

order-filling than to order-getting. Direct-mail advertisements may be evaluated in several specific ways-by their relative effectiveness in different publications, at various times, in various sizes, and in various forms.

The effectiveness of advertising is usually measured by the advertising or market research department. The ideal measure is the variation in net sales as advertising and promotion expenditures are varied. However, the unreliability of such measurements is widely recognized. It is difficult to establish a cause-and-effect relationship between advertising and sales, and conventional accounting tools are not too helpful. However, promising statistical and mathematical approaches have been developed in the field called operations research.

#### Budgeting Order-getting Costs: Influential Factors.

The programming of order-getting costs is affected by the following factors: (1) past experience; (2) general economic conditions; (3) behavior of competitors; (4) new specific objectives; (5) market research and tests; (6) whims of the president; and (7) the maximum that may be spent in light of desired profits.

The last point (7) illustrates the circularity of advertising and sales.

For example, a large soap company introduces new products

which are similar to old products, so that experience with old products, may be used as a guide. Basically, a forecast is prepared as follows:

Sales potential		XX
Manufacturing and other costs	XX	
Desired profit	<u>XX</u>	<u>XX</u>
Remainder available for advertising		<u>XX</u>

If the remainder is sufficient for the advertising necessary to attain the sales potential, the new product is introduced.

#### Measuring Effectiveness: Salesmen's Performance

The fundamental gauge of a salesman's effectiveness is his long-run contribution to net profit. Salesmen should not only know the characteristics of their products; they should also know the relative profitability of the various products. For example, consider a company which sells welding equipment. Lomer is the salesman who consistently attains the highest dollar sales. Karnes is the salesman who ranks third out of seven in sales volume, but he is regarded as the most valuable salesman. Why? Because Karnes allots the bulk of his time to getting orders that provide a minimum of follow-up and a maximum contribution to profit. In contrast, Lomer quotes the lowest possible prices, incurs large travel and entertainment costs, and makes unrealistic delivery promises. His orders require more follow-up and generate more confusion than any other salesman's



## EXHIBIT 10-1

Salesmen's Performance Report  
For the Quarter Ending June 30, 19-

	Lorner	Karnes
Sales	\$ 100,000	\$ 70,000
Travel expenses (hotel, meals, etc.)	1,400	1,000
Entertainment	300	200
Automobile	400	350
Extra direct charges for special handling, delivery, etc.	1,800	200
Cost of goods sold	80,000	49,000
Total charges	\$ 83,900	\$ 50,750
Sales, less above charges (profit contribution)	\$ 16,100	\$ 19,250

## Alternative One: Commission Based on Sales Volume

Sales	\$ 100,000	\$ 70,000
Commission, assumed rate, 4.15 per cent	4,150	2,905

## Alternative Two: Commission Based on Contribution to Profit

Contribution to profit	\$ 16,100	\$ 19,250
Commission, assumed rate, 20 per cent	3,220	3,850

Exhibit 10-1 is a comparison of the performance of the two salesmen. We make the special assumption that these two have

comparable territories and potential sales: otherwise the expectations could not be the same for each man. Note that Lorner's performance appears better than Karnes' under the commonly used measurement, volume of sales. However, Karnes' performance is clearly better when measured as contribution to profit.

## Order-filling Costs and Administrative Costs: Work Measurement

Order-filling costs include costs for warehousing, packing, shipping, billing, and credit and collection. They are much more akin to manufacturing costs than are order-getting costs. Standards for certain order-filling activities, such as truck loading or truck driving, may have to be less refined than for such manufacturing activities as assembly work, but they still provide the best available formal tool for planning and control.

Companies with heavy order-filling activities and clerical and administrative costs have used work measurement techniques as a basis for formulating standards. This is an extension of the control philosophy that originated in the factory. The general idea is that permanent improvement in any performance is impossible unless "scientific" measurement is used to specify the time required for the job.

Work measurement is a detailed analysis of the order-filling or clerical operation. Its objective is to determine the workload in an operation and the number of workers needed to perform that work efficiently. The techniques used include time and motion



study, observation of a random sample of the work (i.e., work - sampling), and the estimation, by a work measurement analyst - and a line supervisor, of the amount of time required for the work (i.e., time analysis).

#### Budgeting of Clerical Costs: A Comparison of the Variable Cost Approach and the Programmed Cost Approach

As we mentioned in Chapter 8, clerical costs are step-variable costs which may be budgeted flexibly along with strict variable costs.

#### Responsibility Accounting and the Contribution Approach to Cost Allocation

Management reports measure and communicate important information about objectives, plans, and performance. We have investigated standards and budgets as key factors in planning and control. Now we shall concentrate on another key factor: - - fixing responsibility.

Management accounting has developed score-keeping and attention directing techniques for helping management to evaluate performance. In this chapter and the next, we shall discuss the strengths and weaknesses of these techniques. In this chapter - we are concerned with responsibility accounting and the contribution approach to the difficult problems of cost allocation. These two modern techniques facilitate measurement of performance and the making of intelligent decisions.

#### RESPONSIBILITY ACCOUNTING

##### Characteristics of Responsibility Accounting

Individuals operate organizations. Any management accounting system, to be effective, must to be designed - - - around the responsibility centers of individual managers. The accounting system must cohesively reflect the plans and actions



of all responsibility centers in the organization from the smallest to the biggest. This basic idea is being implemented on a wide scale in the form of so-called responsibility accounting, profitability accounting, or activity accounting systems.

The impact of the responsibility accounting approach is described in the following:

The sales department requests a rush production. The plant scheduler argues that it will disrupt his production and cost a substantial though not clearly determined amount of money. The answer coming from sales is: "Do you want to take the responsibility of losing the X Company as a customer?". Of course the production scheduler does not want to take such a responsibility, and he gives up, but not before a heavy exchange of arguments and the accumulation of a substantial backlog of ill feeling. Analysis of the payroll in the assembly department, determining the costs involved in getting out rush orders, eliminated the cause for argument. Henceforth, any rush order was accepted with a smile by the production scheduler, who made sure that the extra cost would be duly recorded and charged to the sales department "no questions asked". As a result, the tension created by rush orders disappeared completely; and, somehow, the number of rush orders \_\_\_\_\_

requested by the sales department was progressively reduced to an insignificant level.<sup>1</sup>

Ideally, particular revenues and costs are recorded and automatically traced to the one individual in the organization who shoulders primary responsibility for the item. He is in the best position to evaluate and to influence a situation - to exert control. In practice, the diffusion of control throughout the organization complicates the task of collecting relevant data by responsibility centers. The organizational networks, the communication patterns, and the decision-making processes are complex - far too complex to yield either pat answers or an ideal management accounting system.

#### Illustration of Responsibility Accounting

The simplified organization chart in Exhibit 11-1 will be the basis for our illustration. We will concentrate on the manufacturing phase of the business. The lines of responsibility are easily seen in Exhibit 11-2, which is an over-all view of responsibility reporting. Starting with the supervisor of the machining department and working toward the top, we shall see how these reports may be integrated through three levels of responsibility.

Note, in Exhibit 11-3, that all direct material is charged at standard unit prices to the machining department only. The other producing departments do not include the same direct material in



their budgets. In this way, the Lustre Co. incorporates direct material and direct labor, as well as the variable overhead items, in its departmental flexible.

V O C A B U L A R Y I I

- A -

1. AUTOMATION	Automatización
2. ARISE	Surge
3. ANNUALY	Anualmente
4. ATTRACTING	Atrayendo
5. AT OBTAINING	Al obtener
6. AS PRODUCT MIX	A como se mezcla el producto
7. ALLOTS THE BULCK	Asigna el volumen
8. ASSEMBLY	Ensamble
9. AN OVER-ALL VIEW	Echar una vista general
10. ARE UNIMAGINATIVE	Son no imaginativas
11. ADVERTISING	Publicidad
12. ASSORIMENT	Asignación, Distribución
13. ARGUES	Argumenta

- B -

14. BEHAVIOR	Conducta, Comportamiento
15. BULCK	Volumen
16. BACKLOG	Ordenes atrasadas
17. BOUND	Capacitado

- C -

18. COMMITMENTS	Obligatoriedad, Fianzas, Seguridad.
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