



# **F2 - Management Accounting**

## **ACCA – 117 FAQ**

### **Theory Questions**

**1. Define the labour idle time ratio?**

Idle time ratio = idle hours / total hours x 100%

**2. What is the definition of the Internal Rate of Return (IRR)?**

The IRR is the rate of interest at which the Net Present Value of the project is zero.

**3. In process costing, how are abnormal losses or gains valued?**

Abnormal gains and losses are valued at full cost per unit.

**4. How is the Residual Income (RI) calculated? Outline advantages and disadvantages.**

RI = profit less notional interest on the capital invested

**Advantages:**

- As an absolute measure, RI does not lead to dysfunctional decision making that relative measures may do. Projects with a positive contribution to profit would not be rejected if they have a lower percentage return than existing ones.
- By attributing an imputed interest charge to the capital used, managers are made aware of the funding cost of their division.
- RI is consistent in the long run with the NPV approach criteria that maximized NPV in the long run are normally likely to be consistent with RI maximization.

**Disadvantages**

- Defining the appropriate parameters such as controllable profits and the attributable interest charge (or cost of capital) may be difficult.
- Comparison between divisions of different sizes may present problems where economies of scale offer advantages.
- When organization value assets at net book value, ROI & RI generally increase as assets get older. Consequently, management may hold on to out of date plant and machinery.

**5. What does the sales volume variance measure?**

The sales volume variance measures the effect on the budgeted profit of the difference between the actual sales volume and the budgeted sales volume.

**6. What is top-down budgeting?**

Top-down budgeting is where the budgets are prepared by high-level management and then communicated to lower levels. Lower level management do not participate in the budget process.

**7. A Paasche price index number uses base year or current year quantities. Which?**

A Paasche index number uses current year quantities.

**8. In process costing, what is meant by an abnormal gain?**

An abnormal gain is the amount by which the actual loss is less than the normal (or expected) loss.

**9. Define the labour production volume ratio (activity ratio)?**

The labour production volume ratio =  $\frac{\text{expected hours to produce actual output}}{\text{total hours available (budgeted)}} \times 100\%$

**10. If the linear equation  $y = a + bx$ , were to be drawn on a graph, what would be the gradient of the line?**

The gradient of the line would be 'b'.

**11. In the linear equation  $y = a + bx$ , where y is the total cost and x is the total production, what is the variable cost per unit?**

The variable cost per unit is 'b' in the equation

**12. In the linear equation  $y = a + bx$ , which is the dependent variable?**

The dependent variable is y

**13. If we have an equation relating the total sales revenue to the total advertising spend, which would be the dependent variable?**

The dependent variable would be the sales revenue (it depends on the amount of advertising expenditure.)

**14. When sampling, what is meant by a ‘sampling frame’?**

A sampling frame is a numbered list of all items in a population

**15. What is a ‘semi-variable cost’?**

A semi-variable cost is a combination of variable and fixed costs.

**16. Describe a ‘pie chart’?**

A pie chart is a circle that is divided into segments representing each type of observation. The size of each segment is proportional to the proportion of the total that are within each type of observation.

**17. In the linear equation  $y = a + bx$ , where  $y$  is the total cost and  $x$  is the total production, what is the fixed cost?**

The fixed cost is ‘ $a$ ’ in the equation

**18. What is meant by ‘indirect costs (or overheads)’?**

Indirect costs are those costs which cannot be specifically identified with a specific cost unit or cost centre.

**19. What is meant by a ‘line of best fit’?**

The line that most nearly goes through all the points when the data is plotted on a graph.

**20. What is meant by ‘quota sampling’?**

The population is stratified and a sample of each strata is restricted to a fixed number.

**21. What are the purposes of costing (i.e. calculating the cost of producing a product or service)?**

- ✓ To enable a selling price to be set
- ✓ To calculate a profit per unit.
- ✓ To value inventory

**22. What is the purpose of management accounting?**

To help management run the business in a way that achieves the objectives of the business.

**23. What is meant by an ‘incremental cost’?**

An incremental cost is an extra cost (and is relevant for investment decisions).

**24. What is the Current Ratio?**

The current ratio = current assets / current liabilities

**25. What are the four main elements & the role that one would expect to appear in a Mission Statement?**

The four main elements are:

- ✚ Purpose
- ✚ Strategy
- ✚ Culture
- ✚ Values

*Role*

Many organization have clearly stated definitions of what they exist for and are trying to achieve, but equally, many do not and rely on an implied or cultural awareness of their objectives. Several groups of stakeholders may have a valid interest in the definition of mission. Where an explicit statement of the organization’s purpose exists, it may be used as a slogan for marketing purposes, as an important input into the management and motivation of staff at all levels and, specifically, here, as the apex of system of performance management.

Performance implies purpose and directed rather than random action. Individual performance should contribute to group performance, group to department and so on all the way up to overall

organizational performance. In the same way as performance at each level supports that at each higher level, so the targets at each level flow downwards from higher levels, driving ultimately from the organizational mission.

**26. Give possible reasons for an adverse material expenditure variance.**

Possible reasons for an adverse material expenditure variance include:

- ✓ Paying more than the budgeted price per unit of materials due to errors in purchasing.
- ✓ a price increase in materials
- ✓ purchasing better quality materials
- ✓ incorrect budgeting of the standard cost of materials

**27. What is meant by the ‘payback period’?**

The payback period is the number of years it takes to get back the original investment, in cash terms.

**28. What is a ‘sunk cost’?**

A sunk cost is a cost already incurred (and is not relevant for investment decisions)

**29. What are the purposes of budgeting?**

- ❖ Planning
- ❖ Control
- ❖ Co-ordination
- ❖ Authorisation
- ❖ Communication
- ❖ Motivation
- ❖ Evaluation

**30. How is the coefficient of determination calculated?**

The coefficient of determination is the square of the coefficient of correlation.

**31. What is a ‘variable cost’?**

A variable cost is one which varies in total with the level of activity.

**32. What is a 'delivery note'?**

A delivery note is included by the supplier with the goods, and lists the quantity of goods that are being delivered.

**33. In the formula on the formula sheet for the Economic Order Quantity, what does the symbol D represent?**

D represents the total demand per year.

**34. What is meant by a piecework system of remuneration?**

Employees are paid a fixed amount for each unit produced.

**35. Define the labour capacity ratio.**

Labour capacity ratio =  $\text{Number of hours spent working} / \text{total hours available} \times 100\%$

**36. What is the symbol for the coefficient of correlation on the formulae sheet?**

r is the coefficient of correlation

**37. What is meant by the 'cost gap' in the context of target costing?**

The cost gap is the excess of the estimated actual cost over the target cost.

**38. What are the four main differences between the output of service and manufacturing businesses?**

- Intangibility – the output of a service industry is performance rather than tangible goods.
- Perishability – a service cannot be stored
- Simultaneity – a service is received by the customer at the same time as it is delivered – it cannot be checked first.
- Heterogeneity – every service is likely to be different.

**39. What is meant by the term 'by-product'?**

A by-product is output from a process which has a low value relative to the main product(s) being produced in the process.

**40. What is the difference between a profit mark-up and a profit margin?**

A mark-up is when the profit is calculated as a percentage of cost; a margin is when the profit is calculated as a percentage of selling price.

**41. Under what circumstances will the profit using marginal costing and the profit using absorption costing be the same?**

The profits will be the same if there is no change in the level of inventory over the period (i.e. when the closing inventory is the same level as the opening inventory).

**42. What is the reason for a difference between the profit calculated under marginal costing principles and the profit calculated under absorption costing principles?**

The difference is because of the difference in the way opening and closing inventories are valued. Under marginal costing they are valued at the marginal (variable) cost of production; under absorption costing they are valued at the full cost of production (variable plus fixed).

**43. What is meant by the word 'contribution'?**

The contribution is the profit before fixed costs (or the revenue less all variable costs).

**44. What is the difference between the allocation of overheads and the apportionment of overheads?**

- Allocation – whole cost items are charged to the relevant cost centre
- Apportionment – cost items are shared/divided between several cost centres

**45. In assessing 'Value for Money', what are the three 'E's'?**

The three 'E's' are:

- Economy
- Efficiency
- Effectiveness

**46. How is the Return on Investment (ROI) calculated?**

ROI = profit / capital invested



**47. How is the Interest Cover calculated?**

The interest cover = profit before interest and tax / interest

**48. What is the purpose of an operating statement (as part of variance analysis)?**

The operating statement shows why the actual profit differs from the budgeted profit.

**49. What is bottom-up budgeting?**

Bottom-up budgeting is where lower level managers are involved in the budget process – they prepare budgets for their departments which are then checked and co-ordinated by higher level management.

**50. What is the difference between capital expenditure and revenue expenditure?**

Capital expenditure is the acquisition of non-current assets (which appear on the Statement of Financial Position).

Revenue expenditure is the payment of running expenses (which appear on the Income Statement).

**51. If there is perfect negative correlation between two variables, what will be the value of the coefficient of correlation?**

If there is perfect negative correlation, then  $r$  will equal  $-1$

**52. What does a coefficient of determination of 0.75 mean?**




It means that 75% of the changes in  $y$  are explained by changes in  $x$ .

**53. In process costing, what is meant by an abnormal loss?**

An abnormal loss is the excess of the actual loss over the normal (or expected) loss.

**54. What are the attributes of good information?**

Good information should be:

-  Accurate
-  Complete
-  Cost-effective

- ✚ Understandable
- ✚ Relevant
- ✚ Accessible
- ✚ Timely
- ✚ Easy to use

**55. What is meant by ‘random sampling’?**

Each item in the population has an equal chance of being selected.

**56. What is the ‘prime cost’ of a unit of production?**

The prime cost is the total of the direct costs of a unit.

**57. What is a ‘stepped fixed cost’?**

A stepped fixed cost is one that is fixed in total within a certain level of activity, but where once an upper limit of activity is reached then a new higher level of fixed cost occurs.

**58. What is a ‘purchase requisition form’?**

A purchase requisition form is prepared by the department that requires the material and is sent to the purchasing department.

**59. In the formula on the formula sheet for the Economic Order Quantity, what does the symbol  $C_o$  represent?**

$C_o$  represents the cost of placing one order.

**60. What is the difference between direct and indirect labour costs?**

Direct labour costs are directly involved in the making of products – the basic pay plus overtime premium on specific jobs

Indirect labour costs are all other labour costs – general overtime premiums, bonus payments, and the cost of indirect workers (e.g. canteen, maintenance)

**61. In the formulae for regression analysis on the formulae sheet, what does the symbol  $n$  represent?**

$n$  is the number of pairs of observations

**62. What are the four types of cost relating to quality?**

- ❖ Prevention costs (the costs of improving the quality of the production process)
- ❖ Appraisal costs (the costs of quality control checks)
- ❖ Internal failure costs (the costs of re-working; the costs of rejects)
- ❖ External failure costs ( the costs of delivering poor quality to the customer – e.g. replacements, repair work)

**63. What are the basic principles involved in Total Quality Management?**

- ❖ ‘Get it right first time’ – i.e. good quality production – no re-working, no rejects
- ❖ Continuous improvement
- ❖ Customer focus

**64. What is meant by the term ‘target cost’?**

The target cost is the maximum cost we can allow in order to achieve the target level of profitability based on a pre-determined selling price.

A method that sets a target cost by subtracting a desired profit margin from a competitive market price. Target costing involves deciding on a competitive price for a product and then deducting a desired profit margin from it. The balance is the target cost.

**65. In Activity Based Costing, what is meant by the term ‘cost driver’?**

A cost driver is whatever activity is causing the cost to occur.

**66. What is meant by the FIFO method of valuing inventory?**

FIFO means first-in-first-out and means that we assume that items are issued out of inventory in the order in which they were received into inventory. Therefore, any closing inventory is assumed to be made up of the most recent items received into inventory.

**67. Define the labour turnover ratio.**

Labour turnover ratio = number of leavers who require replacing / average number of employees  
x 100%

**68. How is the Dividend Cover calculated?**

The dividend cover = profit after tax / dividends

**69. What is meant by the ‘marginal cost of production’?**

The marginal cost of production is the total of all variable production costs.

**70. If there is an over - absorption of overheads, does it mean that the actual total overheads are more or less than the total overheads absorbed?**

The actual overheads are less than the total overheads absorbed.

**71. What is a flexed budget?**

A flexed budget is a budget re-written for the actual level of activity.

**72. What is meant by a ‘cost unit’?**

A cost unit is a unit of product or service for which the cost is calculated.

**73. What is the difference between data and information?**

Data consists of facts that have been gathered.

Information is data that has been processed in a way that is meaningful to the person who receives it.

**74. What are ‘direct costs’?**

Direct costs are those that can be specifically measured in each unit of production.

**75. What is meant by the expression ‘perfect positive linear correlation’?**

Perfect positive linear correlation means when the observations are plotted on a graph they all lie exactly on a straight line pointing upwards (i.e. both variables increase together)

**76. In the formula on the formula sheet for the Economic Order Quantity, what does the symbol  $C_h$  represent?**

$C_h$  represents the cost of holding one unit for one year.

**77. What is a ‘fixed cost’?**

A fixed cost is one which remains constant in total over certain levels of activity.

**78. What is meant by the term ‘benchmarking’? Outline disadvantages as well.**

Benchmarking is an attempt to identify best practices. It is a comparison exercise to help improve performance. However, it does not have to be a comparison with a competitor. For example, it could be a different unit within the same organisation. Benchmarking generally leads to greater incidence of team work and cross-functional learning. Comparing units or functions with another in the same industry is the definition of internal benchmarking, not functional benchmarking.

**Disadvantages**

- Difficulties in deciding which activities to benchmark
- Identifying the best in class for each activity
- Persuading other organizations to share information
- Successful practices in one organization may not transfer successfully to another.

**79. What are the four perspectives covered by the Balanced Scorecard?**

The four perspectives are:

- Financial
- Customer
- Internal
- Innovation and learning

**80. What is the Quick Ratio (or Acid-test Ratio)?**

The quick ratio = (current assets – inventory) / current liabilities

**81. What is meant by the ‘principal budget factor’?**

The principal budget factor is the factor that limits the level of activity of the organisation (usually sales).

**82. A Laspeyre price index number uses base year or current year quantities. Which?**

A Laspeyre price index number uses base year quantities.

**83. In process costing, what is meant by a normal loss?**

A normal loss is the loss that is expected to occur.

**84. What is meant by ‘systematic sampling’?**

Every n<sup>th</sup> item is selected, after a random starting item

**85. What is meant by a ‘cost centre’?**

A cost centre is a production or service location, activity, function or item of equipment for which the total cost can be calculated.

**86. Which of the following methods of inventory valuation are acceptable under IAS 2 for financial accounting: FIFO; LIFO; Weighted Average Cost?**

FIFO and Weighted Average Cost are allowed by IAS 2. LIFO is not allowed.

**87. In inventory control, what is the difference between the ‘re-order quantity’ and the ‘re-order level’?**

The re-order quantity is the quantity actually ordered each time. The re-order level is the level of inventory that triggers the placing of an order.

**88. Define the labour efficiency ratio?**

Labour efficiency ratio =  $\frac{\text{expected hours to produce actual output}}{\text{actual hours to produce actual output}} \times 100\%$ .

**89. What is TQM?**

Total quality management involves getting the entire workforce motivated to improve quality, and assessing the costs and benefits involved in improving quality. Things related to TQM are Continuous improvement, Zero defects, Right first time.

**90. Which type of centre would have its performance measured by its ROCE?**

Investment centre

**91. Which method of investment appraisal leads to the selection of projects that maximize shareholders wealth?**

Net present value (NPV)

**92. What is an attainable standard?**

An attainable standard assumes efficient level of operation, but includes **allowances** for normal loss, waste and machine downtime.

**93. Define ‘Cost value’, ‘Exchange value’, ‘Use value’, ‘and Esteem value’?**

Exchange value – the market value of the product or service.

Cost value – the cost of producing and selling an item.

Esteem value – the prestige the customer attaches to the product

Use value – what the article does the purpose it fulfills.

**94. What are the three activities that are associates with budgeting?**

The first activity that needs to be done is to determine the principle budget factor as this is the constraining factor that will affect all budgets. The master budget is prepared next. Flexing the budget occurs after the budgeting process when actuals are known.

**95. Define prime cost?**

The prime cost of a product is the total of all the direct costs of the product.

**96. Define value analysis?**

Value analysis is a planned, scientific approach to cost reduction and Value analysis attempts to enhance the esteem value of a product at the lowest cost.

Value analysis is a planned, scientific approach to cost reduction. It considers four aspects of value: cost, exchange, use and esteem. Market value of the product or service refers to exchange value, not cost value. Cost value is the cost of producing and selling an item. Value analysis is

different from other cost reduction approaches because it encourages innovation and a more radical outlook for ways of reducing costs.

**97. Define imposed budgeting?**

Top management prepare a budget with little or no input from operating staff and It reduces deliberate overestimation of costs and underestimation of revenues in a budget.

Imposed budgets are prepared with insignificant input from operational levels. This way the management is able to prevent intentional creation of cost buffers or power revenue target setting at operational level. One of the disadvantages of imposed budgeting is that it may hinder motivation so it will not increase operational managers' commitment. Imposed budgets are most effective in small organisations, not large organisations.

**98. Explain Activity Based Costing (ABC)?**

Activity based costing recognises that there are other factors than production volume which drive overheads. Overheads may still be under or over absorbed and arbitrary cost apportionments may still be required if activity based costing is used. Activity based costing is most likely to be useful where there is a wide and diverse product range.

**99. Explain the difference between fixed budget and flexible budget?**

Flexible budgets are prepared using marginal costing techniques and fixed budgets are useful for monitoring fixed costs

Flexible budgets are prepared using marginal costing techniques and knowledge of cost behaviour. The flexible budget shows the expected cost or revenue for each item for the relevant level of activity. The flexible budget is amended in response to change in the level of activity.

Fixed budgets are not useful for budgetary control purposes because actual activity levels rarely match budgeted activity levels. Fixed costs should be fixed at any level so a fixed budget is useful for monitoring fixed costs.



**100. Explain your understanding about scatter diagram?**

Scatter diagrams are graphs which are used to exhibit data (rather than equations). They compare the way that two variables vary with each other. There may not be any correlation between the two variables. If there is no correlation then there is no equation. The x axis on a scatter diagram represents the independent variable and the y axis represents the dependent variable.

**101. What would be the best basis of measuring the performance of a manager of an investment centre?**

Controllable operating profit should be used because it includes the total of all costs and revenues that can be attributable to the performance of a manager of an investment centre.

Contribution is not suitable as it does not reflect controllable fixed costs. Traceable divisional profit and divisional net profit are not suitable as they include costs that are outside the control of the investment centre manager.

**102. Explain your understanding about responsibility centre?**

Managers of cost centres should be accountable for controllable costs only. A cost which is not controllable by a junior manager may be controllable by a senior manager

There are more than two types of responsibility centres, namely, cost, profit, revenue and investment. It is important both from a motivational point of view and a control point of view that managers are only judged on areas over which they have control.

A profit centre's performance is usually based on profit, rather than its return on capital. An investment centre is measured by its return on capital.

Costs that are not controllable by a junior manager may be controllable by a senior manager. For example high direct labour costs in a department may be caused by excessive overtime. A junior manager may be obliged to continue meeting production schedules but senior managers may be able to reduce costs by deciding to hire extra full-time staff.

**103. Explain about motivation?**

Motivation is creating a desire to work for the organization. Not all employees are motivated by money. Many are motivated by spending time with their families or a desire to do a good job. It is important that goals for all employees are aligned with the organisation's overall mission. Employers must motivate employees to achieve these goals. This is vital for the future success of the business.

**104. What does the gradient of the regression line represent?**

When analysing the relationship between total cost and activity level the gradient of the regression line represents variable cost per unit. This is because variable cost is the main relationship between total cost and activity level.

**105. Explain the aspect of budget administration?**

A budget manual is a set of instructions governing the preparation of budgets. Whilst a budget committee is involved co-ordinating and administering the budget process it is not involved in the preparation of the actual budgets. This function would usually be undertaken by management accountants or the finance department.

**106. Explain about batch costing?**

Batch costing would be used in industries that produce similar, separately identifiable products (such as in footwear manufacturing and baking). It would not be used where the products are not similar (such as in film making) or where process costing is more appropriate (such as in oil refining).

**107. Explain the difference between cost control and cost reduction?**

Cost control is concerned with regulating the costs of operating a business. Cost reduction is a planned approach to reducing expenditure.

It is easy to confuse cost control and cost reduction but the statements about regulating costs and a planned approach to reducing expenditure are true. The assumption that current cost levels are too high refers to cost reduction, not cost control. Reducing costs to budget level refers to cost control, not cost reduction.

**108. Briefly explain reasons why net profit and net cash flow may be different?**

**Purchase of non-current assets:** for instance you purchase an asset worth MVR 10,000 and depreciation is charged at 10% of the original cost. The cash payment during the year is MVR 10,000 (and this does not affect the profit and loss account), instead you charge depreciation of MVR 1,000. Hence overall profit and loss will reduce.

**Sale of non-current assets**

**Matching receipts from receivables and sales invoice raised:** if goods are sold on credit, the cash receipts will be the same as the value of the sales (ignoring early settlement discounts and bad debts). However, receipts may occur in a different period as a result of the timing of payments.

**109. Briefly explain advantages & disadvantages of high low method?**

**Advantages**

- It is easy to use and understand
- It needs just two activity level

**Disadvantages**

- It uses two extreme data point which may not be representative of normal conditions.
- Using only two points to determine a formula may mean that the formula is not very accurate.

**110. Explain for what reasons spreadsheet used?**

- ✚ Cash flow forecasting
- ✚ Calculation of depreciation
- ✚ Monthly sales analysis by market.

**111. Explain standard costing, uses & identify advantages and disadvantages of using ideal standards?****Definition**

“A control of technique that reports variances by comparing actual costs to preset standards so facilitating action through management by exception.” CIMA

**Uses**

- ❖ To value inventories and cost production for cost accounting purposes.
- ❖ To act as a control device by establishing standards (planned cost), highlighting (via variance analysis) activities that are not conforming to plan and thus alerting management to areas which may be out of control and in need of corrective action.

**Advantages of ideal standard**

Ideal standards and variances from ideal standards are useful for pinpointing areas where a close examination may result in large savings in order to maximize efficiency and minimize waste.

**Disadvantages of ideal standard**

Ideal standards are likely to have an unfavorable motivational impact because reported variances will always be adverse. Employees will often feel that the goals are unattainable and not work so hard.

**112. What is meant by the interdependence of variances?**

When two variances are interdependent (interrelated) one will usually be adverse and the other one favorable. For instance, it may be decided to purchase cheaper material for a job in order to obtain a favorable price variance. This may lead to higher material wastage than expected and therefore, adverse usage variance occurs. If the cheaper materials are more difficult to handle, there might be some adverse labour efficiency variance too.

**113. Explain why the variances used to reconcile profit in a standard marginal costing system are different from those used in a standard absorption costing system?**

There are two differences between the way that variances are calculated in a marginal costing and in an absorption costing system.

In a marginal costing, fixed cost are not absorbed into product costs and so there are no fixed cost variances to explain any under or over absorption of overheads. There will, therefore, be no fixed overhead volume variance. There will, however, be a fixed overhead expenditure variance which is calculated in exactly the same way as for absorption costing system.

**114. Suggest two financial & non-financial measures by which management might seek to monitor the credit control department?**

*Two financial performance measures to monitor the credit control department:*

- i. Monthly cost centre cost per \$ of credit sales
- ii. Salary cost per customer account

*Two non-financial performance measures to monitor the credit control department:*

- i. Number of customer accounts handled per employee
- ii. Average days debt outstanding.

**115. Suggest (financial success, customer satisfaction, process efficiency & organizational learning and growth) critical success factor suitable for hotel chain and also suggest key performance indicator as well?**

|                              | <b>Critical success factor</b>                                      | <b>Key performance indicator</b>  |
|------------------------------|---|---|
| <b>Financial success</b>     | Shareholders value<br>Profitability<br>Cash flow<br>Revenue growth  | Earnings per share<br>Profit before tax<br>Cash target<br>Percentage of increase in revenue |
| <b>Customer satisfaction</b> | Standard of facilities<br>Standard of service<br>Catering standards | Questionnaire results<br>Complaints<br>Percentage of utilization of in house catering       |

|   |   |   |
|---|---|---|
| <b>Process efficiency</b>                   | Utilization of conference facilities<br>Utilization of information technology<br>Daily cleaning<br>Check in | Percentage of occupation of conference facilities<br>Percentage utilization of technology<br>Average cleaning time per specified area<br>Average check in time per customer |
| <b>Organizational learning &amp; growth</b> | Market share<br>Growth in business<br>Staff satisfaction  | Percentage of growth in business conference market<br>Percentage of increase in customer number<br>Staff turnover   |

**116. Explain the balance scorecard approach to performance measurement and discuss its advantages over traditional accounting performance measures such as ROI?**

Kaplan & Norton likened the practice of judging overall performance by reference to single measures such as ROI as like trying to fly an aircraft in cloud by reference to only one instrument: the picture is complex and must be observed through a number of perspectives.

Kaplan & Norton suggest these four perspectives:

- ✚ Financial performance
- ✚ Customer satisfaction
- ✚ Efficiency of internal processes
- ✚ Learning and innovation

Such an approach has a range advantages.

- The wider range of performance measures provides a clear picture of both strengths and weaknesses.
- Dysfunctional decision making, short-termism and manipulation of single measures outputs are discouraged and detected, since progress and performance are required on a board front.

- Managers understand more clearly that broader performance is important and are motivated to achieve it.
- Only financial performance can be easily measured using traditional monetary measures. The other three perspectives require careful attention to the overall quality of what the organization does.

**117. Suggest critical success factor and accompanying KPI that could be useful in measuring performance of an organization (Financial success, Customer satisfaction, Process efficiency & Innovation)?**

| <b>Perspective</b>                   |   |
|--------------------------------------|---|
| <b>Critical Success Factor (CSF)</b> | <b>Key Performance Indicator (KPI)</b>  |
| Profitability                        | ROI, G/P, N/P, ROCE   |
| Cash flow                            | Daily banking, customer days, supplier days, bank balance, cash flow forecast.  |
| <b>Customer satisfaction</b>         |   |
| <b>Critical Success Factor (CSF)</b> | <b>Key Performance Indicator (KPI)</b>  |
| Delivery on time                     | Ratio of late deliveries to those on time, number of complaints as a percentage of orders   |
| Reliability                          | Number of deliveries lost as a percentage of deliveries.<br>Number of parcels damaged as a percentage of deliveries.<br>Percentage of late collection |
| <b>Process Efficiency</b>            |   |
| <b>Critical Success Factor (CSF)</b> | <b>Key Performance Indicator (KPI)</b>  |
| Route efficiency                     | Fuel cost per delivery compared to budget and earlier periods.<br>Vehicle and driver idle time  |
| Transport cost                       | Van downtime, servicing cost per route mile, vehicle availability each day  |

| Innovation                    |   |
|-------------------------------|---|
| Critical Success Factor (CSF) | Key Performance Indicator (KPI)   |
| Introduction of new service   | Percentage of revenue from service introduced within previous year      |
| Technical innovation          | Growth in use of IT for planning and control / reduction in head count. |

