Farabi University

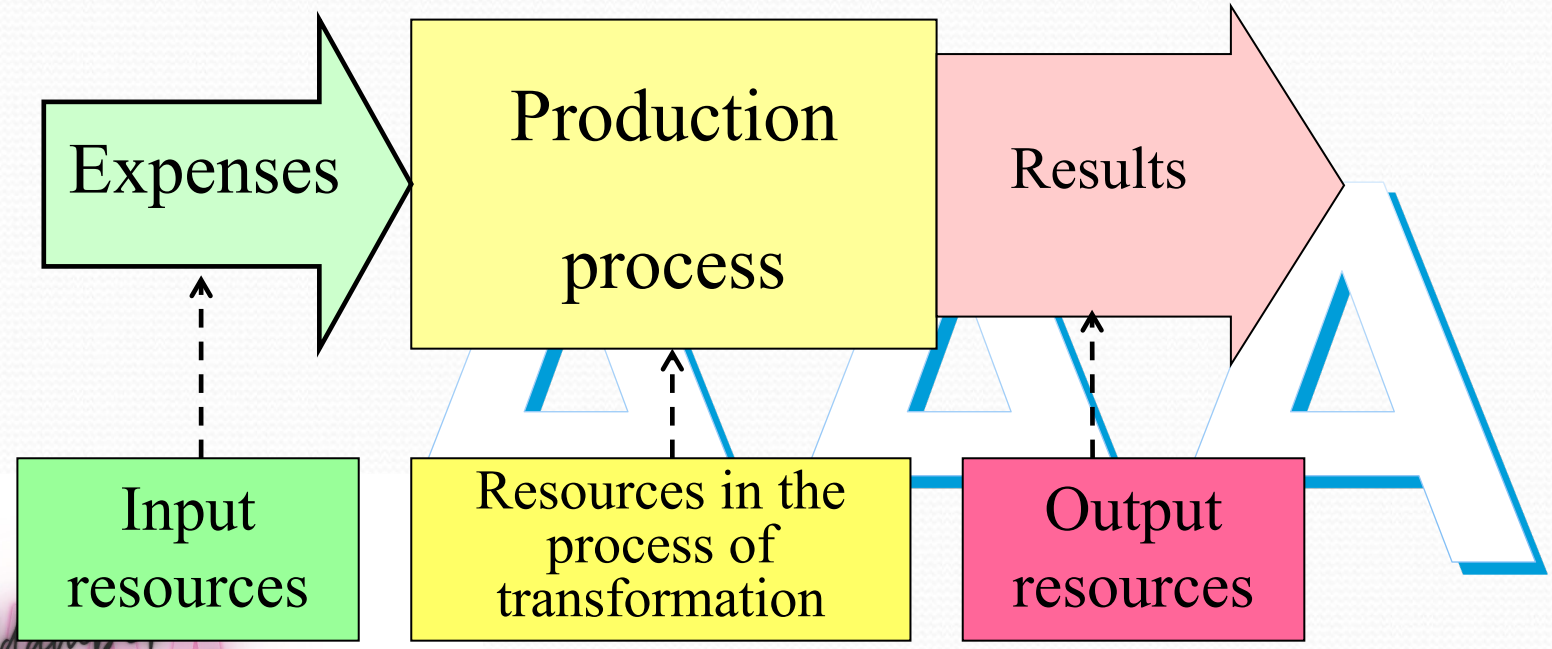
- The impact of cost management on corporate governance
- Management Department
- “Cost Management” Course
- Dr., professor Adambekova A.A.

Cost management in the corporate governance system –

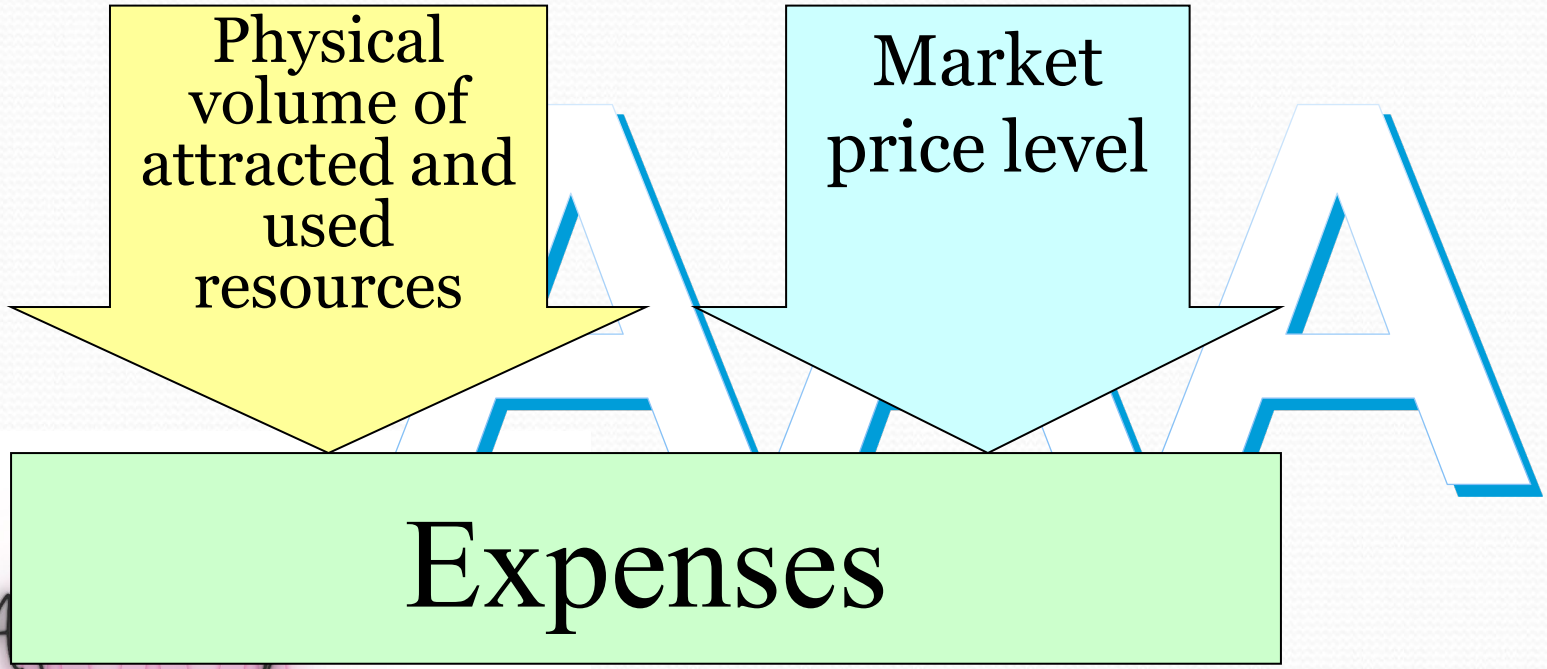
purposeful activity of enterprise management aimed at transforming economic resources into the final result of production in accordance with the goals of the company

Adambekova Ainagul

Enterprise performance efficiency – cost-to-benefit ratio



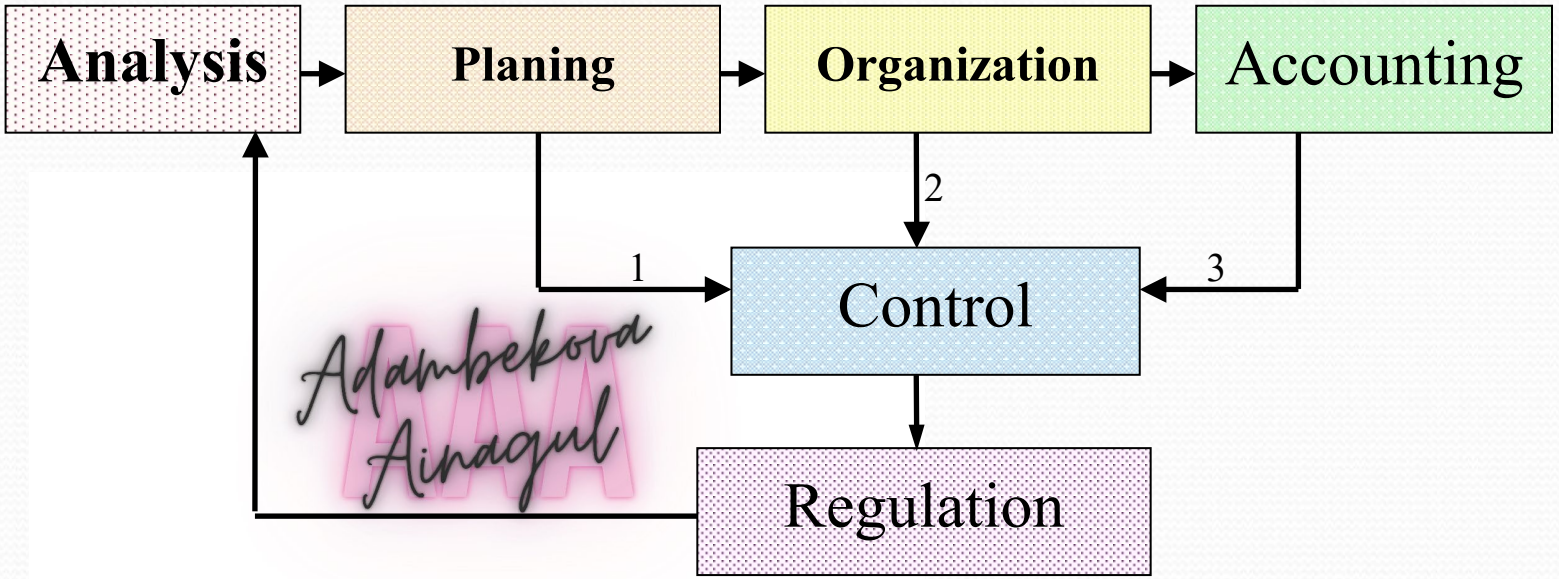
Factors that determine total costs



Cost management tasks

1) determining the degree of influence of the costs of different types of resources on the results of the enterprise's activities
2) choosing the most appropriate cost management methods
3) establishing criteria for assessing efficiency, as well as the economic, environmental, and social effects of cost management

Interrelation of functions of the company's cost management process



1 – preliminary control
2 – current control
3 – subsequent control

From the perspective of corporate governance, the following issues are resolved during cost management:

- it is established who, in what time frame, using what information and documents, in what ways manages costs in the business structure
- cost centers and responsibility centers are determined
- a hierarchical system of linear and functional connections between managers and specialists related to cost management is being developed.

Cost Management Principles

- systematic approach to cost management
- methodological unity at different levels of cost management
- cost management at all stages of the product life cycle
- organic combination of cost reduction with high quality products (works, services)
- focus on avoiding unnecessary costs
- fungibility of resources
- widespread introduction of effective cost reduction methods
- improving information support about costs
- increasing the interest of the enterprise's production departments in reducing costs

The company purchased materials for future use in the amount of $500 thousand.

Subsequently, due to changes in technology, it turned out that these materials are of little use for our own production.

Adambekova Ainagul

The partner is ready to buy products made from these materials from this enterprise for $800 thousand.

At the same time, the additional costs of the enterprise for the production of products will amount to 600 thousand dollars

Adambekova Ainagul

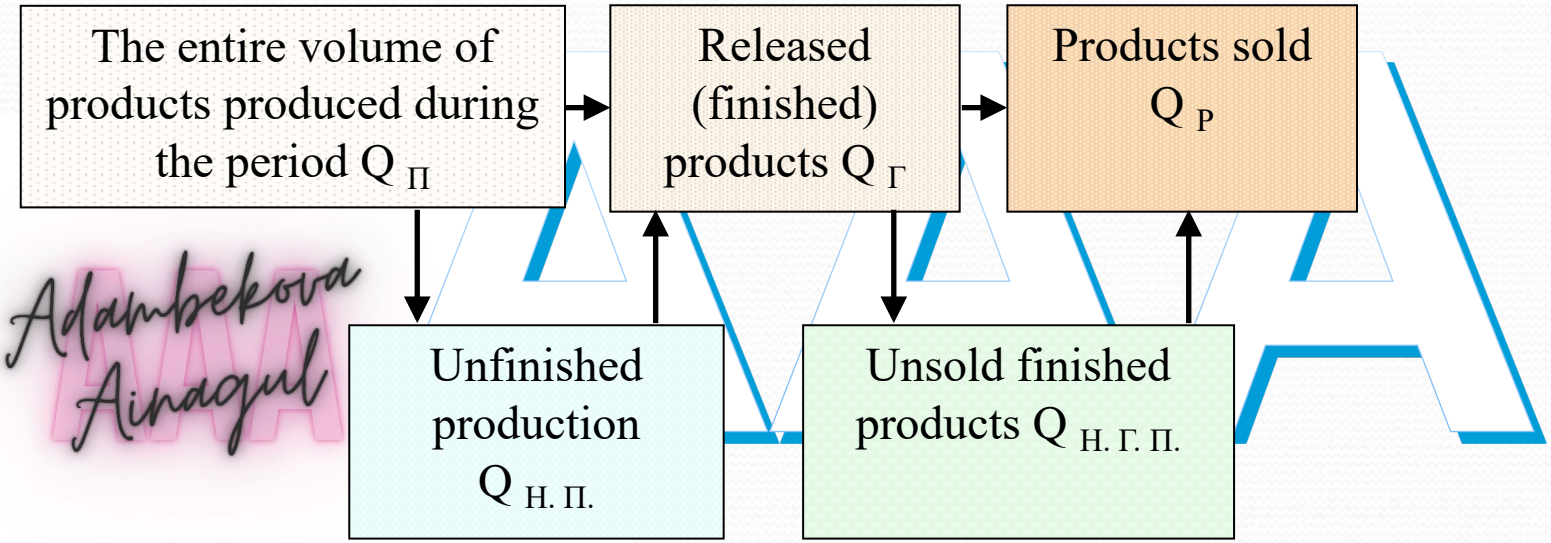
Is it advisable to accept such an order?

Our discussion

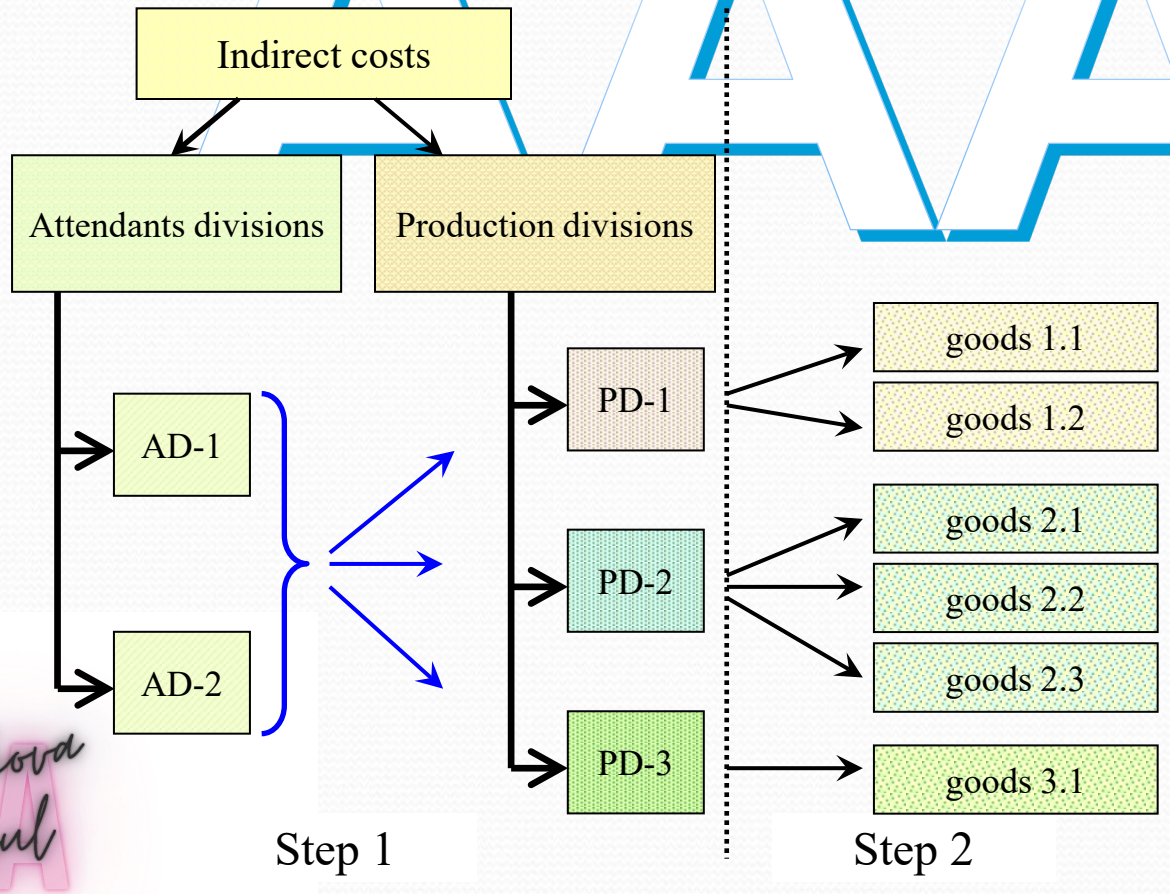
Indicators	Alternative 1 (do not accept the order)	Alternative 2 (accept order)
Revenues from sales	–	800
Additional expenses	–	600
Profit	–	200

What's missing here?
What's wrong here?

The relationship between production volumes and costs as the degree of readiness increases



Traditional systems



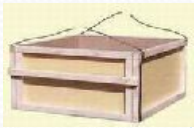
Adambekova Ainagul

Functional systems also implement a two-step cost allocation process:

1. Costs are distributed not by department, but by type of activity
2. Many cost drivers are used, including those that are not directly related to production volume

The company produces several types of products, including products A and products B

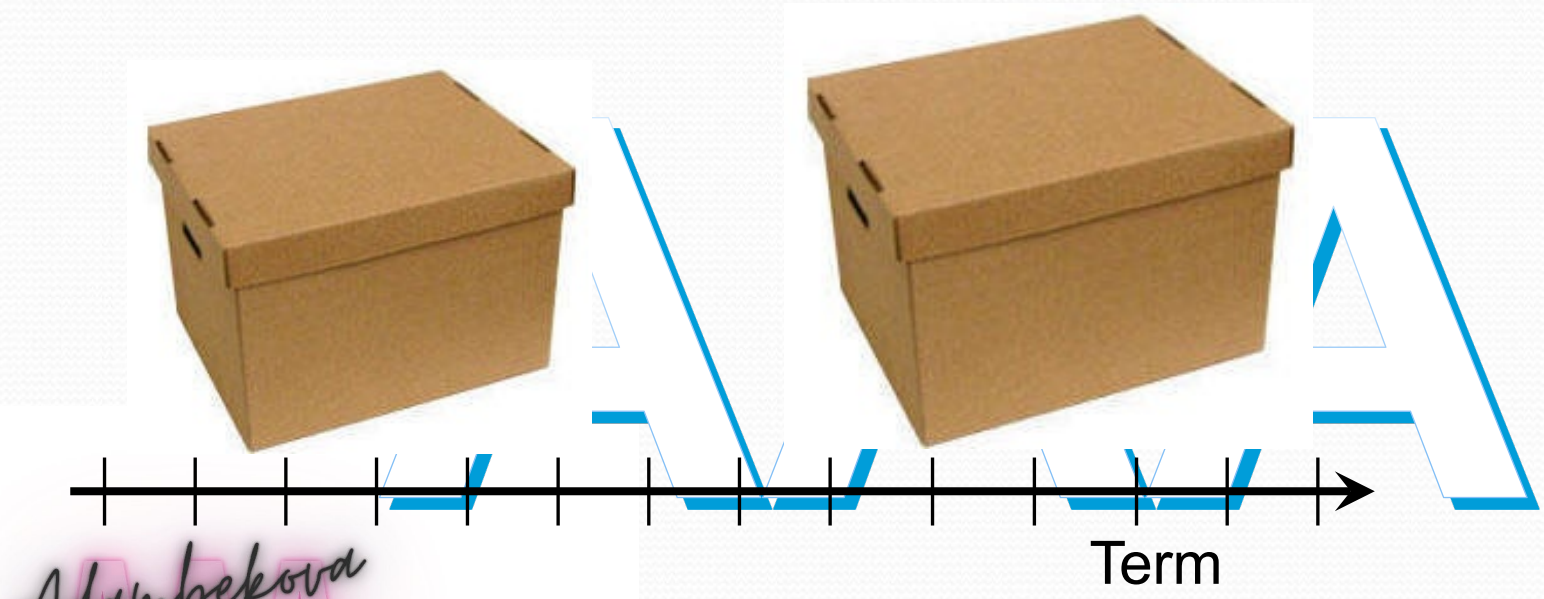
products B



products A

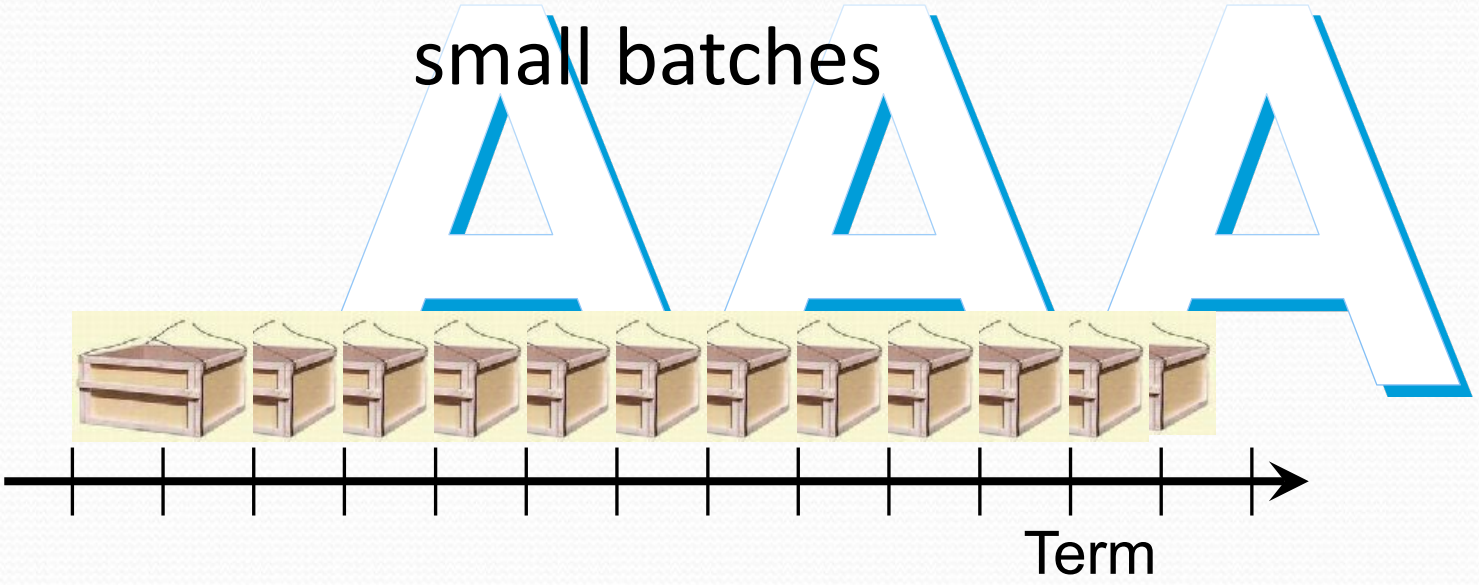
Other products

Product A is produced in large quantities in large batches, but not regularly



Adambekova Ainagul

Product B is produced regularly in small batches



When using the traditional system, the distribution of indirect costs was carried out in proportion to the man-hours of the main production workers:

- Product A requires 25% of the core production workers' time to create.
- Product B requires 5% of the core production workers' time to create

Indirect costs of the enterprise for the period amounted to 1,000,000 $.

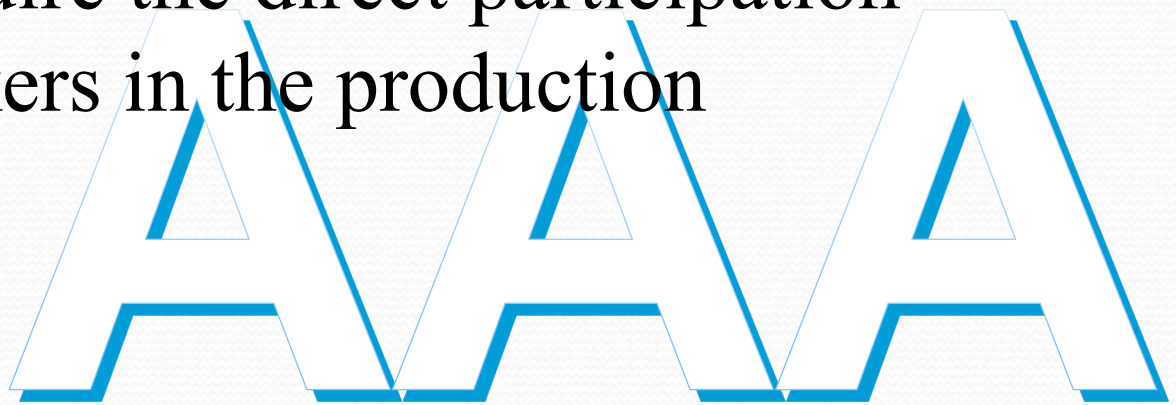
	Traditional system	
	Products A	Products B
Direct costs	310 000	40 000
Indirect costs	250 000 (25 %)	50 000 (5 %)
Sales proceeds	600 000	150 000
Profit / Loss	40 000	60 000

The study showed that overhead costs vary with the number of batches processed. It was decided to move to a functional cost accounting system, the cost driver being “the number of batches processed.” Each product accounts for 15% of the number of product batches processed during the period.

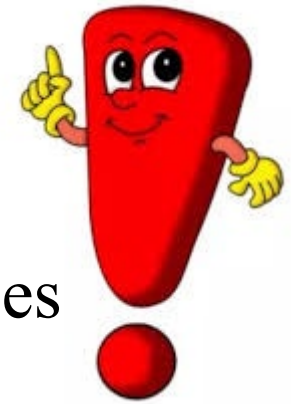
	Functional system	
	Products A	Products B
Direct costs	310 000	40 000
Indirect costs	150 000 (15 %)	150 000 (15 %)
Sales proceeds	600 000	150 000
Profit / Loss	140 000	(40 000)

Distribution of indirect costs by sales volume

often used in companies that provide services or produce products using modern technological equipment that does not require the direct participation of workers in the production process



Pay attention



The main mistake in using such a distribution mechanism is that it often does not take into account the lack of relationship between sales volume and the amount of overhead costs for producing a product or providing a service.

The company produces two types of products using an automated technological complex

Products A

Products B

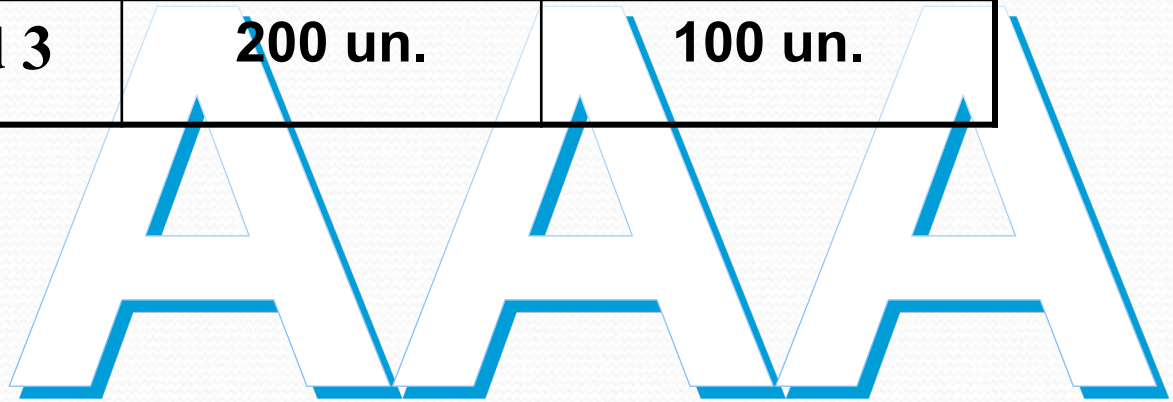
Direct costs per unit of production are:

- Product A – 30 $
- Product B – 40 $

Indirect costs of the enterprise were:

- Period 1 – 300,000 $.
- Period 2 – 350,000 $
- Period 3 – 340,000 $

	Produced and sold	
	Products A	Products B
Period 1	100 un	200 un.
Period 2	150 un.	150 un.
Period 3	200 un.	100 un.



Prices for both types of products are determined by market supply and demand

	Unit price	
	Products A	Products B
Period 1	1000 $	2000 $
Period 2	1200 $	1800 $
Period 3	1000 $	1800 $

Distributions of indirect costs for Period 1

	Products A	Products B
Revenue is the basis for the distribution of indirect costs	1000 $ · 100 un= 100000$	2000$ · 200 un =400000$
Share of indirect costs	20 % 60000$	80 % 240000$
Unit cost	$\frac{60000\$}{100\ un}$+30$=630$	$\frac{240000\$}{200un}$+40$=1240$

If the sales volume is taken as the basis for the distribution of indirect costs

	Unit cost	
	Products A	Products B
Period 1	630 $	1240 $
Period 2	963 $	1440 $
Period 3	925 $	1651 $

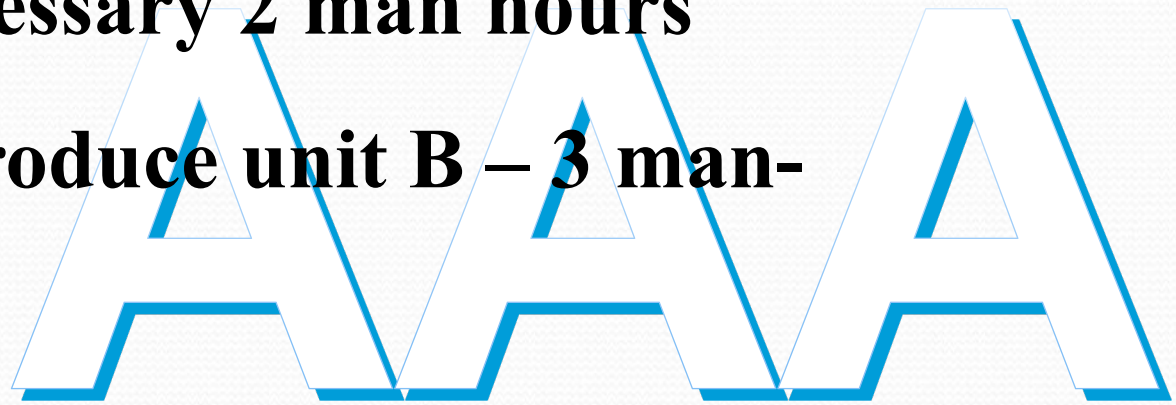
Distribution by wage fund

Such a distribution base is justified in the case when a large share of manual labor is used to produce products or provide services, the amount of payment for which directly depends on the volume of production. In other cases, the use of payroll as a distribution base generates errors in cost calculations

Let's assume that in the previous example, not an automated technological complex was used, but mainly manual labor

Then it will be appropriate to apply the distribution by man-hours for the production of a unit of each type of product

- **To produce a unit of output A it is necessary 2 man hours**
- **To produce unit B – 3 man-hours**



If man-hours are taken as the indirect cost base

	Unit cost	
	Products A	Products B
Period 1	780 $	1165 $
Period 2	963 $	1440 $
Period 3	1001 $.	1497 $

With this method of calculating costs in the 3rd period, the production of product A becomes unprofitable