USING STANDARD COST METHOD FOR COMPANY PERFORMANCE MANAGEMENT

UTILIZAREA METODEI COSTURILOR STANDARD PENTRU MANAGEMENTUL PERFORMANȚEI ÎNTREPRINDERII

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Abstract: *The standard cost method is nowadays one of the most widespread cost calculation methods. The question that arises is: To what extent does this method represent today a performance management tool?. In addition to the incontestable advantages provided, this method also has a series of limitations.*

Key words: *performance, standard cost, calculation*

INTRODUCTION

Performance is assessed based on previously proposed objectives. Performance measurement is made based on certain pre-established objectives, that can be expressed as quantities and/or quantities and must have a completion date. The planning activity necessarily involves the measurement activity needed to provide information to managers in order that they should make decisions meant to improve performance. Consequently, performance can be viewed from the perspective of the manner in which strategic objectives are achieved or exceeded.

Company performance should be assessed based on the level of such objectives. We should take into account that, if the established objectives were modest, reaching or even exceeding such objectives is a modest performance.

The standard cost method is based on the concept of total costs by using the classification of costs into direct and indirect costs, but it also uses the classification of manufacturing costs into fixed and variable costs. The method thus provides the possibility to analyse costs based on the volume of the production.

In the last two decades we have witnessed an evolution of the company performance measurement system, evolution which has had three main directions:

- performance measurement both with traditional financial indicators and with non-financial performance indicators has become widely accepted;
- the relation between the strategic planning process and performance measurement was strengthened at company level;
- the company performance is no longer viewed only from the economic perspective, but also from the social and environmental perspective.

MATERIALS AND METHODS

Performance measurement is a prerequisite for the company development, but it is not sufficient. Performance measurement must be one of the components of performance management.

The need to know the cost level as accurately as possible results, on the one hand, from the limited nature of resources, and on the other hand, from the desire to increase performance. We cannot size the company performance if we cannot to determine the costs generated by the activity of the company with accuracy.

The standard cost method has a number of advantages that led to its rapid spread and improvement worldwide.

In the practice of the countries with market economy, the standard is the production efficiency measurement standard, under certain given conditions. Standards express sizes or values that are scientifically established, based both on data from previous periods, as well as on projected elements correlated with the conditions under which the future business of the company is assumed to take place. Therefore, their main function concerns the future activity, which is why standards are used as means of measuring, controlling and managing the activity performed.

With the standard – cost method, standard costs are deemed real or normal production costs. Usually, cost calculation is reduced to a single calculation, of standard costs, which is the basis for determining sales prices. The standard precalculation should be sufficient, because it determines the costs normally generated in the manufacturing process and is based on scientifically grounded cost standards, reflecting the actual conditions and real possibilities of business units.

Deviations have a central place in the general concept of managerial accounting and of the cost calculation based on the use of standard costs. They reflect the level of organization of the activity, the compliance with the technological discipline, the integration or failure to integrate the scheduled level into the manufacturing, supply and sales process. Guiding decisions concerning company management necessarily requires to know these deviations, as a prerequisite for the effective information of the decision makers in the companies in question in relation to the disturbances occurred in the manufacturing process.

Standard cost calculations per product are made before starting the manufacturing and are made on calculation items, operations and products. All the negative and positive aspects must be highlighted and all the required actions must be taken in the future.

The standard cost calculation per product makes it possible to know the volume of the manufacturing material and wages costs necessary for manufacturing each and every product unit, to compare these costs with the actual cost, to establish the level of participation of various business sectors to the total production cost la and to determine the share of each kind of expense per product unit.

The standard cost calculation per product is made after the elaboration of cost centre budgets. The existence of overhead costs in relation to the manufactured product requires that these costs be known in advance for the total manufactured products at the cost centre in question, and that they be only latter allocated to the products that have passed though the cost centre in question throughout the manufacturing process.

RESULTS AND DISCUSSIONS

The management by exception is to focus on areas in which parameters are not as expected. Areas with higher deviations receive increased attention.

Deviations should be reported taking into account the following:

- the correct identification of deviations on influencing factors;
- establishing responsibilities for each employee, in order to identify the employees responsible for unfavourable deviations;
- the deviation reporting should focus on unfavourable deviations, as a consequence of the management by exception;

- when deviations are reported to the top management of the company, details may be included in the case of the deviations supplied at lower levels, with causes and responsible persons.

The calculation of costs and profit per product using the standard cost method can be represented as in the following figure:

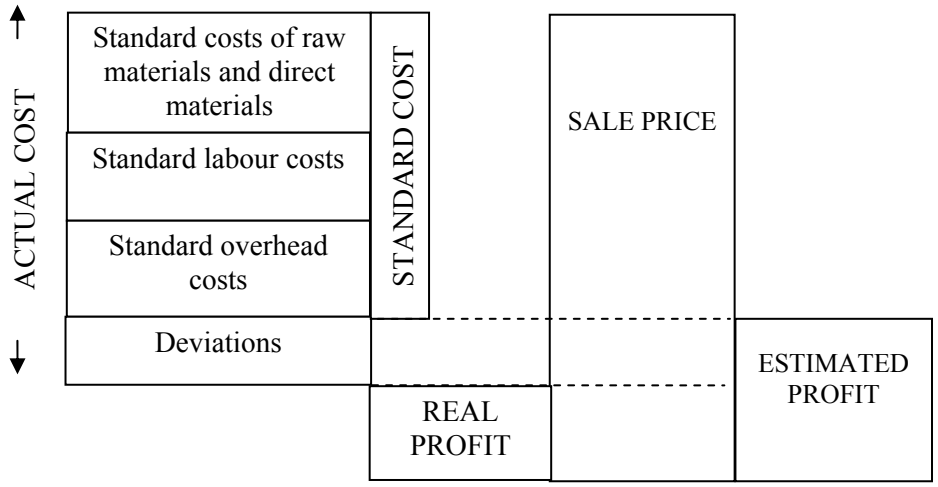


Figure 1. The calculation of costs and profit per product using the standard cost calculation method

Control is exercised especially in the case of unfavourable deviations, and is a consequence of the management by exception. By analysing deviations and determining responsibilities the manager can take corrective actions that may lead to the achievement of the decided performance. Following such analysis the level of the performance that must be reached can also be reviewed. For a better monitoring and interpretation, deviation rates can be calculated, based on the previously determined values in absolute sums.

The analysis of the deviations should not focus only on determining responsibilities, it should also allow us to learn from the understanding the causes and finally to better performance.

The analysis of the deviations must be performed carefully and taking into account the long-term objectives of the company. For example, a favourable deviation of the raw material price may result from the fact that

poor quality raw materials were purchased. Moreover, a favourable deviation at the wage rate may result from the fact that less qualified workers were used, which will affect the quality of the manufactured products.

Deviations within the acceptable range are often unavoidable and are deemed to be under control, and no investigations are necessary as to what caused them. Deviations can be used to assess performance. The Production Manager can receive efficiency bonuses if the operating expenses budget is observed. Understanding the causes which have led o deviations can be used to learn from experience and thus to improve the performance of the company.

The results of the deviation analysis is a basis for the substantiation of costs for the next period.

An advantage of the analysis of the deviations is that it reveals the individual aspects of performance[*]. It is recommendable not to base the performance analysis on a single indicator, due to the fact that managers will tend to make decisions meant to lead to positive values for the indicator in question, to the detriment of other aspects of the performance of the company. Such problems occur when a manager sets a performance assessment and award system which is not focused on the objectives of the company as a whole.

The inclusion of deviations from standard costs into performance reports is meant to provide more accurateness to the performance assessment process.

In order to achieve a purpose, managers should make the assessment taking into account the responsibilities of each manager, which should be expressed clearly and accurately. In the assessment of a manager's performance, only the elements that can be controlled by the manager in question should be taken into account.

The use of the standard cost method has both advantages as well as disadvantages. Essentially, the use of the method is positive, due to the fact that it has the role to stimulate and increase accountability. Nevertheless, the

[*] Horngren Charles, Datar Srikant, Foster George - *Contabilitatea costurilor, o abordare managerială (original title: Cost accounting, A Managerial Emphasis),* 11th Edition, ARC Publishing House, Chisinau, 2006, p. 256

use of standards can also be a negative element if its only purpose is to punish the people responsible for the recorded deviations.

The use of Advanced Manufacturing Technology (AMT) is currently revolutionizing product manufacturing, and has implications on the cost calculation and on the managerial accounting.

For the companies that use AMT, traditional systems used to calculate costs and to determine results are inadequate.

Traditional cost calculation methods use procedures for the allocation of indirect costs based on coefficients that are dependent on the production volume (expressed in man-hours or machine-hours). In an AMT environment, such procedures are considered inadequate.

The standard cost method starts from the idea that performance is satisfactory if it observes certain standards, while the use of AMT is based on the idea of continuous improvement.

The use of AMT takes place in an accelerated environment, in which the deviation calculation and analysis are possible with a certain delay, thus calling in question their usefulness.

CONCLUSIONS

Companies should try to strike a balance between the two purposes of the two purposes of the deviation analysis: performance assessment and organizational learning.

Reaching such balance is not as easy as it may seem. If too much emphasis is placed on the use of deviations for the performance assessment, achieving the standard becomes a purpose in itself for the employees and consequently, the organizational learning process is disfavoured. Managers may be tempted to observe budgets and avoid unfavourable deviations, even if long-term effects are detrimental to the company.

Cost control should monitor two main aspects:

- producing goods and services at a cost as low as possible;
- observing pre-established quality standards

Among the negative aspects we can include the following:

- the implementation of this method requires a long time, and the process is slow;
- standards should be accessible and ambitious at the same time;
- conflicts for the determination of the responsibility for deviations could be triggered;

- standards may be difficult to set and monitor in areas such as research and development, trade, training, etc.

- high costs related to the implementation and adaptation to changes.

Standards can be highly rigid. This us due to the long and tiring way towards their development. Employees develop a natural tendency to keep such standards as long as possible. If the manufacturing technology is changed or changes are made in the business environment in which the company carries out its activity, standards lose their informational valences. The flexibility of standards is the opposite of their rigidity and becomes a disadvantage when, due to the desire to adapt them, they are frequently changed and they lack the stability required over time. Standards are designed to be exciting, but they can be perceived by employees as a source of oppression which lead to the emergence of negative attitudes of resistance to these standards.

The standard calculation is an important cost control system due to several reasons:

- activities cannot be performed without knowing the operating costs and the difference between the real cost and the pre-established cost;

- waste is eliminated and the production capacity is used more efficiently through the development of standards for costs and for production performance;

- decision makers are provided additional information;

- it eliminates the influences related to the fluctuation of the various cost structures and those implying correlated absorption rates, due to the fact that the standard calculation is defined as a normal cost for normal production.

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