

## Chapter 1: Introduction – management accounting and its environments solutions

### Overview of Chapter

This chapter provides the context for the book. It argues that organisations are operating in an ever-changing and increasingly more-complex external business environment. To survive and/or grow in this environment, an organisation's information needs should be shaped by its goals and objectives and driven by its strategy choices. The strategic choices made by the organisation determine its processes and activities and the outcomes they are required to achieve. From a management accountant's perspective, these strategic choices define the design, function and operation of the management accounting or control system that will include accounting-based financial information and non-financial performance and risk measures. These performance and risk measures not only improve the quality and types of decision information available to managers in assessing organisational outcome and strategy performance, but also provide the organisation with the flexibility to adapt to the change and complexity of their business environment.

### Solutions to Review and Discussion Questions

*1.1 Explain why being aware of and managing its external relationships are important to an organisation.*

Being aware of and managing its external relationships are important to an organisation as its internal operating environment is driven by the external relationships the organisation explicitly engages in (such as its customers, suppliers or financial institutions), or is implicitly engaged with (including competitors, government regulation, community and the need for social responsibility). This is because the internal environment is the result of the business activities an organisation undertakes and the quality of the outcomes it desires by engaging in these relationships. Further, because these external relationships are less controllable than relationships originating from the internal operating environment, they have the potential to be associated with higher degrees of uncertainty or risk.

*1.2 Briefly contrast the functional (production) view of an organisation's processes with a strategy-based view.*

A functional (production) view of organisational processes is one where the decision-makers, and thus the information provided to support them, concentrates on the organisation's production processes and departments. By its nature, this means that the focus is on inputs and outputs; and in performance measurement and monitoring terms, the focus is on economy and efficiency. While it is important to concentrate on outputs and their associated achievement in terms of economy and efficiency, if these outputs are not contributing to organisational outcomes then they are neither effective nor equitable, particularly in terms of public sector entities and service delivery outcomes.

In contrast, a strategy-based view of processes is where the decision-makers focus on the activities that give rise to a process and the strategy(s) that they are designed to support. Initiatives such as the value chain, strategic management accounting (SMA) and strategic cost management (SCM) recognise the need for management accounting information to be provided

in a way that supports a strategy-based view. This may include developing supportive management control systems and performance management systems that incorporate management/operational strategies such as Just-in-Time (JIT), Total Quality Management (TQM), and environmental management.

*1.3 Outline what a value chain is.*

The value chain forms part of an organisation's supply chain. It provides a linear view of the interrelationships between the business processes that are necessary to deliver an organisation's customer strategy(s) and contribute to organisational outcomes, such as increasing shareholder wealth. Such business processes (from, for example, a manufacturing viewpoint) include research and development, design, production, distribution, and sales and marketing. Although simplistic, the value chain allows an organisation to focus on the boundary between the organisation's external business environment and its internal operating environment.

*1.4 Discuss why it is important that an organisation should measure its business risk.*

It is important that an organisation should measure its business risk because if it does not it is difficult to measure the strength or sustainability of the performance achievements of the organisation. Whether business risk is quantified (e.g., a percentage) or qualified (e.g., Low, Medium, High), without some measure of degree attached to the level and quality of a particular performance measure, for example profit, it is difficult to assess its sustainable contribution to an organisation's value and, in turn, shareholder wealth. If the level of profit was achieved at an acceptable level of organisational business risk, then there may be higher levels of certainty about profit sustainability in future periods. However, if the profit was achieved at an unacceptably high level of business risk, then there would be less certainty about future profit sustainability, particularly if no strategic adjustment or realignment has been made to reduce or mitigate the sources and types of business risk that have contributed to, or driven, business risk in terms of profit achievement to an unacceptable level. The need to consider business risk directly allows an improved understanding of customer value, supplier value and organisation value and, for these reasons, it is fundamental in understanding what management accountants do.

*1.5 Outline what is meant by an organisational objective, and describe its three components.*

Organisational objectives are an umbrella strategy that incorporates how an organisation intends to achieve its goals or aspirations. The three components of an organisation's umbrella strategy or objectives are its *strategic position*, *strategic approach* and *strategic mission or manner*. Within each of these components, there are a number of sub-components. At the *position level*, there are two well-discussed positions, that of cost leadership and differentiation; whilst the identification of the *approach* to be adopted by an organisation might take the form of defender, prospector/innovator, or analyser. The *manner* is what the organisation wants to achieve, or its mission. This can be to build its business, hold its current position or harvest what it has achieved. How the organisation achieves its objectives is through the strategies it adopts to operationalise organisational achievement of its position, approach and manner.

1.6 Using Table 1.1 (page 7) as an example, provide outcomes for an organisation that has chosen a differentiation position, prospector/innovator approach and build manner to achieve its objectives.

<b>Organisational choice of objectives</b>		
<b>Objective</b>	<b>Choice</b>	<b>Outcomes</b>
Positioning	Differentiation	Increased customers; increased profits; increased market share; increased market/customer differentiation; enhanced organisational image; and other measures of external business environment sources of uncertainty.
Approach	Prospectors/innovators	Innovative edge over competitors regarding new products or product attributes; entry into new markets; capacity to respond to regulatory and/or market change.
Manner	Build	Maintenance of existing customer base as compared with competitors; customer growth due to new markets; brand performance; market expansion; more desirable product attributes compared with competitors' substitute products.

1.7 Explain why it is possible for one strategy to contribute to more than one objective or outcome, and provide one example.

In an organisation, one strategy can contribute to the achievement of more than one objective and/or outcome. This is possible because a number of strategies and associated strategic management tools and techniques may be required to achieve any given strategy. An organisation therefore is not restricted to the choice of only one strategy to achieve an objective. For example (from the text), it may supplement a target pricing strategy with both Just-In-Time and Total Quality Management strategies to manage operating costs by decreasing inventory holding time and handling, outsourcing some components of research and development through stronger supplier relationships, and setting specific product quality targets for different products or services and across products or services. *Other examples are possible.*

1.8 Outline why it is important that an organisation's activities, processes and strategies align with its objectives.

The top-down approach shown in Figure 1.5 (page 12) is designed to ensure that activities, processes and strategies align with organisational objectives. This is critical for ensuring that management control is acting in concert with organisational interests to ensure that there is a match, or fit between the actions of the organisation and its business environment (Donaldson, 2001; Langfield-Smith, 1997). In doing so, the performance and risk management systems allow the provision of decision information that supports informed monitoring and review by management of outcomes (Hunt, Bradshaw & Bui, 2007).

*1.9 Explain the role accounting information plays in the decision-making process.*

Accounting-determined financially based information has a role to play in an organisation's decision-making process. However, it needs to be extended beyond the traditional types of accounting analysis (e.g., tangible quantifiable costs and benefits) to include concepts such as opportunity costs and benefits, intangible costs and benefits, external environmental negative and positive risks, non-financial risks and other qualitative strategic considerations. This is because sometimes the best traditional accounting information answer is not necessarily the best answer for the organisation strategically, and other aspects, both financial and non-financial, need to be factored in.

*1.10 Define what is meant by the following terms: (a) supplier value, (b) organisational value and (c) customer value.*

- (a) Supplier value considers the relationships the organisation has externally with its suppliers and the management of these, including the appropriate inventory management practices to support organisational objectives.
- (b) Organisational value relates to value created within the organisation's internal environment, and includes such things as providing services to clients, supporting internal customers, and assembling products.
- (c) Customer value focuses on the customers external to the organisation and how these are to be monitored and managed to reduce risk exposure.

*1.11 Discuss why it is important to consider how customer value, supplier value and organisational value is created and to incorporate risk implications when assessing and determining value.*

By considering how customer, organisational and supplier value is created, organisations can enhance or improve their value-adding strategies, and related processes and activities, and explore ways of reducing or eliminating non-value-adding strategies and associated activities and processes. Areas that need to be evaluated include cost, timeliness, innovation and quality.

The risk implications to be incorporated when assessing and determining value comprise those from an organisational value perspective as well as supplier and customer perspectives. When considering organisational value, risks to think about include those from the internal environment such as ownership, resourcing, technology, labour disputes and shortages, obsolete facilities, a lack of managerial depth and talent and a weak market image, as well as those from the external environment including competitor behaviour, economic pressures on interest and exchange rates, and costly regulatory requirements. Those associated with supplier and customer value are changes in technology, information sufficiency or deficiency, price and bargaining power changes, substitutable products or services, and economic conditions. Further, any accounting tools, treatments or techniques utilised in the value-determining process needs to incorporate these risk implications.

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