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## Educating the Executive to Appreciate Costs

By ROBERT S. PASLEY, C.P.A.

Much has been written on the subject of cost accounting, and a great deal remains to be written. Much of what has been written has not been read by those that should be most interested, and very few indeed of the suggestions set forth have been put into practice. That cost accounting has not been adopted more generally by manufacturers is not due in all instances to a lack of comprehension on their part as to the advantages to be derived from a scientific cost system, nor is it due to the fact that the subject as written about by accountants and others has not been handled as competently as most such subjects are dealt with on the printed page. Rather, I believe, this subject has been covered more thoroughly and comprehensively than is usually the case with technical questions.

The manufacturer, on the average, is usually a hard-headed man of business. He has to be in order to master successfully the problems which confront him every day. He is alive to the necessity of taking advantage of improvements in methods and scientific discoveries. Why, then, is he so slow in adopting suggestions offered by experts in their line in relation to the recording of his operating costs? It is not because he is indifferent to his costs, for he cannot afford to be indifferent. I believe that this reluctance on the part of the manufacturer to instal cost accounting methods in his factory is because he is frightened at the mental picture of the detail involved, the probable expense of installation and the increased expense over his present office burden of maintaininig an elaborate cost system. To him the advantages are problematical, while a heavy burden of expense appears almost a certainty. He is partly right in that attitude—it does cost money to instal a proper cost accounting system in a plant of any size; it does cost money to maintain such system when installed, and if great care and judgment are not used in the installation and maintenance of the system, the results

## *The Journal of Accountancy*

obtained may be a source of danger, rather than an advantage, inasmuch as prices will be almost invariably based upon such showing of cost.

The manufacturer has to be educated up to a cost system. To me it does not seem reasonable to expect that a firm, which for many years has kept an ordinary financial set of accounts, knowing its net profit once a year at inventory time, is in a position to weigh nicely the benefits as opposed to the increased detail of a cost system and coolly appraise the net advantage resulting therefrom. The progressive manufacturer, however, is restless and dissatisfied and feels that he is handicapped in the conduct of his business, when for 364 days in every year he has to guess at the results of his operations, and the 365th day develops the fact that as a whole his business has been profitable for the year, or the reverse, and develops also that the sum total of his knowledge of his operations is embraced in that one conclusion. What particular department is responsible for the good showing or what particular department has resulted in a loss is as much an impenetrable mystery as ever.

As a practical accomplishment within the reach of any business, large or small, a departmental system of accounting will appeal to the average man of affairs. Almost every business is run by departments, and most men would have greater confidence in accounting if their bookkeeping was arranged to show them which department of their business was profitable and which was not profitable, and how the departments compared one with another as to results, expenses and efficiency of operation. To my mind this is the initial step that should be taken toward the complete education of manufacturers as to the present-day necessity of balanced costs. Not alone the manufacturer but the retail merchant should have accounts arranged to show results by departments.

It has been my experience in discussing accounting problems with business men, that a system of departmental accounting seems to them as difficult of accomplishment as an actual cost system. The accountant, however, knows that this is not the case, and that the accounts of almost any business can be so arranged as to show departmental results periodically. What the accountant does not seem to appreciate, however, is the fact that in many

### *Educating the Executive to Appreciate Costs*

cases, arranging such a set of accounts would fulfil for the time being the client's requirements and, as stated before, would be a step toward his broader education on the importance of adequate accounting. I shall not attempt within the confines of this article to outline a complete set of departmental accounts, but shall endeavor to point out generally what slight modifications are necessary in an ordinary set of accounts to give departmental results.

#### MATERIAL PURCHASES

If a business is of large dimensions and materials are purchased in considerable quantities, invariably it will be found that stores accounts are kept and some attempt is made to charge stores where they are used. Sometimes a cost system is in use, which does not form part of the general books, does not tie up with control accounts, and is more or less in the nature of memoranda. In such cases, purchases of materials could be charged to a stores account through the voucher journal. A few instructions regarding the stores issues and a little supervision on the part of the accountant would be necessary to permit of a summary entry through the journal at the end of each month, charging the several departments, which it is desired to keep separate, but not the individual jobs, and crediting stores account. If it is not the practice to compare the stores accounts with the physical inventory more often than once a year, it should be suggested that when a stock of any material is all used, or has run low, the book account of that particular material should be turned up and adjusted, and if this is done continuously, a very accurate book stock can be maintained.

Where it is stated that the operations do not warrant the keeping of stores accounts, or where it is known for what purpose materials are purchased, columns could be opened in the voucher journal corresponding to the departments which it is desired to keep separate, and invoices of materials could be charged directly to the departments. In this case, however, unless materials are being purchased, as it were, from hand to mouth, or used promptly, the accuracy of the departmental results will be contingent upon the care taken to know the stock remaining on hand at any time. In a small plant a physical inventory could be taken

more frequently than once a year, and in the interval the inventory should be estimated. The inventory can be approximated sufficiently closely each month, where an actual inventory is taken oftener than once a year, to permit of a monthly showing of departmental results which would be materially correct. A system of stores accounts, however, should be recommended in almost all cases, and in time the firm would see that the added expense of keeping such accounts would be warranted by the greater accuracy of the results obtained. Indeed, in some instances there would not be any additional expense. It is a well-known fact that sometimes employes will do the work apportioned to them—just that and no more. By the exercise of a little judgment on the part of the management in such cases, a great deal more detail can be handled by the same office force.

It is frequently the case that materials purchased for one department will be used by another department, or materials charged to one department will be partly used in the department charged and partly in some other department. This can be readily handled by a system of transfer slips, on which should be reported transfers of material at cost from one department to another. A transfer journal should be provided with the same number of debit and credit columns corresponding to the departments. The number and the amount of each transfer slip should be entered in this journal, debiting the department in which the material has been used, and crediting the department from which the material has been transferred. At the end of the month, the totals of the columns are debited and credited to the several departments in the general ledger.

#### LABOR

Whatever system of payroll is in vogue, it is not a very difficult matter, whether the plant be large or small, to analyze the time-sheets monthly and charge the various departments, crediting payroll account—the payroll account itself having been previously charged with the total amount of the payroll through the voucher journal or the cashbook. In some plants it will be found possible to charge the departments direct through the voucher journal with the weekly payroll. Here again, we are liable to be confronted with the same problem as when dealing with material

### *Educating the Executive to Appreciate Costs*

transfers, for labor is often borrowed by one department from another and similar labor transfer slips should be kept to record all transfers of time. These slips could be of a color different from the material transfer slips, and they should be summarized in the same form as the material requisitions. Each of these transfer summaries could be arranged in loose-leaf form and put in the same binder, except that they should be posted separately into the general books.

The question of the allocation of the indirect labor will, no doubt, arise in all cases, but as this generally forms but a small portion of the total labor cost and usually bears a relation to the direct labor, it may be logically apportioned on that basis.

#### FACTORY EXPENSES

Generally it will be found feasible to divide factory expenses as they are incurred for the several departments. Light and power and water, for instance, are billed according to meter readings and can be apportioned accordingly as entered. In some cases the item of rent is absolutely distinct, but in others it must be divided on an equitable basis, such as the space occupied by the different departments, and can be divided in the voucher journal when entered. Rates of depreciation should be established on the different machines in use, and when these rates are once established and it is determined to what departments they pertain, this schedule should be adhered to until some change in the operations necessitates a change in the accounting plan. Other factory expenses that cannot be directly apportioned—and in actual practice they will not be a large proportion to the whole—can be approximately divided as incurred, according to the best judgment of the management.

#### OTHER OVERHEAD EXPENSES

Up to this point we have divided departmentally the direct cost of materials consumed, labor and factory expenses. We can know each month, accurately where a perpetual inventory is kept and approximately otherwise, the cost by departments of goods sold. There remain the various other expenses—general and administrative, office and selling. I would recommend, generally, that these expenses be stated each month in as much detail as is required, and that no attempt be made arbitrarily to divide them

## *The Journal of Accountancy*

over the departments. I believe that nothing much is accomplished in most cases by the division of such expenses over departments in the arbitrary manner in which they are usually segregated. This recommendation, however, is made with this reservation, that in some instances—a department store is a case in point—the several departments are so distinct that it is quite feasible to divide such expenses.

### SALES

The sales as a rule present no particular problem. A summary sales-book can be arranged, perhaps in loose-leaf form, on which the carbon invoices can be summarized monthly, according to departments. It will be found, however, that in nearly all cases a careful record of the sales is kept by departments.

### GENERALLY

The foregoing, of course, is a very general outline as to what can be done with little additional detail in establishing accounts that will show a manufacturer or merchant something more than his net profit or loss, and while individual problems not even suggested here will arise in practice and some of the methods of allocating expenses, outlined above, will doubtless be modified according to circumstances, it will be found that the results as to departments will be approximately in accordance with the facts and may develop the all-important conclusion that some departments are being operated so successfully as to cover losses made in others. The keen manufacturer or business man, when operating a system of this kind, will become more familiar with the results of his operations and will probably in time not be content to know that one department is a very profitable one while another department appears to be not quite so profitable. Results may prove to be a complete reversal of his previous judgment in the matter, and he will have considerable food for thought. He will pay more attention to his accounting, and in the end may make up his mind that perhaps this approximation of departmental results is not enough—that he ought to know more intimately, more accurately, what units in his departments are responsible for the results developed.

To put it briefly, he is being educated.