ON TARGET
intelligent innovative invaluable
e-Mag of the Institute of Certified Management Accountants
On Target Online - September 2011 - Issue 4



# Balanced scorecards: moving beyond measurement

*by Sarath Amukotuwa, management consultant*

Management surveys of global business leaders regularly identify strategy execution as their biggest challenge. Other surveys corroborate this showing that only 10 per cent of organisations consistently deliver on a good portion of their promises while 10 per cent of employees actually understand their roles in relation to organisational strategy.

Yet the major focus of organisations is on creating strategies, not their execution there being no shortage of brilliant strategies, most of them well intended but not implemented.

While the balanced scorecard concept has been promoted as a strategic management system it has not been widely adopted and when it has, in a majority of cases, it has failed to move beyond measurement.

I have studied first-hand numerous balanced scorecard implementations world-wide and have been involved in installing scorecard and other performance measurement systems in several organisations in Australia and overseas.

## The balanced scorecard: A strategy management system?

When Kaplan and Norton introduced the balanced scorecard concept in 1991, the idea of non-financial measures as a supplement to financial measures was an already accepted management principle. Three characteristics distinguished it from existing methods and made it vastly more appealing, although it was not until 1996 that its authors began to explicitly refer to the balanced scorecard as a strategic management system:

- It comprises of four perspectives representing different aspects of performance viewed together
- It links strategy to operations through strategy maps, a labyrinth of cause and effect interactions
- It time slices an entity into the past, current and future T

These three key ideas are represented in Fig 1 below.

Kaplan and Norton have since progressively refined their idea for the balanced scorecard, emphasizing that its primary purpose is to focus organisations on their strategy and that measurement is secondary.

The lack of widespread organizational take up of the balanced scorecard and the high dropout rate by those that have implemented it suggest that the concept has not been as influential a strategy execution tool as claimed. In practice, most organisations that have implemented balanced scorecards have continued operating their existing traditional measurement systems.

One reason for the balanced scorecard's limited impact is because of the way it has been implemented, as demonstrated by the following examples:

- A major Australian bank's "balanced" scorecard comprises existing measures placed into four quadrants (customer, process, innovation and financial) with no linkage to strategy
- A global insurance company's scorecard is complied

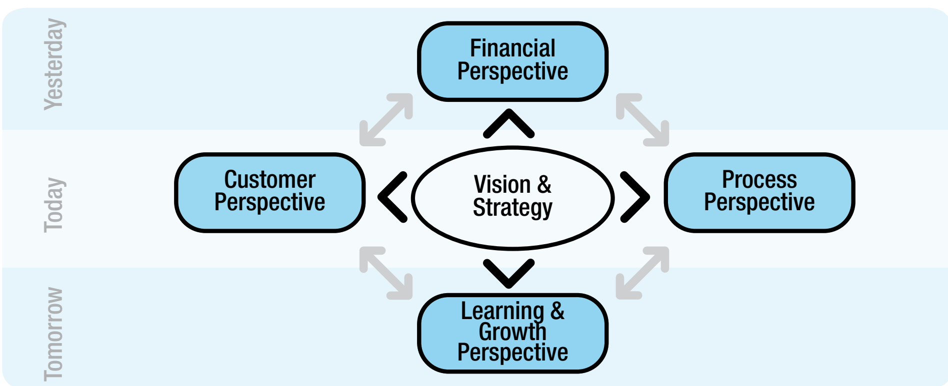



*Fig 1: The Balanced Scorecard Concept*

*continued page 2*

Quit Forward >

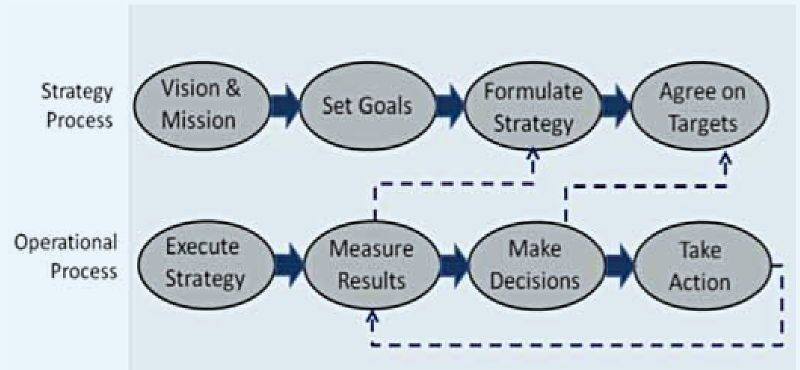



*Fig 2: Strategy and Operational Processes*

monthly and appears on page 25 of its Monthly Performance Report, which is distributed 4-5 days after month end – way too late to trigger any actions

- A large national food company delivers scorecards (comprising dashboards, graphs and charts) to several hundred employees at every level with capability to drill down and slice and dice data to transactional levels so the impact is operational and reactive

Although these and similar systems pass as balanced scorecards and doubtless provide some useful decision making information, they are clearly not strategy management systems and have had little impact on how well an organisation implements its strategy. It is, therefore, unsurprising that global CEO surveys year after year for the past two decades have shown strategy execution to be the biggest challenge, even in organisations that have implemented balanced scorecards.

The much publicized stories of balanced scorecard success must be also viewed with some skepticism as the recognition bodies awarding companies for successful implementations have close relationships with the protagonists of the concept. This calls to mind the sudden and somewhat surprising demise of several well known companies that were touted in management circles as successful companies (having won accolades such as the Malcolm Baldrige Award) some 20 years ago.

The lesson here is that no one technique, including the balanced scorecard, is a panacea.

### High performance organisations

In the corporate world and in government there is no shortage of examples of organisations that pursue laudable goals and have good strategies. Yet too many merely survive or fail completely and others get nowhere close to achieving exceptional results. For these organisations lofty aims remain well intentioned and make for plausible rhetoric but eventually they are punished by the market or in the case of governments, by voters.

In every industry around the globe a handful of organisations consistently out-perform their competition. Year after year, these organisations deliver on their promises. They achieve what management theorists define as success – the achievement of exceptional results in several key areas – satisfied customers, empowered employees, social responsibility, innovative products, and financial stability. The words may differ, but most organizations' vision statements and goals are clothed generically around these five themes.

To succeed consistently in all areas at the same time high performing organisations critically balance these themes. Such organisations:

- Have visionary leaders or ideas
- Set (high but) realistic goals
- Develop focused strategies
- Effectively execute their strategies

Visionary leadership, clearly articulated goals and matching strategies are prerogatives of high performance. Without these results can at best be only mediocre. Emerging management thinking emphasizes strategy execution as equal to or more important than strategy formulation. The suggestion is that admirable aims or brilliant strategies are by themselves worthless unless they are accompanied by an unrelenting focus on the chosen strategy and its effective execution.

At a generic level every organisation performs two macro processes: (see *Fig 2: Strategy and Operational Processes, left)*. Most organisations do not even formally recognize the distinction between the two processes. A majority focus on the strategy process leaving operations (or execution) to middle level managers and operatives. On the other hand, high performance organisations recognize that the difference between being a successful and not so successful organisation depends on whether a strategy once conceived can be made operational.

Research shows that "high performance" is characterized by a set of universal factors, which when cohesively performed, result in exceptional outcomes. Whereas the emphasis placed on each of these factors will vary based on the environmental context (industry sector, competition, access to factors of production, size, location etc), in which each organisation operates, a shared observation is that high performing organisations have adopted an enterprise management approach that seeks to balance the intricate interplay and impact between the various factors and of any misalignment within functional priorities.

In essence, *fig 3: Factors of High Performance (next page)* embodies the two processes mentioned. The central stem in Fig. 3 represents the strategy formulation process, and the surrounding factors illustrate the cause and effect relationships integral to executing the chosen strategy.

What is interesting is that most high performing organisations have in place formal strategy execution processes. These processes are quite distinct from generic value chain activities and from the strategy formulation process itself. While such processes may incorporate scorecards, the balanced scorecard being one among the several techniques used, it is always seen in combination with other management concepts. Coincidentally, those organisations that have formal strategy management processes also tend to be high performers.

< Contents Quit Forward >

### Emergence of strategy execution as a disciplined process

Michael Porter in his seminal article on strategy published in 1996 states, "The essence of strategy is in the activities; choosing to perform activities differently or perform different activities than competitors".

Reading between the lines, it can be interpreted that strategy is achieved by the actions an organisation performs – all the things an organisation does on a day- to- day basis. Ultimately, actions boil down to doing the right things and doing things right.

Although the criteria is simple enough its enactment in relation to a chosen strategy is by no means simple. In reality, choosing what is right can be daunting.

At the heart of any strategy is recognition that to be successful in a complex and ever changing environment an organisation must continually adapt and evolve. This can happen only through the renewal of strategy, deciding on things it must perform now, how it performs these and what projects must be implemented to transition from the current to a desired future state.

If organisations are in a constant state of flux between current and future states, as they must be in order to merely survive, then they face the task of balancing what resources and effort to expend on at least three competing demands:

- Processes that deliver existing products and services
- Optimising current processes to a satisfactory level of efficiency and effectiveness
- Projects and initiatives that will deliver future products and processes

Management must align the three requirements through a trade-off between current performances and future well being. High performing organisations demonstrate that a formal strategy execution process is needed to do this effectively. The components comprising a strategy execution process is represented in several forms, and *Fig 4: Strategy Execution as a Process (right)* illustrates a hybrid approach. The six execution stages shown are tightly integrated; they must operate together in a closed loop. There is no real beginning or end, and excelling at one at the expense of the other can lead to a breakdown in the execution process.

Within high performing organisations strategy execution appears to be a relatively well embedded process. It's emergence as a strong management discipline is reflected by the growing number of texts and articles in reputed management journals. The intricacies of how a strategy execution process works in practice is a topic of its own, and this discourse will not attempt to discuss its mechanics. What is explored here is how techniques such as the balanced scorecard could be used effectively to bolster such a process.

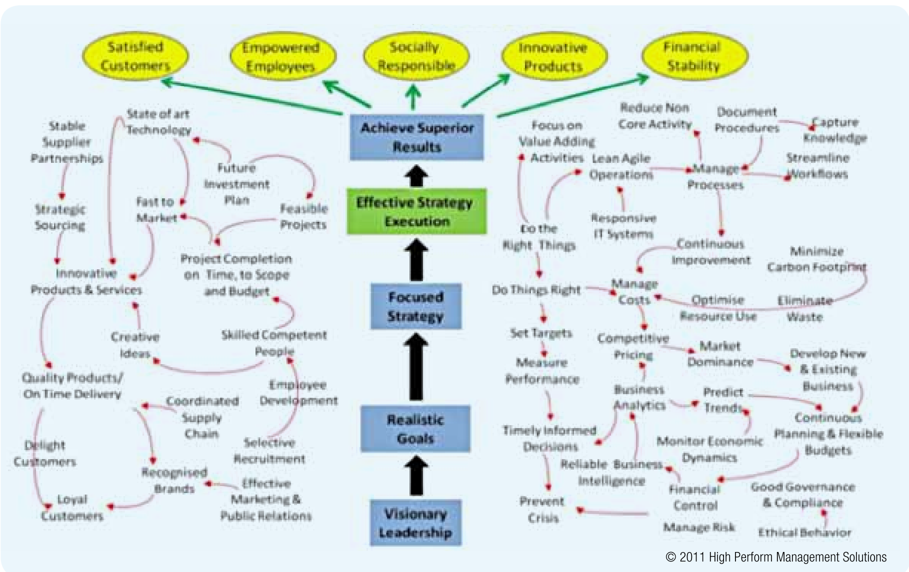



***Fig 3: Factors of High Performance.*** *High performance organisations display a set of characteristics at which they excel irrespective of their industry, size and location*

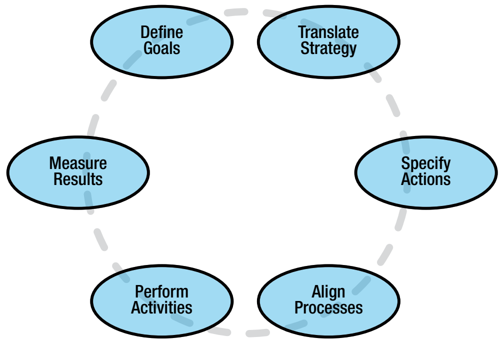



***Fig 4: Strategy Execution as a Process***

### The balanced scorecard and strategy execution

A critical examination of the factors of high performance shown in Fig 3 reveals that several fall under traditional functional management domains such as marketing, purchasing, IT and finance. Modern day organisations, structured around functions and hierarchies, deal with what falls within their turf quite effectively. However, the several high performing factors are more universal and cannot be pinned down under traditional functional classifications.

For instance, which organisational function has responsibility for doing things right, continuous improvement or ethical behavior? Historically, these activities have been conveniently pigeon holed into existing functions or treated as special projects with the result that they rate below functional activity in importance.

These cross functional factors of high performance could be loosely categorized into a few groups:

- Process excellence
- Performance management/measurement
- Resource management
- Project management
- Predictive management and risk mitigation

If excelling at carrying out high performance factors leads to success (i.e., delivering on goals), what tools and techniques does an organisation need to ensure this and where do balanced scorecards fit?

Clearly, balanced scorecards are not the apparent tool for every category listed above. However, the connection between the fundamental characteristics of the balanced scorecard concept as outlined previously with the first two high performance groups is not difficult to see. In practice it's not the only tool to be applied but is used in combination with several other management methods.

The strategy mapping process in balanced

[ **Balanced** scorecards have an ***important*** role to play in the *strategy* management process ]

scorecards is a practical way to translate goals and objectives to critical success factors. An alternative name for strategy maps, the term success maps, coined by the Cranfield School of Management, is finding greater acceptance, however, in principle it is identical to what Kaplan and Norton originally conceived. Determining the right things to do at every level in the organisation requires the chosen strategy to be articulated in a crisp and clear way down to individual activities and projects.

The issue with strategy/success maps is that they have typically been used to translate strategies to success factors at a relatively high level. The line of sight or causal relationships between these and actions taken on the shop floor are generally less obvious. Unless strategy is converted into understandable work at all levels in an organisation, and employees at the operational (i.e., execution) level know what to do, they will tend to act in ways that are reactive, driven by immediate gains which are usually contrary to achieving longer term imperatives. Existing performance assessment and reward systems, employee role definitions and organisational culture also influence how employees act. These issues go beyond installing balanced scorecards, yet have a significant bearing on whether scorecards become useful or add to the management clutter.

At a very basic level balanced scorecards are also measurement systems providing feedback. Reaching towards future goals requires the setting of targets, usually progressively more difficult within defined timeframes, and measuring progress against these. Determining the type of measures, how often these are measured, how these get distributed and provide feedback are some of the issues to consider in setting up a measurement system. This applies to balanced scorecards as well. However, the broader issue is not about measurement. It is about:

- What impact the current rate of performance has on ultimate goals
- What actions need to be taken when it becomes evident that a measure shows adverse results against targets (i.e., the desired result is unlikely to be achieved in the planned timeframe)
- Who takes what action and who else it impacts

These questions shift the balanced scorecard from a system of measurement to one of action, making it a mechanism for strategy execution. Such a shift is not easy to implement as it challenges conventional performance management thinking and will inevitably result in significant pressure on existing organizational culture, both likely to meet with resistance. Perhaps this is another reason why only a few organisations are successful in shifting the emphasis from measurement to action.

Even when scorecards are balanced (i.e., have a mixture of leading and lagging indicators) they almost always look backwards (i.e., they track past performance against previously set targets). The shift required is for scorecards to be used to trigger timely corrective action to curb poor performance and then to predict or forecast the likely outcomes from the actions initiated, signaling to all concerned that corrective action has in fact been taken and that it is expected to bring performance back on course. Management attention can then be diverted to where it is needed most.

The impact of balanced scorecards on the high performance factors falling under the other three groups (i.e., resource management, project management and predictive management and risk mitigation) is less than with the factors discussed above. Management of these requires a multitude of management techniques and methods. However, scorecards are being used increasingly as a measurement and feedback mechanism in these areas, owing to the ability of balanced scorecards to communicate facts on performance more holistically, succinctly and visually than conventional measurement systems.

The increased application of "balanced" scorecards in human resource management, project management and risk management evidence this trend.

High performance organisations demonstrate that success is based on the ability of organisations to skillfully combine a number of appropriate tool sets and apply these in a systematic way to achieve a sustainable edge over competitors.

The balanced scorecard concept has been around for 20 years, and it is beginning to find its true place in organisational management only now. As with most new techniques, the balanced scorecard has had its "flash in the pan" – authors and consultants have made good mileage from it. But it is time to move on. Balanced scorecards have an important role to play in the strategy management process as a co-star rather than as the main act.

*The author welcomes comments and discussion on this article and is happy to exchange ideas with all interested persons. He can be contacted by email: sarath_amukotuwa@highperformancesolutions.com*

< Contents    Quit    Forward >

## Membership Chairman Report

*by Tony Pereira*

The launch of a proprietary magazine has greatly assisted the membership committee's mission to deliver greater value to ICMA members, and I have no doubt that as the publication develops more and more benefits will accrue.

I am very pleased to advise that our membership renewals are exceptional this year, and it is gratifying that the programs aimed at enhancing ICMA profile and increasing brand recognition are resulting in much improved membership retentions.

The membership committee is currently reviewing its strategy for the next three years and expects to submit a plan to the ICMA council before the end of this calendar year.

A number of initiatives aimed at delivering additional membership benefits are under consideration, one being the launch of a focused campaign aimed at expanding the number of registered students. The student registration program will be directed at university graduates and at individuals willing to build knowledge through the various pathways ICMA has made available to suitable candidates wanting to achieve certified status.

The membership committee is also examining the introduction of a campaign that will encourage existing members to introduce at least one new student every year into the ICMA family. As an incentive, a prize may be offered. Watch for an announcement about this campaign early next year.

Meanwhile, *On Target Online* has a new **Students Notes** section in support of the registration program.

We are acutely aware of the need to introduce additional benefits for members and understand that in today's competitive global world possessing post nominals signifying professional membership is not sufficient. Accordingly, my committee is considering a number of potential benefits that will add value to the ICMA connection.

Feedback from members on this issue would be extremely helpful so please email any suggestions or comments to our editor at ontarget@cmawebline.org. The member who sends a response judged to be the most constructive will receive a 50 per cent credit against their 2012 year membership renewal!!

In conclusion, I ask each and every one of our members to become an ambassador for our profession and for our Institute. The communication technology available today is powerful enough to support revolutions; let's use it to deliver our message far and wide.

[ I **ask** each and every one of our ***members*** to become an *ambassador* for our profession and for our Institute ]

# It's a small world - isn't it?

*by Dr Basil Tucker*
*School of Commerce, University of South Australia*

> [ organizations can be **viewed** as social groupings *based on* relationships, ***interactions*** and social ties ]

It's a comment most of us have heard or said - the experience of meeting a complete stranger with whom we have apparently little in common and finding unexpectedly that we share a mutual acquaintance.

"It's a small world!" we say. More generally, most people have at least heard of the idea that any two individuals, selected randomly from almost anywhere on the planet, are "connected" via a chain of no more than six intermediate acquaintances. Known as the, *"six degrees of separation"*, this thesis has been the topic of serious social scientific research since the 1960s and has been revisited in recent years in the academic world as social network theory (SNT).

The small world phenomenon has been shown to be more than unlikely coincidence and curious anecdote. Networks exhibiting small world properties are observable in many different contexts, including computer science, biology, criminology, fashion, operations research, electrical engineering, neurosciences, and the social sciences. These structures share a common blueprint and conform to underlying laws based upon the tendency of networks to self-organize. More than an urban myth then, the presence of small world networks has real world application in many spheres of business life – including management accounting.

### Not what you know, but who you know

As applied to management accounting, the premise of small world networks is that organizations can be viewed as social groupings based on relationships, interactions and social ties formed between people within the workplace. These social networks do not require a formal, organizational hierarchy to get things done. Rather, networks are realities of organizational life and central to the way in which managers manage the demands on their time, make decisions, accomplish specified objectives, and facilitate change. In short, it is often claimed that to get on, it is not what you know, but who you know that is most important.

This is nothing new to experienced management accountants. The traditional management functions of planning, staffing, organizing, directing and controlling as typically taught in business schools rarely reflect the realities of the real world. In practice, effective managers operate quite differently. The use of formal position is not the only way to get results, and one's ability to obtain a central position within informal networks depends to a large extent upon the quality of one's relationships with leaders and subordinates.

### A closer look at social networks

SNT sees an organization as a combination of multiple overlapping networks of complex social and interpersonal relationships. These networks occur in hierarchical layers, formal organizational subdivisions such as departments or business units and informal groups. The social ties comprising these networks are maintained over time, thus establishing a relatively stable pattern of network interrelationships. Directing attention to the structure of such networks, and the linkages and position of individuals within these networks, enables the pattern of interactions and connections to be modeled and predicted. Such networks can play a key role in the dissemination of information within the organization and can, therefore, provide management accountants with rich insights into how their organizations really operate.

*continued page 7*

< Contents Quit Forward >

Analyzing social networks involves identifying clusters, and then connecting the clusters using central elements (known as nodes) within the clusters as reference points. A node is generally an individual person, but nodes can also be a committee, a task force, a professional body, or a department. People within the cluster are directly connected to all other persons within that cluster with the whole cluster not being contained in any larger cluster, although individual members may belong to several clusters.

### Value for management accountants

One particular application of social networks in management accounting is to present a way of observing and assessing means by which control information is transmitted beyond that of the formal hierarchy. As such, network characteristics can be used to better understand, measure, and, therefore, assist issues of cooperating within horizontal organizational structures, cooperating and sharing information (both internally across operations and externally with other organizations). This provides a different insight into control practices and processes which, until now, has been largely unfamiliar territory in management accounting.

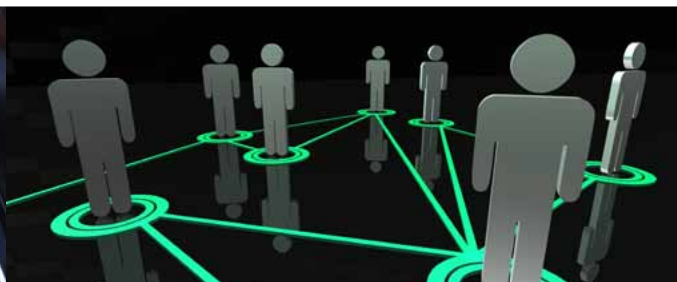
Managing such control practices and processes might involve managing interactions within and between particular clusters in networks. Central individuals within these clusters are highly influential in transmitting information across the network. These gatekeepers are likely to be pivotal to the extent to which control efforts support or act in opposition to formal policies, procedures and rules. From a control perspective then, the challenge becomes one of how to structure social interactions – primarily with and through these gatekeepers – in a way that optimizes control efforts.

Specifically, the adoption of a social network perspective can benefit practitioners by providing insights into a host of important questions:

- What does our informal organization chart look like?
- How clustered is our organization?
- Which clusters are structurally positioned to exert influence?
- Who interacts with whom?
- Who are the central individuals within clusters?
- Who is to be informed about what, where, when, how and why?
- What is the speed of influence and transmission of information?
- Who is instrumental in this process?
- How might their value be harnessed or their negative impact be managed?

In summary, viewing organizations as a collection of networks has a number of potential benefits for getting things done, implementing projects, overcoming resistance to change, and reducing maintenance effort in surveillance and compliance activities. Although relatively new to management accounting, network analysis can assist greatly in what we do as well as how we do it.


< Contents Quit Forward >



## ICMA Reaches Out

One of the strategies adopted by the ICMA council in 2009 was to initiate negotiations with a number of identified organisations over mutual recognition agreements, (MRAs) or mutual cooperation agreements, (MCAs) depending on the nature of the relationship under consideration.

In May, the ICMA applied for a Department of Education Employment and Workplace Relations (DEEWR) grant to fund an outreach program designed to initiate the implementation of this strategy, which was awarded under DEEWR's Professional Services Development Program.

As a result, ICMA's senior vice president Michael Vincent and myself visited the American Institute of Management Accountants (IMA), CMA Canada, CIMA UK, and the Irish Institute of Certified Public Accountants (ICPA) in June during a whirlwind 10 day round the world trip.

The outcomes from those meetings are still being realised and discussions will continue for some months, however, many positive initiatives have been already achieved. As foreshadowed in my column last month, what follows is a report on the mission we have named "Outreach".

In the USA we met with IMA CEO, Jeffrey Thompson and Director of International relations, Jim Gurowka. It is no secret that the relationship between our two organisations has been somewhat strained since the failure of the 2006 merger discussions. I am pleased to report that our discussions resulted in an understanding that the two organisations will move towards formulating and signing a MCA. At this stage, we are looking no further than this, but it is gratifying that dialogue has commenced once more and the animosity of the past is behind us.

In Canada we met with Joy Thomas who is both President and CEO of CMA Canada, and Executive Vice President, Richard Benn.

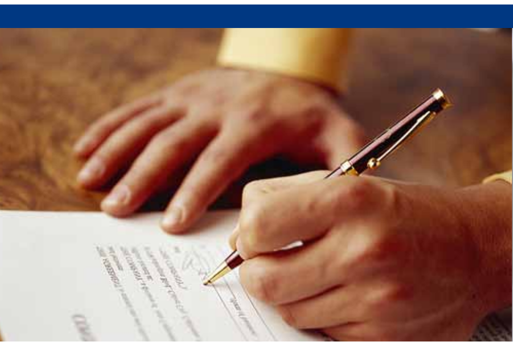
The Canadian accountancy profession is engaged in complex merger negotiations involving the Chartered Institute, CMA Canada and CGA (Institute of Certified General Accountants). It was clearly untimely to open meaningful discussions regarding mutual recognition with CMA Canada because it is not known whether they will remain an independent body or become part of a merged profession.

Outcomes from the Canadian merger negotiations are indeed difficult to predict because despite messages of confidence from the professionals, membership appears to have differing views. Nevertheless, we agreed that it was necessary to await the outcome from the merger discussions. If the merger fails, we will reopen discussions on potential MRAs with CMA Canada; if it is successful, our dialogue will be with the merged body.

In London we met with CIMA Managing Director, Andrew Harding and the CEO, Charles Tilley. The extremely positive outcome was an agreement that ICMA should

< Contents Quit Forward >

# the relationship will **commence** by ***examining*** potential areas of co-operation in locations where ICMA has an *established* footprint



commence dialogue with the CIMA Australian Chapter, the objectives being "to develop a framework that, to mutual benefit, can leverage the openings already made for the recognition by both government and the business community of management accounting as a specialist discipline in Australia".

We agreed also that subject to a constructive modus vivendi being established and at the appropriate time, the two bodies will investigate the implications of entering into a MRA.

There have already been initial discussions between myself and the National Manager of CIMA in Australia, and members will be kept informed of progress as the dialogue evolves.

In Ireland we met with Eamonn Siggins, CEO Institute of Certified Public Accountants in Ireland (ICPA) and Paul Hearney, Director of Education. The meeting was extremely positive, and Mike and I were fortunate to receive a good strong dose of Irish warmth and hospitality for which we were both extremely grateful coming at the end of a very arduous 10 days.

We emerged from the Dublin meeting with a clear understanding of how the two organisations could work together and gradually create the facts on the ground that would lead to the establishment of a MRA.

The relationship will commence by examining potential areas of cooperation in locations where ICMA has an established footprint outside Australia providing immediate potential for joint badging and the gradual promotion and development of a formal relationship.

There is a clear opportunity for both bodies to share existing education resources and potentially to collaborate on developing new education resources in Continuing Professional Development and core education programs mandatory for gaining admission to membership.

The relationship between the two bodies also provides an opportunity for ICMA to participate with ICPA in its nurturing and mentoring of developing professional accountancy bodies within emerging markets.

Both organisations distribute electronic journals which could be circulated to the respective memberships under a reciprocity arrangement.

ICMA's academic network could provide a pathway to assist ICPA members who wish to use prior learning in order to gain recognition for admission into formal university education.

ICMA also recognised the opportunity to gain an understanding of ICPA's governance model and constitution.

We are now drafting a Memorandum of Understanding after which the process of implementing the joint initiatives will commence. As the relationship develops the two organisations will examine the implications for a formal MRA.

As evidenced by this brief report the mission resulted in a number of extremely important outcomes, although its ultimate success will depend on the action taken over the next six to 12 months. We will report back to members as the various projects progress.

In closing, I wish to express my gratitude to DEEWR for their assistance with this important initiative.

Leon Duval

CEO, ICMA

< Contents Quit Forward >

*In this issue we introduce Student Notes, a new section for the benefit of students enrolled in the ICMA Conversion Program for Non-Financial Managers and the Foundation Programs, Certified Accounting Techniques (CAT), Registered Cost Accounting (RCA) and Registered Business Accounting (RBA).*

*In his introductory article, John Donald examines the role of our profession in today's fast moving, complex and volatile world. Not just for readers setting out to acquire a management accounting specialisation, it offers an excellent overview of the valuable contribution our profession makes to economic life today. Indeed, it is a useful script for those challenged to describe what management accounting is and what management accountants actually do.*

# The Role of Management Accounting in the Modern Business Environment

*by John Donald, Lecturer School of Accounting, Economics and Finance, Deakin University.*

[ Management *accounting* can provide information relevant to the ***decisions*** that have to be made in a number of key **managerial** functions ]

The logical way to start a series of short discussions on management accounting is by considering what it is and what it does. Why is it called management accounting? Who uses management accounting information and how is it used?

Before answering these basic questions (and others), it should be recognised that managers are people who are paid to make decisions, both financial and non-financial, regarding their business organisation. Managers are responsible for planning the firm's operations effectively and for ensuring that operations are kept under control. In order to make the right decisions they need the right information and, of course, they must know how to use information correctly. Providing managers with timely, accurate and relevant information for decision making is the main purpose for establishing management accounting systems.

Management accounting is a sophisticated financial and non-financial information system, which is fully integrated into the organisation's overall information system. It uses information gathered from right across the organisation and from outside it. This mass of data is analysed and organised into categories or according to areas of particular interest, evaluated for its relevance and then reported to management on a regular basis to assist in decision making. Management accounting reports may contain details, often confidential in nature, which are not usually found in external reports. They can be prepared in whatever format management desires because there are no rigid rules for the presentation of management accounting information. There are no official management accounting standards in Australia like those for financial accounting, and the information is not relied upon by external investors in making investment decisions. Someone once said that

< Contents Quit Forward >

management accounting is the language that managers and accountants use to communicate with each other in respect of operational matters. This was an accurate remark.

What sort of decisions do managers have to make? Basically, managers make resource allocation decisions. Firms have three types of resources which need to be managed: human resources (people), physical resources (like buildings and equipment) and financial resources (money obtained from the owners/shareholders or from lenders). Managers must allocate these resources in the most efficient way so that strategic profitability and growth objectives are achieved. Resources must be used in such a way that they create value for both the firm and its customers or clients. Value can mean the net worth of the firm which, for a company, would be measured by its shareholders' funds (i.e., its owners' equity). Alternatively, value could refer to the usefulness that the firm's customers obtain from the goods or services that it provides. Remember that people buy something because they value the product more than the money they have to pay for it. By providing things of value, firms are able to generate sales revenue. If managers can ensure that the total amount of sales revenue exceeds the cost of goods sold, the firm will make a gross profit while, at the same time, meeting the needs of its customers.

Management accounting can provide information relevant to the decisions that have to be made in a number of key managerial functions. These include:

**Planning** This covers both strategic (or long term) planning, perhaps with a five-year time horizon, and tactical (or short term) planning which focuses on the immediate future, usually the next 12 months. The setting of specific objectives is the starting point for the planning process. Once objectives are set, plans in the form of budgets can be formulated which set out how those objectives will be achieved. A set of budgets, including budgets for sales, production and costs, along with budgeted financial statements, is sometimes referred to as a master budget.

Planning decisions always relate to possible future courses of action. A senior team of managers must consider the alternative ways of achieving the objectives that have been set for the budget period and then, by using the management accounting information provided to them, select the most advantageous plan of action. This plan is then communicated throughout the organisation so that it can be implemented.

**Performance evaluation and control**
This managerial function involves looking at how segments of the organisation, and the persons in charge of those segments, have performed. For each area of responsibility, actual performance for a period must be measured and then compared with budgeted or planned performance so that decisions can be made about changes in the budget and/or the activities being monitored. If performance has been poor in any part of the organisation what should be done about it? Most organisations use performance evaluations to make decisions about increasing or decreasing the activities of various segments, promoting or removing managers and changing operating procedures. Prompt remedial action is needed when budget targets have not been met. Management accountants have the skills and experience that enable them to explain to managers what the numbers mean and how to improve them.

**Cost management** The emphasis here is on how costs are incurred and what can be done about reducing them. Costs are managed by managing the factors that cause costs i.e., the cost drivers. Accurate cost measurements enable the identification of areas where costs have got out of control. Understanding cost behaviour is vital because it enables accurate predictions of future costs. Often costs are estimated in advance on a scientific basis. These predetermined costs, used for controlling operations, are called standard costs and we will consider them in a later discussion. Management accountants can be directly involved in formulating standard costs, identifying and reporting on variances from them and analysing these variances. Reports are prepared by the management accounting team for all levels of management, thus promoting cost consciousness and aiding operations control.

[ Management *accountants* have the ***skills*** to explain what the numbers mean and how to improve **them** ]

< Contents Quit Forward >

# The Concept of Risk Management in the 21st Century Business Environment

*by Michael Vincent,*
*Vice-President, ICMA Australia*

*The Institute strives continually to enhance your individual professionalism and that of management accounting so ensuring that the business community understands the difference between the various components of the accounting profession.*

*Management accounting is about informed and numerate decision making where the individual decision maker is aware of the scope and the exposure of the decision making process and is even more aware of the ramifications of any decision.*

*The profession recognises that we must extend our knowledge to be central to the strategic decision making framework within organisations and to ensure we remain relevant and functional at their most senior levels. Accordingly, over the next three issues of On Target Online I will examine the concept of risk management and its role in the assurance process within firms.*

*This will reinforce the fact that supplying assurance to the executive management and the board is at the heart of the management accountant's functions. In future, an understanding of risk management will be an important part of the CPD process as it embeds itself further as a core competency of the profession within its accepted definition.*

*The three articles will address the development and history of risk management; the process of risk management utilising AS/NZS/ ISO31000:2009 as the starting point and, the policy setting for risk management*

Managing risk and decision making are at the core of the human condition; it is the ability to think and choose between different alternatives that separate a thinking being from one that is driven solely by instinct. We all manage risk either knowingly or unknowingly by intuition and our background. In business though we need more than intuition; we need process, policies and the desire to implement effective management tools for our organisation's survival.


Modern risk management began at Temple University in Philadelphia circa 1956. The teaching revolved around the concept of risk and insurance, and this relationship remains even though insurance is now viewed as a cash flow assurance tool rather than a risk management tool. Risk, on the other hand, has separated from insurance as a decision tool with direct applicability to an organisation's strategic decision making. Risk management has continued to evolve and embed itself in the decision making process. In Australia, for example, the Stock Exchange has mandated risk as a component of good corporate governance. It is recommended, if you have not already done so, to download and read the "Guide to Good Corporate Governance" from the exchange website, particularly principle 7.

The concept of risk is multi-dimensional and multi-disciplinarian in that risk is a thinking process that impacts on all components within the network system. Risk theory and practice differ between practitioners depending on their underlying discipline. In other words, risk is a disciplinary based process that applies to security, health, finance, business management and beyond. Failure to recognise the scope of risk management and the skills sets needed for an integrated business approach to it can result in a silo mentality developing and the very nature of the process of risk management becoming the greatest risk the business faces. An examination of the recent GFC demonstrates this point, and we are now in the process of paying the price for the failure of risk management and the failure to understand and implement it for value.

Risk management is about understanding the context of the decision and its place within a network; it is about the application of disciplinary knowledge for a multi-disciplinary outcome. An understanding of risk beyond the process revolves around three words, 'respect', 'empathy' and 'communication'.

[ Management accounting is about informed and numerate decision making ]


*1.* *Respect:* The ability of the individual to seek understanding of others even if the discipline is different, e.g., the management accountant versus the project engineer.

*2.* *Empathy:* To identify with and understand the meaning of the term 'risk' by others.

*3.* *Communication:* To be able to sell your message to others some of whom may be suspicious of your motives and message.

In a business world based on silos and separate disciplines understanding and using these three words in a correct context enables a culture of risk management to be developed. The development of a culture goes beyond the mere process and ensures the engagement of the human within the assurance framework.

Risk is an evolving concept; presently the process is the dominant component of the discipline, but this has not necessarily led to a safer or more managed environment. There is a turf war between a range of disciplines professing ownership of risk management, and sadly this has lead to an arrogance developing whereby the holistic nature of risk is missed.

In the next issue I will examine the process accepted as the basis of risk management across most of the business world.

**Dr Nalaka Godehewa** is the ICMA branch President in Sri Lanka and Chairman Sri Lanka Tourism with broad corporate experience in a number of industries.

**Q. You have an impressive breadth of qualifications from engineering to accountancy and marketing and an unusual career path through manufacturing, telecom start ups and now insurance. Why so many disparate disciplines and is there a common thread?**

A. My education has always been linked to the business requirements of my career. For example, I studied accountancy while in the university engineering faculty because I always intended to have a career in management. During my early years at Unilever, my career shifted towards marketing, so I undertook marketing studies. An early MBA was required since I was progressing fast in the corporate sector. The career moves always came as a result of being headhunted. Some opportunities were too good to refuse, and my multi- disciplinary background made it that much easier to adopt to any new industries fast. But I never left a company before achieving the promised goals.

**Q. Am I correct in thinking that your primary role throughout has been in marketing? If so why is it important ?**

A. I have handled different roles in different organisations, particularly during the early stages of my career, including finance, operations management, ICT, HRM, and sales and marketing. However, I developed a liking for marketing and focused more on marketing roles. During the last 10 years I've filled CEO, Managing Director or Chairman positions in different organisations where marketing and finance knowledge were very useful.

**Q. Describe your current job**

A. Currently as the Chairman of Sri Lanka Tourism my role is more involved with government policy making and regulations, and since tourism is considered one of the key economy drivers, it is an interesting and challenging job. We have put in place a five year master plan for the tourism industry, and my main focus at the moment is driving its implementation. I am happy to say that tourism in Sri Lanka is currently growing at a rate of 40 per cent per annum, which is one of the highest growth rates in the world.

**Q. What is the significance of management accounting in terms of your career choices and experience?**

A. I always had a special liking for management accounting from the time I started studying finance, and that knowledge has helped me throughout my career. As we all know, a good knowledge of finance, and particularly of management accounting, helps fast track one's career, particularly, when you are holding non-finance roles.

**Q. How did you hear of and become involved in ICMA?**

A. I got to know about ICMA about six years ago through Professor Janek Ratnathunga and later I got to know Mr. Leon Dual, President of ICMA as well. On their advice I and a few colleagues started promoting certified management accounting in Sri Lanka, which has now become a highly recognised qualification amongst senior corporate executives. We have positioned ICMA not as a qualification just for accountants but as an accounting qualification for senior executives holding non-finance functions. As a result, there are many marketing directors and CEOs seeking this qualification in Sri Lanka.

**Q. Did you think it would benefit your career, has it and in what ways?**

A. The relationship with ICMA has helped me improve my contribution to the country . We have been able to introduce a different dimension to professional accounting qualifications by helping non-finance managers fast track their careers to the board room.

**Q. How big is the Sri Lanka branch?**

A. The Sri Lanka branch is about five years old and we recently had our largest convocation for more than 100 qualified graduates.

**Q. Describe its activities, growth and initiatives.**

A. The branch was initially managed by a few of us. We focused primarily on educational aspects. The intention was to gain recognition for the qualification and build a student base. We had to compete with qualifications such as CIMA, ACCA, CFA etc which had a longer history and were well established. I think now we have found our niche and we are fast gaining recognition within our focus area. We recently formed our first management council which comprises of well reputed senior executives in the corporate sector. I am confident they will take us to the next level.

**Q. How relevant is management accounting to the Sri Lanka economy and business generally in your region?**

A. Sri Lanka is currently experiencing rapid economic growth with a growth rate of over seven per cent. There are many new companies starting operations and existing companies are expanding their businesses. Opportunities are abundant, and all these organisations require professionals with solid management accounting exposure. I think ICMA can clearly contribute in this area.

In each issue *On Target Online* turns the spotlight on someone of interest and achievement in our ranks. All branches are invited to nominate members they consider to be outstanding management accountants who have contributed both to their profession and the wider community. Nominations should be accompanied by a brief outline of why the nomination is significant and contact details for the nominee. Please address contributions to the editor ontarget@cmawebline.org

< Contents Quit Forward >

## Dear Editor,

I'm rather concerned about the CPD requirements outlined in Issue 3. There is a need for continuous development for members, and such courses are essential for the income stream of a successful professional institution.

However, there are some issues which I think are worth considering if ICMA is to follow other organisations such as CPA Australia and make training hours compulsory.

Most of our members are overseas. Considering that we are not an immigration assessment organisation yet (though hopeful of becoming one) this indicates the value members place on CMA courses. Most people arriving from overseas join CPA Australia for immigration reasons. However, the quality of the CPA Australia program is very poor. The exams are based on multiple choice, and with a bit of luck even a student with zero knowledge has a 25 to 33 per cent chance of passing. Students attempting ICMA exams must prove they have understood the problematic. Luck will not save a bad student. ICMA's CPD program is also far stricter than CPA Australia's which allows members to claim company internal training, readings and even excel courses.

But ICMA being less well established and, therefore, less well known means that some employers are reluctant to pay their employee's ICMA membership and course fees or to grant study leave for which employees must sacrifice annual leave. Again, it is a measure of the programs' value that students are willing to do this.

Taking all these points into consideration, I think the organisation is putting too much pressure on members. My solution is to ease the CPD requirements allowing company internal training, SAP, Excel or similar training and OR technics, which I recommend as an ICMA course.

These are just my concerns, but maybe worthwhile considering,

**Sebastian Skrzipek**

*Thankyou very much for this well thought out response. It is very valuable. I will table it for discussion at the next council meeting,*

***Leon Duval***

## Dear Editor,

Thanks for your good work in *On Target Online*, it is getting better and better.

Regarding the CEO message in Issue 3, as a management accountant I fully agree that we should always differentiate ourselves professionally as such. But as the ICMA enters the internet era an appealing internet domain is also an asset to a professional and well branded organisation. The current cmawebline.org does not convey this and I strongly recommend a name change,

**Victor He**

## Branch News

***India***

Keeping up to date with news of CMA India activities will be no problem now the branch has renewed its website http://www.cmaindia.net with active social media and joined Facebook with a page on the CMA India Chapter available at http://www.facebook.com/pages/ICMA-India-Chapter/194517557251674

Published by:

**The Institute of Certified Management Accountants**
Unit 5, 20 Duerdin Street
Clayton North 3168
Victoria

**Australian Branches :**
All inquires please contact
info@cmawebline.org

*** South Australia**
Professor Janek Ratnatunga, PhD CMA
Branch President
University of South Australia

*** New South Wales**
Professor Chris Patel
Branch President
Macquarie University

*** Western Australia**
Dr. Vincent Ken Keang Chong
Branch President
UWA Business School

*** Nothern Territory**
Professor Gweneth Norris, PhD CMA
Branch President
Charles Darwin University

*** Queensland**
Dr. Richard Whitwell, PhD CMA
Branch President
Central Queensland University



**Editor**: Jan McGuinness: ontarget@cmawebline.org

**DTP**: www.toothpick.com.au

http://cmawebline.org

< Contents Quit