

March Management Education Workshop Recap:

Using Cost Accounting to Drive Profitability

Presented by Gary Turnquist, CPA, Shareholder, Blanski Peter Kronlage & Zoch, P.A., CPAs and Consultants

There are two main purposes to cost accounting: external reporting and internal cost management.

At the March 29 MPMA Management Education Workshop, Gary Turnquist, shareholder and manufacturing practice group leader at BPK&Z CPAs and Consultants, presented on "Using Cost Accounting to Drive Profitability." This presentation solely addressed internal cost accounting, which focuses on events and transactions that cause costs to be incurred. Here are some of the highlights of Gary's presentation.

BUDGETING

Tying your company's budget in to your internal cost accounting system is critical to driving profit. The current trend in budgeting is having a dynamic, rolling or continuous budget. This type of budget is set up for 3 – 6 months and the following months are forecasted. It is then reviewed, adjusted and updated regularly (at least every 3 months).

Gary suggested setting up a budget spreadsheet with columns that have the original budget and actual results. A third column shows a revised budget based on actual activity. This last column will allow you to accurately determine variances from actual to budget and adjust the budget for the next 3 - 6 months.

PRODUCT COSTING AND COST MANAGEMENT

The main challenge with product costing and cost management is overhead allocation. General/plant wide overhead allocations are good when trying to gauge overall company performance, but may be inaccurate for individual products/customers.

In the past, overhead allocation was based heavily on labor. Because of technological advances resulting in labor reductions, overhead allocation also should be based on factors such as machine hours and activity. Common activity measures include:

- Normal activity – long term average production volume
- Practical capacity – maximum capacity after allowances for maintenance, break-downs, etc.

The trend is to use practical capacity theory. If you're trying to drive profitability you need to think of where you could be, not where you have been performing historically.

ACTIVITY BASED COSTING

More manufacturing companies are revisiting activity based costing (ABC). ABC considers recent changes from labor based operations to technology based operations.

ABC collects costs by area of responsibility, assigns costs to specific activities, assigns activities to product/service through Bill of Activities (scheduling, inspection, material procurement, etc.).

In order to be more successful with ABC, Gary recommends focusing on core activities rather than trying to apply costing

theory to all activities.

The best way to drive profitability in today's manufacturing market is to employ ABC, lean cost accounting methods, or work center cost accounting methods coupled with variance analysis.

STANDARD COSTING AND VARIANCE ANALYSIS

When defining cost standards it is important to focus on practically attainable standards instead of ideal and historical standards. Practically attainable standards are based on what is realistically attainable if changes are made.

Variance analysis against standards can be measured to identify what's performing well and what's not. Gary strongly encourages that - at the least - the following four are measured: material price, material quantity, labor rate and labor usage

COST-VOLUME-PROFIT ANALYSIS

Cost-Volume-Profit Analysis (CVP) must have good data to be useful. CVP Analysis can:

- Evaluate existing product lines to determine effects of changing sales
- Estimate effects on profits of new products at varying sales levels
- Calculate effects on profits of changes in service delivery, production methods, material changes/substitutes

RELEVANT COSTING AND CONTRIBUTION APPROACH

Relevant costing is most applicable for non-recurring decisions, such as:

- Acceptance of business/contracts at special pricing
- Discontinuance of product or production line
- Make or buy decisions
- Product mix when producing at full capacity

A relevant cost is defined as meeting the following two criteria: expected to be incurred in the future and change or vary within the choices available to management.

Gary joined BPK&Z in 1989 and became a shareholder in 2001. He leads the firm's Business Process and Profit Improvement Services, focusing on internal controls analysis and operational assessments to help clients improve their efficiency and profitability.

Working with start-ups to multi-million dollar companies, Gary facilitates strategic planning in industries such as manufacturing, health care and community-based organizations. He serves as BPK&Z's Practice Group leader for Manufacturing. Gary can be reached at (763) 546-6211 or at gturnquist@bpkz.com.