**INTRODUCTION**

The purpose of this “Strategic Management Accounting” task is focused towards two questions. Accordingly this task is divided into two parts. In the first part critical evaluation is conducted with reference to the statement: “Both Return on Investment and Economic Value Added, when used as performance measures in an organisation, encourage managers to be short-term in their focus and decision making”. Further in the second part critically evaluated the three approaches to costing products or services in the forms of marginal or variable costing; full or absorption costing; and activity based costing.

**PART A**

Managers, shareholders and other stakeholders necessitate being attentive of a company’s performance to facilitate them to create informed decisions for the times to come. From this perspective, measuring the financial performance of a company is significant. Managers in a company has option to make use a range of performance measurements where thetwo most important measures are Return on Investment and Economic Value Added. The decision making about measure decided on by an organisation will be determined by what a business is trying to achieve and the performance being measured (Correira et al., 2007).

**Economic Value Added**

Economic Value Added is one of different measures presented to decide a company’s performance. This measurement model reflects the residual wealth measured by cost of capital deduction from the operating profit adjusted for taxes as regards a cash basis (Stewart, 1990). The real gains of the Economic Value Added measuring are attained whilst managers identify with what the profits of their company involves and they turn out to be motivated to get better such profits in relation to the results of the measure (Evanomics, 2011). The point is that the mission and goal of every company is to generate value for the shareholders, where when long-standing Economic Value Added is maximised, the company is all set to maximize its own value. It is argued that through utilizing a comprehensive Economic Value Added oriented financial management and incentive compensation method, managers in a company will have opportunity get hold of superior information and more importantly would be more motivated to create decisions that tends to make the utmost shareholder wealth. Other advantages of Economic Value Added include integrating the interests of managers together with shareholders, first-rate estimation of managerial performance and conduct in the company’s best interest, making aware the managers that capital has cost hence helping out in decision of disposal of under utilized that do not cover up costs creating managers be cautious of managing assets together with income and assisting to evaluate trade-offs amid the two, and more importantly managers focus on the delivery of shareholder value (Correira et al., 2007).

Economic Value Added is inherently backward looking, as he faces added in the last period of the carrying amount and thus measures the success of past policy decisions and investments. It fails to consider in detail the current strategy pursued by the organization, and does not try to assess whether the organization takes steps to ensure it will build up and uphold a sustainable competitive advantage. One result of this is that the economic value added, it would seem, is of limited use for a young growing company (Correira et al, 2007; Sharma and Kumar, 2010). Use of economic Value Added can promote short-term solutions at the middle management and can lead to managers refuse to make investments that although they have a large positive net present value, would reduce the Economic Value Added in the short term. The main practical issue that arises when calculating the Economic Value Added, profit and capital must be defined. There are a number of common mistakes that are often made ​​in implementing or using economic value added. Most of them are associated with either a lack of understanding, or therefore the concept on the upper levels or training for all staff to use economic value added, and therefore not using the full potential of the concept. For measuring Economic Value Added properly all capital ought to be allocated to units. Typically, the Return on Investment is calculated so that only the capital affectable units counted. With the Economic Value Added is the equal modus operandi might be utilised (Correira et al, 2007; Sharma and Kumar, 2010).

Sharma and Kumar (2010) establish that the utilization of accounting adjustments to evaluate Economic Value Added and to assess performance at divisional point is not worthwhile. As a result, performance metrics might necessitate being free of adjustments and being proficient to determine performance at a divisional rank. Noticeable here researches have had been conducted on greater level as regards Economic Value Added, the giving of Economic Value Added in relation to the value for stakeholders and as well on the appropriateness of Economic Value Added for various economic sectors (Evanomics, 2011). McClure (2011) finds that companies and their consultants utilize Economic Value Added as the most thriving metric performance, wand more importantly financial theory validates the metric of Economic Value Added, which is steady with principles of valuation. These issues are vital to investors whilst analyzing the financial performance of companies. Economic Value Added might be differentiate from supplementary metrics of financial performance measures in the forms of net profit and earnings per share, as it settles on the profits left over after the capital costs of a company, both debt and equity, is deducted from the operating profit (McClure, 2011). The point is that Economic Value Added includes the hidden cost of capital, while conventional measuring methods pay no attention to it, pointing out that Economic Value Added measures profit in the approach that shareholders delineate it (McClure, 2011). This implies that profit must account for the cost of capital whilst measuring shareholder value. Economic Value Added is an estimation of real economic profit, or the sum by which earnings go above or fall short of the necessary smallest rate of return that shareholders and lenders might obtain through investing in supplementary securities of comparable risk. Economic Value Added measure has both plus and minuses, though it is a fact the metrics is turning out to be a popular and enviable tool for measuring financial performance of a company, where particularly the metrics encourage managers to be short-term in their focus and decision making.

**Return on Investment**

Bases the main features of investment instruments in which the total variety of investment instruments may range are the return on investment and the risk is defined as the uncertainty about the actual return that is earned on an investment. Each type of investment vehicles could be characterized by some degree of profitability and risks due to the specific characteristics of those financial instruments (Gitman and Joehnk, 2008). Although all different types of investment vehicles can be compared using characteristics of risk and return and the most risky and less risky investment vehicles can be defined. The risk and return on investment are closely related and only using two important features we can really understand the differences in investment funds (Arnold, 2010). Short-term investment vehicles are all those which have a maturity of one year or less. Short-term investment instruments often described as money market instruments, because they are traded on the money market, the financial market for short-term (up to one year maturity) marketable financial assets presents. The risk and return on investment of short-term investment vehicles are usually lower than other types of investment (Jones, 2010). Bases the main features of investment instruments in which the total variety of investment instruments may range are the return on investment and the risk is defined as the uncertainty about the actual return that is earned on an investment. Every sort of investment vehicles could be characterized by some degree of profitability and risks due to the specific characteristics of these financial instruments.

Return on Investment is one of the most popular performance measurement and evaluation metrics used in business analysis. Return on Investment analysis if used properly is a powerful tool for evaluating existing information and making informed decisions about software acquisitions and other projects. Decades ago, Return on Investment was conceived as a financial term and is defined as a concept that is based on a rigorous and quantifiable analysis of financial income and expenses. At present, Return on Investment is generally recognized and accepted in the business and financial management in the private and public sectors. Wide dissemination of the Return on Investment method, however, has led to the current situation where return on investment is often experienced as a non-strict, amorphous bundle of mixed approaches, sensitive to the risk of inaccuracy and bias judgment (Botchkarev and Andru, 2011).

The point is that Return on Investment is a metric designed for a definite purpose to assess profitability or financial performance of a company and make the managers to be short-term in their focus and decision making. However, Return on Investment might not dependably alternate for numerous other financial metrics in offering a general economic representation of the information solution. Nevertheless, in order to offer a meaningful framework for business decisions Return on Investment is a useful and effective metrics of assessing financial performance focused towards the short-term decision making. The critical discussion clearly substantiate that both Return on Investment and Economic Value Added, when used as performance measures in an organisation, encourage managers to be short-term in their focus and decision making.

**PART B**

**Marginal or Variable Costing**

Marginal cost as the accounts so that the variable costs of units and the fixed costs of the period are fully depreciated against the aggregate contribution on costs. The impairment in recognizing cost behavior and thus helps in the decision. Marginal costing is a costing methods different approach compared to the absorption. Marginal cost method is used to calculate. The cost of an additional unit of service Economists say that the variable costs are equal to marginal costs in the relevant range can be. In a certain range of data of the transport overheads constant, so the incremental cost is equal to the variable costs. As a result, marginal costing requires that the total cost to be split into fixed and variable components (Lucey, 2002; Drury, 2008). Marginal Costing is the technique of costing fully focused on managerial decision making and control. This technique can be used in combination with a low-cost method of determination. It can also be used in conjunction with standard techniques, such as budgeting and calculation. Marginal costing is useful in determining the profitability of products, services, processes and cost centers. During the analysis of the profitability, marginal cost calculation interprets the cost on the basis of the nature of the charges. Marginal cost in other words is the variable costs. For a typical manufacturing the following elements of the costs are variable or marginal costs. Marginal costing is helpful for short-term tactical decisions in the forms of accepting a special order or marginal cost pricing, dropping a product or service, and making make or buy decisions, because the fixed costs remain unchanged. Moreover, long-term and fixed costs will change the differential cost method may well be used.

**Full or Absorption Costing**

Costs that are fixed in the short-term plan such as transport manager salary, custody fees and rates, and do not vary with the level of activity can be attributed to a cost center and optimistically spread over some rational basis for the output concerned. Absorbing various unit costs to avoid different rates of throughput overhead absorption can be applied based on estimated volume and past experience. Individual unit price can be applied to the various stored products, for example a volume basis, or in terms of function of the most appropriate situation. In some areas suitable job markets are not always clear whether the same is not enough or repetitive task of. In addition, no significant change in the volume of transit will lead to over or under recovery of overheads (Drury, 2008). Absorption in the costs involved objects are usually the end products services or jobs, the full cost system widely used to reduce the cost of manufactured products, or services supplied in manufacturing jobs, but also appreciate the service sectors. Even though there is no significant difference in the absorption costing is used in service and non-service industry, defining a product or service difficult job in the service industry (Drury, 2008; Zimmerman, 2003) might be. There are two main fundamental sorts of costs in the form of absorption costing and process costs. Costing estimates the average cost per unit for each job delivered. Process costing assesses the average unit cost for each service in a given period. It is important to remember that the absorption costing allocates historical cost, and therefore the unit cost estimated by the system or not reasonably good estimates of the opportunity cost (Zimmerman, 2003; Drury, 2008). In fact, the absorption costing system can produce inaccurate estimates of unit costs due in part to methods used. Prejudices embodied in the overhead if the overhead method of cause-and-effect relationship between the final product or service work and the costs do not represent the unit cost estimates would be more or less inaccurate, especially in multi-product plants, such as a hospital. Activity based costing has been introduced to improve the accuracy of the unit cost estimates, but it has its limitations.

**Activity Based Costing**

Activity based costing is a comparatively novel approach in full absorption costing. Activity based costing is increasingly used for costing public services, such as diagnostic imaging, laboratory services and intensive care. This new approach to overhead costs fairer. Using activity based costing can improve costs in health care, and shed light on services under cost or cost in the past, using traditional costing methods (Pyke, 1998; Drury, 2008). Activity based costing steps refines and overhead allocation cost basis by dividing large heterogeneous cost pools into several smaller, homogeneous cost pools. Activity based costing then attempt to select as the cost allocation basis for each overhead cost, a cost that best captures the causal link between the cost object and the emergence of overhead.

Absorption costing is the foundation of the entire financial accounting systems. It implies that every cost is included allocated or divided into production and operation statements make no distinction between fixed and variable costs. In other words, both fixed and variable included in the cost. Conversely, the fixed costs are not included in production when marginal costing is used. Marginal and absorption costing can be different render as surplus figures because they differ in inventory valuation. On the other hand, activity-based costing is a new approach to cost and products compared with traditional approaches. Traditional approaches often use flat rate or output as a base for overhead and evenly spread the overhead costs of services and products. Activity based costing try this deficiency of traditional approaches overcome by the use of homogeneous indirect cost pools, and cost drivers rather than the volume of the budget as a cost-allocation bases to assign overhead costs to products or services.

**CONCLUSION**

Managers in a company has option to make use a range of performance measurements where thetwo most important measures are Return on Investment and Economic Value Added. Economic Value Added measure has both plus and minuses, though it is a fact the metrics is turning out to be a popular and enviable tool for measuring financial performance of a company, where particularly the metrics encourage managers to be short-term in their focus and decision making. In order to offer a meaningful framework for business decisions Return on Investment is a useful and effective metrics of assessing financial performance focused towards the short-term decision making. The critical discussion clearly substantiate that both Return on Investment and Economic Value Added, when used as performance measures in an organisation, encourage managers to be short-term in their focus and decision making. Absorption costing is the foundation of the entire financial accounting systems implying that every cost is included allocated or divided into production and operation statements make no distinction between fixed and variable costs. Marginal costing is useful in determining the profitability of products, services, processes and cost centers. During the analysis of the profitability, marginal cost calculation interprets the cost on the basis of the nature of the charges. Marginal cost in other words is the variable costs. For a typical manufacturing the following elements of the costs are variable or marginal costs. However, traditional approaches often use flat rate or output as a base for overhead and evenly spread the overhead costs of services and products. Marginal and absorption costing can be different render as surplus figures because they differ in inventory valuation. Using activity based costing can improve costs in health care, and shed light on services under cost or cost in the past, using traditional costing methods.

**BIBLIOGRAPHY**

Arnold, G. (2010), *Investing: the definitive companion to investment and the financial markets*, 2nd ed., Financial Times/ Prentice Hall, London.

Botchkarev, A. and Andru, P. (2011), “A Return on Investment as a Metric for Evaluating Information Systems: Taxonomy and Application”, *Interdisciplinary Journal of Information, Knowledge, and Management*, 6, 4, pp.303-9.

Correira, C., Flynn, D., Uliana, E. and Wormald, M. (2007), *Financial Management,* 6th edition, Juta & Company, Cape Town.

Drury, C. (2008), *Management & Cost Accounting,* (7th Ed., South-Western Cengage Learning, London.

Evanomics (2011), “Introduction to Economic Value Added”. [Online] available at <http://www.evanomics.com/presentations.shtml> [retrieved on 23/7/15]

Gitman, L. J. and Joehnk, M.D. (2008), *Fundamentals of Investing*, Pearson / Addison Wesley, London.

Jones, C. P. (2010), *Investments Principles and Concepts*, John Wiley & Sons, Inc., London.

Lucey, T (2002), *Costin*g, 6th Ed, Thompson Learning. UK

McClure, B. (2011), “All About EVA”. [Online] available at <http://www.investopedia.com/articles/fundamental/03/031203.asp> [retrieved on 23/7/15]

Pyke, C.J. (1998), *Costing and pricing in public sector*. In: J Wilson (Ed) Financial Management for public services. Open University Press, pp. 77-98.

Sharma, A.K. and Kumar, S. (2010), “Economic Value Added (EVA): Literature review and relevant issues”, *International Journal of Economics and Finance*, 2, 2, pp.200–221.

Stewart, G. III. ( 1990), *The Quest for Value*, Harper Collins Publishers, New York.

Zimmerman J.L. (2003), *Accounting for decision-making and control*, International edition, Fourth edition, McGraw-Hill Irwin, Boston, pp. 29-75.