

Key Takeaways – Performance Measurement

- Managers and Department heads should be evaluated based on CONTROLLABLE costs or things that they can alter.
- Indirect costs from other departments can be allocated using whatever base the company had decided upon. The basic formula is $\text{Indirect Department Cost} / \text{Total Base}$ to get our allocation rate. Then take the number of actual base used by the current department x allocation rate.
- Direct costs are costs that can be directly traced to a segment, department or product and can be either fixed or variable.
- Contribution to Indirect expenses by a segment is used to determine the amount of money the segments gives towards indirect (and often uncontrollable) expenses. It is calculated as $\text{Contribution Margin} (\text{Sales} - \text{Variable expenses}) - \text{direct fixed expenses}$.
- Return on Investment is calculated as $\text{Income} / \text{Investment Base}$. Return on investment tells you how many cents are earned in income for every dollar of investment base.
- Return on Investment can also be calculated as $\text{Margin} (\text{Income} / \text{Sales}) \times \text{Turnover} (\text{Sales} / \text{Investment})$
- Residual Income uses a Cost of Capital set by the company to establish the minimum income or return an investment should have. Residual Income is the difference between segment income and minimum income and can be positive or negative. (Negative would be bad as this would fall below our desired minimum income)
- To calculate minimum required income: $\text{Investment base} \times \text{cost of capital}$
- To calculate residual income: $\text{Segment Income} - \text{Minimum required income}$