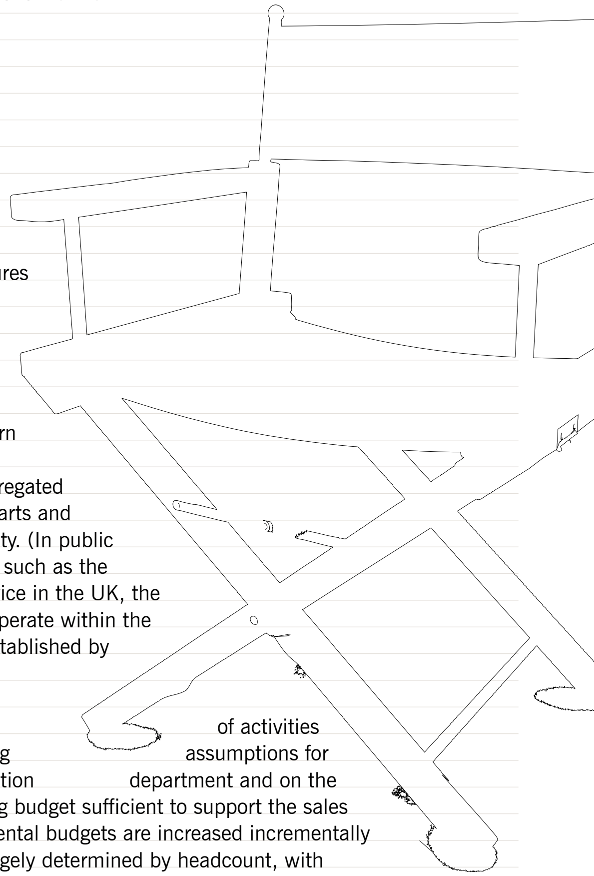
ACCOUNTING AND ORGANISATIONAL CULTURES

RELEVANT TO ACCA QUALIFICATION PAPERS P3 AND P5

Mapping different organisational cultures along a continuum based on Porter's two generic strategies gives two cultures of Financial Control and Excellence/Service.



Students are generally introduced to the subject of organisational culture by studying classification frameworks such as Handy's 'power, role, task, and people cultures', or by a situational approach such as Deal and Kennedy's, which suggests that an organisation needs to align its culture with the degree of risk and the speed of feedback associated with decision making. These frameworks are very broad and seem to imply that there are only four types of culture, which, given the diversity of organisations, is hard to accept.

An alternative approach would be to say that there are many different cultures which can be 'mapped' along a continuum by using Porter's two generic strategies – 'Least Cost Producer' and 'Differentiation' – as the end points of the continuum. The two cultures associated with these two strategies can be characterised as 'Financial Control Culture' and 'Excellence/ Service Culture' respectively.

FINANCIAL CONTROL CULTURE

The Financial Control Culture is based on the belief that success depends on achieving efficiency by having a well-managed/administered organisation in which good management information systems support cost planning and control systems. In this kind of culture, an accounting view of activities is dominant, with a centralised accounting system based on the annual budgeting process. The managerial structure in these organisations is hierarchical, with an emphasis on departmental performance where vertical patterns of communication dominate. There is an annual cycle of budget preparation, negotiation, and implementation, with review against monthly management accounts. The fundamental objective of the organisation is to deliver the budgeted outcome.

Departments are viewed as responsibility centres – principally cost centres with control focused on budget headings such as salaries and other expenses. In manufacturing organisations, the departmental budgeting process is extended to embrace standard costing, which sets the direct labour and direct material costs for products thereby providing a basis for variance analysis. The system assumes that senior management controls the organisation by setting targets in a top-down fashion, and then scrutinises performance by comparing it against the budget. This might be characterised as a 'command and control' philosophy.

The emphasis on financial performance places the short-run interest of shareholders as the primary goal of the business. There will be an emphasis on maximising the efficiency of fixed assets, such as machinery, by use of profitability measures with profit expressed as a return on fixed capital investment. The key performance indicator will be return on capital employed, which can be disaggregated into its constituent parts and on product profitability. (In public sector organisations, such as the National Health Service in the UK, the intention will be to operate within the resource envelope established by the Government and its agencies.)

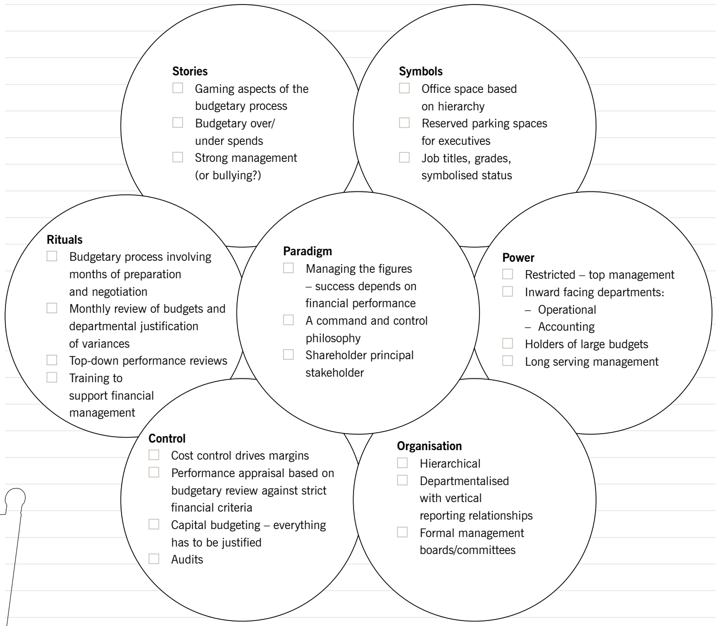
The coordination of activities is based on budgeting assumptions for the sales and production department and on the setting of a marketing budget sufficient to support the sales plan. Other departmental budgets are increased incrementally over time and are largely determined by headcount, with salaries as the principal cost element of operations.

Performance is monitored monthly through review with senior management and, if necessary, the year end forecast will be revised. Department managers are often keen to improve their own department's performance without considering the impact on other departments and how their actions fit with the broader strategic goals of the organisation. It is assumed that if each department operates efficiently, then the whole organisation will be effective.

The cultural web (Johnson et al) for the Financial Control Culture is shown in **Figure 1**.

LINKED PERFORMANCE OBJECTIVES
PERFORMANCE OBJECTIVES 7, 8, AND 9 ARE LINKED TO PAPER P3. FOR PAPER P5, SEE PERFORMANCE OBJECTIVES 12, 13, AND 14

FIGURE 1: FINANCIAL CONTROL CULTURAL WEB



EXCELLENCE/SERVICE CULTURE

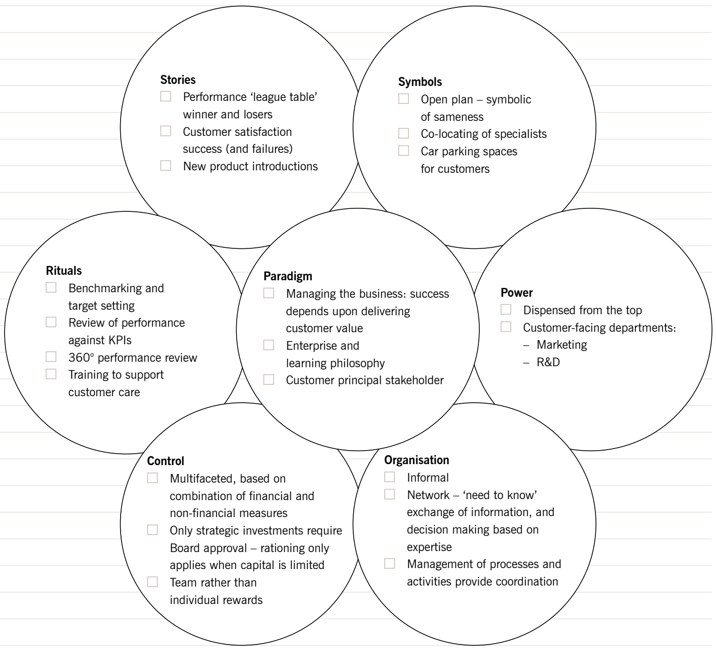
The Excellence/Service Culture is based on the belief that success depends on delivering high levels of customer satisfaction as measured by internal and external benchmarks. Employees of the organisation have a clear and shared view of how competitive success will be achieved. Customer needs are clearly understood and there is an ongoing drive to improve value for customers. The quality/price trade-off can be different, but the offering is clearly targeting specific market segments. Hope instances the following companies as having different but effectively established relationships with customers: 'Whether customers want no-hassle, convenience, and value-for-money products (M&S, Direct Line, and Dell), state-of-the art products or feel-good brands (HP, Microsoft, and Nike), or customised services (GE and Staples), they know what to expect and they are not disappointed.'

A network organisational model operates based on interdependent units. These enhance the organisation's core competences by developing collective expertise which is directed to the provision of 'solutions' for customers. In contrast to Financial Control Culture, management structure is much looser, the emphasis being on the creation of customer-orientated teams that are accountable for customer profitability, which is the key measure of performance. The management of intangible assets, knowledge systems, and brands are key to long-term success. Performance is evaluated and rewarded by comparing teams against benchmarks, peers, and prior years, and rewards are based on the performance of teams rather than individuals. The intention is to foster a philosophy of enterprise and learning.

Given the diversity of contexts in which organisations operate, the Excellence/Service Culture cannot be distilled to one representative set of features. Specific practices regarding target setting via key performance indicators (KPIs), planning, reward, and control systems, will be industry specific, and will depend on an organisation's chosen strategy. However, the overall orientation is to delegate authority and decision making to operational managers who are close to customers and who are controlled against results achieved, with the orientation being 'managing the business' rather than 'managing the numbers'. Such organisations are geared to delivering superior value to customers, and financial performance measures are integrated into wider performance measurement frameworks, such as the Balanced Scorecard, so that financial performance is not the dominant measure of success.

The cultural web (Johnson et al) for the Excellence/Service Culture is shown in **Figure 2**.

FIGURE 2: EXCELLENCE/SERVICE CULTURAL WEB



To see how these two different cultures operate, we can review Hope and Fraser's examination of organisations operating in budget-constrained and budget-free contexts, as reported in their book *Beyond Budgeting*. They characterise this difference as moving from Fixed (Financial/Budgeting) Performance Contracts to Relative Improvement Contracts, and produce a summary table (see **Table 1** on page 46), to distinguish how major managerial practices differ.

Hope and Fraser summarise the change in management practices in the following terms: 'Performance (review) has shifted from short-term fixed contracts with top-down control to medium-term relative contracts with multi-level control. This represents a gradual shift of performance responsibility from the centre to lower levels of the organisation. This is more than a change in the process of agreeing upon a contract, it is a cultural sea change.'

Caulkin, in reviewing the *Beyond Budgeting* approach with Alec Reed, chairman of Reed Executive, reflects on how budgeting can distort priorities: 'Perversely, the budget-based fixed performance contract forces subordinates to face towards senior management and the numbers imposed upon them, rather than the customers. Yet it is the customers, not managers, who supply all important intelligence about market changes. Thus, paradoxically the more budget minders try to enforce control through numbers and budgets, the more they make real control, in the sense of rapid adoption to a changing market, impossible.' Instead of budgets, Reed Executive switches between a range of scenarios as circumstances change. Reed accepts the need for monthly accounts but does not view these as being helpful in anticipating the need to change. Reed concludes by saying 'we want people, not numbers, to manage and control the business'. Hope and Fraser report how Borealis (one of the largest petrochemical companies in the world) created a culture based on 'tougher targets, greater freedoms'. They report how: 'the annual budget was replaced by a set of tools that included the Balanced Scorecard, activity accounting, and rolling forecasts. A key change was the use of the Balanced Scorecard to address the *drivers* behind the financial figures, set medium-term targets and map and communicate the strategy, manage strategic initiatives, and report progress.'

Each manager has a personal scorecard that forms an important part of the personal appraisal process. These changes in performance management and measurement systems were premised on an open style of management, characterised by the sharing of information, a 360° peer review system, and a bottom-up development of plans and target-setting based on benchmarking. They quote Bjarte Bogsnes, Borealis VP of Corporate Control, as identifying external benchmarking as a key factor changing organisational culture: 'Targets are set in relation to either the competition or best practice. We do extensive benchmarking, both externally and internally, on everything from production to support costs. The benchmarking process also removes most of the internal negotiations. As soon as we have agreed whom to benchmark, and where we should be compared to the benchmark, the target sets itself. And it is normally tougher than the old, internally-negotiated one.'

With regard to managing costs, Bogsnes highlights how they re-orientated the cost control process: 'One of the tools to help us manage costs without budgets was more relevant cost reporting using activity accounting. We were convinced we had low-hanging fruit by simply getting a better understanding of our costs. I have always seen it as a paradox that most companies record and report costs down to the last penny on what costs they incurred and who incurs these costs. But they record and report next to nothing on why these costs are incurred (for which activities or processes).' Hope and Fraser report how each business unit produces scorecards, together with a two-page snapshot of performance that includes return on capital, a cost report, and some explanatory text. They indicate the importance of these scorecards by observing how 'Board meetings look at scorecard results *before* financial results'.

CONCLUSION

Given the intangible nature of culture and the diversity of organisational contexts, the principal features of the two cultures described above are inevitably somewhat stereotypical and incomplete. This is especially the case with the Excellence/Service Culture, since this is an emerging form. Even leading companies in this category are not necessarily guaranteed long-term success, as has been demonstrated by the companies identified as 'Excellent' in Peters and Waterman's book. In an ever-changing environment, it can be argued that the management of intangible assets has become the key to long-term success and this would require organisations to move closer to the features of the Excellence/Service Culture. Those companies which operate in stable environments may be able to adopt the Financial Control Culture, as this can be an efficient way to deliver standard goods at low production costs. However, for most organisations, the challenge may be to manage the movement along the continuum towards the Excellence/Service Culture, accepting that, in reality, there are many interim positions between the two ends of the continuum.

REFERENCES

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TABLE 1: TYPES OF PERFORMANCE CONTRACTS ASSOCIATED WITH DIFFERENT CULTURES

	Fixed Performance Contract (Financial Control Culture)	Relative Improvement Contract (Excellence/Service Culture)
Targets	Your (sales/profit) target is fixed at ($x million).	We trust you to maximise your profit potential to continuously improve against the agreed-upon benchmarked KPIs and to remain in the top (quartile) of your peer group.
Rewards	Your rewards for reaching this target are (y%) of profits. No bonus is payable unless 80% of targets are met with a cap at 120%.	You trust us to assess your rewards by a peer review panel based on your performance 'with hindsight' at the end of each year.
Plans	Your agreed-upon action plans are attached to this contract.	We trust you to take whatever action is required to meet your medium-term goals within agreed-upon governance principles and strategic boundaries.
Resources	The agreed resources to support the capital and operating budgets are set out in the attached budget statements.	You trust us to provide the resources you need when you need them. We trust you to keep within agreed KPI boundaries.
Coordination	Your activities will be coordinated with other budget holders according to the agreed plan or as redirected by your superior.	We trust you to coordinate your activities with other teams according to periodic agreements and customer requirements.
Controls	Your performance will be monitored monthly. Any variations will be reviewed, and executives reserve the right to take further action. Forecasts in the form of revised budgets will be required on a (quarterly) basis.	We trust you to provide forecasts based on the most likely outcome. You trust us to monitor performance and interfere only when indicators/trends move out of bounds.

Source: Hope and Fraser, *Beyond Budgeting*, Harvard Business School Press, 2003.