

Functional cost accounting: costs made transparent by function rather than by cost centre

Functional cost accounting is a form of cost accounting that assigns costs not by cost centre or cost object but by operational functions such as procurement, manufacturing or sales. For technical buyers, it makes it possible to reveal the true costs of the procurement and logistics functions and to optimise processes in a targeted manner. In combination with methods such as activity-based costing or target costing, it becomes a tool for fact-based procurement decisions.

Key facts

- Functional cost accounting assigns costs to operational main and auxiliary functions, not to organisational units.
- It increases comparability across sites and business units because function-related key figures are standardised.
- Typically, functional costs are broken down to cost centre processes and allocated to cost objects via allocation bases.
- For procurement, it shows how high the process costs per procurement transaction, supplier or material group actually are.
- It forms the basis for target costing, make-or-buy analyses and cost–benefit analyses in procurement management.
- In practice, allocation questions arise for overhead costs; these are resolved through clear allocation bases and function definitions.

Definition: functional cost accounting

Functional cost accounting is a method of cost determination and cost control that structures all of a company's costs according to the associated operational functions. Functions are areas of activity such as procurement, manufacturing, sales, administration or research and development. The aim is function-related transparency that goes beyond classic cost centre accounting.

Distinguishing it from cost centre and activity-based costing

While cost centre accounting is based on the organisational structure, functional cost accounting maps the value creation logic. Activity-based costing refines this approach by assigning costs to individual processes and volume drivers. In practice, the two methods are combined: functions form the upper level, processes the lower one.

Legal and accounting classification

Functional cost accounting is not a mandatory instrument of external accounting but an instrument of internal controlling. However, for group reporting under international standards, the functional cost

structure can play a role. For tax or commercial law questions, professional review on a case-by-case basis is recommended.

Structure and functions of the procurement area

Functional cost accounting is particularly relevant for procurement because procurement costs are often visible only as a total. A functional view breaks this total down into operational, tactical and strategic activities and reveals where value is created and where effort is incurred without benefit.

Main and auxiliary functions in procurement

Main functions typically comprise requirement clarification, supplier selection, order processing, logistics handling and supplier management. Auxiliary functions such as quality assurance, customs clearance or missing-parts management support these processes. Only the separation of main and auxiliary functions shows where effort is actually running crosswise.

Allocation bases and cost drivers

Functional costs are usually allocated on a cause-and-effect basis using allocation bases such as the number of orders, material master records or supplier call-offs. In practice, suitable cost drivers include order line items, enquiries, complaints and goods receipts. The choice of allocation base determines the informative value of the results.

Methods and approach for implementation

Implementation usually follows a multi-stage approach: define functions, allocate costs, define allocation bases, evaluate results and embed them in control processes. A staged approach reduces effort and increases acceptance in the business departments.

Step 1: Define the function tree and cost allocation

First, a function tree is developed that ranges from the company's purpose down to individual activities. Personnel costs can be allocated via time sheets or hours charged; material costs via cost objects and metering dates. What is essential is a uniform definition of functions across all sites, otherwise results are not comparable.

Step 2: Define allocation bases and allocation rates

For each function, allocation bases and allocation rates are defined, for example costs per order or per goods receipt. Thresholds often prove useful: low-volume orders are charged at a flat rate, complex transactions are valued individually. The rates should be updated and documented annually.

Step 3: Evaluation and anchoring in the control cycle

The results feed into control loops such as sales and operations planning, where function-related capacities and process costs are incorporated into the sales and production reconciliation process. Functional costs also provide a robust data basis for lessons learned from completed projects.

Important KPIs and applications in procurement

Functional cost accounting provides the data basis for a range of key figures and decision calculations. It makes procurement expenditure measurable and allows prioritisation according to economic

efficiency.

Key figures at function and process level

Typical key figures are process costs per order line item, costs per supplier change, the share of procurement costs in material input and the quality of demand coverage. In addition, an ABC analysis of the article structure and supplier rating provide quantitative and qualitative classification.

Application in target costing and make-or-buy

In combination with target costing, functional cost accounting shows which process shares remain within the target cost framework. For make-or-buy decisions and cost–benefit analyses, function-related full costs are compared with alternative procurement routes. A robust cost basis is also created for the negotiation management process.

Functional costs along the supply chain

Supplier-side functions can be included, for example via Incoterms and their impact on transport and customs functions. When agreeing Incoterms FCA or other clauses, functional costs shift between buyer and supplier – an often underestimated cost lever.

Risks and controls in functional cost accounting

Despite its advantages, the method entails risks, above all in terms of data quality, delimitation and currency. Without clear control, there is a risk of spurious precision that provokes wrong decisions.

Typical sources of error

Common mistakes include unclear delimitation of functions, failure to update allocation rates and incomplete allocation of overhead costs. Functional cost accounting is also sometimes set up as an end in itself, without decisions being based on it.

Controls and variance management

Regular plausibility checks using target–actual comparisons and a defined deviation workflow for price or cost variances help to detect adverse developments early. A documented review cycle, typically annually, keeps rates and function definitions up to date. Results should always be combined with qualitative assessments.

Acceptance and change management

Functional costs change the view of cost responsibility and can create resistance. Clear communication, involvement of the business departments and a pilot in one material group sustainably increase acceptance.

Current developments and digital support

Digitalisation is significantly changing how functional cost accounting is handled. Automated process data capture, standardised ERP interfaces and AI-supported analyses considerably reduce the recording effort.

Automated data capture

Procurement processes increasingly deliver process data automatically, for example from ordering

systems, goods receipt recording and supplier portals. This reduces the manual allocation effort and functional cost accounting can be updated in shorter cycles.

Integration into planning and supplier management

Functional costs are increasingly fed into integrated planning processes such as sales and operations planning and used for supplier evaluation. Formats such as a supplier innovation day or co-creation with suppliers benefit from function-related cost data because improvement potential can be addressed in concrete terms.

Agile approaches in procurement

As part of agile procurement, functional costs are used as an iterative control variable: short review cycles replace annualised large-scale analyses. This increases responsiveness but requires stable data processes.

Typical metrics

Process costs per order line item: typically €15–50

Strongly dependent on degree of automation and complexity

Share of low-volume purchase orders: often > 60% of transactions

Where material cost share is low – a typical field for savings

Cost per managed supplier: usually several thousand € p. a.

Benchmark for A-suppliers with intensive management

Update cycle for allocation rates: 12 months in practice

Shorter cycles recommended where volatility is high

Practical example

A medium-sized mechanical engineering company with around 300 employees found that its procurement costs were rising despite falling material prices. A functional cost analysis showed that over 40 per cent of the expenditure was attributable to order processing for small volumes and to missing-parts management. Based on these findings, targeted measures were implemented.

- Introduction of a catalogue ordering process with self-service for C-items, derived from an ABC analysis
- Consolidation of suppliers to reduce the cost of managing each supplier, supported by a supplier rating
- Adjustment of Incoterms agreements to allocate transport and customs functions more efficiently
- Establishment of a structured deviation workflow for price and cost variances instead of individual case-by-case clarification

Conclusion

Functional cost accounting shifts the view of costs from the organisational structure to value creation. For procurement, this means: procurement expenditure becomes measurable, benchmarking becomes possible and investment decisions in the procurement area become comprehensible. The prerequisite is a cleanly defined function tree with well-maintained allocation bases and allocation rates. Combined with activity-based costing and target costing, this creates a powerful steering instrument. Anyone who

regularly updates functional costs and feeds them into planning and negotiation processes creates a robust basis for sustainable cost reduction.

Frequently asked questions

What is functional cost accounting in simple terms?

Functional cost accounting assigns all of a company's costs to operational functions such as procurement, manufacturing or sales. Instead of accounting by department, costs are accounted for by blocks of tasks. This makes visible which function causes which cost expenditure.

What is the difference between functional cost accounting and activity-based costing?

Functional cost accounting forms the upper level and breaks costs down by operational function. Activity-based costing refines this view by assigning costs to individual processes and cost drivers. In practice, the two methods are often used in combination.

Which functions are distinguished in functional cost accounting?

The usual distinction is between main functions such as procurement, manufacturing, sales and administration, and auxiliary functions such as quality assurance, logistics handling or maintenance. Depending on the industry context, additional functions such as research and development can be added. What matters is a uniform, documented definition of functions.

How does procurement use functional cost accounting?

Procurement uses it to make process costs per order, supplier or material group transparent. On this basis, target costing, make-or-buy analyses and negotiation preparation can be underpinned. Supplier evaluation and assessments of process changes also become more robust.

Is functional cost accounting mandatory in external accounting?

No, it is an internal controlling tool and not mandatory under commercial or tax law. For certain group reporting formats, a functional cost view may nevertheless be relevant. Binding legal questions should be examined on a case-by-case basis.

Which allocation bases are used to distribute functional costs?

Typical allocation bases are the number of purchase orders or order line items, enquiries, goods receipts, complaints or managed suppliers. The allocation base should reflect cost causation as realistically as possible. In practice, differentiated rates for simple and complex transactions have proven effective.