

THE TRANSITION FROM TRANSACTIONAL ACCOUNTING

In some ways the Securities Act of 1933 began it all, giving Congress the authority to prescribe methods of accounting to be used for financial statements. The methodology defined the profession---compliance. The job of the accountant was to produce financial statements and tax returns in "compliance" with laws and standards established by Congress. Budgeting, recording transactions, keeping score.

The accountant is in a business "partnership" with the management of the businesses, for which he provides service. Unfortunately, compliance and transactional accounting are among the least valuable tools for management. It does not help them to assess the relative revenue potential of existing and emerging markets, or to determine what customers will want and develop products that will satisfy these needs at a price that customers are willing to pay. Management also must determine what is needed to produce these products at a cost that will generate a profit and what resources will be required to maintain these processes and technologies. Finally, management must monitor the performance which insures that profitable results are being sustained. The language of business activities is absent from general ledger information.

The modern accountant can help his "business partners" understand the financial aspects of business activities by translating financial information into an activity-based view of the business. The two views, general ledger and activity can coexist. But it is the activity view that can be used to enhance performance.

For example, the activity view can help formulate customer service strategies by identifying the costs of the services that support particular products. It can help identify "profitable" customers. An example of this type of analysis is one that revealed that the majority of a business' customers generated a small percentage of the business' total sales and these in small amounts among the least profitable products. The business could profit from "firing" the majority of its customers.

Other benefits are analyzing Product Profitability. A manufacturer believed that he had a very low profit margin on a commodity product that he shipped in bulk and a high profit margin on a number of specialty products. Then he calculated the cost of the activity of warehousing the specialty items and the relatively high sales commissions paid on them.

Perhaps one of the most beneficial areas of analysis is the impact of supplier practices on costs. Such an analysis can often be mutually productive. An example is a baker who determined that he was paying a disproportionate amount for eggs. His supplier pointed to the cost of the extra precautions taken to deliver the eggs unbroken. Since the baker used the eggs after they were broken, a deal was worked out that greatly reduced the cost of the eggs, which could be shipped broken more inexpensively and eliminated a step in the manufacturing process.

Very few companies have totally integrated data-bases and the tools to produce business activity reports. Even fewer accountants are familiar with the systems and applications necessary to generate this information, nor is the profession yet educated in the activity-based, rather than transactional accounting. But the development of these tools is accelerating, because of the automation of transactional accounting. Less and less time is required for traditional compliance services, making more and more time available for activity-based financial analysis.

Companies trying to make the transition to activity-based costing without a conceptual understanding of its customized application to their situation tend to spend a disproportionate amount of time and money and to be disappointed by the results. But those who are in conceptual control of the application of advanced cost management methods and can integrate them into their business processes are reaping huge dividends.