

ACTIVITY BASED COSTING (ABC)

**CASE STUDY: RE-ENGINEERING COST ANALYSIS WITH ABC IN
TELEKOM MALAYSIA BERHAD-FINANCE UNIT KUCHING**
(the gap between theory and practice)



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ABSTRACT

Most traditional costing techniques rely heavily on the volume of items produced or the number of labour hours expended to produce them as the main method of overhead apportionment. The early work on activity-based costing (ABC) going back five or ten years, was based in manufacturing organisation. And yet, one of the most powerful concepts of ABC is its focus on organization-wide activities.

Increasingly, ABC is being seen as an essential tool to enable both profit and non-profit service organizations to improve their utilization of strategic resources in order to meet shareholder performance expectations.

The purpose of this project is to present a framework for developing pricing strategies and policies for regional telecommunications as telecom technologies develop from analog to a worldwide intelligent digital network. It is demonstrated that the key issues that must be addressed are the pricing and accounting arrangements between carriers; and in particular, the pricing mechanisms used for switching and transmission services.

As you can see, the critical business issues facing the management of service (telecommunication) organizations revolve around many of the same issues that face manufacturing organizations. With the traditional accounting methodology of allocating costs "fairly" to products, service organizations face an additional dilemma--no inventory of products on which to do this. However, this doesn't prevent many such organizations from allocating costs to the direct costs of service provision, typically on per cent of revenues or per cent of budget allocation.

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CHAPTER 1

1.1 Introduction

Although the concept of Activity-Based Costing (ABC) has been established for the best part of twenty years its current popularity and form can be traced to the development of practical system in a small number of US companies in the mid-1980s. Their experience have received wide publicity particularly through a series of Harvard Business School cases and publication authored by Professor Robin Cooper and Professor Robert S. Kaplan. ABC emerged in these companies in response to a recognition by both their managers and management accountant that conventional costing systems produced cost information which was often inaccurate as to seriously mislead managerial policymakers.

A costing conundrum of this scale becomes a management problem. For strategic, regulatory or just plain public relations reasons, most companies can't afford simply to drop great numbers of customers and products. That's why some managers look at ABC as only the first step in a process of activity based management, which means figuring out - once an ABC study has pointed out that certain products and customers are costing more than first thought - what to do about it. They identify key factors for success, set benchmarks and decide whether to fix unprofitable process through continuous improvement and total quality management - or re-engineer the process altogether. Either way, it's a critical voyage of corporate self-discovery.

Turney, P.B.B. (1989) notes that

Underlying ABC is the assumption that activities consume resources and products consume activities. Activities include establishing vendor relations, purchasing, receiving, disbursing, setting up a machine, running the machine, reorganizing the production flow, redesigning the product,

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

Many management accountants have accepted in principle that ABC provides a relatively accurate method with which to calculate the cost of activities, processes, cost and profitability of the products, services, customers and served markets that represent the tangible outputs of their organization. However, relatively few organizations have actually implemented ABC as their primary source of cost information.

A number of management accountant have commented that they read many articles and a few available books on the subject of ABC, and they are convinced that it is something that they should implement. But, they say that they have not found a viable description of how to actually do so.

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Much often effort has been put in evaluating more closely their cost accounting practices especially in the area of cost allocation. Here, the main concern has