SUGGESTED SOLUTION

FINAL MAY 2019 EXAM

SUBJECT- SCM & PE

Test Code - FNJ 7081

BRANCH - () (Date :)

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Answer 1:

(i) Magical stay is operating in a business scenario that is highly competitive and dynamic. Focus of the traditional budget was driven towards achievement of the company's strategic goal, which was profit target of Rs. 1,500 million for the year 2018. Accordingly, the senior management followed a top – down approach to budgeting. Most important policy decisions like room rent per day, material procurement, employee hiring, capital investments at each property, advertising and promotional activities are handled directly by the corporate headquarters. Management in charge of operations at each location only implement it. In a changing business scenario, this budgeting methodology has the following shortcomings :

(a) Budgets based on these policies may not be flexible enough in a fast – changing business environment. Although it is based on assumptions and expectations of the management has made about the business growth, in a dynamic scenario, it is very difficult to predict the future accurately. Therefore, targets or benchmarks set by the traditional budgets may become outdated quickly.

(b) These budgets were based on business functions like sales, advertising, operation etc. While a strategy for these functions is important, they are based on internal benchmarks and assumptions made by the management. However, for the company to be flexible in a changing environment, the focus should also be on external factors.

(c) The management aims to make a yearly profit that is 10% more than the previous year's profit. If previous year profit alone is the benchmark for growth, certain decisions may be shelved because they may decrease current year's profits below target. However, had these decisions been implemented they may have generated value in the long term and ultimately may have been better for earning profits in future years. For example, certain capital expenditures that may need to be undertaken quickly in order to improve customer satisfaction, may not be incurred at all simply because there is no budget for it.

(d) Operations management did not have much autonomy since policies were controlled at the corporate headquarters. At the same time, they were responsible for achieving the targets set out as per the budget. Responsibility without authority creates a negative working environment. Consequently, it might be difficult to retain talented personnel.

(e) In order to meet budget targets, managers may try to negotiate for lower sales targets to achieve, more budget allocations to meet costs etc. This does not foster positive business growth. Managers are more intent in meeting targets rather than focusing on business growth. It leads to lower sales than can otherwise the achieved and leas to protection of costs rather than working towards lowering operational costs.

It can be concluded that the traditional budgeting process was more inward looking. Focus is on achieving budget target rather than implementing strategies that can create more value to the company.

(ii) Following feedback from operations managers, the management given them targets based on growth instead those based on the budget alone. This is the philosophy of **"beyond budgeting"**. Below are features of this philosophy that has enabled Magical Stay to achieve better results :

(a) If is a more decentralized and participative way of operating a business. Rather than being made responsible for business decisions, which were not in their control, the employees delegated responsibility, combined with the necessary authority to execute decisions.

(b) Operations management and the personnel at each location are capable of quickly adapting to changing market scenarios. Likewise, since they interact with the customers directly, it enables them to make quicker decisions to ensure customer satisfaction or identify opportunities to general more revenue.

(c) Targets are based on performance of peer group companies. Benchmarks based on peer group performance will be unbiased and reflects the current business scenario better. Due to this, customer's needs and satisfaction automatically gets priority. It is the customers who ultimately drive business growth. Therefore, rather than having an inward – looking outlook, focus is shifted to the external market conditions. Due to autonomy managers at various locations need not compete with each other for budget allocation. This channelizes the operational focus to meet challenges from outside competitors rather than having detrimental competition within the organization. At the same time, the targets for the company are also based on guidelines from the corporate office. Therefore, there is congregation of goals with the shareholders' expectations.

(d) Employee morale is also boosted due to the monthly reward and recognition system. It fosters healthy competition among employees.

Since the focus is on growth, beyond budgeting can be a way of achieving better results in challenging business environment. **(20 marks)**

Answer 2:

Traditional Variance (Actual Vs. Original Budget)

Usage Variance	=	(Standard Quantity – Actual Quantity) × Standard Price
	=	(2,500 Kg – 2,700 Kg) × Rs. 1.50
	=	Rs. 300 (A)
Price Variance	=	(Standard Price – Actual Price) × Actual Quantity
	=	(Rs. 1.50 – Rs. 2.40) × 2,700 Kg

= Rs. 2,430 (A)

Total Variance = Rs. 300 (A) + Rs. 2,430 (A) = Rs. 2,730(A) **(3 marks)**

Operational Variance (Actual Vs Revised)

Usage variance = (2,500 Kg – 2,700 Kg) × Rs. 2.25

= Rs. 450 (A)

Price Variance = (Rs. 2.25 – Rs. 2.40) × 2,700 Kg

= Rs. 405 (A)

Total Variance = Rs. 450 (A) + Rs. 405 (A) = Rs. 855 (A) **(3 marks)**

Planning Variance (Revised Vs Original Budget)

Controllable Variance = (Rs. 2.00 – Rs. 2.25) × 2,500 Kg

= 625 (A)

Uncontrollable Variance = (Rs. 1.50 – Rs. 2.00) × 2,500 Kg

= 1,250 (A)

Total Variance = Rs. 625 (A) + Rs. 1,250 (A) = Rs. 1,875 (A)

Traditional Variance = Operational Variance + Planning Variance

= 855(A) + 1,875(A) = 2,730(A)

A Planning Variance simply compares a revised standard to the original standard. An Operational Variance simply compares the actual results against the revised amount. Controllable Variances are those variances which arises due to inefficiency of a cost centre / department. Uncontrollable Variances are those variances which arises due to factors beyond the control of the management or concerned department of the organisation.

(4 marks)

Answer 3:

INFORMATION TECHNOLOGY (IT) SECTOR

There are a number of challenges associated with the management of the costs associated with the Information Technology expenditures incurred by the Multi-National corporations. Thus, the complexity of the operating structure and the difficulty seen in the implementation of the cost allocation models, it is seen that in order to manage the IT costs, most organizations tend to develop centralized IT departments acting as cost centers for the purpose of managing the IT budgets as well as allocation of costs associated with along with the charging back of expenses that are incurred by the business units.

IT Organization's Engagement Model

The question that needs to be addressed under the same is that whether the IT organization should be organized as a cost center to the organization or whether it should be seen as a strategic partner to the business. With more and more organizations whether large or small in nature, opting for third party allocation or opting for cloud computing services it can be seen that the internal IT departments are fighting hard for remaining relevant for the organization. In order to stay relevant, what the It department needs is a better visibility towards the IT needs of the organization. In order to do the same, organizations operating in the given sector can adopt what is referred as to the 4D framework.

4D IT Cost Optimization Framework

Defining Organization Vision

Any amount of spending carried out in relation to the Information Technology requirements of the organization needs to be aligned to the organizational vision and long term objectives. Business owners should have a sense of ownership and thereby control the IT costs in an effective manner. The perspectives of the key stakeholders i.e. CEO, CFO and directors must be taken into consideration when deciding upon the IT consumption within the organization.

The additional visibility through the model needs to determine the appropriate method of cost allocation in relation to the IT cost burden. Thus, the allocation model that is chosen needs to be both flexible and at the same time avoid being too complex in nature. The organization can either opt for a simple method of dividing the entire IT cost by the number of hours consumed by each department or a more complex but accurate method of ABC costing could be used for allocation of the costs based upon the associated cost drivers associated with each set of activities.

Documentation of the current state

The next step involves documentation of the current state of the IT department implemented within the organization in order to identify gaps and potential weaknesses identified in relation to the current state for the purpose of identification of the appropriate pain points as well as identification of areas for potential automation.

Delineation of target business architecture

Once the current state of the IT architecture has been documented, the next step is developing a target business architecture for the purpose of addressing the gaps and limitations identified and laying down the foundation with regards to the formation of the crux of the IT cost management framework.

Decision: Build v/s Buy

The last step understands whether the framework built is bought or custom built internally. The answer to the question involves a great amount of brainstorming and research taking into consideration the view point of all the strategic stakeholders involved. **(6 marks)**

Answer 4:

Traditional vs. Strategic Cost Management

	Traditional Cost Management	Strategic Cost Management
Time Span	Short term concept	Long term concept
Focus	Internal	Both internal and external
Cost Driver Concept	Based on volume of the product.	Each value activity has a separate cost driver. So, not based on volume but on activities associated with the manufacturing of the product.
Objective	Score keeping, attention directing and problem solving.	Cost leadership or product differentiation.
Cost Reduction	Primary objective is cost reduction.	Primary objective is cost containment – cost reduction and value improvement at the same time.
Approach	Risk – averse.	Risk taking and ability to adapt itself with changing environment.

(6 marks)

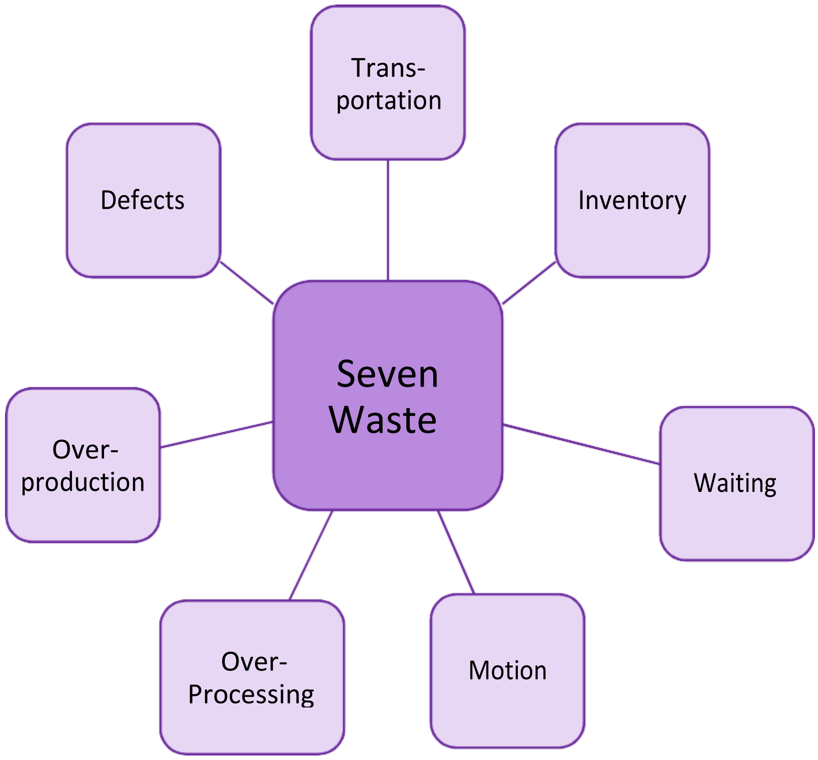
Answer 5:

The management accountant is traditionally considered the resident expert on cost analysis; cost estimation; cost behaviour; standard costing; profitability analysis by product, customer or distribution channel; profit variance analysis; and financial analysis. Today, management accountants must also bring skills in activity-based costing, benchmarking, re-engineering, target costing, life-cycle costing, economic value analysis, total quality management and value chain analysis. Value chain analysis is a team effort. Management accountants need to collaborate with engineering, production, marketing, distribution and service professionals to focus on the strengths, weaknesses, opportunities and threats identified in the value chain analysis results. By championing the use of value chain analysis, the management accountant enhances the firm's value and demonstrates the value of the finance staff to the firm's growth and survival. **(4 marks)**

Answer 6:

Lean System is an organized method for waste minimization without sacrificing productivity within a manufacturing system. Lean implementation emphasizes the importance of optimizing work flow through strategic operational procedures while minimizing waste and being adaptable.

Waste is any step or action in a process that is not required to complete a process successfully (called "Non-Value Adding"). When Waste is removed, only the steps that are required (called "Value-Adding") to deliver a satisfactory product or service to the customer remain in the process. There are generally 7 type of wastes:


Trans-
portation
Defects
Inventory
Seven
Waste
Over-
production
Waiting
Over-
Processing
Motion

(4 marks)