Achievable

CMA PART 1 DUMP SHEET

Responsibility centers and performance measures

Responsibility centers & segments

- **Responsibility centers**, and what each is accountable for:
  - Cost center: costs
  - Profit center: profit
  - Revenue center: revenue
  - Investment center: all + invested capital; judged on ROI and residual income
- **Contribution margin** $=$ sales $-$ total variable costs; **CM%** $= \dfrac{\text{CM per unit}}{\text{selling price}}$
- **Controllable margin** = CM − controllable fixed costs (judges the manager); **segment margin** = controllable margin − traceable but uncontrollable fixed costs (keep or drop: drop only if the avoidable fixed costs exceed the CM lost); both exclude allocated common costs
- **Common-cost allocation:** stand-alone (by independent usage) vs incremental (base user first, then incremental)

ROI, residual income & investment base

- **ROI** $= \dfrac{\text{operating income}}{\text{average invested capital}}$
  A %, easy to compare; ignores risk and TVM; can drive short-termism
- **Residual income** $=$ operating income $-$ (average invested capital $\times$ required rate of return)
  An absolute dollar amount; positive = above the required return; encourages any project earning above the hurdle, even if ROI falls; harder to compare across sizes
- **Investment-base issues:**
  - Income measure: operating vs net income, non-recurring items
  - Inventory: with rising costs, LIFO lowers both the base and income, so ROI rises only if the base falls by the larger percentage
  - Assets: net book value shrinks with age, inflating ROI and RI; gross book value avoids that; current cost lowers them when prices rise
  - Shared assets need fair allocation

Transfer pricing

- **Objectives:** fair divisional evaluation, accurate cost allocation, tax compliance
- **Methods:** market price, cost-based (variable, full, cost-plus), negotiated, dual
- **General rule:** floor = variable (incremental) cost; ceiling = external market price
  - Excess capacity → price near variable cost
  - Full capacity → add opportunity cost

KPIs, balanced scorecard & profitability

- **CSFs** = elements essential to the strategy; **KPIs** = quantifiable metrics tracking the CSFs
- **Balanced scorecard, 4 perspectives:** financial, customer, internal process, learning & growth; a strategy map links them by cause and effect
- **Profitability analysis:** by product, customer, or segment; challenges = cost measurement, cost allocation, and investment/valuation measurement