver:

- Key factor in ABC
- Volumes drive spending
- If you can't count it, you can't measure it!

***Examples: Percentage of Time, Square Feet, Computer Run Time***



# ACTIVITY DRIVERS

A Driver is a method for distributing costs

What is ABC?



## Activity Driver:

- A method for distributing/assigning Activity costs to Outputs
- A measure of the demands placed on an activity by outputs

***Examples: Number of Reports, Number of Transactions, Number of Items***

***WHY DO ABC ?  
IT NEEDS TO KEEP COMPETING***

## WHAT CAN ABC PROVIDE TO AFFECT CHANGE

### ABC Benefits

- Activity based costing can provide management with information about the full and relevant costs of activities, goods, and services, thereby enabling managers to know which activities to pursue and which to eliminate.
- Improves cost control
- Provides more accurate product cost
- Better performance
- Encourages continuous improvement
- Increases effectiveness of budgeting by identifying the cost performance relationships at different activity levels.
- Aids in Cost reduction

## ABM ADDRESSES SEVERAL BUSINESS NEEDS.

### ABC Benefits

- Develop Cost Awareness
  - What does it cost to perform a service, broken down by delivery mechanism ?How much work goes to support specific customers
  - What resources perform what work? How much?
- Provide Decision Support
  - Where can I reduce costs?
- Plan and Anticipate Future Requirements

Analyze unit costs and understand productivity

Identifies the cause-and-effect relationship that better assigns costs of products and services to customers by identifying the activities used in the production and delivery of services to customers.

Serves as an excellent basis of support for program funding justification.

## ABM ADDRESSES SEVERAL BUSINESS NEEDS.

### ABC Benefits

- Supports Benchmarking
- Develop Cost Awareness
- Provide Decision Support
  - Where can I reduce costs?
- Plan and Anticipate Future Requirements
- Improves cost control
- Provides more accurate product cost
- Encourages continuous improvement
- Better allocates overhead

## ABM CAN SUPPORT COST SAVINGS INITIATIVES & FUNDING JUSTIFICATION



**Activity Based Management (ABM) is a management tool that:**

- Provides insight into the **relationship** between **inputs** (resources) and **outputs** (products/services/customers) by quantifying the work performed (activities) in an organization.
- Identifies the cause-and-effect relationship that better assigns costs of products and services to customers by identifying the activities used in the production and delivery of services to customers.
- Serves as an excellent basis of support for program funding justification.

## CRITICAL SUCCESS FACTORS

### ABC Best Practices

- Senior Management Commitment -- “Champion”
- Compelling Need(s)
- Program Personnel OwnP
- Program Personnel and Training
  - use training as an awareness tool
  - provide periodic live project status presentations
- Integrate With Other Management Initiatives
- Plan for Sustainment –resource commitment

# IS ABC STILL RELEVANT FOR MANAGING IT FINANCE?



YOU CANNOT MANAGE WHAT YOU  
CANNOT UNDERSTAND

YOU CANNOT FORECAST WHAT YOU  
CANNOT COUNT