Are Your Cost Records Adequate?

Edith P. Rennison

ARE YOUR COST RECORDS ADEQUATE?

By EDITH P. RENNISON, Cleveland Chapter ASWA

Small business concerns, because of the immediate requirements for large cash commitments at the start of a business, are prone to consider cost records as being an unnecessary expense. This is understandable when management often is in the production line and has first-hand information concerning the prime cost of a unit. However, as larger quantities are sold new units are added, management must step into its own sphere and is then dependent on others and records for the necessary information to conduct business.

A growing going concern can know intelligently which direction to expand or develop its product through a practical use of its cost information. The finger-tip knowledge of a producing executive, which was sufficient while a concern was in its infancy, is no longer adequate when that concern grows into and enters the competitive field. Reports are needed in order to have on record all the pertinent facts regarding that growth. These reports should be in sufficient detail to show the results of performance and answer questions, such as:

Which product has been most profitable?

Is it the best of its kind in the field?

Can we improve it?

Should we change our design?

How much does it cost?

What is its selling price?

How does our product and price compare with that of our competitor's?

Will our percentage of profit permit a lower selling price?

Should we standardize our product?

How much extra can we charge to handle special requirements of our customer?

Can our profit absorb special handling, special tools, special design?

With practical records management should be able to predict answers to future questions, based on past performance, without the necessity of continually resorting to the expensive, time-consuming, effort-wasting, trial-and-error method.

With proper records, management should be able to secure efficient, economical, and profitable lines or units and can then control and direct the sales efforts toward these profit-producing items.

Management can control the margin of profit by using the recorded facts of manufacturing activities in a comparative manner, which will indicate the trend of greater or lesser profits, and with analysis can utilize the opportunity for constructive action.

The concerns whose records show that the accepted principles of accounting are practiced, in all probability, will not be subjected to governmental dictation and interrogation. The answers to the latter are often misconstrued, with the result that unnecessary taxes, may be imposed due to misinterpretation of the inadequate facts.

The primary basis for a sales price per product is the ultimate consumer limit. But what if the cost to produce does not permit sufficient profit in order to meet the consumer demand? Is cost just a matter of wishful thinking? Are we going to delude ourselves by saying, "It shouldn't cost any more than—and so we can sell if for—"? or "We used to produce 100 an hour and it cost—so now all we have to do is use the increased labor rate and material price in order to have a current cost"?

In so doing, consideration has not been given to the elements of time, the wear and tear of depreciating machinery and tools, the individual employee productivity, the "not up to standard" raw material used, the necessity of using the next best size or quality of material, the possibility of increased cost due to a series of setups and therefore broken runs and small quantities, the equal possibility of decreased costs due to using new machinery and equipment.

To use costs which have as their basis an estimated value and to let the year-end inventory adjustment then carry the brunt of inadequate records will cause the monthly statements to be misleading for comparative and analytical purposes. A selling price based on these ficticious costs may result in pricing the product and parts out of the market. Profit, if any, could not be correct, and judgement used in interpreting the financial statement would result in error. Expansion in the wrong direction or line would be very possible. In the event of loss in the financial statement, management would ask for higher prices or would not even consider expenditures for needed expansion. All of this because of lack of necessary recorded information.

If new machinery and tools are purchased and a cost department has not been established, the predictions of the supplier could not be verified that the production would be increased and that the machines would pay for themselves in a short time through decreased costs. For the first few runs attention would be given to the production per hour, and word of mouth reports would be accepted. Six months or a year later when the novelty of something new had worn off or a change in personnel had occurred, would management remember the production per hour or the estimated cost of thousands of parts and assemblies? No! Put it on record, and judge from numerous recorded performances.

Cost Accounting is a special study of its own which has a primary importance within the general subject of accounting. Since its scope is so large, the following is just a very brief review of its component parts.

Prime cost is the basic figure of material and direct labor cost.

Manufacturing cost is prime cost to which has been added the overhead or burden cost to manufacture or assemble.

Gross cost is manufacturing cost or merchandise cost to which has been added the selling and administrative costs.

Sales price is gross cost to which is added an amount which will represent the possible profit.

The methods or types of cost systems are many and it is very possible for more than one method to be co-ordinated within one system. Some of the better known methods are:

Specific Order or Job Order. This method has a job cost sheet to which is entered all cost information beginning with the raw material consumed to the final finished stage. Generally this method is used where companies do special work such as contractors, construction concerns, manufacturers, public utilities, and motion picture productions.

Standard Costs. This method involves a predetermination of what the cost should be with the information being supplied from scientific engineering standards. Any variances from the standard cost when it is compared with the actual cost must be noted and corrective measures taken.

Process Costs. This method has a process cost sheet to which is entered all costs for the process and accumulated for a week, month or some other process period. It is used principally for continuous or mass production of a single product or a variety of products using the same productive facilities such as different types of brick, tile, or ceramic products.

By-Product Costs. This method is usually that of process cost since the by-products very often result from continuous process industries such as meat packing, chemical, oil and coal where the major production is accompanied by lesser or minor products.

Generally speaking, sales prices are not changed because of a fluctuating cost due to various runs of a product, but in a free competitive field it is necessary to keep a weather eye open for attractive sales by being able to offer a better product at a lower price. It has been said that Henry Ford the First, was satisfied with a dollar profit per car, but he *knew* he had the dollar profit.

Therefore, it is imperative that current, active, actual costs be recorded.

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this time. Especially in an initial audit, the trial balance is set up at the beginning of an audit and the initial audit program is prepared simultaneously. The important fact to bear in mind is that the time used to take off a general ledger trial balance should be made as productive as possible.

General Journal

All general journal entries should be carefully scrutinized. Any adjustments which result in a loss of income to the client, or any others of like nature, should be approved by someone in authority. The auditor must satisfy himself that the general journal has not been used as a cloak for inefficiency on the part of the client's staff, and that all entries are factually as well as mathematically correct.

Once again it is important for the reader to note that this article is not to be con-

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