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Retail Profitability Accounting

by David Fleisher

David L. Fleisher, manager in our St. Louis office, has been with TRB&S since 1957. A major part of his professional career has been devoted to working with retail firms, and he has written and spoken extensively in the retail industry. He is the author of the chapter on management reporting in the Retail Accounting Manual published by the National Retail Merchants Association, and is presently participating in the Tobe Lecture series for graduate retail students at Harvard Business School.

Mr. Fleisher holds a B.S. degree in Industrial Engineering and a M.B.A. degree in Business Administration from the University of Michigan. He is a member of the Management Services Committee of the St. Louis Chapter of the Missouri Society of CPAs, a member of the St. Louis Retail Controllers Group and a member of the American Production and Inventory Control Society.

Touche, Ross, Bailey & Smart and its predecessor firms traditionally have been recognized as leaders in the retail accounting field. The vast majority of the major department stores in this country are numbered among our clients. They include Allied, Associated, Federated, Gimbels, Macy's, May Company and Sears Roebuck in the category of national department store chains and several of the major independent department stores such as Gilchrist Company in Boston, Hudson's in Detroit, Miller's in Knoxville, H. C. Prange in Sheboygan, Nieman-Marcus in Dallas, Popular Dry Goods in El Paso and Rich's in Atlanta. In addition, our firm has among its clients several of the large retail discount firms, a number of major food chains and numerous specialty stores handling a variety of merchandise lines.

Further evidence of the participation of Touche, Ross, Bailey & Smart in the retail accounting field is the efforts over the past 40 years of the late J. P. Friedman, John W. McEachren and Kenneth P. Mages, all TRB&S partners, in developing and updating the department store industry accounting manuals which have been a vital part of the department store industry figure exchange program. More recently, James Lynch, manager in our Boston office, was honored at the annual convention of the relatively young discount industry held in May, 1965 for his work in developing the first accounting manual and figure exchange for this industry group. Because of the large number of retailers in this country and their reasonably uniform operating characteristics, the retail industry has traditionally emphasized industry-wide finan-

cial figure exchanges as a key part of their management accounting information. The information is compiled by industry associations, such as the National Retail Merchants Association (NRMA), National Association of Food Chains (NAFC) and several others. In addition, affiliated groups of firms like the Associated Merchandising Corporation (AMC) and Frederick Atkins, which are made up of department stores who use a common central buying office, also exchange financial information among themselves.

Another area in which Touche, Ross, Bailey & Smart has developed a national reputation has been in the development of Profitability Accounting, which is recognized as perhaps the most all encompassing and integrated approach to managerial accounting ever developed. Initially, Profitability Accounting systems were installed primarily in manufacturing firms. Later, systems were installed in a variety of other industries including banking, broadcasting, construction and professional services. Within the last few years, the concepts of Profitability Accounting have been applied to the retail industry. In view of the Firm's background in the development of management accounting techniques for the retail industry, it is worthwhile to consider how the concepts of Profitability Accounting are being applied in retailing.

Fundamental Concepts of Profitability Accounting

In Robert Beyer's book, *Profitability Accounting for Planning and Control,* he defines four fundamental managerial accounting concepts inherent in Profitability Accounting:

1. *Profit Planning* — This is the concept of laying out a detailed, quantitative plan for the performance of each organizational component within the company, usually for a year. The plans are tied together in such a way that each deviation from planned performance can be expressed in terms of its effect on corporate profit.
2. *Responsibility Accounting* — This is the concept of fitting the accounting structure to the organization structure so that performance measures can be compiled and reported in groupings which reflect individual responsibilities.
3. *Exception Reporting* — This is the concept of focusing reporting effort and managerial attention on the exceptions from planned performance which require action rather than on the bulk of the activity which is performed according to plan. This is exemplified by variance reporting analysis.
4. *Profit Contribution Accounting* — This is the concept of segregating revenues and costs which vary directly with product volume from those that do not. The resultant variable cost per unit does not vary with volume. The contribution from revenues less variable costs is shown before deducting the remaining costs to arrive at net profit.

Mr. Beyer also states in his book that a sound Profitability Accounting System incorporates two other techniques which are pertinent to retail management accounting. These are:

1. *Flexible Budgets* for performance control and product costing in the overhead areas.
2. *Return on investment analysis* to measure the profitability of the resources employed in various activities of the business and the desirability of alternative capital investments.

Finally, perhaps the most important feature of Profitability Accounting is that it integrates all of these modern management accounting concepts and techniques into a single consistent and comprehensive system.

Having defined the essential ingredients of Profitability Accounting, it is appropriate to examine how each has traditionally been employed in the retail industry and more important, to determine what can be done to adopt modern Profitability Accounting methods in retailing. Consideration will be given only to the application of Profitability Accounting to department store retailing, with the understanding that there are other types of retailing, such as specialty stores, variety chains, discount houses and food chains, each having similar (but certainly not identical) characteristics and problems to those of department stores.

Characteristics of Department Stores

The department store, as the name implies, is a retail operation built around a series of merchandise departments and carrying the widest assortments of merchandise to be found under one roof in all of retailing. Historically, the key man in the department store has been the buyer. He has been responsible for selecting and promoting merchandise, maintaining a proper inventory turnover, supervising the sales effort and producing a proper profit performance for his selling department. Non-merchandising executives have been responsible for sales supporting activities which have normally been considered to be quite apart from the "lifeblood" merchandising job of selecting, promoting, controlling, and selling merchandise.

Within the last 10-15 years, department stores, like other businesses, have felt the effects of the increasing rate of change in the business environment in this country — principally in four ways:

1. Growing suburban populations have forced department stores to open suburban stores, thus abandoning their traditional "one large downtown store only" operation.
2. Research and development and increased fashion emphasis by consumers have broadened the already-very-large merchandise assortments carried. It is estimated there are approximately one million unique merchandise items in a typical large department store today.
3. Governmental pressures to raise as well as to expand the coverage for minimum wages have created increased labor expense rates.
4. In an effort to meet the challenge both of rising payroll expenses and of a larger, more complex merchandising problem created by multi-store operations and expanded merchandise assortments, and spurred by the availability of electronic data processing, the retail industry increasingly is adopting new and improved techniques for organization planning, personnel training, merchandise control, financial planning and expense control.

There is evidence, among the changes being made in retailing in response to the challenges posed over the last 10-15 years, of the adoption of improved management accounting concepts and techniques along the lines of Profitability Accounting.

Profit Planning

With the exception of some of the larger, more progressive firms, a comprehensive profit planning approach historically has not existed in many department stores. Profits were considered to be a result of good merchandising, which maximized sales and inventory turnover, and sound operating and control practices, which minimized expenses. Consequently, planning emphasis was placed on the merchandise plan, which provides targets for sales, purchases and inventory for the buyer, and expense budgets, which provide expense control goals for sales and sales supporting activities. In many organizations little or no attempt has been made to develop an effective profit plan which pinpoints profit responsibility for all elements of income and expense and results in comprehensive store wide financial goals.

Where a store wide profit plan has been developed, it usually has not pinpointed net profit responsibility below the level of the President or General Manager. There is a very practical reason for this — below the level of the chief executive, there is no individual fully responsible for all elements of net profit. With a single store organization, the buyer was clearly responsible for sales, gross margin and certain direct selling department expenses, including selling payroll, advertising and merchandise clerical payroll. However, the buyer was not primarily responsible for many other elements of expense affected by the sales produced by his department, such as the expenses associated with warehousing, delivery and marking. However, some stores allocate all of these indirect expenses to selling departments in order to measure and, to some extent, hold the buyer responsible for departmental net profit.

Today, with the growth of suburban stores, the problems of assigning selling department net profit responsibility is even more complex. The buyer no longer controls

selling payroll in suburban stores and, in many organizations, he has been relieved of his selling supervision responsibilities in the main store as well. Furthermore, his influence over sales and inventories associated with remote suburban locations is waning as more and more stores are opened.

Recognizing the inherent difficulties of identifying a multitude of indirect expenses with selling departments and stores, it is understandable that net profit planning has generally remained at the total company level only. However, a major improvement in the profit planning process of many stores today would be to establish financial goals for all elements of income and expense and assign responsibility for their attainment through a comprehensive store wide profit plan. Furthermore, as will be shown later, with an integrated information system approach it will be possible in the future to plan profits both by selling department and by store.

Responsibility Accounting

Because of the emphasis on industry figure exchanges, department stores have almost uniformly classified financial data for industry comparison purposes essentially along responsibility lines. The first effort in this direction dates back to 1917 when the NRDGA, the predecessor organization to the NRMA, published a document entitled "The Classification and Distribution of Expense in Retail Stores."

In addition to accounting for expenses by responsibility, department stores traditionally have also measured sales, inventory, gross margin and direct expenses by selling department, thereby accounting for the major elements of income and direct selling and merchandising expense by buyer responsibility. It is probably justifiable to conclude that the department store industry has employed the concept of responsibility *accounting* for a longer period of time than most industries, even though *planning* for profits has not been done in detail by responsibility for all items of income and expense.

Aside from the inherent problem of the dual responsibility of buyers and store management for certain elements of income and expense arising from a growing number of suburban stores, perhaps the only serious problem the department store industry presently faces in implementing effective responsibility accounting is the lack of precision in the industry wide expense centers, particularly for larger stores. For example, the present industry accounting manual defines one expense center to be Maintenance of Reserve Stock — all activities associated with storing and picking merchandise in reserve stock areas. However, since maintenance of stock activities is often performed under individual floor supervisors on each floor of the stores and on each floor in the central warehouse, there actually may be several supervisors responsible for at least payroll expense in the Maintenance of Reserve Stock Expense Center. The obvious answer, and one which has been adopted in several department stores, is to modify expense centers required for industry figure exchange purposes to the precise internal individual supervisory responsibility units required for purposes of internal budgeting and reporting.

Exception Reporting

Only in recent years, as more suburban stores have been added with associated increases in the volume of information generated, has the department store industry generally become interested in exception reporting as it pertains to accounting information. The bulk of the detailed planning and budgeting has traditionally been done for sales, inventory and expense data. No detailed, comprehensive profit plans have been developed. In many stores, even when plans are developed, the prime standard of comparison is still last year's performance rather than the plan for the current year. In any case, reporting has generally not emphasized deviations from standard performance, whatever the standard might be.

There has been a general tendency to flood the management group with voluminous reports which, in some extreme cases, are nothing more than copies of accounting journals. Because the total information requirements have expanded as more and more stores have been added, several department stores have in recent years adopted exception reporting principles in their financial information system. Some examples include:

1. The development of a comprehensive profit plan and the complete elimination of last year's information from all reports except for purposes of identifying sales trends.
2. The development of summary reporting for top management which only highlights key pieces of information. A departmental performance report now issued in one store indicates only 4 key performance indicators for each selling department. This report has replaced a series of departmental operating statements that previously presented approximately 40 pieces of financial information for each of 140 selling departments.
3. The use of expense variance reporting rather than simply account-by-account listings of historical expenses.

As more suburban stores are added and the flood of financial information grows, many more retailers will be forced to adopt exception reporting methods.

Profit Contribution Accounting

The probem of applying profit contribution accounting in department stores has largely been one of size. Since a department store can have up to one million different items of merchandise in inventory, the key question is how to identify variable costs with merchandise. Several attempts have been made in this direction.

There has been the traditional practice of developing profit and loss statements for each selling department. Gross margin is arrived at relatively easily, since data regarding sales, purchases, freight, inventory, mark-on, markdowns, employee discounts, shrinkage, cash discounts and workroom costs have traditionally been developed by the selling department, much of it as part of the retail method of accounting for inventory investment. The real problem has been the assignment of expenses to selling departments. Many stores today assign all expenses to the selling department to arrive at departmental net profit. As far as possible, these expense allocations are normally made on the basis of work units handled by the sales supporting expense units (for example, number of pieces delivered in the delivery expense center) or by direct identification (for example, salaries of salespeople working in the selling department). Of necessity, many fixed items of expense have been allocated on a rather arbitrary basis which often turns out to be the relative percentage of sales contributed by each selling department.

The first major attempt to formally recognize the requirements for more precise selling department profitability measures was known as the Clark Contribution Plan — a concept developed in the early 1930's by the late Carlos B. Clark, controller of the J. L. Hudson Company in Detroit. Mr. Clark divided all expenses into "escapable" and "inescapable," "escapable" signifying those that would not exist if the department were not operated. He then developed departmental profit contribution which was gross margin less "escapable" expenses. In Profitability Accounting terminology, Mr. Clark's "escapable" expense included the variable expenses associated with the sales volume of the department and the specific standby and programmed expenses of the department. Although Mr. Clark's expense classifications were not precisely fixed and variable, he did emphasize the concept of profit contribution, thereby correctly eliminating the allocation of non-specific standby and programmed expenses from the consideration of the profitability of a department.

Today, in measuring selling department profits, most department stores adhere to either the net profit concept whereby all expenses are allocated, or some form of Mr. Clark's contribution concept where only direct expenses are allocated. Some heated discussions have been held over the relative merits of the two approaches. Each side has a valid argument — the net profit system makes the buyer more fully aware of all the expenditures to be made in running a department store before a profit for the total company can be shown, while the contribution system (combined with inventory turnover and space utilization information) provides a more legitimate measure of the relative profitability of selling departments.

Unfortunately, neither approach has provided meaningful profit contribution information for individual items of merchandise. As a result, buyers have continued to focus their thinking primarily on departmental average expense percentages, and they often overlook the profit opportunities available through selective pricing and promotion of particularly profitable merchandise. Emphasis has traditionally been placed on an across-the-board requirement to achieve a specified mark-on percentage on all items in the department. This rigid average pricing formula undoubtedly contributed to the appearance of many discount houses on the retailing scene in the middle 50's. The discounter thrived initially because he built his business by generating dollars of profit rather than by achieving the traditional percentage-of-sales performance emphasized by the department store.

To overcome the inadequacies of buyers' thinking which focused only on percentages of sales, it was necessary to introduce a form of item cost accounting to develop more precise profit and pricing information and to emphasize dollar profit contribution. The result of this thinking was an item profitability measurement system developed in the 1950's called Merchandise Management Accounting (MMA). MMA was undoubtedly the most theoretically correct attempt ever made to employ profit contribution accounting in department store retailing. The approach taken by MMA was to measure all expenses associated with buying, handling and selling a specific item of merchandise through studies of expense patterns. Generally, a distinction was to be made between fixed and variable expenses and only variable expenses to be assigned to the item. Several attempts to apply MMA proved the system to be cumbersome in application. Professor Malcolm McNair, noted Retailing Professor at the Harvard Business School, writing in the May, 1958 issue of

Stores Magazine, voiced the feeling of many retailers toward the system:

> "... So far as theory goes there can be no quarrel with this thinking. It is indubitably correct. The questions arise in the realm of practical application. One of those questions is whether the acceptance of MMA may not be unduly jeopardized by insistence on so much nicety in the differentiation between fixed and variable costs. Aside from the not inconsiderable expenditures of time and money involved in making such elaborate studies, there is the fact that Expense Center Accounting ... has only recently been installed in many stores ... and management at this stage is not likely to look with favor on any new program that seems not to utilize the data from these systems but to require a whole new set of classifications and definitions for the purpose of providing a different set of data."

Professor McNair in his article suggested a modified approach to MMA whereby unit costs would be developed directly by considering each expense center to be fixed or variable in total and then relating the total expense of each variable expense center to the workload processed by the expense center, thereby utilizing the existing expense center system.

Even the simplified approach to MMA suggested by Professor McNair did not gain acceptance in the form of any significant number of installations in department stores. In retrospect, MMA made its biggest contribution to department stores in focusing attention on the need to consider dollar profitability rather than percentages of sales. As a day-to-day working tool it generally has not been accepted.

For the present, the most useful practical application of profit contribution accounting in department stores is to differentiate between variable, standby and programmed expenses in measuring the profitability of selling departments. This at least makes the buyer aware of dollar profit contribution (as opposed to percentage profit only) at the department level and provides a very rough department guide from which the buyer can deviate in evaluating the profitability of particular items of merchandise for purposes of pricing and promotional emphasis. The same approach to profitability measurement should also be used for stores. At some point in the future with the assistance of EDP it may become feasible to apply profit contribution accounting to merchandise classifications which are sub-groupings of departments, thereby obtaining more precise merchandise profitability information.

Flexible Budgeting

It has already been mentioned that most department stores currently develop expense budgets by organizational responsibility unit. Almost without exception these budgets are fixed in nature, with no formal recognition given to varying workload levels, and must constantly be revised as changes in sales volume occur. Furthermore, many stores keep elaborate records of production by expense center so that payroll expense per workload unit can be measured, compared with the productivity of other stores and used to develop further payroll budgets. Some stores now develop production standards through the application of work measurement techniques. With all of the ingredients becoming available in the form of well defined expense centers and some form of productivity standards, there is every reason to believe that flexible budgeting should become more widespread in retailing in the next few years, particularly when its importance in an integrated financial information system is recognized.

Return on Investment Analysis

Traditional retail accounting systems have focused attention on profit as a per cent of sales. Industry figure exchanges report gross margin, expenses and profit as a percentage of sales as do most internal information systems. Return on investment measures have rarely been used either in industry reports or internally.

Recently, the Standardization Committee of the NRMA recognized this deficiency and, as a result of the work of this committee, it is likely that some form of comparative figures will be issued in the near future as part of the industry figure exchange program relating to the profitability of store units based on return on assets employed.

Internally there is a need to develop measures of return on assets employed for departments and selling outlets. The major problem is one of investment allocation. The only asset that is easily identified at the department and selling outlet level is inventory. Both of the other two major assets, accounts receivable and property, plant and equipment present allocation problems, but these problems do not appear insurmountable. It should be possible to develop a meaningful allocation of accounts receivable through statistical sampling which determines relative credit sales, both by department and store, by type of customer account. When accounts receivable records are automated, such an allocation procedure will become relatively simple. Specific property, plant and equipment can be allocated to selling departments based on standards

established for fixturing costs per square foot and to stores through a proper design of property records.

An Integrated Management Accounting System

An integrated management accounting system incorporating all of the applicable concepts and techniques of Profitability Accounting simply does not exist today in department stores. Although many stores employ some of these concepts and techniques, none employ all of them. A description of an integrated retail management accounting system — a Retail Profitability Accounting System — provides a conceptual framework for a modern integrated financial information system toward which today's progressive department store organizations are beginning to move.

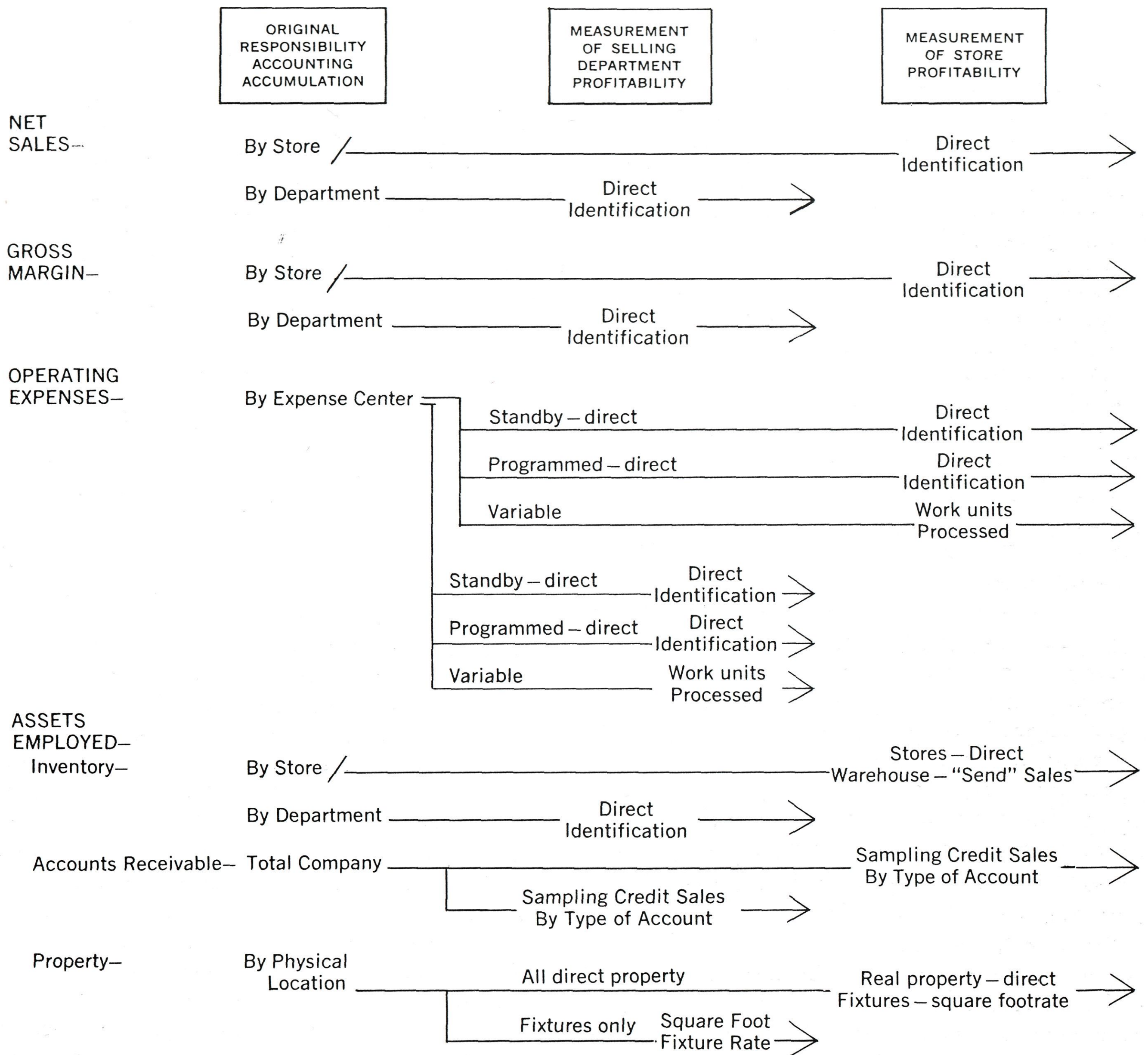
Exhibit 1 provides a schematic diagram of how financial information flows under Retail Profitability Accounting to provide internal measures of profitability for the two key organizational elements, the selling department and the store. Neither is a profit center controlled by a single individual, since a multi-unit department store, of necessity, creates a dual responsibility for many elements of profit. The selling department is the buyer's main area of interest, but store personnel certainly affect the selling department profitability through their display, sales training and scheduling efforts. Likewise, the store manager is primarily responsible for the performance of his store but it would be foolish to say that he has complete responsibility for store performance when buyers at headquarters are selecting, promoting and pricing the merchandise carried in the store.

In spite of this dual responsibility problem there is a need to provide measures of profitability for departments and stores. Exhibit 1 indicates how meaningful profit measures for selling departments and sales outlets would be developed.

1. *Sales* are presently accumulated both by department and by store.
2. *Gross margin* is presently accumulated by department. An accurate breakdown of gross margin by store will require maintaining separate stock ledgers by store — a practice not generally followed today. However, some stores do keep separate stock ledgers, and with more selling outlets causing more severe stock shortages, it is likely many more department stores will go to separate store stock ledgers in the future to pinpoint stock shortage by store.
3. *Expense* will be charged in a variety of ways, depending on the type of expense. Most specific standby and programmed expenses can be identified with departments and stores from expense centers. In fact, the present expense center system separates direct store expenses by store automatically. Variable expenses are charged to departments and stores based on a standard charge for the work units processed as a direct by-product of the use of expense center flexible budgets.
4. *Assets employed,* other than inventory, are allocated through special analysis in most cases. Inventory investment at stores is directly identified from stock ledgers. Central warehouse inventory should be allocated to stores on the basis of the relative percentage of "send" sales at each store. Accounts receivable are allocated through sampling charge sales by department and by type of customer account. In the property category only fixture investment is allocated to departments and this is accomplished on the basis of a standard square foot charge. Store property other than fixtures can be directly identified from property records. Cash and other assets are both too insignificant in amount relative to the three assets just discussed and too difficult to allocate to consider in internal profit measurement.

In addition to developing meaningful internal profit measures based on profit contribution accounting and return on investment principles, Retail Profitability Accounting employs comprehensive profit planning. The profit planning process begins, as it normally does in most stores today, with the merchandise plan for sales and inventory investment for each selling department and each store. In addition, buyers submit plans by selling department for gross margin, buying salaries, buying travel expenses, merchandise, clerical salaries and sales promotion expenses. Other expense center supervisors submit budgets for all other standby and programmed expenses. Departmental profit contribution rates by store are then introduced to complete the development of the total company profit plan.

The final total company profit plan for a department store using an integrated Retail Profitability Accounting system appears on Exhibit 2. This same profit planning format is used for each selling department. Compared with today's typical profit plan, the one shown on Exhibit 2 has two important new features. First, it uses profit contribution accounting in order to obtain a meaningful presentation of store profitability. Store operating profit — which is store profit contribution less specific store standby and programmed expenses — is a true measure of the dollar profits contributed by each store. Second, the plan emphasizes return on assets employed for both



individual stores and the total company. Thus, return on investment analysis becomes an integral part of the profit planning process.

Flexible expense budgets based on productivity standards developed through work measurement are also part of the integrated approach of Retail Profitability Accounting. Exhibit 3 is a worksheet which translates the production for one 5-week accounting.period in a checking and marking expense center into the dollar expense allowances used to measure spending performance in the expense center. The production standards are also used by the supervisor to schedule personnel and measure the efficiency of his expense center. From the flexible expense budgets, the variable rates will be developed which will be

Exhibit 2

RETAIL PROFITABILITY ACCOUNTING
PROFIT PLAN
(Amounts in thousands)

	Store A		Store B		Store C		Total	
	Amount	%	Amount	%	Amount	%	Amount	%
Net sales	$26,000	100.0	$9,000	100.0	$15,000	100.0	$50,000	100.0
Gross margin	$10,114	38.9	$3,285	36.5	$ 5,415	36.1	$18,814	37.6
Profit contribution	$ 6,916	26.6	$2,214	24.6	$ 3,435	22.9	$12,565	25.1
Specific expenses:								
Programmed	$ 365		$ 92		$ 184		$ 641	
Standby	596		210		304		1,110	
Store operating profit	$ 5,955		$1,912		$ 2,947		$10,814	
General expenses:								
Programmed							$ 2,755	
Standby							4,343	
Company operating profit							$ 3,716	
Assets employed:								
Specific	$15,672		$2,988		$ 6,253		$24,913	
General							4,675	
Return on assets employed:								
Store		38.0		63.0		47.1		43.4
Company								12.6

used to charge selling departments and stores for the workload processed.

With internal profit measures based on profit contribution accounting and return on investment, a comprehensive store wide profit plan focused on organizational responsibility and flexible expense center budgets in use throughout the company, an examination of the management reporting system provides a vivid picture of the management information produced by an integrated Retail Profitability Accounting system.

The monthly trend balance sheet in Exhibit 4 is an example of top management reporting under Retail Profitability Accounting. Unlike the management reporting in many department stores today the trend balance sheet introduces three important new features:

1. Information is presented in trend format rather than by simply showing current period results.
2. Emphasis is placed on performance against plan rather than the traditional standard of last year's results.
3. Exception reporting is introduced by summarizing the information presented into only its key elements, thereby eliminating lengthy listings of irrelevant details.

It is important to recognize that the exception reporting technique can *only* be used effectively at all management levels if a comprehensive profit plan exists to provide meaningful performance standards at all management levels. Therefore, it is necessary to develop an integrated Retail Profitability Accounting system in order to reap the increasingly desirable benefits of exception reporting for department store managements faced with the flood of information created by rapidly growing multi-unit organizations.

Between the top management summary reports such as the trend balance sheet and the individual detailed expense center and selling department performance reports there will be a series of variance reports highlighting variances from plan. Variance reporting provides a means of quickly highlighting for the middle management group the problem areas requiring their attention. Broadly speaking, variance reports will fall into two categories: (1) expense variance reports highlighting expense spending performance against flexible budget standards established for each expense center and (2) selling department and store variance reports which highlight profit variances for the revenue-producing elements of the company. A selling department variance report is illustrated in Exhibit 5.

Third, it measures the profitability of selling departments and stores using profit contribution accounting so that meaningful measures of dollar profitability are consistently employed in the reporting system and the impact on net profit of sales and gross margin variances can be directly assessed.

Fourth, it develops expense variances based on performance against flexible expense budgets, which provide realistic dollar spending standards consistent with the productivity standards used by expense center supervisors to staff their work areas.

Fifth, it employs return on investment principles in measuring the profitability of selling departments, stores and the total company, thereby providing a meaningful profitability indicator with which to highlight profit performance exceptions.

Exhibit 3

RETAIL PROFITABILITY ACCOUNTING
FLEXIBLE BUDGET WORKSHEET

Expense Center —
01-743 — Downtown Checking and Marking

Period— II

PAYROLL EXPENSE

Organization		Budgeted Hours or *People for Wk. 3/6	3/13	3/20	3/27	4/3	Total Hours/ *People	Rate Per Hour/ *Per Wk.	Total Budget
Ready-to-Wear Checking and Marking	Supervisors	*1	*1	*1	*1	*1	*1	*130	$ 650
	Nonmeasured	—	—	—	—	—	—	—	—
	Measured	445	397	445	460	449	2196	1.60	3,514
Small Wares Checking and Marking	Supervisors	*1	*1	*1	*1	*1	*1	*95	570
	Nonmeasured	25	21	26	29	31	132	1.30	172
	Measured	245	210	264	290	311	1320	1.50	1,980
Miscellaneous Checking and Marking	Supervisors	*1	*1	*1	*1	*1	*1	*105	630
	Nonmeasured	—	—	—	—	—	—	—	—
	Measured	186	204	145	120	153	808	1.45	1,172
General	Supervisors	*1	*1	*1	*1	*1	*1	160	800
	Nonmeasured	—	—	—	—	—	—	—	—
	Measured	—	—	—	—	—	—	—	—
Total Payroll Budget									$9,488

NON-PAYROLL EXPENSE

Account Name	No.	Budget Rate Amount	Per	Budget Base	Variable Allow.	Fixed Allow.	Total Budget
Supplies	01-743-06	.092	Earned Measured Hour	6120	98	—	$398

RETAIL PROFITABILITY ACCOUNTING TREND BALANCE SHEET

Exhibit 4

(IN THOUSANDS)

	CURRENT ASSETS								FIXED ASSETS		OTHER ASSETS		
	Cash		Accounts Receivable		Inventories		Other Current Assets						
	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	
JAN.		1,175		10,789		4,767		54		8,667		378	JAN.
FEB.	1,250	1,259	10,075	10,171	5,300	5,256	50	54	8,690	8,638	410	402	FEB.
MAR.	1,200	1,212	10,495	10,443	5,200	5,478	55	56	8,610	8,596	415	410	MAR.
APR.	1,300	1,340	11,090	11,282	5,525	5,437	60	71	8,580	8,610	415	418	APR.
MAY	1,160		10,880		5,030		55		8,650		405		MAY
JUN.	1,100		10,935		5,450		55		8,590		400		JUN.
JUL.	1,100		10,765		5,625		55		8,690		395		JUL.
AUG.													AUG.
SEP.													SEP.
OCT.													OCT.
NOV.													NOV.
DEC.													DEC.
JAN.													JAN.

	CURRENT LIABILITIES								Deferred Income Taxes and Long Term Debt		Stockholders Investment		Current Ratio		
	Accounts Payable		Accrued Expenses		Income Taxes		Other Payables								
	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	
JAN.		1,615		116		537		1,311		3,785		18,466		4.69	JAN.
FEB.	1,400	1,438	120	119	620	562	1,250	1,260	3,785	3,785	18,600	18,616	4.92	4.95	FEB.
MAR.	1,175	1,457	135	150	790	735	1,175	1,133	3,785	3,785	18,915	18,935	5.18	4.95	MAR.
APR.	1,600	1,590	225	315	860	880	1,325	1,386	3,785	3,785	19,175	19,202	4.48	4.35	APR.
MAY	1,200		450		635		910		3,785		19,200		5.36		MAY
JUN.	1,125		545		730		975		3,785		19,370		5.20		JUN.
JUL.	1,005		420		825		1,050		3,785		19,545		5.32		JUL.
AUG.															AUG.
SEP.															SEP.
OCT.															OCT.
NOV.															NOV.
DEC.															DEC.
JAN.															

Summary

Faced with a rapidly changing retail environment characterized by growing multi-store operations, increased payroll costs and wider assortments of merchandise, department stores today are increasingly adopting improved management techniques in all areas. The management accounting system is one of the areas undergoing change. Much has been done in recent years but much more remains to be done in the future.

In order to achieve meaningful exception reporting, which is the single most important objective of the changes completed and contemplated in most retail management accounting systems, an integrated financial information system — a Retail Profitability Accounting system — provides a sound guideline for future changes for several reasons:

First, it provides a comprehensive profit plan so that exception reporting can be developed around deviations from company financial objectives.

Second, it employs responsibility accounting so that exceptions are reported according to the individual responsible.

Exhibit 5

RETAIL PROFITABILITY ACCOUNTING SELLING DEPARTMENT VARIANCE REPORT

(Amounts in thousands)

( ) denotes unfavorable year-to-date variance

Department	Net Sales	Gross Margin		Profit Contribution		Expense Variance	Department Operating Profit	Return on Assets – %
		Amt.	%	Amt.	%			
11–Piece Goods	8.5	3.2	(.2)	2.3	(.4)	.7	3.0	4.1
15–Domestics	(24.2)	(9.7)	—	(6.1)	.1	(2.5)	(8.6)	(7.7)
21–Notions	11.9	4.3	(.7)	2.0	(.9)	1.4	3.4	1.8
22–Cosmetics	38.0	14.8	.3	8.1	.6	(3.9)	4.2	2.8
23–Jewelry	(9.4)	(3.7)	(.1)	2.7	—	(1.1)	1.6	.9
24–Silverware	1.5	.3	(.2)	.1	(.3)	4.8	4.9	5.7
26–Boo								