STRATEGIC IMPLEMENTATION OF ACTIVITY-BASED COSTING AT HIZONE SDN. BHD.

A Case Study for Applied Business Project

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Executive Summary

Historically, manufacturing and cost accounting became linked because of the need to determine the amount of profit to be gained by selling, producing, and shipping a product. Early decisions made within this relationship fostered a certain standard upon which a method of determining the overhead cost of products based upon the direct labour content was built. This made sense, because, quite simply, direct labour was a large percentage of the cost that was expanded equally to the manufacturing products. This method became known as the traditional costing method.

For years, the traditional costing method developed into a significant part of the manufacturing control system. In this method, product costing involved the accumulation of direct material and labor costs to the overhead costs. The system worked mainly because manufacturing processes were highly labor intensive where the overhead was a small percentage of the total cost. Moreover, firms had a low level of product diversity.

Today, with the advent of modern technology where manufacturing facilities are no longer labor intensive, the traditional costing system, with its one-size-fits all approach, is becoming less adequate. Not only is the traditional costing method unable to supply the tools for measuring costs, it cannot provide managers with the information needed to run modern manufacturing operations profitably.

In this study, the group consulted with a local furniture manufacturing company, namely Hizone Sdn. Bhd., on a wide range of issues regarding product costing and the methodology involved in allocating overhead costs. Findings from this study highlighted the inadequacies of the current costing method where the overhead was not fully accounted in the costing of the products. The group discovered that the current costing method only allocated a flat rate of 20% of the direct labor and materials costs as overheads.

1.0 INTRODUCTION

Today businesses worldwide are under pressure to implement business improvement programmes that create value and recover production costs. The government and industry leaders for a decade have called for sophisticated and original designs to bring to the world market.

The increased use of information technologies and the effects of globalization have created a more competitive environment in which a low cost structure often becomes a critical success factor. For example, Malaysia's furniture manufacturers are currently scrambling to stay competitive in the face of stiffening competition from China and Vietnam. *(Malaysia Timber Publication; Vol 5; Page 32).*

The global pressures for economic competitiveness have thus far been reshaping the attitudes of many towards costing. The focus on the cost accounts of manufacturing, combined with the reality of ceilings on revenues, has led to rigorous review of the expenditure and the efficiency with which they are utilized. This environment has created a greater need for improved cost measurement and management techniques.

Furthermore, in order to remain competitive while keeping budgets in balance, there is a need to streamline operations, eliminate waste, reduce cycle time, reduce costs, adopt a commitment to total quality and judiciously incorporate advanced technologies such as scanning of documents, electronic data interchange, and paperless offices. Managers seeking to succeed in this environment are turning to their management accounting systems for new types of information. The role of cost accounting has been transformed. This means that cost accounting must