CPA BEC - STUDY UNIT 17
Business Performance:
Core Concepts

A. **Quality Considerations**

1. Overall, an organization must assess quality in two fundamental areas: process quality and product quality. **Process quality** assesses the effectiveness and efficiency of the organization's internal operations. **Product quality** focuses on the conformance of the organization's output to customer expectations.
2. Management **processes** for the improvement of quality include the Plan-Do-Check-Act cycle (the Deming Wheel), kaizen, employee involvement, suppliers' management, competitive benchmarking, quality training, and reward and recognition.
3. **Tools** for analyzing quality control problems include statistical quality control charts, Pareto (80:20) charts, fishbone (cause-and-effect) diagrams, and the Taguchi quality loss function.
4. **Measures** for the assessment of quality must include both nonfinancial measures of internal performance and nonfinancial measures of customer satisfaction.
5. The **costs of quality** are generally divided into two major categories and four subcategories:
   a. **Conformance costs** include costs of prevention and costs of appraisal, which are financial measures of internal performance. Prevention attempts to avoid defective output. These costs include (1) preventive maintenance, (2) employee training, (3) review of equipment design, and (4) evaluation of suppliers. Appraisal embraces such activities as statistical quality control programs, inspection, and testing.
   b. **Nonconformance costs** include internal failure costs (a financial measure of internal performance) and external failure costs (a financial measure of customer satisfaction). Internal failure costs occur when defective products are detected before shipment. Examples are scrap, rework, tooling changes, and downtime. The costs of external failure, e.g., warranty costs, product liability costs, and loss of customer goodwill, arise when problems occur after shipment.

B. **Benchmarking, TQM, and the ISO Framework**

1. **Benchmarking** is a primary tool used in quality management. It is a means of helping organizations with productivity management and business process analysis. **Best practices** are recognized by authorities in the field and by customers for generating outstanding results. They are generally innovative technically or in their management of human resources.
2. The emergence of the **total quality management (TQM)** concept is one of the most significant developments in managerial accounting. TQM recognizes that quality improvement can increase revenues and decrease costs significantly. The following are TQM's **core principles** or **critical factors**: emphasis on the customer; continuous improvement as a never-ending process, not a destination; and engaging every employee in the pursuit of total quality.
3. In 1987, the **International Organization for Standardization (ISO)** introduced ISO 9000, a "family" of 11 standards and technical reports that provide guidance for establishing and maintaining a **quality management system (QMS)**.
   a. Only one of the standards is a certification standard. **ISO 9001:2000**, *Quality Management Systems – Requirements*, is the standard that provides a model for quality assurance programs. For this reason, "ISO 9001:2000 certified" is the only acceptable formulation. There is no such thing as "ISO 9000 certification."

C. **Responsibility Centers, Common Costs, and Transfer Pricing**

1. **Managerial performance** ordinarily should be evaluated based on factors that can be influenced by the manager, such as revenues, costs, or investment. Responsibility centers include cost centers, revenue centers, profit centers, investment centers, and service centers.
2. The purpose of a responsibility system is to motivate management performance that adheres to overall organizational objectives **(goal congruence)**.
3. **Common costs** are the costs of products, activities, facilities, services, or operations shared by two or more cost objects. The term “joint costs” is frequently used to describe the common costs of a single process that yields two or more joint products.
   a. Two specific approaches to common cost allocation are in general use: The **stand-alone method** allocates a common cost on a proportionate basis using data regarding each cost object. The **incremental method** requires ranking the users of the cost object. The primary party is then allocated its stand-alone cost, with the secondary party receiving the balance of the common costs.
4. **Transfer prices** are the amounts charged by one segment of an organization for goods and services it provides to another segment of the same organization. A transfer price should permit a segment to operate as an independent entity and achieve its objectives while functioning in the best interests of the company.

D. **Theory of Constraints and the Balanced Scorecard**

1. The **theory of constraints (TOC)** is a system to improve human thinking about problems. It has been greatly extended to include manufacturing operations. The basic premise of TOC as applied to business is that improving any process is best done not by trying to maximize efficiency in every part of the process but by focusing on the **slowest part of the process**, called the **constraint**.
2. The **steps** in a TOC analysis are as follows: Identify the constraint, determine the most profitable product mix given the constraint, maximize the flow through the constraint, increase capacity at the constraint, and redesign the manufacturing process for greater flexibility and speed.
3. The trend in performance evaluation is the **balanced scorecard** approach to managing the implementation of the firm’s strategy. It is an accounting report that connects the firm’s **critical success factors (CSFs)** determined in a strategic analysis to measurements of its performance. CSFs are financial and nonfinancial measures of the elements of firm performance that are vital to competitive advantage.
   a. A firm identifies its CSFs by means of a **SWOT analysis** that addresses internal factors (strengths and weaknesses) and external factors (opportunities and threats).
   b. A typical balanced scorecard includes measures in **four categories**: financial, customer, internal business processes, and learning and growth.