ACCA

ADVANCED PERFORMANCE MANAGEMENT - APM

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Important terms to understand

Mission Statement: A mission statement is a statement of the purpose of a company or organization.

Following will be included in Mission statement:

1. Purpose and aim(s) of the organization and define what the company is about.
2. The organization's primary stakeholders
3. How the organization provides value to these stakeholders
4. Distinguish the company from all others
5. Serve as framework to evaluate current activities

Benefits of mission statements

Prevent conflict	Communication of key cultural values	Reason for existence	Provides strategic direction

Drawbacks of mission statements

They might be unclear	Un-noticeable	Not represent the actual values	Lack sufficient external focus

Difference between mission and vision

Mission	Vision
1. Concerns what an organization is all about	1. Describes how the future will look if the organization achieves its mission
2. Gives the overall purpose of an organization	2. Describes a picture of the "preferred future

Important terms to understand

Critical Success Factors CSFs are the areas in which business should win. These are good indicators about whether the business will achieve its primary objective or not.	**Key Performances Indicators** KPI tells us whether the CFSs will be achieved or not.

Internal vs. External Factors: Every manager possesses internal Critical Success Factors (CSFs) linked to their department and the individuals they oversee:

These CSFs encompass a wide array of interests, ranging from human resource development to inventory control. The central feature of these internal CSFs is their focus on matters entirely within the manager's realm of influence and control. External CSFs pertain to issues that are typically beyond the manager's direct control, such as the availability or cost of vital raw materials or energy sources.

Monitoring vs. Constructing/Adapting: Managers holding operational responsibilities generally employ monitoring CSFs to oversee the performance of their segment within the organization. These CSFs are subject to ongoing observation and often have a financial orientation (e.g., real performance vs. budget or the present state of product or service transaction costs). Another CSF that can be monitored is the rate of employee turnover.

Managers with a more strategic focus may concentrate on constructing CSFs. Such managers engage in devising long-term organizational changes in response to the surrounding environment. Consequently, they require CSFs to gauge the organization's progress in the desired direction. Examples of such CSFs might include the count of successfully launched new products.

FINANCIAL PERFORMANCE MEASURES

Performance measurement is the process by which businesses, governments and other organizations can assess the performance of an employee, process, equipment or other factor to gauge progress is toward predetermined goals.

Financial performance measure

It includes ratio analysis which is used to measure the profitability, liquidity and risk faced by the organization. Following are the ratios that can be calculated:

PREVIOUS KNOWLEDGE (F5 RATIOS)

Profitability ratios	
1. Return on capital employed $\frac{\text{Profit before interest and tax}}{\text{Capital employed}} \times 100$ Where Capital employed is = All assets – current liabilities The ROCE will be further sub-divided into	
2. Asset turnover $\frac{\text{Sales}}{\text{Capital employed}}$	3. Operating profit $\frac{\text{Operating profit}}{\text{Sales}} \times 100$
4. Gross profit margin $\frac{\text{Gross profit}}{\text{Sales}} \times 100$	5. Net profit margin $\frac{\text{Net profit}}{\text{Sales}} \times 100$

Liquidity ratios	
1. Current ratio $\frac{\text{Current assets}}{\text{Current liabilities}}$	2. Acid test ratio $\frac{\text{(Current assets – stock)}}{\text{Current liabilities}}$
3. Inventory turnover in days $\frac{\text{Inventory}}{\text{Cost of goods sold}} \times 365$ days	4. Account receivables in days $\frac{\text{Accounts receivable}}{\text{Credit sales}} \times 365$ days
5. Accounts payables in days $\frac{\text{Accounts payable}}{\text{Credit purchases/cost of goods sold}} \times 365$ days	

<table>
<tr><th colspan="3">Risk related ratios</th></tr>
<tr><td colspan="3">1. Financial gearing
$\frac{\text{Debt}}{\text{(Debt + equity)}} \times 100$
Or
$\frac{\text{Debt}}{\text{Equity}} \times 100$
Where debt = Long term loans + preference share capital
Where equity= Share capital + share premium + retained profit</td></tr>
<tr><td colspan="3">2. Operational gearing</td></tr>
<tr><td><u>Contribution</u>
Profit before interest & tax</td><td><u>Fixed cost</u>
Total cost</td><td><u>Fixed cost</u>
Variable cost</td></tr>
<tr><td>3. Interest cover
<u>Profit before interest & tax</u>
Finance cost</td><td colspan="2">4. Dividend cover:
<u>Profit after interest & tax</u>
Dividend paid or to be paid</td></tr>
</table>

Note: When performing ratio analysis of the company following points should be considered.

1. Calculate ratio
2. Consider whether it has increased or decreased using comparatives
3. Explain the reason for such an increase or decrease
4. Given your conclusion if required

NEW MEASURES (P5 RATIOS)

1. PROFITABILITY RATIOS

A. EBITDA

Earnings before interest, tax, depreciation and amortization are a measure of a company's operating cash flow based on data from the company's income statement. This earnings measure is of particular interest in cases where companies have:-

1. Large amounts of fixed assets which are subject to heavy depreciation charges
2. Large amount of acquired intangible assets which are subject to large amortization
3. Charges or for companies with a significant amount of debt financing having high interest payments.

Advantages	Disadvantages
1. Easy to calculate and understand 2. Depreciation and amortization is non-cash item and are subject to judgments such as useful lives and residual income so ignoring them allows a realistic comparison between different companies. 3. It is substitute of cash flow from operations so is good measure of underlying performance 4. Interest and tax being non-operating external cost so are irrelevant when measuring the performance of the business. 5. It is useful measure for all managers/departments that do not have the control over acquisition and financing decisions.	1. It can be easily manipulated by changing the accounting policies relating to income recognition and capitalization of expense. 2. It does not take into account the cash flow relating to working capital or fixed asset replacement.

B. EARNING PER SHARE

It indicates the profit earned per share which is a good indicator for investor to decide whether the investment should be made or not. Companies often use a weighted average of shares outstanding over the reporting term.

$$\frac{\text{Profit after tax less preference dividends}}{\text{Weighted average number of ordinary share in issue}}$$

Advantages	Disadvantages
1. Easy to calculate and understand 2. Enables comparison to be made between companies, sectors and period with the same organizations'.	1. Might be subject to manipulation due to changes in accounting policies 2. Study have shown that EPS has poor correlation with shareholder value

B. Dividend Yield

A financial ratio that shows how much a company pays out in dividends each year relative to its share price. In the absence of any capital gains, the dividend yield is the return on investment for a stock.

Dividend per share /Current share price x 100

D. P/E ratio

The P/E looks at the relationship between the stock price and the company's earnings. The P/E gives you an idea of what the market is willing to pay for the company's earnings. The higher the P/E the more the market is willing to pay for the company's earnings.

Share price/EPS

E. Earning yield

The earnings yield (which is the inverse of the P/E ratio) shows the percentage of each dollar invested in the stock that was earned by the company. The earnings yield is used by many investment managers to determine optimal asset allocations.

EPS/share price x 100%

3. NET PRESENT VALUE

It represents PV of all cash inflows less the PV of all cash outflows of a project. Any project that has positive NPV is considered acceptable.

Advantages	Disadvantages
1. Considers time value of money 2. Has a good correlation with shareholder values who are concerned	1. Difficult to calculate and understand. 2. The calculation is based on certain

with longer term cash flows. 3. Decreases the probability of manipulation and subjective decision, as it is based on cash flows and not on accounting profit. 4. Considers the entire life of the project. 5. In case of mutually exclusive projects it is a superior measure to IRR. 6. It can deal with non-conventional cash flows. 7. It is based on the assumption that re-investment is made at the cost of capital. 8. It can deal with changing interest rates.	assumption such as timings and duration of the cash flows and appropriate cost of capital. 3. Unlike profit measure it is not a good measure for motivating the managers.

4. SENSITIVTY ANALYSIS

It is technique from which it is possible to identify the critical variables (such as sales price, material &labour cost) which if changed might affect the ultimate decisions (Brings the project NPV to 0). For example if only a (say) 2% change is required in selling price before losses result an investor may think twice before proceeding. Formula for NPV

$$\frac{\text{Net present Value}}{\text{PV of flows under considerations}}$$

5. Internal Rate of return (IRR)

It is used when there is uncertainty about the cost of capital. It represents the discount rate where NPV is 0. In other words it represents the break even cost of capital. Any project having a greater IRR than the firm's cost of capital should be accepted.

Formula

Advantages	Disadvantages
1. It is easy to understand as the IRR is simply compared to firm cost of capital 2. It considers time value of money and is not based on profit so there is less chances of manipulation. 3. It provides information about how risky is the project i.e. the sensitivity of the returns.	1. Difficult to calculate. 2. It is not an absolute measure of profitability. 3. It is an estimate based on interpolation so any project having sensitive returns may be subject to wrong decision. 4. In case of mutually exclusive projects NPV is a superior measure to IRR. 5. Non-conventional projects having different cash flow patterns may give rise to multiple IRR or no IRR.

6. Modified Internal Rate of Return

This represents the actual return generated by the project because it can deal with different borrowing and re-investment rates.

Steps

1. Find the terminal value of cash inflows from the project if invested at company's reinvestment rate.
2. MIRR will be the discount rate calculated to equate the terminal value to the present value of outflow at T0.

- **Other issues**

1. Short – termism

The objective of the performance measurement system is to judge the true performance of managers. However if the rewards are attached with performance, this might lead to dysfunctional behavior by managers in which they will prefer short term benefits to gain rewards over the long term benefits thus will take decision against the shareholders.

Following are the ways to improve the performance measurement system

1. It should consider both financial and non-financial factors.
2. It should focus on both short and long term objectives
3. It should emphasis only on controllable factors.
4. It should link the manager's performance to company objectives.
5. Used NPV technique

Chapter : NON FINANCIAL INDICATORS

INTRODUCTION

Non-financial performance measures are measures of a company's operations that are not based on financial statement numbers. These measures may use financial statement numbers, but they are also found in many other ways in the organization. In recent years non-financial measures have increasingly grown in importance for companies. A much greater influence has been placed on non-financial measures by investors and other shareholder groups. Today, in order for a company to compete, even survive, the company must use non-financial numbers in everyday operations. The main problem for companies is how to quantify their non-financial measures. In the previous topics emphasis was placed on financial performance indicators which is important for measuring financial performance of organizations but sole reliance on these indicators have certain disadvantages as well.

- Short-term effect

  Financial profits tend to give more short-term profits which is an incentive for managers to make decisions to increase short-term profits but will affect the organization in the long-term and hinder its performance.

- Concentrated

  These indicators mainly focus on factors which produce monetary results but on the whole to compete globally we need to take into account other important factors such as customer satisfaction.

- Managed results

  Just to earn profits managers may manipulate results so that it would show that the target is achieved.

- Does not show everything

  These indicators basically give limited advantage to the company on the whole due to the fact that they don't convey the whole picture since they don't take into account factors such as quality assurance and innovation. Additionally these indicators are traditionally historical.

COMPARISON

In comparison with the above disadvantages, the non-performance financial indicators reflect the long term performance of the organization as a whole. These indicators are good indicators of the future performance and focuses on qualitative factors which are external such as quality, reliability and customer satisfaction whereas a financial performance indicator does not take into account these factors. These factors use more advanced methods and hence latest techniques and technologies are used to minimize costs and increase profits and show the whole picture by assessing all factors and give maximum benefit to the organization.

Conclusion

The main and major objective of all organizations is the maximization of profits both in the long and short run and this could only be achieved by striking a balance between financial performance indicators and non-financial performance indicators.

LINK OF NFPIs AND BUSINESS PERFORMANCE

NFPIs can be used to assess the major areas of business.

- Labour employment

  Labour is a solid asset for any organization. Initially labour was assessed only through cost which is a FPI but gradually organizations realized that for their benefit it is necessary to employ experienced, skilled and qualified labour as to increase the company's performance, cut costs and price the best products.

- Quality assurance

A satisfied customer is a loyal customer. The customer is satisfied when the product or service which he gets when he pays for it, is the best according to him but different customers have different preferences. Therefore the general consensus is that the product/service should be easily available, it should give value for money, best preference when compared with other competitors, long term benefit and very much reliable. If for certain customer's criteria are not fulfilled, it would lead to his/her dissatisfaction and hence resulting in loss of customer and revenue for the company. So giving what each customer wants should be the major motive for a company apart from profit maximization and this could be done through regular customer surveys, assessing customer complaints and acting upon it, ensuring a friendly staff which remains up to date with the customer requirements and regularly innovating and improving products and services.

- Brands

  A brand can be anything a specific name, a sign, an identity, a term, anything that a person can associate with and recognize it instantly and knows all the characteristics of it. A brand ensures quality due to which a customer buys just because it is a brand. If an organization has a brand name attached to it ensures customer loyalty, it promotes uniqueness as it is specific in its name and no one can copy it as is trademarked and is high in quality. If an organization is associated with a brand name and customers are satisfied then it benefits the organization greatly.

EVALUATING FINANCIAL AND NON-FINANCIAL PERFORMANCE

Important terms to understand

Critical Success Factors	Key Performances Indicators
CSFs are the areas in which business should win. These are good indicators about whether the business will achieve its primary objective or not.	KPI tells us whether the CFSs will be achieved or not.

As stated earlier organizations need to strike a balance between financial and non-financial indicators and for that three models are designed:

- Kaplan and Norton's balanced scorecard

- Building block model
- The performance pyramid

The advantages of these models are that they take into consideration both financial and non-financial measures and take into account all the factors whether they are inter related or not and gives a clear picture regarding different areas of performance and brings out motivational strategies for both employers and labour in an organization.

1. The balance score card (Kaplan and Norton)

In the balance score card the focus is on four different perspectives using both financial and non-financial information and considering both internal and external factors. Four each perspective goal (CSF) and measures (KPI) are defined which will improve the performance of the business. The company should have clear vision and strategies which should be linked to four perspectives.

Financial perspective It measures how the company can create value for its shareholders. Examples CSF — KPI Profitability — ROCE Survival — Liquidity Ratios Growth — Market Share	Customer perspective It measures how the business is dealing with its customers and what customer values from the business. Examples CSF — KPI High quality — % of defects and claims Responsiveness — % of on time delivery Customer satisfaction — Satisfaction ratings
Internal perspective It measures the efficiency of the business and identifies what processes are important to satisfy shareholders. Examples CSF — KPI Operational excellence — Cycle time, System down time Employee satisfaction — Labour turnover	Innovation and learning It measures how the business is developing itself for the future and how it will improve and create future value. Examples CSF — KPI Innovation — % on income from new products Staff development — % of time spent of staff training Time to market — Time from identifying a new product to its market launch vs competition.

Implementation of balance score card

- Develop strategy

The first step to produce a balanced scorecard on the basis of the strategic requirements needed to ensure the success of the business such as the products, markets and growth.

- Select measures

The measures selected should be in line with the strategies recognized in the initial step. It is important to select the right measures which then will be communicated to staff as goals. However communication of wrong goals will lead to wrong things.

- Define and refine

The measures identified should then be incorporated into management reporting system which needs to be set up so that the measures are properly tracked on regular basis. It includes the procedures for processing of data and reporting on information. The reported things should be defined and periodically refined.

- Deal with people

In the end the balanced scorecard is then used for communicating with people to find out whether it will work or not. However it is important to ensure that to many measure doesn't create confusion so there should be some kind of priority. More over the measure should be properly linked to the people's remuneration and career progression otherwise the desired benefit will not be achieved if the rewards are attached to an narrow range of financial measures.

DISADVANTAGES OF THE BALANCED SCORECARD

1. Conflicting measures
   The measures used in the scorecard might have conflict with each other. For example speeding up the process time will require a new equipment which may affect the cost measures in financial perspective.
2. Selecting measures
   The selection process of measures should be very thorough process. Focus should just not be on measures which are easy to measure instead on those which add value.
3. Interpretation and action
   It is important that manager should have the skills to interpret the non-financial results which may become difficult for a financially focused manager. Also appropriate action should then be taken accordingly.
4. Management commitment
   If the senior management is not committed to additional non-financial measures success than the cost of scorecard will be exceed its benefit.

2. The building block model (Fitzgerald & Moon) (For Service Industries)

CHARACTERSITICS OF SERVICE INDUSTERIES

Dimensions (CSF) The first two are resultants and next four are determinants.

Focus on improving determinants will lead to improvement in results.

1. Financial performances: It measures profitability, liquidity and capital structure etc.
2. Competitiveness: It focuses on factors such as sales growth & market share.
3. Quality: It measures factors such as reliability and responsiveness.
4. Resource utilization: It focuses on efficient utilization of resources such as productivity.
5. Flexibility: It focus of factors such as speed of delivery, response to customer specification and coping with customer demands.
6. Innovation: It assesses the ability to innovate in terms of both innovation process and success of individual innovations such as no of new products launched.

Standards(KPI)	Rewards (Rewards for achieving standards)
Important things to consider 1. Ownership: It is important that employees take the ownership of the standard. 2. Achievable: Standards should be seen as achievable. So to make sure that, it is important to strike a balance between the organization and employees' perception as to what is an achievable standard. 3. Equity: The standard should be seen as fair for all those concerned.	Important issues to consider 1. Clarity: Employees needs to be clear about the organization objectives and goals. On the basis of which their performance will be assessed. 2. Motivation: It is important to motivate the individuals to make sure that standards are achieved for example by giving bonus or participation in standard setting. 3. Controllability: The performance of employees should only be assessed in areas in which they have significant control.

Advantages

1. It encourages employee participation in setting budgets.
2. Employees are motivation by liking rewards with standards

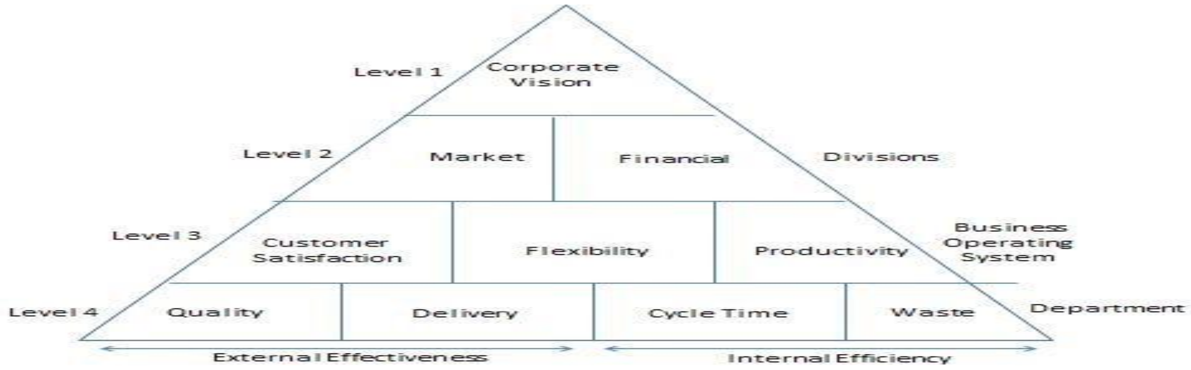
Disadvantages

1. The linking with strategic objectives is not clear.
2. Model is only confined to service industries.

Chapter : NON FINANCIAL INDICATORS

1. The performance pyramid

This model like the above two uses both financial and non-financial measures to assess the performance of the business but shows them in a hierarchy. The diagram shows how the actions flow down through a number of stages from strategic management down to daily operations and these will help in achieving the strategic vision of the organization. The pyramid focuses on both external effectiveness (customer satisfaction) and internal efficiency (flexibility and productivity).



Level 1: this is a level at which the company's vision is developed which describes how it will achieve the competitive advantage and long term success.

Level 2: at this level the market and financial objectives are set in order to achieve the company's vision.

Level 3: the objectives set at level 2 are then linked with the customer's satisfaction, flexibility and productivity. In others these are the strategies that will support the market and financial objectives.

Level 4: at this level more specific operational measures like quality, delivery, cycle time and waste are set which will support the achievement of the level 3 strategies.

Benefits	Weakness
1. It links the performance measures with organization hierarchy thus making it possible to link the strategic vision with day to day operations. This allows assessing the complete performance of the business from lower to higher level. 2. Each departmental will be assessed in terms of their contribution towards the organization's aim.	1. There may be a conflict between measures such as cost & quality which can create confusion for managers and might lead to demotivation. 2. Too much management /staff time will be involved in developing measures and inputting data resulting in less time left for the main business affairs. 3. Measures which are easy to ensure might be given priority over the measures which are important for

	achieving objective because they are difficult or expensive to measure.

Problems with assessing qualitative information

- Mostly decisions undertaken in higher level of organizations are most often quantitative but the consumer decisions are based on qualitative measures.
- Qualitative information depends on factors that are interrelated with each other and therefore it's not easy to differentiate the effect of different factors.
- The information may not be complete and quality wise it is difficult to monitor and analyze plus the cost of analyzing and improving is very high.
- There is no specific formula to calculate qualitative information because it is subjective as it is not associated with quantity.
- Mostly information systems are constructed in a way to monitor quantitative information and cannot properly measure qualitative factors.

PERFORMANCE REPORT

The following approach is suggested as one that may give guidance for good performance report design.

- **Purpose**. What is the fundamental purpose of the report?

An organisation's mission should define its purpose, and any judgment of performance report must report on the extent to which the mission is being achieved.

- **Audience**. For whom is the report produced?

The audience for performance reports will normally be managers, owners, government or, more generally, those charged with governance. However, sometimes the audience will have fewer skills and might need fuller explanations. Care has to be taken to assess the appropriate level of detail, layout and terminology used in reports so that users will properly understand the information that is provided.

- **Information**. What information is needed? This ties back to the first two considerations.

Examples are:

- Financial: sales, profits, costs, GP%, return on capital employed.
- Non-financial quantitative: percentage of product rejects, volume of sales, number of complaints.
- Non-financial qualitative: reputation, effectiveness, customer satisfaction, staff morale.
- **Layout**. The important information, caveats and conclusions must be easy to see.

Layout must help users to understand the information presented and to see quickly the important amounts, trends, results and explanations. One of the most common criticisms of reports is that they present too much information and are much too cluttered. Graphical displays can be used to greatly enhance performance information.

Chapter : APPROACHES TO BUDGETING

INTRODUCTION

A budget is an estimate of costs, revenues, and resources over a specified period, reflecting a management's reading of future financial conditions. In other words a budget is quantified plan of action for a forth coming period providing a summary of probable expenditures and income for that period. The purposes of budgets are:

1. Budgeting process forces an organization to plan for future so that organization objectives are met.
2. It motivates employees and managers to improve their performance by setting targets for them.
3. Enable communication of ideas and plans throughout the organization.
4. Allows to co-ordinate activities to different departments.
5. Establish a system of control by comparing actual result with the budget and taking appropriate action.
6. Enable performance evaluation of different departments and managers.
7. It provides formal authorization to managers for expenditure, hiring staff and pursuing to achieve the plans.

BUDGETING METHODS

1. Fixed budget

Budget prepared at single activity level & remains unchanged regardless of actual activity. They set broad objectives for an organization and are good for controlling fixed cost.

2. Flexible budget

A budget prepared at no of activity levels including the actual activity level for budgetary control purpose. It is also called a flexed budget if prepared on the basis of actual activity level.

Advantages	Disadvantages
1. It will enable like with like comparison leading to better performance evaluation.	1. It may be difficult to separate fixed and variable cost 2. It may become very easy to move the original target resulting in loss of bonus.

Difference between Fixed and Flexible budget

Fixed budget	Flexible budget
Cost are not classified according to their variability	Cost are classified according to the nature of their variability
It remains the same irrespective of the volume of business activity	It can be suitably recasted quickly to suit the changed conditions
It assumes that conditions would remain static	It is designed to change according to a change in the level of activity
Actual and budgeted performance cannot be correctly compared if the volume of activity differs	Comparison are realistic since the changed plan figure are placed against actual ones
Budget has limited application	Budget has more application

3. Rolling or continuous budget

Budgets continuously updated by adding a further period and deducting the earliest period as opposed to periodic budgets. These budgets are suitable where forecast cannot be made accurately due to uncertain conditions for example change in organizational structure, changes in environmental and technological conditions and variations in inflation level or areas where tight control is needed.

Advantages	Disadvantages
1. Realistic and accurate budgets are prepared as the element of uncertainty in reduced thus increasing the management motivation in achieving realistic budgets	1. More costly and time consuming activity 2. Increase in budgeting work may lead to less control over the actual result. 3. Might have an off putting effect on managers who would consider budgeting

2. Control will be based on recent plan 3. Forces management to take budgeting process seriously	as a non-value adding activity due to frequent budgeting.

4. Incremental budget

Budget starts with previous period budget or actual result and adds or subtracts an incremental amount to cover inflation and known changes. It is reasonable procedure if current operations are effective, efficient and economical. Suitable in stable conditions where cost does not change, good cost control and discretionary cost in limited.

Advantages	Disadvantages
1. Administratively quickest and easiest method as it is assumed that historical figures are acceptable and only increment needs to be justified 2. Prevents conflict between departmental managers since a consistent approach is adopted throughout the organization.	1. Previous period problems and inefficiency may be incorporated into the next year budget 2. Uneconomic activities may be continued 3. In-efficient form of budget as it may encourage wasteful spending by managers just to make sure that their budget expenditure allowance is not reduced next year.

5. Zero based budget

With zero-based budgeting, the budgeting process starts from a base of zero, with no reference being made to the prior period's budget or actual performance as opposed to incremental budget. Every activity needs to be justified before being included in the next year budget on the assumption that each activity to which budget relates was being undertaken first time. Zero-based budgeting tries to achieve an optimal allocation of resources to the parts of the business where they are most needed. This budget is suitable in case of discretionary cost, for service departments and public sector organization. Following are the steps of zero based budgets:

Step 1: Managers should identify individual activities which need to be included in the budget.
Step 2: Decision package: is a document that states the purpose of the activity, analysis the cost of the activity and assess the consequences of not conducting the activity. It is subdivided into two package

1. Mutually exclusive package which includes different methods of achieving the same job.	2. Incremental package divides the activity into a series of activities such as the basic package (minimum amount of work required for the activity) and additional packages (packages above the basic packages that will be done at an extra cost)
Step 3: evaluate and rank each package	***Step 4:*** on the basis of ranking allocate the resources.

Advantages	Disadvantages
1. Leads to more efficient allocation of resources 2. inefficient operation are removed and wasteful expenditure is avoided 3. It increases staff involvement at all levels leading to better communication and motivation. 4. Managers are forced to consider alternatives and develop a questioning attitude.	1. More costly and time consuming activity 2. Ranking process can be subjective where benefit are of qualitative nature 3. It may emphasis on short term benefit at the expense of long term benefits 4. Organization may not have the required management skills or the information system to provide suitable information to construct decision packages.

IMPORTANT TERM TO UNDERSTAND BEFORE STARTING ACTIVITY BASED BUDGETS

Activity based costing

Activity-based costing (ABC) is a method of allocating overhead costs to products and services. It is based on the concept that "**PRODUCT CONSUMES ACTIVITIES WHILE ACTIVITY CONSUMES RESOURCES AND CONSUMPTION OF RESOURCES DRIVES COST**". It breaks the overheads into different types and each type is then absorbed into the product according to their rate of consumption, leading to a fair allocation of overheads. Abs allows managers to attribute costs to activities and products more accurately than traditional cost accounting methods. Following are the terms used in ABC:

1. **Cost pools or activities:** these are collecting places for cost which consumes resources that drives cost. Costs are first allocated to these cost pools and then are passed on to the products.

2. **Cost driver or activity level:** it is a factor which causes a change in the organization's major activities.

Examples of cost pools and cost drivers are as follows:

STEPS

1. Identify cost pools and their allocated cost
2. Identify logical cost drivers for each cost pools
3. Calculate overhead absorption rate for each cost pools
4. Absorb overheads into the individual products by using the rates calculated in step 3.

Advantages	Disadvantages
1. It leads to fair allocation of overheads resulting in accurate cost and selling price of different products. Due to complete picture better pricing decision will be made and efforts will be made in the right direction towards right product. 2. It provides much better insight of cost and what drives overhead cost. With complete information about how cost is structured and incurred there is better chance to control cost (value analysis) and increase product profitability.	1. ABC requires the identification of cost pools and cost drivers which may be a time consuming activity. 2. It is important to find a realistic relationship between cost drivers and activities otherwise the desired benefit of ABC will not be achieved. Cost such as property and depreciation are difficult to relate to a realistic cost driver. 3. The ABC will not be beneficial in a manufacturing environment where overheads are related to production level or have small proportion in the overall cost.

3. Better able to cope with the complexity of AMT environment for example wide product range, complex process are best dealt by identifying different cost drivers for different cost pools. 4. It covers all overheads not just production overheads for example distribution, marketing and customer cost.	4. Different cost accounting record will be required for an ABC requiring new information system. 5. The cost of buying, implementing and maintaining activity based system may exceed the benefits of operating them.

Activity based management

ABM is an integrated approach that allows management to focus on activities rather than cost in order to improve strategic and operational decisions. It includes driver analysis (why), activity analysis (what) and performance evaluation (how well) and uses ABC as a major source of information. It focuses on factors that cause an activity cost, what activities to use and how the activities have performed.

It helps in following decision making

Strategic(doing right things)	Operational(doing things aright)
1. By using ABC information it helps in deciding which products to develop and which activities to use. This can also assist a company when considering the option of a new business or venture. 2. By using ABC information it becomes possible to identify profitable products and customers. As a result efforts will direct towards right customers and products. Also by using activity based cost data it is possible to take decision such as re-pricing products or elimination of unprofitable products.	By using ABC information better in sight of cost and what drives cost will be available. This will allow controlling cost by identifying and improving value adding activities and eliminating all non-value adding activities.

6. Activity-based budget

Method of budgeting based on activity framework and utilizing cost driver data in the budget setting and variance feedback processes. By using the principles of ABC it estimates the firm's future demand for resources and hence helps the firm to acquire these resources more efficiently.

Steps for ABB implementation

1. Estimate the production volume of individual products
2. Estimate the demand for activities
3. Identify the resources and its quantity to perform the activities
4. Take action to adjust the capacity of resources to match the projected supply.

Advantages	Disadvantages
1. It draws attention to activities that drives cost which is important if overheads are high. 2. It provides useful basis for cost control by comparing actual results to expectation. Moreover it assumes that overhead are variable which can be controlled if activity is controlled. 3. Provides useful info for TQM by relating cost of an activity with the level service provided	1. Considerable amount of time and effort might be needed to establish ABB. 2. Budget should be prepared on the basis of responsibility centers so it difficult to identify clear individual responsibility for activities.

- **BUDGET IN NOT FOR PROFIT ORGANIZATION**

A non-profit organization (or just non-profit) is an organization that is not allowed to distribute any money that it makes to its owners as profit. For example schools, social clubs, sport governing bodies, hospital etc.

Factors that differentiate NFPO budgets with that of profit organization.

1. Unlike profit organization there is no single identifiable objective like maximization of profits. There will be multiple objectives such as controlling of cost, quality of the service for example.
2. Benefits are largely non-quantifiable such as social welfare.
3. Multiple stakeholders' objectives need to be considered. So there is need to priorities/comprises different objectives for example in case of school – students, staff, government, tax payers, trustees and contributors etc.
4. Funding comes mainly from government. Unlike profit organization there is weak link between obtaining funds and providing a service.

Budgeting approaches used in NFPO are

Incremental approach	Zero based approach	Planned programme budgeting system

Planned programme budgeting system is a process that breaks work into different programmes designed to achieve various objectives. The resources used in programmes are efficient and cost effective. It may require the contribution of several departments towards a single programme.

CURRENT DEVELOPMENTS AND EMERGING ISSUES

DEVELOPMENTS IN MANAGEMENT ACCOUNTING

ENVIRONMENT MANAGEMENT ACCOUNTING (EMA) F5 Recap

- **REASONS FOR THE EMERGENCE ENVIRONMENTAL MANAGEMENT ACCOUNTING**

It is important for companies to recognize the importance of environmental awareness and management for the long term survival and profitability. Following are the reasons for emergence of EMA.

1. Society as a whole has become more environmentally aware so it is important to meet the needs and concerns of the customers relating to environment.
2. Environmental costs are becoming huge for some companies, particularly those operating in highly industrialized sectors such as oil production. In some cases, these costs can amount to more than 20% of operating costs. Such significant costs need to be managed.
3. Regulation is increasing worldwide at a rapid pace, with penalties for non-compliance also increasing accordingly.
4. Demonstrating as an environmental friendly company and managing these cost effectively to improve the public image

- **ENVIRONMENTAL MANAGEMENT ACCOUNTING**

Environmental management accounting is simply a specialized part of the management accounts that is concerned with the accounting information needs of managers in relation to corporate activities that affect the environment as well as environment related impacts on the corporation. It is important to note at this point that the focus of environmental management accounting is not all on purely financial costs. It includes consideration of matters such as:

1. Identifying and estimating the cost of environment related activities
2. Assign the likelihood and impact of environmental risk
3. Identifying and using environment related indicators.
4. Identifying and separately monitoring the usage and cost of resources such as water, electricity and fuel and to enable cost to be reduced.
5. The effect on the public image of the company from failure to comply with environmental regulations.

The effects of EMA on the company's financial performances

1. Improved revenue by the sales of products and services which meets the environmental needs or concerns of the customers.

2. Cost reduction by efficient use of resources and improving the processes.
3. Increase in cost by complying with legal and regulatory requirement
4. Cost of failure resulting from fines and penalties.

- **IDENTIFYING ENVIRONMENTAL COSTS**

Much of the information that is needed to prepare environmental management accounts could actually be found in a business general ledger. A close review of it should reveal the costs of materials, utilities and waste disposal, at the least. The main problem is, however, that most of the costs will have to be found within the category of 'general overheads' if they are to be accurately identified. Identifying them could be a lengthy process, particularly in a large organization. The fact that environmental costs are often 'hidden' in this way makes it difficult for management to identify opportunities to cut environmental costs and yet it is crucial that they do so.

Environmental cost can be split into two categories

Internal cost

1. Improved systems and checks in order to avoid penalties
2. Waste disposal cost
3. Product take back cost
4. Regulatory cost such as taxes
5. Upfront cost such as obtaining permits, site preparation cost and site study cost
6. Back end cost such as decommission cost, disposal of inventory.

External cost (This are borne by society at large because of company's activities)

1. Usage of energy and water
2. Forest degradation
3. Health care costs
4. Carbon emission cost

Governments are trying to convert this cost into internal cost by using taxes and regulations.

- **ACCOUNTING FOR ENVIRONMENTAL COSTS**

1. Input/outflow analysis

This technique records material inflows and balances this with outflows on the basis that, what comes in, must go out. So, if 100kg of materials have been bought and only 80kg of materials have been produced, for example, then the 20kg difference must be accounted for in some way. It may be, for example, that 10% of it has been sold as scrap and 90% of it is waste. By accounting for outputs in this way, both in terms of physical quantities and, at the end of the process, in monetary terms too, businesses are forced to focus on environmental costs.

2. Flow cost accounting

This technique uses not only material flows but also the organizational structure. It makes material flows transparent by looking at the physical quantities involved, their costs and their value. It divides the material flows into three categories: material, system and delivery and disposal. The values and costs of each of these three flows are then calculated. The aim of flow cost accounting is to reduce the quantity of materials which, as well as having a positive effect on the environment, should have a positive effect on a business' total costs in the long run.

3. Activity-based costing

ABC allocates internal costs to cost centers and cost drivers on the basis of the activities that give rise to the costs. In an environmental accounting context, it distinguishes between environment-related costs, which can be attributed to joint cost centers, and environmentdriven costs, which tend to be hidden in general overheads.

4. Lifecycle costing

Within the context of environmental accounting, lifecycle costing is a technique which requires the full environmental consequences, and, therefore, costs, arising from production of a product to be taken account across its whole lifecycle, literally 'from cradle to grave'.

Types Environmental related cost

1. Environmental protection cost: Cost arising due to activities undertaken in order to avoid the production of waste.
2. Environmental detection cost: Is a cost resulted to make sure that organization complies with regulatory standards.
3. Environmental internal failure cost: Cost resulted from activities that have produced waste which has not been discharged in to the environment.
4. Environmental external failure cost: Cost resulting from activities that have produced waste but which has been disposed out in the environment.

EMA & TQM

It is important to understand a vital link between EMA and TQM. A Good Environmental Management is major component TQM in which the aims will be zero pollution, zero waste, zero accidents and zero spill. Proper systems should be in place to ensure that the management performance as regard environment management.

LEAGUE TABLES

A league table, standings, ranking chart, or ladder is a chart or list which compares sports teams, institutions, nations or companies by ranking them in order of ability or achievement. A league table may list several related statistics, but they are generally sorted by the primary one that determines the rankings. Many industries and institutions may compete in league tables in order to help bring in new customers and clients. These are becoming popular in public sector as a performance management tool.

QUALITY

Quality is a measure of excellence or a state of being free from defects, deficiencies, significant variations and is the ability of your product to be able to satisfy your users. In today's highly competitive environment a quality product will provide a competitive advantage to those who struggle for it.

A proper quality management system should be implemented to ensure proper planning and controlling of activities so that products and services are according to the needs of customers. This can be achieved by having proper quality control and assurance system in place.

Quality Control

Quality Control is the implementation of regular testing procedures and routine steps to measure and ensure the quality of product.

Quality Assurance: Quality Assurance is the process that demonstrates your product is able to satisfy your users. This is usually done by an independent third party which measure whether the product is according to the quality standards established.

Types of Quality Cost

Quality Cost			
Conformance		Non Conformance	
Prevention Cost	Appraisal Cost	Internal Failure Cost	External Failure cost

Prevention Cost: Prevention costs relates to activities whose purpose is to reduce the number of defects in first place because it is much. Less costly to prevent a problem from ever happening than it is to find and correct the problem after it has occur.

Appraisal Cost: Appraisal costs relates to activities such as inspection and testing are incurred so that any defective parts and products should be caught as early as possible in the production process before the products are shipped to customers.

Internal Failure Cost: These costs result from identification of defects and conformance with the design specification before they are shipped to customers. These costs include scrap, rejected products, reworking of defective units, and downtime caused by quality problem. The more effective a company's appraisal activities the greater the chance of catching defects internally and the greater the level of internal failure costs.

External Failure Cost: Theses cost arises when a defective product is delivered to customer. External failure costs include warranty, repairs and replacements, product recalls, liability arising from legal actions against a company, and lost sales arising from a reputation for poor quality. The more the internal cost the less chances will be for external failure cost.

QUALITY PRACTICES

JIT	**TQM**	**Target costing**	**Kaizen costing**	**Six sigma**

Just In Time System

Just in time is a ‘pull’ system of production, so actual orders provide a signal for when a product should be manufactured. Demand-pull enables a firm to produce only what is required, in the correct quantity and at the correct time. It also has been described as an approach with the objective of producing the right part in the right place at the right time (in other words, “just in time”). JIT applies primarily to repetitive manufacturing processes in which the same products and components are produced over and over again. This means that stock levels of raw materials, components, work in progress and finished goods can be kept to a minimum. Supplies are delivered right to the production line only when they are needed.

It applies to both purchases with external suppliers (order is placed when customer places an order) and production within the organization (component is produced when required for next stage).

Advantages

- Lower stock holding means a reduction in storage space which saves rent and insurance costs
- As stock is only obtained when it is needed, less working capital is tied up in stock
- There is less likelihood of stock perishing, becoming obsolete or out of date
- Avoids the build-up of unsold finished product that can occur with sudden changes in demand
- Less time is spent on checking and re-working the product of others as the emphasis is on getting the work right first time.

Disadvantages

- There is little room for mistakes as minimal stock is kept for re-working faulty product
- Production is very reliant on suppliers and if stock is not delivered on time, the whole production schedule can be delayed
- There is no spare finished product available to meet unexpected orders, because all product is made to meet actual orders – however, JIT is a very responsive method of production

JIT Requires:

1. Elimination of all non-adding value activities such as waste.
2. Throughput rate should be high that is high rate of converting raw material into finished goods sales.
3. Minimizing inventory level thus its associated cost.
4. Competent and trained staff
5. Up-to-date machinery with proper maintenance plan.
6. Good long term relationship with suppliers to ensure reliable, high quality and timely availability of goods. Also such relationship will avoid frequent negotiation in prices and frequent check and inspection.

Total Quality Management

TQM is an approach to quality that emphasizes continuous improvement, a philosophy of "doing it right the first time" and striving for zero defects and elimination of all waste. More over a management philosophy that seeks to integrate all organizational functions (marketing, finance, design, engineering, and production, customer service, etc.) to focus on meeting customer needs and organizational objectives.

TQM functions on the premise that the quality of products and processes is the responsibility of everyone who is involved with the creation or consumption of the products or services offered by an organization such as involvement of management, workforce, suppliers, and even customers, in order to meet or exceed customer expectations.

Basic features of TQM

1. Continuous Improvement at all the times.
2. Involvement at levels of the organization that is from the employee to the CEO, with the responsibility of ensuring quality in their respective products and services, and management of their processes through the appropriate process improvement channels.
3. Aim more doing it right for the first time so preventing the errors before than occur resulting in more focus on prevention cost.

Target Costing

Target costing is defined as a cost management tool for reducing the overall cost of a product over its product life cycle. It reveals a direct link between the marketplace, corporate long-term profit goals, and cost management practices. In target costing the desired profit is subtracted from the target price to arrive at target cost which reflects what a new product should cost rather than what it does cost. Target costing is particularly popular among Japanese firms such as Toyota, Nissan, Toshiba and Daihatsu Motor in various industries such as automobile manufacturing, electronics.

Steps

1. Estimate the market price by conducting an external analysis which will identify customer's taste, demand for the product, competitor's products and other market conditions.
2. Identify the desired profit by return of capital employed orrate of return on sales.
3. Deduct the desired profit from the estimated selling price to arrive at target cost.
4. Calculate or compile the current estimated cost based on current cost level, process and technology.
5. Calculate the cost gap (difference between the current estimated cost and the target cost). Efforts will be made to close the cost gap by some form of cost reduction to ensure desired profit is achieved.

Features

1. Due to complete market awareness at initial phase, it allows customer requirements to be incorporated at design stage which will make it easy to market products once launched and will lead to the development of better pricing strategies.
2. It derives focus on planning, development and design stage where most of the cost is incurred thus allowing cost to be controlled at design stage. This creates a cost control environment at initial stage, diverting focus from recording to controlling of cost. Research has shown that 20% to 40% cost has been reduced using target costing depending on the type of product and market conditions.
3. New working ways will be identified to make sure target cost is achieved for example by de-skilling the process, joint working with suppliers to share information and enable cost reduction.

4. Target cost is set at an initial face (development) of the life cycle so considers the total cost associated with the product and gives a complete opportunity to control cost before the production stage.
5. It requires the involvement of staff from all function such as representatives from engineering, production, marketing and finance departments for brainstorming sessions and decision making about the product.

Ways to close gap

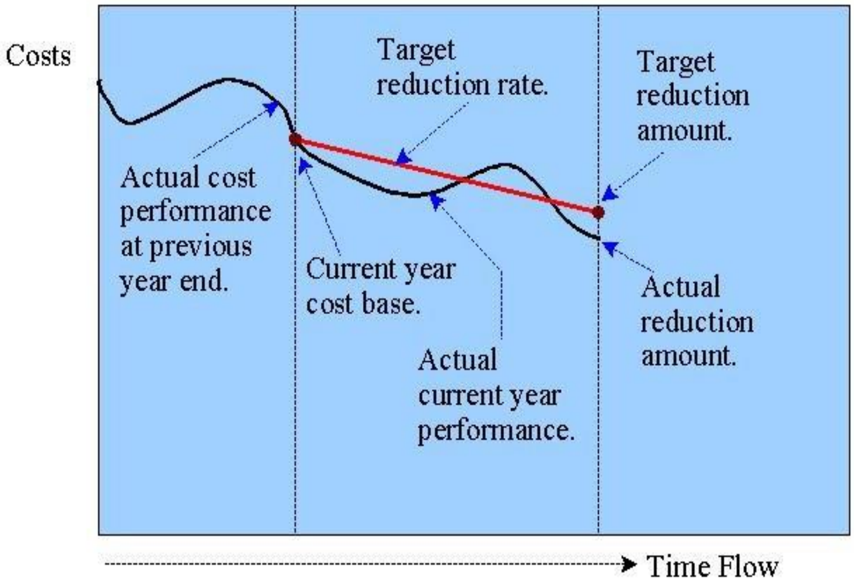
1. Using cheaper material without affecting quality
2. Review the entire supply chain to identify likely areas of cost saving for example obtaining quotations from suppliers
3. Using cheaper labor without compromising on quality or giving training to existing staff to improve productivity.
4. Purchasing part assembled components to cut down manufacturing operations
5. Increase the volume of production to benefit from economies of scale
6. Moving from labor to machine intensive environment to improve production efficiency
7. Using ABC technique for reducing overheads by identifying value added activities
8. Performing value analysis
9. Use JIT & TQM

Kaizen costing: Kaizen costing is the process of continual cost reduction that occurs after a product design has been completed and is now in production. Cost reduction techniques can include working with suppliers to reduce the costs in their processes, or implementing less costly re-designs of the product, or reducing waste costs. It focuses on continuous improvement in performance not with radical approach but using incremental steps. Following are the characteristics.

1. Continuous improvement leading to cost reduction
2. Tightening the standards on continues basis
3. Elimination of all kind of waste

1. Continuous improvement involves close examination and on the basis of that continuous improvement of existing processes. Changes made are not radical one like in BPR but incremental. As the aim is to go for perfection which is never achieved but such a focus will bring near to perfection. It is important to embed such continuous approach in the organization culture.
2. The standards are scrutinized continually so that cost reduction effects are incorporated into them on regular basis. This is done by functional analysis which is applied at the design stage for a new product, and a target cost for each function is set. The functional target costs are summed, and the result is a product target cost. After the first year of production for a new product, the actual cost of the previous period becomes the starting point for further cost reduction and whole process starts again.

The Cost Base and Cost Reduction Amount*



* Adapted from Monden and Lee Figure 2, p. 24

3. The focus should be on eliminating all kind of waste on regular basis as this lead to cost reductions. Examples are as follows:

Over production	Unnecessary inventory	Production delays/idle time
Defective units	Transportation cost	Over-processing

Difference between standard costing and kaizen costing (CMSMTV)

Standard costing	Kaizen costing
1. It is a cost controlling technique. **2.** It is based on the assumption that current manufacturing conditions are unchanged. **3.** Staff is seen as major problem **4.** The focus is on meeting cost performance standard. **5.** Performance Targets (Standards) are set annually or semiannually. **6.** Variance analysis means comparisons between standard and actual cost	1. It is a cost reduction technique. 2. It strives for continuous improvement in manufacturing conditions 3. Staff is seen as a source of improvement 4. The focus is on meeting cost reduction targets. 5. Cost reduction targets are set on a monthly basis. 6. Variance analysis means comparison between target cost reduction and actual cost reduction.

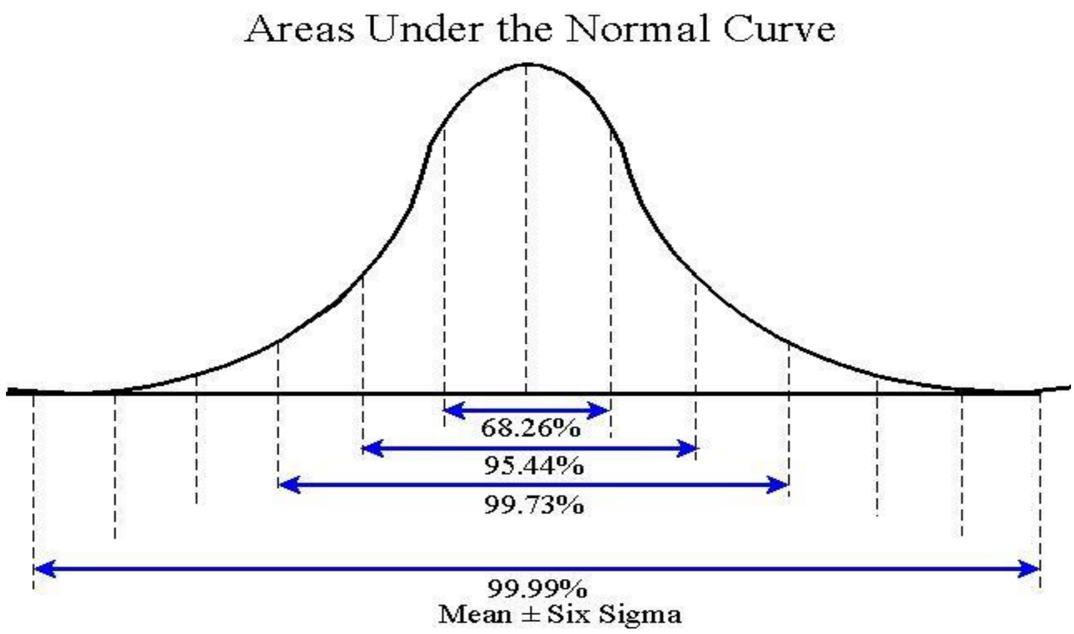
Six sigma model (Motorola developed six sigma methodology in mid-1980's)

Introduction

It is a disciplined approach that helps companies focus on developing and delivering near to perfect product. The central idea is to reduce the number of defects that go beyond the tolerance level which is done by measuring the number of defects in a process which then will be eliminated so that the company gets as close to zero defects.

Process of six sigma

The statistical representation of six sigma describes quantitatively how a process is performing. The sigma stands for standard deviation so six standard deviation are allowed in the process .to achieve six sigma, a process must not produce more than 3.4 defects per million opportunities. A six sigma defect is defined as anything outside of customer specifications. A six sigma opportunity is the total quantity of chances for a defect. If the process is within the six sigma this means the process is 99.99% accurate as illustrated below:



Uses of Six Sigma

Existing process DMAIC	New process DMADV
Both six sigma processes are executed by six sigma yellow belts, six sigma green belts and six sigma black belts, and are overseen by six sigma master black belts.	

Existing process: the six sigma DMAIC process (defines, measure, analyze, improve, control) is an improvement system for existing processes falling below specification and looking for incremental improvement.

- Define: Define the problem and the customer requirements. It is important to specifically define the problem. The customer requirement be divided into those that are the minimum that is acceptable, those that improve the customer's service experience and those that go beyond the customer's expectations. Also it is important to establish project goals that will determine what will be achieved and project team is establish with required resources.

- Measure: Measuring the current processes to see how it is performing and collect data that will determine the factors that have influence over the outcome of the process or identifies what is causing the quality problem. Such measurement will include measuring inputs (raw material), process elements (time, skills) and outputs and customer satisfaction.
- Analyze: The collected data is then analyzed to find root causes of the problems using statistical tools and fish bone analysis. Also such analyses will divide the process in to value adding, supporting activities for value adding activities and non-value adding activities.
- Improve: If the problem is real, the six sigma team identifies possible solutions to improve the process based on the data analysis.

- Control: Control planning, including data collection and control mechanisms is required on continuous basis. It is important to ensure that early deviations from the target do not materialize into process defects.

New process: the six sigma DMAMV process (define, measure, analyze, design, verify) is an improvement system used to develop new processes or products at six sigma quality levels. It can also be employed if a current process requires more than just incremental improvement.

Six sigma model advantages

1. Six sigma is driven by the customer and thus aims to achieve maximum customer satisfaction and minimizing the defects. It targets the customer delight and new innovative ways to exceed the customer expectations.
2. Implementation of six sigma methodology leads to rise of profitability and reduction in costs. Thus improvements achieved are directly related to financial results.

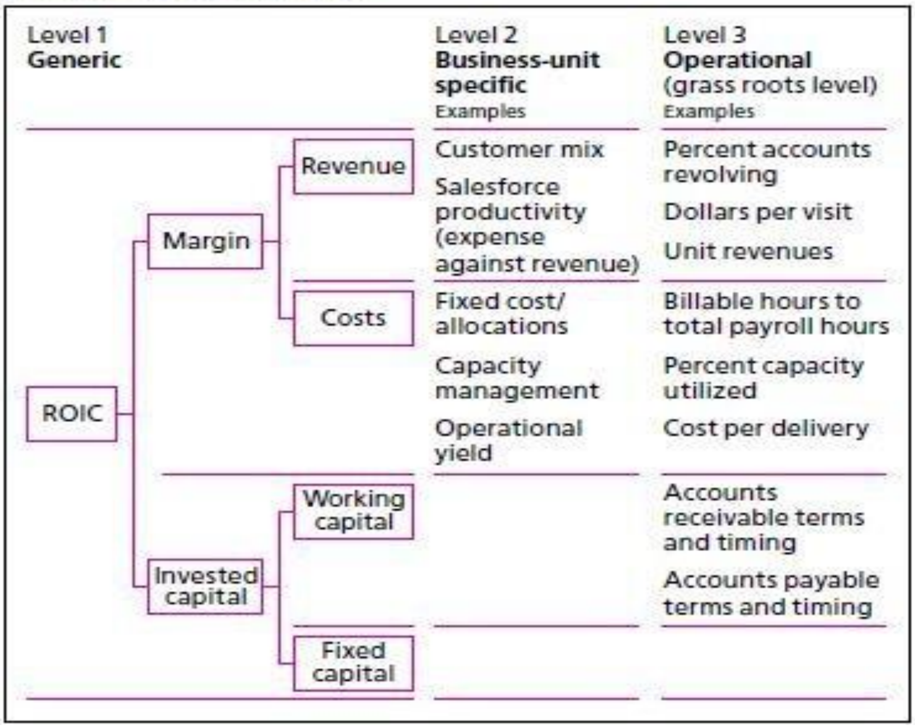
Six sigma model dis**advantages**

1. Applicability of six sigma is being argued among the six sigma critics. They opined that the quality standards should be according to specific task and measuring 3.4 defects per million as standard leads to more time spent in areas which are less profitable.
2. Six sigma gives emphasis on the rigidity of the process which basically contradicts the innovation and kills the creativity. The innovative approach implies deviations in production, the redundancy, the unusual solutions, insufficient study which are opposite to six sigma principles.
3. Six sigma implementation constantly require skilled man force. Thus control and employee dedication are hard to accomplish if it’s not implemented regularly.
4. Six sigma set tight targets but still accepts some failure i.e. Unlike TQM it doesn’t strive for zero defects.

Value based management

It is an approach which focuses on shareholder wealth creation by aligning the company's strategy, objectives and processes. The management should possess a value mindset at all the times i.e. it should be in their mind that ultimate financial objective is maximizing shareholder value and all other objectives such as environmental goals etc. are behind it. The management should continuously focus on performance variables which will improve the value of the company that is value drivers. There are three types of value drivers as shown by the below diagram:

Levels of value drivers



Measures like ROCE and EPS were traditionally used to measure the shareholder value but none directly correlates to market value of the company. However value based management measures are direct measures of value creation which are as follows:

1. Economic value added (already discussed before)
2. Market value added

   MVA is calculated by accumulating EVA generated by organization over time. It represented the value added since the business started i.e. Over and above the money invested by the shareholders and debt holders. A positive MVA represents value addition whereas negative represent value destroyed.

3. Shareholder analysis.

   Share holder analysis is calculating the value of the whole business rather than a single investment by discounted cash flow techniques. Different valuation techniques could be used on the basis of further dividend growth, earnings and free cash flows.

VBM requires planning and target setting, performance measurement and incentive system to be in line with the value creation at all the levels of the organization. Furthermore it is also important to ensure that value based thinking is incorporated at all the levels of the management that is corporate, business unit and functional levels. The implementation of VBM involves four steps which are as follows:

1. Strategy should be developed at corporate and business unit level.
2. Short and long term performance targets are set in terms of key value drivers.
3. Budgets and actions plans will be established for the next year.
4. At last the performance measurement and incentive system is established to monitor the performance and motivate the employees to achieve targets.

Changes in PM due to internal and external factors

The performance management system is continuously adapting with the internal and external changes that are techniques and methods used 50 years ago are not same today for example. Following are the reasons and impact of changes on performance management systems.

1. Technological changes

   Changes in technology have resulted in fast, accurate and real time performance information for managers. All such information can be analyzed in different way to counter different situations. However it has become a bit more challenging for the mangers as to how they use, interpret and acts in response to a situation due to more availability of data and information.

2. Increase in the scope of pm

   A shift of focus from financial to non-financial performance resulted in techniques which focuses on both financial and non-financial such as balance score card and performance prism etc. More over there has also been a greater focus on every ones involvement within the organization in performance management system and even of those outside the organization.

3. Governance

   The increasing focus on corporate governance due to corporate scandal has required the organization to demonstrate good corporate governance. Such a changed required organization's performance management systems to measure and report on improvement in governance comply with legislation and regulation relating to performance reporting and fulfill the demand on external accountabilities.

Chapter - DIVISIONAL PERFORMANCE

DIVISIONALISATION

In divisionalisation the organization is structured into divisions such as product or services wise. Each division is then responsible for production and sales of its own products. This type of structure leads to decentralization of authority and responsibility which is term as responsibility accounting. There are four types of responsibility centers:

Cost center	Manager is responsible and accountable for cost only. The performance of the centers assessed byconsideringthe cost variances and non-financial performance indicators such as productivity, efficiency ratios.
Revenue center	Manager is responsible and accountable for revenues only. The performance of the centers assessed by considering sales price &volume variances.
Profit center	Manager is responsible and accountable for cost & revenues both but can't take investment decision. The performance of the center can be assessed by considering cost variances, sales variances & controllable profit.
Investment center	Manager is responsible for profits as well as making valuable investments in new assets and disposing existing one. The performance of the center can be assessed by considering return on investment, residual income and EVA.

FACTORS TO CONSIDER IN DIVSIONALISATION

Goal congruence	Inter-dependence	Head office cost
Transfer price	Controllability	Co-ordination

MEASURING DIVISIONAL PERFORMANCE

A. Return of investment

Performance measure used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments. In other words ROI measures how effectively the firm uses its capital to generate profit; the higher the ROI, the better.

Advantages	**Disadvantages**

1. Widely accepted measure as its results are easily understood. 2. Relative measure enables comparison to be made between different sized division & companies. 3. There is no need for cost of capital to calculate ROI.	1. It might lead to dysfunctional behavior for example the manager will not accept any investment which will dilute the target ROI required for bonus. 2. ROI is a profit measure and has poor correlation with shareholder value

B. Residual income

It is the income that an investment can earn over the minimum rate of return (average cost of capital). In other words it measures the profitability of an investment center after deducting a notional interest cost.

Advantages	Disadvantages
1. Manager will accept any investment that adds to RI so this will reduce the probability of dysfunctional behavior. 2. It does correlate with shareholder 8value to greater extent than ROI as it is an absolute measure.	1. Not useful for comparing the division of different sizes. 2. Does not relate size of a division's profit to asset employed in order to obtain that profit.

Common ROI and RI problems

1. Manipulation can be done to improve the ROI & RI results. 2. Identifying controllable (traceable) profits and investment can be difficult. 3. If assets are valued at net book value, ROI and residual income figures generally improve as assets get older. This can encourage managers to retain outdated plant and machinery.

ECONOMIC VALUE ADDED

It is an absolute measure but is superior to RI. It is directly related to shareholder value creation. It is calculated by using economic profits and economic capital employed and using weighted average cost of capital.

FORMULA

EVA = NET OPERATING PROFIT AFTER TAX – *NOTIONAL CAPITAL CHARGE

* Notional capital charge = economic value of capital employed x WACC

Following are the adjustment made to profit and capital employed:

1. PROFIT AFTER TAX	2. CAPITAL EMPLOYED
Add back	Add back
Accounting depreciation	Net replacement cost of tangible non-current asset
Provisions, allowance for bad debts and deferred tax provisions	Cumulative amortized goodwill
Non-cash expense	Provision for doubtful debts
Interest net of tax	Economic value of capitalized development cost
Goodwill amortized	Economic value of capitalized operating cost
Operating leases	**ECONOMIC VALUE CAPITAL EMPLOYED**
Research & development cost	
Advertising and staff training cost	
Less	
Economic depreciation	
Impairment of goodwill	
NOPAT	

3. COST OF CAPITAL

A weighted average cost of capital should be used.

Formula

(Proportion equity x Cost of equity) + (Proportion of debt x Post tax cost of debt)

Advantages	Disadvantages
1. Easy to understand as it is in absolute terms. 2. It is based on figures which closer cash flows so are in line with shareholders long term objectives and will be less subject to manipulation.	1. EVA may become difficult to calculate as it requires a number of adjustments to both profits and capital employed. 2. EVA is based on historic data so may not be a good indicator of future investment and strategy

3. It measures the value created by the organization by deducting a charge on capital. So manager's performance can be linked to EVA by linking the rewards to value created for the organization. 4. Is consistent with NPV as any projects that have a positive NPV means will also increase EVA.	decisions. 3. EVA being absolute measure cannot be used to measure different sized divisions. 4. Difficulty in calculating WACC.

TRANSFER PRICING

Transfer price is the price at which goods and services are transferred from one division to another division within same organization in order to calculate each division's profit and loss separately. It represents the revenue per unit from the supplying division and cost per unit for receiving division. The purpose of transfer price is to motivate managers and to improve divisional performance. However an incorrect transfer price might result in suboptimal decision which will affect overall organization's profitability.

Objectives of transfer pricing

Goal congruence	**Performance measurement**	**Autonomy**
Each profit center manager should make sure that their decisions are in line with company's objectives in order to achieve goal congruence. This is true because without a fair transfer price there might be a disagreement as to how much work should be transferred to internal division and much sales should be made to external market in order to maximize the division's profit.	A properly set transfer price will enable the performance of each division to measured and assessed. However an incorrect transfer price will create disputes between the divisional mangers thus making it difficult to measure the true performance.	Profit center manger should have the autonomy when setting transfer prices for their divisions in order to motivate them. However this might lead to suboptimal decisions for example trying to improve their own division performance at expense of other divisions resulting in self-interested segments.

Minimizing global tax liability	A properly set transfer price will lead to fair allocation of profits.

When setting a transfer price following things should be considered.

Goal congruence	Performance measurement	Autonomy

Types of transfer pricing

1. **General rule (Theoretical transfer price)**

   Marginal cost + opportunity cost

Where opportunity cost will be either:

1. The contribution forgone by not selling the product externally. In this case the market price will be equal to marginal cost plus the opportunity cost. However for this to take place it is important that the competition should be a perfect competition.
2. The contribution loss by not using the resources on same other alternative use.

Exemption to the above rule

If there is spare capacity then the transfer price will be the marginal cost only as the

opportunity cost will not exist.
Practical transfer prices
2. Market prices Market based transfer price will be considered as fair transfer price for all the managers and will reduce the chances of dysfunctional behavior. However following are the problems associated with market based transfer price: 1. No immediate market is available for the intermediate product resulting in no market price. 2. Publish market price are fictitious. 3. The transferring division has monopoly in the market.
3. Adjusted market prices Transfer made internally will often result in cost saving when compared with external sales in form of saving in selling, distribution, bad debts risk and administration cost. All such savings will make it possible for the selling to give discount on the market price to buying division.
4. Cost based approach Transfer price based on cost should only be based on standard cost and not on the actual cost because in actual cost there is a risk that inefficiency of the supplying division will passed on to the buying division.

Key points to remember

1. For the receiving division the transfer price will be a variable cost but that transfer price might include the fixed cost of the supplying division. So any decline in the receiving division's demand or receiving division giving preference to external market will lead to under absorption of fixed overhead of the supplying division.
2. As long as the divisions continues trading with each other so there are less chances that the overall company profitability gets affected but any preference given by the division to external market over the internal division there is a high probability that the overall company's profits will get affected.

Other transfer prices

1. Marginal cost plus lump sum (two part charging system)

   The supplying division transfers the each unit to buying division at variable cost and also receives a lump sum fixed fee in order to cover its fixed cost.

2. Dual pricing

   Dual pricing means that two different transfer prices are used i.e. supplying division records a transfer price based on full cost whereas buying division records a transfer price based on marginal cost. This method ensures optimal decisions and avoid the possibility of reporting losses however period end adjustment are required in the accounts.

International transfer pricing

Multinational companies have different subsidiaries operating in different countries. So almost two third of the world trade takes place within multi-national companies so it is important to consider international transfer pricing. Following are the factors that should be considered in international transfer pricing.

1. Taxation

   A group having divisions in different countries will be subject to different tax rates. A well set transfer price can save the global tax liability however artificial attempts to reduce tax liabilities can give a signal to country's tax authorities who have the power to alter the transfer prices.

2. Import tariffs

   The country in which buying division is situated might be subject to import tariffs so a low transfer price can minimize the duty cost.

3. Exchange rates

   A well set transfer price should consider currency exchange rate fluctuations.

4. Remittance controls

   The country's government in which buying division is situated might block the remittance of dividend to parent company. A properly set transfer price can overcome this problem if the selling division charges extraordinarily high prices from buying division thus converting profits into revenues.

TYPES OF TRANSFER PRICES USED IN MULTINATIONALS.

1. Market based transfer price will be seen as completely acceptable for the tax authorities of both the countries but it have certain practical limitations.
   A. Prices may vary between different countries.
   B. Changes in exchange rates will affect the transfer prices
   C. Prices may be set considering demand and supply situation.
2. A full cost transfer price will be considered acceptable for tax authorities as it gives them some indication that it approximates to the real cost of supplying division.
3. A transfer price based on variable cost will not be acceptable for the tax authorities of the supplying division country because it will transfer all the profit to buying division and will show losses in supplying division.

Chapter : ENVIRONMENTAL INFLUENCES

INTRODUCTION

There are different environmental influences that affect the organization. Such factors should be considered in order and appropriate action plan should be devised to counter them. Following are the factors that should be considered.

1. Continuous changes in business environment
2. External forces
3. Stake holder's impact
4. Ethical issues
5. Impact of government's policy

CONTINUOUS CHANGES IN BUSINESS ENVIRONMENT

1. The rapid change in business environment is mainly due to globalization and increase in the use on Information technology which required that introduction of new management accounting techniques and changes in the existing ones. Such a change also required changes in the roles of a management accountant, who now needs to consider a broader and strategic perspective than just operational perspectives. Such changes in roles and skills are as follows:
2. Good interpersonal and communication skills are required
3. A balanced focuses on financial and non-financial information and also needs to make use of existing techniques to a non-financial context.
4. Ensure efficient use on financial and other resources
5. Work in cross functional teams

1. Exogenous Variables

Exogenous (from the Greek words "exo" and "gen", meaning "outside" and "production") refers to an action or object coming from outside a system. From organization perspectives it means factors that originates from outside organization and are considers as uncontrollable factors examples includes government policy, economic and social factors. Due to the existence of such factors organizations are subject to risk and uncertainty.

Risk

It is the threat or probability that an action or event may or may not occur and will adversely or beneficially affect an organization's ability to achieve its objectives and whose probability of occurrence can be calculated.

Uncertainty

It is the situation where the nature of things is unknown, consequences are unknown, conditions or events are unpredictable and probabilities to possible outcomes cannot be assigned.

Types of decision makers

Risk seeker:

Decision maker who is interested in the best outcomes no matter how small the chance that they may occur.

Risk neutral:

Decision maker concerned with what will be the most likely outcome.

Risk averse:

Decision maker who acts on the assumption that worst outcome might occur.

Sore loser:

Decision maker who doesn't take failure well and blames everyone around them for their loss except themselves.

- **FOLLOWING ARE THE WAYS TO DEAL WITH RISK AND UNCERTAINTY**

1. Expected value **(**In case of risk**) (**Risk neutral)

Expected value is the weighted average value which is calculated by the sum of all possible values for a random variable, each value multiplied by its probability of occurrence. It is a long term average provided the event should occur over and over again.

Criticisms of expected value

1. The probabilities itself are estimate and therefore will be unreliable or inaccurate
2. Expected value are long term averages and may not be useful in one off decisions
3. Expected values do not consider the people's attitude toward risk.

2. Decision rule **(**in case of uncertainty**)**

I. Maximax **(**Risk taker**)**

Select the maximum payoff, from the list of maximum payoffs. When applying Maximax rule in a payoff table the focus should be on decision alternatives.

Criticisms of maximax

1. Over optimistic
2. Ignores probabilities

II. Maximin**(**Risk averse**)**

Select the maximum payoff, from the list of minimum payoffs. When applying Maximin rule in a payoff table the focus should be on decision alternatives.

Criticisms of maximin

1. Defensive and conservative
2. Ignores probability
3. Do not consider opportunity to maximise profit

III. Minimax regret rule **(**Sore loser)

Select the minimum regret, from the list of maximum regrets. Regret is the opportunity lost by making wrong decisions. A regret or opportunity loss table will be prepared by focusing on the state of nature however for finding the answer the focus again will be on decision alternative.

3. Sensitivity analysis

It is technique from which it is possible to identify the critical variables (such as sales price, material &labour cost) which if changed might affect the ultimate decisions. For example if only a (say) 2% change is required in selling price before losses result an investor may think twice before proceeding. In other words it tells how vulnerable are the decisions from changes is any variable. Is it also called what-if-analysis.

Limitations

1. Ignores Probability
2. Cannot consider changes in multiple factors

4. Simulation models:Simulation models can be used to deal with decision making problems involving a number of uncertain variables. Computer models can be built to simulate real life scenarios. The models use random number tables to assign values to the uncertain variables that business is subject to.
5. Scenario planning

Scenario planning is a method for learning about the future by understanding the nature and impact of the most uncertain and important driving forces affecting the business. A group of executives sets out to develop a small number of scenarios—stories about how the future might unfold and how this might affect an issue that confronts them. The goal is to craft a number of diverging stories by extrapolating uncertain and heavily influencing driving forces. The stories together with the work getting there has the dual purpose of increasing the knowledge of the business environment and widen both the receiver's and participant's perception of possible future events.

EXTERNAL FORCES

Countering the external forces requires a thorough external analysis which can be performed at both macro environment and industry level.

Macro environment

The major external and uncontrollable factors that influence an organization's making, and affect its performance and strategies. These factors include the economic factors; demographics; legal, political, and social conditions; technological changes. The technique of PESTAL analysis can be used to consider such factors in detail and systematic way. PESTAL analysis breaks the environmental factors into six segments which are as follows:

- Political factors are how and to what degree a government intervenes in the economy. Specifically, political factors include areas such as tax policy, labor law, environmental law, trade restrictions, tariffs, and political stability. Political factors may also include goods and services which the government wants to provide or be provided (merit goods) and those that the government does not want to be provided (demerit goods). Political decisions can impact on many vital areas for business such as the education of the workforce, the health of the nation and the quality of the infrastructure of the economy such as the road and rail system.

- Economic factors include economic growth, interest rates, exchange rates and the inflation rate. These factors have major impacts on how businesses operate and make decisions. For example, interest rates affect a firm's cost of capital and therefore to what extent a business grows and expands. Exchange rates affect the costs of exporting goods and the supply and price of imported goods in an economy
- Social factors include the cultural aspects and include health consciousness, population growth rate, age distribution, career attitudes and emphasis on safety. Trends in social factors affect the demand for a company's products and how that company operates. For example, an aging population may imply a smaller and less-willing workforce (thus increasing the cost of labor). The ageing population also has impact on demand: for example, demand for sheltered accommodation and medicines have increased whereas demand for toys is falling.
- Technological factors include technological aspects such as R&D activity, automation, technology incentives and the rate of technological change. They can determine barriers to entry, minimum efficient production level and influence outsourcing decisions. Furthermore, technological shifts can affect costs, quality, and lead to innovation of create new products and new processes
- Environmental factors include ecological and environmental aspects such as weather, climate, and climate change, which may especially affect industries such as tourism, farming, and insurance. Furthermore, growing awareness of the potential impacts of climate change and the general move towards more environmentally friendly products and processes is affecting how companies operate and the products they offer, both creating new markets and diminishing or destroying existing ones and creating business opportunities.
- Legal factors include discrimination law, consumer law, competition law, employment law, and health and safety law. These factors can affect how a company operates, its costs, and the demand for its products.

Industry level

Porter’s 5 forces model can be used to analysis the industry pressures, determine how attractive the industry is and is also used for assessing and analyzing the competitive strength and position of a corporation or business organization. According the this model the industry is influenced by five following factors:

1. Threat of New Entrants: New entrants to an industry can raise the level of competition, thereby reducing its attractiveness. The threat of new entrants largely depends on the barriers to entry. High entry barriers exist in some industries (e.g. Shipbuilding) whereas other industries are very easy to enter (e.g. Estate agency, restaurants). Key barriers to entry include Economies of scale, capital / investment requirements, Customer switching costs, Access to industry distribution channels, the likelihood of retaliation from existing industry players.
2. Threat of Substitutes: The presence of substitute products can lower industry attractiveness and profitability because they limit price levels. The threat of substitute products depends on buyers' willingness to substitute, the relative price and performance of substitutes, the costs of switching to substitutes.
3. Bargaining Power of Suppliers: Suppliers are the businesses that supply materials & other products into the industry. The cost of items bought from suppliers (e.g. Raw materials, components) can have a significant impact on a company's profitability. If suppliers have

high bargaining power over a company, then in theory the company's industry is less attractive. The bargaining power of suppliers will be high when there are many buyers and few dominant suppliers, there are undifferentiated highly valued products, suppliers threaten to integrate forward into the industry (e.g. Brand manufacturers threatening to set up their own retail outlets), buyers do not threaten to integrate backwards into supply, the industry is not a key customer group to the suppliers.

4. Bargaining Power of Buyers: Buyers are the people / organizations who create demand in an industry. The bargaining power of buyers is greater when there are few dominant buyers and many sellers in the industry, products are standardized, Buyers threaten to integrate backward into the industry, suppliers do not threaten to integrate forward into the buyer's industry, and the industry is not a key supplying group for buyers.

5. Intensity of Rivalry

The intensity of rivalry between competitors in an industry will depend on:

- - The structure of competition - for example, rivalry is more intense where there are many small or equally sized competitors; rivalry is less when an industry has a clear market leader.
- - The structure of industry costs - for example, industries with high fixed costs encourage competitors to fill unused capacity by price cutting.
- - Degree of differentiation - industries where products are commodities (e.g. Steel, coal) have greater rivalry; industries where competitors can differentiate their products have less rivalry.
- - Switching costs - rivalry is reduced where buyers have high switching costs - i.e. there is a significant cost associated with the decision to buy a product from an alternative supplier.
- - Strategic objectives - when competitors are pursuing aggressive growth strategies, rivalry is more intense. Where competitors are "milking" profits in a mature industry, the degree of rivalry is less.
- - Exit barriers - when barriers to leaving an industry are high (e.g. The cost of closing down factories) - then competitors tend to exhibit greater rivalry.

The Stakeholder’s impact

A person, group, or organization that has direct or indirect stake in an organization because it can affect or be affected by the organization's actions, objectives, and policies. Key stakeholders in a business organizationinclude creditors, customers, directors, employees, government (and its agencies), owners (shareholders), suppliers, unions, and the community from which the business draws its resources. So it is important for an organization to understand their stakeholders and their needs to properly manage them. One way of managing stakeholders is by usingMendelow's matrix provides a way of mapping stakeholders based on the power to affect the organization and their interest in doing so. It identifies the responses which management needs to make to the stakeholders in the different quadrants.

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Power / Interest Matrix (Gardner et al. (1986)

		Level of Interest	
		Low	High
Power	Low	A Minimal effort	B Keep informed
	High	C Keep satisfied	D Key players

Minimal Effort

The company may require little or no effort to be focused on this group. The stakeholders pose no threat due to a lack of both interest and power so they accept what they are told and follow instructions.

Keep Informed

This group, although having a high interest, has little power to exercise control so they can be maintained through the management of information to keep them informed of company events otherwise they will gain power with other stakeholders.

Keep Satisfied

This group may or may not realize the degree of effect they have over the company and therefore must be kept satisfied. However, because of their low interest in events, they are unlikely to cause significant disruption but it is important to keep them reassured about the outcome of the strategy in advance in order to avoid them gaining interest.

Key players

The company must try to satisfy this group first and foremost as they have the power to affect the company and a high degree of likelihood that they will use their power. It is important to involve them in the planning process as they have the power to bring change if they are satisfied with the plans.

Stakeholder's conflict: Organization may face conflicts between stakeholder's objectives and needs for example shareholders want increased profit but customer wants lower prices and employees' wants higher wages. Such conflicts can be managed by following ways:

1. Prioritization

   The stakeholders should be priorities according to their power and interest as discussed above in Mendelow's matrix.

2. Negotiation and satisficing

   The will negotiate and will go for satisficing rather than complete satisfaction i.e. finding the minimum acceptable outcome for each group.

3. Sequential attention

This includes focusing on different stakeholder group in different time periods

4. Side payments

   This includes providing benefits to stakeholders other than wants they actual required.

5. Exercise of power

   This involves resolution of conflict by senior figure simply on the basis of the power they possess.

ETHICAL ISSUES

Ethics are moral guidelines which govern good behavior. So behaving ethically is doing what is morally right**.** Behaving ethically in business is widely regarded as good business practice. Such a focus on ethics will make it easy to achieve the primary objective of maximization of shareholder's wealth. Examples include use of child labour and forced labour, ignoring health, safety and environmental standard, violation of the basic rights of workers and experiment on animals etc.

You will probably note the link between business ethics and corporate social responsibility (CSR). The two concepts are closely linked:

- A socially responsible firm should be an ethical firm
- An ethical firm should be socially responsible

However there is also a distinction between the two:

- Ethics is about morally correct behavior.
- CSR is about responsibility to all stakeholders and not just shareholders.

Corporate Social Responsibility means

- Conducting business in an ethical way and in the interests of the wider community
- Responding positively to emerging societal priorities and expectations
- A willingness to act ahead of regulatory confrontation
- Balancing shareholder interests against the interests of the wider community
- Being a good citizen in the community

Benefits of focusing on CSR

- Wining new business
- Increase customer retention
- Develop and enhance relationships with customers, suppliers and networks
- Attract, retain and maintain a happy workforce and be an Employer of Choice
- Save money on energy and operating costs and manage risk
- Differentiate yourself from your competitors
- Generate innovation and learning and enhance your influence
- Improve your business reputation and standing

- Provide access to investment and funding opportunities
- Generate positive publicity and media opportunities due to media interest in ethical business activities

Attitudes towards corporate ethics

1. Amoral organization: Such organization allows any actions that are in favor of the corporate aim without the fear of getting caught which is considered as a bad luck. There is no written code, no set of values other than own greed.
2. Legalistic organization: These are the organization that obeys the laws just for the sake that no harm should be on organization. Ethics is considered only when it becomes a problem and such problems will require the use of formal code of ethics.
3. Responsive companies: Such organization agrees that ethical behaviors will benefit them for example organization considering the staff welfare will be able to retain and attractive high quality labour. If such organization has formal code of ethics then it will consider all stakeholders' concern.
4. Emerging ethical: They proactively take interest in business ethics. In such organization's ethical values are part of culture and code of ethics are action documents, ethical measures are in place and ethical audit and review commitment are also established.
5. Ethical organization: These have total ethical profile i.e. follows ethics completely.

Impact of Government policy and regulations.

Introduction

The government policies will have an impact on the organization's performance and on their strategy. So it is important for the company's strategic team to have a thorough knowledge of the laws and regulations. There are many different types of law and regulations that can impact company such as environmental protection, labour and consumer protection, social and business legislations and taxation legislation etc. Moreover there are also specific laws and regulations for particular industries for example transport and food industries. For companies that are operating internationally have to face more legislation complexity for example there will be a conflict between domestic and host company laws. So it is a challenge now for the strategic teams to plan and devise proper action plan for political changes by:

1. Focusing on economic activities
2. Problems arising because of physical infrastructure and environment
3. Monitoring future government policies and action plans for example political party's conferences, commentaries of political analysts, actions of public pressures groups, international events and public interviews of party leaders etc.

We will now consider the impact of government policy and regulations in details.

1. Supply side policy

Supply side policy includes any policy that improves an economy's productive potential and its ability to produce by providing adequate, cost effective supply of materials, services and labour to an economy. It includes

1. Improve labour mobility will also have a positive effect on labour productivity, and on supply-side performance.
2. Better education and training to improve skills, flexibility, and mobility – also called human capital development. Spending on education and training is likely to improve labour productivity and is an essential supply-side policy option.
3. The adoption of performance-related pay in the public sector is also seen as an option for government to help improve overall productivity.
4. Using the tax system to provide incentives to help stimulate factor output, rather than to alter demand, is often seen as central to supply-side policy i.e. Reducing direct tax rates, including income and corporation tax. Lower income tax will act as an incentive for unemployed workers to join the labour market, or for existing workers to work harder. Lower corporation tax provides an incentive for entrepreneurs to start and so increase national output.
5. Promotion of greater competitionin labour markets, through the removal of restrictive practices, and labour market rigidities, such as the protection of employment.

2. Green policies/externalities

Is any [course of] action deliberately taken [or not taken] to manage human activities with a view to prevent, reduce, or mitigate harmful effects on nature and natural resources, and ensuring that man-made changes to the environment do not have harmful effects on humans. The example river pollution caused by manufacturer and motor vehicle pollution. Thus green policies focuses on problems arising from human impact on the environment, which retroacts onto human society by having a (negative) impact on human values such as good health or the 'clean and green' environment. Example includes government has used taxes to increase the real price of petrol and there is greater discussion in EU over the introduction on carbon tax.

3. Competition policy

These are the policies intended to prevent collusion among firms and to prevent individual firms from having excessive market power. Major forms include oversight of mergers and prevention of price fixing and market sharing in order to promote or maintain market competition by regulating anti-competitive conduct. The term competition policy, however, has a broader meaning, and refers to a set of measures and instruments used by governments that determine the overall conditions of competition that are likely to be met in specific markets. As such, competition law is a subset of competition policy.

Monopoly: A situation in which a single company owns all or nearly all of the market for a given type of product or service. This would happen in the case that there is a barrier to entry into the industry that allows the single company to operate without competition.

Advantages

- Research and Development. Supernormal Profit can be used to fund high cost capital investment spending. Successful research can be used for improved products and lower costs in the long term. E.g. Telecommunications and Pharmaceuticals.
- Economies of scale. Increased output will lead to a decrease in average costs of production. These can be passed on to consumers in the form of lower prices.

- International Competitiveness. A domestic firm may have Monopoly power in the domestic country but face effective competition in global markets. E.g. British Steel
- A firm may become a monopoly through being efficient and dynamic. A monopoly is thus a sign of success not inefficiency. For example - Google

Dis Advantages

- Supernormal Profit: Higher Price and Lower Output than under Perfect Competition. This leads to a decline in consumer surplus.
- Allocative Inefficiency: A monopoly is allocatively inefficient because in monopoly the price is greater than MC.
- Production Inefficiency: It is argued that a monopoly has less incentive to cut costs because it doesn't face competition from other firms so a monopoly is productively inefficient because it produces output at a higher cost.
- Higher Prices to Suppliers: A monopoly may use its market power and pay lower prices to its suppliers. E.g. Supermarkets have been criticized for paying low prices to farmers.
- Diseconomies of Scale: It is possible that if a monopoly gets too big it may experience diseconomies of scale. - higher average costs because it gets too big.

Government Reponses to monopolies

Self-regulation	Nationalization	Monopoly control	Public regulation

3. Impact of macro-economic policy on business sectors

It is important that the macroeconomic policy to work properly, its instruments (fiscal and monetary) should impact the economy and business sector. Following are the impacts:

Aggregate demand	Cost of business sector
The macroeconomic policy will impact AD which is central to the determination of level of inflation and unemployment. An increase in AD will lead to inflation whereas a low AD will lead to unemployment.	Macroeconomic policy will impact the cost of business sectors by affecting exchange rates (raising the domestic prices of imported products), taxation (will increases the prices of products) and interest rates (cost of borrowing and investment).

Let's now consider the macroeconomics instrument in detail:

1. **Fiscal policy**

   Fiscal policy is the government policy for dealing with the budget (especially with taxation and borrowing). In economics, fiscal policy is the use of government expenditure and revenue collection to influence the economy. It includes the aspect of Government economic policy dealing with tax, welfare payments and government expenditure. Government requires an adjustment between taxation, borrowing and spending.

Expenditure
Government spends money in order to stimulate the economy. Such money would be raised either through taxes or borrowing. However to much economic stimulation will lead to inflation as people

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will compete for resources and services.	
Taxation Raising money through increasing taxation levels will affect public expenditure resulting in slow economic growth. However to stimulate economy taxation levels could be reduced but this should not reduce the government spending.	Borrowing & Repayment In order to stimulate economy when taxation levels are not high government need to borrowings to spend more.
It is important to strike a balance between all three.	

2. Monetary policy

Monetary policy is the process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest for the purpose of promoting economic growth and stability. The official goals usually include relatively stable prices and low unemployment. Monetary theory provides insight into how to craft optimal monetary policy. It is referred to as either being expansionary or contractionary, where:

1. An expansionary policy increases the total supply of money in the economy more rapidly than usual. Expansionary policy is traditionally used to try to combat unemployment in a recession by lowering interest rates in order to promote consumer demand, encourage business to increase spending because it will be cheaper to borrow and saving do not earn a lot of interest.
2. Contractionary policy is intended to slow inflation in hopes of avoiding the resulting distortions and deterioration of asset values by reducing the size of money supply.

   Changes in monetary policy will affect the cost of borrowing, inflation levels, consumer demand and exchange rates.

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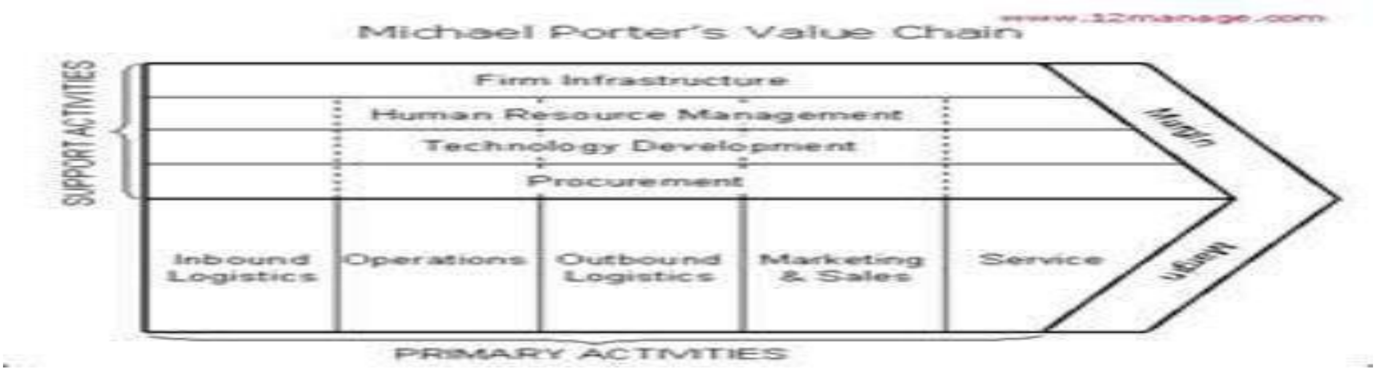
Business integration

The unification of one or more separate business functions into a single function. In includes aligning all aspects of the business to ensure maximum use of business resources so that objectives are achieved effectively. The frame work that we will use to understand business integrations and linkages is Porter’s value chain model. The value chain model helps to analyze specific activities and their link and the value of these activities. It is subdivided into primary and secondary activities which are as follows:



Primary activities

Inbound logistics. It includes receiving, storing inventory control and transportation planning of inputs to the systems.

Operations: This includes general operations of the business such as, machining, packaging, assembly, equipment maintenance and all other value adding activities that convert inputs into final products.

Outbound logistics: This includes activities required to deliver the final products to customers such as warehousing, order fulfillment, transportation and distribution management.

Marketing and sales: This includes activities that result in buyers purchasing the product such as advertising, promotion, pricing and retail management.

Service: These are the activities and create and enhance the product value such as training, customer support, installation, upgrading and spare parts management.

Support activities

Procurement: This includes procurement of input such as raw materials, servicing, spare parts, building and machines etc.

Technology development: This includes development of technology to support value chain activities such as R&D, Process design and redesign and automation.

Human resources management: This includes activities associated with recruiting, development, retention and compensation of employees.

Firm Infrastructure: This includes general management, planning management, legal, finance, accounting and quality management.

Advantages of Value chain

1. A big advantage is that the value chain is a very flexible strategy tool for looking at your business, your competitors and the respective places in the industry's value system.
2. The value chain can be used to diagnose and create competitive advantages on both cost and differentiation.
3. It helps you to understand the organization issues involved with the promise of making customer value commitments and promises because it focuses attention on the activities needed to deliver the value proposition.

4. Comparing your business model with your competitors using the value chain can give you a much deeper understanding of your strengths and weaknesses to be included in yourSwot analysis.
5. It can be used for assessing the performance of the overall process by setting targets and monitoring the actual performance.2

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Chapter - CHANGES IN BUSINESS STRUCTURE AND MANAGEMENT ACCOUNTING

ORGANISATIONAL STRUCTURE AND ITS TYPES

An organizational structure is a mainly the way in which a firm has arranged its lines of authority and communication, and allocated duties and responsibilities. The structure may be of a functional, divisional and Network structure.

1. Functional Structure

A structure that divides the organization into different functions and activities and for each function there is manager responsible and accountable for that function. In other words the next level after the top-management is divided into functional departments, e.g. R&D, sales & marketing, production and finance. In this structure the decision making is mainly restricted to senior management resulting in centralization. Data and Information in this structure is passed from functions to upper level who the aggregates and analysis the data and information and responds back to the functions with plans and decisions.

2. Divisional Structure

An organizational structure composed of separate business units having complete autonomy and decentralization and within which are the functions that work together for a specific product and geographical location. The data and information requirements of divisional structure are different from that of functional structure in that information is required by the lower level management to devise plans and make prompt decisions.

3. Network structure (Virtual)

A network-based organization structure outsources most or all business functions, have very little physical presence, use volunteer labour and leverages information technology. Network-based organizations favor democratic decision making that involves most members across the organizational structure. A network based organization structure outsources a variety of tasks and business functions for the purposes of cutting costs, maintaining a flexible infrastructure and aiding in the scalability of the company. The information requirements of such structure is that people running the organization requires information for proper resource allocation and each different party also needs information to compare their progress and performance in relation to others.

Empowerment

A management practice of sharing information, rewards, and power with employees so that they can take initiative and make decisions to solve problems and improve service and performance. Empowerment is based on the idea that giving employees skills, resources, authority, opportunity, motivation, as well holding them responsible and accountable for outcomes of their actions, will contribute to their competence and satisfaction. In an empowered organization information used should be financial and non- financial which should be transparent and is available immediately for decision making. Also budgets should be set for each team member who should get feedback information to assess his /her own performance.

Business process re-engineering

Business process re-engineering is the fundamental rethinking and radical redesigning of the business process in order to improve critical variables of cost, quality and speed etc. Examples includes combining several jobs into one, establishing cross-functional team which has become popular because of the desire to re-engineer separate functional tasks into complete cross-functional processes, management information systems developments aim to integrate a wide number of business functions, workers make real decisions and controls and reconciliation process are reduced. The ultimate aim is to improve customer satisfaction. It resulted in automation and greater use of IS/IT such as shared database, extensive use on internet, wireless communication and tracking technology for warehouses and delivery system etc.

Advantages

- BPR focuses on customer satisfaction by fulfilling their needs.
- BPR eliminates non value adding activities thus resulting in cost saving for the organizations.
- BPR leads to new work methods in order to change the current process completely.
- By reviewing the entire business, companies may well be able to spot areas where they can improve efficiency.
- Disadvantages
- BPR assumes that a company's existing processes are the main drag on its performance and the main barrier to the company reaching its full growth potential. But this may not be the case.
- BPR has been accused of underestimating the resistance to change that is likely to exist in anorganizations.
- BPR requires a serious long term commitment from management and staff which may not be an easy task.
- Research should that too much focus on BPR resulted in drift from monitoring the competitor activities.
- Companies that implemented BPR didn't enjoyed the complete benefit that was promised by redesigning their processes.

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Chapter - IMPACT OF INFORMATION TECHNOLOGY

The developments in information technology have a significant impact on businesses and on strategic management accounting systems. Following are the recent developments in it:

1. Data warehouses

A collection of data designed to support management decision making. Data warehouses contain a wide variety of data that present a coherent picture of business conditions at a single point in time.

Development of a data warehouse includes development of systems to extract data from operating systems plus installation of a warehouse database system that provides managers flexible access to the data. The term data warehousing generally refers to the combination of many different databases across an entire enterprise. Such databases are then used to extract the data according to individual requirement. Such data warehouses can then be used for data mining which analyses the data to find unknown patterns and correlations with data.

2. Internet

A global network connecting millions of computers. More than 100 countries are linked into exchanges of data, news and opinions. Unlike online services, which are centrally controlled, the internet is decentralized by design. There are a variety of ways to access the internet. Internet provides access to vast of information and resources.

3. Intranet

An intranet is a private network that is contained within an enterprise and is accessible only by the organization's members, employees, or others with authorization. An intranet's web sites look and act just like any other web sites, but the *firewall* surrounding an intranet fends off unauthorized access. The main purpose of an intranet is to share company information and computing resources among employees. An intranet can also be used to facilitate working in groups and for teleconferences.

4. Extranet

An **extranet** is a computer network that allows controlled access from the outside, for specific business or educational purposes. In a business-to-business context, an extranet can be viewed as an extension of an organization's intranet that is extended to users outside the organization, usually partners, vendors, and suppliers, in isolation from all other internet users.

5. Networks

Organization connects their computers together to share data and devices using Lan and Wan. *Local*-**a***rea* **n***etwork* (Lan) is a computer network that spans a relatively small area. Most Lans are confined to a single building or group of buildings; however, oneLan can be connected to other Lans over any distance via telephone lines and radio waves. A system of lans connected in this way is called a *wide-area network (wan).*

Need for continual developments

It is important for business to change them and continuously bring developments in their systems in order to make sure that they don't become out of date. Following are the other reasons for a business to respond quickly and continuously.

1. Introduction of new accounting techniques such ABC, Backflush etc. Requires change in information systems.

2. Implementing JIT systems requires detailed information.

3. Increased competition and obtaining competitive advantage requires quick, relevant and detailed information.

4. Quick innovation of new products requires sophisticated manufacturing ways such as computer aided manufacturing

5. Increased focus of services and service industries requires new methods of costing for services. (service industries will be discussed below).

Needs of modern service industries

Services are intangible products such as accounting, banking, cleaning, consultancy, education, insurance, expertise, medical treatment, or transportation. Unlike manufacturing services are more subject to qualitative information due to its characteristic requirements which are as follows:

1. Intangibility

The services are intangible, with no substantial physical aspect to a service delivery where as in manufacturing the delivery is in physical form.

2. Heterogeneity

fundamental characteristic of services which results in variation from one service to another, or variation in the same service from day-to-day or from customer-to-customer.

3. Simultaneity

It refers to the idea that the production and consumption of a service occur simultaneously, making it impossible to produce and store a service prior to consumption.

4.perishability

perishability is relating to the fact that services cannot be stored. They must be consumed when offered; they cannot be held or stocked.

Measuring quality in services industries

Unlike manufacturing in services industries there no substantial physical aspect to a service delivery so it is important to focus on

1. Comfort and ambience

2. Speed of delivery

3. Responsiveness and flexibility

4. Consistent quality.

Access to data and information technology

Traditional accounting systems which were less based on it used to result in late availability and slow processing of data thus affecting flexibility and responsiveness. Such problems of traditional system can be overcome by using modern accountings systems which are it based for example:

1. Inaccurate cost: traditional accounting system rarely used ABC instead preferred the use of absorption costing based on single oar. However incorporating ABC in modern systems can provide accurate and complete cost measurement.
2. Delays: traditional systems resulted in delays in due to manual recording, analyzing and comparison with budget which resulted in delay knowing the whether the actual result were different from budget. However the modern systems recording and processing is in real time allowing analysis and comparison on daily basis.

It systems impact on budgeting and benchmarking

It system provides instant access to data for budgeting and benchmarking.

Budgeting

A control system which compares the actual performance with budgeted performance. Following are the elements of budgetary systems.

Standard: it represents the budget which will be used for comparison.

Sensor: it represents the method used for recording the actual result

Feedback: is the actual result for the period

Comparator: it involves the comparison of the actual result with the budget

Effector: it represents the manager responsible for taking action in case of variances, with consultation of others.

Benchmarking

It systems provide managers with instant access to internal data so that they can see patterns and changes in trend and also external data so that they can revise benchmarking quickly. This makes sure that managers have completely up-to-date data and information about the relative performance thus helping in benchmarking.

Use of RFID

RFID abbreviation is that “refers to any electronic device that uses radio waves to facilitate the communication of data for the purpose of identification, and sometimes to locate and/or sense the condition(s), of animate and inanimate objects. “Anything that communicates using radio waves needs to be able to identify and differentiate itself from other things.

RFID is also used by numerous other things:

1. The keys to open your car door;
2. The automatic payment passes used in toll booths;
3. Building access systems;
4. Passports, payment cards, and even student id cards;
5. Wireless sensors and mesh networks.
6. For inventory controlling and tracking

Chapter - PERFORMANCE MEASUREMENT IN NOT FOR PROFIT ORGANISATION

INTRODUCTION

An incorporated organization which exists for educational or charitable reasons, and from which its shareholders or trustees do not benefit financially. IT is neither a legal nor technical definition but generally refers to an organization that uses surplus revenues to achieve its goals rather than to distribute them as profit or dividends. Examples include schools, hospitals, charitable institutions, welfare societies, clubs, public libraries, resident welfare association, sports club etc.

Characteristic

1. The objective of such organizations is not to make profit but to provide service to its members and to the society in general.
2. The main source of income of these organizations is not the profit earned from purchase and sale of goods and services but is admissions fees, subscriptions, donations, grant-in-aid, etc.
3. These organizations are managed by a group of persons elected by the members from among themselves. This group is called managing committee.

These are of two types

Private Sector Based	Public Sector Based

Like a profit organization it is important to assess the performance of Not for profit organization. However following are the causes of concern.

Non Quantifiable Cost and Benefits	Uses of funds
Stakeholders objectives	Impact of politics

1. Non quantifiable cost & benefits

The benefits (customer satisfaction or increased staff morale) and the cost(reduced corporate image or adverse public perception) associated with these organizations are largely of qualitative in nature thus making it difficult to measure the performance. For example there will be no measurement scale; it will be difficult to justify the balance between cost and benefits obtained.

Solution

A cost and benefit analysis is the answer to the above problem by quantifying all cost and benefits in financial terms although doing this in very situation might not be very easy. For example increased staff morale, may lead to high productivity, which may lead to less over-time and adverse public perception will lead to fines and penalties or lower sales revenue.

1. Use of funds

In not for profit organization particularly public sector organizations, funding is the primary source of cash inflow (normally from governments) as they don't generate revenue. An expenditure budget is set according to which they use their funds. However such expenditure and funding structure has serious issues such as:

1. Funding is not correlated with more and quality of service provided.
2. In according to qualify for funding focus will be on targets which are not important from the organization's perspective.

Solution

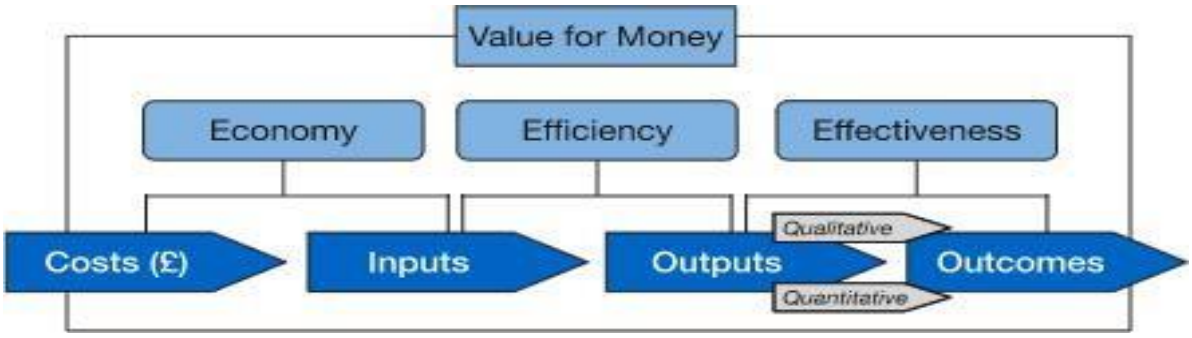
The concept of value for money is best for measuring the performance of not for profit organization which is based on three factors:

Economy is what goes into providing a service, such as the cost per hour of care workers or the rent per square meter of accommodation.

Efficiency is a measure of productivity i.e., how much you get out in relation to what is put in. For example, the number of people visited per home care worker per week or the amount of refuse collected per refuse-lorry.

Effectiveness is a measure of the impact that has been achieved, which can be either quantitative or qualitative. Examples include how many people were prevented from needing residential care through using home care services (quantitative), and feedback from different sections of the community with arrangements for tenant participation (qualitative). Outcomes should be equitable across communities, so effectiveness measures should include aspects of equity, as well as quality.

VFM is high when there is an optimum balance between all three elements - when costs are relatively low, productivity is high and successful outcomes have been achieved. The link between all three is shown by below diagram



VFM AUDIT: Independent audit of a not-for-profit organization conducted to assess the economy, efficiency and the effectiveness in the utilization of funds. It is employed where the standard commercial performance (profit oriented) measures cannot be used.

Multiple and diverse stakeholder's objectives

The NFP are subject to multiple objectives due to multiple stakeholders' involvement. Also the objectives are diverse as there are no single objectives of maximization of shareholder's wealth. So it is important to fulfill the needs of all the stakeholders.

Solution

Prioritization of objectives will overcome this problem but sometimes it will not be easy to set establish such priority so compromise between objectives will be required.

Impact of politics

Performance management in public sector organization suffers with the problem of political interference which may focus on short term political gain at the expense of long term organizational benefit. Funding might not be provided for improvement in service rather than to gain some political popularity or deliberately not incurring expense for service betterment due to political pressure. All such issues will not allow to assess a realistic performance of the company.

Chapter - STRATEGIC MANAGEMENT ACCOUNTING

THE PERFORMANCE HIERARCHY

1. Mission
2. Strategic plans and objectives (discussed below)
3. Tactical plans and objectives (discussed below)
4. Operational plans and targets (discussed below)

Mission Statement: A mission statement is a statement of the purpose of a company or organization.

Following will be included in Mission statement:

1. Purpose and aim(s) of the organization and define what the company is about.
2. The organization's primary stakeholders
3. How the organization provides value to these stakeholders
4. Distinguish the company from all others
5. Serve as framework to evaluate current activities

Benefits of mission statements

Prevent conflict	Communication of key cultural values	Reason for existence	Provides strategic direction

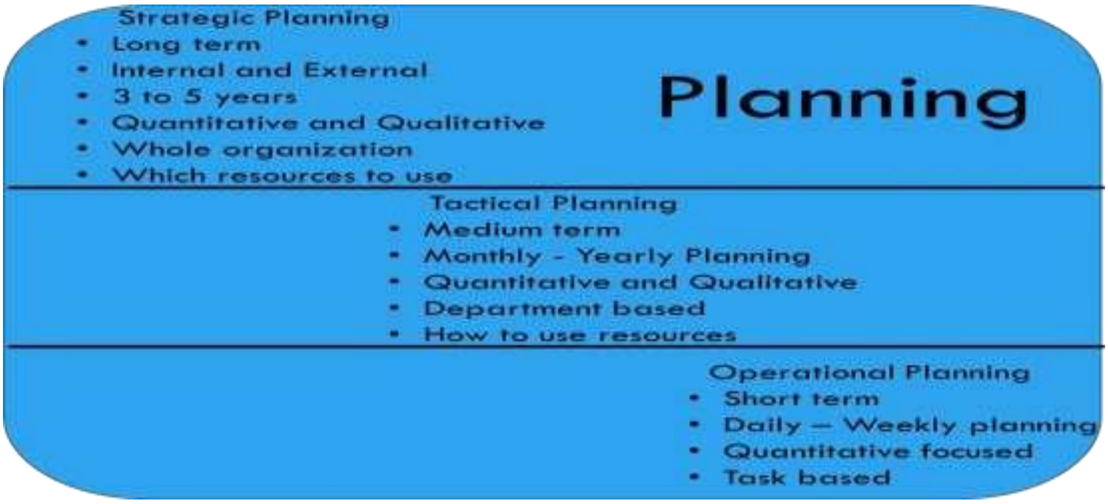
Drawbacks of mission statements

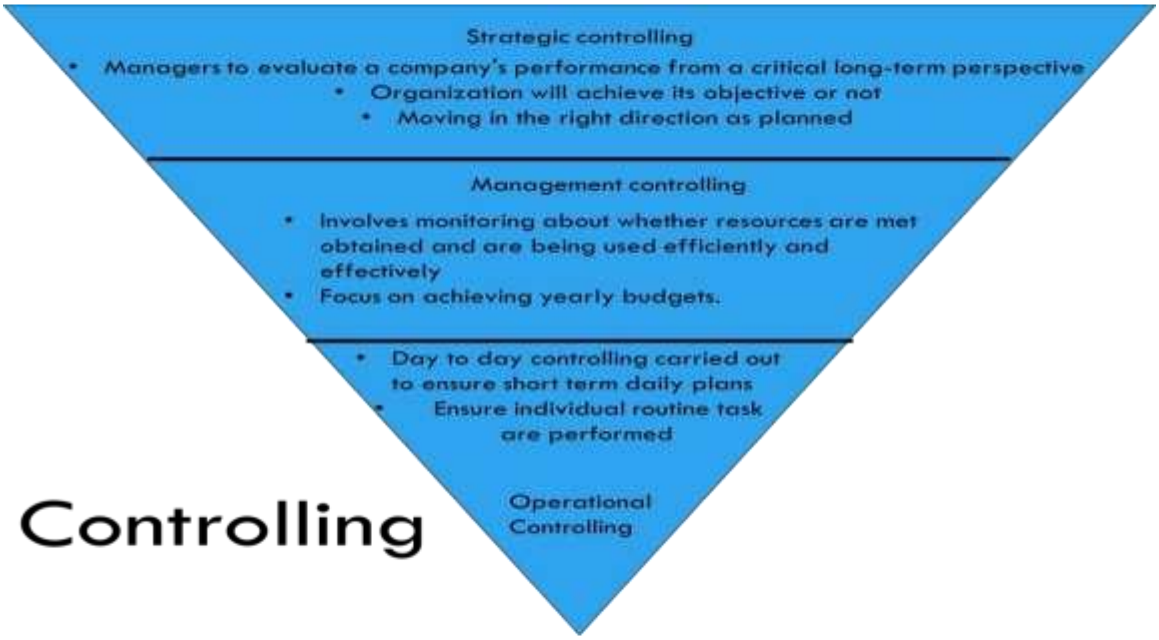
They might be unclear	Un-noticeable	Not represent the actual values	Lack sufficient external focus

Difference between mission and vision

A mission statement concerns what an organization is all about. A vision statement, on the other hand, describes how the future will look if the organization achieves its mission. A mission statement gives the overall purpose of an organization, while a vision statement describes a picture of the "preferred future."

PLANNING AND CONTROLLING





Role of management accounting

Traditionally the focus of management accountant was limited who were responsible for financial controlling but in today's environment the focus is more strategically i.e. business support. The focus now is not just limited to number specialist but more of a generalist. Traditionally the management accountant was kept separate to operational side in order to ensure their independence in reporting accounting information to senior managers.

According to the study of Burns and Scapens the role of management accountant has changed over number of years and today accountant has become a hybrid accountant. According to this study there are three reasons for such a change which are as follows:

1. Technology: Traditionally the management accountant was one of the few people who had access to IT system in order to prepare financial reports. However in today environment due to sophisticated IT system data input and report generation can be made from other organizational users which traditional was done by management accountant. So now the management accountant has become another user of the system, producing reports from data inputted by other departments.

2. Management structure: Due to delayering of management hierarchy the focus now has shifted to operational management who now are expected to have knowledge of budgeting and cost control even they are not finance specialist. They are expected to be accountable for their own budget and are responsible for cost under control. They also produce forecast based on the local knowledge together with the performance indicators to give statement of performance in relation to their own area. The role of management accountant is now as a second reporter to senior management, who then can link these financial report with the strategic consequences of the activities which have been undertaken.

3. Competition: Due to high competition the focus has now shifted from financial accounting to commercial orientation which required management accountant to have a more strategic focus and consider both financial and non-financial information. Also the focus now shifted from short term profit to future long term earning capacity of the company.

Management accountants will be involved in the strategic planning process which is discussed below.

Strategic planning process as suggested by Johnson and Scholes is 3 stages strategic planning model which consist of:

1. Strategic analysis: It involves a thorough analysis of external opportunities and threats, internal strengths and weakness, stakeholder's values, power and interest and identification of gap between desired and expected performance. (Tools used in strategic analysis are discussed below)
2. Strategic choice: Choice is at the center of strategy formulation. This involves identifying strategies for growth (in which markets and products to invest, organic growth and acquisition), strategies to close the gap. The strategic choices includes:

   1. Generation of options
   2. Evaluation of options Refer to SAF below
   3. Selection of options
3. Strategic implementation: This involves implementation of detailed plans and budgets and establishing KPI which are then used to monitor the actual performance against the budgets and plan.

Note: CSF and KPI have significant importance in strategic planning process

Strategic analysis tools

1. Swot analysis

A tool that identifies the strengths, weaknesses, opportunities and threats of an organization.. The method of Swot analysis is to take the information from an environmental analysis and separate it into internal (strengths and weaknesses) and external issues (opportunities and threats). The result of the analysis is a matrix of positive and negative factors for management to address:

	Positive factors	Negative factors
Internal factors	Strengths	Weaknesses

External factors	Opportunities	Threats

The key point to remember about Swot is that:
strengths and weaknesses

- Are internal to the business
- Relate to the present situation

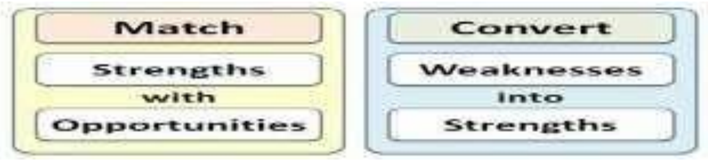
Opportunities and threats

- Are external to the business
- Relate to changes in the environment which will impact the business

Using SWOT analysis

There is no point producing a Swot analysis unless it is actioned. Swot analysis should be more than a list. It is an analytical technique to support strategic decisions.

The key words are match and convert:



2. Benchmarking

Benchmarking is the process of identifying "best practice" in relation to both products (including) and the processes by which those products are created and delivered. The search for "best practice" can take place both inside a particular industry, and also in other industries. The objective of benchmarking is to understand and evaluate the current position of organization in relation to "best practice" and to identify areas and means of performance improvement. Benchmarking is very useful in public sector organization (Chapter 4) which can be compared to private sector in order to identify areas of improvements. There are a number of different types of benchmarking, as summarized below:

Type	Description
Strategic Benchmarking	Where businesses need to improve the overall performance by focusing on strategies of best performers when their own strategies have become inappropriate. It involves considering high level aspects such as core competencies, developing new products and services and improving capabilities for dealing with changes in the external environment.
Competitive Benchmarking	Businesses consider their position in relation to performance characteristics of key products and services. In order to identify performance gaps. Benchmarking partners are drawn from the same sector. This normally undertaken through method of reverse engineering.

Functional Benchmarking	Businesses look to benchmark with partners drawn from different business sectors to find ways of improving similar functions or work processes. This sort of benchmarking can lead to innovation and dramatic improvements.
Internal benchmarking	Involves benchmarking businesses or operations from within the same organization The main advantages of internal benchmarking are that access to sensitive data, standardized data is available, and usually less time and resources are needed. But problems like real innovation may be lacking.

Steps

1. Set objective and decide areas to bench mark
2. Identify key performance drivers and indicators

These will be identified depending on the type of organization and area to be benchmarked for example public sector may focus on cost efficiency whereas private sector may focus on both cost and differentiation.

3. Select organization
4. Measure performance of organization involved
5. Compare performances
6. Specify improvements
7. Implement and monitor improvements

EFFECTIVNESS OF BENCHMARKING

1. It should be considered a learning exercise rather than measuring exercise
2. The influence of stakeholder towards improvement is important.
3. The economic pressure in some cases is also important to bring improvement
4. The focus should not be just on improving numbers being measured rather it should be on underlying performance. **(DYSFUNCTIONAL BEHAVIOUR CHAPTER 3)**

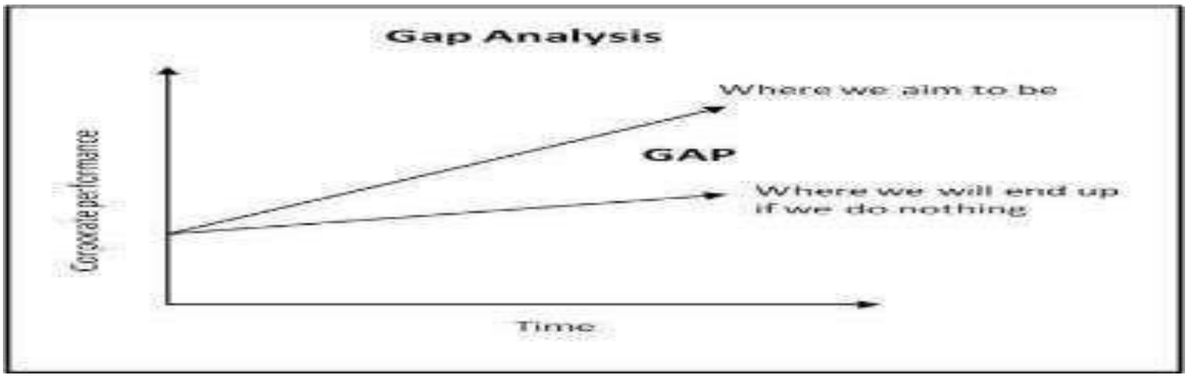
BENEFITS OF BENCHMARKING

1. It leads to the identification of gaps in performance
2. Provides opportunity to learn from the success of others
3. Allows applying best practices
4. Focus on continuous improvement
5. Decreases the feeling of self-satisfactions

Gap analysis

This is an analysis which identifies the gap between desired and expected performance. The purpose of gap analysis is to establish what the organization will achieve if it did nothing and what it wanted to achieve (The planning gap is most often measured in terms of demand but may also be reported in terms of net profit, return on capital employed etc.

The following diagram shows the gap.



The defined gap can be reduced by using Ansoff's Matrix (Chapter 3) i.e. by making different strategies which are as follows:

Market penetration	Market development	Product development	Diversification

The other strategies that can be used include efficiency strategies which are designed to increase profits (or throughput) by making better use of resources in order to reduce costs. Also it is possible to reduce a planning gap that is measured in terms of profit by divesting of loss-making business units. This would obviously not be the case where a planning gap is measured in terms of sales revenue.

Multiple objectives and strategic analysis

At strategic analysis stage multiple objectives identified then needs to be resolved. For example maximization of shareholder wealth, survival, quality of service and respect for environment etc. Such conflicts need to be resolved by converting them into SMART (specific, measurable, achievable, relevant and time bounded) targets.

TECHNIQUE FOR STRATEGIC CHOICES

Strategies should be **evaluated** on the basis of three criteria to help strategic choice which are as follows:

1. **Suitability**
   This includes answering question about strategy like does it has a suitable strategic fit i.e. Will it take advantage of opportunity and build on strengths.
2. **Acceptability**
   This involves considering whether the strategy is suitable and acceptable to the organization stakeholders both in terms of return and risk.
3. **Feasibility**
   It concerns with availability of the necessary resources and competencies in order to implement and successfully achieve the strategy.

STRATEGIC MANAGEMENT ACCOUNTING IN MULTINATIONAL ORGANIZATION

A multinational company is one that operates in more than one country so for effective strategic management accounting it is important to consider following factors:

1. Process specialization: It deals with locating certain types of activities in certain countries in order to get cost advantage for example many companies have shifted their manufacturing plants to china in order to benefit from low cost.
2. Product specialization: It deals with providing different countries with minor or major changes in standard product in order to fulfill the needs of local condition for example pizza hut have introduced pizza having local names.
3. Political issues: Multinational companies have to consider local political issues, laws and regulations and have to trade with these requirements.
4. Administrative issues: Multinational companies will be subject to exchange rate fluctuation, currency exchange controls and international tax treaties.

1.

Chapter 11: PERFORMANCE MEASUREMENT SYSTEM

Why do organizations need information?

Managers need useful information for the following purposes:-

1. Decision making 2. Planning 3. Controlling

These functions are carried out at three different levels in organizations. (Discussed before)

Types of information

Quantitative information can be expressed in numerical terms.

Qualitative information is usually expressed in the form of opinions regarding employees, customers and suppliers. Importance of qualitative information cannot be underestimated and need to be considered in the decision making process.

Sources of information

Internal source: Information comes from within the organization. For example:

External source: Information comes from outside the organization. For example:

Qualities of good information

Good information has a number of specific qualities. The mnemonic ACCURATE is a useful way of remembering them.

A---Accurate C---Complete C---Cost beneficial U---Understandable R---Relevant
A---Adaptable T---Timely E---Easy to use

These qualities should be kept in mind during the input, processing and output in systems.

Controls should also be exercised, the types of which are as follows:

Input controls

These ensure accuracy, completeness and validity of inputs into the system. These may contain measures for data verification for example control totals and limit checks.

Processing controls

These ensure that processing of data is accurate and complete. Passwords may be used to ensure security of data.

Output controls

The ensure accuracy, completeness and security of output. Examples include follow up on exception reports and batch controls to ensure all data is complete.

Enterprise resource planning is a business management software—usually a suite of integrated applications—that a company can use to collect, store, manage and interpret data from many business activities.

Planning and Information systems

Strategic planning sets the course of future for the organization. Information Systems used at this level are:

Executive Support Systems

An executive support system pools data from internal and external sources and makes information available to senior managers in an easy-to-use form. ESS helps senior managers make strategic, unstructured decisions.

Tactical/Middle Level

This is the level at which middle managers monitor and control resources. (eg cash flow forecasts, budgeting). DSS are used at this level.

Decision Support Systems

DSS combine data and analytical models or data analyses tools to support semi-structured and unstructured decision-making.

Operational

Day to day activities is tracked at this level (cash receipts, payments etc.). Information systems at this level are:

Transaction Processing Systems

A TPS performs and records routine transactions.

Other systems used at all levels of the organization are:

1. **Management Information Systems**

   MIS convert data from mainly internal sources into information (e.g. summary reports, exception, directing and controlling activities for which they are responsible)

2. **Expert Systems**

   An expert system is a computer program that captures human expertise in a limited domain of knowledge.

Open and Closed Systems

Closed System: A closed system is one which has no interaction whatsoever with the environment. It cannot receive input or produce outputs. Such a system is not practical as there needs to be interaction with the environment for any sort of growth to take place. This system:

1. Has a short life 2. Becomes irrelevant as environment changes

Open System: This system interacts with the environment hence both internal and external factors would be considered for this.

Contingency approach to Management Accounting would be relevant for an open system. This states that there is no universally applicable system for accounting in all circumstances. Five factors need to be considered:

- The external environment: whether it is static and stable or dynamic and uncertain,
- Competitive strategy: how Porter's five forces are applicable on low cost product/ differentiated product.
- Technology: Sophistication of accounting software
- Business units: Independence within the organization
- Knowledge and observability: Availability of required information

Lean Management information system: This is a philosophy of Management that involves cutting down unnecessary activities and eliminating wastage. This can be done through a quality control system that focuses on continuous improvement. Two elements of this system are:

- Just in time production and purchasing (JIT) (Discussed before)
- Total Quality Management (TQM) (Discussed before)

Joint Methods of expansion

- Joint venture: In this case, a new project based company is formed (only for that project) whose shares are owned by two or more business entities. This forms a separate business entity.
- Strategic alliance: An alliance between two or more business in which a separate business entity is not formed.
- Supply chain structure: An association between all customers and suppliers in a chain (producer, transporter, warehouse, retailer and so on) to increase the overall value throughout the chain.

Relationship between Performance Management and Performance Measurement

Performance Management is the system ensure that goals are consistently being met in an effective and efficient manner. Performance management can focus on the performance of an organization, a department, employee, or even the processes to build a product of service, as well as many other areas.

The way through which the achievement of objectives is evaluated and measured is known as Performance Measurement.

Behavioral aspects of Performance Measurement

Human Resource Management: HRM is the "strategic and coherent approach to the management of an organization's most valued asset."

Goals of HRM are: 4Cs

- Commitment
- Competence

- Congruence
- Cost-effectiveness

Victor Vroom's Expectancy Theory

This theory was amongst the process theories of motivation which answered the question:

"How can people be motivated?"

Vroom proposed a formula to determine the force of motivation that an individual would be felt by an individual:

F= V x e

Where:

F= force of motivation

V= valence representing preference for an outcome (can be 0, -1 or 1)

E= expectancy representing whether an individual expects that he will be able to achieve the outcome (can be 0 or 1)

Agency Theory

This theory revolves around the relationship between an agent and the principal. It suggested that the agent is only motivated to work if he or she has something to gain from it. In case of employee manager relationship, the manager would need to ensure that he uses the correct means to keep his subordinates motivated with a positive attitude towards work.

Hopwood identified three styles of performance appraisal for managers:

- Budget constrained style: In this case, focus is on the short term. There would be a negative impression if the manager is unable to control costs in the current term and cannot meet short term targets and there is no room for flexibility.
- Profit conscious style: The overall effectiveness of the manager with respect to long term organizational goals is appraised.
- Non accounting style: This focuses on the non-financial aspects of performance appraisal and is more general.

Performance Appraisal is required for two purposes.

1. Judgment
2. Development

Obstacles to effective appraisal

1. Appraisal as confrontation: People may consider appraisal to be a confrontation or mismatch of ideas which may result in a lack of agreement on performance levels.
2. Appraisal as judgment: Subordinates may take their manager's word as the law and would not be open about their problems or needs as a negative atmosphere would be created.
3. Appraisal as chat: Many managers may be reluctant to criticize individuals and will hence conduct appraisal in an informal and friendly way which may undermine the importance of the appraisal process.

4. Appraisal as bureaucracy: In this case appraisal may be seen as a formal obligation that needs to be conducted to satisfy HR department.
5. Appraisal as unfinished business: Appraisal should be seen as ongoing and focused on future rather than just a duty to be done during the year.
6. Appraisal as an annual event: Performance targets set during annual appraisal meetings may become outdated and unnecessary. Appraisal should be a continuous process.

Hard and Soft Accountability :

Hard accountability will require:

1. Counting: i.e., converting activities and outcomes into numbers. For example, the number and percentage of new customers or the number and type of customer complaints.
2. Accounted for: i.e., reporting on activities and outcomes and providing a discussion of how and why they occurred as they have. For example, management reports might indicate, we achieved 20% new customers through promising a just-in-time delivery of orders (how) and 80% of complaints related to an inability to meet the JIT timetable because of internal failure of the pull-through system due to lack of a synchronised manufacturing system (why).
3. Held accountable for: where the person or group or team who is counted and accounted for is responsible not just for the accounting but also for the events and circumstances leading to the records. For example, being responsible for failure to meet unrealistic delivery promises to new customers and for failure to institute action such as the purchase of new assets and the training of personnel in order to try and bring the promises to fruition.

Soft accountability is through the recognition of human input and its role in shaping subjective evaluation, stressing human values and higher level goals.

Importance of Rewards

Rewards are required:

- To create a fair system of motivating employees
- To encourage better performance
- To create a pathway for promotions
- To control cost of salaries

Rewards are given in three ways:

- Basic pay
- Performance Related Pay
- Benefits

When setting rewards, the following factors need to be considered:

- Aspect of performance which needs to be measured so strategic objectives are met
- Rewards offered by others in the market
- Compliance with legislation

Wrong signals and inappropriate actions

- Misrepresentation: Window dressing or creative accounting creates a false positive impact on results
- Misinterpretation: Problem in understanding the market
- Short termism: Forgoing long term strategic objectives in favour of the short term(Myopia)
- Measure fixation: Focusing on measures that produce ineffective results
- Tunnel vision: Narrow focus-not looking at the broad picture
- Sub-optimization: Not achieving all the required objectives
- Ossification: Reluctant to adapt to change-focused on old methods
- Gaming : Gaming is dysfunctional behavior.

Accounting and accountability perspectives Accounting and accountability perspectives as the basis of management control may be seen to require:

Hard accountability via financial and quantitative results. There is an ongoing debate as to the most appropriate set of results. For example, what type of budgeting should be used? Are standards and variances too static and should their use be replaced by an increased focus on measures of continuous improvement both internal and external to the business? This hard accountability will require:

� Counting: i.e., converting activities and outcomes into numbers. For example, the number and percentage of new customers or the number and type of customer complaints.

� Accounted for: i.e., reporting on activities and outcomes and providing a discussion of how and why they occurred as they have. For example, management reports might indicate, �we achieved 20% new customers through promising a just-in-time delivery of orders (how) and 80% of complaints related to an inability to meet the JIT timetable because of internal failure of the �pull-through� system due to lack of a synchronised manufacturing system (why).

� Held accountable for: where the person or group or team who is counted and accounted for is responsible not just for the accounting but also for the events and circumstances leading to the records. For example, being responsible for failure to meet unrealistic delivery promises to new customers and for failure to institute action such as the purchase of new assets and the training of personnel in order to try and bring the promises to fruition.

Soft accountability through the recognition of human input and its role in shaping subjective evaluation, stressing human values and higher level goals.

� consider the construction of the �accountable person�. This aims at �self accountability� by employees who will ACT in a way which mirrors their role in the system.

� focus on the use and development of transferable skills such as communication, negotiation and motivation.

The degree of achievement of self-accountability is highly likely to be affected by the reward system. Individuals are likely to be motivated through financial and non-financial rewards such as their remuneration package and job-satisfaction respectively. The development of transferable skills in fostering self-accountability may be aided through a comprehensive training and development programme for all staff. It may also be fostered through the way in which employees are grouped in order to achieve specific business outcomes. For example, the formation of multidisciplinary project teams who will identify with the successful implementation of a specific project on behalf of the organisation. Also the concept of quality circles in a total quality environment where a group of employees are encouraged to discuss problems in the implementation of their range of tasks and ways in which improvement may be achieved.

THE END

DeAr Students

These notes Are very vAluAble for exAm prepArAtion covering All the AreAs of your syllAbus. tfowever it is highly AdvisAble for you to go through the text book for further in-depth knowledge And understAnding.

LAstly do revise the notes before your exAminAtion dAy As it will give you the required confidence regArding your knowledge, understAnding And the coverAge of your syllAbus.

ThAnks & RegArds

RIZWAN MANIYA

INTEGRATED REPORTING

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IR is focused on showing the connectivity of strategic objectives, risk and performance to demonstrate how organizations create value. This means that organizations need to understand and report on all areas of performance and not just focus on short-term financial results.

The following IR Content Elements are particularly relevant to APM:

- **Organisational overview and the external environment**
- **Opportunities and risks**
- **Strategy and resource allocation**
- **Business model**
- **Performance**
- **Future outlook**

Organizational overview and the external environment

What does the organization aim to do? Who are the major stakeholders? Where is it located? How is it structured? What external events will affect if most?

Fairly obviously the organization's mission and objectives, stakeholder analysis, organization chart and a PEST analysis would be relevant to this section of the IR

Opportunities and risks

These must cover both internal and external matters. The traditional SWOT analysis usually categorizes opportunities and threats (risks) as external, but it is essential to also look internally.

Some risks can be quantified (for example, by expected values and sensitivity analysis)

The report should also mention how the risks are being managed and mitigated

Strategy and resource allocation

Does the organization intend to develop new products, set up new factories or expand to new markets?

This section of the IR can make extensive use of Porter's models, BCG matrix

Business model

An organisation's business model is 'its system of transforming inputs, through its business activities, into outputs and outcomes that aims to fulfil the organisation's strategic purposes and create value over the short, medium and long term' (IIRC).

Porter value chain, business process re-engineering, value-based management, activity-based management are also all methods that can influence an organisation's business model.

Performance

This area of IR addresses how an organization has performed against its strategy and what are its key outcomes.

It is also recognizes the importance of reporting on non-financial, qualitative results.

Examples include revenue, cash flow, customer satisfaction, brand loyalty, environmental impacts, etc.

Future outlook

An integrated report should answer the question: What challenges and uncertainties is the organisation likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?

PEST and a five forces analysis are likely to be particularly relevant here.

IR and capital (SIX TYPES)

- Financial capital

  e.g. shares, bonds or banknotes.

- Manufactured capital

  e.g. tools, machines and buildings

- Intellectual capital

  e.g. value of a company or organization's employee knowledge, business training and any proprietary information

- Human capital

  e.g. people's health, knowledge, skills and motivation

- Social and relationship capital

  e.g. Families, communities, businesses, trade unions, schools, and voluntary organizations

- Natural capital

  e.g. land, water, energy and those factors that absorb, neutralize or recycle wastes and processes – e.g. climate regulation, climate change, CO2 emissions