Management Control System (MCS)

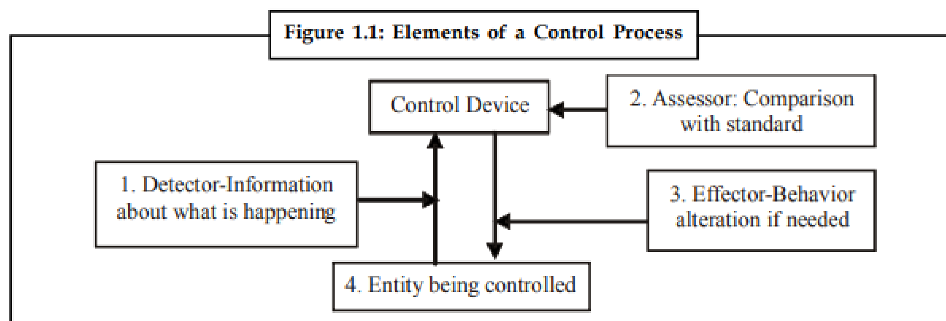
Unit I

Management: An organization consists of a group of people who work together to achieve certain common goals (in a business organization an important goal is to earn a satisfactory profit).
Control: is a function of management that helps to check errors and take corrective actions. This is done to minimize deviation from standards and ensure that the stated goals of the organization are achieved in a desired manner

Every control system has at least four elements:

- *A detector or sensor* – a device that measures what is actually happening in the situation being controlled.
- *An assessor* i.e. a device for determining the significance of what is happening i.e. comparison with some standard or expectation.
- *An effectors* i.e. a device that alters behavior if the assessor indicates the need. This device is often called "feedback."
- *A communication network*, i.e. devices that transmit information between the detector and the assessor and between the assessor and the effectors.

These four basic elements of any control system:



System: A system is a prescribed way of carrying out an activity or set of activities, usually the activities are repeated. A system is characterized by more or less rhythmic, recurring; co-ordinate series of steps that are intended to accomplish a specific purpose.

Definition and Meaning of MCS:

A management control system (MCS) is a framework of processes and procedures that an organization uses to ensure its strategies and objectives are being effectively implemented and accomplished. It involves collecting and interpreting information to assess performance and guide decision-making.

MCS means the methods put in place to make sure the actual company performance is on track with the company goals for the period.

Characteristics of Management Control Systems:

(i) Management control systems should be closely aligned to an organization’s strategies and goals.

(ii) Management control systems should be designed to fit the organization’s structure and the decision-making responsibility of individual managers.

(iii) Effective management control systems should motivate managers and employees to exert efforts toward attaining organization goals through a variety of rewards tied to the achievement of those goals.

Purpose of Management Control System:

- **Goal Alignment:** MCS helps to coordinate the organization's activities with its strategic goals and objectives. It ensures that all departments and individuals are working towards common goals, which is essential for achieving long-term success.
- **Decision-Making Support:** MCS provides timely and accurate information to management, which supports in making right decisions. It helps in allocating resources effectively, identifying areas of defects and make corrective decision making for optimizing the business processes.
- **Resource Optimization:** MCS helps optimize the allocation of resources, such as finances, human capital, and technology. By monitoring resource utilization, an organization can identify inefficiencies and allocate resources where they are needed most.
- **Strategic Planning:** MCS supports strategic planning by providing data and insights that inform the development of strategic goals and the allocation of resources to achieve those goals.
- **Performance Evaluation:** MCS provides a mechanism for evaluating the performance of different parts of the organization, including departments, teams, and individuals. This evaluation helps identify areas of excellence and areas that require improvement.

Factors influencing the design of Management Control Systems are as follows:

(i) Size and Spread of the Enterprise:

The size and spread of a large firm is bound to be different compared with that of a small firm. This would certainly determine the content and nature of the control system for each organization.

(ii) Organizational Structure, Delegation and Decentralization:

Statutes and conventions govern organizational structure, and the extent of decentralization and delegation in all enterprises.

(iii) Nature of Operations and Divisibility:

Nature of operations and their divisibility affect management control systems.

(iv) Type`s of Responsibility Centre's:

Different control systems are needed for the various responsibility centres or sub-systems within an organization. Whether the performance of a responsibility centre should be measured in terms of expenses or profitability or return on investment depends on the type of responsibility centre.

(v) People and their Perceptions:

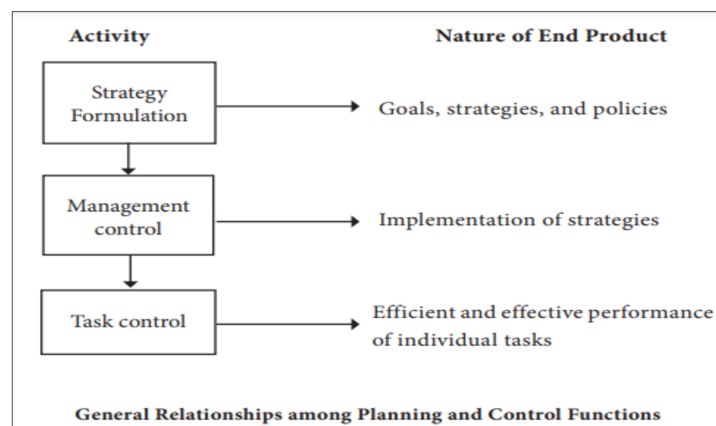
Perceptions of people in the organization about the likely effects of the control system on their work life, job satisfaction, job security, promotion and general well-being could differ across organizations.

<u>Boundaries of Management Control</u>

Management control is distinguished from two other systems or activities that also require both- Planning and control: strategy formulation and task control.

. Strategy formulation is the least systematic of the three, task control is the most systematic, and management control lies in between.

Strategy formulation focuses on the long run, task control focuses on short run activities, and management control is in between.



General Relationships among Planning and Control Functions

The planning process is much more important in strategy formulation, the control process is much more important in task control, and planning and control are of approximately equal importance in management control.

1. **Management Control**

Management control is the process by which managers influence other members of the organization to implement the organization's strategies.

i. Management Control Activities- Management control involves a variety of activities including

- Planning what the organization should do
- Coordinating the activities of several parts of the organization
- Communicating information

- Evaluating information
- Deciding what, if any, action should be taken
- Influencing people to change their behavior

ii. Conforming to a budget is not necessarily good, and departure from a budget is not necessarily bad.

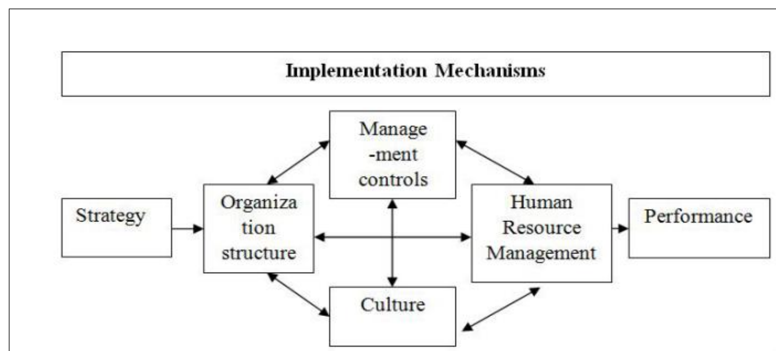
Budgets or plans are based on circumstances believed to exist at the time they were formulated. If these circumstances have changed at the time of implementation, the actions dictated by the plan may no longer be appropriate. If a manager discovers a better approach – one more likely than the predetermined plan to achieve the organization's goals – the management control systems should not obstruct its implementation.

iii. Goal Congruence

Organizational goals explain how an organization intends to go about achieving its mission. Goal congruence means the goals of an organization's individual members should be consistent with the goals of the organization itself.

iv. Tool for Implementing Strategy

Management control systems help managers move an organization toward its strategic objectives. Therefore, management control focuses primarily on strategy execution.



a) **Organizational structure**:

An organizational structure is a mostly hierarchical concept of subordination of entities that collaborate and contribute to serve one common aim. Organizational structure allows the expressed allocation of responsibilities for different functions and processes to different entities. Ordinary description of such entities is as branch, site, department, work groups and single people.

b) **Human Resource Management (HRM):**

Human Resource Management is the strategic and coherent approach to the management of an organization's most valued assets - the people working there who individually and collectively contribute to the achievement of the objectives of the business

HRM is the selection, training, evaluation, promotion, and termination of employees so as to develop the knowledge and skills required to execute organizational strategy.

c) Organizational Culture:

Organizational culture is defined as the underlying beliefs, assumptions, values and ways of interacting that contribute to the unique social and psychological environment of an organization

Organizational culture includes an organization's expectations, experiences, philosophy, as well as the values that guide member behavior, and is expressed in member self-image, inner workings, interactions with the outside world, and future expectations.

Culture is based on shared attitudes, beliefs, customs, and written and unwritten rules that have been developed over time and are considered valid

d) Organizational climate

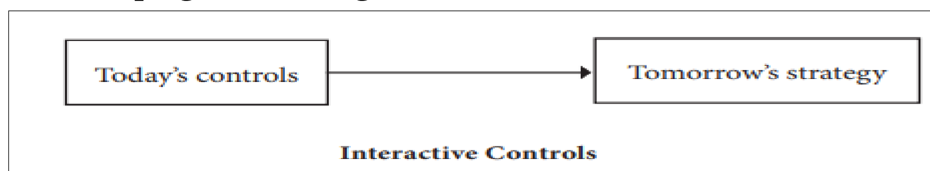
Organizational climate, defined as the recurring patterns of behavior, attitudes and feelings that characterize life in the organization, while an organization culture tends to be deep and stable. Positive relationships between positive organizational climates and various measures of organizational success, most notably for metrics such as sales, staff retention, productivity, customer satisfaction, and profitability

v. Financial and Non-financial Emphasis

Management control systems encompass both:- Financial and Non-Financial Performance Measures.

The financial measures are focused on the Monetary "Bottom Line" – net income, return on equity, etc. and Non Financial objectives – product quality, market share, customer satisfaction, on-time delivery, and employee morale.

vi. Aid in Developing New Strategies



In industries that are subject to rapid environmental changes, management control systems can also provide the basis for considering new strategies.

This function, referred to as interactive control, draws management's attention to both positive and negative developments – that indicate the need for new strategic initiatives. Interactive controls are an integral part of the management control system

2. Strategy Planning & Formulation

- **Meaning of Strategic Planning:**

Is an organization's process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy, including its capital and people

- **Meaning of Strategic Plan:**

To determine where it is going, the organization needs to know exactly where it stands, then determine where it wants to go and how it will get there.

- **Meaning of Strategy Formulation:**

It's the process of deciding on the goals of the organization and the strategies for attaining these goals.

- **Meaning of Goals:**

Describe the broad overall aims of an organization and objectives describe specific steps to accomplish the goals within a given time frame.

Various business analysis techniques can be used in strategic planning, including;

- SWOT analysis (Strengths, Weaknesses, Opportunities, and Threats)
- PEST analysis (Political, Economic, Social, and Technological analysis)
- STEER analysis involving Socio-cultural, Technological, Economic, Ecological, and Regulatory factors
- EPISTEL (Environment, Political, Informatics, Social, Technological, Economic and Legal)

All strategic planning deals with at least one of three key questions: Today's controls Tomorrow's strategy *1. "What do we do?"*

2. "For whom do we do it?"

3. "How do we excel?"

Threat (e.g., a shift in customer tastes, or new government regulations, or market inroads by competitors)

Opportunity (e.g., technological innovations, new perceptions of customer behavior, or the development of new applications for existing products)

3. Task Control

Task Control is the process of ensuring that specified tasks are carried out effectively and efficiently. It is transaction-oriented i.e., it involves the performance of individual tasks according to rules established in the management control process.

<u>The Four Paradigms of Control</u>

"Paradigms" refer to the dominant models, beliefs, or conceptual frameworks that influence how control systems are designed, implemented, and understood within organizations.

The Four Paradigms are:-

- Adaptability,
- Integration across organization,
- Optimal mix of control and coordination,
- Reinforcing cooperative instincts

1. **First Paradigms:**

A control system enables organizations to adapt themselves according to external environmental factors, according to their goals and objectives to be achieved. An adaptation leads to the success of an organization along with their competitors, by implementing best strategies and instruments of control to achieve.

2. **Second Paradigms:**

Describes the Span of Control-

Corporate Governance (Strategic Control) At board Level
Management Control at Senior Level
Process (Operational Control) at Supervisory Level
Task or Transaction Control at the Grass-Root Level

- The behavior of top level is described as corporate governance,
- Senior levels as management controls,
- Supervisory levels as process or operational controls and
- Grass root level as task controls.

3. **Third Paradigms:**

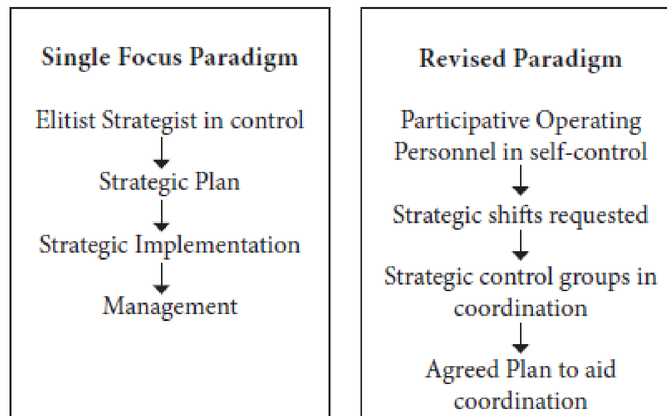
It deals with coordinating control systems with self-control and designing and implementing systems for controlling the not-so-sincere people. There is a traditional and modern approach to it.

The Single and Dual Approach

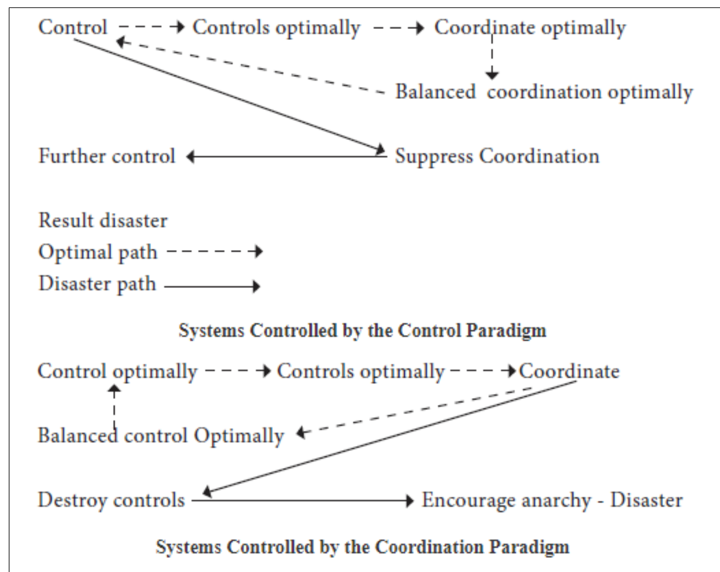
Single focus is on the manner in which leaders could control the not-so-sincere people and systems.

Dual focus is emerging in which it incorporates the need to encourage and build self-control in organizations.

The diagram shows two alternative paths for control- the single focus and the dual or multiple focuses. The image of the autocrat and policeman in the earlier focus and the emerging trends of empowerment in the altered paradigm of control systems have been invoked here.



The New Paradigm of Dual Focus in Control Systems

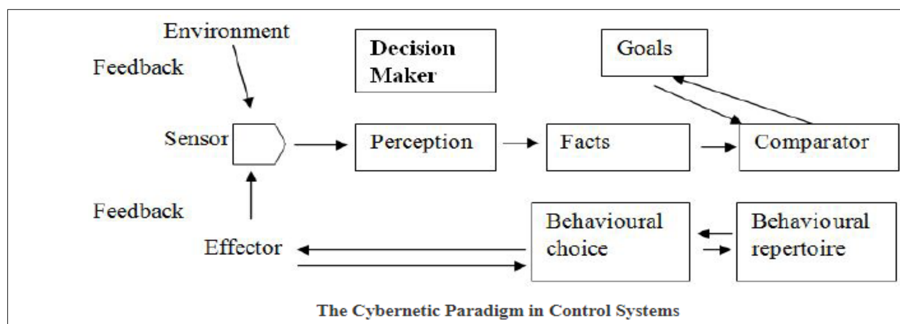


Systems Controlled by the Control Paradigm

Systems Controlled by the Coordination Paradigm

4. **Forth Paradigms:**

Simons makes very heroic assumptions about human beings that they want to contribute, achieve, innovate and work competently even if they do not have specific external inducements to be so. Systems designers for controls need, however, make sure that there are no organizational blocks to dissuade them to the contrary.



The Cybernetic Paradigm in Control Systems

Twelve Commandment Principles and Guidelines of Control Design Management:

1. **Suitability:**

The control system should be appropriate to the needs, kind of activity and circumstances of an enterprise. Control is executed through managerial position. The flow of information concerning current performance should correspond with the organizational structure employed.

2. **Simplicity:**

To be effective, control system must be clear, easy to understand and operate. Unless the control system is understood properly by those responsible for its implementation it cannot succeed. A complex system will not only create hurdles in the performance of activities, but it will also not bring the results expected of it.

3. **Objectivity:**

The fixation of standards, measurement of performance and corrective action must be objective and impersonal. Subjective and arbitrary control cannot be effective. It is essential that the standards to judge the actual performance are clear, definite and stated in numerical terms.

4. **Economical:**

The systems of control must be worth their costs. They must justify the expenses involved. The cost of control system should not exceed the possible savings from its use. Therefore, becomes essential to concentrate the control system on factors which are important to keep the costs down and make the system economical.

5. **Flexibility:**

The system of control must be flexible, i.e., workable even if the plans have to be changed. A good control system must keep pace with the continuously changing pattern of a dynamic business world. Control system should be flexible so that it can be adjusted to any modification or alteration in a plan.

6. **Quick Reporting:**

Time is an important element in enforcing a control system. Subordinates should inform their superiors quickly with actual results and all deviations from standards. Delays in reporting of information will make control ineffective.

7. **Suggestive:**

A control system should not only measure performance and detect deviations; it should suggest remedial measures as well. In other words, good control system should be self-correcting.

8. **Forward-Looking:**

The control system should be directed towards future. In fact, the control system can at times be so devised as to anticipate possible deviations or problems. It should be preventive and not merely corrective Ideal control is spontaneous.

9. **Individual Responsibility:**

Control can be effective when it focuses on individuals rather than on jobs or works.

10. **Strategic Point Control:**

All deviations from standards are not of equal importance. Hence, to control all deviations is not desirable. Therefore, the control system should focus on key, critical or strategic points which require management attention. Effective and Efficient control is control by exception. Uncontrollable deviations need not be given much care and thought.

11. **Self-Control:**

Different departments may be asked to control themselves. If a department can have its own control system, much of the detailed controls can be handled within the department. These sub-systems of self control can then be tied together for an overall control system.

12. **Feedback:**

It means information on previous performance. For effective control, regular flow of information regarding the actual performance is necessary. Feedback can be supplied through personal contact, observation or reports. Automatic feedback assists in taking corrective action at the right time or in adjusting future operations.

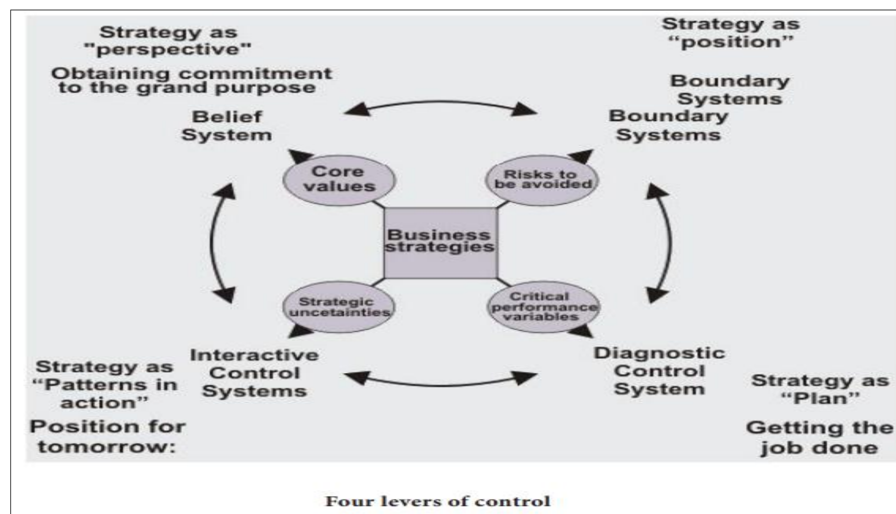
The Four Levers of Control

"Levers of control: How Managers use innovative control systems to drive strategic renewal" (1995) Robert Simons introduced the four levers of control framework, giving managers in large companies a framework to manage the tension between (value) creation and control (managing and measuring value).

R. Simons of the Harvard Business School calls it – the four levers of control. Within the company, mechanisms exist to ensure that four things happen effectively:

- Obtaining commitment to the purpose of the company
- Staking out the territory
- Getting the job done
- Positioning for tomorrow

For each aspect there is a lever of control to ensure it *"Stays on track"*



Four levers of control

The Four Levers of Control are

1. Core values (controlled by Belief systems, such as mission statements, vision statements, credos and statements of purpose)
2. Risks to be avoided (controlled by Boundary Systems, such as Codes of conduct, predefined strategic planning methods, asset acquisition regulations, operational guidelines)
3. Strategic Uncertainties (controlled by Interactive Control Systems, such as incorporating process data into management interaction, face to face meetings with employees, challenging data, assumptions and action plans of subordinates)
4. Critical Performance Variables (controlled by Diagnostic Control Systems, such as output measurement, valuation standards, incentive systems and compensation systems).

Administration and Organization

Meaning of Administration:

The administration is a systematic process of forecasting, planning, organizing and decision-making functions at the highest level of the enterprise. The main function of administration is the formation of plans, policies, and procedures, setting up of goals and objectives, enforcing rules and regulations, etc.

Meaning of Organization:

According to Louis Allen, "Organization is the process of identifying and grouping work to be performed, defining and delegating responsibility and authority and establishing relationships for the purpose of enabling people to work most effectively together in accomplishing objectives."

Difference between Administration and Organization

	Administration	Organization
Definition	It refers to the process of managing and coordinating the resources, people, and activities within an organization to achieve specific goals and objectives.	This term has a broader meaning and can refer to the structure or arrangement of components within a system.
Focus	It deals with day-to-day operations, resource allocation, and ensuring that the organization's goals are met.	Refers to the overall structure of the entity, including its hierarchy, departments, and the way tasks and responsibilities are distributed among its members.
Role	Encompasses the individuals or departments responsible for carrying out the plans and policies established by the organization's leaders.	Describes the broader framework and structure of the entity, including its mission, vision, and the arrangement of various elements to achieve specific objectives
Scope	Typically deals with the operational aspects of an organization, ensuring that day-to-day tasks are performed efficiently and in accordance with established policies.	Encompasses the entire entity, including its purpose, structure, culture, and the coordination of resources to achieve long-term goals.
Time Frame	Often focuses on short-term goals and immediate tasks necessary for the organization's smooth functioning.	Involves long-term planning and the establishment of a framework that supports the organization's sustainability and growth over time.

Role of MCS in Organization:

Control is like planning, organizing, staffing and directing. It is an important function because it helps to check the errors and to take the corrective action so that divergence from standards are minimized and stated goals of the organization are achieved in desired manner. An effective organization is one where managers understand how to manage and control.

Management control is the process of assigning, evaluating, and regulating resources on an ongoing basis to accomplish an organization's goals. To successfully control an organization, managers need to not only know what the performance standards are, but also figure out how to share that information with employees.

Some features of controlling are:

- It helps in achieving organizational goals.
- Facilitates optimum utilization of resources.
- It evaluates the accuracy of the standard.
- It also sets discipline and order.
- Motivates the employees and enhances employee morale.
- Ensures future planning by revising standards.
- Improves overall performance of a firm.
- It also minimizes errors.

Some common controls which are essential in each organization:

- **Financial Controls:** The three most important financial controls are:

(1) The balance sheet
(2) The income statement (sometimes called a profit and loss statement)
(3) The cash flow statement. And another most important is financial budgeting

- **Marketing Controls**: Some most common marketing controls are

(1) Sales analysis,
(2)Quality controls
(3) Marketing budget
(4) Ratio analysis
(5) Marketing research, sales forecasting
(6) Customer feedback.

- **Operational Controls**:

There are three major groups of activities performed by operations management, deriving from its planning or designing, organizing, and supervising functions. All activities involve considering assets, costs, and human resources, and are preceded by a thorough analysis of processes.

Some common operational controls are
(1) Inventory stock taking
(2) Route tracking
(3) Goods in process
(4) Production line control
(6) Quality controls.

- **Human Resource Controls:**

Human resource management function involves the recruitment, placement, evaluation, compensation, and development of the employees of an organization.

Some common HR controls are:

(1) Performance Appraisals

(2) Disciplinary policies such as timing maintenance, behavioral code of conduct etc

(3) Training & Development control (whether training has been absorbed and after training job appraisal) etc.

- **Information Technology Controls:**

IT general controls (ITGC) are controls that apply to all systems, components, processes, and data for a given organization or information technology (IT) environment.

(1) System and data backup and recovery controls

(2) Computer operation controls

(3) Data governance & audit are some of the common IT controls in organizations.

Organizational Structure:

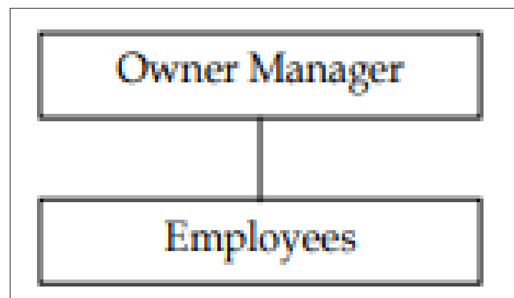
An organizational structure is a system that outlines how certain activities are directed in order to achieve the goals of an organization.

The Various structures of an organization are:

- Entrepreneurial Structure
- Functional Structure
- Business Unit Organization Structure
- Matrix Structure

1. Entrepreneurial Structure

The entrepreneurial structure is the most elementary form of structure and is appropriate for an organization that is owned and managed by one person. The owner manager looks after all decisions, whether they are day-to-day operational matters or strategic in nature.



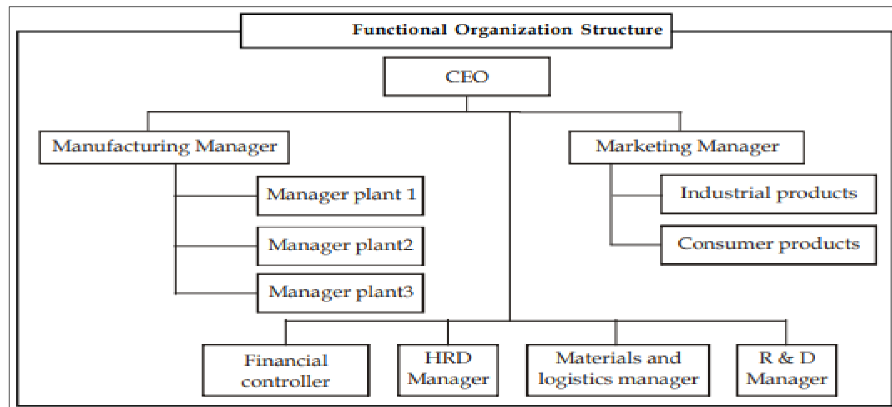
2. Functional Structure

A functional organization tends to bring together people with similar skills and interests and these groups are more congenial and more likely to recognize individual's skill. The functional form of organization involves the notion of a manager who brings specialized knowledge to bear on decisions related to a specific function as contrast to general purpose manager who lacks that specialized knowledge.

The management control process in a functional organization works as follows:

- The senior managers are responsible for developing the company's overall strategy to compete, in its chosen industry as well as its functional strategies in such areas as research and development, manufacturing and marketing.

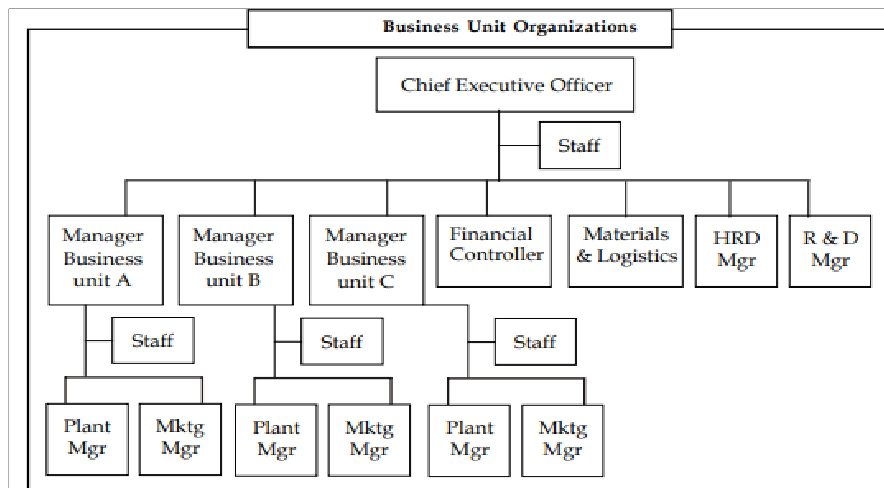
- The plans for the organization as a whole must be made at the very top (CEO's level) because these plans necessarily involves co-ordination of all the functions that contribute to the final output.
- The strategic plan/long term planning involves only senior executives and a planning staff. In a very small organization the process may involve only CEO assisted by the controller.
- The operating budget shows the details of revenues and expenses for the budget year for each responsibility area and for the organization as a whole.



3. **Business Unit Organization Structure**

The business unit form of organization is designed to solve problem inherent in its functional organization. A business unit also called a division is responsible for all its functions involved in producing and marketing a specified product line or group of product lines.

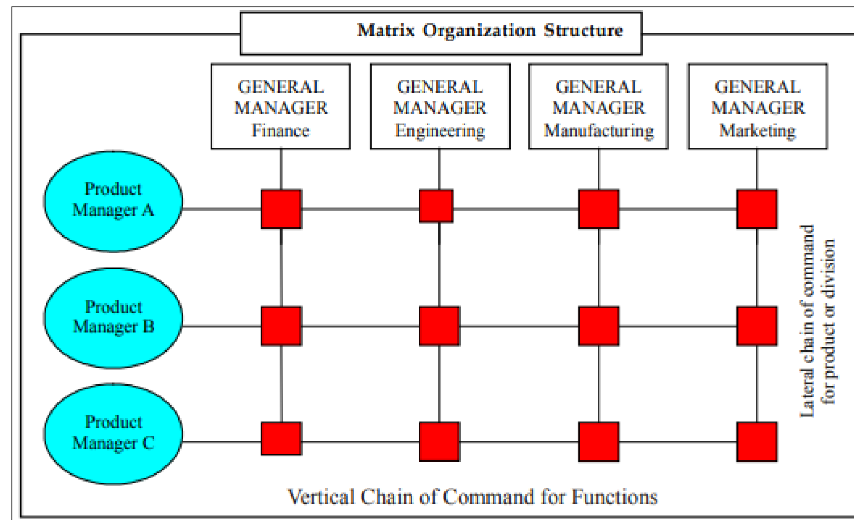
They are responsible for planning and co-coordinating the work of the separate functions – ensuring that the plans of the marketing department are consistent with production capabilities – and for resolving the disputes that arise between these functions.



4. Matrix Structure

In large organization, there is often a need to work on major products or projects, each of which is strategically significant, hence the requirement of a matrix type of organization structure. Structure is created by assigning functional specialists to work on a special project or a new product or service.

For the duration of the project, the specialist from different areas forms a group or team and report to the team leader. Once the project is completed the team members revert to their parent departments.



Management Control Process:

Controlling function of management can be defined as comparison of actual performance with the planned performance. If there is any difference or deviation then finding the reasons for such difference and taking corrective measures or action to stop those reasons so that future thee is match between actual and planned performance.

The meaning of controlling makes it clear that controlling function is undertaken for right and timely implementation of plans.

1. Establishing goals and standards

The task of fixing goals and standards takes place while planning but it plays a big role in controlling also. This is because the main aim of controlling is to direct a business's actions towards its goals. If the members of an organization know their goals clearly, they will invest their entire focus in achieving them.

2. Measuring actual performance against goals and standards

This step basically helps them in knowing whether their plans are working as intended. After implementing a plan, managers have to constantly monitor and evaluate them. They must always be ready to take corrective measures if things are not working properly.

3. Taking corrective action

In case there are deviation between actual performances and goals, managers need to take corrective actions immediately. Timely corrective actions can reduce losses as well as prevent them from arising in the future again.

4. Following up on corrective action

Just taking corrective measures is not enough; managers must also take them to their logical conclusion. Even this step requires thorough evaluations and comparisons. Managers should stick to the problem until they solve it

Strategic Planning:

Strategic planning is a systematic process that organizations use to define their direction and make decisions on allocating their resources to pursue this direction. It involves setting goals, determining actions to achieve those goals, and mobilizing resources to execute the actions.

Strategic planning with MCS:

1. **Setting Strategic Objectives:**

Strategic planning involves defining the long-term goals and objectives of an organization. These objectives provide a clear direction for the organization and serve as a basis for developing the management control system.

2. **Aligning Control Mechanisms with Strategy:**

Once strategic objectives are established, the management control system is designed to align with these goals. This includes setting performance metrics, key performance indicators (KPIs), and other control mechanisms that are directly linked to the strategic objectives.

3. **Performance Measurement and Monitoring:**

Strategic planning defines the performance metrics that are critical for assessing progress toward strategic goals. The management control system incorporates these metrics to monitor performance at various levels of the organization.

4. **Feedback and Adaptation:**

Strategic planning process involves regular reviews and adjustments. The management control system provides feedback on performance, enabling the organization to adapt its strategies and plans as needed to stay on course or respond to changes in the business environment.

5. **Resource Allocation:**

Strategic planning identifies the resources required to achieve strategic objectives. The management control system helps in allocating these resources efficiently, ensuring that they are deployed in a manner that maximizes their impact on strategic goals.

6. **Risk Management:**
Strategic planning involves assessing and managing risks that could impact the achievement of objectives. The management control system incorporates risk management mechanisms to identify, assess, and mitigate risks that may arise during the implementation of strategic plans.
7. **Communication and Coordination:**
Strategic plans often involve multiple departments and teams. The management control system facilitates communication and coordination by ensuring that everyone is aware of the strategic objectives and the role they play in achieving them.

8. **Performance Evaluation and Incentives:**
The management control system plays a key role in evaluating individual and organizational performance. Performance evaluations are often tied to incentives, and these incentives should be aligned with the achievement of strategic objectives to motivate employees and teams.

Organizational Goals:

Organizational goals are the specific outcomes that an organization aims to achieve over a defined period. These goals are the result of the organization's strategic planning process and reflect the overall purpose and direction of the organization.

Organizational goals provide a roadmap for decision-making, resource allocation, and the measurement of success. They are typically derived from the organization's mission and vision and are set at different levels, including the overall organizational level, departmental level, and sometimes individual level.

Types of organizational goals: There are three main types of organizational goals:

1. Strategic goals
These are goals -- often big picture, qualitative, long-term goals -- an organization aims to achieve. They may also be referred to as strategic goals. Strategic goals detail a company's objectives as described in its mission statement or in public statements, such as a corporate charter or annual reports

2. Tactical goals
These are smaller picture, qualitative goals -- often with a quantitative element -- that focus on transforming official goals into operational goals. These are team goals. Tactical goals bridge the gap between strategic and operative goals. They help connect measurable everyday business processes to the big picture goals outlined in a company's strategic plan.

3. Operative goals
Operative goals are often short-term goals or individual goals that the organizations seek to achieve through their operating policies and undertakings and are measured quantitatively and this also includes: employee and management performance, productivity, profitability, innovation, market share and social responsibility goals.

Steps for Setting Organizational Goals:

1. Assess the state of the business. To examine the current state of the business changes due to uncertain external factors such as industry trends, external factors analyzed through SWOT and PESTLE analyzes.

A SWOT analysis can help identify a company's -- or team within the company -- strengths, weaknesses, opportunities and threats.

A PESTLE (political, economic, social, technological, legal, environmental factors) analysis can be useful for accounting for external factors.

2. Establish each goal. Brainstorm goals and choose those goals that capitalize on opportunities for growth and decide how the business or team wants to use this information to improve it-self.

3. Prioritize goals. Establish a time frame and delegate the goals to different teams or team members based on responsibility and ranking. Consider external factors when determining goal deadlines.

4. Establish measurement metrics Determine how the progress of goals will be measured. Some goals may more readily lend themselves to quantitative measurement. Set tangible benchmarks that teams can reach.

5. Integrate goals with processes. Incorporate the goals into the team's or business's way of working and develop methods to achieve them.

6. Communicate goals to those involved. Share the goals with others who weren't immediately involved in devising the goals and look for ways that different teams can work together to reach goals. Make goals visible and communicate them in a clear and concise fashion.

7. Evaluate progress. As time goes by and progress is made or circumstances change, evaluate progress using predefined metrics, and revise goals and optimize processes if appropriate. Encourage feedback to help assess goals and team performance.

6 Sources of Tension in Control System:

Simons lists the six tensions of management control systems. These can be grouped into three categories A, B, and C. They are:

A. Tensions arising due to the Need to make Strategic Choices
1. The tension between profit, growth and control
2. The tension between long-term and short-term needs

B. Tensions due to Goal Divergence among Stakeholders and the Efforts needed to imaginatively establish Goal Congruence.
1. The tension between the several stakeholders all of whom want a bigger share of the pie. Organizations must seem to benefit all those who have a stake in it. Conflict of interest is built into this situation.
2. The tension between the varying and often conflicting motivation of the employees.

3. The tension between different professional aspirations, propensities and functional skills of the different segments of an organization.

C. Tensions due to Limitations Managerial of Cognitive Powers.
1. The tension between the need and desire to seek opportunities and the constraint due to limitation of the span of attention

A. Tensions arising due to the Need to make Strategic Choices

1. Profit, Growth and Control:

Some companies see growth and market share as the ultimate end of their control systems. Growth can be stimulated by heavy advertisements and abnormally low pricing which may be less than the variable costs.

Example- **Jio** Increased Growth and Market share via heavy advertising and low pricing. Controls must be set in place, to ensure long term sustainability.

2. Conflicts between Long Term and Short Term Goals

Short Term	Long Term
Methods of measurement of performance are simpler.	Methods of measurement of performance are extremely uncertain and difficult.
Strongly governed by financial output based on temporary results.	Focused on financial output but mostly on permanent/long lasting results.
Less creativity and more process involved.	More creativity along with a specific process.
Focused on Results.	Focused on Innovation and overall good.
Rewarding employees regularly.	More tuned to long-term achievement.

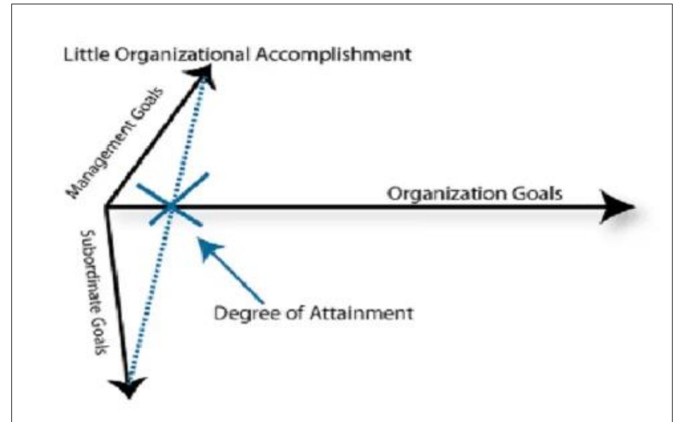
The methods of measurement of performance regarding short term goals are simpler and may be strongly governed by financial results. Long term projections also rely on financial projections, but evaluation and monitoring of present performance from the point of long term benefits, is an extremely uncertain and difficult task.

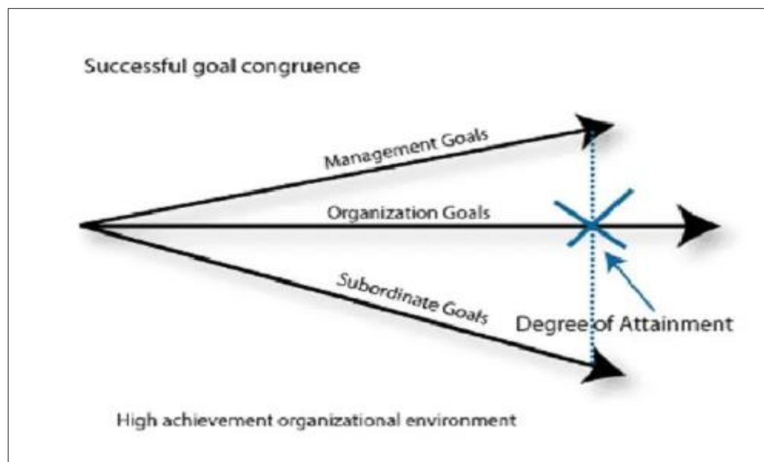
B. Tensions due to Goal Divergence among Stakeholders and the Efforts needed to imaginatively establish Goal Congruence.

Meaning of Goal Congruence:

Goal Congruence means consistency or agreement of actions with organizational goals. It identifies the managerial principle that all of a firm's sub goals must be congruent to achieve one central set of objectives.

Integration of goals and effectiveness when team building





3. **Conflict Among Stakeholders**

Several group of stakeholders work together in order to the success of the organization. Working together also inevitably results in conflict on interests between them and a clash of their perceptions during acceptable risk taking. Control systems will have to take all this into consideration.

4. **Complexities of Employee motivation**

All organizations need highly motivated employees so that they work at their maximum potential. Employee motivation is complex because employees differ in their own personalities and they are motivated by different factors. The managers must be aware that employee motivation theories are only guides and they must use their own information to motivate employees and achieve goals

5. **Inter-Departmental Conflicts and Politics of Control Systems**

Different organizations need varied types of skills and knowledge to work in departments, teams, or task groups.

Most companies required geographical spread. This inevitably results in conflicts between different groups. This is a major control problem in most large organizations and gives rise to politics of control systems

Span of Control

Span of control is a term originating in military organization theory, but now used more commonly in business management, particularly human resource management. Span of control refers to the number of subordinates a supervisor has.

Factors Considerable deciding span of Control: These are the factors affecting span of control:

1. **Geographical dispersion;** if the branches of a business are widely dispersed, then the manager will find it difficult to supervise each of them; as such the span of control will be smaller.
2. **Capability of employees;** if employees are highly capable, need little supervision, and can be left on their own, e.g., Theory Y type of people, they need not be supervised closely as they are motivated and take initiative to work; as such, the span of control may be broader.
3. **Capability of managers;** an experienced manager with good understanding of the tasks, good knowledge of the workers and good relationships with the workers, will be able to supervise more workers
4. **Similarity of task;** if the tasks that the subordinates are performing are similar, then the span of control can be wider, as the manager can supervise them all at the same time.
5. **Volume of other tasks**; if the manager has other responsibilities, such as membership of committees, involvement in other projects, liaising (exchange information) with stakeholders, the number of direct reports will need to be smaller
6. **Business process;** streamlining, effectiveness, and efficiency can reduce the span of control.

Management by Objectives (MBO):

Management by Objectives (MBO) is a strategic approach to enhance the performance of an organization. It is a process where the goals of the organization are defined and conveyed by the management to the members of the organization with the intention to achieve each objective.

Steps in Management by Objectives Process

1. Define organization goals

Setting objectives is not only critical to the success of any company, but it also serves a variety of purposes. It needs to include several different types of managers in setting goals. The objectives set by the supervisors are provisional, based on an interpretation and evaluation of what the company can and should achieve within a specified time.

2. Define employee objectives

Once the employees are briefed about the general objectives, plan, and the strategies to follow, the managers can start working with their subordinates on establishing their personal objectives. This will be a one-on-one discussion where the subordinates will let the managers know about their targets and which goals they can accomplish within a specific time and with what resources.

3. Continuous monitoring performance and progress

Though the management by objectives approach is necessary for increasing the effectiveness of managers, it is equally essential for monitoring the performance and progress of each employee in the organization.

4. Performance evaluation

Within the MBO framework, the performance review is achieved by the participation of the managers concerned.

5. Providing feedback

In the management by objectives approach, the most essential step is the continuous feedback on the results and objectives, as it enables the employees to track and make corrections to their actions. The ongoing feedback is complemented by frequent formal evaluation meetings in which superiors and subordinates may discuss progress towards objectives, leading to more feedback.

6. Performance appraisal

Performance reviews are a routine review of the success of employees within MBO organizations.

Management by Exception (MBE)

Definition: Management by Exception shortly called as MBE is a management style or philosophy that empowers the manager to concentrate on the exceptionally important or critical matters and taking important decisions while facilitating the front line workers to complete the day to day activities. It aims at keeping the focus of the management on extremely important tasks and problems or areas in need of action.

Components of Management by Exception

The six fundamental components of Management by Exception are:

1. **Measurement**: Assignment of values to the past and present performances, so as to easily recognize an exception.
2. **Projection**: Forecasts that measurement which is relevant to the organizational objectives and extends the same, to future expectations.
3. **Selection**: Determines the parameters used by the management to pursue organizational objectives.
4. **Observation**: Measurement of existing performance so that the managers are having the knowledge of the existing state of affairs of the organization.
5. **Comparison**: Compare the actual and planned performance and indicating the exception which needs managerial action and reports the variances.
6. **Decision Making**: Prescription of the course of action which needs to be taken so as to ensure that the performance is back in control or to adjust expectations, which represents the changing conditions.

Process of Management by Exception

The steps involved in the process of Management by Exception (MBE), are listed as under:

- Identifying and describing Key Result Areas (KRA).
- Establishing standards and determining an acceptable level of deviations.
- Making Comparison of actual result with that of the expected or the standard result.
- Ascertaining variance.
- Analyzing the causes of such variance (deviation).
- Strategizing and taking necessary actions wherever required and possible.

Importance of Management by Exception

The importances of management by exception are:

- Prompt decision making and a suitable flow of action.
- Assists the firm in growing and improving its output.
- Optimum utilization of the organization’s resources.
- Better delegation of authority
- Identification of crises
- Enhances degree of communication

Strategic Business Unit (SBU)

SBU or Strategic Business Unit is an individual unit that operates on its own and has its own vision about the business strategies. It is a fully functional unit and operates separately in a company but it still is one of the most important units of the company.

Characteristics of Strategic Business Unit (SBU)

1. Separate Mission and Objectives: Every SBU has its vision and missions for which it works. Their objective is to achieve those missions and contribute towards the entity's business.

2. Group of Related Businesses: SBU can have either a single business or a collection of related businesses so that independent planning can be done.

3. Own Set of Competitors: Every Individual SBU has its own set of competitors for which different strategies and goals are formulated.

360 degree Technique:

360-degree feedback is a process that allows an employee to understand their strengths and weaknesses. In this feedback system, the employer and other staff members, like co-workers, peers, subordinates, and people who share the same work environment, provide feedback to an employee.

The process of 360 degree takes place:

1. An administrator invites 6-10 entities to complete an anonymous online feedback form.
2. Employees are also given self-evaluation forms to judge their performance.
3. The reviewers' responses turned into a report presented during the 360-degree feedback.
4. Using this report, the employee and reviewers discuss the former's performance. They also suggest ways to increase their efficiency and productivity.
5. A follow-up plan is set to monitor the employee's performance in the long run.

Advantages and Disadvantages:

Advantages of 360-Degree Appraisal Feedback
It provides feedback to the employees from different sources, which helps them understand how others perceive them as a part of the organization
The employee gets to understand their strengths and weaknesses. It also gives them clarity on the role they play in the organization

Disadvantages of 360-Degree Appraisal and Feedback
It can cause misunderstanding or conflicts in the organization if a process is implemented and executed hastily
The review process focuses on the weaknesses and shortcomings of the candidate and side-lines their strengths

SWOT Analysis:

What Is SWOT Analysis?

A SWOT analysis is designed to facilitate a realistic, fact-based, data-driven look at the strengths and weaknesses of an organization, initiatives, or within its industry.

Components of SWOT Analysis

- **Strengths**

Strengths describe what an organization excels at and what separates it from the competition: a strong brand, loyal customer base, a strong balance sheet, unique technology, and so on

- **Weaknesses**

Weaknesses stop an organization from performing at its optimum level. They are areas where the business needs to improve to remain competitive: a weak brand, higher-than-average turnover, high levels of debt, an inadequate supply chain, or lack of capital.

- **Opportunities**

Opportunities refer to favorable external factors that could give an organization a competitive advantage.

- **Threats**

Threats refer to factors that have the potential to harm an organization.

SWOT analysis will involve the following steps.

Step 1: Determine Your Objective

A SWOT analysis can be broad, though more value will likely be generated if the analysis is pointed directly at an objective.

Step 2: Gather Resources

Every SWOT analysis will vary, and a company may need different data sets to support pulling together different SWOT analysis tables. A company should begin by understanding what information it has access to, what data limitations it faces, and how reliable its external data sources are.

Step 3: Compile Ideas

For each of the four components of the SWOT analysis, the group of people assigned to performing the analysis should begin listing ideas within each category.

Internal Factors

What occurs within the company serves as a great source of information for the strengths and weaknesses categories of the SWOT analysis.

Potential questions to list internal factors are:

- (Strength) What are we doing well?
- (Strength) What is our strongest asset?
- (Weakness) What are our detractors?
- (Weakness) What are our lowest-performing product lines?

External Factors

What happens outside of the company is equally as important to the success of a company as internal factors.

Potential questions to list external factors are:

- (Opportunity) What trends are evident in the marketplace?
- (Opportunity) What demographics are we not targeting?
- (Threat) How many competitors exist, and what is their market share?
- (Threat) Are there new regulations that potentially could harm our operations or products?

Step 4: Refine Findings

With the list of ideas within each category, it is now time to clean-up the ideas. By refining the thoughts that everyone had, a company can focus on only the best ideas or largest risks to the company. This stage may require substantial debate among analysis participants, including bringing in upper management to help rank priorities.

Step 5: Develop the Strategy

Armed with the ranked list of strengths, weaknesses, opportunities, and threats, it is time to convert the SWOT analysis into a strategic plan. Members of the analysis team take the bulleted list of items within each category and create a synthesized plan that provides guidance on the original objective.

Delegations & Decentralization:

DELEGATIONS:

To delegate means to grant or confer; hence the manager who delegates grants or confers (authority) on others (subordinates) to accomplish certain duties in the form of work.

According to O. Jeff. Harris, it is an authorization to subordinate managers to act in a certain manner independently. The delegation of authority is the delivery by one individual to another of the right to act, to make decisions, to acquire resources and to perform other tasks in order to fulfill job responsibilities.

Delegation of Authority

Process of delegation involves four steps, they are:

1) The determination of results expected from persons in a position;
2) The assignment of tasks to persons;
3) The delegation of authority for accomplishing these tasks;
4) The holding of people responsible for the accomplishment of these tasks

Elements of Delegation

a) Assignment of task or duties: In the first step, the delegator (superior) assigns duties to delegate (subordinate). While assigning the duties, the delegator must be clear in his mind as to what tasks he should assign to subordinates. Thus the work or task to be assigned is identified and clearly defined before it is assigned.

b) Conferment of power of authority: Authority may be defined as the powers and rights granted to another to perform the delegated work. These powers may include the authority to acquire necessary resources for the performance of the assigned work. Without adequate authority, the subordinate (delegate) cannot be expected to perform his task or duties.

c) Accountability: Accountability is the obligation of an individual to render an account of the fulfillment of his responsibilities to the principal to whom he reports. The subordinate is always answerable to the superior for the task assigned to him. The superior can control the performance of his subordinate through accountability. The delegate is accountable to his delegator through reports, meetings and evaluation.

Principles of Delegation

Principles of competence: The person selected as a delegate should be competent for the task assigned to him

Principle of trust and confidence: It is necessary that there is an atmosphere of trust and confidence in the organization as a whole and that there is feeling of trust between the delegator and the delegate.

Principle of effective control: As the delegator delegates his authority but not the responsibility, he should ensure that the authority delegated is properly used.

Principle of reward: A rational rewarded system of reward would act an incentive to subordinates to willingly take the responsibility and assume authority and also create a healthy environment within the organization

DECENTRALISATION

Decentralization is the systematic effort to delegate to the lowest levels all authority except that which can be exercised at central points. It is the pushing down of authority and power of decision-making to the lower level of organization.

Factors Determining the Degree of Decentralization

- **Size of operations:**

As an organization grows in size and complexity, need for decentralization tends to increase. More decision is taken at different places and coordination of a large number of departments becomes difficult. Thus as the size increases, decentralization becomes inevitable.

- **Cost and risks of decision-making:**

As the organization grows in size the decisions involving heavy costs also multiply. With decentralization of authority the high cost and high-risk decisions may be taken at the top level but routine decisions can be taken at lower levels.

- **Availability of management resources:**

The extent of decentralization is limited to the extent of availability of trained and competent managerial personnel.

- **Environmental influence:**

The most important environmental forces affecting the degree of decentralization are: Government controls, tax policies, and unionism

New People Management (NPM):

People management refers to the practice of recruiting, training, engaging, and retaining people to optimize their talent and maximize their productivity.

Key Components of People Management

1. Create – building a workforce that builds a better future

When you're building teams, it is important to choose the right tools to do so. This begins with choosing the right recruitment platforms, creating an employer brand the candidates trust and want to work with and providing an engaging candidate experience. Creating the right team structure also involves setting up processes, boundaries and a robust framework of functioning.

2. Comprehend – understanding the present and the future better

Effective people management involves understanding the people who make up the organization – their personalities, motivations as well as their personal and career goals. It is important to understand that people are different and have different traits and skill predispositions.

3. Communicate – opening channels to connect effectively

The format and culture of communication prevalent in an organization is also a key element in the perception that an employee has of the larger picture that they are a part of. Organizations today need to ensure that they are providing their employees with the right channels of communication and feedback in order to encourage that they can communicate often, effectively.

4. Collaborate – cooperating smarter, faster and stronger

Success is a team-function – and so is failure. With the wide array of collaboration tools available in the market today, organizations and managers can ensure that sharing and delegation lead to the best results. In order to add value to the process of work and to the lives of employees while also multiplying the effectiveness of the team, individuals need to be assigned responsibilities that they can step up to and achieve with effective team collaboration.

Social Responsibility:

CSR is a process by which an organization thinks about and evolves its relationships with stakeholders for the common good and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies.

Socially responsible companies use CSR to integrate economic, environmental and social objectives with the company's operations and growth.

Need for Corporate Social Responsibility

• To reduce the social cost.
• To enhance the performance of employees.
• It a type of investment. • It leads to industrial peace.
• It improves the public image.
• Can generate more profit.
• To provide moral justification.
• It satisfies the stakeholders.
• Helps to avoid government regulations & control.
• Enhance the health by non polluting measures.

Types of CSR:

1. Environmental corporate responsibility

Environmental responsibility refers to the organization's commitment to sustainability and environmentally friendly operations.

This can mean reducing the company's carbon footprint or greenhouse gas emissions, opting for sustainable resources by avoiding single-use plastics and keeping environmental aspects at the heart of all operations.

2. Ethical/human rights social responsibility

Ethical responsibility refers to a company's commitment to operate their business in an ethical manner that upholds human rights principles, such as fair treatment of all stakeholders, fair trade practices and equal pay.

3. Philanthropic corporate responsibility

Philanthropic responsibility refers to a corporation's aims, goals and objectives for actively bettering society as a whole. One huge aspect of corporate philanthropy is donating money

from company earnings to worthy causes within the local community — often in the form of a trust or foundation.

4. Economic corporate responsibility

Economic responsibility refers to the practice of making financial decisions based on a commitment to doing well.

Conflict Management:

Conflict Management is the use of processes, tools, and skills to find creative and respectful ways to manage disagreements and disputes. It includes the ability to resolve conflict collaboratively through effective communication skills, such as active listening and assertive speaking.

What are the common conflict management styles?

1. Collaborating:

This conflict management style produces the best long-term results, but it is frequently the most difficult and time-consuming to achieve. The needs and desires of each party are considered, and a win-win solution is found so that everyone is satisfied.

2. Competing:

The competing conflict management style rejects compromise and does not give in to the opinions or desires of others. One party is adamant about how they believe a situation should be handled and will not back down until they get their way.

3. Avoiding:

A conflict manager that has great conflict management skills seeks to reduce conflict by ignoring it, removing the conflicting parties, or evading it in some way. Team members who are in disagreement can be removed from the project, deadlines pushed, or people reassigned to other departments.

4. Accommodating:

The accommodating conflict management style is all about putting the needs of the other party ahead of one's own. Accommodation can be the best way to resolve a minor conflict and move on to more important issues.

5. Compromising:

This conflict management style seeks a middle ground by asking both parties to give up some aspects of their desires in order to reach an agreement.
This style is sometimes referred to as "lose-lose," because both parties will have to give up a few things in order to reach an agreement on the larger issue.

What are the 6 C's of conflict management?

- **Communication**

When conflicts emerge, it becomes imperative to create well-defined channels of communication that enable all parties in the dispute to openly express their viewpoints, worries, and emotions. This entails actively listening, demonstrating a genuine effort to comprehend the perspectives of others. Miscommunication can worsen conflicts.

- **Collaboration**

Collaboration is a key in conflict management, aiming to achieve mutually beneficial outcomes rather than a winner-takes-all scenario. It involves exploring options, brainstorming, and creative problem-solving to prioritize shared goals, fostering compromise and cooperation.

- **Compromise**

Compromising means finding a middle ground between opposing views, recognizing that complete satisfaction for everyone may not be achievable. It requires a fair and balanced approach where both sides give up something in exchange for an agreement.

- **Control**

Maintaining emotional control is vital in conflicts to prevent escalation. Emotions can disrupt communication and resolution efforts. Conflict management includes recognizing and managing emotions for a rational approach. Techniques like deep breathing and breaks help maintain composure.

- **Civility**

(Civility means refraining from personal attacks, name-calling, and disrespectful conduct that can escalate conflicts). It remains essential to approach others with politeness and empathy. Treating people with respect and courtesy helps diffuse tensions and creates an environment conducive to conflict resolution

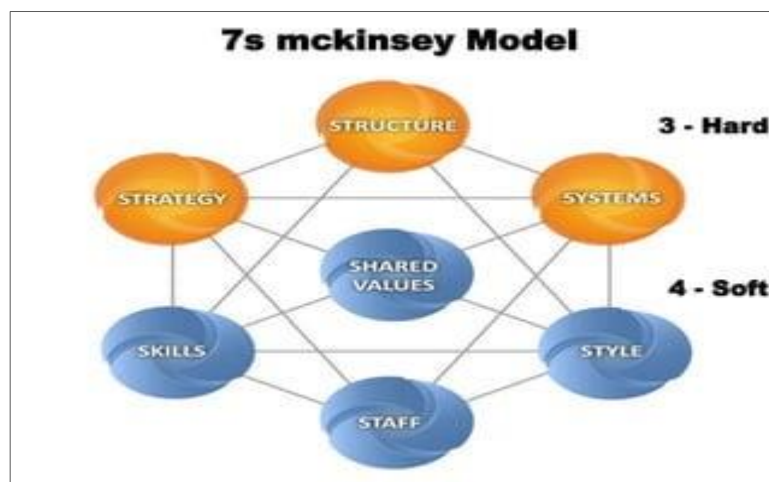
- **Commitment**

Commitment means being dedicated to resolving the issue. It requires investing time and effort to reach a satisfactory conclusion. Parties in conflict must commit to finding common ground, implementing agreed-upon solutions, and ensuring their effectiveness through follow-up.

<u>Mutual Supportive Management System (MSM):</u>

The effective operation of control system is a culmination (the end point or final stage of something you've been working toward or something that's been building up) of the mutual support of several systems, most of all the Formal and Informal.

A more explicit conceptual support for the concept is from the ***Mackenzie Framework of the 7` S***



1. Structure

Structure is the way in which a company is organized – the chain of command and accountability relationships that form its organizational chart.

2. Strategy

Strategy refers to a well-accurate business plan that allows the company to formulate a plan of action to achieve a sustainable competitive advantage, reinforced by the company's mission and values.

3. Systems

Systems entail the business and technical infrastructure of the company that establishes workflows and the chain of decision-making.

4. Skills

Skills form the capabilities and competencies of a company that enables its employees to achieve its objectives.

5. Style

The attitude of senior employees in a company establishes a code of conduct through their ways of interactions and symbolic decision-making, which forms the management style of its leaders.

6. Staff

Staff involves talent management and all human resources related to company decisions, such as training, recruiting, and rewards systems

7. Shared Values

The mission, objectives, and values form the foundation of every organization and play an important role in aligning all key elements to maintain an effective organizational design.

Unit II

Traditional Instruments of Control in Organizations

Meaning of Audit:

An audit is a type of investigation of existing reports, statements or business as a whole. Individuals and companies hire an auditor to examine the financial reports of an entity, accounting statements, management reports, expense and revenue reports and operational accounts.

Definition of Auditing:

Auditing is defined as the on-site verification activity, such as inspection or examination, of a process or quality system, to ensure compliance to requirements. An audit can apply to an entire organization or might be specific to a function, process, or production step.

Objectives of Auditing:

The objectives for carrying out Auditing can be discussed under three heads. They are:

- Primary objectives
- Secondary objectives
- Specific objectives
-

Primary objectives: are to check truthfulness of the books of accounts. That is to see whether they reflect the true and fair view of state of affairs of the business concern. Therefore, the primary objectives to determine whether the financial statements depict the true and impartial view of financial position and working results of an organization

Secondary objective: is aimed at detection and prevention of errors and fraud and also check the Misrepresentation of accounts.

Specific objective: is fixed depending up on the nature and subject matter of the Audit. For example in a Management Audit the Specific objective is to promote the operational efficiency of the managerial functions, also identify the areas of weakness.

Internal Control:

Internal control refers to the entire system of control employed by the management in order to carry on the business of the organization in an orderly and efficient way, by using an automatic check and balance all the transactions. It has in itself internal check, internal audit and other tools of control.

Definition of Internal Control:

The American Institute of Certified Public Accountants (AICPA) has defined internal control as; "The plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and the reliability of its accounting data, promote operational efficiency and encourage adherence to prescribed managerial policies. A system of internal control extends beyond those matters which relate directly to the functions of the accounting and financial departments".

According to the Institute of Chartered Accountants of England and Wales (ICAEW);
"Internal Control means not only internal check or internal audit, but the whole system of control, financial and otherwise established by the management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible accuracy and reliability of its records".

Objectives of Internal Control:

The internal control system aims at providing reasonable assurance to the clients that:

1. Records are valid, complete, and accurate.
2. Recorded transactions are duly authorized.
3. Transactions are properly classified and valued.
4. Transactions are recorded at proper time.
5. Transactions are properly posted to the ledger accounts, and correctly summarized.

Requisites of Good Internal Control:

1. A properly designed accounting system is required to be in operation. Financial and accounting operations must be separated. Different persons must be entrusted with the responsibility of handling cash and the recording of the movement of cash.
2. Presence of well designed organization structure is important. So that Responsibility for the performance of the job can be clearly stated.
3. Rotation principle relating to transfer of an employee from one job to another should be the inflexible guiding rule. This is an effective safeguard against collusion.
4. Mechanization of the work wherever possible can be adopted. Mechanical devices such as cash register, recording time clocks, calculation machines, etc. should be introduced.
5. A written record of work done by each employee should be maintained and the work should pass through several hands in a well-defined manner.
6. Employees must be in bond so that the tempted employee will be deterred from committing fraud and employer being protected.

Techniques for Evaluation of Internal Control System:

There are four techniques evaluating internal controls. These are:

Oral approach: Oral discussion is held to identify strengths and weaknesses.

Memorandum approach: Analysis of weaknesses is undertaken and suggestions are offered through management letter for improvement.

Internal control questionnaire (ICQ): An ICQ consists of questions in respect of each element of business. Questionnaire contains close end questions.

Flow charts: A flow chart is a graphic representation of a system in use. A flow chart provides a simple, concise and comprehensive view of what is happening within the organization. It explains what documents or information are raised, how they are treated, details on the circulation of cash and goods, and actions taken there off. Flow charts of each business activity are reviewed and internal controls are evaluated.

Different Types of Audit:

- Classification based on Organizational structure.
- Classification based on timing and scope of audit procedure.
- Classification based on the specific objective behind the audit.

1. Classification based on Organizational structure

a) Statutory Audit:

i) Joint Stock Companies:-

Incorporated under the Companies Act1956, since there is divorce between ownership and control in this Joint stock Company, the Law requires that the business affairs of the company must be checked and its accounts need to be verified by an external auditor. This makes its financial information reliable for people to come and invest in such companies.

ii) Co-operative Societies:-

Registered under the co-operatives Societies Act, These Societies are registered under Cooperative Societies Act 1912. The management of affairs of this society is handled by few elected members even though the capital is contributed by all members. This makes it compulsory for audits of accounts of this society by an external qualified auditor.

iii) Banking Companies: - governed by the Banking Companies Act 1949.

iv) Insurance Companies: - governed by the Insurance Act 1938.

v) Public and Charitable trust registered under the various Religious and other Endowment Acts.

vi) Local Authorities and government undertakings established under special Laws.

b) Private Audit:

i) Audit of Sole Proprietorship:

It is a single man business. The audit is conducted according to the whims and fancies of the trader. The auditor conducts audit according to the requirement and expectations of the sole trader.

ii) Audit of Partnership Firm:

It is not compulsory for a partnership firm to get its accounts audited. The Auditor is appointed by the partners and he will conduct the audit keeping

c. Government Audit:

The government departments, offices and enterprises registered as companies need to have their accounts audited by an auditor appointed by Central government on based on the advice of comptroller and Auditor general of India

This audit is conducted with the following objectives

1. Ensure that the financial transactions are carried out with the prior approval of concerned authorities.
2. Make sure that expenses incurred are in accordance with the allocation of funds.
3. Obtain maximum output from the minimum input
4. Make sure that public funds are not misappropriated.

2. Types of Audit based on Timings and scope of Audit procedure:

❖ External Audit:

External Audit is defined as the audit of the financial records of the company in which independent auditors perform the task of examining the validity of financial records of the company carefully in order to find out if there is any misstatement in the records due to fraud, error or embezzlement and then reporting the same to the stakeholders of the company.

The Aims of an External Audit

In simple terms, an external audit will seek to determine the condition of a business and its operations across a specific period. It will be carried out by a registered firm of accountants, and can take place as part of a standard annual review or during a special review. Auditors will be appointed at an annual general meeting (AGM) or by the board of trustees.

The independence of the auditors is vitally important, and means that they must in no way be personally connected to your business, and cannot have played any role in preparing the accounting records being audited.

❖ Internal Audit:

Under this type of Audit, the auditing is carried out by an auditor who is appointed by the Management of the organization. This audit is done with a view to appraise the functioning of various departments present within the organization.

Objectives of internal audit

- To check whether the rules, regulations, policies and procedures are followed in the organization or not.
- To assure that all assets and valuables belonging to the organization are safe against probable misuse.
- Spot out the weak areas of the organization and give suggestions to strengthen such areas.
- Check whether the functioning of the institution is smooth in all respects.

❖ Compliance Audit

A compliance audit is a comprehensive review of an organization's adherence to regulatory guidelines. Audit reports evaluate the strength and thoroughness of compliance preparations, security policies, user access controls and risk management procedures over the course of a compliance audit.
Compliance audits are formal evaluations or assessments of an organization's adherence to frameworks and/or regulatory requirements

Characteristics:

- Based on frameworks or regulatory requirements
- Evaluates an organization's posture in-depth based on the guidance and requirements of the target framework or compliance regulation.
- Performed by an independent or third-party auditor
- Results in some kind of final deliverable, like a report, an assessment, or an audit opinion.

3. Classification based on the specific objective behind the audit.

✓ Cost Audit:

The audit of Cost accounting records is called as "Cost Audit".
The chartered Institute of Management Accounting of UK defines it as "Verification of Cost accounts and a check on adherence to the cost accounting plan".
That the cost accounting plans are properly implemented. In India, Cost audit was introduced under 233B in the Companies Act 1956 with a main objective of verifying the accuracy of cost records. It also serves as an effective cost control.

✓ Special Audit:

The Special audit is conducted as per the order of the Central Government. According to section 223A of the companies Act 1956 the central government at any time, by order require the organization to conduct a special audit of its books of accounts. This may be conducted by an auditor appointed for the purpose or by the Company's statutory auditor.

The following are the circumstances in which the central government can order for the conduct of special audit:

a. When the company does not follow sound business principles or prudent commercial practices.
b. Financial position of the company is very poor and is expected to file insolvency petition any time.

✓ Management Audit:

Management Audit has its origin from America. It means the audit of management process and functions. It refers to an appraisal activity done, within an organization for the review of the entire departmental activities.

Internal Audit's aim is to find out the weak areas in the organization, its idea is to study the various activities of the organization with a view to help management in the discharge of their duties efficiently.

Operational Audit concentrates on the efficiency of operation of the various functional areas of management. Management Audit is concerned with the evaluation of management process to its entirety.

- ✓ **Distribution / Operational Audit:**

This audit aims at improving the overall performance efficiency of various functional areas of management so as to provide for improvement in future business operations.

- To evaluate the efficiency and effectiveness of the firm's operating procedures and Methods.
- To enhance the profit earning capacity of the organization
- To give suggestions for further improvement in the required areas of operation
- Help the organization to achieve its objectives relating to maintaining social responsibilities

- ✓ **Efficiency Audit**

Efficiency is the level of productivity of an organization. Essentially, it is the ratio of productivity, i.e. the levels of inputs (raw materials) we need to achieve the desired output (finished goods).

Important terms in relation to efficiency,

- Input: Resources of any kind, example – human resources, finances, raw material, assets, machinery etc
- Output: Goods and services produced by the company to meet the needs of the customers
- Quantity: Amount of goods/services produced
- Productivity: A ratio of goods produced to the amount of resources needed to produce them

- ✓ **Proprietary Audit:**

Propriety audit has been described as an audit of the actions and decisions of the executives. The focus of such an audit is on the financial discipline, the authority structure, efficiency, rules and regulations and the protection of public interest.

Important aspects of verification during a propriety audit are as follows

- Financial records and accounts are accurate and up to the mark
- The assets of the company are safeguarded and not misused
- Propriety audit will check the utilization of funds
- The results that are budgeted and expected are being met

- ✓ **Marketing Audit:**

Philip Kotler "A marketing Audit is a comprehensive, systematic, Independent and periodic examination of a company's or business unit's marketing environment, objectives, strategies and activities with a view to determine problem areas and opportunities and recommending a plan of action to improve the company's marketing performance".

Features of Marketing Audit:

- It is comprehensive in nature
- It is carried out in a systematic manner.
- It is carried out by an outside consultant
- Marketing Audit is carried out on a periodic basis.

- ✓ **Social Audit:**

Social audit is carried out to assess how for the organization society is oriented. The amount of weight-age is given for society's values and well being. The information for conducting social audit is collected through social book keeping, surveys and case studies.

This report brings to light the accountability of the organization towards its stake holders. It serves as a management tool and act as a tool for promotion, marketing and advocacy purposes.

- ✓ **Energy Audit:**

This audit aims to verify whether the energy resources like electricity, natural gas, fuel oil, are efficiently used in the organization. It evaluates the efficiency of all building and process system that use energy. His audit tries to identify cost and energy saving opportunities.

The following are the activities included in this type of audit:

- Identify all energy systems.
- Estimate the conditions of such systems
- Analysis of impact of improvements on those systems.
- Produce energy audit report

Management Audit:

According to L.R.Howard, Management Audit is "An investigation of business from the highest level downward in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with the outside world and the most efficient organization and smooth running internally".

Characteristics features of Management Audit:

- It's the process of examining and evaluating the performance of management functions
- It appraises the policies and procedures of an organization.
- Provides for healthy and rapid growth of the organization.
- It is futuristic and forward looking.
- It is result oriented and dynamic activity.
- It is the next higher level to internal audit.

Objectives of Management Audit

- To improve organizational efficiency
- Guide all members of the organization to perform their duties in efficient manner.
- Assist management in managing their affairs in a better manner

- Make sure that objectives and mission of the organization are met.
- Proper utilization of available resources.
- Improve the overall profitability of the firm.

Uses of / Benefits of Management Audit:

1. It helps to overcome managerial deficiencies.
2. It locates the lacking in the internal control and give ideas to overcome them.
3. Management Audit provides guidelines to all members of the organization for the efficient discharge of their duties.
4. Management Audit provides for fixing Accountability for poor performance among employees of the organization.
5. Management Audit helps in locating the reason for inefficiencies in the operation of public enterprises.
6. Management Audit helps for conservation of scarce resources and proper utilization of available resources.
7. Paves way for enhancement of operational efficiency and there by leading to enhancement of profitability of the organization.

Management Audit Process:

1. Preliminary survey:

Management Audit begins with the ascertainment of objectives and goals of the firm. Auditor must study the policies, plans and the procedures followed by the management. He will also check the efficiency of the internal control system in operation. He must be aware of the standards set and level of actual performance of the organization.

2. Collection of Data:

Auditor must collect required information for the conduct of audit with the help of a structured questionnaire.

3. Examination of documents:

Audit carries out detailed examination of relevant documents and convinces himself of the authenticity of the source of such information. If required, he verifies the original source of information for clarification of facts.

4. Observation of work environment:

Apart from collecting information through questionnaire, the auditor also collects data by personally observing the work environment because such observation helps him to be aware of certain problems which cannot be found in records.

5. Internal Auditor's Report:

Management Auditor's work is based on the internal auditor report. Because this report helps the Management Auditor to easily identify the problem areas where the management so for did not take any action. This also enables Management Auditor to spot out the weakness of internal control system which management is not aware previously.

6. Physical inspection:

Management Auditor conducts the verification of some physical activities carried out in the organization to find out the in competencies so as to suggest some remedial actions to improve such areas of efficiencies

7. Transaction tracking:

Management Auditor selects on random basis some of the transactions of the organization to study the efficiency of the procedure from start to end.

8. Enquiry with the employees:

In order to find out real picture of the problem Management Auditor conducts personal discussion with the concerned employees who are involved in the conduct of operation under examination.

9. Suggestions for improvement of performance:

Finally after carrying out this detailed investigation and verification Management Auditor is in a position to provide ideas and suggestions to solve and overcome the problems. This will lead to enhancement in the productivity level of the system and employees in the organization.

Contents of the Management Audit Report:

Generally the auditor's report will state his opinion on the following matters;

- Adequacy and authenticity of Internal Control system.
- Whether the operating cost of this organization is as reasonable as the other organizations in the industry
- Suitability of the available tools and equipment for getting optimum production.
- Interpersonal relationships that exist between the employees are cordial and smooth or not.
- The overall performance of the enterprise in satisfactory or not.

Different Roles of an Auditor:

According to the expectations of the statute the Auditor plays the following Roles:

1. **Agent of the Members:**

In a company the auditor is appointed by the share holders and his main duty is to safe guard their interest. Auditor carries out auditing and submits the audit reports to the share holders. Hence agent-Principal relationship exists between the auditor and share holders.

2. **Officer of the company:**

Generally, an auditor is not treated as a regular employee of the company excepting under certain circumstances mentioned in the provisions of the Companies Act 1956.

3. **Auditor is not an Advisor:**

Auditor is only entrusted with the responsibility of checking the correctness of books of accounts maintained by the company and to see whether they reflect true and fair view of affairs of the business concern. Hence he cannot act as an advisor to the Directors of the company or to the share holders.

4. Auditor is not a Guarantor or an insurer:

Auditor simply checks the accuracy and correctness of the books of accounts and gives a report. He does not guarantee that books of the company depict true position of the company. He only certifies to the share holders on the true financial position of the firm.

5. Auditor is not a critic of Management Decision:

Auditor does not carry out a critical analysis of the policies and decision made by management. Rather he only carries out a verification of the books maintained.

6. Auditor is not a Detective:

An auditor cannot be made responsible if he is not able to detect cleverly planned and committed frauds. Because, he relays on the probity of the employees of the company who enjoys a position of trust and confidence in the organization

Green Accounting:

Green Accounting, also known as environmental accounting or sustainable accounting, is a system of accounting that takes into accounts the economic, environmental, and social costs and benefits of business activities. It involves measuring and reporting the impacts of economic activities on natural resources and the environment, in addition to traditional financial measures.

Green Accounting Objectives:

- Integrate environmental costs and benefits into national accounts and decision-making processes.
- Provide a comprehensive view of the true costs and benefits of economic activities by incorporating environmental and social considerations.
- Promote sustainable development and support the transition towards a green economy.
- Encourage transparency and accountability in the use of natural resources and the management of environmental impacts.
- Foster stakeholder engagement and participation in environmental decision-making

Green Accounting Components

Components	Description
Environmental Management Systems (EMS)	An EMS involves establishing policies and procedures for environmental management, conducting regular environmental audits, and implementing continuous improvement measures
Environmental Performance Indicators (EPI)	Metrics are used to track and report on environmental performance, such as greenhouse gas emissions, energy consumption, and water use. EPIs enable businesses to monitor progress toward environmental goals and targets.
Life Cycle Assessment (LCA).	A method for evaluating the environmental impacts of a product or service throughout its entire life cycle, from raw material extraction to disposal. LCA can help businesses identify opportunities to reduce environmental impacts at all stages of the product life cycle

Full Cost Accounting (FCA)	An accounting approach that includes both the direct costs (such as materials, labor, and overhead) and indirect costs (such as environmental and social costs) of business activities. FCA can help businesses make more informed decisions by accounting for the full costs of their activities
Environmental Reporting and Disclosure	Reporting on environmental impacts and performance to stakeholders, such as investors, regulators, and customers. Environmental reporting can take the form of sustainability reports, environmental impact assessments, and other disclosures

Green Accounting Types:

- **Environmental Management Accounting (EMA):**

Focuses on internal decision-making and resource management by identifying, measuring, and analyzing environmental costs and benefits of a company's operations, and incorporating this data into management systems to improve environmental performance

- **Full Cost Accounting (FCA):**

It calculates the total economic, social, and environmental costs of a product or service, including hidden costs that are not typically included in financial accounting such as, pollution and health impacts. This allows for a more comprehensive evaluation of the true cost of production and consumption and can inform policy and business decisions to reduce negative environmental impacts

- **Sustainability Accounting:**

Measures and reports on a company's economic, social, and environmental performance over time, using indicators such as energy and resource consumption, greenhouse gas emissions, and social impact assessments. Sustainability accounting aims to provide a holistic view of a company's sustainable development and can help identify areas for improvement and promote stakeholder engagement

Green Accounting Importance

✓ **Environmental Protection**

Green accounting helps to identify the environmental impacts of economic activities and promotes sustainable development by encouraging the conservation and efficient use of natural resources.

✓ **Cost Savings**

By measuring and managing environmental impacts, businesses can identify opportunities for cost savings through improved resource efficiency, reduced waste, and lower environmental compliance costs.

✓ **Risk Management**

Green accounting helps businesses to identify and manage environmental risks that could impact their operations or reputation, such as regulatory changes or environmental disasters.

✓ **Stakeholder Engagement**

By reporting on environmental and social performance, businesses can demonstrate their commitment to sustainability to stakeholders, including customers, investors, and regulators.

- ✓ **Policy Development**

Green accounting can inform the development of policies and regulations that promote sustainable development and help to address environmental challenges such as climate change and biodiversity loss.

Environmental Accounting

It’s a way to track a company's impact on the environment. It measures greenhouse gas emissions, water usage, and waste management. The goal is to help companies understand how their actions affect the environment and find ways to be more sustainable. Governments use environmental accounting to gauge the impact of industries such as mining and oil and gas. This information is utilized to create policies and regulations to reduce environmental harm.

Importance of Environmental Accounting

- **Reducing Environmental Costs**

Environmental accounting helps businesses become more environmentally friendly. Companies identify areas where they can make changes to reduce their environmental impact by measuring the environmental costs of their production and consumption.

- **Meeting Environmental Regulations**

Environmental accounting helps companies follow government environmental regulations. These rules are getting stricter. Businesses must ensure they're following them to avoid fines.

- **Enhancing Corporate Reputation**

Customers care more and more about the environment. Companies need to have a good reputation when it comes to sustainability. This can make customers loyal and help the company stand out.

- **Assessing Environmental Risks**

Environmental accounting help companies identify environmental risks and take steps to prevent them. Businesses can see what could go wrong and fix it by analyzing their activities. This can help the company avoid disasters and protect its reputation.

- **Improving Resource Efficiency**

Environmental accounting can help businesses use resources more efficiently. Analyzing their environmental impact, companies can use less energy and water resources. This can save them money and help the environment.

- **Encouraging Innovation**

Environmental accounting can also encourage innovation. Companies can come up with new technologies that are more sustainable and efficient.

Objectives of Environmental Accounting

- **Separating Environmental Accounts**

By separating environmental accounts, companies understand the money needed to preserve the environment. This also helps us see how much it costs to fix any problems caused by our actions, like pollution. By doing this, we can manage environmental risks and opportunities.

- **Linking Environment & Resources Accounts**

Environmental accounting has a few goals. It aims to connect the environment, resources, and money to see how they relate. By linking natural resources and financial information, we can determine how to use resources better and make more money.

- **Assessing Environmental Costs and Benefits**

Environmental accounting determines the good and bad effects of a company's actions. We measure things like pollution and the use of natural resources. This helps companies make better choices. So they don't break the law or damage their reputation. Knowing the environmental costs helps companies find ways to reduce their impact.

- **Accounting For Tangible Asset Maintenance**

Environmental accounting also tracks how we care for things like machines. Maintaining them well is important so they work and don't harm the environment. It monitors how much energy and resources they use and tries to find ways to use less. By accounting for tangible asset maintenance, companies ensure their assets work efficiently. And don't harm the environment.

- **Green Product and Income Metrics**

Environmental accounting requires developing and measuring indicators. The indicators show how producing and using products affect the environment. This is important as traditional financial indicators, like GDP, only consider money. And they ignore environmental costs.

Investigation:

An investigation is a process of reviewing and examining its financial records, transactions, and reports to determine their accuracy, completeness, and compliance with accounting standards and legal requirements.

The investigation may be conducted by internal auditors or external auditors hired by the company or organization, or by regulatory authorities such as the Securities and Exchange Commission (SEC) or tax authorities.

The investigation may involve reviewing bank statements, invoices, receipts, contracts, and other financial documents, as well as conducting interviews with employees and stakeholders.

Powers and procedure of an investigation

Section 217 of the Companies Act, 2013 deals with the powers and procedures of an investigation, as per the section, the following powers are available to the investigating officer:

- The power to require any person to produce any document or thing which is in his possession or under his control
- The power to conduct an inspection of books and registers maintained by a company
- The power to examine any person who is or was an officer or employee of the company
- The power to examine any person who has or has had business dealings with the company
- The power to examine any person who is or was an auditor, legal advisor, or consultant of the company
- The power to inspect or survey any property, movable or immovable, of the company

Difference between Auditing and Investigation

S. No.	Basis of Difference	Auditing	Investigation
1	Meaning	Auditing is concerned with examining the accounts and reporting on financial statements.	Investigation is the examination of accounts of a business for special purpose.
2	Objective	The objective of Auditing is to express an opinion on the financial statements of the concern.	Investigation is done for some specific purpose.
3	Compulsion	It is compulsory in case of Joint stock companies.	It is not compulsory
4	Period	Auditing is done at the end of the financial year.	Investigation can be done over a period of years.
5	Conduct	Audit is conducted on behalf of the owners of the company	Investigation is conducted on behalf of outsiders and owners at some times.
6	Scope	It is has a narrow scope	It has a wide scope
7	Appointment	An auditor is appointed by the shareholders or directors or by Government.	An investigator is appointed by the outsider.
8	Report	Auditor has to give a report about the true and fair view of the final accounts.	The Investigator gives a report on the basis of conclusion and enquiries. Expression of the opinion is not necessary.
9	Qualification	Only Chartered Accountants are qualified to conduct audit.	An investigation need not be conducted by a Chartered Accountant.
10	Process of Work	Investigated accounts are not audited in ordinary course.	Generally audited books of accounts are taken up for investigation.

Unit III
Accountability and Responsibility in Organizations

Responsibility Accounting:

Definition of Accountability:

Accountability is the acknowledgment and assumption of responsibility for actions, products decisions, and policies including the administration, governance and implementation within the scope of the role or employment position and encompassing the obligation to report explain and be answerable for resulting consequences.

Definition of Responsibility Accounting:

C.I.M.A., London, defines responsibility accounting as "a system of management accounting under which accountability is established according to the responsibility delegated to various levels of management and management information and reporting system instituted to give adequate feed-back in terms of the delegated responsibility

Concept of Responsibility Accounting:

- Responsibility Accounting is a collection, summarization, and reporting of financial information about various decision centers (responsibility centers) throughout an organization; also called activity accounting or profitability accounting.
- It traces costs, revenues, or profits to the individual managers who are primarily responsible for making decisions about the costs, revenues, or profits in question and taking action about them.
- Responsibility accounting is appropriate where top management has delegated authority to make decisions. The idea behind responsibility accounting is that each manager's performance should be judged by how well he or she manages those items under his or her control

Factors of Responsibility Accounting for Management Control:

- **Planning:** The entire activities of the organization must be well planned based on responsibility. The effective planning has to prepare with the consultation of the respective person of those who held responsibility.
- **Fixing standards:** For the execution of plan, the management must fix the standards, set up budgets and estimate the actual. The targets must be very clear and precise and it should be very realistic.
- **Allocation of resources:** After fixing the standards, the management has to allocate the resources while executing the plan for action and also it has to give necessary direction for such execution to the staff. The training must provide to the staffs whenever they required for execution.
- **Evaluation of Performance**: The actual performance of each responsibility centre must evaluate, compare the actual with standards and find the variances. The positive motivation should be provided to the persons showing performance of favorable variance.
- **Analyze the variances:** The corrective measures should be taken when there are any negative deviations. A leader's job is to ensure every member of the team wins, and winning is defined as meeting the organization's top objectives.

Steps to Increase Accountability in any Organization:

STEP 1: Establish the organization's top three objectives. This means the significant few, not the important many. Once identified, objectives must be clear, concise, measurable and obtainable.

STEP 2: Assign each team member his or her respective objectives. They must allow the organization to achieve its top objectives when coordinating the activities.

STEP 3: Identify the problems or hindrances of team members to accomplish the objective. The team leader or manager must help people to win by removing the obstacles.

STEP 4: Establish the individual responsibility to its team members by way of delegating the authority

STEP 5: Follow up. Make schedule for monthly report to update the results. Mark the results which are completed and compare with budgeted by using green shade. The uncompleted task must be underlined with red mark and find the way to achieve.

STEP 6: Share lessons learned. Hold quarterly meetings with all direct reports present to discuss lessons learned identify critical barriers and make specific offers to help any team member behind plan. The leader wins when everyone on the team wins.

STEP 7: Reward results. Reward is essential and unequal when objectives are achieved by the team members. Those who achieve the most get rewarded the most– and everyone ought to know that.

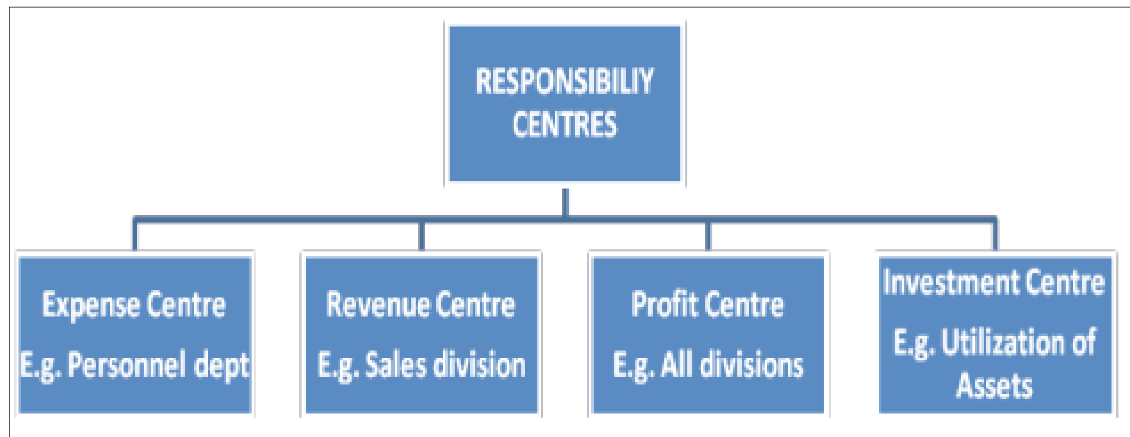
Advantages of Responsibility Accounting

- It provides a way to manage an organization unless otherwise it is unmanageable.
- It helps fixing divisional responsibilities through assigning responsibility to lower level managers that allows higher level managers to pursue other activities such as long term planning and policy making.
- It also provides a way to motivate lower level managers and workers.
- Managers and workers in an individualistic system tend to be motivated by measurements that emphasize their individual performances.
- It is a tool for cost control and cost reduction exercises resorted to, by the management from time to time. Budgetary and standard costing techniques are applied

Criticisms of Responsibility Accounting:

- The Responsibility accounting is separating a company into various parts or units of responsibility centers for controlling the entire organization.
- Ignoring the interdependencies prevents teamwork and creates the need for protection such as additional inventory, workers, managers and capacity.
- The effectiveness of the management as a whole become worthless however, these additional resources lose their utility because it is being kept idle for long time.

Responsibility Centers



I. Expense Centers

The responsibility of the cost or expense centre is only the cost incurred by the unit or divisions. The division manager is responsible for the entire process of cost control in their respective units. The process includes estimation of cost, evaluation of performance, and comparison of actual with budgeted.

a. Engineered Expenses centre:

This type of centre is applicable in manufacturing, warehousing, distribution and trucking. Here the inputs are measured in terms of money value but the output is measured in units. Moreover, the centre is responsible in respect of quality of output and employees training and development

b. Discretionary Expenses centre:

The administration and developmental activities of the product developments are covered in this type of centre.

- Research & Developmental Expenditure
- Marketing activities of capturing the market of the product
- The customer service
- Financial planning

c. Administrative and Support centers

It provides services to other responsibility centers, so it is difficult to evaluate and quantify the contribution of the services of the staffs. The manager of this unit can prepare budget to control the expenditure.

d. R & D centers

Every organization must develop their product based on the changing technology, for that they have to spend lot of money and time on Research and development. Heavy expenditure incurred for the experiment while developing a new technology, innovate a new product and improving the old product, it is very difficult to quantify the results.

e. Marketing Centers

The activities are related to obtaining orders which includes advertising, sales promotion, and training sales force. The evaluation in terms of sales is very difficult for this centre.

II. Revenue Centre

A revenue centre is responsible for selling products and services and the responsibility is decentralized into various divisions on the basis of geographical area.

III. Profit Centre

Profit centre is applicable to all divisions in the organization. This is because of the overall organization goal is striving to attain the maximum profit

The effective profit centre system must have the following requirements:

- ✓ A Sound system of Transfer prices
- ✓ Autonomy to the Divisional Manager
- ✓ Survival of Market facilities
- ✓ Negotiation power to the Divisional Managers
- ✓ Uniform system of Accounting
- ✓ Adequate knowledge of management required to the Divisional Managers

IV. Investment Centre:

The responsibility of this centre is based on the assets employed i.e. Return on investment and optimum utilization of the asset. In this respect all assets are considered as investment, which is directly and indirectly involved in the investment activities

Activity-Based Costing (ABC)

Meaning of ABC:

Activity-based costing (ABC) is a costing method that assigns overhead and indirect costs to related products and services.

Definition of ABC:

Activity Based costing is "A method of measuring the cost and performance of activities and cost objects. Assigns cost to activities based on their use of resources and assigns cost to cost objects based on their use of activities. ABC recognizes the causal relationship of cost drivers to activities." -- Peter B. B. Turney

Some examples of indirect costs and their drivers are:

1. Maintenance costs-- are indirect costs and the possible driver of this cost may be the number of machine hours,

2. Handling raw-material cost-- is another indirect cost that may be driven by the number of orders received,

3. Inspection costs-- that are driven by the number of inspections or the hours of inspection or production runs.

The basis of Activity Based Costing is

1. Identify the activities required to produce the cost of the product or service.

2. Allocate the resources on each activity

3. Establish the cost drivers on each activity and count its numbers,

4. Determine the cost per cost drivers,

5. Determine the amount of activity required for each product and service

6. Determine the real cost for a single product or services.

Difference Between Traditional and Activity Based Costing:

	Traditional	Activity Based Costing
1	Uses Unit Based Costing	Recognizes activities are the causes of costs
2	Geared to manufacturing environments	Concepts can be implemented outside manufacturing
3	Useful in a one product environment	Valuable in a multi-product environment
4	External reporting focus	Internal management decision making focus
5	Potential for poor decisions due to product cross-subsidization	Potential to cut costs by identifying the "true" costs of the product and increase profitability

Activity-Based-Costing is necessary for the following reasons:

- To understand True profitability of the customers, products, or services
- To quantify the cost of non-value added activities such as errors and reworks,
- To identify opportunities to reduce costs and/or increase efficiency,
- To obtain actionable information to negotiate price increases for unprofitable clients,
- To understand why profitability may be mediocre despite good strategic fundamentals,
- To stratify overhead costs so they can be managed more effectively

ABC Model:

Developing the initial model consists of the following five steps:

1: Identification of Resources:

Resources represent the expenditures of an organization.

2: Determination of Activities:

Activities represent the work performed in an organization.

3: Description of the Cost Objects:

ABC provides profitability by one or more cost object, usually represented by products, customers, and/or services.

Cost Object profitability is utilized to identify money losing customers, to validate separate divisions or business units, or to measure the performance of individual projects, jobs, or contracts.

4: Determination of Resource Drivers:

Resource Drivers provide the link between the expenditures of an organization and the Activities performed within the organization

5: Determination of Cost Drivers:

Determination of Cost Drivers completes the last stage of the model. Cost Drivers trace, or link, the cost of performing certain Activities to Cost Objects.

Transfer Pricing

Transfer Pricing Definition:

Transfer price is a notional value at which goods and services are transferred between divisions in a decentralized organization. The prices are set for intermediate products, which are goods, and services that are supplied by the selling division to the buying division.

Objectives of Transfer Prices

A sound transfer price system should accomplish the following objectives:-

1. **Divisional Autonomy**

The division manager must take sound decisions to show their divisions' efficiency through its responsibility centers, a sound transfer pricing system act as a motivational force and it serves the effective communication for such decision. This can happen when the division manager takes the action to improve the reported profit of his division and it improves the profit of the company as a whole.

2. **Divisional Performance**

Appraisal Profit is the yardstick for measuring the performance. Transfer pricing facilitates to measure the divisional performance.

3. **Goal Congruence**

The division manager's goal must be positively correlated with the goal of organization as a whole. The decisions taken by the divisional managers for increasing their divisional profit should not affect the profits of the other divisions. The transfer pricing system must serve as a motivational force to the division managers and at the same time it should not go to the beyond level at which injures the goal of entire organization

The advantages of transfer pricing:

To identify unit contribution to the total profit,

To encourage profit consciousness,

To Measure management performance,

To maximize operating unit profitability,

To locate profits to minimize tax,

To serve as a tool for control

The disadvantages of transfer pricing

- Divisional managers may try to achieve the divisional profits rather than corporate profit,
- It creates confusion on the price of the final product due to the lengthy disagreements on prices,
- It may be incurred an additional administrative costs,
- Arguments over disposition of variances,
- Task of eliminating book profits arising from interdivisional profits

Factors are to be considered when developing procedure for determining transfer prices:

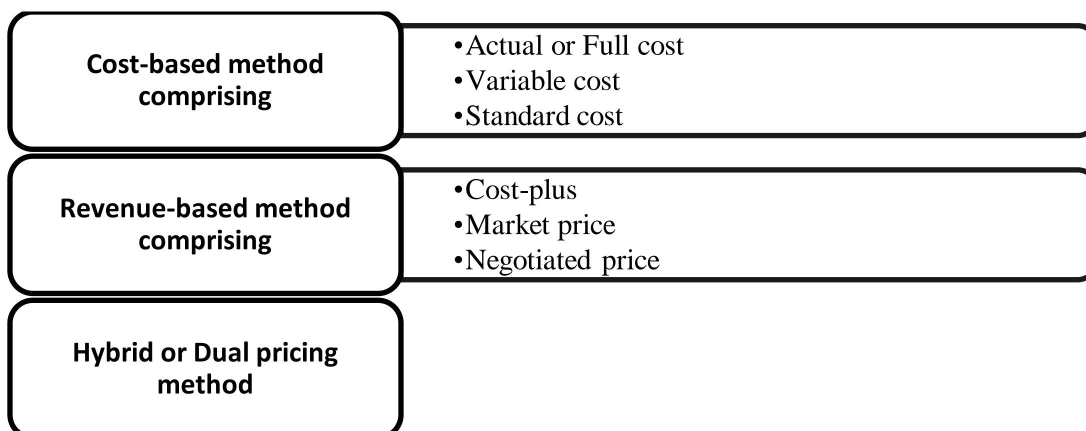
1. The role of the corporate office when the prices are centrally administered

2. The degree of internal bargains

3. Accountants' role

4. Whether the prices are to be related to costs or resulting from selling prices

Types of Transfer Pricing



Cost-based method comprising:

a) **Actual / Full cost-**

There are different types of cost such as direct cost & indirect cost, variable cost & fixed cost and cost of production & cost of sales. The adoption of cost is differing in one firm to another, based on the nature, volume and capacity of the business enterprise. The cost of sales is adopted for fixing transfer price.

b) **Variable Cost-**

The expenses that are directly associated with the production and transfer of the goods and services. The direct expenses are raw materials, Wages and production of the division. These expenses are varied with the volume of output. This method is very useful for overall view when there is an excess capacity in the supplying division; it leads to the purchasing division to act accordingly.

c) Standard Cost-

The materials, labor and overheads are charged at pre-determined rates. The costs of goods are free from fluctuations in the components of cost. The buying division is known in advance about the transfer price; hence it can plan in well advance to show the effective performance in their appraisal.

Revenue-based method comprising

a) Cost-plus mark-up pricing

The cost of sale of goods is taken as usual in cost concept but here it is added with some percentage of profit. The percentage of profit is determined the Companies that follow cost-plus pricing method is taking the position that profit must be shown for any products or service at every stage.

b) Market based Transfer price

A market based transfer price is derived from the price required to be competitive in the market. Under this method the goods are transferred between divisions on open market prices, which possesses the advantage for optimal decisions without any constrains.

c) Negotiated price

Negotiated price is the price of mutual bargain between the buying and selling divisions for transferring goods or services. The purchase division may or may not accept the deal and it may obtain outside bids and negotiate with external suppliers.

The negotiated price is suitable under the following circumstances:-

➢Negotiators must share the market information.

➢the full support and involvement of the top management is essential.

➢the external market should be existed.

➢there should be a freedom of external buying and selling for both divisions.

➢the market information must be available

Dual Rate Method

The dual pricing strategy overcomes the problems between buying and selling division of marginal cost. That is the selling division is credited with a price based on the total cost plus mark-up and the buying division is debited with marginal cost. This may lead to some difference between the two prices and the difference is transferred to the Transfer Price Adjustment Account.

Drawbacks of the Dual Rate method:-

- This method is not suitable when multi-variety of goods or services are being transferred to different divisions.
- The principle of decentralization is affected because the head office has to maintain the Transfer Price Adjustment Account.
- Both buying and selling divisions cannot get high incentives because of non-monitoring the performance

Budgetary Control

Meaning of Budget:

Budget is a detailed plan of operations for some specific future period. It is an estimate prepared in advance of the period to which it applies.

Definition of Budget:

According to Gordon and shilling law budget may be defined as "a predetermined detailed plan of action developed and distributed as a guide to current operations and as a partial basis for the subsequent evaluation of performance".

Meaning of control:

Control means "some sort of systematic effort to compare current performance to a predetermined plan or objective, presumably in order to take any remedial action required"

Meaning of budgetary control:

Budgetary control refers to the principles, Procedures and Practice of achieving given objectives through budgets and budget reports.

"It is the system of management control and accounting in which all operations are forecasted and so for as possible planned ahead, and the actual results compared with the forecasted and planned ones.

Budgetary control in short:

It's an essential tool of management for controlling cost and maximizing profits. It is a useful management tool for comparing the current performance with pre-planned performance with a view to attain equilibrium between ends and means, output and effort.

The process of budgetary control System can be organized in the following lines:

1. **Determination of Objectives:**

A budget being a plan for the achievement of objectives, it is desirable that same are defined very precisely. The objectives should be written out and the areas of control should be clearly demarcated in order to give clear understanding of the plan and its scope to all those who must cooperate to make it a success.

2. **Establishment of Budget centre:**

A budget centre is a section of the organization of an undertaking defined for the purpose of budgetary control. A budget is prepared for each centre and therefore the budget centre should be properly selected. A budget centre may again consist of a number of cost centre representing different groups of machines.

3. **Introduction of adequate accounting records and their codification:**

The accounts department gives data required by the budget department and with the help of it the budget department can make estimates.

4. **Preparation of budget organization chart:**

Organization chart is a map that depicts the functions and responsibilities of each member of the management and ensures that each one knows his position in the organization and his relationship to other members. It should be supported by written directives concerning the function of the staff members. The organization chart depends up on the nature and size of the enterprise.

5. **Establishment of Budget Committee:**

The budget committee consists of chief executive or Managing Director, Budget Officer or Director or Controller and Heads of main departments. The managers of different departments prepare the budget and submit to this committee. The committee makes necessary adjustments, coordinates all the budgets and prepares a Master Budget.

6. **Preparation of Budget Manual:**

It's a document or Schedule or Rule Book which sets out the responsibilities of the persons engaged in the preparation routine of forms and records required for budgetary control. This manual lays down the budget programme, specific and general duties of the executives, departmental managers and the budget committee.

7. **Level of activity:**

It is essential to establish a normal level of activity since it forms the basis of the budget. Level of activity can be attained by efficient working under the existing condition.

8. **Selection of the Budget period:**

The period covered by a budget is known as budget period. The length of the budget period normally depends up on the nature of the plan, circumstances of the business, the control aspect, production period and timings of availability of finance.

9. **Locating the Principle Budget Factor:**

Sales & Demand are the key factors of every company which should be correctly identified and diagnosed. If the sales figure proves to be in accurate, most of the budget will be affected. Similarly, materials, labor, cash, space, equipment, management etc may also be the key factors.

10. **Determination of Budget Cost Allowance:**

It is the cost which a budget centre is expected to incur during a given period of time in relation to the level of activity attained by the budget centre.

11. **Implementation of the Budget and recording of actual performance:**

a copy of the section of the master budget appropriate to each department sphere of activity is issued to the respective heads for execution.

12. **Budget Variance Analysis and Reporting:**

A variance is the divergence between any planned result and the actual result measured in monetary terms. Variance between a planned cost and an actual cost is usually due to a number of factors. Ascertaining the contribution of each factor to the overall variance is known as variance analysis.

Elements of a Successful Budgetary Control System:

Objectives: All planning requires that objectives have been established since the plan is merely a means to an end, not an end in itself. The objectives are the end.

Knowledge of Cost Behaviour: understanding of the cost pattern of the firm is essential and the Cost-volume –profit Analysis is a useful tool to the budgeting

Education: All levels of Management must be educated on the usefulness of the budget and must be taught the part that each must play in planning and control through budgets. This necessitates a continuous training in budgeting methods.

Acceptance and cooperation: successful budgeting also requires that budget should be accepted by the people who must execute them. Budgeting should have the active cooperation of the entire organization.

Adequate Systems Support: This will come mainly from the accounting, where it must be ensured that records and procedures are sufficient for the task in hand

Characteristics of Budget:

- It estimates the profit potential of the business unit.
- It generally covers a period of one year
- It is a management commitment; managers agree to accept responsibility for attaining the budgeted activities
- The budget proposal is reviewed and approved by an authority higher than the one who prepares the budget
- Once approved, the budget can be changed only under specified conditions
- Periodically, actual financial performance is compared to budget, and variances are analyzed and explained

Types of Budget:

1. Flexible Budget

A Flexible Budget is a dynamic budget which is designed to change in accordance with the level of activity. It is also called as variable budget or Sliding scale budget. A budget prepared in a manner so as to give the budgeted cost for any level of activity is known as Flexible Budget.

The main idea behind the preparation of flexible budget is that for any given volume of business there should be some type of expenditures and that type should be known well in advance to provide assistance for doing the actual expenditures.

There are two ways using which flexible budget can be prepared they are:-

(a) Formula Method. (b) Multi activity or Tabular Method.

Generally following steps are followed in the preparation of flexible budget:

1. Decide the range of activity to develop a flexible budget.

2. Determine the cost behaviour- fixed, variable and semi variable to each element of cost.

3. Select the activity level (generally in terms of output).

4. Prepare a budget at each activity level

2. Zero Base Budgets

The inefficiencies of the previous year to the current year hence to streamline the allocation of funds and to control cost a new technique called Zero Base Budgeting came in to existence. The “Zero-base” means a “nil budget” as the starting point.

There is no given base figure for a budget. A fresh budgeted figure is determined keeping in view the circumstances and the requirements. The basic concept of ZBB is “Starting from Scratch” that is every activity in an organization must be examined and justified, giving consideration to the alternatives and the results are obtained.

ZBB is a Planning, resources allocation and Control tool. According to ZBB system, justification of the expenditure may be required on the basis of the required output. So while ZBB may be applicable to only a portion of the budgeting effort in an organization, those areas to which it is directly applicable are the hardest to plan and control

Basic Principles underlying the preparation of ZBB

1. Every budget starts with a Zero base

2. No previous year figure need to be taken as base for adjustments.

3. Fresh examination of each activity

4. Give due consideration to alternatives.

Benefits of ZBB

1. makes planning and controlling activities in an organization more effective and efficient.

2. Higher degree of Coordination can be achieved at all levels of activities.

3. Operating efficiency of the firm is greater because responsibility and accountability can be easily pinpointed.

4. Efficient allocation and optimum utilization of available resources.

5. Better interpersonal relationship is developed among employees

3. Master Budget

The Master budget is the summary budget incorporating all the functional budgets of the firm.

Master budget is prepared in the form of:-

an Income statement, starting with Sales Revenue, followed by cost of sales, operating income, non-operating expenses and other income reaching profit before tax and interest and there after arriving at net profit after deducting financial charges and income tax. Master budget requires the approval of Budget Committee to put it in to operation.

4. Performance Budgeting

The National Institute of Bank Management define the Performance budgeting as "The process of Analyzing, identifying, simplifying ad crystallizing specific performance objectives of a job to be achieved over a period in the frame work of organizational objectives, the purpose and the objective of the job".

Performance budgeting aims at evaluation of performance of the enterprise keeping in view the specific and overall objective of the organization.

Its main focus is on the contribution of each employee for the attainment of organizational objective in general and short term business objectives in particular. It provides a concrete direction to each employee and acts as a control mechanism to top management.

Performance budgeting involves preparation of performance report. These reports are prepared by comparing the budget with the actual data and reveal the variance. These reports are prepared using the data provided by the accounting system. The head of the each department is vested with the responsibility of preparing this budget.

Analysis of Variance

Variance Analysis:

Variance analysis is a process of analyzing variance by fragmenting the total variance in to smaller identity so that the responsibility for such variance can be pin pointed easily.

If the actual is less than the expected then the variance is said to be Favorable

If the actual is more than the expected, then it is called as unfavorable variance.

During the course of analysis if any individual is identified as responsible for such variance, it is called Controllable Variance.

The variation might have occurred due to factors beyond the control of an individual, it is called as uncontrollable variance.

In order to minimize the occurrence of variance the management must be cautious in the following aspects:

1. Fix a reliable Standard.
2. Provide for incidental expenses.
3. Consider change in the Market situation.
4. Provide allowances for possible loss of material, machine hour, labour hour etc.
5. Consider changes in Managerial policies

Standard Costing Control Variance:

Standard cost variances occur when there is a difference between the actual costs of goods sold and the Standard Cost of those same goods. Standard costing is an accounting method that uses predetermined costs for materials and labor to value inventory and calculate the cost of goods sold.

A favorable variance occurs when the actual cost is less than the budgeted cost

An unfavorable variance occurs when the actual cost is more than the budgeted cost.

Negative vs. positive variances or Zero variances- Standard Costing

- A negative cost variance occurs when actual expenses exceed budgeted expenses. This can indicate that a business is overspending and may not have enough funds to cover the shortfall.
- A positive cost variance happens when actual expenses are less than budgeted expenses. This can be due to either effective cost-saving measures or simply luck.
- A zero cost variance means that expenses match the budget exactly. This is the ideal situation, as it indicates that the business is spending as much as planned.

There are two typical reasons for the cost variance fluctuating positively or negatively rather than zero:-

Differences in cost variance can be overestimations

Underestimations about a specific outcome

Here are two types of standard cost variances: static and dynamic.

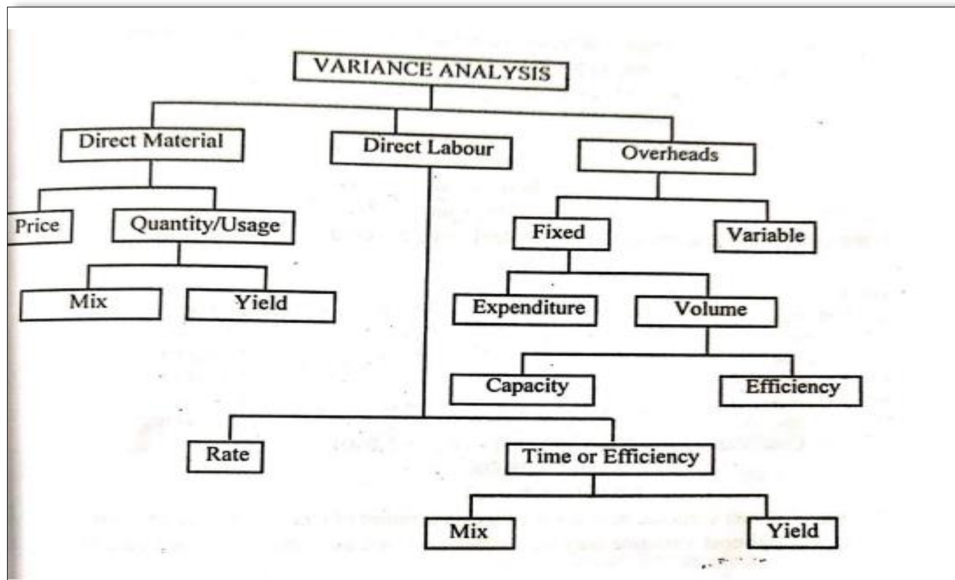
Static variances occur when there is no change in the price or quantity of the inputs used in production.

Dynamic variances occur when there is a change in the price or quantity of the inputs used in production.

Standard costing can be used to investigate both types of variances.

Standard costing and variance analysis, which is aimed at profit improvement mainly by reducing:-

Direct Material, Direct Labor & Overheads



Nature and Purpose of Standard Costing System:

- The main purpose of standard cost is to provide management with information on the day-to-day control of operations.
- Standard costs are predetermined costs that provide a basis for more effectively controlling costs.
- Standard cost offers a criterion against which actual costs incurred by the business can be measured and analyzed.
- The difference between actual costs and standard costs is known as variance. Variance is identified and carefully analyzed, and it is reported to managers to inform suitable corrective actions.

Objectives of standard costing system:

- A standard costing system may be used to control costs, which is achieved mainly by setting standards for each type of cost incurred: material, labor, and overhead.
- A standard costing system may be used to achieve is to help in setting budgets.
- A system may be used to provide useful and detailed information for managerial planning and decision-making.
- A standard costing system may be used to assess the performance and efficiency of staff and management.
- Standard costing is a control technique that follows the feedback control cycle. Therefore, the feedback system may help to eliminate unwanted costs in the future, leading to a potential reduction in costs.

Financial Statement and Control

Financial Statements:

Financial statements are written records that convey the business activities and the financial performance of a company. Financial statements are often audited by government agencies, accountants, firms, etc. to ensure.

Financial Statement Components:

Balance Sheet

It provides information about the financial success and position of the company against expectations at a particular point in time. It has two components – assets and liabilities.

Cash Flow Statement

It shows the total cash available for a business, i.e., cash received minus cash expended every month of a fiscal year. Negative cash flow necessitates a re-evaluation of corporate strategies.

Income (Profit and Loss) Statement

It depicts the relationship between business income and expenses over time. It consists of revenue, sales cost, gross profit, operating costs, and net income

Financial Control:

Financial controls provide the basis for sound management and allow managers to establish guidelines and policies that enable the business to succeed and grow.

Budgeting refers to a simple listing of all planned expenses and revenues. On the basis of this listing, and a starting balance sheet, you can project a future one.

The overall budget you create is a monthly or quarterly projection of what the balance sheet and income statement will look like but again based on your list of planned expenses and revenues.

Meaning:

Financial controls are the procedures, policies, and means by which an organization monitors and controls the direction, allocation, and usage of its financial resources. Financial controls are at the very core of resource management and operational efficiency in any organization.

Four processes are completed before implementing financial control in a business:

1. Detecting overlaps and anomalies

Financial budgets, financial reports, profit & loss statements, balance sheets, etc., present the overall performance and/or operational picture of a business. Hence, while formulating financial control policies, it is very important to detect any overlaps and/or anomalies arising out of the data available. It helps in detecting any existing loopholes in the current management framework and eliminating them.

2. Timely updating

Financial control is the essence of resource management and, hence, the overall operational efficiency and profitability of a business. Timely updates of all available data are very important. In addition, updating all management practices and policies concerning the existing financial control methods is also equally important.

3. Analyzing all possible operational scenarios

Before implementing a fixed financial control strategy in an organization, it is important to thoroughly evaluate all possible operational scenarios. Viewing the policies from the perspectives of different operational scenarios – such as profitability, expenditures, safety, and scale of production or volume – can provide the necessary information. Also, it helps establish an effective financial control policy that covers all operational aspects of the organization.

4. Forecasting and making projections

While implementing a financial control policy, forecasting and making projections are very important steps. They provide an insight into the future goals and objectives of the business. In addition, they can help establish a financial control policy in accordance with the business objectives and act as a catalyst in achieving such goals.

Importance of Financial Controls:

1. Cash flow maintenance

Efficient financial control measures contribute significantly to the cash flow maintenance of an organization. When an effective control mechanism is in place, the overall cash inflows and outflows are monitored and planned, which results in efficient operations.

2. Resource management

The financial resources of an organization are at the very core of any organization's operational efficiency. Financial resources make available all other resources needed for operating a business. Hence, financial resource management is crucial in order to manage all other resources. Effective financial control measures hence are crucial to ensure resource management in an organization.

3. Operational efficiency

An effective financial control mechanism ensures overall operational efficiency in an organization.

4. Profitability

Ensuring an organization's overall operational efficiency leads to the smooth functioning of every organizational department. It, in turn, increases productivity, which comes with a direct, positive relationship with profitability. Hence, establishing effective financial control measures ensures the improved profitability of any business.

5. Fraud prevention

Financial control serves as a preventative measure against fraudulent activities in an organization. It can help prevent any undesirable activities such as employee fraud, online theft, and many others by monitoring the inflow and outflow of financial resources.

Cost-Volume-Profit (CVP) Analysis:

Definition of CVP:

The CVP analysis can be defined as a managerial tool showing the relationship between various ingredients of Profit Planning, i.e., cost, price and volume

This technique is used by Finance Manager for taking various decision making in the process of Management control system in the following respects:-

- ➢Forecasting of profit
- ➢Pricing and sales volume decisions.
- ➢Make or Buy decisions
- ➢Plant Merger decisions
- ➢maximizing the profit when there is Key factor or limited factor,
- ➢Export decisions whether to accept or reject,
- ➢Shut down or continue in production decision

The basic principles of CVP analysis:

- Period cost is known as fixed costs which are constant at any level of activity up to the present capacity. The fixed cost may vary when expanding the capacity.
- Variable cost which is varied with the volume of output and therefore if one extra unit of product is made and sold, total costs can rise by the variable cost (the marginal cost) of production and sales for that unit.
- The total costs may fall by the variable cost per unit for each reduction by one unit in the level of activity.
- The additional profit earned by making and selling one extra unit is the extra revenue from its sales minus its variable costs, i.e. the contribution per unit.
- As the volume of activity increases, there can be an increase in total profits which is equal to the total revenue minus the total additional variable costs. This is the additional contribution from the additional output and sales.
- The total profit in a period is the total revenue minus the total variable cost of goods sold, minus the fixed costs of the period

Marginal cost statement	
Revenue	X
LESS: Variable cost of sales	(X)
CONTRIBUTION	X
LESS: Fixed Costs	(X)
PROFIT	X

Example of --Cost-Volume-Profit:

A company sells 2,000 units of its only product for Rs.50 per unit, variable cost is Rs.20 per unit, and fixed costs are Rs. 40,000 per month. Given these conditions, the company is operating at the breakeven point

Revenues, 2,000 X ₹ 50	₹ 100,000
Variable costs, 2,000 X ₹ 20	40,000
Contribution margin	60,000
Fixed costs	40,000
Operating income	20,000

Contribution margin can be expressed three ways: in total, on a per unit basis, and as a percentage of revenues.

Solution:

1. Total contribution margin is ₹ 60,000.
2. *Contribution margin per unit* = selling price - variable cost per unit:

   ₹ 50 – ₹ 20 = ₹ 30.

Contribution margin per unit is also equal:

= contribution margin divided by the number of units sold:

= ₹ 60, 000 / 2,000 = ₹ 30.

3. *Contribution margin percentage (also called contribution margin ratio or Profit Volume ratio i.e., PV ratio)*

= contribution margin per unit divided by selling price:

= ₹ 30 / ₹ 50 = 60%;

It is also equal to

= contribution margin divided by revenues:

= ₹ 60,000 / ₹ 100,000 = 60%.

This contribution margin percentage means that 60 percents in contribution margin is gained for each ₹ 1 of revenues.

Break Even Point:

To avoid operating losses, managers are interested in the breakeven point calculated using CVP analysis.

The formula for BEP is,

BEP in Units =	$\frac{\text{Total Fixed Costs}}{\text{Contribution Per unit}}$
BEP in Revenues =	$\frac{\text{Total Fixed Costs}}{\text{P/V Ratio}}$

Example:

Company X Ltd. makes and sells a single product. The variable cost is Rs. 4/unit and the variable cost of selling is Rs. 1/unit. Fixed costs total Rs. 6,000 and the unit sales price is Rs.6. Co X. Ltd. budgets to make and sell 3,600 units in the next year.

Calculate BEP in units and Value in terms of Rupees. And also draw a breakeven chart, and a P/V graph, each showing the expected amount of output and sales required to breakeven, and the safety margin in the budget.

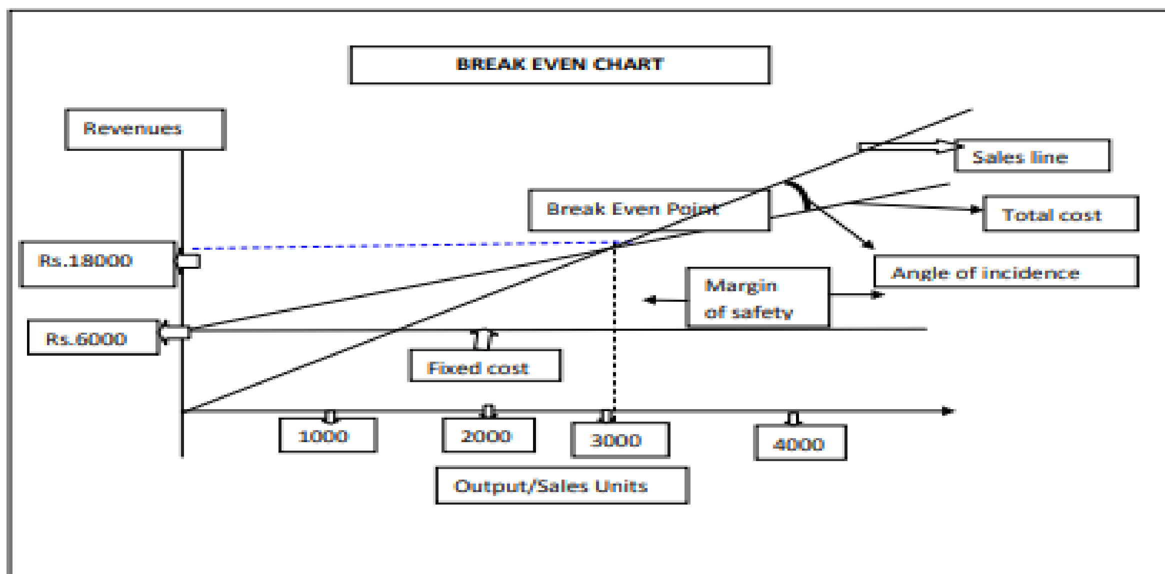
Solution: BEP in Units & Revenues

BEP in Units =	Total Fixed Costs / Contribution Per unit
Fixed cost =	₹6000
Contribution per unit =	Selling price per unit - Variable cost per unit ₹ 6 - ₹ 4 = ₹2
BEP in Units =	₹ 6000/ ₹ 2 = **3000 Units**

BEP in Revenues =	Total Fixed Costs / P/V Ratio
Fixed cost =	₹ 6000
P/V Ratio =	contribution/sales * 100 (₹ 2/ ₹ 6)*100 = 33.33%
BEP in Revenues=	₹ 6000/33.33%= ₹ **18000**

A breakeven chart

A breakeven chart records the amount of fixed costs, variable costs, total costs and total revenue at all volumes of sales and at a given sales price as follows:



- The 'breakeven point' is where revenues and total costs are exactly the same, so there is no profit or loss.
- It may be expressed in terms of units of sale or in terms of we can understand while reading from the graph,

the breakeven point is 3,000 units of sale and Rs. 18, 000 in sales revenue.

The margin of safety

The 'margin of safety' is the amount of difference between actual output/sales and the Break Even sales/output and it can be expressed as a percentage of the budgeted sales volume.

	Units
Budgeted sales	3,600
Breakeven point	3,000
Margin of safety (MOS)	600

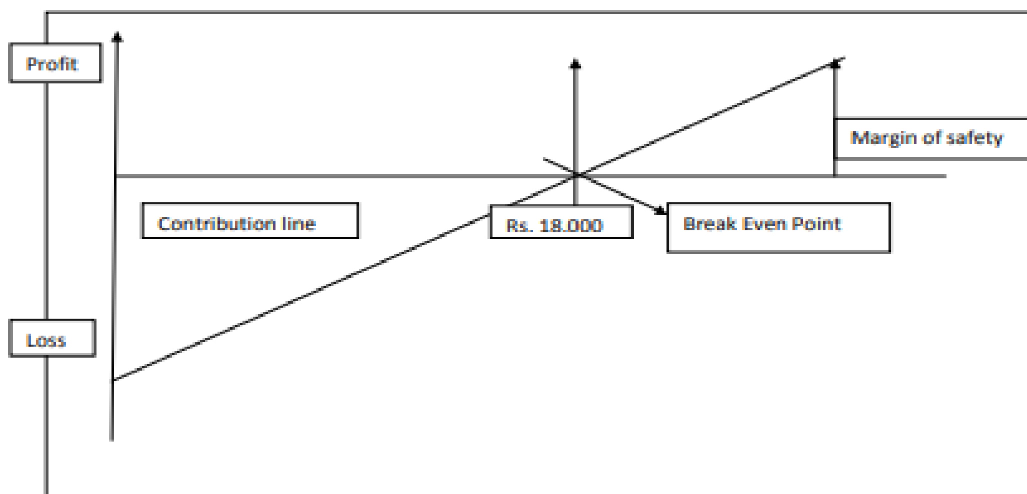
As a percentage of budgeted sales;

The MOS = 600/3,600 = 16.67%.

A high margin of safety shows a good expectation of profits, even if the budget is not achieved

The Profit/Volume (P/V) graph:

The breakeven point may be read from the graph as Rs. 18,000 in sales revenue, and the margin of safety is Rs. 3,600 in sales revenue or 16.67% Budgeted sales revenue.



The profit/volume (P/V) graph

Utility of CVP analysis:

- **Fixation of selling price:**

CVP analysis helps in fixing the selling price of the products. The cost of the product and the desired profitability are two important factors which govern fixation of selling price of a new product

- **Maintenance of a desired level of profit:**

A company may change its prices from time to time but at the same time they want to maintain the present level of profit or desired level of profit.

Sales volume in units = (Fixed cost + Desired Profit)/Contribution per unit

Sales Volume in ₹ = (Fixed cost + Desired Profit)/P/V ratio

- **Export decisions:**

The Export order price of a product is lower than the domestic price which is accepted due to compete in the global market. Sometimes this price may be much lower than the total cost of a product.

- **Key factor decisions:**

A firm is producing different types of products; it may have the problem of shortage in its factors of production such as shortage of Raw material, limited labor hours, Machine hours, limited production/sales etc.

The manager must decide the level of production for each product and at the same the combination of these productions must achieve a maximum level of profit.

The contribution per key factor determines the production level to achieve maximum profit.

- **Shut down or continue in production decisions**

Shutdown problems involve the following types of decisions:

- Whether or not to close down a factory, department, product line or other activity, either because it is making losses
- A shutdown should result in savings in annual operating costs for a number of years in the future
- Closure results in release of some fixed assets for sale. Some assets might have a small scrap value, but others, e.g. property, might have a substantial sale value.
- Employees affected by the closure must be made neglected or relocated, or they may be even offered early retirement.

- **Make or buy decisions:**

A company is often faced with the decision as to whether it should manufacture a component or buy it outside.

Example;

A company makes four components, A, B, C and D, with expected costs for the coming year as follows:

	A	B	C	D
Production (units)	1,000	2,000	4,000	3,000
Variable cost per unit ₹	14	17	7	12
Direct fixed costs ₹	1000	5000	6000	8000
Other committed fixed costs ₹	30,000			
Total Fixed cost of all components ₹	50,000			

A subcontractor has offered to supply units A, B, C and D for Rs.12, Rs.21, Rs.10 and Rs.14 respectively. Decide whether the company A should make or buy the components.

Solution:

	A	B	C	D
Unit variable cost of making ₹	14	17	7	12
Unit variable cost of buying ₹	12	21	10	14
	(2)	-4	-3	-2
Annual requirements in units	1,000	2,000	4,000	3,000
Extra variable cost of buying per annum ₹	(2,000)	8,000	12,000	6,000
Fixed cost saved by buying ₹	1,000	5,000	6,000	8,000
Extra total cost of buying ₹	(3,000)	3,000	6,000	(2,000)

a) The relevant costs are the differential costs between making and buying. They consist of differences in unit variable costs plus differences in directly attributable fixed costs. Subcontracting will result in some savings on fixed cost.

b) The company can save Rs. 3,000/annum by sub-contracting component A, and Rs.2, 000/annum by sub-contracting component D.

Sensitivity Analysis (What if Analysis)

- This model is also referred to as a what-if or simulation analysis.
- Sensitivity analysis can be used to help make predictions in the share prices of publicly traded companies or how interest rates affect bond prices.
- Sensitivity analysis allows for forecasting using historical, true data.
- While sensitivity analysis determines how variables impact a single event, scenario analysis is more useful to determine many different outcomes for more broad situations.

Meaning:

Sensitivity analysis is a financial model that determines how target variables are affected based on changes in other variables known as input variables. It is a way to predict the outcome of a decision given a certain range of variables. By creating a given set of variables, an analyst can determine how changes in one variable affect the outcome.

Usefulness of Sensitivity Analysis

- **Understanding influencing factors.** This includes what and how different external factors interact with a specific project or undertaking. This allows management to better understand what input variables may impact output variables.
- **Reducing uncertainty.** Complex sensitivity analysis models educate users on different elements impacting a project; this in turn informs members on the project what to be alert for or what to plan in advance for.
- **Catching errors.** The original assumptions for the baseline analysis may have had some uncaught errors. By performing different analytical iterations, management may catch mistakes in the original analysis.
- **Simplifying the model.** Overly complex models may make it hard to analyze the inputs. By performing sensitivity analysis, users can better understand what factors don't actually matter and can be removed from the model due to its lack of materiality.
- **Communicating results.** Upper management may already be defensive or inquisitive about an undertaking. Compiling analysis on different situations helps inform decision-makers of other outcomes they may be interested in knowing about.
- **Achieving goals.** Management may lay long-term strategic plans that must meet specific benchmarks. By performing sensitivity analysis, a company can better understand how a project may change and what conditions must be present for the team to meet its metric targets.

CASE STUDY

X Ltd., has purchased a small company that specializes in the manufacture of a part identified as No.AIL-201. The company is a decentralized organization and as such treats the newly acquired company as an autonomous division called Spare Parts Division with full profit responsibility. The Spare Parts Division incurred fixed cost of Rs. 30, 000/- per month and variable cost of Rs.18 per unit. The selling price per unit is Rs.30/-. The operating capacity of this division is 5,000/- units per month. The Finished Goods Division of the company is currently purchasing 2,500 units per month of the part No.AIL-201 from an outside supplier at Rs.29/- per unit, which represents the normal price of Rs.30/- less quantity discount. The top management of the company wishes to decide what transfer price should be used.

The following alternative prices are under consideration:

a. Market price of Rs. 30/-

b. The price of Rs.29/- that the Finished Goods Division is currently paying to the outside supplier

c. A negotiated price of Rs.23.50 that is calculated as variable cost plus half of the benefits of an internal transfer

d. Full cost of Rs.24/- which is variable cost plus fixed cost per unit

e. Variable cost of Rs.18/-

Solution:

Solution:				
Spare Parts Division 5,000 Units				
	(a)	(b)	(c)	(d)
Selling Price Less: Variable cost	1,50,000 90,000	1,47,500 90,000	1,33,750 90,000	1,20,000 90,000
Contribution Less: Fixed cost	60,000 30,000	57,500 30,000	43,750 30,000	30,000 30,000
Profit and Loss	**30,000**	**27,500**	**13,750**	**NIL**
Finished Goods Division 2,500 Units				

	(a)	(b)	(c)	(d)
Buying Price	75,000	72,500	58,750	60,000
Less: Price being paid to Outside supplier	72,500	72,500	72,500	72,500
Additional amount being spent on account of Internal Transfer / Net savings	**2,500**	**NIL**	**13,750**	**15,000**

(a)

The alternative of transferring the product at Market price of Rs. 30/- is unrealistic because the Finished Goods Division will never agree to pay a price more than the price it is currently paying.

Thus the overall profits of the organization would decline by Rs. 2, 500/- which represents the additional amount being spent by Finished Goods Division on account of internal transfers

(b)

The price of Rs. 29/- that the Finished Goods Division is currently paying to the outside supplier would be the most appropriate transfer price if the top management wishes to treat the two divisions as autonomous investment centre's.

This price will bring all the benefits of internal transfer to the Spare Parts Division while maintaining the position of the Finished Goods Division

(c)

A negotiated Price of Rs.23.50 which is calculated as variable cost plus half of the benefits of an internal transfer would be an appropriate transfer price if top management wishes to treat the divisions as investment centre's, but wishes to share the benefits of an internal transfer equally between them. Both the divisions are able to benefit from this price.

(d)

Full cost of Rs. 24/- will be appropriate transfer price if the top management treats the division like cost centres with no profit responsibility.

All benefits from both the divisions will accrue to the buying division. This will help the company to earn profits as a whole, but affect the performance of the selling division (Spare Parts Division) adversely.

Another disadvantage of this cost-based approach is that inefficiencies of the selling division are passed on to the buying division

(e)

The transfer price at variable cost of Rs. 18/- would be an appropriate transfer price for guiding the top management in deciding whether transfers between the two divisions should take place. Since Rs.18/- is less than the price prevailing in the external market and the selling division has excess capacity the transfer should take place. This will maximize the profits of the company as a whole.

Conclusion:

If transfer price of Rs.18/- is used, all the benefits of this transfer will accrue to the buying division and it will hurt the performance of the selling division

Fixing the right transfer price is a complex phenomenon. Therefore, the managers should adopt a proper route which is consistent with the overall objective and it must try to achieve the shareholders wealth maximization. Even though, the transfer pricing has many issues which is using as a tool for the mechanism of control and fixing managerial responsibilities

Unit IV

The Newer Dimensions of Control

Behavioral Aspect of Management Control:

Both formal and informal systems influence human behaviour in organizations. This in turn affects the alignment of individual goal and organization goal achievement. Even though the organization is in formal system, still we have to take in to consideration the informal processes like Ethic, Management styles, culture and climate of the organization in order to implement organization strategies.

External factors:

External factors are norms of desirable behaviour that exists in the society of which the organization is a part. These norms include a set of attitudes, often collectively referred to as the work ethics, which is manifested in employee's loyalty to the organization. These may vary from area to area, nation to nation. It depends on the culture of the society, Education system; background of the person, parental style and so on

Internal factors:

- Culture:

The most important internal factor is the organization's culture. The values and beliefs, Norms and behavior play an important role in the behavior of an individual. A company's culture usually exists unchanged for many years. Certain practices become automatic habits because it is carried out for years.

- Management Style:

The management style also has a strong influence over the behavior in a control system. Normally what one gets from the superior is given to the subordinates, and the subordinate gives more or less the same to his subordinates and it goes on.

- Informal Organization:

The importance of an informal organization is well understood when practicality is observed. Even though the chart says whom you should report to and whom you should communicate to, in reality you may be communicating and informally reporting to many departments in an organization. A control system when allows space for this informal organization and flexible enough to accept this succeeds easily.

- Perception and Communication:

In working towards the goal congruence, the personnel who are real performers in the field should know what to be done and what is expected from them. The channels of communication are often wide and complex leading to misunderstandings and misperceptions.

Motivation

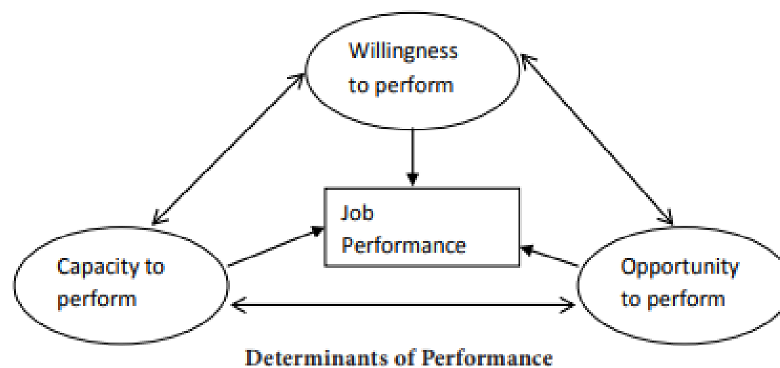
Motivation plays the central role in shaping one's behaviour, especially influencing work performance in organizations.

Motivation is made up of three distinct components.

First one is Direction which refers to what an individual chooses to do when presented with a number of possible alternative courses of action.

The second one is intensity, which refers to the strength of the individuals responses once this choice is made.

Finally, persistence refers to the staying power of behaviour, or how long a person will continue to devote effort.



Determinants of Performance

The capacity to perform relates to the degree to which an individual possesses what is supposed to be done and how to do it.

Opportunity to perform is often viewed as a critical factor. One may fail in this not only because of lack of capacity but nay be failing to identify or failing to make right decisions.

Willingness to perform relates to the degree to which an individual both desires and is willing to exert effort towards attaining job performances. It is in other words, motivation and it is what really counts. No combination of capacity and opportunity will result in high performance if the willingness or motivation is missing.

The performance of employees is can be influenced by the motivation given by the managers. If managers intervene and help creating an atmosphere that encourages, supports and sustains improvement, certainly the performance level raises.

The needs, abilities and individual goal of the employees must be considered by the mangers while considering differences in preferences

Agency Theory:

Agency theory explores how contracts and incentives can be used as motivation tools to achieve goal congruence. An agency relationship exists whenever one party (the principal) hires another party (The agent) to perform some service and in so doing, delegates decision making authority to the agent.

Agency theory conceptualize that the principals and agents have divergent preferences or objectives. The theory assumes that all individuals act in their own self-interest.

Agents are assumed to receive satisfaction not only from financial compensation but also from the perks involved in an agency relationship, such as leisure time, good environment, club memberships etc.

Control Mechanisms:

Monitoring and Incentive contracting are the two control mechanisms suggested by the agency theory.

Monitoring:

The principal can design control systems that monitors that agent's actions. Agency theory has attempted to explain why different agency relationships involve different levels of monitoring. If the task is not well defined or easily monitored, then incentive contracting becomes more appealing as a control device. Monitoring and incentives are not mutually exclusive alternatives.

Incentive contracting:

A principal may attempt to limit divergent preferences by establishing an appropriate incentive contracts. The more an agent's reward depends on a performance measure; the more incentive there is for the agent to improve the measure. Therefore, the principal should define the performance measure to that it furthers the employee's interest. The ability to accomplish this is referred to as goal congruence

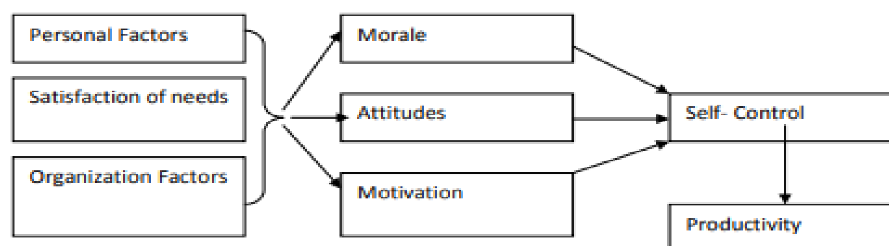
Morale

The attitude differs for each individual. The environment the employees work in greatly influences the behaviour and attitude. Managers at all levels are highly concerned about the Morale.

Mc Farland defines morale as follows:

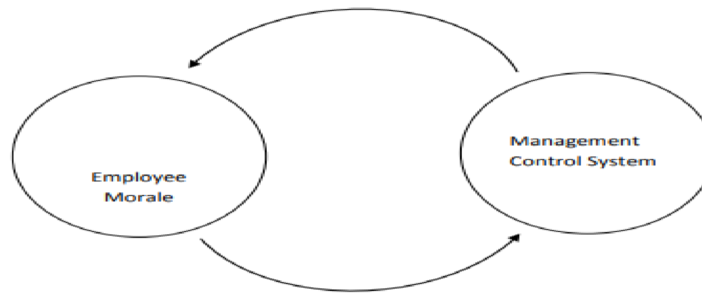
Morale is basically a group phenomenon. It is a concept that describes the level of favourable or unfavourable attitudes of the employees' collectively to all aspects of their work- the job, the company, their tasks, working conditions, fellow workers, superiors.

Morale and control:



Morale leads to self-control

Management View



Morale is contagious. The reason being, people learn from one another through various communication channels. Hence, to implement an effective management control system, the cultivation of favourable attitudes with morale building objectives is one of the important characteristics of management process.

Control and morale are interrelated. On one hand, the high morale level improves self control in the organization, which helps in effective implementation of management control system.

On the other hand, an effective control system like control of absenteeism and tardiness will improve morale. It is a continuous process and a miss in the link may develop a serious trouble for the system

Participative Management:

Participative Management Advantage:

Participative management is a method, which gives employees responsibility, accountability, and authority over their work. The method provides simple tools for employees to improve their work performance and positively impact the bottom line.

The process provides an environment to make employee needs known and creates a vehicle for improved communication between all areas of the organization. What differentiates this work is that people's recommendations are actually implemented and acted upon.

The criteria for superior performance are:

- Control
- Learning
- Variety
- Mutual Support and Respect
- A Promising Future
- Engage one or several of their preferred life interests
- Challenges that match and stretch individual skills
- Concentration and Focus
- Fun

Resistance to the Participative Management Process:

Wilfred Bion's work on group process, or what he calls fight or flight behaviours, or dependency is constantly at play in most bureaucratic organizations. Most organizations are still in part bureaucratic. People will either fight or run away and these behaviours can be very subtle in nature.

An effective method for managing this type of situation is to reassure the person or group that the change is for the best interest of the organization. From our facilitation experience, all stakeholders are likely to reap tangible and intangible rewards.

Learning Curves:

The term learning curve refers to a graphical representation of the "average" rate of learning for an activity or tool. It can represent at a glance the initial difficulty of learning something and, to an extent, how much there is to learn after initial familiarity.

Initially introduced in educational and behavioural psychology, the term has acquired a broader interpretation over time, and expressions such as "experience curve", improvement curve", progress curve" and efficiency curve are often used. Most tasks get faster with practice.

The learning curve has implications for learning in education and everyday life. It suggests that practice always helps improve performance, but that the most dramatic improvements happen first.

Another implication is that with sufficient practice people can achieve comparable levels of performance. The learning curve is visible with enough aggregation of dissimilar tasks or across similar tasks down to the level of individual subject's strategies. In this context, control system can use this concept in designing phase

Human Resources Accounting:

Defination:

The American Accounting Association's Committee on Human Resource Accounting (1973) has defined Human Resource Accounting as "the process of identifying and measuring data about human resources and communicating this information to interested parties".

HRA, thus, not only involves measurement of all the costs/investments associated with the recruitment, placement, training and development of employees, but also the quantification of the economic value of the people in an Organization. Flamholtz (1971) too has offered a similar definition for HRA.

They define HRA as "the measurement and reporting of the cost and value of people in organizational resources"

Why Human Resource Accounting?

According to Likert (1971), Human Resource Accounting (HRA) serves the following purposes in an organization:

- It furnishes cost/value information for making management decisions about acquiring, allocating, developing, and maintaining human resources in order to attain cost-effectiveness;
- It allows management personnel to monitor effectively the use of human resources;

- It provides a sound and effective basis of human asset control, that is, whether the asset is appreciated, depleted or conserved;
- It helps in the development of management principles by classifying the financial consequences of various practices

Measurements in Human Resource Accounting:

(a) **Valuation at cost:** Under this method the employees of an organization are evaluated on the basis of the cost which the organisation has incurred in selecting and training them. human resources accounting this cost is capitalised and is shown as an asset in the balance sheet

(b)) **Valuation Economic Cost:** Under the first method the human asset is shown in the balance sheet at its historical cost which is not enough if the balance sheet is to serve as a health chart of the organisation. It is essential for this purpose to show all assets (including human asset) in the balance sheet at their economic value. This is the capitalised value of future benefits expected of each asset.

(c) **Valuation of Replacement Cost:** Employees can also be valued at their replacement cost, i.e., the amount which will be needed to replace them completely. It should be noted that it is always impossible to replace the present personnel by a new set of people and still have the same organization.

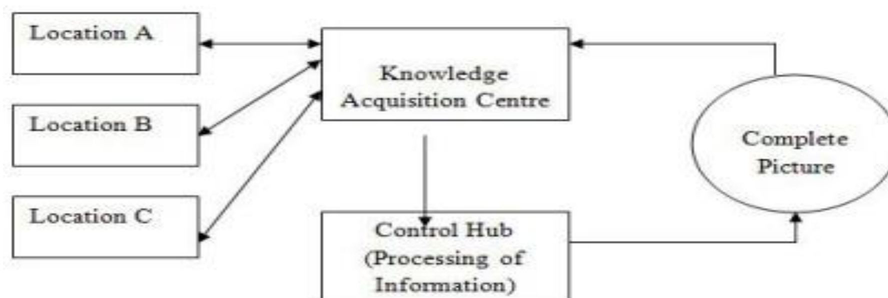
Knowledge Management control

The Knowledge Management Control System is an organizational approach to bridging organizational knowledge gaps between organizational disciplines by providing an uninterrupted process of transforming business data into decision making information.

Knowledge Management Control System empowers people, the right people, throughout the organization to make decisions based on predefined structures of authority. This ensures transparency of data, enabling critical informational to be available at the touch of a button

The innovation of Knowledge Management control system gives companies a huge competitive advantage over its competitors.

Knowledge Management Control System Model:



'Complete Picture' Model

Knowledge Management Control System Model, business branches spread at various locations, often various countries or continents are linked to a central Hub called knowledge Management control centre.

What are the types of knowledge to include in knowledge management?

- **Explicit knowledge**
- **Implicit knowledge**
- **Tacit knowledge**

Explicit knowledge

This is the knowledge that needs to be documented and is usually easy to turn into an article. It is a description about, or a set of steps towards, achieving something.

Implicit knowledge

This is information customers need to infer from explicit knowledge. It requires customers to interpret existing pieces of explicit knowledge as described above, or general knowledge to create desired outcomes.

Tacit knowledge

This is knowledge coming from experience and typically requires a lot of context and practice to acquire. Tacit knowledge is hard to gather because it is often specific and requires individual testing. Start by getting specialists or senior members of your team together to disseminate complex ideas and use that to build larger training content.

Benefits of a knowledge management system:

- **Identification of skill gaps:** When teams create relevant documentation around implicit or tacit knowledge or consolidate explicit knowledge, it can highlight gaps in core competencies across teams. This provides valuable information to management to form new organizational structures or hire additional resources.

- **Make better informed decisions:** Knowledge management systems arm individuals and departments with knowledge. By improving accessibility to current and historical enterprise knowledge, your teams can up-skill and make more information-driven decisions that support business goals.

- **Maintains enterprise knowledge:** If your most knowledgeable employees left tomorrow, what would your business do? Practicing internal knowledge management enables businesses to create an organizational memory. Knowledge held by your long-term employees and other experts then make it accessible to your wider team.

- **Operational efficiencies:** Knowledge management systems create a go-to place that enables knowledge workers to find relevant information more quickly. This, in turn, reduces the amount of time on research, leading to faster decision-making and cost-savings through operational efficiencies. Increase productivity not only saves time, but also reduces costs.

- **Increased collaboration and communication:** Knowledge management systems and organizational cultures work together to build trust among team members. These information systems provide more transparency among workers, creating more understanding and alignment around common goals.

- **Data Security:** Knowledge management systems enable organizations to customize permission control, viewership control and the level of document-security to ensure that information is shared only in the correct channels or with selected individuals. Give your employees the autonomy access knowledge safely and with confidence.

Knowledge management process:

1. **Knowledge Creation:** During this step, organizations identify and document any existing or new knowledge that they want to circulate across the company.

2. **Knowledge Storage:** During this stage, an information technology system is typically used to host organizational knowledge for distribution. Information may need to be formatted in a particular way to meet the requirements of that repository.

3. **Knowledge Sharing:** In this final stage, processes to share knowledge are communicated broadly across the organization. The rate in which information spreads will vary depending on organizational culture. Companies that encourage and reward this behavior will certainly have a competitive advantage over other ones in their industry.

Knowledge management tools:

- **Document management systems** act as a centralized storage system for digital documents, such as PDFs, images, and word processing files. These systems enhance employee workflows by enabling easy retrieval of documents, such as lessons learned.

- **Content management systems (CMS)** are applications which manage web content where end users can edit and publish content. These are commonly confused with document management systems, but CMSs can support other media types, such as audio and video.

- **Intranets** are private networks that exist solely within an organization, which enable the sharing of enablement, tools, and processes within internal stakeholders. While they can be time-consuming and costly to maintain, they provide a number of groupware services, such as internal directories and search, which facilitate collaboration.

- **Wikis** can be a popular knowledge management tool given its ease of use. They make it easy to upload and edit information, but this ease can lead to concerns about misinformation as workers may update them with incorrect or outdated information.

- **Data warehouses** aggregate data from different sources into a single, central, consistent data store to support data analysis, data mining, artificial intelligence (AI), and machine learning. Data is extracted from these repositories so that companies can derive insights, empowering employees to make data-driven decisions.

The Human Resource Management / Risk Management Interface:

Human resource activities lead to four important implications for risk management:

First, these activities are necessary to keep human resources in harmony with the risk management tools adopted by the management team. Risk management decisions are carried out by people. Placing the right people in right place, training, motivation and rewards are essential to success in risk management.

Second, human resource calamities, e.g., chronic illness, accidental death, interpersonal relationships can create risk in business. To avoid risk careful and appropriate risk management decisions are to be taken by risk specialists. Risk management should anticipate the likelihood of human resource calamities. Human resource contingency planning needs to be an internal part of the risk management.

Third, no management team stays together indefinitely. Every organization will eventually have different managers or be out of business. Management succession is a significant source of risk. Human resource considerations, plus legal and financial considerations, directly affect success in management succession and thus risk management.

Fourth, human resource performance evaluation should be tied to risk management. Risk management strategies are carried out through people. Human resource failures can cause the best planned risk management strategies to fail. Risk management depends on explicit duties being specified in manager's job descriptions, delegation of power and authority to manage risk following indicated guidelines, and responsibility at the action level or risk management.

Role of Managers in Risk Management:

Leadership and control:

Every human resource manager has responsibility of leadership. No group of people can come close to their goal without effective leadership. Planning, organizing, staffing, and controlling can substitute some extent of leadership. Delegation of authority and responsibility and other tools of empowering employees decrease the need of leadership. Motivation, trust, and careful development of procedures and policies are also helpful. Still, leadership is necessary.

Communication:

Communication is an essential skill for effective human resource management and risk control. In human resource management, clear messages, listening and use of feedback are especially important. Interpersonal relations, interviewing in hiring process, building rapport in the management team and with employees, orientation and training, performances appraisal, conflict resolution and discipline all requires in communication.

Training:

Training helps people to learn. Effective training requires teaching skills, an understanding of how adults prefer to learn, practices, communication a systematic approach and evaluation of whether training has been effective.

Motivation:

Motivation of employees challenges every manager. Employee motivation helps the organization to accomplish its goal and also helps workers to accomplish their career goals. The managers use a combination of understanding and satisfying employee needs, compensating fairly, making it possible for employees to do their jobs with minimum frustration and treating employees equitably.

Conflict:

Conflict is inevitable among employees, between employees and the management team and among management team. Managers must learn to deal with conflict rather than to avoid it. Conflict management strategies provide the management team positive steps for addressing the conflict. Effectiveness with the strategy is an essential skill for managing human resource as well as to risk control.

Evaluation:

Most employees have keen desire for evaluation i.e. information about their performance. Many supervisors find it extremely difficult to share performance evaluation in a honest and helpful manner. Supervisors lacking evaluation skills combat their frustrations by postponement, inflated evaluations and vague communication. Both supervisors and employees need training in evaluation for making it pleasant for both parties.

Differentiated Controls for Different Situation:

Factors	Single industry	Diversified Industry
Familiarity of Top management to each unit	High	Low
Function of top management	In all areas including Marketing, R & D, Manufacturing and finance	Mainly finance
Decision making authority	Centralised	Decentralised
Corporate culture	Strong	Weak

Management Control:

While organization structure defines the reporting relationships and the responsibilities and authorities of different mangers, it needs an appropriately designed control system to function effectively. When the organization structure gets wider and bigger, the experience and knowledge level of the top-level managers will not be sufficient enough to handle the diversified functions.

Top-level managers for highly diversified firms cannot expect to control the different businesses on the basis of intimate knowledge of their activities, and performance evaluation tends to be carried out at arm's length.

Strategic planning:

The horizontal dimension might be incorporated into the strategic planning process in a number of different ways.

- First, a group executive might be given the responsibility to develop a strategic plan for the group as a whole that explicitly identifies synergies across individual business units within the group.

- Second, strategic plans of individual business units could have an interdependence section, in which the general manager of the business units identifies the focal linkages with other business units and how those linkages will be exploited.

- Third, the corporate office could require joint strategies fir interdependent business units. Finally, strategic plans of individual business units could be circulated to mangers of similar business units to critique and review.

Budgeting:

The chief executives of single industry firms may be able to control the operations of subordinates through informal and personally oriented mechanisms, such as frequent personal interactions. If so, this lessens the need to rely heavily on the budgeting system as the tool of control

Transfer Pricing:

Transfers of goods and services between business units are more frequent in single industry and related diversified firms that in conglomerates. The usual transfer pricing policy in a conglomerate is to give sourcing flexibility to business units and use arms –length market prices. However, in a single industry or a related diversified firm, synergies may be important.

Incentive Compensation:

They calculate incentive compensation as bonus on actual economic value added (EVA) in excess of budgeted EVA.

In diversified firms, the incentive bonus of the business unit mangers is determined on the profitability of those units, rather than the profitability of the entire organization. This will motivate the unit managers and gives them a feeling that they are also owners of the units.

Competitive Advantage:

Choosing a differentiation approach, rather than a low-cost approach, increases uncertainty in a business unit's environment for the following three reasons.

1. Product innovation is more critical for differentiation business units. This is partly because a differentiation business unit focuses primarily on uniqueness and exclusivity, which require greater product innovation, whereas a low-cost business unit, with its primary emphasis on reducing cost, typically prefers to keep its product offerings stable over time.

2. Smaller firms have narrow product lines to minimize the inventory carry costs. Differentiated business units, on the other hand, tend to have broader set of products to create uniqueness. Product breadth creates high environmental complexity and higher uncertainty.

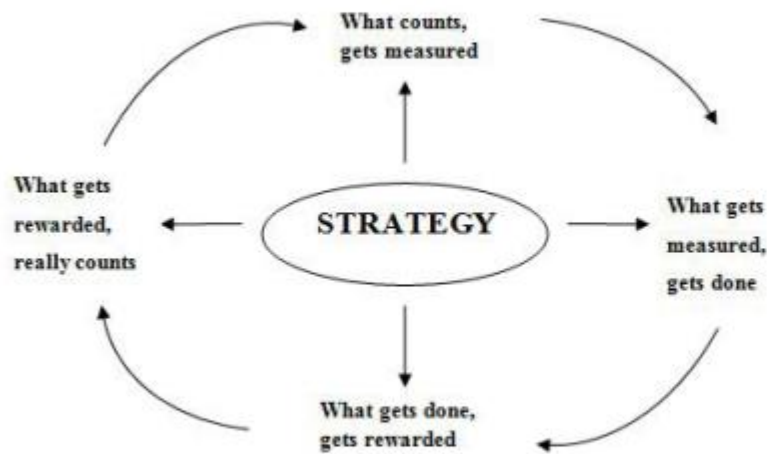
3. Smaller units succeed with their products as they are priced lower.

Performance Measurement Systems:

The goal of performance measurement system is to implement strategy. In setting up such systems, a senior management selects measures that best represent the company's strategy.

These measures can be seen as current and future critical success factors; if they are improved, the company has implemented its strategy. The strategy success depends on its soundness.

A performance measurement system is a simply a mechanism that improves the likelihood the organization will implement its strategy successful.



Framework for Designing Performance Measurement System

A performance measurement system attempts to address the needs of the different stakeholders of the organization by creating a blend of strategic measures;

- outcome and driver measures,
- financial and no financial measures
- internal and external measures

Outcome and Driver Measures:

Outcome measurement indicates the result of a strategy (e.g. increased revenue). These measures typically are "lagging indicators"; they tell management what has happened. By contrast, driver measures are, "leading indicators"; they show the progress of key areas in implementing a strategy.

Outcome and driver measures are inextricably linked. If outcome measures indicate there is a problem but the driver measures indicate the strategy is being implemented well, there is a high chance that the strategy needs to be changed

Financial and No financial Measures:

Organizations have developed very sophisticated system to measure financial performance. during the 1980s industries were being driven by changes in non-financial areas, such as quality and customer satisfaction, that eventually impacted company's financial performance.

the importance of non financial measures, many organizations have failed to incorporate them in to their executive-level performance reviews because these measures tend to be much less sophisticated than financial measures and senior management is less adept at using them

Internal and External Measures:

Companies must strike a balance between external measures, such as customer satisfaction, and measures of internal business processes, such as manufacturing yields. Too often companies sacrifice internal development for external results or ignore external results together, mistakenly believing that good internal measures are sufficient.

Key Success Factors:

Customer-Focused Key Variables:

The following key variables focus on the customer:

- **Bookings:** In most business units, some aspect of sales volume is a key variable. Ideally, this is sales orders booked, since unexpected changes in this variable can have future repercussions throughout the business. Because bookings precede sales revenue, this is a better indicator than sales revenue itself.

- **Book orders:** An indication of an imbalance between sales and production, back orders can suggest customer dissatisfaction

- **Market share:** Unless the market share is watched closely, deterioration in the unit's competitive position can be obscured by reported increases in sales volume that result from overall industry growth.

- **Key account orders:** In business units that sell to retailers, the orders received from certain important accounts-large departmental stores, discount chains, supermarkets, mail-order houses-may indicate early the entire marketing strategy's success.

- **Customer satisfaction:** This can be measured by customer surveys, "mystery shopper" approaches, and number of complaint letters.

- **Customer retention:** This can be measured by the length of customer relationships.

- **Customer loyalty:** This can be measured in terms of repeat purchases, customer referrals, and sales to the customer as a percentage of the customer's total requirements for the same product or service

Key Variables:

Key Variables Related to Internal Business Processes:

The following key variables to internal business processes

- **Capacity utilization:** Capacity utilization rates are especially important in businesses in which fixed costs are high (e.g., paper, steel, aluminum manufacture). In an organization, the percentage of the total available professional hours that is billed to clients-sold-time is a measure of fixed-resource utilization.
- **On-time delivery**

- **Inventory turnover**

- **Quality:** Indicators of quality include the number of defective units delivered by each supplier, number and frequency of late deliveries, number of parts in a product, percentage yields, scrap, rework, machine breakdowns, number of customer complaint, level of customer satisfaction, warranty claims, field service expenses

- **Cycle time:** This equation for cycle time is a tool used to analyze inventory requirements.
  Cycle time = processing time + storage time + movement time + Inspection time

Implementing a Performance Measurement System:

- **Define Strategy:**

The scorecard builds a link between strategy and operational action. Therefore, the process of defining a scorecard begins by defining the organization's strategy. In this phase, it is important that the organization's goals are explicit and that targets have been developed

- **Define Measures of Strategy** :

The next step is to develop measures to support the articulated strategy. The organization must focus on a few critical measures at this point or management will be overloaded with measures. Also, it is important that the individual measures be linked with each other in a cause-effect manner

- **Integrate Measures into the Management System:**

The scorecard must be integrated with the organization's formal and informal structures, culture, and human resource practices. For instance, the effectiveness of scorecard will be compromised if managers' compensation is based only on financial performance.

- **Review Measures and Results Frequently:**

Once the scorecard is up and running, it must be consistently and continually reviewed by senior management.

The organization should look for the following:

➢How is the organization doing according to the outcome measures?

➢How is the organization doing according to the driver measures?

➢How has the organization's strategy changed since the last review?

➢How have the scorecard measure changed?

The most important aspects of these reviews are as follows:

➢They tell management whether the strategy is being implemented correctly and how successfully it is working.

➢They show that management is serious about the importance of these measures.

➢They keep measures aligned to ever-changing strategies.

➢They improve measurement

Balanced Score Card:

Balanced Score Card is a comprehensive performance measurement framework that translates an organisation's strategy into clear objectives, measures, targets and initiative. It represents management system that can motivate breakthrough improvement critical areas of product, process, customer and market development. It integrates the measures used across the organization and helps it to grapple with the intangible or intellectual assets

Defination:

Kaplan and Norton describe the innovation of the balance score card as follows:

"The balanced score card retains traditional financial measures. But financial measures tell the story of past events, an adequate storey of industrial age companies for which investments in long-term capabilities and customer relationship were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology, and innovation."

David Chaudron in his article, 'Using the balanced scorecard to combine viewpoints of Company's successes defines Balanced Scorecard as

➢A way of Measuring organizational, business unit of department success

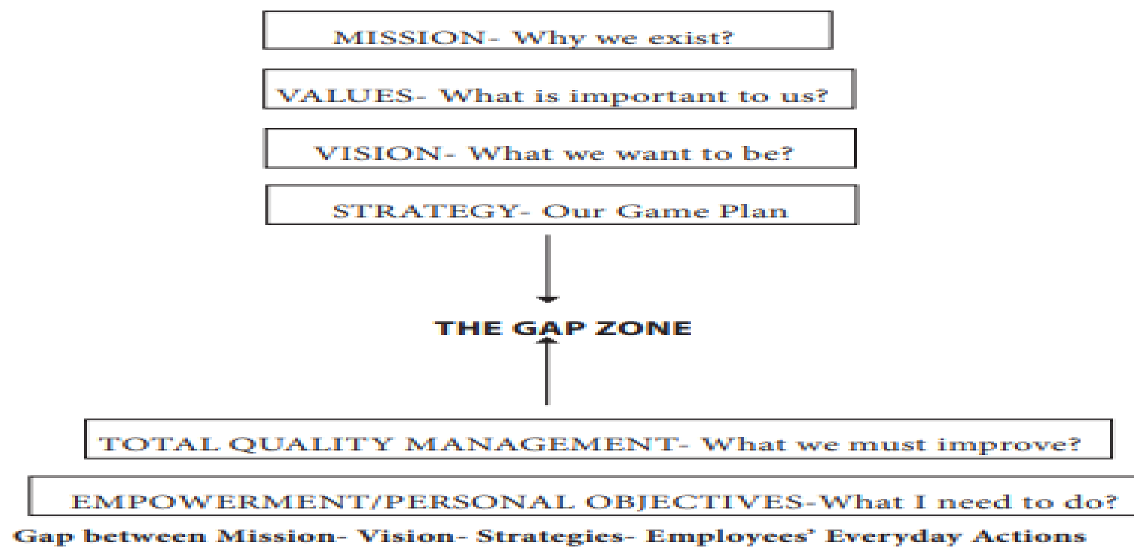
➢A way of Balancing long-term and short-term actions

➢A way of Balancing different measures of success such as: Financial, Customer, Internal Operations and Human Resource Systems & Development

➢A way of trying strategy to measure to action

Need For Balanced Scorecard:

The need for balanced scorecard arises from the fact that there is a gap that exists between the mission, vision, strategy and the actions initiated by employees on a daily basis. This can be depicted with the help of the following figure



Gap between Mission- Vision- Strategies- Employees' Everyday Actions

Benefits of Balanced Scorecard:

- **Alignment of strategy with key performance objectives at all levels of the organization:**

The result is an organization that is not operating at maximum efficiency, typically leading to less than optimal performance as well as missed opportunities. With a Balanced Scorecard, the corporation, down to each organizational unit and even to the individual level, can understand the key performance indicators that they have control of and responsibility for and understand the relationship to the overall success of their organization

- **Measuring and managing business performance effectively**

The balanced scorecard provides management with visibility into operations and issues of all business units and enables them to easily monitor and understand how organizations are progressing against plan. However, a truly effective scorecard also goes a step further and enables organizations to implement and track key initiatives for addressing problems areas or pursuing business opportunities.

- **Strategic feedback**

Balanced Scorecard that has been deployed across the enterprise offers the divisional units an unsurpassed communication platform for feedback and information sharing. Often looked upon as “the strategic knowledge management system” within an organization, a scorecard focuses on proactive communication for addressing problems early and pursuing business opportunities faster and more effectively than traditional management models.

- **Maximising the overall IT investment**

Most organizations have significant investments in data warehouses, data marts as well as OLTP and ERP systems, such as SAP, people soft and Baan. A balance scorecard, as the strategic analytical application within an organization, should work in harmony with existing sources of data, extracting and packaging this information and sharing it as part of the scorecard.

- **Outcome Metrics**

The measurement tool should provide information on the key business drivers and variables that managers need to watch. Managers have to then evolve processes to collect information relevant to these metrics and reduce it to numerical form for storage, display, and analysis. Decision makers examine the outcomes of various measured processes and strategies and track the results to guide the company and provide feedback.

Thus the value of tools measurement lies in their ability to provide a factual basis for defining:

➢Strategic feedback to show the present status of the organization

➢Diagnostic feedback into various processes to guide improvements on a continuous basis.

➢Trends in performance over time

➢Feedback

➢Quantitative inputs to forecasting methods and models for decision support systems

Unit V

Management Control in Specialized organization

Sectorial Applications:

I. Service Organizations

Characteristics of Service Organizations

1. Absence of Inventory Buffer:

Goods can be held in inventory, which is a buffer that dampens the impact on production activity of fluctuations in sales volume. Services cannot be stored. Thus although a manufacturing company can earn revenue in the future from products that are on hand today, a service company cannot do so. It must try to minimize its unused capacity. Moreover, the costs of many service organizations are essentially fixed in the short run.

2. Difficulty in Controlling Quality:

A manufacturing company can inspect its products before they are shipped to the consumer, and their quality can be measured visually or with instruments. A service company cannot judge product quality until the moment the service is rendered, and then the judgments are often subjective. Restaurant management can examine the food in the kitchen, but customer satisfaction also depends on the way it is served.

3. Labor Intensive:

Manufacturing companies add equipment and automate production lines, thereby replacing labor and reducing costs. Most service companies are labor intensive and cannot do this.

4. Multi-Unit Organizations:

Some service organizations operate many units in various locations, each unit relatively small. These organizations are fast-food restaurant chains, auto rental companies, gasoline service stations, and many others. The information for each unit can be compared with system wide or regional averages, and high performers and low performers can be identified.

5. Historical Development:

Cost accounting started in manufacturing companies because of the need to value inventories. Standard cost systems, separation of fixed and variable costs, and analysis of variances were built on the foundations of cost accounting systems. Until a few decades ago, most texts on cost accounting dealt only with practices of manufacturing companies.

II. Professional Service Organizations

Special Characteristics

1. Goals:

These organizations have relatively few tangible assets; its principal asset is the skill of its professional staff, which doesn't appear on its balance sheet. Their financial goal is to provide adequate compensation to the professionals.

2. Professionals:

Professional organizations are labor intensive, and the labour is of a special type. Professionals who are also managers tend to work only part time on management activities. They give inadequate importance to the financial implications of their decisions which affect the attitude of support staffs and non professionals which in turn leads to inadequate cost control.

3. Output and Input Measurement:

The output of a professional organization cannot be measured in physical terms, such as units, tons, or gallons. Revenues earned is one measure of output in some professional organizations, but these monetary amounts relate to the quantity of services rendered, not their quality. Furthermore, the work done by many professionals is non repetitive.

4. Small Size:

With a few exceptions, such as some law firms and accounting firms, professional organizations are relatively small and operate at a single location. Senior management in such organizations can personally observe what is going on and personally motivate employees. Even a small organization needs a budget, a regular comparison of performance against budget, and a way of relating compensation to performance.

5. Marketing:

In professional organisation, the ethical code limits the amount and character of overt marketing efforts by professionals. Since marketing is an essential activity, if it can't be conducted openly, it takes the form of personal contacts, speeches, articles, etc. These marketing activities are conducted by professionals who spend their time mostly in production work, i.e., working for clients

Management Control Systems

1. Pricing:

The selling price of work is set in a traditional way in many professional firms. If the profession is one in which members are accustomed to keeping track of their time, fees generally are related to professional time spent on the engagement. The hourly billing rate is based on the compensation of the grade of the professional, plus a loading for overhead costs and profit.

2. Profit Centres and Transfer Pricing:

Support units, such as maintenance, information processing, transportation, telecommunication, printing, and procurement of material and services, charge consuming units for their services.

3. Strategic Planning and Budgeting:

In general, formal strategic planning systems are not as well developed in professional organizations as in manufacturing companies. Partly it is because professional organizations have no great need for such systems. The principal assets are people. The strategic plan of a professional organization typically consists primarily of a long range staffing plan, rather than a full-blown plan for all aspects of the firm's operation.

4. Control of Operations:

Much attention is given to scheduling the time of professionals. The billed time ratio, which is the ratio of hours billed to total professional hours available, is watched closely. If engagements are billed at lower than normal rates, the resulting price variance warrants close attention. When the work is done by project teams, control is focused on projects

5. Performance Measurement and Appraisal:

At the extremes the performance of professionals is easy to judge. Appraisal of the large percentage of professional who are within the extremes is much more difficult. For more professions, objective measures of performance are sometimes available. The recommendations of an investment analyst can be compared with actual market behavior of the securities.

III. Financial Service Organizations

Financial Service organizations include commercial bank and thrift institutions, insurance companies, non-banking financial institutions, mutual funds and securities firms. These companies are in business primarily to manage money.

Some act as intermediaries (obtain money from depositors and lend it to individuals), some act as risk shifters (obtain money in the form of premiums, invest these them and accept the risk of occurrence of specific events) and still others as traders (buy and sell securities, either for their own account or for customers)

Special Characteristics

1. Monetary Assets:

Most of the assets of financial service firms are monetary. The current value of monetary assets is much more easily measured than the value of plant and other physical assets. Currency is the extreme example of a fungible commodity.

2. Time Period for Transactions:

During this period, the soundness of the loan as well as the purchasing power of money will change. So, it means performance of financial personnel cannot be measured at the time the initial decision is made. It also means that control should be in the form of continued surveillance of the soundness of the transaction during its life.

3. Risk and Reward:

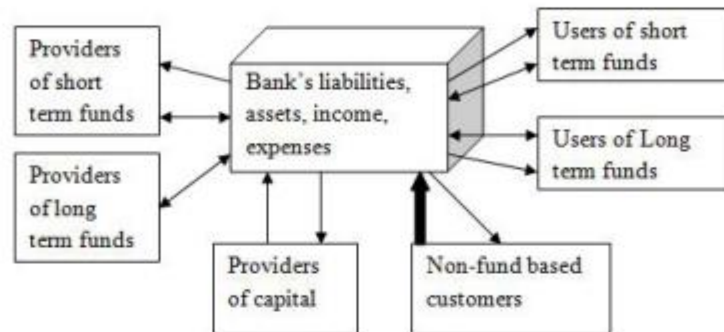
Many financial services firms are in the business of accepting risks in return for rewards. Most business decisions involve a trade-off between risks and rewards. The greater the risk, the greater should be the anticipated reward. Interest rates on loans and premiums on insurance policies are based on assumptions about risk that may or may not turn out to be accurate.

4. Technology:

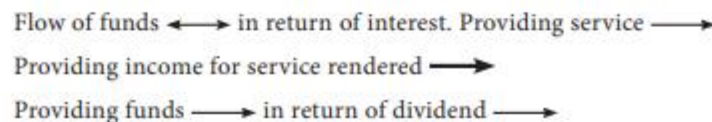
Technology has revolutionized the financial services industry. Financial service firms have used information technology as a way to offer innovative services. The Automated Teller Machines of banks, electronic marketing of products and services through internet, cyber-payment systems and online brokerage services are such innovative examples

The Banking Sector: Logical consequence of Flow of Transactions

The first step in constructing a management control system for an industry is to understand the skeleton of their flow of transactions. The flow chart is given in diagram below.



The Flow Chart of the Banking Industry



The Balance Sheet Concept

Definition:

A Balance Sheet is a statement of the financial position of a business which states the assets, liabilities, and owners' equity at a particular point in time. In other words, the Balance Sheet illustrates business's net worth

It is a statement of the total assets and liabilities of an organization at a particular date, usually the last day of the accounting period. The first part of the statement lists the fixed and current assets and the liabilities, the second part shows how they have been financed; the totals for each part must be equal.

All accounts in the General Ledger are categorized as an asset, a liability or equity.

The relationship between them is expressed in this equation:

Assets = Liabilities + Equity. The Balance Sheet is divided into these three sections. It is also known as Statement of financial position

IV. Insurance Industry Overview

Insurance is a contract binding an insurance company to compensate a beneficiary for the loss of life or loss or damage to property of a person insured. Benefits accrue due to an individual due to statutory obligation of the benefit provider to compensate for the expenses involved in health care, retirement plans of the beneficiaries by entering into a contract with the provider either singly or in groups by paying a predetermined premium at predetermined intervals.

The processes involved in Insurance and Benefits Management Business are described below:

a) Publicity and Promotion of Products.

b) Product Evaluation.

c) Enrolment of Beneficiaries for the Plans.

d) Receipts and Accounting of Premiums.

e) Processing and Settlement of Claims.

f) Payments Processing and Settlement of Accounts with Vendors.

g) Payments processing and Settlement of accounts with Agents/ Brokers. h) Routine and Exception Reporting for Management Control.

i) Customer Relations Management with Beneficiaries and Vendors.

j) Accounting and Audit.

k) System Administration.

Processes involved in Insurance and Benefits Management Business

A. Publicity and Promotion of Products

1. Insurance and Benefit Product Vendors offer Perennial as well as Plan Year Based Products.

2. The Promotional Materials including Application Forms for Perennial Products should be made available on the Client's Website.

3. Upon requests from individual, the CRM staff should be capable of dispatching hard copies by Surface Mail.

4. Insurance Agents also canvass for Products and their management for a specified Commission amount. The details of Agents are held in the database.

5. Insurance and Benefit Vendors also promote their Products through brokers for Corporate Clients on a specified brokerage. The details of brokers and Corporate Client Information are to be stored in the database.

6. Enrolment Management Staff is responsible for collection and dispatch of promotional materials, maintenance of the concerned web page(s), receipt and approval of Applications, maintenance of master data of Plans.

B. Product Evaluation

1. The selection of Products for promotion and management depends on the business yield, the popularity of the Product with benefits, the reliability of Vendors, and the business relationship with the Vendors, legal and statutory requirements.

2. To have an objective analysis of the Products, the Program will be using statistical tools to analyze the data on Plans, Premiums, Claims, Revenue Flows and Revenue earned.

3. To gauge the relative effectiveness of the Vendors, the lead-time for Claims Adjustment, Rejections, Net Rebate Earned, and the total number of beneficiaries will be given by the program

4. The Enrolment Management will select the appropriate Vendors and Products in the best interest of the business and Clients for promotion.

C. Enrollment of Beneficiaries for the Plan

1. Applications for Enrolment in the Insurance / Benefit Plans will be obtained through:

a. Internet

b. Surface Mail

c. Bulk enrolment through:

- i. Brokers
- ii. Agents
- iii. TPA's

d. Client Representative.

e. Its Own Representative.

2. The data will be entered individually, where needed and validated through validation program for accuracy and completeness.

3. The approved list will update in the Master list of affected tables.

4. The rejected list will be sent to the applicant / the forwarding agency for resubmission or rejection. 5. Where the applications are received through Internet a confirmation letter will be sent to the Applicant on hard copy for his /her authentication and return. The Plan becomes effective only after the receipt of the signed copy.

D. Receipts & Accounting of Premium

1. Premium may be received from Individual Beneficiary through Check, Demand Drafts, Money Order, Pay Order or Credit or Debit Card Authorization.

2. Corporate Clients may send the details of Premium Cutting as a separate file or as part of their combined Pay Roll.

3. Groups may send their Premium Payments through a separate file.

4. Import definitions for each of the Clients / Groups should be customized.

5. The Imported data will be reconciled for short, missing, invalid or overpayment against actual due and the Client notified accordingly.

6. After reconciliation, the premium payment will update individual running ledger entry.

E. Processing and Settlement of Claims

1. Individuals prefer Claims against Products.

2. These are required to be settled by the Carriers as per the entitlement.

3. Claims are validated by Program as well as by the Claims Staff who are trained Claims Settlers.

4. The Program does the validation for Effectiveness of the Claim, limits of liability.

5. Once the Claim is processed, it is passed for Payment or Rejected.

6. The Payment Order would be generated and sent to the Beneficiary or the Rejection slip with reasons.

F. Payments Processing and Settlement of Accounts with Vendors

1. The records should be updated and prefer a claim on the Vendor. Based on the business relationship with the Vendor, reimbursement of the Claims passed will be by book adjustment against Vendor Payment or Imprest Account.

2. Then generate Payment advice, Payment Orders and Control Reports as per the needs of the management as well as Vendors.

3. Similarly when Premium Payments are received from Individuals, Groups and Corporate Clients by Carriers, the Processing Staff will calculate the amount payable to Vendors for their plans and credit the amount to the Vendor.

G. Payments processing and Settlement of accounts with Agents/ Brokers:

1. The Agents / Brokers / TPA's canvass for enrolment into Insurance and Benefit Products. The commission amount to Agents / Brokers / TPA's will be paid as per business rules and agreements. This may be fixed or based on a percentage of Premium amount. The periodicity of payment may be either onetime or periodic.

2. The Brokers can make use of custom developed software to promote both Software & Insurance / Benefit Providers for soliciting their Products. The software would calculate the amount due to Agents/ Brokers / TPA's to cater for all types of payments. It wills also Generate Pay orders, update Accounts and print needed control and information reports.

H. Routine and Exception Reporting for Management Control:

1. Reports are required to have control on the activities outlined in each of the above processes. These reports will help the management for decision-making.

2. Ready reckoned for calculating Premium amount, commission and brokerage for different plans will be made.

3. There will also be a list of FAQ's for use by Management, Agents / Brokers / TPA's, Individual beneficiary, Clients and Staff.

I. Customer Relationship Management

1. This process would enhance the relationship between Management, Staff, Agents / Brokers / TPA's, Beneficiaries, Groups, Clients, Vendors.

2. The concerned departments of Carrier would be responsible for maintenance and updating of Information pertaining to CRM activities.

3. This process [CRM] includes Call / Request Registration, Call / Request Tracking and Call / Request Closure.

4. Control Reports will be generated for Pending, Open and Closed Calls / Request.

J. Accounting and Audit

1. The amount received as Premium will be validated against the expected and exception report will be generated for each client and plan.

2. The amount paid against Commission and brokerage will be based on type of payment and periodicity.

3. The amount due to Individual beneficiary will be based on Service charges to the Client and the rebate from the Carrier.

4. Carriers will carry out audit on percentage of approved and rejected Claims manually at random and an audit report will be made.

5. The payment dues towards service charges and rebate will be credited to Corporate Accounting.

6. The Commission and Brokerage will be calculated for payments to Agents and brokers.

7. The Premium Payments to Vendors will be calculated and payments made/ adjusted.

V. Non-profit Organizations

A non-profit organization, as defined by law, is an organization that cannot distribute assets or income to, or for the benefit of its members, officers or directors.

The organization can, of course, compensate its employees, including officers and members, for services rendered and for goods supplied. This does not permit an organization from earning a profit; it prohibits only the distribution of profits

1. Absence of the Profit measure:

A dominant goal of all businesses is to earn a satisfactory profit; net income measures performance toward this goal. No such measure of performance exists in non-profit organizations. Many of them have several goals, and an organizations' effectiveness in attaining its goals rarely can be measure by quantitative amounts. The absence of a satisfactory, quantitative, overall measure of performance is the most serious management control problem in this organization

2. Contributed Capital:

Non-profit organization receives contributed capital in two forms: plant and endowment. Plant includes contributions of buildings and equipment, or contributions of funds to acquire these assets. Endowment consists of gifts whose donors intend that the principal amount will remain intact indefinitely.

These organizations have two sets of financial statements.

One set relates to operating activities including an operating statement, a balance sheet, and a statement of cash flows.

The second set relates to inflows and outflows of contributed capital during a period and a balance sheet that reports contributed capital assets and the related liabilities and equity.

3. Fund Accounting:

Many non-profit organizations use an accounting system that is called “fund accounting”. Accounts are kept separately for several funds each of which is self-balancing (i.e., the sum of the debit balances equals some of the credit balances).

Most organizations have

i. A general fund or operating fund, which corresponds closely to the set of operating accounts mentioned above.
ii. ii. A plant fund and an endowment fund, which account for the contributed capital assets and equities mentioned earlier.
iii. iii. A variety of other funds for special purposes.
iv. Others are useful for internal control purposes. For management control purposes, the primary focus is on the general fund.

4. Governance

Non-profit Organizations are governed by boards of trustees. Trustees are usually are not paid, and many of them are unfamiliar with business management. Therefore, they generally exercise less control than the directors of a business corporation.

The need for a strong governing board in a non-profit organization is greater than in a business because the vigilance of the governing board may be the only effective of detecting when the non-profit is in difficulty. In a profit oriented organization, a decrease in profits signals this danger automatically.

Management Control System:

Product pricing:

Many non-profit organizations give inadequate attention to their pricing policies. Pricing of services at their full cost is desirable. A “full-cost” price is the sum of the direct costs, indirect costs and a small allowance for increasing the organization’s equity. This principle applies to services that are directly related to the organization’s objectives.

Strategic Planning and Budget preparation

Absence of a profit measure makes program decisions more subjective. Non-profit industries know before the budget year begins the approximate amount of their revenues. They do not have the option of increasing revenues during the year by increasing their marketing efforts. They budget expenses so that the organization will at least break even at the estimated amount of revenue

Operation and Evaluation

In non-profit organizations there is no way of knowing what the optimum operating costs are. Therefore, responsibility centre managers tend to spend whatever is allowed in the budget, even though the amount is higher than is necessary. Conversely, they refrain from making expenditures that have an excellent payoff simply because the expenditure was not included in the budget.

Legal Environment

The important aspects of the legal environment in India are:

- The provisions of the Income Tax Act allow donations to non-profit organizations, unless they are for religious purpose, to be deducted from income.
- There are restrictions on foreign funding under Foreign Contribution Regulation Act.
- Their governance structure is laid down by the Society's Registration Act and Charities Act. These provide for trustees, management committees, board of directors

VI. Government and Cooperative Business

Process of Setting of Strategy and Objectives of Government Business

Government in business could owe much of its inspiration to the features of the Soviet Union formality in its analytic frame work, focus on internal controls, and connection to the economics of the classical approach, but its rationale is hardly based on profitability and is vague, as in the procedural approach. It does not grow from within by learning from local conditions, as in the system approach, or evolutionary approach

VII. Control in Projects

Nature of Projects "A project is a set of activities intended to accomplish a specified and result of sufficient importance to be of interest to management".

Projects include construction projects, the production of a sizeable unique product (such as turbine), rearranging a plant, developing and marketing a new product, consulting engagements, audits, acquisitions and divestitures, litigation, financial restructuring, research and development work, development and installation of information systems and so on.

Project Control Environment

1. **Project Organization Structure**

A project organization is a temporary organization. A team is assembled for conducting the project, and the team is disbanded when the project has been completed. Team members may be employees of the sponsoring organization, may be hired for the purpose, or some or all of them may be engaged under a contract with an outside organization

Matrix Organizations: If members of the project team are employees of the sponsoring organization, they have two bosses – the project manager of the functional department to which they are permanently assigned. Such an arrangement is called matrix organization.

However, their basic loyalty is to their functional department. The project manager has less authority over personnel than the manager of a production department, whose employees have an undivided loyalty to that department

2. Contractual Relationships

If the project is conducted by an outside contractor, an additional level of project control is created by the sponsoring organization which has its own control responsibilities.

The contractor may bring its own control system to the project, and this system may need to be adapted to provide information that the sponsor needs

i. Fixed-Price Contracts:

Here, the contractor agrees to complete the specified work by a specified date at a specified price. Usually, there are penalties if the work is not completed to specifications or if the scheduled date is not met. If the sponsor decides to change the scope of the project, a change order is issued. The parties must agree on the scope, schedule, and cost implications of each change order. If the change orders involve increased costs, then it must be borne by the sponsor.

ii. Cost-reimbursement Contracts:

The sponsor has considerable responsibility for the control of costs and therefore needs a management control system and associated control personnel. Cost-reimbursement contract is appropriate when the scope, schedule, and cost of the project cannot be estimated reliably in advance. In this contact, the profit component, or fee, usually should be a fixed monetary amount. If it is a percentage of costs, the contractor is motivated to make the costs high and thereby increase his profit.

3. Information Structure

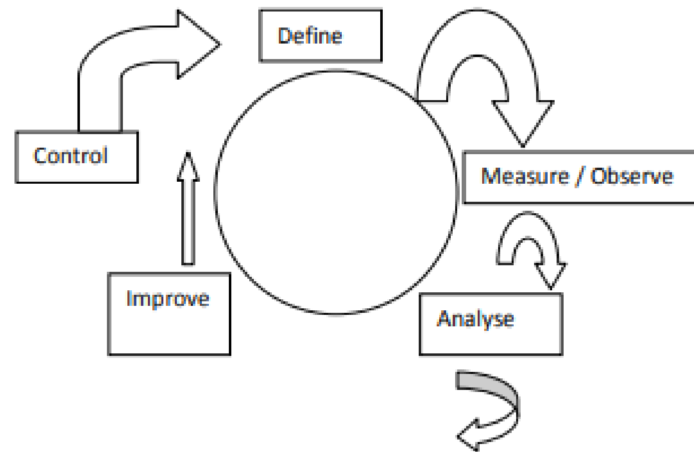
i. Work Packages:

In a project control system, information is structured by elements of the project. The smallest element is called a work package, and the way in which these work packages are aggregated is called the work breakdown structure. A work package is a measurable increment of work, usually of fairly short duration of a month or so. It should have an unambiguous, identifiable completion point, which is called a milestone.

ii. Indirect Cost Accounts:

Apart from work packages for direct project work, cost accounts are established for administrative and support activities. Unlike the work packages, these activities have no defined output. Their estimated costs usually are stated as per unit of time, such as a month. The chart of accounts, the rules for charging costs to projects, and the approval authorities and their specific signing powers are also developed in advance.

The Twelve Step Process of Designing Control System:



The DMAIC Process

Step 1:

The first step in the process of designing control systems is to attentively hear the client's needs. Active listening, effective questioning, conceptualization of vague situations, and clarifying are first necessary steps in any type of consultancy task and any consultancy style.

Step 2:

A attempt to mentally it the whole project in a holistic framework or sectional framework or with a zero based approach, as if what currently exists either needs to be ignored, or it should improve the present situation.

At this stage, we need to decide the style we would like to adopt:

1. That of an expert, used specially by IT consultants who tell what to do based on their experience

2. The doctor-patient model, where you are an expert but you need considerable assistance to understand the symptoms of the organization

3. The helping model, to develop alternate approaches for the consideration of the organisation

Step 3:

to clearly frame the objectives of the exercise. There should not be any commitment on the means to achieve the objectives. This is the stage at which one should have an understanding of the formal as well as the implied 'strategy' of the organisation, which is often hidden from the consciousness of its members and has to be ferreted out and clarified.

Step 4:

It's a workshop in which a conversational style should be encouraged and the person's at all hierarchical levels are encouraged to speak out on the objectives and the means to achieve them.

Step 5:

Form the database and make a chart of flow of transactions. Suitable computer software for this is available and should be used profitably.

Step 6:

Identify critical indicators and compare it with the advice obtained earlier at step four.

Step 7:

Decide on the measurement and, or observational methods of inputs and outputs.

Step 8:

Analyse the data with reference to these measurements and observations.

Step 9:

Discuss the findings.

Step 10:

Prepare a draft report with alternative remedies and discuss.

Step 11:

Redraft the report.

Step 12:

Submit final report to the management.

Future of Management Control Systems:

Management control principles that will always be important or that can guide the redesign of systems to meet new management needs follow.

1. Always expect that individuals will be pulled in the direction of their own self-interest. You may be pleasantly surprised that some individuals will act selflessly, but management control systems should be designed to take advantage of more typical human behavior.

2. Design incentives so that individuals who pursue their own selfinterest are also achieving the organization's objectives. If there are multiple objectives as in usually the case), then multiple incentives are appropriate.

3. Evaluate actual performance based on expected or planned performance, revised, if possible, for actual output achieved. The concept of flexible budgeting can be applied to most goals and actions, both financial and non financial.

4. Consider non financial performance to be just as important as financial performance. In the short run the manager may be able to generate good financial performance while neglecting non financial performance.

5. Array performance measures across the entire value chain of the company. This ensures that all activities that are critical to the long run success of the company are integrated into the management control system.

6. Periodically review the success of the management control system. Are goals being met? Does success in accomplishing an action mean that goals are being met, too? Do individuals have, understood, and use the management control information effectively?

7. Learn from the management control successes (and failures) of competition around the world. Despite cultural differences, human behavior is remarkably similar. Successful applications of new technology and management controls may be observed in the performance of others.

Network Analysis:

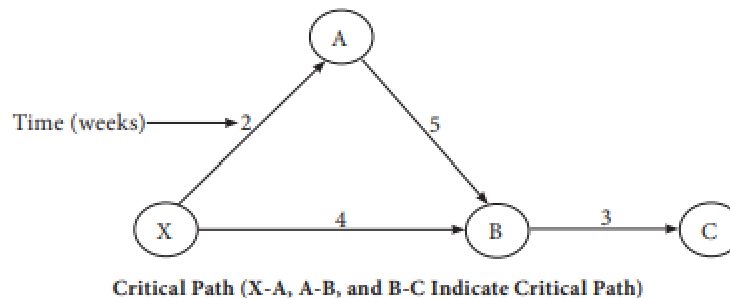
The important tools for constructing the time schedule for the project are PERT (Program Evaluation and Review Technique) and CPM (Critical Path Method).

These are techniques for network analysis. Each technique has three basic steps:

i. estimating the time required for each work package,

ii. Identifying the interdependencies among work packages – which must be completed before another can be started,

iii. Calculating the critical path



Critical Path (X-A, A-B, and B-C Indicate Critical Path)

CPM: Critical Path and Slack

The management control implications in CPM are:

➢ First, in the control process, special attention must be paid to those activities that are on the critical path, and less attention needs to be paid to slack activities.

➢ Second, in the planning process, attention should be given to possibilities for reducing the time required for critical path activities; if possibilities exist, the overall time required for the project can be reduced.

➢ Third, it may be desirable to reduce critical path times by increasing costs, such as incurring overtime, but additional money should not be spent to reduce the time of slack activities

PERT:

PERT is a method to analyze the involved tasks in completing a given project, especially the time needed to complete each task, and identifying the minimum time needed to complete the total project.

It is applied to very large-scale, one-time, complex, non-routine infrastructure and Research and Development projects.

➢Optimistic time (O): the minimum possible time required to accomplish a task, assuming everything proceeds better than is normally expected

➢Pessimistic time (P): the maximum possible time required to accomplish a task, assuming everything goes wrong (but excluding major catastrophes).

➢most likely time (M): the best estimate of the time required to accomplish a task, assuming everything proceeds as normal.

➢Expected time (TE): the best estimate of the time required to accomplish a task, assuming everything proceeds as normal (the implication being that the expected time is the average time the task would require if the task were repeated on a number of occasions over an extended period of time