

Example of essay on cost allocation methods

[Business](#), [Management](#)



Direct Allocation methods are most widely used methods by the firms to allocate or apportion the shared overheads of many departments of a business. It is different from other allocation methods because it completely disregards the services provided to different departments by the service department, and instead is divides all the costs amongst the departments on the basis of an agreed and specified ratio or percentage.

The second important method that is used is the step-down or sequential method of cost allocation. Here the costs of one service department are attributed to the other services department in the order of important of each service department. It must be remember that once the costs of one services department has been allocated, then can be allocated back to the same department again. For example:

Source: Caplan, 2010

The above figure shows different departments with different costs, and different allocation percentages. This example shows how the costs of each department are being allocated to other departments in an agreed percentage. It must also be remember that the costs are not being allocated to the same department.

Healthcare organizations are using a method of patient-level cost to apportion the shared or common costs among the various departments. The purpose behind this cost is to find out how much the actual patient treatment has cost the clinic. It is helpful in determining the profitable patients from non-profitable ones. It is also done to understand which of the clinic's staff is more profitable, and which department is incurring lower costs and providing higher revenues. It is helpful in management decision, and at

the same time improves the overall efficiency of the healthcare organization.

Cost to charge ratio is another important concept used in the modern and up-to-date healthcare organization. It tells the decision makers and the healthcare organization's management that how much costs have been incurred to generate marginal or extra revenue, or how much does the cost change before the extra revenue is generated. This is an important tool for the management, because if the ratio is greater than one it tells the management that the operations are not effective as more costs generate less revenue, and hence the company needs to improve its efficiency cut down on loss making operations. It is an important tool because it tells the overall condition of the efficiency and management of the hospital in just one glance without having to go through the set of financial records, and financial statements.

The most important approach and most widely used approach that is being used by the healthcare organizations around the world is the activity based costing approach. It helps the healthcare institutions to allocate and apportion their costs and overhead expenses to the different departments such as OPD and Inpatient service depending upon the level of activity or the revenue generated. It helps the fair allocation of costs to the department and helps the healthcare organizations into making decisions that are profitable and good for both the business, and the patients who are getting the treatments from the hospital and healthcare organizations. It is a frugal attempt to understand and investigate which departments are necessary for

the company, and which department can be outsourced because they are more expensive to run. (Mogyoronsy and Smith, 2014)

References

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