

Total Costs – a Method Used in Managerial Accounting

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Abstract: Cost accounting has long been used to help managers understand the costs of running a business. Modern cost accounting originated during the industrial revolution, when the complexities of running a large scale business led to the development of systems for recording and tracking costs to help business owners and managers make decisions.

Cost, as an instrument of financial administration control, reports to informing the decision factors. It permits managers to form a global view about enterprise and to manage the relations with costumers by prices.

Having a informative character, it is necessary that this instrument to be review by qualitative characteristics of accounting information. Thus, the main characteristics of cost information are: opportunity, reliability and signification.

Opportunity refers to terms when cost information must be known by the manager. Thus, information is timely if it is available at the moment of decision.

Reliability – information is reliable if it doesn't contain errors or incomplete elements, thus the manager trust in it.

Signification – information is significant when it influence the decisions of managers, permitting them to evaluate the past, present and future events for confirm or correct the past evaluations. For financial administration control a cost is significant if it can be used in a decision, having relation with every of managers decisions.

Belong these qualitative characteristics of cost information and the necessity of an equilibrium between them, it must be said that the usage of information in decision process depends of the medium in which the enterprise is evaluating. This medium is complex and it includes many factors like:

- production size;
- sale size;
- technological level.

Depends of these factors, the medium in which the enterprise evoluate can be stable or unstable. The main characteristic of stable medium is the stability of factors.

For calculating the complete costs we ca use the analysis centers method, which requires separating costs in two important categories:

- costs which can be affected to the product, direct costs;
- costs which can not be affected to the product, indirect costs; these costs will be collected and then charged to the production using the repartition process.

Complete costs are important for making decision process regarding the market. However, complete costs have also some drawbacks as:

- including some insignificant information for decision process – because the methodology of complete costs refers to allocation of all costs about products, including insignificant elements in complete cost information is unavoidable;
- repartition bases need – because not all the production costs are directly repartitioned to the product, it's necessary to use repartition bases. The problem is that these repartition bases involve a subvention cost phenomenon.
- opportunity - complete cost is a reliable information, but isn't timely because it is obtained at the end of production process. However, complete cost is a reliable information in condition of constant volume of production and sales – stable medium.

The enterprise is under submission of many mutations from external medium (market conditions) and from internal medium (internal structure conditions and production).

In daily economical condition, the market has been evaluated, being characterized by an exacting demand speaking of quality because of a powerful competition.

The competition belongs to the enterprises capable to keep up an evolution of technical progress and managerial innovations, because there is an evolution of market and also a change of internal production conditions. The growth of technical measure of production goes to minimize the difference between direct labor and indirect labor.

The growth of automatization production and the development of service activities goes to the subtraction of direct expenses and the growth of indirect expenses. Thus, the allocation of indirect expenses with repartition bases offers unreal information about cost.

The classic model of organization of the enterprise suffers important changes because the organizations have now a network of decentralized structures with few hierarchical levels and a transfunctional approach.

The usages of classical complete costs go to the appearance of a phenomenon of subvention for the complete cost of products which have the same repartition base.

In the specialty theory it has been identified three kinds of subvention effects:

- effects because of diversity of activities and of disparity of costs;
- effects because of production size;
- effects because of made investments for growing productivity.

The improvement of complete costs method can be done by using the calculation method Activity Based Costing (ABC). This method became an international researching trend, being considered one of the most important innovations in managerial accounting at the end of the twentieth century. Activity cost model is an analytic accounting system built on the activity concept.

An activity is defined as an ensemble of elementary operations done by one or more people, which permit the supply of some utilities, depart of some resources. The activities are grouping in processes. So, an activity is composed from elementary operation and it is included in a process.

A process is defined as an ensemble of activities structured for obtain a common objective and has three essential characteristics:

- it is structured in a transversal way unlike hierarchical structure and unlike the main functional structures of enterprise;
- each process has a global unique output;
- has an internal or external customer.

This method is not only a simple cost calculation system for products, but it is an expenditure resources system.

In Activity Based Costing method, the customers generate the existence of some calculation objects which create the demand of consumer resources activities. The structure of enterprise by activities offers a good presentation of expenditure resources processes, because the ABC method is concerned first to the expenditure of resources by the activities which compose the enterprise. Financial administration control must establish the activities.

In our days, financial administration control becomes an advantage in market competition.

Fixing the activity cost means to associate activity with an explicative factor of cost variation, named cost inductor.

The cost inductor is an allocation base for indirect expenses to activities and to calculation objects. Each cost inductor must express a determination relation with indirect expenses. The cost inductors are the determination factors which generate indirect costs.

The identification of cost inductors is realized using a cause - effect analyze, because a cost inductor must be the reason of recourses expenditure. Regarding the type of performance, the inductor can be a cost inductor, quality inductor or execution term inductor. Thus, Activity Based Costing method introduces a multicriterial administration of enterprise, based to a information system about the quality and a information system about delivery term. The effective expenses and the bugting expenses are following to activities.

In the specialty literature, it can be find the following types of cost inductors:

- operational inductors – specific for operational activities, as: supplies, fitting and distribution;
- structural inductors – which are specific for structure activities, as: general administration, treasury administration.

Inductor cost bases can be used for allocating indirect distribution costs (the number of hours of direct labor, machine-hours, the quantity produced or sold.), but may be introduced new inductor cost, such as the number of checks, number of manipulation, the number of opinions expedition.

In ABC method, which are the intermediate points of accumulation of indirect costs because, in the end, consumption of resources are charged an object of calculation. Thus, an object of cost calculation includes two components:

- direct cost, which express expenditures direct raw materials, energy, labor, etc.. which does not require an analysis of activities;
- indirect costs measured by the cost of activities consumed.

The cost of attending activities involves the following steps:

Stage 1 Setting activities of the company

Each center is associated with the enterprise is a process and then descompus in basic activities. The objective is to identify activities going from their justification in the process of creating value within an enterprise, this being a stage organizational analysis.

Stage 2 Identifying explicative factors of expenditure resources: inducers cost

For each activity to find an explanatory factor of consumption of resources called inductor cost. In terms of management control, utility activities have retained only to the extent that, for each activity, an associate inductor cost, which is due to that activity.

Stage 3 Regrouping activities based on a cost-inducer

At this stage, all activities that have the same cost inductor are grouped into a center regrouping. Also in this round are calculated a unit cost of inductor equal to the ratio of expenditure gathered in the center of regrouping and the total cost inductor.

Stage 4 full cost calculation, the costs of activities affecting the various objects calculation of costs

In this last stage to determine the cost calculation of the object by summing direct expenditure and consumption inducers of costs from regrouping centers, related to obtain usefulness. The item is a specific way of distributing indirect costs, which contribute to the production and sale of a particular product. This mode of training full cost of a product allows a more efficient analysis and more effective controls over indirect costs, items that tend to become significant in the total cost of the products.

The novelty introduced by the ABC method is that the manager is concerned about the processes of generating costs before the focus of these costs attachment to an object of calculation. Management activities focus on the causes expenditure resources, as much as possible even in time of consumption, to intervene on the operational costs of activities defined in the company. Thus, managers are distinction between activities that create added value and those who do not bring value-added enterprise. Therefore, information on the cost of the activity becomes, in terms of decision-making, more important than on the full cost of the product.

The plan theoretically, the method ABC has renewed regulatory issues in accounting research management because it generated debate on methodological and conceptual classification, identification of the causes, management and forecast the indirect costs.

Among the factors that have motivated enterprises in applying cost activities can enumerate:

- determine the need for a real cost of products;
- unsatisfying level of the current system cost complete management company;
- the need to identify and reduce costs;
- improving yield measurements;
- a large share of indirect costs in the manufacturing cost of the products completely.

Among the causes that led to failure ABC method can remember:

- enterprise managers do not want the application method;
- lack the necessary data;
- resistance to changing the system information on costs.

Although the method produces an analysis of ABC indirect expenditure toward classical model of full cost as an instrument of control in performance management, and it presents certain limits. Thus, the determination of the volume various inductors cost assumes the existence of physical inductors, which usually, are not followed, where the need for a system of measuring activities.

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