



51A Middle Street Newburyport MA 01950

Phone: 800-588-7039 Fax: 877-902-4284

contact@bhfe.com

www.beaconhillcpe.com

Course Information

Course Title: Cost Management Guidebook #3615

Number of continuing education credit hours recommended for this course:

CPA: 17 (All states)

In accordance with the standards of the National Registry of CPE Sponsors, CPE credits have been granted based on a 50-minute hour.

National Registry of CPE Sponsors ID Number: 107615.

Sponsor numbers for states requiring sponsor registration

Florida Division of Certified Public Accountancy: 4761 (Ethics #11467)

Hawaii Board of Accountancy: 14003

New York State Board of Accountancy: 002146

Ohio State Board of Accountancy: M0021

Texas State Board of Accountancy: 009349

Program Delivery Method: QAS Self-Study (interactive)

Subject Codes/Field of Study: Finance

Course Description:

Level: Overview

Prerequisites: None

Advance Preparation: None

The *Cost Management Guidebook* addresses a number of tools that can be used to examine the cost structure of a business, including analyses for cost objects, constraints, and processes. The course also addresses how to reduce costs in all of the major areas of a corporation, including compensation, sales, production, procurement, and administration. There are also extensive discussions of asset reduction techniques, as well as cost management reports and measurements.

Course Materials

Publication/Revision date: 9/27/2014.

Course book: *Cost Management Guidebook* by Steven M. Bragg, CPA.

Final exam format: Eighty-five questions (multiple-choice).

Instructions for taking this course

In order to receive CPE credit for this course, you must complete the course within one year of the date of purchase. This includes achieving a passing grade of at least 70% on the final exam. The exam may be retaken if not passed on first attempt (no charge).

Complete the course by following the learning assignments and objectives listed below and studying the review questions at the end of each chapter. Once you have completed each learning assignment and you are confident that the learning objectives have been met, answer the final exam questions.

⇒bgfhi WjcbgZcf HU_]b['h Y:]bU`9l Ua 'Cb`]bY.``
j "@c[]b`hc`mci f`UWti bh'cb`]bY`Uh'k k k "V\ZY"Vta ""
j "; c`hc`fA m5Wti bh`UbX`j`Yk`mci f`Vti fgYg""
j "GY`YWf`HU_Y`9l Ua f`Zcf`h`]g`Vti fgY`UbX`Zc`ck`]bgfhi Wjcbg""
<Uj`Y`U`ei`Ygh]cb3`7U`i`g`Uh, \$\$!) , , !+\$' - `cf`Ya U]`i`g`Uh`VtbHUVW V\ZY"Vta ""

Learning Assignment & Objectives

Learning Objectives:

- Note the advantages and dangers of having an active cost management program.
- Identify the various types of costs, and how they are used.
- Cite the applications to which direct costing analysis can be put, as well as any limiting factors.
- State the components and derivation of the cost-volume-profit concept, and how it is used.
- Identify the uses to which target costing can be put, as well as how costs can be altered to meet target costing goals.
- Note the costs that are associated with cost objects, and the decisions that can arise from cost object analysis.
- Identify the key components of constraint analysis, and how profits can be improved under this type of analysis.
- Cite the tools used to conduct a process analysis.
- State the components of a zero-base budgeting system, and the situations in which zero-base and conditional budgeting can be used.
- Note the analysis tools to use for different cost reduction strategies.
- Cite the types of cost reduction methods available when reducing compensation costs, and the side effects of using these methods.
- State the methods used to reduce benefit costs, and the side effects of using these methods.
- Identify the techniques available for increasing the effectiveness of sales and marketing activities, and the side effects of using these methods.
- Identify the cost reduction techniques that can be used to reduce the costs of production and maintenance operations, and the side effects of using these methods.
- Cite the key procedural steps and forms needed to maintain a proper system of procurement.
- State the range of methods available for the reduction of costs for accounting, human resources, legal services, and other areas of administration.
- Identify the cost reduction tactics available for managing facilities costs.
- Note the methods used to reduce finance costs.
- Cite the range of techniques used to reduce the investment in accounts receivable, and the situations in which they are most applicable.

- State the cost reduction concepts used to reduce the level of inventory, and the situations in which they are most applicable.
- Identify the analysis methods used to evaluate prospective investments in fixed assets, as well as alternative forms of payment for these assets.
- Identify the key reports and report formats needed to support a system of cost management, and the situations in which these reports might be used.
- Cite the most essential measurements used to evaluate the cost structure of a business, and the situations in which these measurements might be used.

About the Author

Steven Bragg, CPA, has been the chief financial officer or controller of four companies, as well as a consulting manager at Ernst & Young. He received a master's degree in finance from Bentley College, an MBA from Babson College, and a Bachelor's degree in Economics from the University of Maine. He has been a two-time president of the Colorado Mountain Club, and is an avid alpine skier, mountain biker, and certified master diver. Mr. Bragg resides in Centennial, Colorado. He has written the following books:

Accountants' Guidebook	Credit & Collection Guidebook
Accounting Controls Guidebook	Financial Analysis
Accounting for Inventory	Fixed Asset Accounting
Accounting for Investments	GAAP Guidebook
Accounting for Managers	Human Resources Guidebook
Accounting Procedures Guidebook	IFRS Guidebook
Bookkeeping Guidebook	Inventory Management
Budgeting	Investor Relations Guidebook
Business Ratios	Lean Accounting Guidebook
CFO Guidebook	Mergers & Acquisitions
Closing the Books	New Controller Guidebook
Constraint Management	Nonprofit Accounting
Corporate Cash Management	Payroll Management
Cost Accounting Fundamentals	Public Company Accounting
Cost Management Guidebook	Revenue Recognition

Copyright © 2014 by AccountingTools, Inc. All rights reserved.

Published by AccountingTools, Inc., Centennial, Colorado.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without the prior written permission of the Publisher. Requests to the Publisher for permission should be addressed to Steven M. Bragg, 6727 E. Fremont Place, Centennial, CO 80112.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

ISBN-13: 978-1-938910-43-2

Printed in the United States of America

Table of Contents

Chapter 1 - Overview of Cost Management	1
<i>The Economics of Cost Management</i>	<i>1</i>
<i>How Costs Increase</i>	<i>2</i>
<i>Advantages of Cost Management</i>	<i>3</i>
<i>The Cost Management Environment</i>	<i>4</i>
<i>The Customer Service Conundrum</i>	<i>5</i>
<i>The Effects of Cutting Too Deep</i>	<i>6</i>
Chapter 2 - Types of Costs	8
<i>Fixed Costs</i>	<i>8</i>
<i>Variable Costs</i>	<i>9</i>
<i>Mixed Costs</i>	<i>9</i>
<i>Step Costs</i>	<i>11</i>
<i>Marginal Costs</i>	<i>11</i>
<i>Differential Costs</i>	<i>12</i>
<i>Discretionary Costs</i>	<i>12</i>
<i>Committed Costs</i>	<i>12</i>
<i>Sunk Costs</i>	<i>12</i>
Chapter 3 - Direct Costing as an Analysis Tool	15
<i>Overview of Direct Costing</i>	<i>15</i>
<i>Contribution Margin versus Gross Margin</i>	<i>16</i>
<i>Direct Costing as an Analysis Tool</i>	<i>17</i>
Automation Investments	17
Cost Reporting	17
Customer Profitability	18
Profit-Volume Relationship	19
Outsourcing	20
<i>Direct Costing Pitfalls</i>	<i>21</i>
Increasing Costs	21
Indirect Costs	22
Relevant Range	22
Chapter 4 - Cost-Volume-Profit Analysis	25
<i>Contribution Margin</i>	<i>25</i>
<i>Contribution Margin Income Statement</i>	<i>26</i>
<i>Breakeven Point</i>	<i>27</i>
<i>Margin of Safety</i>	<i>30</i>
<i>Cost-Volume-Profit Analysis</i>	<i>31</i>
<i>Sales Mix</i>	<i>32</i>

Chapter 5 - Target Costing	36
<i>The Basic Steps of Target Costing</i>	36
<i>Value Engineering Considerations</i>	37
<i>The Cost Reduction Program.....</i>	38
<i>The Milestone Review Process.....</i>	39
<i>Problems with Target Costing</i>	39
<i>The Members of a Design Team.....</i>	40
<i>The Role of the Accountant in Target Costing</i>	40
<i>Data Sources for Target Costing</i>	41
<i>The Product Life Cycle and Target Costing.....</i>	42
Chapter 6 - Cost Object Analysis	44
<i>Factors in Cost Object Analysis.....</i>	44
<i>The Assignability of Costs.....</i>	45
<i>The Customer Cost Object</i>	46
<i>The Employee Cost Object.....</i>	47
<i>The Product Cost Object.....</i>	48
<i>The Product Line Cost Object.....</i>	50
<i>The Sales Channel Cost Object.....</i>	51
<i>Cost Object Termination Issues</i>	52
<i>Which Cost Objects to Track.....</i>	53
Chapter 7 - Constraint Analysis	55
<i>Constraint Analysis Operational Terminology</i>	55
<i>Overview of Constraint Analysis.....</i>	56
<i>The Cost of the Bottleneck</i>	57
<i>Local Optimization.....</i>	58
<i>Constraint Analysis Financial Terminology</i>	59
<i>Constraint Analysis from a Financial Perspective.....</i>	59
<i>The Constraint Analysis Model.....</i>	60
<i>The Decision to Sell at a Lower Price.....</i>	61
<i>The Decision to Outsource Production.....</i>	62
<i>The Capital Investment Decision</i>	63
<i>The Decision to Cancel a Product</i>	64
Chapter 8 - Process Analysis	67
<i>Process Analysis Tools.....</i>	67
Value Stream Mapping.....	68
Flowcharts	69
Run Charts.....	70

Check Sheets	71
Root Cause Analysis.....	71
Traffic Analysis	72
Chapter 9 - Zero-Base Budgeting	75
<i>Overview of Zero-Base Budgeting</i>	<i>75</i>
<i>The Zero-Base Budgeting Process</i>	<i>76</i>
<i>Advantages of Zero-Base Budgeting.....</i>	<i>82</i>
<i>Problems with Zero-Base Budgeting.....</i>	<i>83</i>
<i>Conditional Budgeting</i>	<i>83</i>
Chapter 10 - Cost Reduction Strategy	86
<i>Failing Business Scenarios</i>	<i>86</i>
<i>Dealing with Unrelated Business Segments.....</i>	<i>86</i>
<i>Failing Business Model: Remain in the Same Business</i>	<i>88</i>
<i>Failing Business Model: Shift to New Model.....</i>	<i>89</i>
<i>Dealing with Expense Drift.....</i>	<i>91</i>
<i>Incorrect Cost Reduction Strategies</i>	<i>92</i>
Chapter 11 - Compensation Cost Reduction	96
<i>Proactive Hiring Solutions.....</i>	<i>96</i>
<i>Temporary Cost Reductions.....</i>	<i>97</i>
<i>Permanent Cost Reductions</i>	<i>99</i>
<i>Productivity-Based Solutions</i>	<i>101</i>
<i>Total Labor Cost Analysis.....</i>	<i>102</i>
<i>Timing of Compensation Changes</i>	<i>103</i>
<i>The Downsizing Process</i>	<i>103</i>
Chapter 12 - Benefits Cost Reduction.....	106
<i>Benefit Cost Sharing</i>	<i>106</i>
<i>Benefit Reductions.....</i>	<i>107</i>
<i>Benefit Limitations</i>	<i>108</i>
<i>Benefit Exclusions</i>	<i>109</i>
<i>Benefit Swaps</i>	<i>109</i>
<i>Benefit Aggregation Concepts.....</i>	<i>109</i>
<i>Benefit Terminations.....</i>	<i>110</i>
<i>Workers' Compensation Issues</i>	<i>110</i>
<i>Corporate Wellness Programs</i>	<i>111</i>
<i>Training Benefits.....</i>	<i>111</i>
<i>Eligibility Audits</i>	<i>112</i>

<i>Benefit Cost Administration</i>	113
<i>Other Cost Management Concepts</i>	114
Chapter 13 - Sales and Marketing Effectiveness	117
<i>Sales Effectiveness Improvements</i>	117
<i>Marketing Effectiveness Improvements</i>	119
<i>Customer Service Issues</i>	121
<i>Raise Prices</i>	122
Chapter 14 - Production and Maintenance Cost Reduction	124
<i>Production Cost Reduction</i>	124
Complexity Reduction	124
Manufacturing Systems	125
Production Cells	126
Production Line Issues	127
Quality Issues	128
Bottleneck Analysis	129
Outsourcing Issues	129
Inventory Reduction	130
Administrative Issues	130
<i>Maintenance Cost Reduction</i>	131
Equipment Maintenance	131
Maintenance, Repair, and Operations Procurement	132
Chapter 15 - Procurement Cost Reduction	136
<i>Purchase Requisition Procedure</i>	136
<i>Purchasing Procedure</i>	139
<i>Procurement Process Changes</i>	144
<i>Procurement Centralization</i>	144
<i>Supplier Relations</i>	145
Consolidation Activities	145
Standardize Supplier Dealings	146
Integrate with Suppliers	146
Other Cost Management Opportunities	147
<i>Total Cost Concept</i>	148
<i>Outsourcing Concepts</i>	148
<i>Spend Management</i>	150
Chapter 16 - Administration Cost Reduction	155
<i>General Administration Cost Reduction</i>	155
<i>Accounting Cost Reduction</i>	156
Accounts Payable	156
Auditing	157
Collections	158
Cost Accounting	159
Customer Billing	159
Fixed Assets	160

Payroll	161
Reporting	162
Systems.....	162
<i>Human Resources Cost Reduction</i>	<i>163</i>
If Human Resources is Supported	163
If Human Resources is Not Supported	164
<i>Legal Services Cost Reduction.....</i>	<i>164</i>
<i>Information Technology Cost Reduction.....</i>	<i>165</i>
<i>Travel and Entertainment Cost Reduction.....</i>	<i>167</i>
Chapter 17 - Facilities Cost Reduction	170
<i>Facility Location.....</i>	<i>170</i>
<i>Lease Rates</i>	<i>170</i>
<i>Facility Costs</i>	<i>171</i>
<i>Facility Usage.....</i>	<i>172</i>
<i>Furniture and Office Equipment</i>	<i>173</i>
<i>Projecting Future Usage.....</i>	<i>173</i>
Chapter 18 - Finance Cost Reduction	176
<i>Banking Cost Management</i>	<i>176</i>
<i>Debt Management.....</i>	<i>177</i>
<i>Cash Management Cost Reduction</i>	<i>178</i>
<i>Investment Strategy.....</i>	<i>179</i>
<i>Leasing Cost Reduction</i>	<i>182</i>
<i>Insurance Cost Reduction</i>	<i>182</i>
<i>How to Operate with Zero Working Capital.....</i>	<i>183</i>
Chapter 19 - Accounts Receivable Reduction	186
<i>Credit Risk Reduction</i>	<i>186</i>
Payment Guarantees	187
Title Retention.....	187
Credit Insurance	188
Factoring.....	188
Letters of Credit.....	188
Export-Import Guarantees	189
Outside Financing.....	189
Distributor Sales	189
Adjustment of Days to Pay.....	189
<i>Collection Tactics</i>	<i>190</i>
Dunning Letters	190
Take Back Merchandise	190
Hold Orders	190
Split Payments.....	191
Postdated Checks.....	191
Promissory Note	191
Arbitration	191

Attorney Letters	192
Issue Small Claims Court Complaint	192
Collection Agency	192
Money Judgment Collection Activities	192
Chapter 20 - Inventory Reduction	195
<i>The Cost of Inventory</i>	195
<i>Product Planning</i>	196
<i>Purchasing and Receiving</i>	197
<i>Inventory Storage</i>	198
<i>Production</i>	199
<i>Fulfillment</i>	199
<i>Distribution</i>	200
<i>Inventory Disposition</i>	200
<i>Inventory Management Practices</i>	201
Chapter 21 - Capital Budgeting Decisions.....	204
<i>Overview of Capital Budgeting</i>	204
<i>Bottleneck Analysis</i>	205
<i>Net Present Value Analysis</i>	205
<i>The Payback Method</i>	207
<i>Capital Budget Proposal Analysis</i>	208
<i>The Outsourcing Decision</i>	209
<i>The Post Installation Review</i>	210
<i>The Lease or Buy Decision</i>	211
Chapter 22 - Cost Management Reports	214
<i>Expense Reporting</i>	214
<i>Payroll Reporting</i>	215
<i>Margin Reporting</i>	216
<i>Spend Reporting</i>	218
<i>Responsibility Reporting</i>	219
<i>Cost Reduction Opportunity Reporting</i>	220
Chapter 23 - Cost Management Measurements.....	223
<i>Compensation Measurements</i>	223
Profit per Person	223
Proportion of Pay at Risk	224
Employee Turnover	224
<i>Benefits Measurements</i>	225
Benefits to Base Pay Ratio	225
Employee Cost Sharing as Percent of Pay.....	226

<i>Sales Measurements</i>	227
Sales Productivity.....	227
Sales Effectiveness.....	228
Quote to Close Ratio.....	228
<i>Production and Maintenance Measurements</i>	229
Manufacturing Effectiveness.....	229
Throughput of Post-Bottleneck Scrap.....	230
Order Cycle Time.....	230
<i>Procurement Measurements</i>	231
Procurement Card Usage Percentage.....	231
Proportion of Spend Managed.....	232
Proportion of Spend with Preferred Suppliers.....	233
<i>Administration Measurements</i>	233
Administration FTEs per \$1,000,000 Revenue.....	233
Administration Cost as Percent of Revenue.....	234
Transaction Error Rate.....	235
<i>Facilities Measurements</i>	235
Square Feet per Person.....	235
Cost per Square Foot.....	236
<i>Finance Measurements</i>	237
Proportion of Cash Invested.....	237
Average Interest Rate Paid in Excess of Prime Rate.....	238
<i>Asset Measurements</i>	238
Receivables Turnover.....	238
Inventory Turnover.....	239
Fixed Asset Turnover.....	240
Answers to Chapter Questions	242
Glossary	258
Index	262

Preface

One of the primary responsibilities of management is to ensure that costs are appropriately managed. This means that costs are focused on the primary needs of a business, and that controls are in place to keep other expenditures from taking place. In the *Cost Management Guidebook*, we explore how these analysis and control requirements can be achieved, while also including several hundred suggestions that are targeted at cost reductions throughout a business.

The *Cost Management Guidebook* gives you the tools to decide which costs are essential and which can be pared away, while also addressing the following topics:

- How can I use direct costing to analyze expenditure decisions?
- How can target costing be used to reduce the cost of a product?
- Why do certain cost objects accumulate more costs than others?
- How can I improve profitability by analyzing constraints?
- What specific strategies can I use to reduce costs?
- How can I put a lid on the costs of compensation and benefits?
- What are the techniques for enhancing the effectiveness of sales and marketing?
- What is the best process flow to reduce the total cost of procurement?
- How can I reduce the cost of company financing arrangements?
- What decision path should I follow when making capital budgeting decisions?
- Which reports and measurements can be used to support a system of cost management?

The *Cost Management Guidebook* is designed for both professional accountants and students, since both can benefit from its detailed approach to overhauling the entire system of corporate cost management. The book also provides enough specific cost reduction tips that you may spend years using them to drive down costs. As such, it may earn a place on your book shelf as a reference tool for years to come.

Centennial, Colorado
September 2014