

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT PLAN AND DEPLOY COST TARGETS

## Control practices

The following control objectives provide a basis for strengthening your control environment for the process of planning and deploying cost and quality targets. When you select an objective, you will access a list of the associated business risks and control practices. That information can serve as a checklist when you begin reviewing the strength of your current process controls.

This business risk and control information can help you assess your internal control environment and assist with the design and implementation of internal controls. Please note that this information is at the generic business process level and many companies will need to go beyond generic models to address the specific business processes that support the financial and nonfinancial disclosures being made. You can combine the insight of this business risk and control information with your industry-specific knowledge and understanding of your company's environment when conducting internal control assessments and designing and implementing recommendations.

## Effectiveness and efficiency of operations

- A. Reliable information necessary for effective target costing is available when needed.
- B. Personnel are committed to the process of establishing and achieving cost targets.
- C. Cost targets are consistent with market demands and company strategy.
- D. Management involves suppliers in the target costing process.

## Effectiveness and efficiency of operations

### **A. Reliable information necessary for effective target costing is available when needed.**

#### **Business risks**

- Traditional cost accounting systems do not provide sufficient information for successful target costing.

#### **Control practices**

1. Develop a detailed bill of activities for the product, highlighting those activities that are already operating at capacity (leading to the need to acquire new or incremental resources) and those that are currently underutilized and will, therefore, not be significantly affected by the new product.
2. Identify accurately value-added and non-value-added activities early in the product life cycle.

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## **B. Personnel are committed to the process of establishing and achieving cost targets.**

### **Business risks**

- Established cost targets will not be achieved.
- Inaccurate cost targets will be established.
- Low employee morale will result from misunderstanding of company objectives.

### **Control practices**

1. Ensure performance measures are relevant and achievable and are set at the level that achieves the objective of cost control.
2. Link recognition and rewards to achievement of performance measures and to the success of the product being developed.
3. Ensure all personnel understand the target costing process and that they are knowledgeable about such factors as qualities of the product or service, desired market share, desired profit, maximum allowable cost, and necessary steps to achieve that cost.

## **C. Cost targets are consistent with market demands and company strategy.**

### **Business risks**

- Target costs will result in product prices exceeding competitive levels.
- Company profitability objectives will not be achieved.
- Target costs will be set too low for sufficient investment in the product to meet customer demands.

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## Control practices

1. Establish costs based on the product's intended market price and the company's profit requirements.
2. Establish target costs prior to product design and development and represent the desired product cost on the first day of normal production.
3. Use process mapping to effectively understand the design and production processes.
4. Use activity-based costing to help create more effective design and production processes.
5. Employ cross-functional teams to develop target costs. Until normal production volumes are achieved, ensure that various functions continue to share information so that necessary adjustments can be made to the products, processes, and cost targets.
6. Develop target costs within the larger context of profit planning over the full product life cycle.
7. Gather input from all functions within the company to ensure that management's expectations are being handled properly and that all parties are working together to develop and interpret targets.
8. Ensure that an effective planning and budgeting process is in place to support effective planning of cost targets.
9. Develop financial plans based on various scenarios to allow for flexibility and to provide for changes in the market.
10. Assign responsibility for product cost and customer satisfaction to the same individual. Require that this person has an in-depth understanding of both the product and the target customer.
11. Use performance measures that impact compensation and advancement to focus the assigned individual on achieving desirable results.
12. Document decisions regarding the product and its costs during the process so that they can be evaluated later.
13. Use value engineering throughout the development process to achieve target costs. (Value engineering is an activity used to reduce costs without loss of product performance.)
14. Develop, maintain, and make accessible to personnel extensive cost-estimating data that reflects actual processing, parts, and material costs.
15. Use a protected database management system to control access and integrity of cost data.
16. Integrate the protected database to make it useful to multiple functions, such as production, engineering, accounting, and marketing.
17. Reward employees for developing production methods that result in reduced cost estimates.
18. Cross-train personnel to perform financial analysis. This allows for decentralized cost-estimating skills within organizational units where estimates are required.
19. Use a consistent approach and planning format for capital investment planning. This allows comparison of information from project to project.
20. Develop and maintain data underlying each capital investment plan for use by different user groups.

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## **D. Management involves suppliers in the target costing process.**

### **Business risks**

- Cost targets will not be as accurate as possible.
- The company will lose competitive advantage to competitors that cooperate with suppliers to reduce costs and increase profitability.

### **Control practices**

1. Involve suppliers early in the product development process (design stage) to allow the company and supplier to work toward common objectives.
2. Work with suppliers to create joint performance measures that provide incentives for quality, reliability, and improvements.