

Managing Information from Data to Decisions  
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As dairy businesses become larger and more complex decision-making becomes increasingly important. Information is the foundation of sound decisions. Owner-managers of modern dairy businesses need timely and accurate information to make critical decisions on a daily basis. In the past, many producers used their financial records to minimize income tax liabilities. This practice is no longer acceptable.

Modern dairy businesses are comprised of numerous entities that contribute, either positively or negatively, to the overall profit of the business. It is important to determine the impact of each entity on the profitability of the whole business. Some dairy producers have attempted to implement enterprise accounting systems to accomplish this. In such a system the various enterprises (profit/loss centers) of the business are defined and direct expenses are allocated to each. Overhead expenses are allocated on a percentage basis. Movement of commodities from one enterprise to another is done at *market* value in “phantom” transactions. Phantom transactions occur when commodities move from one enterprise to another, but no cash is exchanged. It is extremely important to protect the integrity of cash records when implementing such a system or tax records can become distorted.

A more appropriate practice for large modern dairy businesses might be managerial cost accounting. In a managerial cost accounting system, the individual entities of the business are defined as profit or cost centers. A profit center generates actual income, while cost centers do not. Cost centers operate in support of the profit centers. There are a number of different managerial cost accounting models. A commodity based managerial cost accounting system might be appropriate for a dairy business that raises feed and replacements. In this type system the profit and cost centers are defined by the various commodities produced. The profit and cost centers of such a system might include corn silage, alfalfa, dairy replacements and the milking herd.

The best model for dairy businesses might be activity-based managerial cost accounting. In this approach cost centers are defined based on activities with management responsibility and accountability assigned to them. Some examples of

activity-based cost centers might include the milking center operation, dry and transition cow management, nutrition and feeding management, housing and animal care and nutrient management. It is possible to have a combination of both systems with activity cost centers defined for the various commodities. In both models, important cost centers to monitor also include support operations, such as machinery and equipment, general and administrative and financing functions. Major corporations have utilized managerial cost accounting for decades. Such systems require comprehensive and detailed information systems capable of integrating financial and production data. One key feature of any managerial cost accounting system is the integral relationship between the balance sheet and the profit and loss statement. As product is produced, it is placed in inventory (on the balance sheet), at cost value, until sold or utilized by another entity of the business. This detail is missing from most current dairy accounting systems. In recent years, the higher end agriculture accounting programs have begun to build managerial costs accounting capabilities into their systems. This has been done in response to efforts made by the pork and soybean industries to encourage implementation of managerial cost accounting by their producers.

Although implementation of a managerial cost accounting system should be the goal of the owners of large modern dairy businesses, an intermediate step may be to develop an accounting system that allows the producer to conduct periodic activity-based cost center analysis. Defining the activity-based cost centers of the dairy business and organizing the chart of accounts to keep the data necessary to conduct such an analysis is the first step to implementing such a program. A good example of such an analysis would be to determine the milk harvest costs of the dairy business. This analysis would provide valuable feedback on how efficiently the milking center is operating. By conducting a milk harvest cost analyses of their dairy businesses, producers can compare the results to industry benchmarks and determine if and where improvements in milking center operations can be made to improve the profitability of their overall businesses.

# A Simple Illustration of Managerial Cost Accounting



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