CHAPTER 4

Ford's budgeting and costing procedures

Budgeting

4.1. Ford commences its budgeting procedures in May each year. The financial budget reflects both financial and physical objectives in terms of volumes, timing and financing. Broad objectives for the United Kingdom include establishing objectives for its share of the total market for the ensuing year. This total market for Ford is then analysed as to the mix and models of cars etc, body styles to meet expected customer demand, and profit implications. A detailed budget is prepared for the ensuing year and a less detailed one on a broad basis for five and ten years ahead.

4.2. The amount of market support required to attain the sales volumes needed to meet the budget plan is determined. Costs of production are calculated, to which are added other overhead costs (eg administration, R & D, and tooling) to arrive at a projected level of profitability for the business.

4.3. Costs are budgeted in considerable detail; there are over 2,000 cost centres. Each person controlling a cost centre prepares his detailed budget for the ensuing financial year. Cash flow budgets are also prepared. These budgets are then submitted for approval by Ford's board. The consolidated budgets are also sent for review by, and discussion with, Ford of Europe and, ultimately, the parent company—Ford USA. Ford's financial year is the calendar year and it is not uncommon for the budget for the ensuing year to be finalised as late as the preceding December.

4.4. Ford bases its financial controls on achieving its budget and places considerable importance on management achieving or improving on budgeted costs.

Costing

4.5. Ford operates a standard cost system integrated with its financial records, which covers the 2,000 cost centres noted at paragraph 4.3.

4.6. Each particular segment of control—manufacturing plant, support function or other activity—comprises a number of cost centres, adding up to the total plant or activity. Cost budgets are established for each cost centre, and are used for financial control purposes by measuring the performance of each operating area against its cost budget.

4.7. Cost centres of manufacturing plants are charged with direct labour and overheads relating to production of vehicles, major assemblies and components, including those used as replacement parts. Products are transferred between locations at standard cost except where transactions are between Ford companies in different countries. Ford told us that the latter transactions were effected at what is known as 'billing' prices, negotiated at arm's length between the Ford companies as, for example, between Ford in the FRG and Ford in the United Kingdom. The 'billing' price is negotiated from the basis of the domestic wholesale selling price of the selling company (with elements subtracted for marketing and other uniquely domestic costs) at the prevailing exchange rate. Parts which are sub-contracted to manufacturers outside the United Kingdom would be purchased either at the price negotiated on behalf of Ford companies in Europe (if better terms are thereby obtainable), or at the price negotiated by Ford with the European sub-contractor, whichever was appropriate.

4.8. The main costs included in the cost centre budget of a manufacturing plant are:

(*a*) direct labour costs, based on standard hours at the hourly wage rate; and

(*b*) overheads, including indirect labour, power and water etc, maintenance, depreciation, expense tooling[1] and operating supplies.

4.9. Standard costs include direct production material costs, direct labour costs and fixed and variable overheads associated with the location. Standard costs are revised in May of each year to take effect from the following 1 June. Once established, standard costs are maintained throughout the following year, and variances between standard and actual cost (known to Ford as 'off standards') are identified separately from the standard cost. Such off standards or variances arise, for example, from changes in material prices, the amount of material used, changes in hourly labour rates and production volumes. Overhead recovery or absorption will vary, depending on differences in output levels compared with budget, changes in the mix of wage and salary elements, changes in price in respect of services etc.

4.10. The standard cost system reflects only those costs which local production management can control. Standard cost data are maintained on the basis of historic costs, with adjustments for inflation and other economic factors being made only at a 'total' corporate level.

4.11. Ford told us that its financial systems and controls are geared to its philosophy of a total business,[2] with particular emphasis on budgetary control. Off standard costs are recorded separately from the standard cost,[3] and are dealt with as a whole rather than charging each variance to the specific item concerned. There are also various overheads which are not allocated to cost centres since local production management has no control over such overheads, which are treated on a company-wide basis. Thus, although Ford has an elaborate standard costing system, it told us that it did not have information readily available which would disclose the actual total cost of production for the very large number of items within the reference goods market. Ford said that because it managed its operations as a total business, it was unable to distinguish investment costs or profitability associated with the reference goods. The effects of this system in calculating a royalty are seen in paragraph 5.41.

[1] 'Expense tooling' costs relate to expendable items such as 'perishable' tools (drills, cutting tools etc), repair and replacement of damaged tools, changes in manufacturing that require duplicate or increased tooling as a result of increases in planning volumes or product mix, if such costs are below £50,000.

[2] See paragraph 5.4.

[3] See paragraph 4.9.