

# The problem of selecting information on costs: Development and current state

## El problema de la selección de información sobre los costos: desarrollo y estado actual

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#### ABSTRACT:

The article is devoted to the analysis of the problem of selecting information on costs when forming a system of management accounting. The purpose of this article is the identification of the criteria of selecting information on the costs, which are significant from the point of view of analysis, management and decision making, in their connection with the changing economic conditions and the modification of the strategy and purposes of business. The analysis carried out allowed drawing the conclusion on the existence of two such criteria, each of which was applied to the filtration of information on costs during a certain period of economic development, in the conditions of business orientation to the achievement of definite purposes. The use of the term "basic unit of activity" is offered for the combination of the available mechanisms of the analysis of companies' internal activity and their representation as a uniform, "process" approach to the activity of the company. The conclusion is drawn that the criterion of selecting information on costs developed within the "process" approach to the activity of the company – "adding value to the end product from the point of view of the consumer" - can lead to loss of the relevance of information on the costs of the company and making unreasonable, incorrect administrative decisions.

#### RESUMEN:

El artículo se dedica al análisis del problema de la selección de información sobre los costes a la hora de formar un sistema de contabilidad de la gestión. El propósito de este artículo es la identificación de los criterios de selección de información sobre los costos, que son significativos desde el punto de vista del análisis, gestión y toma de decisiones, en su conexión con las cambiantes condiciones económicas y la modificación de la estrategia y propósitos del negocio. El análisis realizado permitió concluir la existencia de dos criterios, cada uno de los cuales se aplicó a la filtración de información sobre los costes durante un determinado período de desarrollo económico, en las condiciones de orientación empresarial a la logro de propósitos definidos. El uso del término "unidad básica de actividad" se ofrece para la combinación de los mecanismos disponibles del análisis de la actividad interna de las empresas y su representación como un enfoque uniforme, "proceso" a la actividad de la empresa. Se concluye que el criterio de seleccionar información sobre los costos desarrollados dentro del enfoque de "proceso" a la actividad de la empresa – "añadir valor al producto final desde el punto de vista del consumidor"-puede conducir a la pérdida de la relevancia de información sobre los costos de la

Besides, the information on the costs of the company, which do not meet this criterion, is not included into calculations, is not analyzed regarding the efficiency of costs, and the costs themselves are not exposed to control.

**Keywords:** management accounting, costs, business processes, value creation chain

empresa y la toma de decisiones administrativas irrazonables y erróneas. Además, la información sobre los costos de la empresa, que no cumple con este criterio, no se incluye en los cálculos, no se analiza con respecto a la eficiencia de los costos, y los costos por sí mismos no están expuestos al control.

**Palabras clave:** contabilidad de gestión, costos, procesos de negocio, cadena de creación de valor

## 1. Introduction

Today's condition of world economy, characterized by aggression of competitive fight and acceleration of economic conditions change and also transformation of models, strategies and principles of the organization and business led to the fact that it becomes more difficult for the management of modern companies to find a way around in the flow of information and to make proved, balanced management decisions.

In such a situation, a request is formed by the management system of companies for the mechanisms of selection and sorting of information in order to clear the information stream as much as possible of the data which hold no value from the point of view of analysis, management and decision-making.

From two information collections, available for the management of a concrete firm: 1) information, characterizing the external environment of the firm; 2) information, characterizing the internal environment of the firm, the main attention will be paid to the second (the main source of its formation is the system of management accounting, the main object – the costs of the firm).

## 2. Methods

The information on the internal environment of the firm characterizes the object of management; therefore, the problem of information filtration of this collection requires primary decision. The research will designate in more detail the essence of the problem of selecting information selection on costs, by means of general scientific methods to investigate its development and current state. The result of the work is the designation of approaches to the solution of the problem of information selection, which can be received in the form of certain mechanisms of costs accounting which would allow filtering the entering data on costs and providing at the exit of the registration system only those of them which are significant for analysis, management and decision-making.

Thus, the full range of the information on costs, from the point of view of the designated problem, can be divided into 2 groups. The first group can include data on the costs which are valuable, significant (from the position of management, analysis, and decision-making). Respectively, the second group consists of data on costs which are neither significant nor valuable. In the course of time, the understanding of the importance of information on costs underwent essential changes; in this connection, the ratio between two groups of costs also changed.

One of the factors determining the development of the theory of management accounting is continuous expansion of the general costs of the companies, as well as the changes in the structure of costs caused by a number of objective circumstances. As a result of the action of this factor, the list of "significant" costs, from the point of view of analysis, management and decision-making, also constantly extends.

For example, at the end of the 19th – the first third of the 20th century, the scientific and technological revolution enabled companies to significantly increase the volumes of production, which it became possible to sell due to the rapid development of transport. The orientation of companies to the greatest possible increase in production became a basis for control systems creation. As a result of the action of these objective factors, the total costs of companies

significantly extended due to the expansion of their production part. And it was the production costs that were considered as significant for analysis, management and decision-making.

The accounting tools developed during this period – the systems "standard-cost", "direct-cost" and others, in general, are characterized by special attention to production costs and by almost full ignoring of a non-productive part of costs, up to its complete elimination from calculations. Such filtration was caused by insignificant share of non-manufacturing costs in the structure of total costs of companies.

This kind of "production" approach to the accounting of costs remained relevant approximately till the 1960s. By this time, scientific achievements created prerequisites for a new change in economic conditions – informatization and computerization of economy. The introduction of new technologies, firstly, created a number of new branches in economy, secondly, expanded the list of costs and led to changes in the structure of costs of companies.

The accelerating technical progress, the expansion of activity scales and the complication of control systems connected with it, as well as the gradual introduction of computer technologies in economic activity gradually forced the companies to bear increasing non-manufacturing costs, reducing at the same time a share of production costs. At the same time, the strengthening of international competition drew the attention of business to the consumer whose satisfaction ensuring gradually became one of main goals of a firm's activity.

In this historical period, understanding was formed in the business environment that it is insufficient just to make goods in new economic conditions. The orientation to the maximum satisfaction of the consumer makes important each stage of product creation – from initial development to sale and even further away – throughout after-sales service. The activity of a firm is ordered and considered as the sequence of equivalent processes (business processes) where the process of production is only "the first among equal". Therefore, the attitude to non-manufacturing costs also changes.

Thus, the list of "significant" costs extends. However, the accounting systems focused on selection of only information on production costs cannot satisfy the appeared demand for information on non-manufacturing costs.

The formed gap between the business practice and theoretical practices in the field of management and accounting of costs by the 1980s reaches a limit. The tools of traditional systems of costs accounting did not pay adequate attention to non-productive business processes, and, therefore, non-manufacturing costs. They did not correspond to the new orientation of business to the maximum satisfaction of the consumer.

These circumstances generalized in the work "Relevance Lost: The Rise and Fall of Management Accounting" (Kaplan, & Johnson, 1987) were a prerequisite for the formation of a new approach to costs accounting.

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### **3. The choice of a "basic unit of activity" and modern approach to selecting information costs.**

Today, the following concept was formed in literature: a firm is perceived as a sequence of kinds of activity aimed at creation of good or service (Atkinson *et al.*, 2000). The kind of activity is a unit of work or task containing a specific goal, connecting people, equipment, materials, energy and other resources for product production and rendering services. At the same time, the processes are understood as the sequence of interconnected kinds of activity for the achievement of a specific goal: purchases of materials, productions of products, repair and technical maintenance of equipment or service of consumers (Atkinson *et al.*, 2000).

As a result, the formation of costs is described by the terminological chain: processes – activity/kinds of activity – expense (costs).

In this case, the point at issue is business processes which, according to the American Standard

on Management Accounting (Statements on Management Accounting "Implementing Process Management for Improving Products and Services") of SMA No. 4 NN, are understood as material embodiment of the flow of information in the company aimed at creating value for the consumer.

Within each business process, as a rule, several subprocesses or operations are carried out, which sometimes are also referred to in literature as "kinds of activity".

The concept of a "stream of value creation", which is understood as "everything that we do for value creation for the consumer", is close in content to business processes (Maskell, & Baggaley, 2004). In the work of the American authors' group, the term "value creation chain" (value chain) is found – "the sequence of kinds of activity which create or deliver goods or service to clients" (Atkinson *et al.*, 2000).

K. Drury operates the concept "value chain" – it is the interconnected set of activity kinds during which value is created, beginning from basic sources of initial materials for suppliers of components and further to the end product or service provided to the consumer (Drury, 2000). The similar concept is used by the authors of another work for designation of interaction of a firm's functional divisions in the course of business (Garrison *et al.*, 2008).

The process approach to firm's activity, first of all, is focused on the use of accounting systems of ABC costs. Within this system, the classification of kinds of activity is applied from which kinds of activity are distinguished: at the level of product unit; at the level of party of product; at the level of product in general; at the level of enterprise.

The adherents of the concept of activity kinds and value creation also occur among the Russian authors. In A.Yu. Sokolov's work, the term "stream" is used – a complex of kinds of activity which create product value (works, services) from the point of view of the consumer, or the sequence of processes, passing through which, the product is transformed and delivered to the consumer (Sokolov, 2008). At the same time, a "kind of activity" is understood as a set of consecutive actions or processes at various levels of management of the organization in the spheres of supply, production, distribution aimed at the achievement of certain result by means of use of material, labor and other resources" (Sokolov, 2008).

The classification of streams creating value is also given in A.Yu. Sokolov's work: production (includes only production processes); classical (includes processes of transformation of raw materials and materials in the finished product delivered to the consumer); expanded (classical stream + processes connected with acquisition of materials and work with suppliers).

The allocation of functions, carried out by structural divisions, can be one more option of the specification of a company's internal activity. Defining of the purpose and tasks, as well as the functions of each of divisions of the company, is fixed by internal documents (for example, the provision on structural division). In its turn, the performance of this or that function assumes a certain set of actions and operations which are focused on the solution of narrower tasks and, in total, allow achieving the general, functional objective.

We do not stop on the detailed analysis of each model of the organization of management accounting system of costs, identification of their shortcomings and advantages. Sufficient attention to these issues was paid in a separate work (Zhigunova, & Kovalev, 2016). However, a certain common view of these models on the activity of a company, on its internal processes, allows uniting them in the uniform, "process" approach to the activity of a company.

In general, the concept of the process approach to the activity of a company comes down to the fact that all this activity is represented as a set of elementary, routine, atomic operations, each of which assumes consumption of resources, respectively, is the place of the emergence of costs. These operations can be united in larger massifs of actions, some kind of, "basic units of activity" – kinds of activity, processes, streams, functions, etc. At the same time, irrespective of which one from the basic units of activity is taken as a basis at the organization of management accounting system of costs, the general principles of information formation remain.

First of all, it is about information filtration. The criterion of the division and filtration of the information on costs is whether they add value to the end product from the point of view of the consumer.

At such approach, the data on the costs, carried out in basic units of activity and atomic operations, not adding value to the end product from the point of view of the consumer, are not admitted as "significant" for analysis, management and decision-making. Only the costs adding value are taken into consideration, and information on them is regarded as valuable and significant for analysis, management and decision-making.

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## **4. Comments to the modern model of information selection on costs**

Thus, two main selection criteria of significant information on costs are offered today. At the same time development of each of them happened in the corresponding historical and economic circumstances forming a certain approach, firstly, to the organization of business and, secondly, to the costs accounting.

The first criterion assumes selection of information on costs, from the point of view of their participation in production. At use of this criterion, only costs of production character are admitted as significant. The development of such criterion was favored by some features of the era of economy industrialization, with orientation inherent in it to the maximum utilization of capacity (Emerson, 1992) and a low share of non-manufacturing costs.

The second criterion has been elaborated relatively recently. It is characteristic of the process approach to the activity of a firm and means the selection of information on the costs, which, from the point of view of management, adds value to the end product. The development of this criterion was favored, on the one hand, by the growth of a share of non-manufacturing costs in costs structure of manufacturing installations, and also the rapid development of service trade which began in the second half of the 20th century, on the other hand – by the development of the theory and practice of management, first of all, operational (for example, O'Shaughnessy, 1979).

In today's conditions, the management of a concrete firm can use any of two criteria for selecting information on costs, taking into account the industry affiliation, the scale of activity and other features of a firm. However, even more often preference is given to the second criterion, especially by management of medium-sized and large companies.

Concerning this criterion, it is necessary to make several comments.

It is obvious that the management regards as excessive and unproductive all operations and processes, which do not add value to the product. Therefore, the resources consumed in these operations and processes (material, labor and others) are estimated as losses, waste. The information on such costs is not taken into consideration as it does not meet criterion of importance. As it was noted by us earlier, all non-manufacturing costs within the production approach to the accounting of costs in this way were considered as resulted, firstly, in lack of control over such costs and their growth; secondly, in irrelevant data on costs, prime cost and, respectively, in incorrect administrative decisions.

Doubtless, the operations and processes which are not adding value to the end product have to be excluded from economic activity. However, it must be kept in mind that the assessment of that, whether it adds or does not add concrete operation or process value to the end product, can be rather subjective.

Besides, it is necessary to consider that the costs result from consumption of resources. It means that if the resource is consumed by the certain activity (which is adding or not adding value to the end product), costs are incurred and have to be considered when calculating cost of production. It should also be noted that the firm is forced to bear some of the costs which are not adding value to the products (works, services), due to the legislation system acting in

the country of maintaining activity, the standard business practice, the level of development of productive forces, scientific and technical development, economic conditions and other objective factors.

Such costs, anyway, have to be covered at the expense of the price of the output product (work, service); so, they have to be considered at the calculation of the cost of production.

At the same time, the operations both adding and not adding value to the product can be carried out inefficiently; therefore, the company bears additional, excess costs caused, for example, by the duplication of operations, mistakes in their implementation, lack of control, etc. By an example of production costs, this problem can be solved by means of rationing of operations, as well as by the establishment of personal responsibility for consumption of resources when performing operations, or for execution of a concrete function including several operations.

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## 5. Conclusion

Therefore, it is obvious that the established criterion of selecting information on costs at the organization of management accounting allows ignoring part of a firm's costs. The costs which, by management estimates, do not add value to the end product are overlooked, ignored.

This, in its turn, results in the lack of control over them and the loss of the relevance of the information on the total value of costs. In our opinion, operation and processes which the company is forced to carry out in the existing economic situation at the current orientation and architecture of systems of production and management have to be considered and taken into consideration equally, regardless of whether they add or do not add value to the products (works, services).

Certainly, it does not cancel the need for the maximum exclusion of unproductive processes and operations from the chain of economic operations. However, in this case there is a question of administrative decisions and creation of the internal architecture of business processes.

Accounting, anyway, only adapts to the production and administrative system which works at present.

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