OUTLINES REGARDING THE ORGANIZATIONAL POLICY OF COST CENTER MANAGEMENT

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Abstract: *The cost center represents one of the most important responsibility centers and its manager is mostly responsible for achieving operational efficiency and minimizing product costs. Across all company units, cost centers are operated for various accounting and control purposes, such as: classification, planning and allocation objects. This study brings a theoretical and practical contribution to the general considerations of cost center management and state through a feasible example, the influence of the cost center tariff as a support in the make or buy decision.*

Keywords: *cost center, cost center tariff, managerial decision, cost allocation, make or buy*

JEL Classification: *M11, D24, 61, D81*

1. INTRODUCTION

The importance of better analytics and decentralization of decision-making is increasing in today's fast-paced, complex business operations. Responsibility accounting was introduced to meet the need for decentralization, accurate information and cost analysis. Understanding the relationship between responsibility centers provides an organized flow of information that can improve decision making and cost control (Iffat M. et al., 2018).

The measurement of managers' performance depends on the level of responsibility and a system for measuring it involves structuring the organization in responsibility centers, thus distinguishing three main types of centers: cost, profit and investment (Briciu S. et al., 2012).

In the past decade, there have been several studies on the international diffusion of responsibility accounting implementation. For example, Fowzia R. (2011) studied the usage and satisfaction level of service organizations in Bangladesh and found that three factors determine the resulting satisfaction level, namely: attribution of responsibility, performance measurement technique and reward system. In Uganda universities, the application of responsibility center accounting has been found to increase efficiency and create more satisfaction in decision making (Owino P. et al., 2016).

Another recent research result on the subject came from Vietnam, where Tuan T. (2017) investigated textile manufacturing organizations regarding the level of application of responsibility center accounting. The author used different criteria to define medium and high usage levels of responsibility center accounting and concluded that it was not properly applied among textile manufacturing organizations in Vietnam.

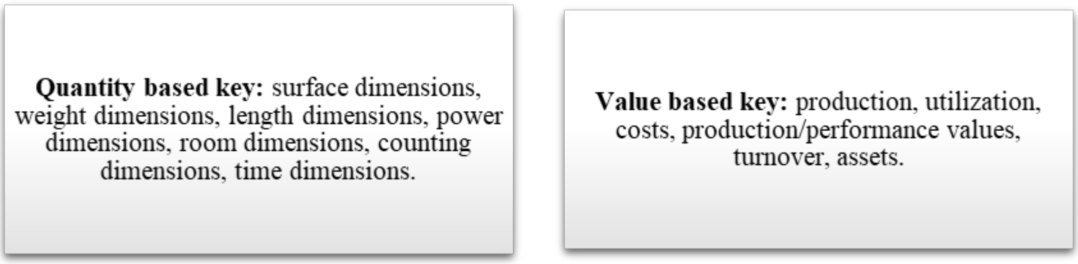
The cost center represents one of the most important responsibility centers and its manager is mostly responsible for achieving operational efficiency and minimizing product costs. Across all company units, cost centers are operated for various accounting and control purposes, such as: classification, planning and allocation objects.

The allocation of a company's expenses or costs to cost centers is based on where the costs originate or activities are performed, where the costs are incurred, and based on the purpose of the allocation.

If it is desired to accurately assign overhead costs to individual products, services, it must further allocate costs to those cost centers directly involved in creating the products or services. From these cost centers different methods can then be used to assign activities and costs to relevant products, services and market segments.

Quantitative or value-based keys are used to distribute costs:

Figure 1. Cost center accounting – organization goals



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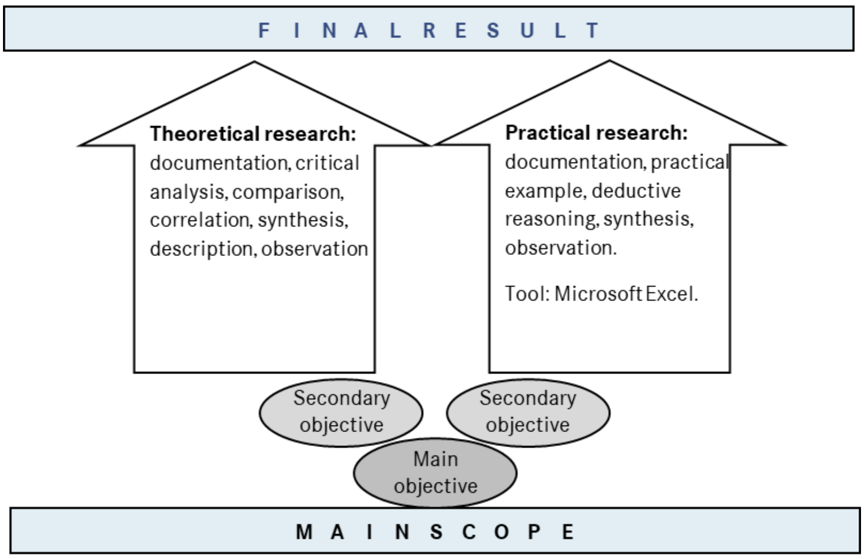
This study brings a theoretical and practical contribution to the general considerations of cost center management and state through a feasible example, the influence of the cost center tariff as a support in the make or buy decision.

The multivalence of the studied phenomenon denotes the obligation of an appropriate methodological approach, combining fundamental and quantitative research through modern and classic research tools. The methodological framework is built based on two components and they are arranged schematically as follows:

Figure 2. Methodological framework



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The scientific approach brings to the fore the analysis of the accounting context by responsibility centers and the presentation of general aspects regarding the organizational policy of cost center management. From the theoretical point of view, the motivation for choosing the research theme is proven by the desire to determine the understanding regarding the organizational policy on cost centers. According to the literature review, we can have observed that the level of scientific research in this field is not as popularized as other subjects in the field of managerial accounting research.

Across all company units, cost centers are operated for various accounting and control purposes, such as: classification, planning and allocation objects. This study brings a theoretical and practical contribution to the general considerations of cost center management and state through a feasible example, the influence of the cost center tariff as a support in the make or buy decision.

2. ORGANIZATIONAL POLICY OF COST CENTER MANAGEMENT

A responsibility center is a unit or subunit of an organization. According to the specialized literature, there are four main types of responsibility centers: cost, revenue, profit and investment; all these centers being closely connected and requiring the communication of decisions to function smoothly.

The cost center represents one of the most important responsibility centers and its manager is usually responsible for achieving operational efficiency, minimizing product cost and maximizing efficiency. A cost center is a location of production or service, function, activity or equipment whose costs can be assigned to cost units (CIMA - Chartered Institute of Management Accountants - cimaglobal.com).

The main object of costing is the analysis of financial records to subdivide expenses, carefully allocate them to selected cost centers, and thereby build a total cost for the departments or processes of the enterprise. From a business perspective, managing cost centers includes setting up, modifying and validating them and internal approval processes are required for this. The relevant department is responsible for cost center administration.

Cost centers are part of the master data in Controlling and are therefore subject to special requirements and regulations; therefore, they depend on the consistency and availability of relevant information. Cost centers are managed in a cost center directory, usually based on the system and a cost center classification.

To cover the cost accounting control function, each cost center must be an independent area of responsibility. This means that the tasks or scope of work for cost centers must be clearly defined and separated from each other. It is also used to determine an appropriate activity type as a cost causality measure and to assign correctly to functional areas. Responsibility accounting refers to the authority given to managers responsible for cost control, holding them accountable for the costs of their operations.

The cost center responsible (eg group or head of department) should be able to influence costs through his actions or decisions. For this reason, a relatively large number of cost centers are usually formed in the production area of an industrial company, while the number of cost centers in the administration area is quite small (Reichhardt M., 2019).

Large organizations typically have many departments and centers, with complex day-to-day operations; thus, responsibility accounting may not be as useful in small organizations as it is in large ones (Biswas, T., 2017).

Because this action is burdensome, responsibility centers are needed. It is a combination of cost accounting and managerial accounting, and cost accounting is the core of organizational activity, starting from the basic recording of financial transactions to the generation of complex cost reports.

In general, there is a conflict of objectives between detailed information on the one hand and a high level of administrative effort and complexity on the other. Many cost centers represent a high administrative effort (due to cost budget planning, target discussions, cost control, etc.), but this is compensated by higher calculation accuracy and better cost control.

Making practical decisions requires proper cost reports and these decisions affect all users. Their results are reflected in financial statements prepared in accordance with generally accepted accounting principles and International Accounting Standards (IAS).

Responsibility center accounting is closely related to cost accounting because cost accounting must assign responsibility for expenditures. The responsibility accounting system depends on the interrelationship between the accounting and the information system and the organizational structure of the company (Tran V. et al 2022).

Certain influencing factors (for example, the cost accounting system used, central and/or company-specific accounting and control requirements) must be taken into account when creating cost centers. If these factors are ignored, insufficient overhead rates could lead to miscalculations of costs and therefore wrong decisions.

The cost accounting system used influences the establishment of cost centers so that when standard costing is used, special requirements apply to the establishment of cost centers in terms of planning and control. Within a cost center, there should always be a clear relationship between the costs incurred and the activities performed. This allows the determination of an appropriate activity type for the cost center, which represents a proportional relationship between variable costs and the activities performed.

Cost control requirements, calculation accuracy, and other factors also influence the creation of cost centers. Cost centers are primarily used for planning, controlling and allocating overhead costs to services/products provided. Therefore, when creating cost centers, the requirements for the informative value of cost controls (plan/actual comparison) and calculation accuracy play a key role. There are other influential factors (eg, production processes, product range) for creating cost centers. These influencing factors or requirements define the aggregation/allocation of work methods, activities and resources (eg machines) to cost centers and therefore affect the level of differentiation for the cost center structure.

A company's cost centers are objects used for various accounting and control purposes (for example, for cost center accounting, calculation) in all company units (materials management, production, research and development, sales, administration). Cost centers are used for the structured recognition or allocation of services rendered in a company and the related resource consumption (eg material consumption, depreciation) or expenses. To cover the cost accounting control function, each cost center must be an independent area of responsibility.

Since the costs incurred by the organization should be transparent, cost center accounting is used for control purposes within it; thus enabling the verification of the profitability of individual functional areas and providing the necessary data for management decision-making. This requires that all costs be allocated according to their source. However, source-related attribution is particularly difficult for overhead costs.

Company departments or units are generally where the costs originate. A cost center can consist of one or more departments. For planning and control reasons, a department can also be divided into work areas (eg groups of identical machines). Each job can then be assigned its own cost center.

For certain control purposes, project cost centers can also be established. This is necessary, for example, if there are no special account assignment objects as part of a project's accounting to show project costs.

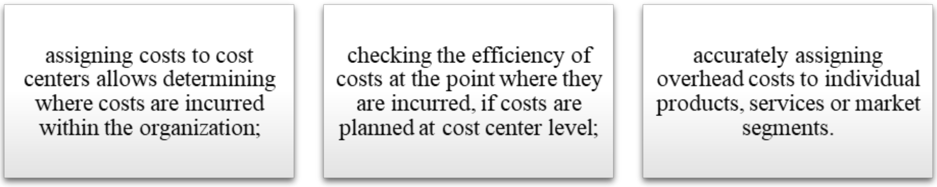
In the case of assignment by location where costs are caused, it is noted that the locations are different from where the costs originate and where the costs are caused, the final assignment of costs must be made to the cost generating objects (e.g. other cost centers, cost units) using the internal assignment of the activity.

In some cases (for example, for efficiency), costs cannot or should not be entered directly where they originate, where services are performed, or where costs are incurred. In these cases, the appropriate cost centers must be established for allocation purposes. This avoids unsafe links in account assignment. For example, the energy costs for a unit are not recorded by the department because of the amount of work involved. Therefore, a unit cost center is established in the unit to record regularly occurring energy costs. Using internal activity allocation and an appropriate allocation key, these energy costs are distributed or further allocated as primary costs to consuming cost centers.

A cost center can consist of one or more departments. For planning and control reasons, a department can also be divided into work areas (eg groups of identical machines). Each job can then be assigned its own cost center. For certain control purposes, project cost centers can also be established.

Dividing an organization into cost centers allows you to pursue multiple goals:

Figure 3. Cost center accounting – organization goals



Source: Own processing

Cost centers can be classified as follows:

- Productive, non-productive and mixed cost centers;
- Personal and impersonal cost center;
- Operation and process cost center.

Productive cost centers are those that are actually engaged in manufacturing products. Non-productive cost centers do not make the products, but are essential aids to the productive centers. Mixed cost centers are those that are employed some on productive lines and others on service works. A personal cost center consists of an individual or a group of individuals. An impersonal cost center is one that consists of a department, plant or equipment (or group). Where a cost center consists of those machines and/or people performing the same operation, it is called an operating cost center. If a cost center consists of a continuous sequence of operations, it is called a process cost center.

Determining an appropriate cost center is very important for establishing and controlling costs and the manager in charge of a cost center is responsible for controlling the cost of his cost center.

3. PRACTICAL EXAMPLE REGARDING THE INFLUENCE OF THE TARIFF RELATED TO A COST CENTER ON MANAGERIAL DECISIONS

The following analysis starts from the improvement of a technical process, respectively the calibration of the existing measuring devices by assembling a calibration system on a fixed base plate and creating a single cycle calibration program. For the economy calculation, we should consider the costs related to a cost center, consisting of all the expenses reported for one year, resulted in the tariff per cost center, the value of the investment needed for implementation and the saving in time which can result from the implementation.

The following Table represents the initial cost center tariff (before applying the assumptions of savings due to the changes made on the technical process), the tariff according to the economy made and the tariff scenario according to the investment. We can observe from the resulting calculations with the initial premises, that the hourly rate for the respective cost center is 34 €/h.

Table 1. Methodological framework

Indicators	Values €
Indirect personnel tariff	7
Tariff current costs	3
Depreciation tariff	11
Maintenance tariff	3
Energy tariff	2
Building tariff	3
IT tariff	3
Administration tariff	2
Initial tariff	34
Recalculated tariff acc. to the economy	31
Recalculated tariff acc. to the investment	36

Source: Own processing

In order to be able to determine the total savings achieved due to technical process improvements, we have to take into consideration the time that can be saved through this implementation:

- The total time of calibration before the process improvement = 68 min
- The total time of calibration after the process improvement = 44 min
- Time saved during 3 working shifts = 72 min/day

Notable is the fact that the improvement can be done internally or performed by a supplier. In Table 1 we can observe the difference between each scenario. The cost center tariff recalculated taking into account the investment, is 16% higher compared with the tariff in case of the improvement will be done internally. The tariff based on the process improvement is -9% less compared with the initial tariff, due to process automatization thought one single cycle calibration.

According to the offer received from the supplier, the investment requires to purchase a new reference fixing table, in total of 20.000 EUR. If the management decide that the process improvement should be performed internally, a trained employee can assemble an existing fixing plate, dismantled from a fully depreciated and out of use measuring machine. Thus, the investment for the change that occurred is null, avoiding the increase of the tariff per cost center.

Analyzing the economy from a tariff point of view, by avoiding additional investment costs allows managers not only to allocate funds for the development of other projects, but also reduces the blocking of cash flow. Also, avoiding the capitalization of costs by contracting an external company or an external supplier results in reducing the risk of diminishing cash availability. Therefore, in this practical situation, the management decision regarding the technical process improvement was influenced by cost center tariff in order to “make” and not to “buy”.

The existence of means of saving is essential in any production activity, be it small or large scale, as these actions are necessary for increasing the market competitiveness of a production company, the economic and technical evolution of the implemented, existing processes, but also the stimulation innovation and development from a technical point of view, of available working means.

4. CONCLUSIONS

In recent years, management accounting has become more relevant to the needs of modern corporations. To accommodate these changes in management accounting practice, teaching and research in the field have similarly changed. Traditional approaches, developed for the large corporations that emerged in the early part of the 20th century, have proven inadequate for today's global and technological environment. Academics have turned to research field in order to discover the new techniques developed and implemented by successful organizations.

New approaches focus on improving the information provided to managers and employees about their organizations and paying more attention to the design of information and control systems. Different authors have looked at responsibility accounting from different perspectives, but they have agreed on a common concept: controllability with authority and responsibility.

Based on the literature review, some studies focused on cost controllability, responsibility centers, the budgeting process and the relationship of responsibility accounting and analyzed the relationship of responsibility accounting with cost accounting and managerial accounting, focusing on the relationships between responsibility centers. cost that are used in all business functions of a company.

Managerial accounting has been greatly affected by the remarkable improvements in the computer technology sector. Today's technology allows management to track overall performance information that builds on the cost-based information of traditional systems.

The main concepts of managerial accounting include monitoring as well as predicting costs. These consist of cost collection, analysis and evaluation. It is necessary to develop managerial accounting to allow greater accuracy of accounting information and to favor the development of information systems that had better adapt to the needs of users, thus supporting managers in making strategic decisions of the company. Representing a system of collecting, measuring and exploiting financial data, with a guiding role in management activity, managerial accounting develops and supports the indispensable values for achieving the company's strategic objectives.

At organizations level, the knowledge and understanding of production costs is important for at least two reasons: providing information necessary to identify actions to make the organization's activity more efficient and information necessary for the management of the organization that is the basis for substantiating decisions. As classification objects, they structure the operating expenses and revenues related to the (generally non-revenue) cost center for a company. As planning objects cost centers are used to plan e.g. capacity, quantities, costs, cost rates.

As allocation objects, they are used to allocate internally performed activities to the cost/activity beneficiary as part of the internal activity allocation.

Responsibility accounting is a combination of cost accounting and managerial accounting, and cost accounting is the core of organizational activity, starting from the basic recording of financial transactions to the generation of complex cost reports (Iffat M. et al., 2018).

Cost center accounting can be found between cost type and cost unit accounting as part of internal accounting. With cost center accounting, costs are (as far as possible) allocated to the appropriate cost center based on their cause.

While individual costs can be assigned directly to the cost unit, overall costs must be allocated to their respective cost centers using an allocation key via the cost accounting sheet. Cost center accounting provides the results, which should certainly be considered in subsequent cost unit accounting for the purpose of a commercially reasonable pre/post or interim calculation. With cost unit accounting, total costs are then assigned to the cost generator within cost unit or time unit accounting.

The aspects of saving can be approached from several perspectives when a technical improvement of a machine is required, an economic analysis being necessary that must include all the cost elements.

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