Traditional or advanced cost calculation systems? – This is the question in every organization

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Abstract

In present context preoccupations regarding cost calculation, control and cost reduction are major challenges within organizations. Globalization represents a major change, which leads to performance and performance measurement. We are also the witnesses of technological and organizational mutations and evolutions, the automation of the production processes, the evolution of demands and competition, the new forms of competition.

These phenomena are raising serious doubts on the classical instruments of managerial accounting and the traditional cost calculation methods. An answer appeared and we are facing new challenges and perspectives regarding cost calculation.

The purpose of this article – after analyzing the existing literature in the field – is to make a comparison between the traditional and modern, complex cost calculation systems and to emphasize that new cost systems such as ABC and ABM represent major innovations and permits not only the cost calculation and analysis but also measuring performances, defining strategies and are oriented through competition and customers.

Keywords: traditional and complex cost calculation systems, job order costing, process costing, ABC/ABM

Introduction

Changes in the business environment are having significant influences on production processes, management, cost accounting and management accounting systems. Due to technological changes, both the structure and the composition of product costs have been changed substantially. Concerning product cost structure, the ratio of fixed costs to variable costs has increased (Kerremans *et al.*, 1991) and many costs viewed as indirect costs in traditional companies are in fact "direct costs in high-tech companies" (Seed, 1984).

Technological change has an impact on both cost composition and structure (Kerremans *et al.*, 1991). This change in cost structure created a need for organizations to review their existing management accounting system and consider important to implement new systems within their activities.

Another important fact is that nowadays, in a worldwide competitive environment companies are facing new challenges in terms of products or services, quality, delivery terms, after sales services and customer satisfaction. Until re-

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cently management accounting systems have not reported on these variables despite the fact they represent key competitive variables.

Usually, companies are using their cost systems to (Kaplan & Cooper, 1998):

- design products and services that both meet customers' expectations and can be produced and delivered at a profit;
- signal where either continuous or discontinuous improvements in quality, efficiency and speed are needed;
- assist employees in their learning and continuous improvement activities;
- guide product mix and investment decisions;
- negotiate about price, product features, quality, delivery and service with customers;
- efficient and effective distribution and service processes to targeted market and customer segments.

Still, many companies are not gaining competitive advantages from these enhanced cost systems because they rely on information from a cost system designed for a simpler technological age when competition was only local instead of global, and companies were producing standardized products and services and when speed, quality and performances were less critical for success. Using these systems managers don't have timely and relevant information to guide their improvement activities and they don't have accurate and valid information to shape their strategic decisions about processes, products services and customers.

However, in response to the changing environment, cost and management accounting systems, besides financial information, must place greater emphasis on the collection and reporting of non-financial, quantitative and qualitative information, especially on those variables that are necessary to compete effectively and which supports the strategies of an organization.

In order to compete in today's competitive and often tumultuous environments, companies must become more "customer-driven" and to make customer satisfaction a top priority. In order to provide customer satisfaction organizations must concentrate on those key success factors that directly affects costs, product quality, time and innovations. These new approaches require continuous improvement, employee improvement and value-chain analysis.

"New management accounting techniques have aimed at helping business decisions and taking control in an increasingly sophisticated way, more so than has previously done before. Such things as strategic management accounting, activity based costing (ABC), strategic cost management, …, non-financial measures, balanced scorecard (BSC) and target costing have been sugges-

ted. Some of these, for example, ABC and BSC, have also gained a degree of popularity in practice." (Jarvenpaa, 2007:100)

Activity Based Cost (ABC) and Activity Based Management (ABM) Systems emerged to meet the need for accurate information about the cost of resource demands by individual products, services and customers and these systems also enabled indirect and support expenses to be driven first to activities and processes and then to products, services and customers. In this way managers have obtained a clearer picture of the economics of their operations.

Research methodology

Usually, the originality of a research topic depends on critical reading of wide literature in order to identify and distinguish the main ideas and methodologies from which contributions to knowledge might be made. It is very difficult to see how academic research could lead to new applications of a methodology or to contribute to knowledge without a systematic search and critical reading of the available literature in the field both on national and international level.

In other words, knowledge generation and understanding is an emergent process and not a universal product. In order to know the nature and character of the implications of a development, we need to know the intellectual context of that development (Hart, 1998).

Quality is also important when doing research and it means (Zimerman, 2001; Lukka & Mouritsen, 2002) rigor and consistency, clarity and brevity, effective analysis and synthesis. Ideas undertaken from the available literature must justify the approach to the research topic, the selection of methods and demonstration that the research contributes to something new.

Qualitative researchers, unlike their quantitative counterparts, do not intend to test hypotheses at the beginning of their research process. Theory is used not to obtain predictions but to gain understanding of a certain phenomenon. Data analysis is a process of reality construction whereby the researcher, the theory, and the method used in the research, together with the data derived from the research, are all interdependent and interrelated (Siti-Nabiha, 2009).

This article is a qualitative and theoretical study and its purpose is to present the new perspectives in cost calculation, to make a comparison between traditional and new and complex cost systems in order to emphasize that cost calculation by using a traditional method or cost system does not accomplish the requirements of managers and organizations especially in high-tech companies. Thus organizations must focus toward complex cost systems. The background of this paper is formed by information and data gathered from the existing literature and practice on national, European and international level.

Tradicional cost calculation systems

Many companies use a traditional cost system to measure the manufacturing costs of products in a two-step process: (1) the measurement of costs that are applicable to manufacturing operations during a given period and (2) the assignment of these costs to products. These systems accumulate all manufacturing costs such as materials, labor and factory overhead and assign them to cost objectives: finished goods and work in process by using one of the two basic approaches to cost calculation: *job-order costing* and *process costing*.

Job-order costing is the cost accumulation system under which costs are accumulated by jobs, contracts, or orders and the use of this method is appropriate when the products are manufactured in identifiable lots or batches or when the products are manufactured to customer specifications. Job-order costing is widely used by custom manufacturers such as printing, aircraft, and construction companies, service businesses and professional services. Job-order costing keeps track of costs as follows: direct material and direct labor are traced to a particular job. Costs that are not directly traceable - factory overhead - are applied to individual jobs using a predetermined overhead (application) rate.

Process costing is a cost accumulation system that aggregates manufacturing costs by departments or by production processes. Total manufacturing costs are accumulated by two major categories, direct materials and conversion costs (the sum of direct labor and factory overhead applied). Unit cost is determined by dividing the total costs charged to a cost center by the output of that cost center. In that sense, the unit costs are averages. Process costing is appropriate for companies that produce a continuous mass of similar units through a series of operations or processes in industries as petroleum, chemicals, oil refining, textiles, and food processing.

The basic differences between the two cost systems are as follows:

Table 1. Differences between Job-order Costing and Process Costing

	JOB-ORDER COSTING	**PROCESS COSTING**
1. Cost unit	Job, order or contract	Physical unit
2. Costs are accumulated	By jobs	By departments
3. Subsidiary record	Job cost sheet	Cost of production report
4. Used by	Custom manufacturers	Processing industries
5. Permits computation of	(a) unit cost for inventory costing purposes (b) profit or loss on each job	A unit cost to be used to compute the cost of goods completed and work in progress.

Source: Shim and Siegel, 1998:310

As we can see, the distinction between the presented cost systems is that while job-order costing focuses on applying costs to specific jobs or orders, process costing accumulates accounting data by the production department (or cost center) and averages over all of the production that occurred in the department.

Although the traditional cost systems can be used successfully in different production sectors, in time appeared a major force in the rationalization of the production process: the automation. (Kerremans et al, 1991)

Society and organizations are confronted with technological evolution and as the result of these changes they are experiencing significant changes in size, form, production and labor process. Although production methods and processes have been developed and make use of advanced technologies, management accounting and cost systems have lagged behind because they are not useful in a "high-tech" environment (Cooper&Kaplan, 1989) and management has different accounting information needs. "The challenge is to provide correct information in time so that it is useful for planning and control purposes." (Kerremans et al., 1991:147)

The growth in the automation of manufacturing has changed both the structure and the composition of total product cost.

• Concerning the structure of product costs we can observe that the ratio of fixed costs to variable cost has increased and many costs viewed as indirect cost in traditional companies are in fact direct cost in high-tech organizations.

• Concerning the structure of product costs we can observe that the significance of direct labor costs has diminished and often became insignificant while overhead cost has increased and has become more important.

Another important aspect is that traditional cost systems were designed decades ago, during the 1980's, when most companies marketed a narrow range of products, direct labor costs represented only a small fraction of total costs and indirect costs were relatively small and the distortions arising from overhead allocations were not significant. After the 1990's companies started to market a wide range of products, indirect costs were no longer unimportant and the introduction of more sophisticated cost systems started to become necessary. Furthermore, the intense global competition resulted in decision errors from poor cost information. These aspects determined the appearance of complex cost systems such as: Activity Based Costing and Activity Based Management.

Advanced (complex) cost calculation systems

Activity-based costing (ABC) is defined as a methodology that measures the cost and performance of activities, resources, and cost objects. Specifically, re-

sources are assigned to activities, then activities are assigned to cost objects based on their use. ABC recognizes the causal relationships of cost drivers to activities. (Institute of Management Accountants, 1998)

ABC begins (Hughes & Gjerde, 2003) with the companies' products, determines the activities used in the production and delivery of those products, and computes the costs of the various activities. The costs of the activities used in the production of a product are then assigned to that product in a manner that approximates a causal relationship. As a result, advocates insist that ABC systems provide more useful information for cost management purposes than traditional systems do. These differences are significant for companies with large amounts of overhead, multiple products, and high product diversity.

The major differences between traditional cost systems and ABC are as follows:

Table 2. Differences between Traditional cost systems and ABC

	TRADITIONAL	**ABC**
Cost pools	One or limited number	Many to reflect different activities
2. Applied rate	Volume based, financial	Activity based, non-financial
3.Suited for	Labor-intensive, low-overhead companies	Capital-intensive, product-diverse, high-overhead companies
4. Benefits	Simple, inexpensive	Accurate product costing, possible elimination of non-value-added activities

Source: Shim and Siegel, 1998:337

In today's competitive environment organizations require a reliable cost system and relevant cost information to survive. By implementing an ABC system managers will obtain accurate information about the true cost of products, services, processes, activities, distribution channels, customer segments, contracts, and projects.

Needy et al (2003) suggests that the implementation process of an ABC system should rely on the following four steps: (1) cost system evaluation; (2) ABC design; (3) ABC implementation; and (4) system evaluation and validation.

Benefits of an ABC system are numerous. They include (Shim and Siegel, 1998):

• Improved products or services, improved decisions about pricing, services and strategies;

• Cost reduction by eliminating the non-value-added activities;

• Greater control of costs because of its focus on the behavior of costs at their origin, both short-term and long-term;

• More accurate evaluation of performance by programs and responsibility centers;

ABC's originators recommended it for economic, normative, realist and deterministic reasons – that is, it represents best value, accurately represents financial events and aids rational decision-making and contracting. Alleged benefits include: increased cost awareness and understanding; better tracing of costs to objects; superior allocation of overheads to cost objects; and financial (cost driver rates) and non-financial (cost driver volumes) measures for cost management and operational decision. (Hopper & Major, 2007)

The clearer picture from ABC systems led naturally to activity-based management (ABM). ABM enables the organization (Kaplan & Cooper, 1998) to accomplish its outcomes with fewer demands on organizational resources.

Activity-based management (ABM) is subsequently defined by CAM-I (Consortium for Advanced Manufacturing-International) as a discipline that focuses on the management of activities as the route to improving the value received by the customer and the profit achieved by providing this value. ABM includes cost driver analysis, activity analysis, and performance measurement, drawing on ABC as its major source of data. Using ABC data, ABM focuses on how to redirect and improve the use of resources to increase the value created for customers and other stakeholders.

Movement from ABC (for product profitability assessment) to ABM (for more general managerial control and decision support) has been supplemented by the broadening of ABC/M application to different types of business, to different functional specializations within business and to the complementarities of ABC/M to other new high-profile management and accounting techniques. (Bjornenak & Falconer, 2002: 504)

Together, ABC and ABM methodologies provide the tools and the knowledge base for making informed decisions – decisions, which relate to the pricing, management, and improvement of products and services. They are utilized to gain a fuller understanding of the real cost dynamics and cost structures involved in business operations. ABM together with ABC principles can enable managers to better understand (a) both product and customer profitability, (b) the cost of business processes, and (c) how to improve them.

ABC and ABM are a continuum of value. ABM is the application of ABC da-

ta to manage product portfolios and business processes better. ABC becomes ABM (management) when it is used to (CIMA, 2001):

- design products and services that meet or exceed customers' expectations and can be produced and delivered at a profit;
- signal where either continuous or discontinuous (re-engineering) improvements in quality, efficiency and speed are needed;
- guide product mix and investment decisions;
- choose among alternative suppliers;
- negotiate about price, product features, quality, delivery and service with customers;
- employ efficient and effective distribution and service processes to target market and customer segments;
- improve the value of an organization's products and services.

ABC/ABM systems are a very effective means for improving company performance on many fronts. An organization can realize the power of ABC and ABM when the right individuals access the right information in the best format for improving performance

The use of cost calculation systems in practice

Traditional cost calculation systems were developed decades ago and they are still used today worldwide (Horngren et al, 2003:109) in services (audit firms, consultancy companies, postal services), trade (product delivery, grain trade, timber trade) and production sphere (aircraft assembling, construction, oil refining, beverages).

A study made by Joye&Blayney (1990) shows that both job-order costing and process costing are widely used in several industries.

Other surveys (Ask&Ax, 1997; Inoue, 1998) identified that companies around the world are using mostly one of the traditional cost calculation methods at the expense of other methods. Still the percentages are close, there are no large variations.

With regard to the usage of ABC/M cost calculation systems a study made in the USA (CAM-I 1995) shows that companies adopted Activity Based Cost systems in order to: (1) determine/calculate the cost of products and services; (2) reduce costs; (3) enhance the production process; (4) elaborate price strategies.

Similar ideas emerge from surveys made in Europe (UK, Netherlands, Ireland). Researchers (Innes&Mitchell, 1995; Groot, 1999) concluded that in European countries there are relatively high adoption rates of the ABC/M couple and they found that the benefits of using the method were: (1) accurate infor-

Table 3 – Traditional cost calculation systems used in various industries

	Food industry	**Textile industry**	**Steel industry**	**Chemical industry**	**Oil industry**
Process costing	96%	91%	92%	75%	100%
Job-order costing	4%	18%	25%	25%	25%
Others	-	-	8%	12%	-

	Printing and publishing industry	**Furniture and accessories**	**Machinery and computers**	**Electronic products**
Process costing	20%	38%	43%	55%
Job-order costing	73%	63%	65%	58%
Others	13%	-	9%	10%

Source: Joye&Blayney (1990)[2]

Table 4 – The use of cost calculation systems worldwide

Cost calculation systems used	**USA**	**Canada**	**Australia**	**Japan**	**Sweden**	**UK**
Other cost calculation systems	31%	48%	33%	31%	42%	52%
Traditional cost calculation systems	69%	52%	67%	69%	58%	48%

Source: Ask&Ax, 1997; Inoue, 1998

mation regarding the costs of products and services; (2) improved cost control and better cost management; (3) performance measurement; (4) more accurate customer profitability analysis.

A recent study (Cohen et al, 2005) reveals high adoption rates of ABC/ABM in the USA and UK and smaller adoption rates in other European countries.

[2] The data shown in the table exceed 100% because the analyzed companies use more than one costing method.

Rates less than 10 percent characterize the European countries with the exceptions of the Netherlands where 12 percent of firms had implemented ABC, as well as Belgium. In France adoption rates were higher, about 20 percent.

The same survey shows that the reasons to implement ABC/ABM are driven by the need to improve customer profitability, to gain accurate and relevant cost information for pricing or budgeting, to modernize their cost systems, improve cost control and improve their business processes. However the implementation process has also disadvantages and presents difficulties such as the reluctance of employees or managers, difficulties in identifying and selecting activities, problems when collecting data for these new systems.

Besides ABC adopters there are companies that consider ABC implementation as a future target and companies that do not consider adopting ABC. According to the findings of relevant researchers the main reasons of rejecting the implementation process of ABC/ABM might be: satisfaction with the existing traditional cost systems, lack of management support and interest, implementation process being associated with high costs, consumption of time and resources.

Conclusions

From the examination of the literature in the field of managerial accounting and cost accounting we can conclude that traditional cost accounting and cost calculation systems do not provide detailed quantitative cost data and business process information that safety managers need. Without such data, managers do not know where to focus decision-making efforts in order to become more cost-competitive.

If we look back, traditional cost systems were developed in the early 1900's and are still widely used today. Advanced cost systems emerged in the late 1980's and many organizations have implemented these methods with real success.

Still there are organizations that continue to operate in a traditional way. Managers often use traditional systems and the information of these because they have little or no alternative or when the system is used to generate information for performance evaluation and the correlation between usage and success is higher in case of traditional systems.

Both traditional and advanced systems vary in their level of sophistication but in general traditional cost systems tend to be simplistic whereas advanced systems tend to be sophisticated.

Simplistic (traditional) systems are inexpensive to operate, they can generate inaccurate cost assignments and inaccurate costs and this can lead to mistakes and errors in the decision making process. These systems are not well

equipped to provide regular, complete and reliable information on customer profitability.

On the other way ***advanced and complex cost systems*** are more expensive to operate but they minimize errors and mistakes regarding cost, they link the activities with competitive strategies. Usually, the implementation of these systems often requires higher costs and difficulties might appear during the use of these because various activities can appear. The implementation processes bring new rules and suppose a change of attitude and behavior and needs quite a long assimilation period before the general use within each company.

All in all the optimal cost system varies for different organizations. Within companies if the indirect costs have a low percentage of total costs and a fairly standardized product range, it will be more appropriate to use a traditional cost system because this may not result in the reporting of inaccurate cost. Else if there is a high proportion of indirect costs and products consume resources in different proportions, the optimal cost system might be a more sophisticated one because they are able to capture the diverse resource consumptions and assign the high level of indirect costs to different cost objects.

Knowing the managerial needs regarding costs, activities and strategies, each company needs to consider what method or system contributes to their unique needs. Management accounting systems must help organizations to achieve quality goals providing reports and measures that motivate and evaluate managerial efforts to improve quality, must develop cost systems that accurately measure costs and profitability.

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Guide for authors

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office@rmkt.ro

The text should be between 15 and 20 printed pages, numbered, A4 format, characters Times New Roman 12, single spacing.

The first must contain the title of the article, the author's name, their complete scientific title and affiliation (professional address, phone, e-mail), followed an abstract of 5-10 lines, that should present the main results of the article. The abstract will be followed by 5-7 keywords.

The authors are also required to submit an English and Romanian abstract with keywords in a separate document.

The presentation of bibliographical references:

In the text the references quotes will appear between brackets, with the name and the publication date, e.g.: (Gyerőffy 1997).

For two co-authors they will use for example (Black and Scholes, 1973).

In the case of three or more than three authors, only the first will be mentioned, under the form (Barberis et al., 1998).

If two references have the same author and the same publication year, they will be differentiated through letters (Fama, 1965a). These letters will also appear in the bibliography. At the end of the article the references will be presented as follows:

Periodicals: The list of the authors including the first name initial, the year of publication, the title of the article, the name of the periodical in italics without abbreviations, the number of the volume and the number of pages.

Books: The list of authors including the first name initial and the year of publication, the title of the book in italics without abbreviations, the publishing house, the place of publication.

An MRP-based integer programming model for capacity planning

LEVENTE SZÁSZ[1, 2]

Abstract

Capacity planning decisions represent an important topic in the operations management literature, as they greatly influence the performances of the firm and determine if the firm is able to satisfy market demand in each period. In order to be able to deal with uncertainties and fluctuations of market demand and other elements of the internal and external environment, capacity planning decisions are broken down into several levels of aggregation. This paper builds a general integer programming model for capacity planning at the master production scheduling (MPS) level. Input data and parameters for the model can be gathered from a typical MRP/MRP II-based information system. Using the integer programming model we can determine the optimal level of production capacities, at which operating costs are minimal. The last chapter of the article presents a case study, where we use the integer programming model built to investigate what cost reductions are possible by optimizing capacity levels at a small-sized firm from the textile industry.

Keywords: capacity planning, MRP/MRP II system, production planning and control, integer programming, master production schedule.

Return to schooling in Hungary before and after the transition years

MELINDA ANTAL[1]

Abstract

In this paper, I compared the return to schooling in Hungary by using datasets available from the Hungarian Wage Survey carried out in 1986 and in 2000, with more than 600 thousand observations altogether. The results are in conformity with the expectations and other empirical researcher's works, showing an increase in the return to schooling of 74% in these 14 years, and large increases in returns to education for those who attended a high school or a university/college. The lower positioned education levels didn't bring significant changes in their premiums, this fact being one of the most plausible explanations why attendance to vocational schools dropped so dramatically after the communism collapsed. I also searched for explanations and solutions for the puzzle: why changes occurred in these 14 years, highlighting some possibilities which could be used as extension to the present work, solving the data selection problems faced with the current dataset.

Keywords: return to schooling, wage inequality/ differentials, human capital, transition economies, Hungary

Influencing factors of early-stage entrepreneurial activity in Romania

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Abstract

In Romania a representative sample of adult population was interviewed using a standard GEM questionnaire. After emphasizing the special situation of Romanian entrepreneurship in international context we aimed to determine the influencing factors of opportunity-motivated and necessity-motivated early-stage entrepreneurs, using socio--demographic and perceptual variables.

Keyword: Entrepreneurship, opportunity-motivated early-stage entrepreneurs, necessity-motivated early-stage entrepreneurs.

Traditional or advanced cost calculation systems? – This is the question in every organization

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In present context preoccupations regarding cost calculation, control and cost reduction are major challenges within organizations. Globalization represents a major change, which leads to performance and performance measurement. We are also the witnesses of technological and organizational mutations and evolutions, the automation of the production processes, the evolution of demands and competition, the new forms of competition. These phenomena are raising serious doubts on the classical instruments of managerial accounting and the traditional cost calculation methods. An answer appeared and we are facing new challenges and perspectives regarding cost calculation.

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