

## **COSTS IN THE PUBLIC SECTOR IMPORTANCE IN RELATION TO BUDGETING**

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### **SUMMARY**

This paper has the intention to disclose the importance of the treatment of costs in the public sector, making known the necessity to analyze in depth and to think on the importance of its correct use, in order of satisfying the greater amount of possessions and services that the State (Nation -Provinces - Municipalities), through its government programs, included annually in the public budget, allow to make specific the demands that the population has a right to receive, as it contributes the necessary resources for such an aim.

For that, papers by distinguished professionals were selected, who have noticed the importance that the subject deserves.

Also methods or systems of costs were incorporated that will allow to make a specific budgetary proposal whose priority is based in the effectiveness, the efficiency and the economization in the obtaining of the public resources, and the destination of the expenses that allow the fulfillment of the foreseen goals for the fulfillment of the purposes that have as a non delegable objective, to obtain the well-being of the population.

Considering that the university studies plans, of the Economic Sciences do not often emphasize the importance of the Public Sector, specially in the Public Accountant's one, it is

considered necessary that the students and the young professionals notice the importance of handling the " public matter " has, and the strict relation that exists between paying tribute - evasion - expenses and costs necessary to satisfy the necessities of the community, which is the reason of our preoccupation.

**KEY WORDS:** Budget, Cost, Expenses, Well-being, Community

## **INTRODUCTION**

When writing the book "Casos Prácticos de Contabilidad Pública" that we published together with Professor Horacio Francisco Mastrantonio in 1990, with the support of Macchi Editions, we treated the matter of the costs in programming the Public Budget.

In it when expressing a concept of Budget for Programs we pointed out: "it is the expression of the budgetary allocations, practiced based on government plans, for a certain period in the different scopes of its competence, so as to obtain the maximum fulfillment of such, at the minimum cost"

Taking into account very specially, at that time, the importance that the "Norms for the Preparation of the Budget" fixed by the National Secretary of Property, gave to two specific subjects, for the application of the scheme of Budget for Programs: costs and management control:

In this paper we will refer to the first one mentioned, to which we pointed out: "As an integral part of the budget for programs, it is necessary to count on a system that allows measuring the cost of the different programming levels".

"The use of this system will make possible to establish the degree of efficiency in the fulfillment of the program, and will have to adapt itself to the different detail modalities in agreement with the characteristics, importance and aims of each institution ".

"The budgetary system allows coming near to the costs through the foreseen or carried out expenses, grouped by means of the economy classification and by object of the expenses."

"The total cost of a program or activity will be given by the expenses foreseen or carried out in its execution, adjusted based on the differences (social costs or of opportunity, consumption or use of the goods, amortization, etc ) and, of the indirect costs originated in the expenses of those programs, fundamentally of management and administration, whose action is of support to another set of programs, among which they must be distributed ".

"The unit cost will arise from the relation of the goal of the program or quantified result of the activity through some measurement unit, and the cost necessary to obtain them ".

In the same publication when the general features were included on the elaboration of the Budget for Programs and very specially the advantages of their application which Gonzalo Matner in his book " Planificación y Presupuesto por Programas" Published by Editorial Siglo XXI - México 1971, describes very accurately, pointing out as to the subject of this paper: "Opportunity to reduce costs"

Following the analysis of other writers we can indicate, that from a general point of view, cost is synonymous of effort.

This definition is sufficiently ample to involve so much the physical, moral and intellectual effort as the economy one.

But while the first are not measurable in value units, although their consequences can be so, the economy effort is always represented in that way.

Economically, then, cost is synonym of expense, that is to say, of sacrifice. But that sacrifice must have been produced to reach a determined objective, which originally differentiates the cost from a simple or pure loss that depends on eventual factors or others, independent to reach a determined objective.

From the aforesaid matter it arises that, economically speaking, cost is the wealth sacrifice that is incurred in, so as to reach a certain objective.

As the objectives vary according to the characteristics of the entities that persecute them, we will try to classify the entities in function of these objectives, in order to primarily interpret the characteristics of the erogations in which they incur, that is to say, its costs.

The entities (and their patrimonial representation, the properties) of expenditure have as their main objective the satisfaction of their necessities.

There are private and public, being able the first of being as well as individual or collective.

The typical entity of individual private expenditure is the individually considered human being. Its objective is the satisfaction of its necessities and the activity that it tends to obtain it.

The erogations in which it incurs in, i.e., their cost, commonly take on the form called "cost of living".

They are simple expenditures. that represent, in almost all the cases, decreases in the patrimony of the entity directly when they are incurred in.

In the same way it happens with the entities of expenditure private collective. Such as can be a civil association of mutual character.

Its objective is the satisfaction of the necessities of the communities and the expenditures. which it incurs in, for that constitutes the cost of the mutual service it renders.

Its objective is the satisfaction of the necessities of the community which they represent and the expenditures, that they do for that, constitute the cost of the management of the public matter and the rendering of the communitarian services.

The activities that the States develop to fulfill these objectives can be more or less complex and it will affect, of course, in the conformation of the expenditures, in which they incur.

The distinguishing characteristic of the three types of entities that we have mentioned is the absence of the aim of profit.

When this one appears, i.e., when the objective of the entity is the increase of wealth, we are in the presence of the entities (and their properties) of production.

The production concept coincides here, with the one of increase of wealth.

Considering the aforesaid matter, the economy cost is not only the sacrifice of present wealth, but also of concrete expectations of future wealth.

Economy cost is, therefore a synonym of economy sacrifice.

In our scope of action, that of Economic Sciences, the economy objective of the activity being developed, must never be lost.

Thus the study of the cost in itself constitutes but only a theoretical version, devoid of usefulness.

Its determination and control must be done based on the best fulfillment of the objective of the entity which it incurs in.

Thus, in the expenditure entities, it will be done based on the most rational satisfaction of the necessities; and in those of production, in function of the most rational way of obtaining profit.

If we wanted to condense in one only definition, all the analyzed concepts, we could say, without pretending that it is the best one that:

Cost is the economy sacrifice originated in the development of a certain activity, through which one searches to fulfill with the given objective.

Finally it is possible to say, when speaking of cost in general; one does not particularize with respect to the total or partial fulfillment of the objective or to the total or partial development of the activity.

But one sees that both references are implicit in the definition which we have given, so that it includes so much the concept of total, global cost, i.e., referred to the universe activity or the fullness of the objective, like the one of unit cost, i.e., referred to each of the units in which the universe can be divided.

Cost generating factors. Its physical and monetary component.

In the formation of cost the basic factors of the Economy are three:

1. Nature; 2) Work; 3) Capital

The cost generating factors are in fact six:

Three primary ones: 1) Nature; 2) Work; 3) Capital

Three derivatives: 1) Materials; 2) Equipment; 3) Services

They constitute the great factors of all present cost.

Each one of those factors is formed by two parts or components: one physical, represented by the amount of the factor units used; and another one of value, that when expressing itself usually in currency term, it is usually denominated monetary, represented by the price of each factor unit.

Here we have the base of the present system of Budget for Programs:

1, The programming, budgeting (forecast of the fulfillment degree), execution, evaluation and physical control: fulfillment of goals. Expressed in units.

2, The programming, budgeting (allocation of credits) execution, evaluation and financial control: budgetary result: (economy and financial). Expressed in currency

By everything expressed in the previous paragraphs it allows us to point out the importance to us of the application of the "3E" in the norms anticipated in Law N° 24,156 of Financial Administration and of the Public Sector Control Systems, whose 4<sup>th</sup> article indicates that it must guarantee the principles of:

1, Legality

2, Financial Regularity

3, Efficiency

4, Efficacy and

5, Economicity

With the object of a better illustration we make clear the concepts of the three last ones, which concretely are referred to the subject, which is the reason for this paper.

With respect to its direct entailment with Investment Account foreseen in Article 75<sup>th</sup> clause 8) of the National Constitution, and the commentaries that must include the same in function of Article 95<sup>th</sup> of Law N° 24,156 (LAFySCSPN), this one last one specifically solicits:

b) the behavior of the costs and the indicators of efficiency of the public production."

Dr Alfredo Le Pera, in November 2003 published a research entitled "Trabajos Técnicos Nacionales" "Ciclo Presupuestario Integrado Predeterminación de Costos en el Sector Público"

With the object of making specific his work the author took into consideration the following systems:

- 1) Budget
- 2) Investments
- 3) Public Credit
- 4) Treasury
- 5) Accounting
- 6) Administration of Goods
- 7) Contracts
- 8) Tributary Administration
- 9) Internal and external Control

He developed the following aspects:

- a) The budget, accounting and costs systems
- b. Methods for predetermination and determination of costs:
  - b.1) Normalizers or standards
  - b.2) Direct and indirect
  - b.3) Absorption
  - b.4) Orders

#### b.5) Processes

10) Fixed, semi-fixed and variable costs

11) Closing of the Financial Year

All the preceding indicated concepts, are guaranteed by an Integral Practical Exercises, with their corresponding double entry bookkeeping, including:

- a) Results of the fiscal execution.
- b) Determination of the Savings-Investment-Necessity Financing Chart
- c) Management Analysis
- d) Meditation

Continuing with Dr Alfredo Le Pera's work, one considers it excellent to transcribe the following concepts:

On the systems of budget and accounting of costs:

The effectiveness and efficiency of the cost requires predetermination and determination of the costs of public production.

The costs must be:

- a) Predetermined in the budget
- b) Determined in the accounting

Both must offer the necessary information for the management control in charge of the higher authorities of the organizations and the specific organs of internal and external control, in addition to the controls of normative fulfillment and of financial type that includes accounting and analysis of accounts.

Methods of predetermination and determination of costs.

The techniques of measurement of costs ex-ante and ex-post which are used in the private activity are usable.

The courses of action only differ from the private ones in the aims of the production and the way of obtaining productive factors.

The following methods, among others are applicable:

- a) Normalizing or standards
- b) Direct and indirect
- c) Absorption (includes Activity Based Costing - ABC)
- d) Orders
- e) Processes

a) Normalizing or standards ex-ante based on efficient processes of production with relation to a given volume and then are determined ex- post, buying them among themselves, verifying deflections and analyzing them.

They relate, for an expected product, the 2 essential variables, consume-product in the formulation and the execution of the exercise.

Relative knowledge and abilities take part of each type of production to obtain the best possible combination of productive factors.

In the execution the quality of the standard is verified and the real use of the programmed consumes.

- b) Direct and indirect

The predicted costs are direct and that later take place in the final production that satisfies the necessities with the community: Examples: Health, Education. The indirect are those necessary to produce required intermediate goods and services for the final production. Example: General administration

- c). Absorption

The indirect costs are prorated on the direct ones. The distribution bases are varied.  
Example: energy consumption, occupied personnel.

It makes it possible to know the real cost of the productive actions. It is a complex and discretionary procedure.

An absorption method is the ABC - Activity Based Costing.

It allows the allocation and distribution of the indirect costs according to the conducted actions, identifying the origin of the cost in the action courses.

It is based on the required actions that are developed in the jurisdictions and organizations, they are those that consume the resources and originate costs and not the products that only demand the actions required for their production.

ABC constitutes an integral management system.

The imputation bases are related to the measurement of the actions to be developed and developed.

ABC improves the vision of the courses of action, since it draws up the map of the network of productive actions and its costs and identifies those that provide low or null added value, with the purpose of eliminating them and concentrating the weight of the management in those of higher performance.

In Administration it is suggested to apply it partially, without prorating.

In this paper costs are associated to the action courses but the indirect ones are not prorated

d). Orders

They are applicable to actions destined to produce individual capital assets or services.  
Example: Naval constructions at the Rio Santiago Shipyard in the Province of Buenos Aires; a business trip on Naval Transport ship.

e). Processes

Is the most appropriate for jurisdictions or organizations that develop continuous production cycles. Example: Elaboration of medicinal oxygen for hospitals.

Fixed, semi-fixed and variable costs.

This typification is important to reach the efficiency as demanded, by the Argentine legislation, the equilibrated financial closing.

Next we indicate the type of cost with the volume of inputs.

Fixed Cost: It is indifferent to the changes in the production volumes fixed between a minimum and a maximum.

Semi-fixed cost: It varies when changing the production volume, whenever the factor that is altered is:

a) change in the working time

b). over or sub taking advantage of the goods of use because of having varied the flow speed.

Variable cost: It correlatively increases or diminishes with the increase or diminution of the product.

An equilibrium should be obtained, among them, facing the different production levels. If they assign insufficient item variable, it diminishes or the production becomes paralyzed and they carry on incurring on the same expenses, fixed and semi-fixed.

These are little useful, or worse still, useless

Some considerations

1. The Financial Administration (FA) intends to obtain efficiency in the taking on of the income and its use in the productive activity. It is accepted that the legitimacy of the

governments besides being based on the norms (constitutional and legal) and on the rendering of these services (productive activity) it must also be based on efficiency.

2. An important contribution for reaching effectiveness and efficiency is the application of the general theory of FA systems; it is operated considering the interrelations and reciprocal conditioning of each FA system component

3. Efficiency, requires measurement and previous evaluation, coetaneous after the results in terms of products and production costs.

4. The accounting system should render the information for the management control of the organizations superior authorities and the specific organs of internal and external control

5. The management control is added to controls of legality and finance. These must be continued. The three types of control complement each other.

6. The management control requires the predetermination and determination of production costs

7. The consideration of expenses with financial gravitation is insufficient in costs; they only foresee:

- a) financial expenses to be carried out (they will constitute obligations to be paid)
- b) financial resources to be carried out (they will render the means of payment of the obligations to be contracted).

Therefore, one must incorporate, as a minimum, the calculation of depreciations of the amortizable capital and the variation of storing of consumer goods. Also in this paper the interest of the real capital is computed and, simultaneously, so as not to affect the result "variation of the net patrimony", is considered in the current account as a current entrance without financial gravitation.

8. The incorporation of the preceding mentioned data makes possible the forecast and the systemic efficiency verification.

9. The item of costs must be defined homogenously as accounts of the classifiers and of the general accounting

10. The techniques of measurement of costs ex-ante, and ex- post that are used in private activity are usable, among others:

- a) estimated or standard;
- b) direct and indirect;
- c) by absorption (it includes ABC);
- d) by orders;
- e) by processes.

What differ from the private one are the types and the reasons of the production.

11. The classification of the variability of the requirement based on the level of activity of the institution helps to define the priority of the different supplies that are required, because it allows in each allocation center:

- a) to fix the most economic dimension.
- b) to measure how much is used of the productive capacity.
- c) to determine the negative weight of halting production.
- d) to establish the cost of initiation of activities.

12. One must reach the Equilibrium between the different kinds of expenses (fixed, semi-fixed and variable) facing the different production levels.

If one assigns insufficient item variables, it diminishes or halts production and they continue incurring in the fixed and semi-fixed expenses.

These therefore results little useful, or worse still, useless

13. The Argentine experience as far as stability demonstrates that the fiscal EQUILIBRIUM is a primary requirement to reach it and maintain it.

14. A means for the equilibrium closing is the programming of the execution. Quarterly quotas or of shorter time, anticipated, to authorize commitments (basically authorizations to contract expenses) under the consideration of the expected effective income, obligations to be paid and money in Cash Box. The financial closing must be equilibrated (expenses incurred into that generate payment obligation of immediate or short term payment, smaller or equal than the collected income to take care of them).

15. If the income falls, the quotas are reduced, among other possible measures. If the rebates are in %, one tends to cover fixed costs without taking care of the variables indispensable to operate. Therefore the fixed costs become partial or totally useless.

16 The remedy consists of giving quota to the 3 types of high-priority costs for programs with the purpose of obtaining a reasonable production. Simultaneously, programs of smaller priority are due to be disaffected. This operative is difficult due to the rigidity of adaptation of some productive factors, specially the work. In spite of it, as the equilibrium closing is basis for stability, the possible efforts must be done.

17. In this paper the direct cost is used, as not being necessary for the management analysis to absorb indirect costs; they also analyze fixed, semi-fixed and variable costs.

18. In the example one can observe how a slight diminution of the quotas that affects the variable expenses, degrades in a degree, more than proportional of the obtained final product.

19. The progress as to effectiveness and efficiency of the cost, demands that the accounting system integrates costs.

Dr Jose Maria the Heras, when dealing with the subject costs - expenses and specially in "Las Técnicas de Estimación" in his book "Estado Eficiente" – Published by Buyatti, Editorial, points out:

Concept and importance:

1. To estimate is not the same as to evaluate the cost, although both terms are usually used indiscriminately.

2. The estimation refers to the prevision of a cost to be done in the future.

3. The evaluation includes the set of procedures destined to critically analyze the performance of a cost already made.

4. In the matter of financial administration (in the public environment) a good budget is a necessary condition, but nonsufficient. Also, an excellent accounting system is indispensable that shows the quality of its execution.

5. All cost must be analyzed "in itself" in a function of a situational criterion, (non incremental) considering multiple aspects in its relation with the objective to be obtained, and the best productive technique, the reflection of the changes in the relative prices of the inputs, among the points most important to be considered.

6. This matter is not confined to countries with little budgetary culture, as is the Argentine case. It is also seen in developed countries.

Techniques for cost estimation:

1. Cost technique.

2. Equilibrium point.

3. Base Zero Technique (x)

As to the Base Zero Budget technique we took care of it in detail, including practical exemplification in the mentioned Book, "[Casos Prácticos de Contabilidad Pública](#)" which opportunely was published by Macchi Editorial, however other outstanding professionals in the matter are incorporated into the present material.

1) Cost technique: These must be taken into account:

a. Raw materials

- b. Manual labor.
- c. Manufacturing costs

With these components we have the systematic interrelations:

- a Prime cost
- b. Conversion cost
- c. Production cost
- d. Commercialization cost
- e. Structure cost

- 1) Raw materials + Manual labor = PRIME COST
- 2) Prime Cost + Indirect manufacturing expenses = PRODUCTION COST
- 3) Manual labor + Indirect manufacturing expenses = CONVERSION COST
- 4) Commercialization expenses + Administration expenses + Structure expenses =  
TOTAL EXPENSES

Specified in other terms we can indicate:

TOTAL EXPENSES + PRODUCTION COST = TOTAL COST

The cost according to the activity level: we should take into account:

- 1) Fixed costs - 2) Variable Costs

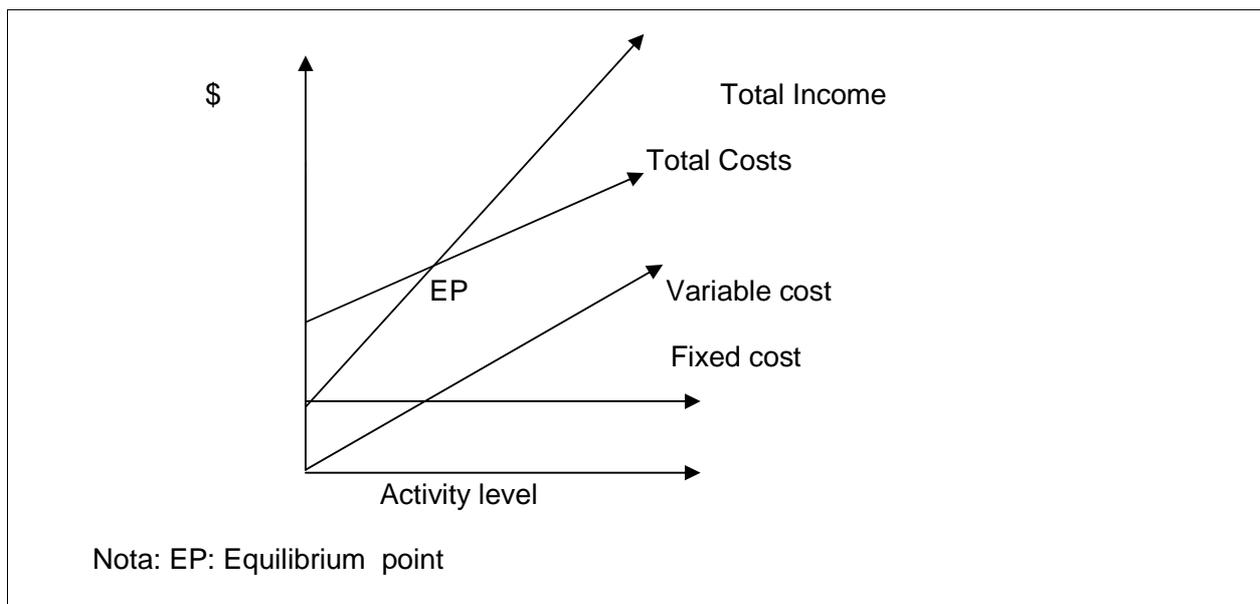
Fixed Costs: they are independent of the level of public production. They stay constant, as would be the case of the rent of the classroom, be there one or several people.

Variable costs: they depend on the production level, they grow in proportional form or less proportional at the level of public production. E.g. the material handed over in relation to the assistants.

2. Equilibrium point: The amounts are considered - Activity Level – Fixed costs – Variable Costs - Total Costs.

By means of its graphical representation one is able to visualize the areas of profits and the areas of losses of a program, a project, etc.

Equilibrium point, is understood as the intersection between the total of costs or expenses (according to the case) and the total of income



### 3) Technical Base Zero

Process phases

Phase I: Political lines and action guidelines

Phase II: Identification of the organization units

### Phase III: Decision Packages

#### Integration of the packages

- a) Objectives
- b) Aims
- c) Costs
- d) Benefits

#### Activity levels

- 1) Normal
- 2) Minimum
- 3) Superior
- 4) Optimum

### Phase IV: Ordering of the decision packages

According to Dr Humberto Petrei: the Budget Base Zero is complementary of the Budget for Programs.

Dr. Lea Cristina Cortes de Trejo in her paper "Costos para la gestión en el sector público", presented at the Inter-American Regional Accounting Seminary in - Cordoba 2001, points out as "Objectives of Accounting of Costs" the following aspects,

Taken to the public sector, the objectives of Accounting of Costs consist in:

a). To optimize the use of public resources from the perspective of effectiveness, efficiency and economy, making possible the management control and diminishing the taxes burden on the contributor.

b). To provide information for the planning, control and taking of decisions in the Public Sector, being the base for the formulation and evaluation of the public budgets, contributing to the fiscal equilibrium and a greater production in state action.

c). To determine the cost of the activities and the benefit of public services, (fixation of prices and tariffs).

d). To make effective and economic the information system of the entity, in general, and the accounting one, in particular.

e). To give useful investigation to internal and external users, backing the taking of decisions on the production of goods and public services in terms of quality.

f). To help towards fiscal transparency, since to the citizen is more and more interested in avoiding wastes, inefficiencies and embezzlements in the use of public resources.

g). To promote the responsibility of the civil employees in terms of productivity of their services at an optimal cost and quality.

Also in the same presentation she indicates as Conditioners of the Costs Accounting in the Public Sector the following matter:

The instrumentation of the accounting costs in the Public Sector depends on particular factors that condition that process, among which we find:

- 1). Political Framework - normative.
- 2). Modernization of the Public Administration.
- 3). Distinctive characteristics between the public properties and the private properties.
- 4). Environment of Governmental Accounting.
- 5). Necessities and interests of the users.
- 6). The components of the Public Sector.
- 7). The internal and external control systems.
- 8). Access to adequate financing and computer science equipment.

Before treating the conclusions of this paper, nothing better than to remember Dr José Terry's words in his cathedraic character which he bequeathed on us in an 1897 conference, which is right up to date, therefore I consider it opportune to transcribe some of its paragraphs:

Where there is an expense there must be a necessity.

In the budget, in the first article those expenses are approved and in second one are the main sources produced by the State rent...

One can say that after the fundamental Law of the our country, that is the National Constitution, the most important one is the budget, because it serves as authorization and commitment between the Contributors, the people (mandates), that by its representatives determines to the Mandatory Government what it has to spend and what it does not have to spend, and in which necessities it must apply the resources voted.

The Government handles money of others, and consequently, it must be subordinated in everything to the instructions of the owner of that money is a serious commitment, no to do so, it has serious responsibilities.

The budget can be compared to a mirror where the Nation's life is reproduced faithfully.

The Budget is necessary because it serves the program for the managing of the country, with the budget one establishes the improvements and advances to be done in the coming year, the necessities that are to be done and the progresses that are to be made.

Who must vote the resources? The one that provides them; that is to say the contributor, the people by means of their representatives

This is the fundamental principle in all system of free government, and is of almost universal application.

The great principle of the resource vote brings as a consequence, the necessity vote and of the corresponding expense.

The power to grant the resource concerns the power to authorize the cost.

Who votes the contribution must vote the expense.

There is something more concerning this: the one of being able to appreciate if the granted resource has been published and in the expense authorized, that must be "published".

Dr Ferry's expressions exempt us from all explanation on the matter between budget - expenses - costs.

Also to notice the importance of the subject that occupies us, several centuries ago Montesquieu said to us; "When in a State, when speaking about the Public Matter, each one says: WHAT DO I CARE! "THE PUBLIC MATTER IS LOST"

## **CONCLUSIONS**

1. The relevance that it acquires to consider for the decision making the Fixed Costs and the Variable Costs.

2. To take into consideration the differences of the treatment of the cost that must exist in the Public Sector with the cost in the Private Sector. (According to Dr Cayetano Licciardo "the difference is in the businesses of different nature").

3. In the Public Sector the cost should not be the only element, or substantial element, to be taken into consideration by the Governments, for the decision to do something in favor of the population.

4. If the competence is of the State (National, Province, Municipal) the cost does not have to be what decides if it done or not. The benefit must be sustained in the common welfare.

5. The most suitable techniques must be applied, that allow to make its fulfillment possible.

6. Among all the indicated ones in this paper we can conclude as a contribution that in their totality aim to verify the fulfillment of:

Efficiency - Effectiveness – Economicity

7. Our professional responsibility is based in the reaching of the objectives, trying to analyze which is the most suitable technique for such an objective.

8. In the Budget for Programs technique used at present we synthesize in this chart the relations which exist between Costs - Products - Objectives

<u>STATE</u> <u>Producer of Goods and Services</u>	
Terminal Product	Intermediate Product
Final Objective	Partial Objective
PROGRAMME	ACTIVITY
Supplies	Supplies
Measurement Units	Measurement Units
OBJECTIVES	WORK VOLUME
Quantity of satisfied demand	Impact on the Community

9. By all the exposed in the paper, the importance of the treatment of the cost, its close connection with the public cost which reveals the fulfillment of the Objectives, is what sustains a correct budgeting and its corresponding execution, as verified in the chart in point 8), ends up in the impact received by the community.

## **BIBLIOGRAPHY**

Please refer to articles Spanish bibliography.