Budgets – Section 4.3.1 page 67 (follows section 4.3)

Budgets are typically very useful for organisations, and their uses can be remembered by recalling the CRUMPET acronym:

**C**o-ordination – Budgets help managers to organise their departments by ensuring that the work efforts undertaken are consistent in helping the organisation to achieve its objectives.

**R**esponsibility – Budgets provide the organisation’s managers with the authority needed to undertake expenditure in accordance with wider organisational plans.

**U**tilisation – Budgets help to ensure that managers have better visibility over the efficient deployment of the resources that they are responsible for.

**M**otivation – Budgets, if set appropriately, can have a motivating effect on managers as they may be more inclined to work within the budgets that have been set for them.

**P**lanning – Budgets help to focus the attention of managers as they require them to be forward-looking in terms of how best to use the resources that they have been allocated, taking into account relevant opportunities and threats.

**E**valuation – Budgets provide a helpful point of reference during the process of assessing the performance the manager responsible for that budget.

**T**elling – Budgets are a useful communication tool as they set out the expectations of the organisation in terms of the level of performance that managers are required to deliver over a period of time.

Treasury – Section 4.4 page 67

Some of the specific roles that a treasury accountant may be involved in will include:

- **Managing inventories** – balancing the need to have adequate supplies versus tying up cash in inventory
- **Trade receivables** – balancing the risk of slow and non-payment against offering competitive credit terms
- **Trade payables** – taking the longest possible credit period whilst keeping supplier relations cordial
- **Cash balances** – minimising overdraft use, or, if a cash surplus is available, ensuring a reasonable return is earnt, whilst keeping enough cash on hand to meet current liabilities
- **Weighing debt v equity mix** – debt finance is typically cheaper to arrange and service than equity (share) finance, but, too much debt brings insolvency risks. Within this the treasury team must manage interest rate risk eg ensuring that the company does not suffer if interest rates suddenly rise or fall
- **Foreign currency** – deciding whether, and how to hedge foreign currency risks eg the risk of currency movements can be accepted, part-hedged or entirely hedged
- **Tax** – ensuring that the company is complying with the law, whilst minimising its tax liabilities. Here a balance must be struck between tax avoidance (legal) and tax evasion (illegal), as well as being aware of the public perception of large corporations that appear to be paying too little tax
CIMA defines internal audit as ‘an independent appraisal activity established within an organisation as a service to it. It is a control which functions by examining and evaluating the adequacy and effectiveness of other controls; a management tool which analyses the effectiveness of all parts of an entity’s operations and management’.

(CIMA’s Management Accounting Official Terminology, 2005)

The internal audit function form a key part of organisational control by ensuring that the organisation is running efficiently. The work of the internal audit often involves investigating accounting sub-systems to ensure transactions are recorded correctly and that they have not been tampered with. Internal auditors also audit the business’s operations to give assurance that business objectives are valid, control information is reliable, and that activities are effective, efficient and economic. The role of many internal auditors extends to helping set corporate objectives and designing and monitoring performance measures to ensure these objectives are met.

Internal audit and corporate governance

A well operated internal audit function should help the board ensure good corporate governance. An effective internal audit function can conduct thorough risk assessments throughout the organisation, and then recommend the actions needed to enhance any weaknesses identified.

Best practice in corporate governance, such as the UK Corporate Governance Code (FRC, 2018), requires that companies that do not currently have an internal audit function should consider on an annual basis whether they should create one. The board or audit committee should review the effectiveness of the internal audit function on an annual basis. The effectiveness of the internal audit function can be enhanced by appointing staff that are sufficiently qualified and experienced.

Scope of internal audit

Roles that come under the remit of internal audit include:

- Reviewing internal controls, risk management systems and financial reports
- Managing the data used by management to identify risks
- Identifying methods for prioritising and managing risks
- Reporting on how the effectiveness of risk management controls
- Prevention and detection of fraud and intentional misstatements in financial statements

Internal audit will only be successful if the department is appropriately staffed and funded. Even though internal auditors are not as independent as external auditors, they are expected to act objectively as if they were independent. This can make their role difficult, especially if they uncover fraud or misstatements and fear internal repercussions on their career if they report it, especially if these are being perpetrated by senior staff members eg directors.

These issues can be mitigated by the use of audit committees which set the work of the internal audit, receive their work, ensure the department has the resources it needs, and has a strong voice at board meetings.

Purpose of internal audit

- Advise those charged with governance (usually the board of directors) on the effectiveness of internal controls.
- Make recommendations in relation to improving deficiencies identified in internal controls.
- Adopt a risk-led approach to identifying and assessing organisational risks.
- Remit of work undertaken is determined by the organisation’s management and can cover a broader range of areas than financial matters, and may include operational areas.
- There is no requirement in law for companies to operate an internal audit function, but as illustrated above, the UK Corporate Governance Code (FRC, 2018) requires a company to consider on an annual basis whether it should create one.
**Fraud and internal audit**

As mentioned above, one of the roles of internal audit is to **prevent** and **detect fraud** and **intentional misstatements**. Fraud is a **criminal activity** and can be described as ‘**theft by deception**’. In regard to misrepresentation in financial statements, fraud is the use of deception to gain an **unjust** or **illegal advantage**, for example by falsifying documents, ignoring deliberate errors and suppressing relevant information.

Fraud can have a number of **impacts** on a business. The primary effect is a **loss of assets** or **financial difficulties** that may occur following the fraud. This may lead to **reduced confidence of shareholders** and the **collapse of the company** if the fraud is severe and widespread. **Fines** may also be imposed by authorities if the organisation did not follow certain rules and regulations, designed to help prevent fraud.

For a fraud to occur, **three prerequisites** are usually required to be present. These are **dishonesty** (a lack of integrity or honesty in the people committing the fraud), **opportunity** (usually created by weak internal controls) and **motivation** (the rewards of the fraud outweigh the risk of being caught).

**Factors** that contribute to an **increased chance of fraud** or misstatement can be split between causes and symptoms of fraud:

**Causes of fraud**

- Low staff morale – unhappiness can create the motivation to defraud
- **Lack of monitoring and control systems** – controls need to be reviewed and monitored in order for fraud to be detected
- **Lack of segregation of duties** – increases the opportunity for fraud if tasks are not shared
- **Unnecessarily complex corporate structures** – increases the opportunity for staff to hide fraud by making it harder for transactions to be traced
- **Domination of management by one person or a small group** – dominant individuals may avoid controls and procedures

The **Symptoms of fraud** include:

- **Staff not taking leave or holiday** – may be a sign that staff do not want others to find out what they have been doing
- **Strange transactions** – for example, cash payments to staff or transfers to unnamed bank accounts may be a sign that the transaction is fraudulent
- **Payments being made out of proportion to work done** – this may be a sign of fraud
- **Lavish lifestyles of employees** – staff living beyond their means may mean they are defrauding the company, or may need to do so in future if their funds run out

It should be noted that **good design of business systems** helps to prevent as well as detect fraud. If systems are poorly designed, they will not be effective at either preventing or detecting fraudulent activity.

The internal audit function play an important role in investigating suspicions of fraud. In the event that a fraud is found to have taken place then the internal audit function can recommend to the affected department the actions needed to deter similar events from happening in the future. It is good practice for the recommendations of the internal audit function to be shared with the audit committee.
Limitations of internal audit

<table>
<thead>
<tr>
<th>Limitation</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence</td>
<td>As internal auditors are employees of the organisation this raises issues over their independence in providing objective advice to management and those charged with governance.</td>
</tr>
<tr>
<td>Organisational constraints</td>
<td>Due to the nature of the work of the internal audit function there is an argument to suggest that it should operate completely independently of other key department such as the finance department. Creating this separation in smaller organisations is not as easily achieved as it is in larger, listed entities. As a consequence, internal audit is not always as independent as it could otherwise be.</td>
</tr>
<tr>
<td>Poorly qualified and experienced staff</td>
<td>An inability to employ sufficiently qualified and experienced staff will undermine the work performed by the internal audit function.</td>
</tr>
<tr>
<td>Self-interest threat</td>
<td>Internal auditors may still be exposed to a self-interest threat by the virtue of being fearful that making recommendations which are unpopular with management may undermine opportunities for future career progression.</td>
</tr>
</tbody>
</table>

Many of the limitations listed above can be mitigated through the creation of an audit committee.
Chapter 7

Transaction costs – Section 5.1.1 page 124 (follows section 5.1)

Transaction costs and transaction cost theory is highly relevant to many of the organisational developments that have impacted the finance function in recent times. Transaction cost theory is particularly relevant to outsourcing decisions, which may in turn lead to the establishment of shared services and business reconfiguration.

A transaction cost is incurred by an organisation as a consequence of having a business activity performed by a third party. Such costs arise from activities associated with the arrangement, for example creating product specifications, managing quality and co-ordinating delivery and manufacturing operations. **Standard products** which are mass produced may have low transaction costs due to the standardisation of design. However, **non-standard products** may have high transaction costs which can be classified as:

(a) **Search and information costs.** These are the result of determining which products are needed and selecting a supplier at an appropriate cost and quality.

(b) **Bargaining costs.** These result from negotiating a deal with the supplier and completing any legal formalities such as drawing up contracts.

(c) **Policing and enforcement costs.** These are the costs of monitoring whether the supplier adheres to the terms of the contract and taking appropriate legal action if they do not.

**Transaction cost theory**

According to Williamson (1981), an organisation has a choice of whether to produce goods itself (by owning assets and running the production process) or to buy in the use of another organisation's assets to produce the goods for it. Williamson (1981) defined these two options as:

**A hierarchy solution** - Deciding to own the relevant assets (or employ staff directly), managers focus on controlling their use and performance.

**Market solutions** – Deciding to enter into a contract to buy in the relevant asset (or staff) from outside the organisation.

If the transaction costs associated with the market solution are too high, the hierarchy solution will be preferred.

Williamson (1981) identified **three aspects** to the make or buy decision:

(a) **Uncertainty** – Uncertainty in the business environment makes it difficult to arrange long-term contracts and therefore it is more likely for a process to be undertaken in-house.

(b) **Frequency** – Work is more likely to be outsourced if it is infrequent or unlikely to reoccur.

(c) **Asset specificity** – Where the assets required are specific to the transaction then the process should be taken on in-house as the corresponding transaction costs will be high.

Williamson (1981) suggests that the main concern in the decision is asset specificity which can be classified into six main types.

<table>
<thead>
<tr>
<th>Types of asset specificity</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Site specificity</strong></td>
<td>Some sites, such as factories, are immobile and therefore specific to a certain location.</td>
</tr>
<tr>
<td><strong>Physical asset specificity</strong></td>
<td>Customised assets, or those with limited other uses, have lower alternative use values. This means they are more specific to the task.</td>
</tr>
<tr>
<td><strong>Human asset specificity</strong></td>
<td>Workers acquire knowledge or skills that are specific to their role. This knowledge or skill has a higher value within the activity (and therefore within an organisation) rather than outside it.</td>
</tr>
<tr>
<td><strong>Brand name capital specificity</strong></td>
<td>A brand name may become so associated with an activity or process that it cannot be used in other activities or for other customers.</td>
</tr>
<tr>
<td>----------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Dedicated asset specificity</strong></td>
<td>This is similar to physical asset specificity but relates to assets acquired solely for work undertaken for a specific customer.</td>
</tr>
<tr>
<td><strong>Temporal specificity</strong></td>
<td>Some activities, such as those involving perishable goods, are so time specific that an alternative processor is unlikely to be found in time if the current supplier fails.</td>
</tr>
</tbody>
</table>
A process: 'Is a bounded set of activities that are undertaken, in response to some event, in order to generate an output'. (Harmon, 2014).

Process design is concerned with understanding the activities that are undertaken in a business process with the aim of enhancing its efficiency and effectiveness.

Organisations may seek to improve their processes in order to:

- Reduce costs, particularly during an economic downturn
- Provide a scalable platform for expanding production, or entering new markets
- Offer better products or services in order to be more competitive
- Exploit opportunities offered by technology (eg cheaper communication)
- Execute a new strategic direction

Process design is closely linked to the design of new products and services.

Before changes are made to a process organisations need to understand how their existing business processes are working. This exercise often involves the creation of a process map, which presents in visual form the steps involved in creating a product, delivering a service or performing a business operation.

The following diagram shows a simple process map of the steps that an organisation might take when purchasing a piece of specialist machinery.

![Simple process map diagram]

(Diagram: Simple process map)

Process maps offer a number of advantages:

- **Enhanced understanding**: They help managers to easily understand the main steps within an organisational process from beginning to end.
- **Role understanding**: They can help managers better understand how to make the best use of their workers by allocating individuals to specific tasks.
- **Opportunities**: They help to highlight areas for streamlining and standardising processes.
- **Identify inefficiencies**: They make it easier to identify areas where processes are inefficient, e.g. duplicating work efforts. This makes making improvements easier to identify and implement.
- **Support organisational schemes**: They can be used in respect of specific corporate initiatives, such as enhancing the process for managing customer interactions with the organisation.
The following diagram is an example of a process map that a Professional Accountancy body may undertake when marking the scripts submitted by candidates following an examination session.

Cousins supply wheel – Section 3.3.2 page 152 (follows section 3.3.1)

Cousins (2002) conducted a 12-month research project to investigate the level of strategic maturity in the purchasing function of UK/European companies.

Cousins’ Strategic Supply Wheel

The research revealed that all of the aspects identified and shown in the Strategic Supply Wheel are interconnected so all need to be considered when looking at strategic supply issues. The Strategic Supply Wheel shows that a firm needs to balance these issues. Cousins identifies that there are two potential supplier relationships that can be adopted:

- Adversarial – low level of cooperation, suppliers are selected on the basis of price and the threat of buyer power
- Collaborative – high level of cooperation, working together to meet market needs
Other writers on quality – Section 4.1.17 page 162 (follows section 4.1.16)

Quality is a widely researched academic area, and other notable writers on this topic include:

<table>
<thead>
<tr>
<th>Writer</th>
<th>Main contribution</th>
</tr>
</thead>
</table>
| Deming  | Managers should prompt continual improvements  
Managers should seek feedback from their workers  
Workers should be trained on what needs changing and how |
| Juran   | Drew on the Pareto Principle – 85% of the quality issues are due to systems weaknesses rather than the workers themselves  
Organisational focus should be on systems improvements, not employee motivation  
The customer should be the focus of quality, irrespective of who they are eg the department receiving goods or the end consumer |
| Crosby  | Introduced the concept of zero defects  
Prevention is key – the cost of prevention is usually lower than the cost to fix  
Workers should be involved in quality projects, and should be motivated to do something about quality |
Chapter 10

Features of service organisations – Section 3.2.8 page 181 (follows section 3.2.7)

Marketing is perhaps more important to service organisations, as unlike manufactures they do not have a physical product with which to distinguish themselves. The specific features of service organisations that marketing departments must pay attention to include:

- **Intangible outputs** – it is harder to give potential customers assurances over quality. Customer testimonials may be useful for this
- **No storage** – services cannot be stored, thus meeting customer needs on demand is vitally important. It is better to ‘under sell and over perform’
- **Heterogeneity** – maintaining consistent service quality is a real challenge in the absence of standardised process that can be employed by manufacturers. Extra care must be taken with training and development.
- **Inseparability** – as the product cannot be separated from the service delivery it is vital that service quality is maintained at all times
- **No transfer of property** – as there is nothing for the customer to ‘hold’ it can be hard to sell the benefits of the service they are buying. This can be overcome to a degree by using tools such as certificates or awards.

Market data gathering techniques – Section 4.2.2 page 182

A further primary research method is **trial testing**, for example asking consumer which new drink formula they prefer when testing reduced sugar fizzy drinks.

Segment validity – Section 4.3.2 page 183

Illustration

Family lifecycle segmentation categorises customers by their current position in the family lifecycle as follows (though it should be noted that these descriptions are very generalised):

<table>
<thead>
<tr>
<th>Life cycle stage</th>
<th>Characteristics</th>
<th>Example of products bought</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bachelor</td>
<td>Well off, fashion leaders, recreation orientation</td>
<td>Cars, holidays, kitchen equipment</td>
</tr>
<tr>
<td>Newly married couple</td>
<td>Still well off, high consumption of durables</td>
<td>Cars, furniture, holidays, refrigerators</td>
</tr>
<tr>
<td>Full nest (i)</td>
<td>Liquid assets low, peak home purchasing, low savings</td>
<td>Kitchen appliances, baby foods, clothes, toys, medicines</td>
</tr>
<tr>
<td>Full nest (ii)</td>
<td>Better off, less influenced by advertising</td>
<td>Larger sized grocery packs, cleaning materials, bicycles</td>
</tr>
<tr>
<td>Full nest (iii)</td>
<td>Better off still. Purchasing durables again</td>
<td>New furniture, luxury appliances, recreational goods</td>
</tr>
<tr>
<td>Empty nest (i)</td>
<td>Satisfied with financial situation</td>
<td>Travel, luxuries, home improvements</td>
</tr>
<tr>
<td>Empty nest (ii)</td>
<td>Drastic cut in incomes. Tend to spend lots of time at home</td>
<td>Medicines, health aids</td>
</tr>
</tbody>
</table>
Chapter 11

Employee motivation: Other factors – Section 6.2 page 224

Flexible working arrangements can be a useful tool in attracting, retaining and motivating a workforce. Flexibility can be achieved in the following ways:

- **Remote working** – using the internet to allow employees to work from home
- **Flexitime** – hourly targets can be achieved in a pattern to suit workers
- **Shift system** – allowing staff to work outside of the ‘normal’ workday
- **Compressed week** – working fewer, longer days
- **Job sharing** – two employees combine to perform a full-time job between them
- **Part-time** – allowing staff to work a reduced number of hours

These systems can be further enhanced to allow organisations to achieve task/functional flexibility eg giving employees the ability to move freely between tasks, and **financial flexibility** by using compound remuneration systems; such as salary plus bonus to allow them to link performance to reward.

Chapter 12

Knowledge management systems – Section 2.1 page 237

What all of the organisational systems will have in common is a goal of converting data into information, and information into knowledge.

**Key terms**

Data – raw facts and figures

Information – processed, organised data that has some value

Knowledge – an application of a cognitive process such that it becomes useful eg something that you know and understand

There are two broad categories of knowledge:

- **Tacit knowledge** – knowledge that the organisation has, but, is unaware of, or, is unable to use eg a customer services worker may know that a customer has a specific requirement, but fails to pass this onto anyone
- **Explicit knowledge** – knowledge that an organisation has, is aware of, and is able to exploit eg the customer services worker passes their knowledge onto the sales team, and the customer is sold the goods they want

Knowledge management uses IT/IS to help the organisation collect, store, processes and share knowledge, such that it changes from tacit to explicit.

Benefits of information systems – Section 4.1.2 page 248

The benefits of a new IS may include:

- **Speed** – faster processes and outputs
- **Accuracy** – reduction in human error
- **Volume** – more data can be processed, 24 hours a day, all year round
- **Complexity** – integrated systems can process more data streams than older systems
- **Collaboration** – real-time data sharing can improve intra-company working
- **Presentation** – data visualisation can make complex data easier to present and understand
- **Lower costs** – all of the above can see the benefits outweigh the costs of new IS investment
Bibliography


