

Management Accounting
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Management Control System and Responsibility Accounting I

Welcome all, so after discussing certain important concepts of the management accounting, certain techniques of management accounting, now we are moving towards the last technique, last concept that is management control systems and responsibility accounting right. So, ultimate purpose of this subject is this area of learning is, this area of accounting is that how to manage the organizations successfully, and take the decisions means management should take the decisions which are always in the best interest of the organization and all its stakeholders.

Every company is created with some objectives in mind and those objectives means achieving those objectives, attaining those objectives is the ultimate motto of every organization and there we mean use different concepts, different techniques, different processes so that the say desired results can be achieved.

When you talk about the management control system and responsibility accounting means everything what we do in the organization whether it is the financial or the non-financial terms. Ultimate purpose of that is that to say do at its best possible level by all the stakeholders contribute at the best possible level by all the stakeholders and then to say give the best performance.

Management control system when we talk about we talk something here about the planning what they are going to do in the future and then controlling the affairs of the organization right. So, beginning is the planning and end up is the control. It means there is a big process whole process which involves everything where you call it as one word or one way that is the execution.

So, you plan, you set the target, you set the objectives, whether it is a question of say using the budgets or preparing the cost sheets means when we discuss the other techniques till now we started with the statement of the cost or the cost sheet, and then cost sheets first we prepare the budgeted cost sheet, standard cost sheet and that standard cost sheet remains as the guide for attaining the desired cost of the production per unit for the different products and preparing the cost sheet and giving it as a target to the different say stakeholders, internal stakeholders,

different departments, units, and subunits of the organization means it is an indication that the total cost of the production should not be more than this. It has to be up to this limit or maximum within this limit. So, we prepare the cost sheet.

The cost sheet serves the purpose of the guiding force and a minimum benchmark. If the cost increases beyond that then again we have to look for the reasons for that and if it is within the control then it is fine we have attained the objectives. After that, we move to the next organization level macrotechnique of planning and that was budgets.

We talked about the master budgets, we talked about the flexible budgets, and in the budgeting, what we do in the budgeting, why we do the budgeting, what all is the involved in the budgeting, what is the whole process of the budgeting, we have seen that right from the operating budget to financial budget, we start with the sale for costing and we end up with the budgeted income statement and then we go up to the budgeted balance sheet right.

So it means in the budgeted financial statement we have to prepare based upon the information collected in the past or before that. So the entire process of budgeting is the planning but that is called the macrolevel planning for the firm as a whole, for the organization as a whole and cost sheet is only for the one product right.

After this, we talk about the standard costing process. In the standard costing we again talked something about setting the standards with regards to the sales, with regards to the cost, with regards to the different components of the cost, with regards to the say overheads and then say putting fixing up that benchmark so that the people remain focused and clear about means that how everything has to be taken care of and what is the say standard cost of the production for different units or for different products we are manufacturing in the organization and those standards once remain communicated to all the say units and subunits involved in the manufacturing process right from the procurement of the material to the sales of the finished product.

So, in this whole process, in this whole value chain say we keep on informing the people that this should be the standard material cost, this should be the standard labour cost, this should be the standard overall cost and this is how you have to attain the total cost of the production and then we calculate the variances. So, there also we plan, we execute and then we control that when we

prepare the standards, we plan, then we go for the actual performance and manufacturing the products and then calculating the two costs one cost is the production cost and second is the budgeted cost, actual cost, and the budgeted cost and then we try to find out the variances or the deviations.

So, ultimate purpose there is the cost control right. Management control is a bigger function which includes everything financial and non-financial operations of any organization but the cost control is the that function which is say linked to the only cost part of the organization or the cost part of the products then we move to the next part marginal costing.

Marginal costing is also known as a technique where we say, we plan to stay in the market for some period of time, till that condition is not conducive, or may be some different challenges have come up in the market for the time being. We anticipate that in the time to come situation will improve overall say this process will improve but currently because of some temporary changes in the market dynamics we are means finding it difficult to operate the market so we plan whether we can recover the variable cost, marginal cost, even if it is possible to recover the variable cost or the marginal cost still we are happy and we will postpone the recovery of fixed cost.

Again there is a sort of technique of controlling say the business organizations during the state of difficulty or during the state of stiff competition or you can call it as say some extraordinary situation coming up in the market. Then we talk about the in the next we talk about the activity-based costing.

Under the activity-based costing also, we learned about how to calculate the accurate cost of production, exact cost of production and how to say keep the cost under control right. So there we try to find out the alternative of the cost sheet where we use the total costing system or the absorption system and here we try to use the concept of corrected costing system setting aside the loopholes of the total costing system.

So, if you talk about the entire process of this all the techniques we learnt till now, all the five techniques we learnt till now we are somewhere planning for something, executing and then we are trying to compare with the actual performance. So ultimate purpose is the planning execution and control and in the nutshell, you call it as the overall management control system. So, finally

before means winding up the discussion on the subject I thought of sharing with you what the management control system is and what is the way we can implement or achieve the complete management control and what is the concept of the responsibility accounting right?

So, let us talk about the management control system now. So, if you talk about the management control system it is something like say first question is what is the management control system? And it is a logical integration of techniques to gather and use information. Everything we are doing in the subject is we are gathering information, we are using the information for the decision making on the basis of premises of cost and benefit analysis and we try to find out if the cost is lesser than the benefit certainly we will implement that particular thing otherwise we ignore it right.

So, it is a complete process of information collection which can be presented to the management and can facilitate the decision making by the top or the middle-level management right. So what we do here is three things.

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We do planning and control, we go for motivation, and we go for evaluation. Planning and control right means planning and control we have been learning in the past also. Standard costing we are using for planning and control, budgeting we are using for the planning and control even

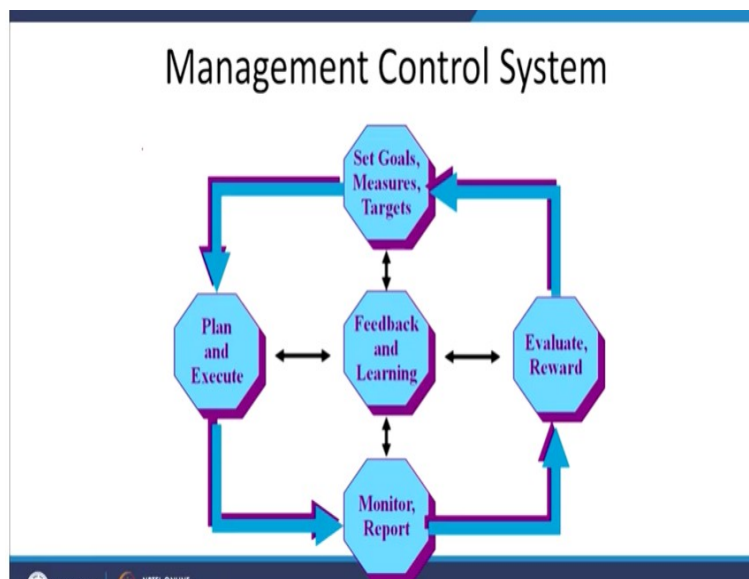
to some extent you can say marginal costing we are using for planning and control and then if for example if say your planned objectives have been achieved.

Whatever we have planned, our objectives have been achieved, our total say targets have been achieved, so what happens, our employees, all the stakeholders, from the bottom to top, top to bottom they remain motivated. They feel encouraged that whatever the targets we set, we have achieved those targets, we have been able to fulfill those requirements and those targets so we remain motivated.

So purpose of the management control system is one is something like motivation right and continuous evaluation. You do not feel motivated at one point of time only we go for the process of the continuous evaluation system, we keep on evaluating the things, we keep on knowing say about us, our performance that where we have to start from, where we have to go, in between what are the different obstacles hurdles involved and how to remove them and how to achieve the target.

So planning and control, motivation of all the stakeholders and continuous evaluation are the three important pillars of say implementing very efficient and effective management control system in any organization..

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Now, when we talk about this management control system you follow this kind of the structure right. In this kind of the structure say we start with this thing something like that you can say we start with the set goals and measure targets. First of all, we have to set the goals that where we want to go. For any business organization that for example in the coming year, next year, 2020 what should be the total market size of the company means the company where the market where the company is operating means we know that market size of the market as a whole and what should be our share in that market means out of the total market available how much share we have to have in the market. That is our objective that is the target.

What should be the level of the sales we want to attain in the local market, in the different countries market? Are we happy as a say local company or we want to become a national company or international company or a multinational company or a transnational company, we set the targets? Every entrepreneur, every businessman means whenever they start a startup their objective is that I am starting this company today and my objective is 10 years down the line I want to see this company at the national level right.

May be for example, when Nirma was created by say Karsan bhai he must have certainly thought about if my product Nirma washing powder if it is successful in the market then certainly today I am starting as a mean he started distributing the product free of cost in the market then he started manufacturing at the commercial level and selling it in the market and then when the sales picked up people liked the product then he must have fixed the target that after some period of time maybe 5 or 10 years down the line this company I will take it up to the national level and it will become the Nirma chemicals and detergents right.

So I think he was very much successful on achieving the target and once say you achieve the target going up to the national level then you can think of whether in the same area vertically we have to grow and cross the say boundaries of the country and move into the other countries markets then it is called as the process of internationalization or the globalization right.

Or other way around can be that we will remain in the four walls of the country, we will not go outside right because we do not have the knowledge of those markets and systems so what we will do we will remain within the four walls of the country and within that four walls of the country we will diversify. So we will start manufacturing different products as Nirma did.

They have the agencies in the other countries also but as a international company, they do not have the manufacturing facilities outside India. They have the manufacturing facility inside India only and then they export their products to the other countries also. So, if you have the presence in other countries, your product is seen in the other countries then fine you are a international company but not a multinational company because for the multinational company you have to create the manufacturing facility outside your own economy, your home economy right.

So, they must have, their strategy must be let us remain our manufacturing facility within the four walls of the country, stay within the four walls of the country and then diversify. So, they have diversified from the detergents, now they are into the cosmetics, they are into the say toiletries, they are into the soaps and they are into the education in a big way. So, different areas they are into right. So diversification, overall you have to create the group of companies and you are concerned for the turn over of a group as a whole right. So, in that case, setting the goals, setting the targets is the first important thing and then within that goal and target, you start planning.

In the first one year what we are going to do, how we are going to attain the targets and how we are going to achieve those targets right and then according to those plans we go for the say bringing all the factors of production at a common place and start executing, start manufacturing process.

Then we go for the say this evaluation process, continuous evaluation process and then we monitor our progress, we may monitor our performance and then we move to the next part evaluate and reward. Once, we see whatever we have planned whatever we have executed that it was as per our objectives or even sometimes more than our goals and objectives then we feel means blessed all our employees' contribution is considered as very very important. It is appreciated and it is rewarded right and after that, at the same time, we take the feedbacks also and reset the old objectives may be some time improved targets, improved objectives, something new, something different right.

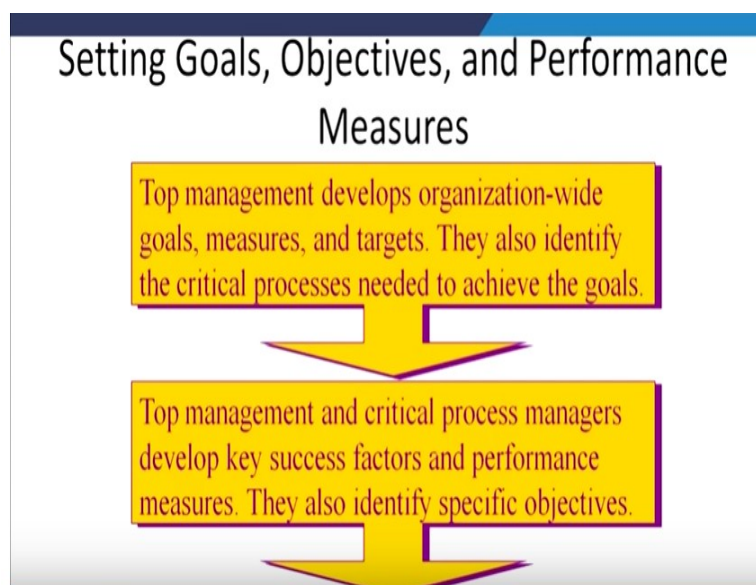
So this is a continuous process of setting the goals, planning and execution, monitoring the report and then evaluating the evaluating and rewarding the people and then finally resetting the goals, improved goal, a further bigger goal. So, in this case, you can say that feedback and learning is a

continuous process. This feedback and learning we are showing here also, we are showing here also, we are showing here also because every step, at every step of our performance, execution, and control we need the continuous feedback.

For example, in case of setting the targets, whatever the targets we set, we are able to achieve those targets very easily so the learning is that next time when we set the targets they have to be little bigger targets, higher objectives so that we can go one step higher. About the planning and execution we have say adopted different methods of execution or maybe sales and distribution in the market or maybe advertising also, so if we get some feedback that which of the methods were good, which of the methods need improvement, which of the methods need to be dropped, so it means continuous feedback is required from the different processes and the system and subsystem which we adopt and follow and on the basis of that, on the basis of that learning we go for the improvements.

Monitoring also we get the regular feedback and continuous evaluation also we get the regular feedback and on the basis of that feedback we go for improving the overall process and this is all about the management control system. Different techniques are available in the next few slides I will discuss with you that how we can facilitate the management control system. What is the basic premises is? Setting the targets, planning, execution and then measuring that whether your performance has up to the target, has been up to the mark or not and if it is not then learn from the failures and if it is up to the mark then further go for the improvement so that is what we want to do in this management control system processes.

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So it means this is the further explanation, setting goals, objectives, and performances because you have to start from the planning. On the basis of those broad planned say goals you have to set some specific objectives in terms of production, in terms of sales, in terms of profitability, in terms of distribution, in terms of advertising and then some performance measures have to be identified.

Some performance measures say for example there are different methods of production available in the market for our product in which we are into. So which method is good for us, which method is not good for us. Which method should be adopted, which method should not be adopted because which one is the cost-effective most value-adding, most rewarding, we will have to go for that.

So performance measures are important right from the production till your distribution, your advertising, your control, everything, your measures are important and top management develops organization-wide goals, measures, and targets. They also identify the critical processes needed to achieve the goals. What are the critical factors? You can have everything but for example, if power is not available 24 hours a day then how could you achieve the desired objectives. So we have to make sure that whatever the power comes from the power company or the power organization or the power board, fine, we will use that. Later on, for the remaining period out of

24 hours, we will generate our own power and we will make sure that the plant will run for the 24 hours right.

So, critical factors are we have to find out you have everything in place but something, some important factor or production is not in the right place. How you can think of means going for that production means that critical process is very important. So what are the total required inputs which are easily available, which are less easily available and which are available in a very very difficult manner you have to keep identified all those means say the facilities available, the obstacles and then other things and then finally take a decision so that make sure that your production process is continuous and regular.

Setting goals, objectives, and performance measures or we talk about critical process managers and lower-level managers develop specific performance measures for each objective. Your critical factors of production can be raw material also, it can be power also, it can be any other input also, it can be some technical manpower also, so some people are held responsible and they are strategic people of that organization who make sure that how those inputs have to be arranged, from where those inputs have to be arranged so that the process being critical it is going to be available with us all the time and is going to play a very very important role.

Now organization goals. What are the organization goals and how we set them?

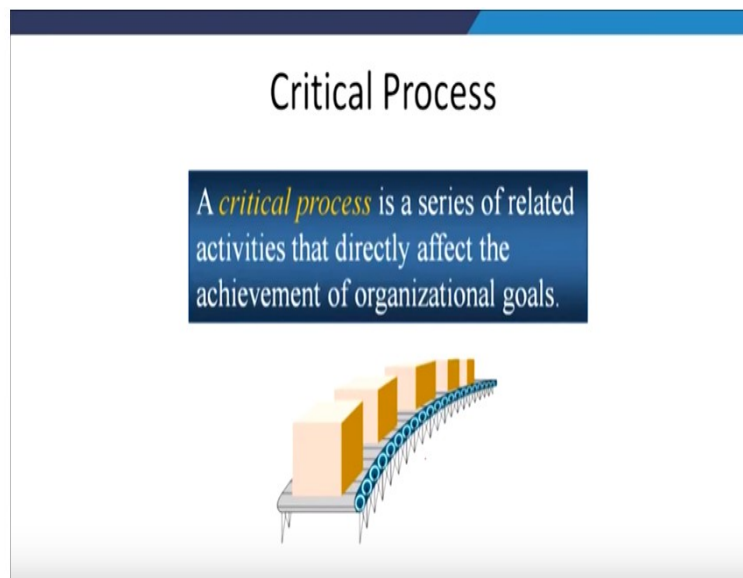
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A well-designed management control system aids and coordinates the process of making decisions and motivates individuals throughout the organization to act in concert. A well designed management control system aids and coordinates the process of making decisions. Management control system means if it is a very good MCS then it helps us in fixing the other targets even itself deciding the objectives also going for the execution and then going for the say measuring between what is the target what is the execution and how to control the say any kind of the abrasion is coming up and motivates individuals throughout the organization to act in concert. It is a continuous process of motivation also.

People get motivated also if we achieve our target if we achieve our objectives we remain motivated, we remain focused, we will get encouraged, so it all happens when you have set the targets we are going for the best way of execution and then you are measuring the performance and you are finding, you are finding that your performance is much better or has been up to our desired level and whatever we desire to perform we have done that. Critical processes now like this.

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A critical process is a series of related activities that directly affects the achievement of organization goals. It is a chain like this right. The structure given here is that you have these blocks given. So, one block is there, second block is there, third block is there, fourth block is there, fifth block is there. for example, this third block is a critical factor here, now if you have

raw material, you have labour, you have the manufacturing process and say you have the way to distribute in the market also but if the power is not available up to the 24 hours or at least 20 hours a day so it means that your entire manufacturing process gets disturbed.

So, what is the critical process you have to identify? What are the different steps involved in the critical process you have to identify and try to find out that no obstacle comes in this process all around, all through or no obstacle comes throughout this process and everything right from the material to the labour, to the overheads, to the power, to the say manufacturing process, and then finally taking the product from the place of production to the place of consumption performing all the commerce-related activities we have ensured everything going well smooth and up to the mark so that means whatever the desired objectives because if there is one obstacle in between you are not able to have the power, you thought that you will manufacture 1000 units per day but that is going to be possible if the power is available 20 hours a day. If the power is not available and we have not made the alternative arrangements for the power also then what will happen? Your target will not be achieved.

So the critical factor here is to achieve that 1000 units of production. The critical factor is you have to make sure all the factors, inputs are easily available in the market and we are able to have those inputs, factors right. So if you are not able to identify or conceive that in advance that what is going to be the possible obstacle in this critical process then I think the desired objectives cannot be achieved. So, you have to make sure, what we are planning, how to execute that and how to evaluate the process of planning, execution and finally making sure what has happened

that is called as the control.

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Key Success Factors

- Key success factors are **actions** that must be done well in order to drive the organization towards its goals.




Key success factors. Apart from the critical factors, there are some factors which are called as the critical success factors. Key success factors are actions that must be done well in order to drive the organization towards its goals. One by one performing all the operations. Key success factors. Critical factors are something different means something very very important very very rational, very very useful and if that is not available then your process will get affected and key success factors are making sure that all critical factors are in place, proper sequencing and say the process is well defined predefined and we are not going to face any kind of the problem.

So it means key actions, key success factors are also known to us and all those obstacles we are going to remove, we know them well in advance, we are in a position to remove them. So, that miss are some apart from the critical factors, key success factors. Identification of the key success factors is also the another important task.

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Responsibility Center

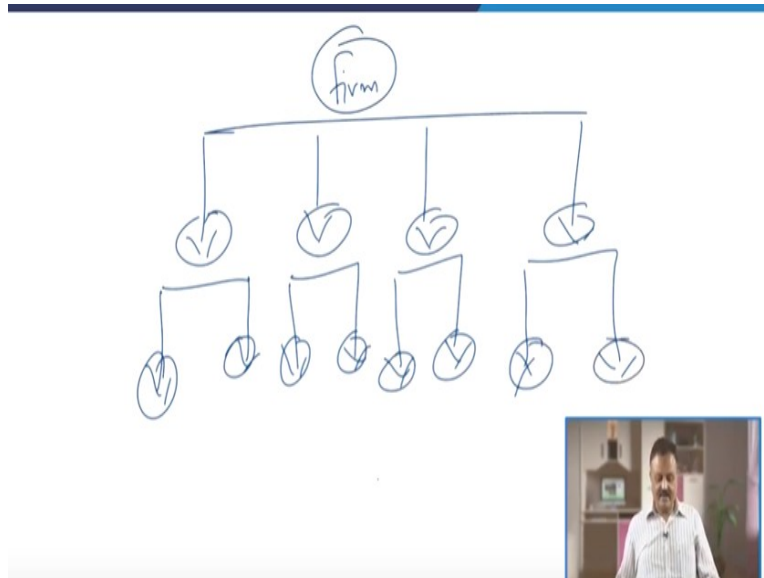
- A responsibility center is a set of activities assigned to a manager, a group of managers, or other employees.



Now, we come to the very very important concept, very very interesting and important concept of responsibility accounting. Responsibility accounting is one technique, which is a new technique, latest technique which has been identified, which has been identified to implement and ensure an effective MCS, management control system.

There are different techniques. I will be talking. Now, in the next few slides, I will be talking about the different techniques of the say management control system. First thing here we are going to talk about is the first and the most important technique is the responsibility centers. Responsibility center means the whole firm is divided into the different responsibility centers.

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Means this is the total organization at the top and then you have the different responsibility centers here right and then within these centers you have further subcenters here and you are going to have these subcenters right. So whole firm is going to be divided into sections and subsections.

If you want to achieve the firm's target you must achieve this target, this target, this target, and this target and for achieving this target, these two must be complete, for this these two must be complete, for this, these two must be complete, for this these two must be complete and once all the objectives are met finally the organization's objectives will be met.

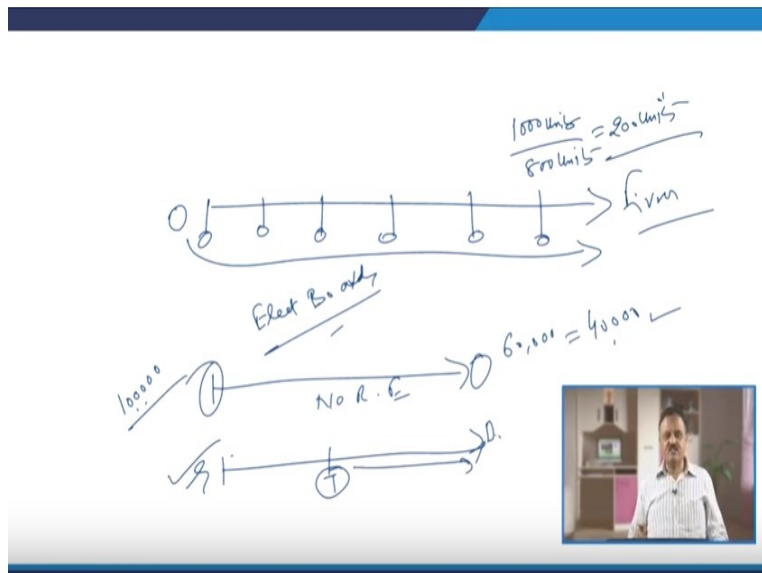
So what we do. We divide the whole firm into different units and subunits, different units and subunits and then we make some people responsible for those units, we make some people responsible for those units and they are means they are made the incharges, they are put on the charge of that unit or subunit and say making sure that is going to be the best performing unit or subunit of the organization. All inputs output related say assistance are given to them and then finally we try to evaluate the performance of all the responsibility centers individually, all the responsibility centers individually.

So, when we talk about the responsibility centers we have different centers here and in those different centers say for example when you talk about the responsibility centers, one is the say cost centers, those centers like say procurement of material, then manufacturing processes, then is the distribution process, they all are the cost centers.

Then we have the investment centers. Investment centers where we have to make long term investments for say entering into the new markets or increasing the overall manufacturing capacity of the organization or maybe doing other activities supportive activities which facilitate and make sure the long term sustenance of the organization right. So they are called the investment centers and third centers are known as the profit centers.

So, in the profit centers also when you talk about the profit centers, in the profit center we try to find out where one could be the input center only, raw material you cannot expect the profit coming up but the sales department is a profit center even sometimes advertising department is a profit center that if you spend this much on the advertising how much impact on the sales is going to be there and how much impact on the final output on the sales has to be. So, this all has to be very clear.

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Different centers are created and then when we have to think about that for example when you are creating the different centers and whole organization is say for example divided into different

units right. We are starting from here and we are ending up here. One responsibility center, second responsibility center, third responsibility center, fourth responsibility center and this last is it is the firm right. This is the firm here.

So what happens that we have to start the process this from here and reach through up to this point. If for example whatever the goal say 1000 units, we want to manufacture 1000 and we want to sell in the market right for example that has not been achieved. We have only been able to sell 800 units manufactured and sell those 800 units in the market. It means there is a shortfall of how many, 200 units. There is a shortfall of how many, 200 units and in those 200 units why we could not manufacture and sell and achieve the target.

We have to now look for the performance and as per these different responsibility centers right. Different responsibility centers, where the problem has come, who has not contributed in the desired manner or the desired fashion, where has the problem come up, we have to look for that and fix up the problem. If we are able to, if you are not dividing the whole firm into the different responsibility centers and if the performance at the end of the period is not up to the mark then how to make sure that who is the cause of concern, who is cause of the problem and whom to hold responsible right.

So, it means we have to find out that these are different key success factors, these are the different critical success factors, every factor has a role to play in this performance and when the performance is up to the mark fine, everybody has contributed and we have been able to achieve the target but when performance is not up to the market, is not up to the mark and we want to find out that why this all has happened who has not contributed, who has defaulted, who has given the lesser performance.

It is very much possible if the firm is divided into different units and subunits, sections and subsections which are called as the responsibility centers, different responsibility centers, so we can find out that how the performance has been less than the say desired and how it can be improved. For example, I can tell you that earlier olden days we have some organizations called electricity boards right who were supplying the electricity boards who are supplying us the electricity, so even today and till recent past, most of the state power boards were in a loss-making situation. Most of them means whatever the input they are making, whatever the

investment they are making say for the generation of the power that much of the revenue is not coming from the market right.

So at the time what was there? It was the board like this. They were starting their performance like this and ending up with this. In between, there was no responsibility center-right and when you for example invested say here at this beginning we generated 100000 units of the power right and finally in the market when we taken this only 60,000 units of the power have reached in the market. So, it means what will happen. Your revenue will come back equal to the 60,000 units only and this revenue for the remaining 40,000 units is lost somewhere in the market and when your almost half of the revenue is lost somewhere in the market you can understand what is the future of that organization. What could be the financial health of that organization?

So it means when the situation get on deteriorating in the market then government thought that now we have to do something to revitalize these boards and means sometimes either to privatize them or to find out some solution. So in that case government needed funds because there was not availability of the desired amount of the funds. So they requested the ADB Asian Development Bank to give us the funds, right and when ADB means studied this whole power board's structure, they found serious lapses.

They found that you are manufacturing, you are generating (1000) 100000 unit, you are finally taking to the market 60000 units so we are 40,000 units are lost in the market, why you are not able to find it out. Until and unless you do it, you are not able to improve the condition of these boards. So, they said, that yes, we are ready to fund these boards and given them funds but we have to create a proper responsibility accounting system in these organizations.

So what they did? They then set that you divide and create, and recreate these power boards or revitalize companies into three centers. One is the generation, this is here, the generation, then here is the transmission and then here it is the distribution. Generation can be done by anybody by the public company, by the private company, anybody. Then it has to be given to the transmission company and then Transmission Company has to give it to the distribution company and distribution process should be normally privatized so that whatever the amount of the power is going to the people they are properly utilizing it and paying the funds back. So,

larger is the collection system, distribution system is with the private sector that will be more effective.

So you might see that in these days in most of the states, now the distribution part is with the discoms, distribution companies and they are largely private sector companies. Transmission is by the government companies and the generation can be by anybody by the government companies also, by the private entrepreneurs also. When they manufacture power they have to sell it to the government board and the board will transmit and then we will give it to the distribution companies.

So for example, now if today there is a loss of 40,000 units in this system so what will happen, we are easily able to find out. We generated 100000 units right and taking into consideration the standard transmission losses here we should have reached 95000 units. Have 95000 units reached at the transmission level? And after this further providing for the standard normal distribution losses 90000 worth of the units of revenue should have been collected. If these objectives have been achieved fine, everybody doing his job but for example, this generation is for 100000 units.

It means generation responsibility center is doing its job honestly. But transmission is not up to the transmission not 95000 units have reached. Only 90,000 units have reached. It means where is the 5000 units have been lost. That is somewhere from the generation to transmission and then after that, if it is not 90, it is 80,000 units then why the revenue for the 80,000 units have been collected. Where the 10,000 units have gone?

So it means when the whole power board is divided and subdivided into the sections, subsections, units, and subunits and different responsibilities centers are created it is very very useful, and easy, and interesting to control the performance of those units and subunits and the firm as a whole. Further ore on this responsibility accounting and say some other techniques of ensuring management control system I will discuss with you in the next class. Thank you very much!

