

On the following screens we have set out for you a detailed guide to the content of **P5: Advanced Performance Management**.

It's a good idea to start here, and read it through to get an idea of the kind of material that you are likely to encounter in your studies of the online text.

Think of what you already know of this subject and try to relate the new things that you will learn about to practical examples in your work or personal life.

Once you feel confident with the breadth and scope of the subject, you can begin to study the online text to fill in the details.



Introduction to strategic management accounting ***

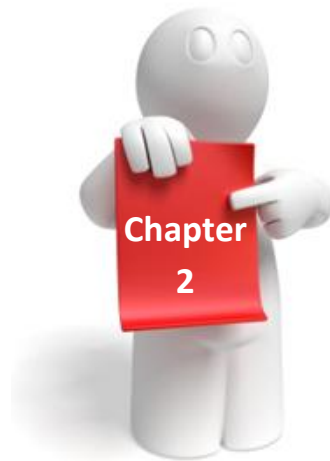
The first thing to get to grips with is what strategic management accounting actually *means*. By strategic management accounting we mean taking a long term (as opposed to a purely short term) view of the organisation, and looking outside the organisation as well as within it. By long term view we can mean extending the planning process to include not only the development stage, but the *whole* of the product life cycle and therefore we will need to accommodate a substantial degree of uncertainty.

Additionally, we will need to incorporate the different approaches of different levels of the organisation; specifically the strategic and operational levels (cf Anthony's hierarchy) and remember that staff at different levels will have a different focus. In particular you must be aware of the conflict that exists between short and long term plans.

The purpose of all this is to establish a plan of campaign for moving the company forward and allowing it to deal with any threats that emerge in the environment, and also to take advantage of any opportunities that arise. In other words we need to develop a **strategy** that will allow our organisation to succeed in whatever it is trying to do.

A key tool to use in this paper is one that you will have seen before: SWOT. It brings together the internal / external, now / future angles and helps you to remember what it is you're trying to do.

Benchmarking is mentioned and gone into in some depth — notice why; because it identifies an eminently achievable target and also recommends a way of achieving it (i.e. a plan).



Environment influences ***

The key to this chapter lies in Section 1, where we have two very useful models that you *must* learn: Porter's five forces and PESTEL. PESTEL looks at the general environment that an organisation operates within, while Porter's model looks at five specific forces within a particular industry.

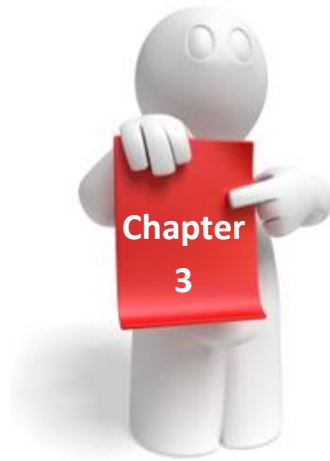
The chapter first looks at the PESTEL model by looking at a variety of environmental forces. It concentrates on the impact of government regulation. While it is important as an accountant to be aware of the major issues in the commercial environment, the chief importance of this section is to make you realise the very wide range of factors that impact upon an organisation. Don't try and learn all these points, but do try to read the quality press at least once a week, so that in the exam you can bring up a range of sensible ideas. You'll be a qualified accountant soon, remarkable though it may seem and people will expect you to be commercially aware. Remember, if something has actually happened to a company, or a company has actually taken a particular stance in respect of some aspect of government legislation, then it is a realistic — and mark scoring — point to bring up in your exam.

Porter's model is really an attempt to assess how attractive a particular industry is and helps an organisation to decide whether or not it wants to operate in that particular industry. For instance, the threat of new entrants will be reduced if there are substantial barriers to entry, but the position of a company will be weaker if its suppliers have a monopoly on essential components.

You must learn these now and begin applying them to yourself, your company and any organisation you come across. The more practice you can get in using these models the greater the likelihood of passing the exam.

Stakeholders: make sure you can identify a range of stakeholders in any given situation and be able to identify points of conflict. Learn Mendelow's matrix (which is useful for identifying the relative importance of stakeholders) and also Cyert and March's methods of resolving conflict.

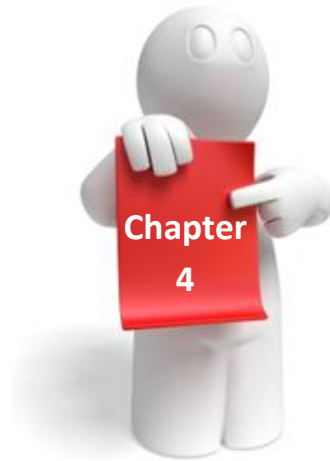
Ethics is becoming increasingly significant, but in this part concentrate on corporate social responsibility and in particular, the arguments for and against it. A key issue here is the question of maximising shareholder wealth and how corporate social responsibility impacts upon it. Is it always the case that CSR is bad for the shareholders? Pricing should represent nothing new - it's simply a reprise of F5. In this paper what matters is setting the price in the light of the strategic plan of, say, cost leadership or differentiation.



Approaches to budgets ***

This chapter is pretty much a reprise of a lot of F5, and should pose few real problems. It goes through all the various types of budgeting processes: ABB, Zero Based Budgeting and Rolling Budgets before moving on to the behavioural aspects of budgeting and linking it to performance evaluation.

In this paper, while you *may* be asked to prepare budgets, it is much more likely that you will need to consider them within the context of strategic management accounting, which means linking up short-term performance targets with the longer term strategic aims of the organisation. You must therefore expect that any questions in this area will ask you to show a much more mature approach - so for instance you may be asked to consider how problems of dysfunctional behaviour such as budgetary slack may undermine the budgeting process.



Changes in business structure and management accounting ***

Before getting into the nitty gritty of changes in business structure, this chapter looks at some of those forces that have led to the need for a change in the business form.

Principal amongst these have been changes to the business environment that most companies now operate within. In particular, you need to be up to talking about increasing competition, globalisation, increasingly informed (and discriminating, and demanding) customers and the opening up of markets.

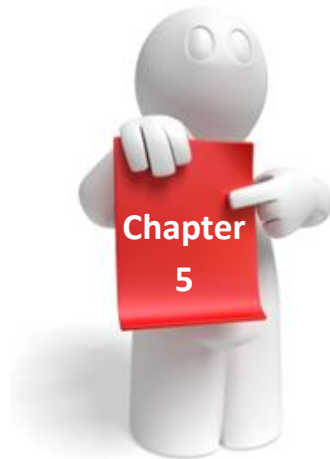
Remind yourself here about the traditional organisational forms, and be able to think of the advantages and disadvantages associated with them particularly in the context of performance management. Then you need to move on to network structures. Think about companies like Amazon for instance, where many of the roles traditionally performed in house have now been outsourced.

Business integration is a very useful area. Learn Porter's 5 value chain model (it can be applied to a variety of different topics throughout the syllabus) and also McKinsey's 7S model: they are both extremely useful when identifying what has gone wrong within an organisation and particularly for spotting which areas of a business have led to conflict. Remember Porter's value chain deals with *activities*, not departments.

Ironically, because these models are so important, it is perhaps unlikely that there will be many marks for simply describing them. It is more realistic to expect that you will be asked to apply them to a given scenario. We would recommend that you start applying these models *now* - by thinking perhaps how different activities within your organisation link together and perhaps more importantly where breakdowns in communication occur.

You must understand what BPR is, and in particular learn the definition provided. Note that BPR is an expensive and risky process, and not to be undertaken lightly, so learn a few advantages and criticisms of it.

Finally ABM needs to be addressed. Be able to show how it links to ABC, and say what the benefits of it are, but probably don't expect any numerical questions on ABC.



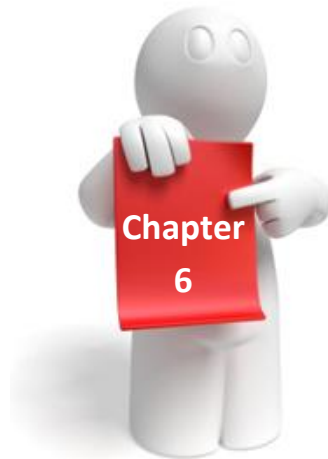
The impact of information technology ***

The important thing to remember about this chapter is that it is *not* a technical one. You won't be asked to talk about the minutiae of different computer systems. When we talk about the impact of information technology what we mean is how it will affect our organisation and how we need to change to respond to the challenges and opportunities created.

You must be able to discuss recent and technological developments and be able to recommend how a company can use these developments to progress. So think about the nature of the organisations you deal with as a consumer, as well as the organisations you work for. Don't be afraid to describe modern developments in the exam, but make sure you are able to identify and assess the business impacts, such as reduced costs. However, you must be able to show why costs have been reduced by IT. The key to scoring marks in the exam in this topic is **specifics**.

In the UK, where only 18 per cent of GDP comes from the manufacturing sector, it is the service sector which is pre-eminent. It is therefore no accident that this chapter quickly moves on to dealing with the specific problems faced by service companies. There are four key differences between manufacturing and service businesses: intangibility, simultaneity, heterogeneity and perishability. Learn them and be able to describe them.

An extremely useful model (process, sensor, comparator, standard, effector) is shown in Section 3. This is described as a budgetary control system but in fact is the basis any form of control system and is used by all organisations to some degree.



Performance measurement systems and design ****

The key issue to bear in mind here is that an organisation consists of groups of people operating in different levels. Traditionally we use Anthony's three levels of control: strategic, management and operational. You need to be aware of the different characteristics of these at each of the three levels.

The chapter then goes on to consider systems theory, a very useful model that we have already encountered. Learn the terminology but more importantly notice how it can be applied, i.e. by thinking of an organisation as being a system we can consider how open or closed it is and to what degree the sub-systems within an organisation communicate effectively. Link this up to Porter's value chain in chapter 4.

The rest of this chapter is concerned with the type of information that people need if they're going to do their job properly and in particular the strategic information that will be required by the top level of management within an organisation. First it considers the contingent variables that affect the character of management accounting within an organisation - learn these.

Section 7 starts by looking at the behavioural aspects of performance management, in other words, what people actually do. You need to consider what dysfunctional behaviour means. For the purposes of this paper, we will take it to mean actions carried out by individuals for their own benefit, which ultimately are harmful to the organisation as a whole. Note that we're not talking about anything immoral or illegal here. It's more the case that, say, a manager may decide not to invest in some plant and equipment (even though it has positive NPV) simply because of the way his performance is rated. Read through section 2 - don't try to learn them all but *do* read it thoroughly, especially the very important area of reward schemes. These are fraught with problems because people can act in completely unexpected ways, particularly if the scheme has not been thought out properly.

Your aim should be to be able to link together business strategy with performance management systems design with an emphasis on motivating staff through KPIs.



Financial performance measures in the private sector ****

This is the principal numerical element of the paper and as such, many students will dive into it without thinking and simply produce a dozen or so financial ratios. The problem with this approach is that in this paper we are not looking just at short-term performance. We need to make sure we have a wide range of performance measures, *not* just taken from the income statement and balance sheet, but from a wide variety of sources. The balanced scorecard (see chapter 10) will help you to come up with non-financial measures. Remember, non-financial means items not found in the financial statements and specifically *does* include non-numerical elements.

The key thing you have to do in this part of the paper is identify what needs to be measured and then devise a way of measuring it. In more junior papers such as F5, we could limit ourselves to things such as gross profit margin or debtor days - this paper is different. Read through the chapter and see some of the things that could be measured, but bear in mind that these are meant to be examples, not an exhaustive list.

Do go through the chapter in detail, working through all the numbers, but remember, in the exam you will be expected to identify **appropriate** performance measures, so as you go through the material try to think of what would prompt you to investigate this particular ratio or that particular measure.

Of particular significance to this paper, is the question of long-run financial performance and what could be done to encourage a longer term approach.



Divisional performance appraisal and transfer pricing *****

Before getting into this chapter, a word of warning: there is a lot in it, and it might seem impenetrable, but don't give up! A lot of models/techniques are brought in that we've seen before (Ansoff's matrix, BCG matrix, transfer pricing) but what you've got to get to grips with is that an organisation will usually have a lot of different parts and we've got to use the models we've seen before either to plan or control.

Again in this chapter it is very important to bear in mind the strategic element at this level. In other words you must look at the long-term plan for the whole organisation, rather than looking at the purely financial, short-term techniques you will be familiar with from F5.

The transfer pricing section of this chapter is a reprise of F5. You do need to go through it to make sure you can understand it and can do the calculations but it shouldn't take too long. Note that what we are concerned about is the use of transfer pricing as a form of control: i.e. getting divisions to act the way we want them to. The most important part of this chapter is about divisional performance appraisal.

The key thing to get to grips with here is that companies often split themselves up into semi-autonomous divisions, which indeed often become strategic business units in their own right. Think about what this means. They can develop their own strategy and therefore when deciding upon performance appraisal measures, you have to think about what a particular division is actually trying to *do*.

In section 2 of this chapter we have a variety of typical measures for divisions depending upon whether they are cost centres, profit centres or investments centres. Remember, when you go through this chapter that the notes are giving you examples of what could be measured, but in the exam you would have to recommend a particular area to be assessed, say *why* and then say *how*.

The chapter goes through ROI and residual income in a fair bit of detail, but it should be nothing more than revision. Do make sure though that you can explain the advantages and disadvantages of each, including why each method might encourage dysfunctional behaviour.

Then we consider economic value added (EVA). Do make sure you can explain what it is trying to do and say why it differs from ROI

The next section looks at managerial versus divisional performance. This section is heading towards the idea of assessing how an individual division is contributing to the overall strategy of the business. So in this section, Ansoff's matrix pops up. This was covered in P3, so don't be surprised to see it in this exam as deemed knowledge. The point is, that by identifying what the organisation is trying to do (such as developing new markets or developing new products) we can more easily identify which areas of performance really matter. This then allows us to identify appropriate performance measures. In the exam don't be surprised if you come across an organisation with several subdivisions each of which has a different strategy, which means that the performance appraisal for each sub-division will be different.

Along with this, you may also need to bring in the BCG matrix, because if we are trying to set challenging but achievable targets for our divisions then it is clearly important that we know whereabouts in the grid they actually are. Also, of course, there could be the question of what do we do to turn the dog into a star, or an already problem child into a cash cow. It could be that we need to bring critical success factors into play here so we can identify what we need to do to achieve the appropriate growth.



Performance management in not-for-profit organisations ***

This chapter is really a continuation of the previous one, in that it is forcing you to focus on what the organisation is trying to do, rather than just assuming that it is going for short-term growth in earnings or profits or whatever. The reason why we have a specific chapter on not-for-profit organisations is because, in addition to the diversity of targets that we saw in Chapter 8, we also have the problem of a much greater range of stakeholders who will hold divergent and often conflicting views about what the organisation should be trying to achieve.

Again we could bring out the balanced scorecard in order to identify a range of possible perspectives that stakeholders might have. It is probably fair to say that not-for-profit organisations rarely view the financial perspective as being pre-eminent. In the exam it is essential that you come up with a range of different targets for the opposition, and therefore can identify different ways of assessing performance.

The chapter looks at its range of different not-for-profit organisations and considers the problems that they face. There are different approaches that can be considered but again the three E's are extremely useful: economy, efficiency and effectiveness. Note that these three are interlinked and an over-emphasis on one will be damaging to the others. A key problem faced by NFPOs is balancing the three.

The rest of this chapter considers various practical problems faced by NFPOs such as the impact of politics (politicians notoriously have short term perspectives) but the important point to focus on is that often organisations are forced to concentrate on those things that are *easy to measure*, rather than on achieving things that are important but more nebulous. To get round this problem some NFPOs try to carry out cost-benefit analysis. Make sure you can understand the technique, but bear in mind that even the best CBA approach is based upon judgement and estimates and therefore will always be subjective to some degree.



Non financial performance indicators *****

This is an extremely useful chapter giving details of several very important tools: the balanced scorecard, the performance pyramid and the building block model of performance measures.

Underpinning all of these models is the idea of non-financial performance indicators. In the low-level papers there was an emphasis upon the calculation of ratios such as debtor days and gross profit margin using numbers taken from the financial statements. This is useful, but limited and in the real world most organisations would not allow themselves to ignore other, perhaps more important, indicators of performance.

The balanced scorecard is an essential tool for your exam, because it gets you to do what organisations do in practice, i.e. they look at a wide range of indicators to find the most appropriate measures of performance. So learn the three models and make sure you read through the chapter in detail. Don't try and learn everything that is given to you in there, but do try to appreciate the approach. So for instance, if learning and growth perspective is to be monitored, a goal might be to reduce the time taken to create a marketable product. An appropriate measure could, therefore, be the amount of time it takes to get a new product to market, perhaps compared to target, or compared to the performance of your competitors.

The performance pyramid has a slightly different focus. It is aiming to show how the different levels of an organisation impact upon one another. So, looking at illustration 2, success in customer satisfaction cannot be achieved without good quality products and good delivery systems. Therefore, if you are having problems maintaining customer satisfaction, you should make sure that your performance targets are being met in terms of quality and delivery, but notice that when measuring quality, it is unlikely that you'll be using financial information - in other words, non financial performance indicators will have a direct and unavoidable impact all the way up through the pyramid.

Being able to identify the most appropriate measures therefore becomes an **organisation-wide** exercise, not something limited to an individual department in isolation. We could link this back to Porter's value chain that we looked at in chapter 4.

Again and again throughout this syllabus you will find this emphasis on the wider and longer term — in other words **strategic** — viewpoint. You ignore this at your peril!

The rest of the chapter can be viewed as applying these approaches to a variety of real-life situations. Do read through them properly, as they will help you to understand how organisations use NFPIs in practice. In particular, do make sure you understand and can explain the importance of qualitative (non numerical) information

The last two sections of this chapter are extremely useful, because it's always much more fun to look at somebody else's failings! A company will fail for a variety of reasons, such as a lack of cash, or customers, or because a competitor has brought a new and better product out, but at bottom it usually comes down to one of two things: not hearing the alarm bells, or not taking appropriate action.



Current developments in performance management ***

This chapter then goes on to other topics that you have covered before such as Kaizen costing, target costing, just in time, total quality management etc. Do read through them thoroughly as revision, but remember, at this stage, it is unlikely you will get away with simply being able to describe them. You need to be able to link these topics with what we looked at already, i.e. performance measurement.

Total quality management, for instance, is unlikely to use variance analysis, because variance analysis is entirely focused on quantitative measures such as cost, rather than quality. So if you are presented with an organisation that is seeking to implement TQM, you will have to address the issue of how it could control costs and whether or not the existence of variance analysis will actually reduce the effectiveness of any TQM programme. Actually, with TQM you are much more likely to use the six sigma approach in section 7. Do have a good read through that section and try to incorporate it into any answer on TQM.

Similarly six sigma is an important contemporary approach to incorporating quality into performance management.

Do read through section 6 on environmental reporting. The last big thing in this chapter is on value-based management approaches. Economic value added (EVA) has become increasingly important in recent years and you should not be surprised if it comes up in your exam, particularly in tandem with shareholder value added (SVA).

That rest of the chapter is useful as an overview of some of the more common developments in management accounting, but it's probably best to treat them as background reading.