



Management Accounting – Risk and Control Strategy

David Laws offers his guide to the balanced scorecard and explains why a sound understanding of non-financial controls is important for both P3 and P6 students.

All businesses can be thought of as a system. A system takes some inputs (materials, labour, finance etc) and processes them in some way to produce outputs (goods and services).

A system will also monitor what's going on. For example, the output will be measured and compared with what was expected to happen (the standard) and appropriate action will be taken if necessary. You may have seen this referred to as the feedback loop.

For many organisations the key measurements revolve around financial measures. Companies will produce budgets (the standards) for various items such as sales, costs, residual income and return on investment. The actual results are compared with what was expected and, if necessary, remedial action is taken. This may be done monthly (the dreaded "month-end") or annually (the financial statements).

From the point of view of paper P6, Management Accounting – Business Strategy, these monthly checks should allow the organisation to determine whether it is on course to meet its financial objectives. These might include keeping stakeholders such as shareholders and financial institutions happy with profits and dividend growth.

A key problem with looking at financial measures alone is that it gives only one particular perspective. In fact, it may even lead to poor decision-making. For example, if one of the main performance measures is cost per customer, managers may try to cut costs to such an extent that the customers become unhappy with the products they are buying and will take their business to a competing supplier. In paper P3 we would say that the company has failed to appreciate reputation risk or business risk; in P6 we would say that it has fallen below the threshold competence required. Whichever way we refer to it, the company would now have serious difficulties winning back these customers.

From a P3 point of view, we want to identify whether we're going to fall short of any objectives as soon as possible, so that we can do something about it in time – for example, will we have enough cash to pay our suppliers? We need to be measuring things that give us some idea of what action to take in order to remedy a problem.

Another serious drawback of relying on financial measures alone is that it's hard to do. If we know at the end of month eight that our return on investment is falling below the budget, for example, it's not obvious how we can remedy this.

In the early nineties Robert Kaplan and David Norton published their first work on the balanced scorecard system of measurement, which strives to give an all-round view of an organisation's performance. Let's look at this using a question from the P6 pilot paper (*see panel*).

In answering the first part of the question we need to consider the big picture: why would the balanced scorecard be useful to the Royal Botanical Gardens? One of the areas in

SAMPLE QUESTION ON THE BALANCED SCORECARD

The Royal Botanical Gardens has been established for more than 120 years and has the following mission statement: "The Royal Botanical Gardens belongs to the nation. Our mission is to increase knowledge and appreciation of plants, their importance and their conservation, by managing and displaying living and preserved collections and through botanical and horticultural research."

Located towards the edge of the city, the gardens are visited regularly throughout the year by many local families and are an internationally well-known tourist attraction. Despite charging admission, it is one the top five visitor attractions in the country. Every year it answers many thousands of inquiries from universities and research establishments, including pharmaceutical companies from all over the world, and charges for advice and access to its collection. Inquiries include requests for access to the plant collection for horticultural work, seeds for propagation or samples for chemical analysis to seek novel pharmaceutical compounds for commercial exploitation. It receives an annual grant in aid from central government, which is fixed once every five years. The grant is due for review in three years' time.

The finance director has decided that, in order to strengthen its case when meeting the government representatives to negotiate the grant, the management board should be able to present a balanced scorecard demonstrating the performance of the gardens. He has asked you, the senior management accountant, to help him.

Many members of the board, which consists of eminent scientists, are unfamiliar with the concept of a balanced scorecard.

Required:

- For the benefit of the management board, prepare a briefing on the concept of a balanced scorecard that also analyses its usefulness for the Royal Botanical Gardens (ten marks).
- Discuss the process you would employ to develop a suitable balanced scorecard for the Royal Botanical Gardens and give examples of measures that would be incorporated within it (15 marks).



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which the balanced scorecard is useful is as a tool for turning the mission of an organisation into quantifiable measures. This allows the organisation to set measures that can be used both by the managers and by the staff. Part of the Royal Botanical Gardens mission refers to "displaying living and preserved collections". This strategic intent can be used to devise appropriate measures.

It may well be more useful to use a range of measures than to rely on purely financial ones – what can most employees do about return on investment, for example? It would be difficult for the Royal Botanical Gardens to use such traditional financial measures exclusively. First, they aren't particularly appropriate for a not-for-profit organisation. Second, financial information is historical, so measures based on it may not help the organisation in the future. Lastly, using financial information alone may lead the board to focus too closely on those stakeholders who provide finance – the government in this case. This might lead to cost-cutting, which will reduce the quality of service provided to other stakeholders, or to a lack of investment for the future.

In answering the second part of the question, we should look at the specific measures that the Royal Botanical Gardens could introduce. As well as considering the organisation from a financial viewpoint, Kaplan and Norton discussed three new perspectives that businesses should consider: the customer perspective, the internal business perspective and the learning and growth perspective. We should start the task of developing a balanced scorecard by looking at the organisation from all of these perspectives.

The customer perspective considers areas such as customer satisfaction and how the organisation adds value to these customers. In the Royal Botanical Gardens' case this would include everyone who makes an inquiry as well as all of its visitors. The internal business perspective considers the internal processes that the organisation needs to perform well in order to be successful. For the Royal Botanical Gardens



these would include the procedure it goes through to reply to a query from a university. The learning and growth perspective considers areas that require constant improvement. For the Royal Botanical Gardens this would include staff training and investment in modern equipment.

The organisation could then look at a range of measures for each area mentioned in the mission statement. For example, one of the aspects was "displaying living and preserved collections". The balanced scorecard could turn these into specific measures:

- **Financial perspective.** Budget for the cost of adding new preserved collections.

Clarification

Although the article on decision analysis on page 53 of the March issue is of general relevance to students taking managerial level papers in the management accounting and business management pillars and provides background information for P2, P4 and P5 candidates, the methods it mentions are not covered specifically by the syllabus and will not be the subject of exam questions.



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- **Customer perspective.** Attractiveness of displays. Quality of information provided about displays.
- **Internal business perspective.** Time spent on maintaining preserved collections.
- **Learning and growth perspective.** Number of new displays presented during the year. Number of visits made to overseas equivalents of the Royal Botanical Gardens. A similar exercise could be performed for the other areas of the mission statement – for example, research, plant appreciation etc. From the point of view of paper P6, it is important to stress the forward-looking nature of this process, because the measures will evolve over time. Non-financial measures feature in the paper P3 syllabus as part of the control process of an organisation. Performance targets will be set in a number of areas with the aim of motivating employees to achieve these targets. This should mean that individuals will take action if it appears that they will fail to meet their targets, thereby placing employees firmly in the feedback loop. This is particularly true if the achievement of these targets is linked to the organisation's reward scheme. The balanced scorecard stresses how these targets should be linked to the mission of the company. Many organisations have targets that have evolved over a long time and may have little to do with current strategy. Some organisations will even undermine their own strategy by continuing to measure areas that do not support it. A basic example of this would be for an organisation to pursue a strategy of product differentiation while operating a range of targets and rewards that emphasise cost control. Students may be aware of the saying "what gets measured gets performed". It is vital, therefore, that the organisation is measuring the right things. The balanced scorecard can be of enormous assistance in ensuring this. **FM**

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- **May 2006 exam entry**

The May exams take place on Tuesday 23, Wednesday 24 and Thursday 25.

Online entry for these exams closed on March 21. In extreme cases CIMA will consider a very late entry if you can supply suitable evidence from your employer. An additional very late entry fee will be charged on top of the standard fee. If you would like such an entry to be considered, get in touch with CIMA Contact.
- **Cancellations and changes**

We do not accept cancellations and will not refund fees. The closing date for requesting changes to papers or exam centres was March 31.

- **Admission advice letters**

If you entered for the exams online, you must print off your admission advice. This shows the exact details of your exam centre, as well as the papers for which you are entered. You must take the admission advice with you to the exams and retain it afterwards, because it contains your candidate numbers.

You must download and read the exam rules when you download your admission advice.

- **Going to the exam**

As well as your admission advice, you will also need to bring another means of identification to the exam centre – for example, a passport or driving licence.

You must complete an attendance slip before starting each exam. The slip has a tear-off section that you should retain. This is your confirmation of attendance and it is valid for four months from the date of the exam.

- **Exam centre changes**

A full list of exam centres is available online at www.cimaglobal.com/

- examcentres. Special centres will charge an extra fee, which must be paid directly to them, on top of the standard exam fees.
- The following will be reclassified as special exam centres from May:
- Abu Dhabi (850).
 - Budapest (871).
 - Dhaka (874).
 - Kuching (920).
 - Muscat (913).
 - Nicosia (910).
 - Ahmedabad (916) will become a new special centre from May.
 - Bangalore (526) will be reclassified as a regular exam centre from May.

- **TOPCIMA pre-seen material**

The pre-seen material and assessment matrix for TOPCIMA have been available at www.cimaglobal.com/topcima since March 13. (An article analysing the material is also available.) It is your responsibility to download this and familiarise yourself with it before the exam. A "clean" copy will be given to you in the exam. You cannot take any notes in with you.

- **Ask a tutor – April event**

Visit CIMA's web site to find out about the next "ask a tutor" event, to be held in April. Use this chance to ask an experienced tutor a syllabus-related question.

- **Computer-based assessments at certificate level**

For full information about entering for a certificate level CBA, visit www.cimaglobal.com/certificateentry.

- **Queries**

If you have any questions, please visit the CIMA web site (www.cimaglobal.com) to see if they are answered there, or get in touch with CIMA Contact (see page 41 for details) or your local office. **FM**