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COST ACCOUNTING AND BUDGETING 1/

by

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INTRODUCTION: - The purpose of this paper is, obviously, to give a clear understanding of cost accounting and budgetary techniques for practising and potential Managers. Consequently, I intend to confine myself to the bare essentials without going into too much detail. For those who are interested in a more serious study of these techniques, I refer them to the various textbooks which give a more rigorous treatment of the subjects.

However, I shall endeavour in this short paper to give answers to the following questions:-

1. What are the cost accounting and budgetary techniques and how are they related to the other accounting techniques?

2. What steps are involved in installing cost accounting and budgetary systems?

3. What are the types of cost systems and budgets?

4. Lastly, How can management make use of these new techniques in decision making?

I. COST ACCOUNTING, BUDGETING AND THEIR RELATION TO OTHER ACCOUNTING TECHNIQUES:-

Cost accounting and budgeting techniques are a part of what is now known as Management Accountancy which also includes financial accounting, material control, labour control, production control and the reporting systems. The tendency now is to use all these techniques together to assist various levels of management to run their areas of responsibility more efficiently.

There are seven major processes involved in management accountancy techniques:-

1. Forecasting

2. Planning
   In the first two mentioned processes we decide what should be done and prepare plans to achieve the desired objectives.

3. Organising: Define authority and responsibilities clearly.

4. Motivating: Establishing sound leadership and getting the most out of employees through a high standard of morale and co-operation.

5. Co-ordinating: All the activities of a project should be co-ordinated in such a way that all units operate at the highest degree of efficiency and produce maximum profit.

6. Controlling:- This involves comparing actual performance with the standard to ascertain whether there are any deviations and taking corrective action.

7. Communicating: Transmitting instructions and information, not only within the organisation, but also to outsiders like customers, suppliers and others.

In other words, [illegible] an important role [illegible] and it is inconceivable for [illegible] without the aid of these [illegible]

II. [illegible] IN INSTAL[illegible] COST [illegible] SYSTEMS:-

. Whenever a new [illegible] control system is being introduced, these steps should be followed:-

A. Survey of existing [illegible] to study problems

B. Preparation of [illegible] Chart and job descriptions.

C. Design Systems:

1. Material control system. This will start from the point of ordering up to the point of receiving and issuing from store.

2. Labour Control System. This includes all the procedure [illegible] to paying out wages.

3. Financial accounting [illegible] (chart of accounts [illegible] forms and vouchers)

4. Cost accounting [illegible]

[illegible] classification and coding of:

[illegible] Indirect

[illegible] Indirect labour

[illegible] Cost and [illegible]

[illegible] and vouchers

[illegible] Standards and [illegible]

D. Define [illegible]

E. Design reporting [illegible]

F. Implement the [illegible] and training the staff.

G. Follow-up the systems.

It should be apparent that not every company has got these systems implemented. Some companies have only got financial accounting and actual cost systems. And yet, needless to say, these companies cannot benefit fully from actual cost systems unless they are implemented in conjuction with budgetrary and standard cost systems.

III. **TYPES OF COST SYSTEMS:-** Cost accounting systems are traditionally divided into:-

- Standard Costs
- Job Order Costs
- Process Costs

However, in practical experience, combinations of all three types will be found.

TYPES OF BUDGETS:- Budgets are used for future planning and control and they consist of the following:-

A. Operating budgets. These show planned operations for the forthcoming period. The operations include:-

i) Sales
ii) Production
iii) Stocks
iv) Purchasing
v) Labour
vi) Costs

- Manufacturing
- selling & distributing
- Administration

vii) Forecasted profit and loss

viii) Balance Sheet forecast

These will show physical quantities and monetary values

ix) Financial Budget, showing the anticipated sources and uses of funds. (Cash Flow)

x) Capital Budget showing planned changes in fixed Assets.

IV. COST ACCOUNTING, BUDGETING AND MANAGEMENT DECISIONS

I have already indicated the importance of cost accounting and budgeting to management. Here, I am going to give some examples of the value of costing information in arriving at conclusions which allow management to maximize profits or minimise losses.

As you may be aware one of the main problems in decision making is to pre-determine, the effect of a given decision on the long-term efficiency of the business. Some of the problems which may be solved by the use of cost accounting and budgeting techniques are:-

1) Profitability of departments or products

2) Pricing of products

3) Suspending activities (closing down)

4) Make or buy decisions

5) Expand or buy decisions

6) Comparing Machines and manual labour

A. As an example of profitabiy of departments or products, consider company S which manufactures three products A, B, and C. The cost of each is as follows:-

	A U.Shs	B U.Shs	C U.Shs
Sales/Revenue	160,000	80,000	120,000
Direct Costs (Direct Materials, direct labour & other variable expenses)	48,000	30,000	92,000
Contribution	112,000	50,000	28,000
% Contribution to Sales	67%	62%	23%

Product A is more profitable than the other two. In other words, the more of product A that the company produces, the more profit it makes if the market accepts excess quantities and if other co-operating factors like labour and machines are available.

B. Pricing

As a rule, the management of any company should be very cautious when fixing the price for any new product. Alternative courses of action should be considered, that is what percentage of profit should be adopted. The following example will illustrate the situation. S Company is marketing a new product, and this is the information presented to the management of the company:-

1. Percentage of profit for other products of the company is 25% of total costs.

2. The quantity that can be sold if price is fixed at a profit margin of 25% is estimated at 10,000 units.

3. The unit cost of this product is 20/- at this expected level of production.

4. The quantity that can be sold if the profit margin is 15% of costs is estimated at 20,000 units. At this level of production the cost per unit is U.Shs. 18/-

5. The expected quantity to be sold if profit margin is only 10% is 100,000 units and cost per unit at this level of production is U.Shs. 17/-

Decision:-

(1) % of Profit	25%	15%	10%
(2) Expected quantity to be sold	10,000	20,000	100,000
(3) Cost per unit (U.Shs)	20/-	18/-	17/-
(4) Selling Price (U.Shs)	25/-	20/70	18/17
(5) Total Cost of expected quantity to be sold (U.Shs)	200,000	360,000	1,700,000
(6) Sales (U.Shs)	25,0000	414,000	187,0000
Net Profit 6 - 5 (U.Shs)	50,000	54,000	170,000

It is clear that management will find the decision to produce 100,000 units that can be sold at a profit of 10% is the best.

These two examples give a simple idea about the importance of cost and budgeting information for decision-making and efficient running of a company. Other examples can be given for the other problems listed above.

In conclusion, I wish to express the hope that in this short paper, I have given a clear picture of the new techniques of cost accountancy and budgeting systems.

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