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Uniform Cost Accounting in Trade Association: Organization of Activities

Chamber of Commerce of the United States. Fabricated Production Department

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Uniform Cost Accounting in Trade Associations

ORGANIZATION OF ACTIVITIES



[Third Revision]

FABRICATED PRODUCTION DEPARTMENT
CHAMBER OF COMMERCE OF THE UNITED STATES
WASHINGTON, D. C.

FOREWORD

After several years spent in investigations of cost accounting plans and methods, especially those used by trade associations, we became convinced of the desirability and practicability of such organizations building their own systems making use of the accounting talent within the industry and securing such additional experienced service as is necessary from outside retained accountants.

Mr. Thomas W. Howard, in charge of our cost work, has herein outlined a plan which suggests how it may be done. This plan is in successful operation in a number of representative industries. The Department is prepared further to elucidate it and to assist in the organization of activities under the plan.

E. W. McCULLOUGH, *Manager,*
Fabricated Production Department.

December 1, 1923.

Uniform Cost Accounting in Trade Associations

Organization of Activities

The importance of uniform cost accounting as a major activity of a trade association is coming to be generally appreciated. Each association in taking up these activities, however, has developed its own plan and often through expensive experimentation has finally developed the one best way for carrying on such activities.

It is the purpose of this brief treatise to bring together what experience has taught to be the most effective plan for the organization of cost accounting activities in a trade association, based on these actual performances. Herein the essentials of a plan are set forth, and it has seemed best to make the plan concrete and specific, even though it may be found necessary in each industry taking up such activities to use this plan only as a model and apply such variations in details as are necessary on account of local conditions.

It is hoped also that these suggestions will be of service to those trade associations in industries that have previously taken up cost accounting activities but which have not as yet finally emerged with successful accomplishments.

UNIFORM COST ACCOUNTING DEFINED

Uniform cost accounting comprises a set of principles and in some cases of accounting methods which when incorporated in the accounting systems of the individual members in an industry will result in the obtaining of cost figures by the individual members of the industry which will be on a comparable basis. Uniform cost accounting does not mean the preparation of average or standard cost figures for the industry, nor the inclusion in costs of predetermined or fixed elements of cost.

Each industry has its peculiar accounting problems just as it has its peculiar problems of production and of distribution.

The problems of the shipbuilder are different from those of the cotton finisher; the stove manufacturer has little in common with the pickle packer. In one industry the cost of material may require the closest cost determination; in another overhead expenses must be most carefully accounted for. Again, in such an industry as the electrical industry the accounting problem may be concerned with the costs of thousands of small items, while in the cement or brick industries there are just a few staple products. In the chemical industries, for example, the accounting for by-products is important. So it is that each industry has its own peculiarities in cost accounting.

It is quite possible, however, in any one industry to develop cost accounting technique that will result in the figuring of costs by the members individually on a comparable basis. It will give each manufacturer in the industry assurance that all other manufacturers in the same line have included the same items in their costs; that their businesses have been departmentalized in substantially the same way; that there is a common understanding of overhead or burden; that there is a tie-up of the financial and cost records; there is a control of raw materials, and so on. In other words, those differences in cost between the members of the industry, which are bound to exist, are due to different efficiencies in management and to economic reasons and not because of a lack of cost knowledge.

Uniform cost accounting is concerned solely with fundamentals. In the system of the individual manufacturer there is wide scope and latitude for originality in office methods and accomodation to peculiar accounting requirements; hence uniform cost accounting is not comprised in a rigid classification of accounts.

ADVANTAGES OF UNIFORM COST ACCOUNTING

Among the many advantages offered uniform cost accounting:

1. Provides the "one best way" known to the industry to figure costs (although cost accounting is a progressive science and provision should be made for keeping the uniform methods up to date) thereby eliminating expensive experimentation by the members of the industry individually and independently.
2. Results in a better informed competition within the industry.
3. Enables the industry instantly to place facts before regulatory bodies.

4. Inspires confidence in the public that selling prices are established by producers who have full knowledge of the costs of the articles offered for sale.

5. Tends to make the manufacturer who otherwise would fail to see the advantages of good cost accounting convinced of the desirability of adopting the methods which his competitors are successfully using.

6. Reveals lines of individual products which have been marketed on an unprofitable basis.

7. Provides in addition to the above specific reasons all of the valuable features of good cost accounting generally, among which are the following:*

- (a) Shows the danger line below which goods cannot be sold at a profit; thus serving as an insurer of profits.
- (b) Acts as a guide to the value, efficiency, and waste of workers, machines, methods, operations, and entire plants.
- (c) Provides a reliable guide and basis for estimating the cost of prospective business.
- (d) Furnishes current reports for comparing major cost items with standards which are predetermined and thereby measures and increases operating efficiency.
- (e) Establishes a standard manual of accounting practice so that if your cost clerk, bookkeeper, or accountant leaves you his successor will find a system the operation of which has been fully and completely developed.

ESSENTIALS FOR SUCCESS

Out of the experiences of more than one hundred industries it has been pretty clearly demonstrated that there are certain essentials for success which must be followed in the organization of uniform cost accounting activities in trade associations. Briefly these may be stated as:

1. *Arousing Interest.*—The necessity for securing a keen appreciation on the part of the executive officers of the individual concerns of the industry of the importance of the development of uniform cost accounting technique and a willingness to contribute their time and that of their accountants, and funds towards the expenses of the movement.

*The Fabricated Production Department has prepared a pamphlet entitled "What a 'Cost System' Should Do For You" which elaborates on and reinforces the arguments herein presented.

2. *Developing Technique Through Committee.*—The practicability of developing the uniform cost accounting technique through a voluntary committee of accounting officers of representative concerns of the industry, aided when necessary by a retained accountant.

3. *Securing Accountants' Cooperation.*—The importance of gaining the interest of the practical accountants of the industry in the cooperative development of the one best way to figure costs in the industry and of securing their cooperation toward this end through the medium of a council of accountants of the industry.

4. *Arranging for Installation.*—The need for formulating a workable plan for securing the installation of the uniform cost accounting after its adoption by the association and the making of a provision for continuous accounting assistance through the trade association offices.

WAYS OF CREATING INTEREST

There are various ways open to the trade secretary to stimulate interest in uniform cost accounting. One is through letters to his members. These should be short, covering at a time not more than one advantage derived from uniform cost accounting. The second method is by placing before his members selected cost literature confined to fundamentals not intricacies of cost accounting. The Fabricated Production Department has prepared several pamphlets dealing with cost accounting that may be found of value used in this way. A list of these publications will be found on the last page of this pamphlet. Again many members can be reached through pertinent articles on cost accounting placed in trade or association journals. Such articles often carry a weight not attached to the ordinary letter or bulletin. The regular monthly meeting or annual convention affords an excellent opportunity to introduce the subject of cost accounting.

The full value of the addresses, however, will be lost unless they are followed by discussion. Such discussion clears up misunderstandings and often contributes worthwhile experience not originally developed by the speaker. Speakers on cost accounting before regular meetings or conventions should be chosen very carefully since a poor speaker will do more harm than good. As far as possible manufacturers within the industry or practical business men from without having adequate cost systems should be selected since no suspicion can arise that they have something to sell.

Topics suitable for convention or meeting addresses follow:

1. Advantages of uniform cost accounting, by a secretary of a trade association operating under such a system.
2. What uniform cost accounting means to our industry.
3. How the executive can use costs.
4. The distribution of overhead expenses.
5. Tying up the cost system with the financial books of account.
6. A practical demonstration of how a cost system works.
7. The results of a questionnaire on the cost of a standard product.
8. Applying depreciation equitably.

ORGANIZATION OF A COST COMMITTEE

When interest has been thoroughly aroused in the membership a cost committee should be appointed. This committee should consist usually of not less than five nor more than ten executives who are responsible for cost accounting activities in their respective establishments and who are known to have gone far in the development of cost systems for their own companies. It will be the duty of this committee by frequent conferences to develop the uniform cost methods.

SELECTION OF A RETAINED ACCOUNTANT

In order to develop a thoroughly modern system not only will it be necessary to draw upon the ability and experience of the members of the cost committee, but it may also be well to engage an experienced cost accountant doing public work. He will set up an outline of the system as he believes it should be and the committee will collaborate with him in developing it step by step. He will also render valuable service as an umpire in instances of differing views.

Great care should be exercised in the choice of a retained cost accountant. One who has had long experience in the particular industry minimizes the risk and should be secured if possible.

DEVELOPMENT OF THE UNIFORM PRINCIPLES

The work now having been launched should proceed without let-up until the uniform technique has been developed to which the committee can fully subscribe. The results of their work should be set up in the form of a cost manual. This cost manual is a very important matter. It should be logical, comprehensive and expressed in language that is clear and unmistakable in its meaning.

The Fabricated Production Department is now giving special attention to the matter of the organization of the work of the cost committee and the development of its cost manual. Any committee desiring the Department's views or assistance is invited to write the Department.

ARRANGEMENTS FOR INSTALLATION

After the uniform cost accounting procedure has been approved by the association arrangements for its installation must be made. The Fabricated Production Department has prepared a pamphlet bearing on this subject* and inquiries in regard to special problems will be gladly answered. Some of the steps that should be taken to secure widespread installation will now be outlined:

ORGANIZATION OF A COST COUNCIL. After the uniform cost accounting technique has been approved as complete and accepted by the association and installation is under way, a cost council of the practical accountants of the industry should be formed. This council should meet four times a year to compare notes and exchange experiences and to make such improvements and changes as may be proved to be desirable as the result of experience with the use of the uniform procedure. Furthermore, the frequent contacts of the working accountants of the industry tend to make easy the adoption of the uniform methods on the part of the individual members.

COST BUREAU. It also may be desirable to provide a cost bureau within the association or effect a new arrangement with the retained cost accountant to render service to individual members in making the installation of the uniform methods.

Sometimes individual members desire the cost accountant of the association to make the complete installation. Others wish their department heads to take part responsibility and hence to

*Pamphlet No. 8—The Acceptance and Installation of Uniform Methods of Cost Accounting.

utilize the services of the association's cost accountant on a part time basis, and still others may wish to make the installation entirely themselves, possibly securing the services of the association's cost accountant for a day or two every few months until the work is done.

Under any scheme of installation, however, the secretary must keep the pot boiling and watch every possible opportunity to forward the use of uniform cost accounting.

WHAT WILL IT COST?

It is natural to raise the question of the cost of uniform accounting activities. Obviously it can only be answered in general terms. In some lines where the volume and the character of the business will not allow of great refinements in cost accounting, and actually the problems are not great from a practical point of view, the cost both in time and in money will not be large. In other lines where possibly the values handled are far greater and the production and accounting problems are intricate, uniform cost accounting carried to its ultimate conclusion may cost much in time and money if the attempt is made to go the whole way in the initial activities.

It is our belief that usually it is far better to resort to simplicity in the early stages in any industry. Particularly in the more important and complicated industries it is better first to develop the absolute fundamentals leaving for later consideration the numerous intricate problems of detail that are bound to arise.

Naturally upon organization the cost committee will study thoroughly the general problem of uniform cost accounting in the industry and determine upon the plan the cost of which in time and money will yield the greatest return and which a careful appraisal shows will be accepted readily by the industry.

CONCLUSION

It will be seen from what has been said above that the carrying to a successful conclusion of cost accounting activities in a trade association is one that requires continuous attention. The trade secretary, however, should not be discouraged at this, for ultimately he will win out and when that time does come he will be amply rewarded by improved conditions in his industry.

Cost accounting takes time and money, but it is all more than justified by the increased knowledge and control of business derived.

Some Comments on Uniform Cost Accounting

Results in the Malleable Iron Industry

"In the malleable iron industry it is known that the benefits from uniform accounting have been very great in affording reliable comparisons of operating results which locate waste and inefficiency not easily spotted in any other way. The most fruitful fields have been a comparison of departmental labor costs, of departmental labor turnover and of labor earnings. The monthly and quarterly statements of labor costs are considered by members as the most important statements issued by the Association. The proof of their value is the substantial savings effected and the careful analysis made of the comparative results. Cooperative work of this character, and it cannot be pursued without substantial uniformity in accounting methods, is essential to the maximum economic and financial strength of any industry."

Changed Conditions in the Tent and Awning Industry

"In one city where there were seven manufacturers in 1921 one firm having a cost system and six firms with none, there was very little cost used as a guide in production. Today in that same city four firms have cost systems and are guided in their production by cost facts. The result most naturally would be that the selling price is based upon cost plus profit and is of course a true selling price according to economic law."

Importance of Arousing Interest

"Without doubt one of the greatest factors that enabled us to bring our manual to a successful conclusion was due to the fact that we made every effort during the period of its construction to create and sustain interest of the members in the work which we had set about to do." (Milk Industry.)

Uniform Cost Accounting Saved the Day

"As far as my own business and experience is concerned, our industry went through about as severe a readjustment after 1920 as any line of business and I do not know of anything that we have leaned on that has been as valuable and useful as this cost accounting system." (Electrical Manufacturing Industry.)

Sticking to Their Knitting

"Last year we were quite proud to announce to our National Association that sixty per cent of our western members were actually contributing hard dollars to a movement to unify cost accounting systems of the Knitted Outerwear Industry."

The Dangers of Unwise Competition

"Four or five years ago the firm with which I am associated lost an important contract on account of very much lower prices made by a competitor. Not knowing how it was possible to produce the goods at such

low prices I made it my business to visit the factory of this competitor to learn, if possible, how it could be done.

"A few minutes in the office of this competitor revealed what I had already suspected—that no cost system worthy the name was in use. The manager of this concern was very boastful of his ability to run the business without a lot of overhead expense, stating that he was by this means able to produce goods at much lower prices than his competitors, and in this way always undersell them, while the true facts in the case were he did not know what the goods were really costing, and was selling them at less than actual cost.

"This was proven by the fact that the concern went out of business a few years later. All concerned in the transaction were losers; we lost a contract on which we were making a profit, our competitor lost because he furnished goods at less than a profit, and even the purchasers of the goods were losers because they are no longer able to obtain necessary repairs, so that they have to discard the machines long before the end of their natural life." (Pump Industry.)

Inspiring Confidence

"Generally speaking, it is our opinion, based on experience, that it (a uniform cost system) has strengthened the position of the electrical manufacturers in dealing with the Government and with large customers in all contracts or reports in which costs were an essential feature. That is to say, a cost based upon the standard practice of the industry inspires confidence as the soundness of the basis on which it is compiled."

FABRICATED PRODUCTION DEPARTMENT PUBLICATIONS

BULLETINS

11. Cost Accounting Work in Trade Organizations
 - *12. Money Saved—Production Simplified—Service Improved
 13. Methods Which Make for Success—Uniform Cost Accounting
 14. Cooperative Depreciation Studies (with a Governmental Contribution)
 15. Real Profits in Eliminations Savings
 - *16. Cost Accounting Information You Ought to Have
 17. The Value and Use of Statistics in Business Control
 18. Research Work—A Constructive Trade Association Activity
 19. The Waste of Too Many Kinds—Are You Guilty?
 20. Collective or Group Studies of Uniform Cost Accounting Methods
 21. System in Scrapping the Obsolete
 22. What Is Your Cost System Doing For You?
 23. What Some Lines are Doing to Reduce Wasteful Variety
 24. Two Worthwhile Addresses
 25. Still After Waste—Have You Checked Yours?
 26. Quality Standardization—Protection to Seller and Buyer.
 27. Waste Elimination. Is it in Your 1924 Program?
 28. What Is Your Cost Program for 1924?
- * *Out of Print*

PAMPHLETS

1. What a "Cost System" Should Do For You
2. The Fabricated Production Department—Service to Those Engaged in Manufacturing
3. Overhead Expenses—How to Distribute Them in Good and Bad Times
4. Depreciation—Its Treatment in Production
5. Perpetual Inventory or Stores Control
6. Budgeting for Business Control
7. Simplification and Standardization—A Means of Reducing Industrial Waste
8. The Acceptance and Installation of Uniform Methods of Cost Accounting
9. Uniform Cost Accounting in Trade Associations.

Single copies of these publications will be furnished on request, without charge.