

The ABCs of Cost Accountability

Want to know how to do less with less? Activity-based costing has great promise.

BY: Justin Marlowe | February 2015

There's an old adage: Politicians are all for efficiency, but only for programs they don't like. That's why asking if a program is cost-effective is usually a political nonstarter.

But sometimes what stuff costs becomes a hot political question. In fact, we've seen a predictable pattern since the mid-1980s: The economy starts to bounce back from the most recent recession; state and local leaders recall the dreadfully blunt ways in which they cut their budgets during that recession; and they vow that if they ever have to do it again, they'll get the right information to whittle down spending in a strategic, focused way. Around this time they start to hear about an accounting method known as activity-based costing (ABC) that can solve this problem.

We replay this cycle precisely because ABC has never really taken hold. But in the post-Great Recession world, the money, technology and, most important, the politics might have finally aligned for ABC.

To illustrate how ABC works, say a county health department runs a restaurant licensing program. Department staff visit restaurants, document any public health concerns, and report to appropriate state and local authorities. Let's assume the program's budget is organized around things the department must purchase to issue licenses, such as salaries, travel and office supplies. If the program spends \$75,000 in a year, and if the department issues 150 licenses in a year, then traditional cost accounting suggests the cost per inspection is \$500.

Activity-based costing shifts the focus from "what" the inspection program spent to "why" it spent it. To issue a license, the program carries out such activities as restaurant site visits and communications with restaurant owners. Each activity requires a bundle of salaries, commodities, overhead and other costs. Under ABC, the cost per license is the cost of the activities it demands. A routine case that involves a quick site visit and a few emails might cost \$50. But a restaurant with health code violations and an uncooperative owner might cost up to \$2,500 once the program accounts for all the expensive communication and coordination.

Here's what's really different: Activities can absorb costs from many different programs and services. For instance, a restaurant inspector concerned about an outbreak of foodborne illness might coordinate a response with the local disease prevention program and the public outreach staff. Under traditional cost accounting, the costs to these other programs don't really impact the cost per license. Under ABC, each agency involved would assign those costs to the "coordinated responses" activity.

Governments can use the information ABC produces to set fees that better reflect the true cost of the goods or services they provide, to better scrutinize bids for contracted services and to improve benchmarking. ABC also sheds light on the "hidden" costs of activities that don't fall neatly into a single program or agency. Moreover, it's easy to implement with advanced GPS and new HR management systems that can carefully track how employees spend their time.

ABC clearly has a lot going for it, and yet, only about a quarter of state and local governments report that they use it systematically. Why? Some critics say it's too costly and that it's invasive for employees to track the time they spend on activities. Others say it places too much emphasis on outputs and not enough on benefits you can't directly observe, like preventing crime or reducing chronic disease.

But in the wake of the Great Recession, ABC can serve a different and new purpose. For the past few decades the central question in state and local finance was how to do "more with less." Oddly enough, better cost information adds little to that debate, mostly because efficiency has no natural political constituency.

But today many jurisdictions want to know how to do "less with less." To that end, ABC has great promise. It can show whether a program pays for itself. It can facilitate meaningful comparisons of different service delivery models. It can help leaders argue for programs that don't operate at maximum efficiency. In short, it can be the connective tissue between cost analysis and priority setting. That's why it might enjoy a bright future.

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