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# MANAGEMENT CONTROL SYSTEM

## Brief Content

Preface	xiii	<b>11</b> Remedies to the Myopia Problem	448
Acknowledgements	xvi	<b>12</b> Using Financial Results Controls in the Presence of Uncontrollable Factors	517
<b>SECTION I</b> The Control Function of Management			
1 Management and Control	3	<b>SECTION V</b> Corporate Governance, Important Control-Related Roles, and Ethics	
<b>SECTION II</b> Management Control Alternatives and Their Effects			
2 Results Controls	33	<b>13</b> Corporate Governance and Boards of Directors	573
3 Action, Personnel, and Cultural Controls	86	<b>14</b> Controllers and Auditors	629
4 Control System Tightness	128	<b>15</b> Management Control-Related Ethical Issues	677
5 Control System Costs	173	<b>SECTION VI</b> Management Control When Financial Results Are Not the Primary Consideration	
6 Designing and Evaluating Management Control Systems	221	<b>16</b> Management Control in Not-for-profit Organizations	721
<b>SECTION III</b> Financial Results Control Systems			
7 Financial Responsibility Centers	261	Index	761
8 Planning and Budgeting	297		
9 Incentive Systems	353		
<b>SECTION IV</b> Performance Measurement Issues and Their Effects			
10 Financial Performance Measures and Their Effects	397		

# MANAGEMENT CONTROL SYSTEM

## Section III

# Financial Results Control Systems

**7** Financial Responsibility Centers

**8** Planning and Budgeting

**9** Incentive Systems

# Planning and Budgeting

## Chapter 8

# MANAGEMENT CONTROL SYSTEM

## Chapter 8

### 8 Planning and Budgeting

Purposes of planning and budgeting

Planning cycles

Target setting

Planning and budgeting practices,  
and criticisms

Conclusion

Notes

*Royal Wessanen NV*

*The Stimson Company*

*Multiple Versions of the Plan*

*Vitesse Semiconductor Corporation*

*VisuSon, Inc.: Business Stress Testing*

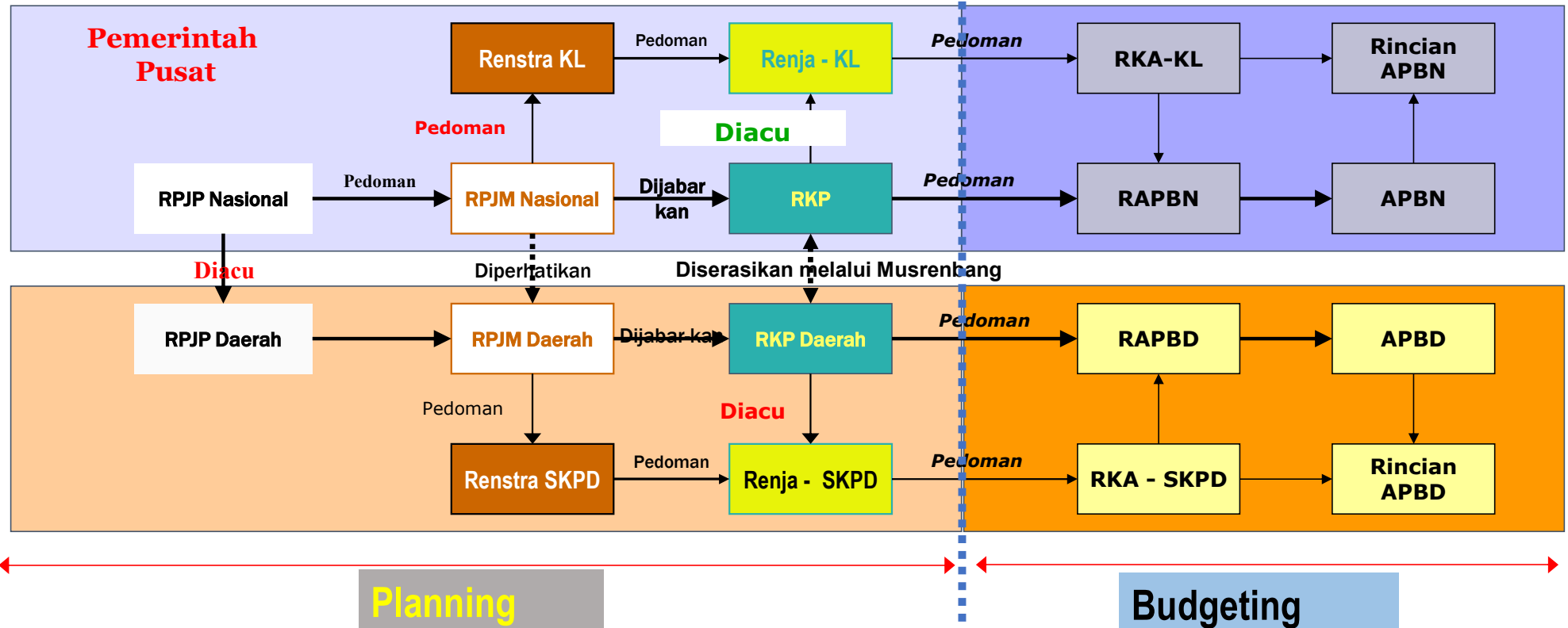
# Outline of this text book (cont'd **chapter 1**)

Teks book membahas MCS dari beberapa sudut yang berbeda...

- Bagian III fokus pada elemen utama sistem kontrol **hasil** keuangan, jenis kontrol hasil adalah penting di mana hasil didefinisikan dalam hal keuangan.
- Bagian ini mencakup pembahasan
  - struktur tanggung jawab keuangan (Bab 7),
  - sistem **perencanaan dan penganggaran** (Bab 8), dan
  - sistem insentif (Bab 9).

# PERENCANAAN DAN PENGANGGARAN

Siklus APBN: untuk komparasi dengan perusahaan



# INTRODUCTION

Planning and budgeting systems produce **written plans** that clarify

- where the organization wishes to go (**goals**),
- how it intends to get there (**strategies**), and
- what results should be expected (**performance targets**).



# INTRODUCTION

Planning and budgeting systems are management tools that serve several purposes.

- provides a **way** to turn a manager's vision into an organized set of tactics
- provide **standards** that can be used to assess the success or progress of the organization.
- has many behavioral **implications**, such as:
  - regarding the effort invested in thinking about the future and
  - Commitment to achieving performance targets.

# INTRODUCTION

This chapter 8 discusses planning and budgeting systems,

- The second core **element** of the financial result control system.
- It has several **control** objectives, some of which are, such as
  - purpose of transfer pricing

# PURPOSE OF PLANNING AND BUDGETING SYSTEM

Planning and Budgeting systems serve four main purposes:

1. *Planning*: a powerful form of **action** control forcing managers to think about the future and make decisions in advance.
2. *Coordination*: forces the **sharing** of information across the organization
3. *Top management oversight*: occurs in the form of pre-action **reviews**, as plans are examined, discussed, and approved before actions are taken at successively higher levels in the organization.
4. *Motivation*: plans and budgets become targets that **affect** manager motivation because the targets are linked to performance evaluations

# PLANNING CYCLE

**Three** cycles of planning & budgeting:

1. Strategic planning:
2. Capital budgeting:
3. Operational budgeting

# PLANNING CYCLE (cont'd)

## Three cycles - 1. Strategic planning:

- the relatively broad processes of thinking about the organization's missions, objectives, and the means by which the missions and objectives can best be achieved.
- It involves analyzing the past and forecasts of the future.
- A complete, formal strategic planning process leads to definitions of the corporate diversification strategy and the strategies of all the strategic business units.

# PLANNING CYCLE (cont'd)

## Three cycles - 2. Capital budgeting:

- Identification of specific action **programs** or **projects**
  - to be implemented over the next few years and
  - specification of the resources each will consume.
- The outcomes are almost always dependent on
  - the track record,
  - preparation,
  - arguing skill, and
  - political power

of the managers involved.

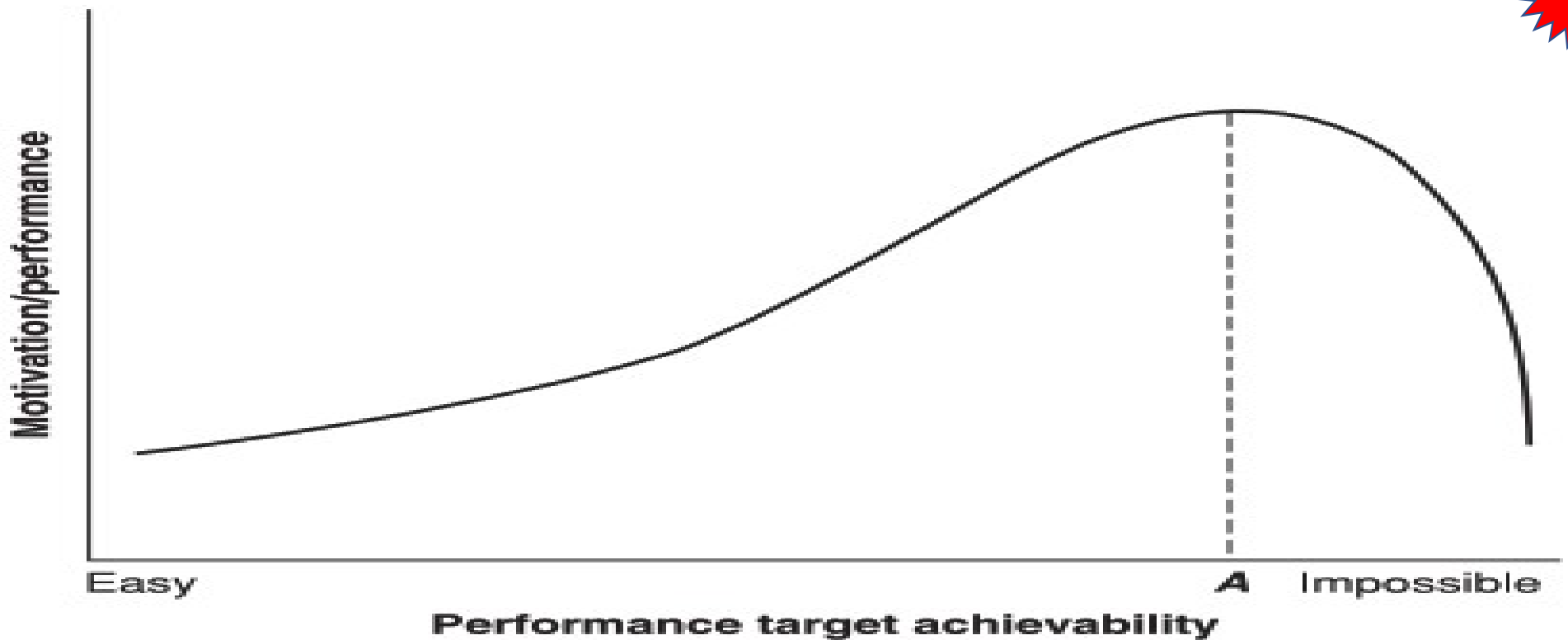
## PLANNING CYCLE (cont'd)

Three cycles: 3. **Operational budgeting**

- Preparation of a short-term financial plan, a budget,
- usually for the next 5 years.

# Performance target setting

Financial performance target issues (Figure 8-1)

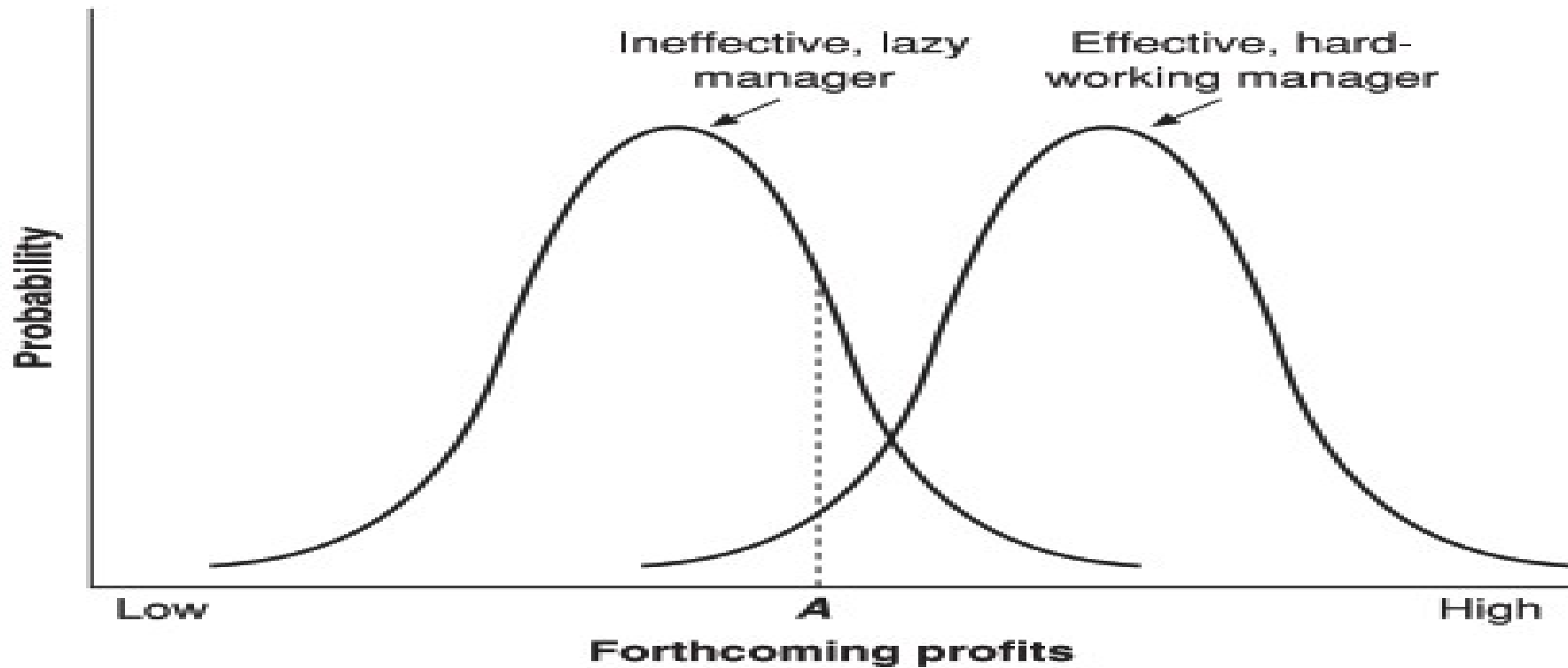




# Performance target setting

Financial performance target issues (Figure 8-2)

307



# PERFORMANCE TARGET SETTING

- Reviews that **compare** actual performance with plans and budgets
  - can lead to improved understanding of what is and what is not **working** well.
- They also improve coordination and they provide important motivational benefits

# PERFORMANCE TARGET SETTING (cont'd)

**Types** of financial performance targets:

1. model-based, historical, or negotiated
2. fixed or flexible
3. internal versus external targets

# PERFORMANCE TARGET SETTING (cont'd)

Types of **financial** performance targets – 1. model-based, historical, or negotiated:

1. Model-based targets:

- provide a **prediction** of the performance that should ensue in the upcoming measurement periods.
- When they are used in areas where activities are programmable (direct and stable causal relationship between inputs and outputs) ◇ engineered targets.

2. Historical targets: derived directly from performance in **prior** periods.

3. Negotiated targets: **negotiated** between superiors and subordinates.

- Tight control is easiest to implement when targets are engineered because the link between effort and results is direct.

# PERFORMANCE TARGET SETTING (cont'd)

## Types of financial performance targets: 2. **fixed or flexible**

- Fixed targets **do not vary** over a given time period.
- Flexible targets **are changed** according to the conditions faced during the period.
- Most of financial targets: fixed, at lower organizational levels: flexible

# PERFORMANCE TARGET SETTING (cont'd)

## Types of financial performance targets: 3. **internal versus eksternal Target**

- Internally focused: managers consider what is possible within the organization and focus on period-over-period, continuous improvements.
- Externally focus: organization benchmarks its performance and practices with those of other organizations

## PERFORMANCE TARGET SETTING (cont'd)

Two of the most important financial performance target issues are related to:

1. the optimal amount of challenge in a target
2. the proper amount of influence to allow subordinates in setting targets

# PERFORMANCE TARGET SETTING (cont'd)

Two problems with financial performance targets - the optimal number of challenges in a target:

- Targets should be challenging, but achievable.
- Advantages of highly achievable budget targets:
  - They increase managers' commitment to achieve the targets.
  - It protects the organization against the costs of optimistic revenue projections.
  - They are motivating; they make most managers feel like winners.
  - They reduce the costs of organizational interventions by superiors.
  - They reduce the risk of gameplaying



# PERFORMANCE TARGET SETTING (cont'd)

Two of the financial performance target issues - **The proper amount of influence to enable subordinates in setting targets:**

- How much influence should subordinates have in setting their financial targets?
- Allowing them to participate in, and to have influence on, the process of setting their performance targets can have benefits:
  - commitment to achieve the targets: they understand why the targets were set
  - information sharing: sharing information about business possibilities and corporate preferences and resources.
  - Cognitive: thinking about how best to achieve the targets.

# PERFORMANCE TARGET SETTING (cont'd)

Top-down target setting when:

- an activity or operation is programmable.
  - No need to negotiate targets through some form of bottom-up process.
- Superiors have an excellent understanding;
  - they exert greater influence on the final decisions about performance targets.
- Top-level managers have the information available for evaluating performance on a relative basis.
- Lower-level managers are not good at budgeting
- Lower-level managers are prone to impart biases into the budgets that cannot be controlled.

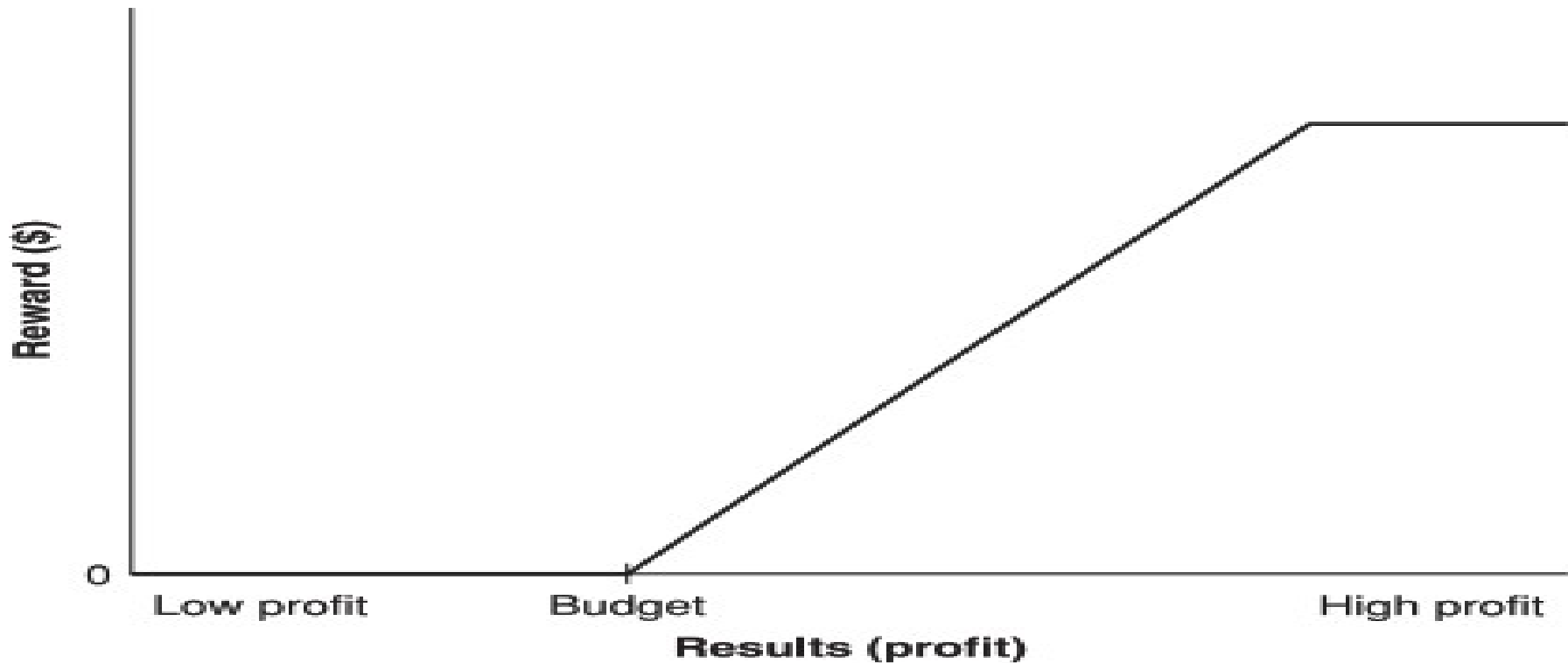
# PERFORMANCE TARGET SETTING (cont'd)

Top-down target setting – the principle:

- Managers must be careful
- that their subordinates commitment to achieve the targets is still there.

# TARGET PERFORMANCE (AND MOTIVATION) SETTING

Financial performance target issues (Figure 8-3)



# VARIATIONS IN PRACTICE

## Planning and budgeting system **variations**:

- planning horizon: number of years
- planning content: quantitative versus qualitative.
- Length and timing of planning processes:
- Planning updates
- Planning guidance

# CRITICISM OF THE COMPANY'S PLANNING AND BUDGETING PROCESS

They claim that planning and budgeting processes:

- are rife with politics and gameplaying
- produce only incremental thinking, minor modifications to the plans and budgets prepared in the preceding periods, and are not responsive to changes in today's fast-moving economy
- centralize power in the organization and stifle initiative
- focus on cost reductions, rather than value creation
- separate planning from execution
- cause too many costs for too few benefits

## REFERENSI

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Simons, Robert. 2014. *Performance Measurement and Control Systems for Implementing Strategi*, 1st edition, USA: Pearson