



Understanding cost differences in the public sector—a cost drivers approach

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Estimation of cost causality has always been an important part of the accountant's work. This includes the identification, classification and estimation of factors causing a change in the total cost of a related cost object. In the recent literature these factors are called cost drivers. Different approaches and conceptual frameworks for understanding cost causality are found in the economics, strategy and accounting literature. This paper examines different cost driver approaches in a public sector setting. The study is based on data from primary and secondary schools in the four largest cities in Norway. The findings show that a strategic management accounting approach provides a framework for selecting a broader set of explanatory variables than the traditional cost estimation literature. This set includes product attributes, institutional factors and government policy as cost drivers in the public sector.

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1. Introduction

Cost causality has always been a major theme in management accounting, both as a guideline for the allocation of cost to different cost objects and as a base for the design of responsibility accounting systems (Shillinglaw, 1989). Insight into the factors causing a change in total cost is also important for estimation, planning, performance measurement and decision making in the public sector. Changes in policy may cause changes in total cost and an important part of the accountant's work is to estimate the effect of discretionary decisions. This also relates to the role played by the budget in the public sector, both as a tool for allocating resources and as a tool for measuring performance. The introduction of more formula funding systems in the budget process

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increases the importance of knowing how and why different factors change total cost. Structural differences in factors changing the total budget and factors changing total cost might encourage exploration of these differences (Bjørnenak and Pettersen, 1999). Knowledge of cost causality is also important for performance measurement in the public sector. Budget variances may be analysed using this knowledge and exogenous factors may be separated from endogenous factors to explain, for example, a budget deficit (or surplus).

The recent introduction of Activity Based Costing (ABC) has increased the focus on factors causing cost, partly by naming them cost drivers. The rhetoric of ABC is heavily based on the failure of traditional systems to represent cost causality in their allocation of costs (see e.g. Cooper, 1988). The 'modern' approach to the allocation problem is to identify and use cost drivers (e.g. Cooper and Kaplan, 1988). Although the original ABC articles written by Cooper and Kaplan did not include any definitions, a cost driver may be interpreted as any factor that causes change in the total cost of a related cost object. This very broad definition is now commonly used in textbooks (e.g. Horngren *et al.*, 1997). However, the more recent ABC literature stresses the difference between consumption and spending, i.e. cost driver being a factor causing a change in the consumption of resources. This consumption may or may not cause a change in total spending (Cooper and Kaplan, 1992). From this perspective a cost driver may be interpreted as a factor causing workload and not necessarily a change in the total cost (Innes and Mitchell, 1992).

Cost causality also relates to the estimation of cost functions by using econometric analysis. This may be called an econometrics or economist's approach to the cost driver concept, although the term cost driver is seldom used:

In general estimation literature, these explanatory variables are called independent variables. Recent jargon in accounting, marketing, and management literature calls them cost drivers. This is a little too trendy for our taste.

Demski (1997), p. 9.

Some studies integrate ABC terms and the economist's approach by using, for example, regression analysis to estimate the effect of different cost drivers (Foster and Gupta, 1990; Banker and Johnston, 1993). This approach to estimate local linear approximations to underlying cost functions is fully consistent with the traditional cost estimation literature (Demski, 1997).

Another approach to the cost driver concept is found in the strategy literature. In fact, Porter's (1985) definition of 10 structural cost drivers might have begun the spread of the cost driver concept in the literature. This set of cost drivers is further developed in the strategic management accounting literature (Riley, 1987; Shank and Govindarajan, 1993) where cost drivers are divided into groups. *Structural cost drivers* are factors that affect the underlying economic structure of the organization, such as scale, scope, experience, complexity or technology. The other group of drivers, *executional cost drivers*, focuses on how the activities are executed. This group includes continuous improvements, total quality management (TQM), capacity utilization, production layout, linkages and product configuration.

Another branch of the SMA literature focuses on product attributes as cost drivers (e.g. Bromwich, 1990). This approach is based on the work of Lancaster (1966), which states:

... the good, *per se*, does not give utility to the customer, it poses characteristics, and these characteristics give rise to utility

p. 134.

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