

Activity based management (ABM) E.1.e

ABM is part of the lean management aims of **continuous improvement** to provide increasing value to the customer at ever reducing prices in order to stay competitive. Higher prices can only be justified when the customer perceives new value through innovation. From this it can be deduced that the factors critical to success are: quality, innovation, efficient cost management and time. Time is essential because new products have to be brought to the attention of the customer on time otherwise other suppliers will take its place substitutes

Performance measurement and management techniques associated with ABM are

Zero-based budgeting

Requires every activity to be justified in terms of what it contributes to the organisation's value proposition to customers: goods and services offered at a price that is market tested. If the customer buys the good at the offer price then the entity's value proposition is accepted and this can be the basis for growth, sustainability and market share in the face of competition.

The following specific AMB techniques are claimed to be new but actually they are not: they are simply repackaged methods from management accounting and organisation and management; they contribute to the same overall goals of giving value to the customer which is the objective of management accounting and performance management.

Process value analysis (PVA): query the process's existence and efficiency (input/output) relationships to determine if it is adding enough value to the customer. Lean accounting can isolate and help in this assessment because lean accounting ... So in the spirit and intent of AMB incremental budgeting would be inappropriate because it assumes the process or department will continue to be needed in the future just because it was need in the past. Instead, ZBB (and BB beyond budgeting) would require defined outputs that contribute value e.g. design products that meet quality specifications. Delivering valued outputs become the primary criterion of successful cost management, not keeping within budgets. Managing product/service - cost interaction involving deep understanding of cost structure would be an essential requirement and the management style and rewards must reflect that.

Activity-based costing (ABC):

Customer profitability analysis (CPA)

Activity-based performance evaluation: carry out performance evaluation on each activity to appraise its contribution. This is part of PVA and is within the scope of Kaizen costing (KZC).

Driver analysis: what is the **dependent** (on customer activity e.g. sales demand drives variable cost of production and selling) and **independent** variable that is causing the cost? E.g. firm infrastructure planning and financing (independent of customer activity within the relevant range of planning).

Activity analysis:

Value-added analysis:

All the above performance management techniques fit within the **zero-based budgeting** philosophy.

Performance prism

As this models performance management where stakeholder satisfaction justifies the existence of all other facets of management (strategies, capabilities, processes and stakeholder contributions) the prism is a suitable model for AMB.

The balanced score card

As this model integrates four different but interconnected perspectives of performance measurement and management for customer satisfaction as a basis for growth and shareholder wealth maximisation it is compatible with ABM.

Coherence

There is logic to strategic performance management - strategic coherence. All aspects of strategic performance are carefully considered, justified and applied in pursuit of a defined objective or unified set of objectives focused on a single overall goal – to satisfy stakeholder expectations. For example, the CSFs determine the KPIs and the appropriate tools (performance management frameworks e.g. the balanced scorecard) are used to measure, monitor and control performance. Hence links must be found between concepts such as profits, strategy, plans, systems, processes, methods and staff. This is the basis of McKinsey 7 S model.

Commercial awareness

Commercial awareness (and insightful understanding) is assumed and must be demonstrated as part of exercising professional judgement. What is commercial awareness and what aspects must be applied and how do you know when and how to apply it? This is the challenge of a professional accountant and your task is to learn how to recognise and meet that challenge.

Commercial awareness is showing that you understand how a business is conducted and managed for the benefit of its stakeholders and to understand the issues that arise and how they are dealt with. At the professional level you are required to show that you understand the complexities of business issues and how accounting techniques and judgement deal with those complexities. For example, the strategies of the business are based on **assumptions** which reflect management's **judgement** about future trends, conditions events and risks. Therefore, it makes sense that the financial planning and reporting practices adopted by the accountant are forward looking, to provide **feedforward control** (to influence and support proactive action) , rather than **backward looking** providing only feedback control (to learn about past events about which the management can do nothing).

To study and prepare well for this paper it is essential that all aspects of the subject are viewed through the lens of **performance**. At its most elemental level performance is the application of effort to transform resources into goods and services at a value proposition (price) that customers are expected to accept. This expectation is confirmed or refuted by the customer in the market place. A combination of the risk of rejection of the organisation's goods and services as a result of competition (or quality failure) and the desire to meet shareholder expectations for wealth maximisation encourage the development of performance management techniques that aim to deliver value to the customer at competitive prices.

As a minimum the operations of the business must be understood: these form the value chain. So you should understand Porter's value chain framework inside out and what it adds to performance management.

In commerce there are **conflicts**, for example, the need to manage and reduce costs in order to be competitive in terms of prices may conflict with the need to offer quality in terms of customer care. Hence there are trade-offs. Commercial awareness alerts you to that eventuality and warrants that you exercise judgement in undertaking analysis and evaluation of scenarios.

The complexities of commerce means that decisions always have **implications** for other connected facets of the business; you need to think in an integrated way reflecting the integrated nature of commercial problem solving. So when you study TQM you should ask what does quality management mean for

- cost management (e.g., Kaizen costing),
- budgeting (e.g. ZBB or BB),
- information systems (ERPS),
- staff motivation (rewards, structure, culture and management style),
- performance measurement metrics (what metrics are most affected?)

The complexities of commerce require individuals to be responsible for other individuals and groups so that resources can be applied in an orderly manner to achieve quality goods and services. Thus **structures** and **cultures** are a key feature of commercial organisations. Associated with these features are

- Accountability
- Governance chain
- Management chain
- Controls, systems, processes, procedures, policies, practices
- Targets and performance measures: inputs, outputs, performance metrics
- Critical success factors, KPI, tolerance limits
- Feedback
- Reward

Commercial situations provide the context to all P5 questions: in the first line of every question the industry in which the organisation operates is identified for a reason. The reason is that all the tools of performance management e.g. the metrics in the balanced scorecard, EVA, etc. are meaningful only when applied to a certain context. For example, if the organisation is a high volume producer in pursuit of a cost leadership strategy an appropriate metric in its dashboard would be **unit cost of production**. This would be monitored closely to see if it is falling relative to the industry average and the nearest competitor, as this would give the leader an advantage over weaker rivals that cannot afford to reduce their total costs below a certain level, and thus will be forced out of the industry. However, unit cost or production would be wholly inappropriate to an organisation operating a JIT production system in pursuit of a differentiation strategy where quality is the key means of satisfying customers and beating the competition. A JIT producer would be more interested in time-to-produce and would monitor to see if this metric is falling as speed of response to demand-pull production schedules would be a critical component of quality and a contributor of success in such a commercial situation.

Examples

Dec 2013 q2a (answer)	"An exercise should be undertaken to identify how strongly customers value the durability of Graviton's products and if this is
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	significant, then measures of quality such as level of complaints should be made. It is possible that in a fast-changing, trend-driven industry such as Graviton's, there is little interest from customers in the durability of their garments, as they will be purchasing new ones on a regular basis to keep up with fashion."
Jun 2013 q1 (answer)	"The learning and growth perspective would appear to be an obvious area to address, given the objective of product innovation. Yet there is no measure given for this. A possible metric would be percentage of revenue generated from new hotel types or hotel services. Hotels are a fairly mature business and so this may be a difficult objective to realise. "

Exam question verbs

Verb	Example	Illustration
<p>Describe</p> <p>Jun 2013 q1(iv) (7mks) (answer) Dec 2012 q5a (12mks) (answer) Jun 2011 q2a (4mks) (answer) Jun 2011 q2d (7mks) (answer)</p> <p>Study guide 2016/17 D.3.a (p11)</p>	<p>State the features or functions. Features are what identifies the thing; what it is known by. Functions are what the thing does because it has those features (the enablers).</p> <p>There are two types of enablers: <i>inherent</i> and <i>situational</i>. The inherent enablers are the core features that make the thing (e.g. the budget) do what it is designed for.</p> <p>E.g. the budget is the financial plan that enables management to identify the resources required to perform the tasks in the operational plan; at the same time where appropriate it identifies the resources generated as a result of carrying out the tasks in the operational plan. By relating the resources required to the resources generated the budget enables management to determine whether the operation is financially feasible i.e. the total revenue at least covers total cost. Additionally, the budget can help management determine whether the operation can meet financial objectives other than break-even. E.g. an absolute surplus of revenue over cost or a relative (%) e.g. provide surplus of 10% on revenue.</p> <p>The situational enablers are the factors such as leadership, strategy, staff motivation, etc. that allows the core enablers to fit and function</p>	<p>Study the relevant examples in the selected past questions</p>

as intended (McKinsey 7Ss). For example, competent management will select a budgeting system such as BB or ZBB that suits their needs (for innovation and project management) and make the system work for them. Incompetent management will select the wrong type of budgeting system (e.g. incremental budgeting because it is easy to prepare or because of experience or “culture capture”) and cause behavioural and financial problems as a result.

Describe questions are rare in the exam (not more than 5 marks). Make sure you claim them all as they relate to very notable tools that you should know about such as the balanced score card, building blocks, PESTEL, prism, pyramid, TQM, Kaizen budgeting, beyond budgeting, incremental budgeting.

Be careful: don't write too much and waste time just because the answer is straight forward.

Exam technique

Don't be vague: think in terms of the **core identifiers**. What are the distinctive features by which you can identify the tool, concept, method, or principle? For example, when writing about **Kaizen costing** by what features can you recognize it?

- Lean thinking
- Beginning period
- Target savings for the period
- Staff motivated to look for savings
- Continuous monitoring
- End of period review
- New savings targets set

Situational enablers (these need not be in the description but description questions lead unto **capability** and **process** elements. To study them together.)

- Used with target costing to deliver increasing value to customers
- Used in Kaizen budgeting environment
- Requires ERP system to furnish information about costs (that can be saved and that have been saved for targeting and motivation)
- Used in JIT processing environment

	<ul style="list-style-type: none"> - Used in lean management environment - Used in generic strategies for innovation, cost leadership, differentiation. 	
<p>Explain</p> <p>Dec 2015 q1(iii) (answer) Jun 2015 q1(v) (answer) Dec 2014 q1(i); q1(iv) (answer) Jun 2014 q1(iv); (answer) Dec 2013 Jun 2013 q1(i); q1(v); (answer) Dec 2012 q5(a); (answer) Jun 2012 q3; q4a; (answer) Dec 2011 2b; (answer) Jun 2011 q3c; (answer) Dec 2010 q3a; (answer)</p> <p>Study guide 2016/17</p> <p>A.1.a A.4.d D.1.f D.3.e D.7.a</p>	<p>“Describe” questions require you to state what happened (or what is expected to happen) by contrast “Explain” question is concerned with linking cause and effect in order to understand, appraise and interpret the <u>observed</u> or <u>anticipated</u> effects of management action. Hence “explain” answers use the logical connectives: “as”, “since”, “in that”, “because”, “therefore”, “given”, “and so”; conditional structures, “if, then”, “if and only if”.</p> <p>“Explain” questions require you to say</p> <ul style="list-style-type: none"> - why (enabling conditions e.g. generic strategies for innovation executed by competent management results in new value streams to customers) and - how (process, capabilities) it happened. - what metrics are required? E.g. number of new products (direct); increasing market share (indirect); customer satisfaction surveys (indirect – could be for quality of service which is not necessarily innovation). - when e.g. to bring new products to market to get first-mover advantage. <p>Exam technique</p> <p>Again, be careful: don’t write too much. Hit the bull’s eye: use a model such as McKinsey 7s or the Performance pyramid. Make sure you refer to <u>specific aspects</u> in the answer e.g. according to McKinsey 7Ss the system of budgeting must fit the strategy.</p> <p><i>Be context grounded in order to hit the bulls eye in every sentence and claim. In other words, whatever the claim, point to the evidence in the scenario to support, analyse, explain and develop it as required by the question.</i></p> <p>Unlike “describe” questions that are general (does not mean vague) and not dependent on context, “explain” questions are <u>context-determined</u> and so should the answers be.</p>	<p>Study the relevant examples in past questions</p>

Every sentence must hook unto (refer, infer, project) the scenario detail(s) most relevant to it (evidence-based). Thus, scenario details (and issues) are the drivers of “explain” answers; for the answers to have structure and technical validity they must be based on *principles and models* of **performance management** (e.g. McKinsey 7Ss, performance prism, building blocks, pyramid, PEST, BSC, etc.).

Why does **beyond budgeting** (BB) fit (is suited to, acceptable and feasible) **innovation strategy** but **incremental budgeting** (IB) does not?

Answer: Incremental budgeting

Incremental budgeting is backward looking being based on past costs with small adjustments - both are unsuited to the requirements of innovation explained above.

Answer: Beyond budgeting

As Z is pursuing an innovation strategy BB would be a good fit because BB’s forward looking perspective will support anticipation of trends necessary for innovation and provide resources to meet emergent strategies that exploit new opportunities. Also, BB is process and outcome (not function) focused and does not limit managerial initiative to the department or the amounts available in the budget for the period in the way that incremental budgets are designed to operate. For Z, this flexibility is significant because it is essential to innovate to stay competitive in the long-run.

An attempt at an “explain” answer is not an effective answer if it does not embed the scenario details; also, it is not an effective answer if it does not link cause and effect (feature and function.) You are wasting time if you simply reel off general or vague knowledge hoping for marks. You won’t get any.

How do you learn to be able to **explain**? First understand the difference between **rote learning** and **active in-depth learning** that leads to understanding and the ability to apply or transfer what you

	<p>understand.</p> <p>Rote learning is when no processing of the input takes place; the learner merely skims the surface and “thinks he understands” what he has just read or copied. But when you ask him to explain he can’t – he is confused. Why? The reason he can’t use the knowledge to explain is that the knowledge is not <i>internalised</i> – it is not yet in his long-term memory in a form that can be used. The learner has not made the knowledge his own by applying it to examples, checking its relevance and limits. This kind of knowledge (assuming the learner has it) is called <i>inert knowledge</i>. Inert because it is not active and usable. Until knowledge is usable it cannot support any form of <u>cognitive activity</u> except simple recall, if that.</p> <p>So how can knowledge be made usable (or actionable)? Through <i>active learning</i>. Active learning is when the learner processes the input deeply into his long-term memory to form mental models that support <i>transfer</i>.</p> <p>Transfer is when acquired knowledge is retrieved from memory and used to explain, predict and solve problems. This is what you are expected to do in the exam - to show you have <i>applied understanding</i> (ability to transfer) consisting of “<i>knowledge that</i>”, “<i>knowledge how</i>” and “<i>knowledge why</i>”? Make connections (basic insights); make decisions (advanced insights); evaluate decisions (sophisticated insights).</p>	
<p>Apply</p>	<p>“Apply” questions are concerned with assessing your ability to select and apply the correct principles, methods, models, concepts and measures and metrics in the context of performance measurement.</p>	<p>Study the relevant examples in past questions</p>
<p>Analyse</p>	<p>Break-up the parts to show more deeply how it works. This prepares you to evaluate whether it works well or not and to be able to give full and clear reasons because you can see the component parts and their features and functions.</p>	<p>Study the relevant examples in past questions</p>
<p>Evaluate/assess/appraise</p>		<p>Study the relevant examples in past questions</p>

Exercise professional judgement		Study the relevant examples in past questions
Comment		Study the relevant examples in past questions

Examiner's reports & Marking scheme

Examiner's descriptor	Examiners details	How to improve the answer
Fairly well done	<p>"with candidates offering a good range of issues" <i>March 2016, q1(v)</i></p> <p>"This was generally fairly well done by those candidates that knew the headings from the model." <i>March 2016, q2(a)</i></p> <p>"This part was fairly well done with candidates showing a reasonable grasp of the basic benefits." <i>March 2016, q2(b)</i></p>	<p>Answers to this question <u>would have been improved</u> with the use of specific illustrations of the general points being made <u>using the information</u> in the scenario. P5 is about specific application not just generic points that could apply to any business and those candidates that do this often shift their marks materially into the range of a good pass.</p>
Generally well done <i>March 2016, q1(i)</i>		
This part was often ignored by candidates or poorly attempted. <i>March 2016, q1(iv)</i>		
Often poorly done	<p>"...as candidates offered a performance evaluation or a discussion of the suitability of the indicator rather than focussing on their reliability." <i>March 2016, q1(iii)</i></p>	
Often well done		

How to apply what you learn

Consider the following guide to advanced performance management thinking and problem solving. It will help you to read the question critically and answer fully to score full marks. Read this in conjunction with **How to score – Marking scheme**.

- **Context:** what is the immediate pressure point? Usually this comes from a failure to satisfy customers, deal with competition, manage costs (other **internal** and **external** factors must be considered e.g. dealing with environmental issues)

- **Intervention** e.g. insert new costing systems; new cost management techniques; information systems, management style, reward system? How do you know the appropriate intervention method? This is why extensive practice is required. Practice at what? Applying the concepts, principles, methods, models, frameworks, theories, etc. as set out in the Revision and Practice guide. These comprise the toolkit for advanced performance management.
- **Comparisons** e.g. what is the best option?
- **Management of interests**: who are the project champions that will make the intervention work? What are their priorities? What instructions have they given? Pay careful attention to these: they are usually given in the imperative mood using “must”, “should”; the instructions occur at the end of the case study after setting out the “context” and the “intervention” and the expected “outcomes” from the “intervention”.
- **Outcomes**: are the expected outcomes clearly defined; are they coherent with the strategy and other aspects; e.g. what indications are there that the **outcomes** will be achieved?

How to learn from your mistakes

To improve rapidly requires that you learn effectively from your mistakes. This cannot happen by accident or by default. It is essential to have a **deliberate** and **organized** approach and to be **efficient**. What you score after each practice sessions may indicate a weakness. How can you turn weaknesses into strengths? Below is a suggested approach.

Identify the error with the learning outcome	Study a model (exemplar) of the learning outcome in which you fell short	Practise repeatedly to the required standard of proficiency	Obtain and apply feedback
<p>The exam assesses precise learning outcomes (comprising “verb”, “attributes”, “subject” or “topic”) e.g. ability to:</p> <div style="display: flex; justify-content: space-around; margin: 10px 0;"> <div style="border: 1px solid black; padding: 5px; background-color: #e6f2ff;">Verb</div> <div style="border: 1px solid black; padding: 5px; background-color: #e6e6ff;">Attributes</div> <div style="border: 1px solid black; padding: 5px; background-color: #e6ffe6;">Subject/topic</div> </div> <p>“Evaluate the strengths and weaknesses of alternative budgeting models and compare such techniques as fixed and flexible, rolling, activity based, zero based and incremental. [3]” Study guide reference A.3.a ACCA study</p>	<p>The <u>next best thing</u> is to study the standard features of the learning outcome in question.</p> <p>Refer to: Exam question verbs How to score – marking scheme</p> <p>After studying the standard features of the learning outcome study an exemplar to see how that learning outcome actually works in a particular context.</p>	<p>Attempt the question again until you fix all the problems and deficiencies identified.</p> <p>Keep your papers for future reference. Review them regularly so you don’t forget what you have learnt.</p> <p>Select and attempt another similar question. Distribute practice over time to retain and improve what you have learnt.</p>	<p>Obtain and apply feedback from a tutor or by marking your script and thinking about where you went wrong.</p> <p>Practise again to improve.</p> <p>Transfer all this learning into future practice.</p>

<p>guide, 2016-17 p8</p> <p>Therefore, the more specifically you can pinpoint the <i>relevant learning outcome</i> the more likely it is that you will use adequate measures to address and overcome the practice weakness associated with it.</p> <p><u>What tools do you need for this?</u> That should come naturally if you use the study guide frequently as a study tool.</p>	<p>If you have attempted a question <u>study the suggested answer carefully</u>; try to understand how the answer works. Can you identify and explain the <u>distinctive features</u> of an evaluation process?</p> <p>Use the marking scheme for the question (along with How to Score, Exam question verbs) to <u>pinpoint</u> where you went wrong and what you need to improve:</p> <ul style="list-style-type: none"> - Was it the lack of analysis? What is analysed in the answer? Can you follow the reasoning? - Was it the lack of examples of evaluation of strengths and weaknesses? - Was it the lack of context details? - Was it the lack of evaluative conclusion? - Was it the lack of a model, framework, principle, commercial awareness? - Was it the lack of professional judgement? <p>Use the Revision and Practice Guide to find more exemplars from past questions.</p>		
<p>Use the study guide to identify the learning outcomes for each question part.</p> <p>An example of a student's marked script for practice.</p>	<p>Question paper Answers & mark scheme</p> <p>Student's marked script</p>	<p>Attempt this question, applying the lessons learned.</p>	<p>Obtain and action feedback.</p>

This student has scored well in some parts but not in others.	Identify the student's weaknesses using the above guidance: pinpoint how and why the student lost marks.		
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How to score – Marking scheme

Exam verbs give a detailed **analysis** and **explanation** of what is required by each verb. This section gives a brief outline of the **scoring criteria**. Each question will direct you as to its specific requirements. This section only gives a concise description of the generic requirements for scoring categories used by the examiner. Most of these categories map to distinct exam verbs. All must be **exhibited** at the intellectual level 3: **synthesis and evaluation**.

Scoring categories Categories the examiner uses frequently	Scoring criteria What you must address in order to score full marks.	When you may not score Generally you don't score unless you apply the knowledge in context (this is level 3: synthesis and evaluation underpinned by application and analysis). So verbatim knowledge (knowledge that you simply regurgitate from notes and textbooks) does not score.
Professional marks	Style, structure and format. Read annotated question 1 December 2015 for an explanation and analysis of the implications of this requirement.	When you don't present information in an organised and attractive way (<i>structure and format</i>) with good clear language (<i>style</i>). As you learn and practise ensure your thoughts are clearly focused on the following standards. Conformance with prototypical formats/layouts <ul style="list-style-type: none"> - Formal order e.g. board reports have standard structure and format ranging from an introduction to a conclusion (and sometimes a recommendation) - Logical order e.g. arguments and explanations employed in discussions must be correctly arranged for clarity, control and coherence - Order of importance e.g. PESTEL, SWOT must be used to structure the answer in the order of importance of the factors identified in the scenario - Natural order e.g. priorities for solving business

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		<p>problems must reflect business needs identified in the scenario and must also address time issues (<i>time order</i>)</p> <ul style="list-style-type: none"> - Functional order e.g. answers involving models and frameworks such as the Value Chain Framework must be meaningfully arranged to reflect the functional relationships between the elements
Definitions	Basic knowledge (intellectual Level 1)	<p>When you are not specifically asked for this; the available mark and time is for application only!</p> <p><i>The skill is to show, don't tell.</i> Show you understand the definition of the concept or (whatever it is) while applying it in context.</p> <p>There are no marks for mere definitions as this paper is examined at Level 3 requiring you to apply, rather than to repeat knowledge from text books.</p>
Identify	Critical features that significantly affect the relevant performance activities. Get into the habit of prioritising relative power, strength, contribution, etc. For example, why is an ERP system a key factor in the success of a TQM system?	When you identify features that are not critical to performance or to the issue under discussion.
Examples	Concrete: clear and certain meaning. Must be relevant to the question asked.	When you don't give examples; remember that the case study may give examples. If they are relevant use them. But remember that you can hardly justify using the same examples in more than one part of the question. So if you are lazily repeating examples in different parts of the question you are probably doing something wrong.
Illustrations: <i>An expanded example – a demonstration of how the thing actually works.</i>	Concrete: ideas in a working form; principles in action. Used in questions that require justification, comparisons of relative strengths and weaknesses.	<p>When you don't illustrate fully, which means you don't quite understand how the thing (e.g. rolling budget) works.</p> <p><i>When you practise make sure you spend time</i></p>

		<p>checking how principles apply in practice. E.g. do you know how JIT actually works in a specific manufacturing context? Do you understand what is required to make it work effectively?</p> <p>How for example, does JIT relate to TQM, IT, costing, management style, reward systems, etc.?</p> <p>Can you explain (give clear reasons) the implications (how will they change and why) of adopting JIT for</p> <ul style="list-style-type: none"> - Cost structure and costing - Performance metrics - Staff behaviour & management style - Competitiveness <p>Can you explain the problems and difficulties to be overcome in implementing JIT?</p> <p>Can you explain how JIT might be applied to non-manufacturing industries such as</p> <ul style="list-style-type: none"> - Leisure - Education - Fashion
<p>Calculations</p>	<p>Concrete: layout essential for clarity and illustration of points (application of principles) e.g. EVA calculation several principles including the key principle that that profit is only earned after the cost of capital has been deducted.</p>	<p>When you don't explain e.g. in an EVA calculation you don't explain the principles of the adjustment which score more marks than the figures.</p> <p>But don't write too much– just give succinct explanations of the salient principles that underpin the adjustments e.g. “marketing costs capitalised as benefits expected to accrue to future periods”.</p> <p>Contractions are permissible.</p> <p>You may also lose marks when your workings are untidy, unreferenced, incorrect and generally sloppy.</p>
<p>Interpretations</p>	<p>Proof of technical knowledge e.g. the variables of sales (e.g. volume),</p>	<p>When you simply state what is already available</p>

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	<p>the variables of cost (e.g. closing stock) affect gross margin.</p> <p>Insightful understanding of logical relationships e.g. cause and effect as in linking relatively low ROCE to increased investment in plant.</p> <p>Clear and concise expressions.</p> <p>Predictive data response:</p> <ul style="list-style-type: none"> - Understand the meaning of data - Understand the implications of data 	<p>instead of <i>generating new insights</i> that are not obvious.</p> <p>NOT AN INTERPRETATION E.g. if you say gross profit is down by x% on the previous year – that is not an interpretation because that information is obviously given..</p> <p>AN INTERPRETATION The x% decline in gross profit is unexpected given the targeted increase of y% for the period. The problem seems to be in the cost of sales as the lower than expected closing stock deviates from the company’s normal stock holding levels, and this decline is not accounted for by a corresponding increase in sales. Further investigation is required to establish the cause in the decline of gross profit conclusively as the data does not yield any further clues as to how it may have occurred.</p>
<p>Discussions</p>	<p>Make a claim and try and prove it by means of arguments and evidence. Understand the nature of argument: a set of linked statements in which premises are offered as a reason to support a conclusion.</p> <p>Structure is essential</p> <ul style="list-style-type: none"> - Argument structure: coherent thinking underpinning developed arguments and explanations. - Paragraph structure <p>Examples are essential.</p>	<p>When, instead of discussing, you do something else such as “describe” or “narrate” which is not what the question required. “Discuss” is a higher order thinking (HOT) skill which must be practised. See question verb for a more detailed illustration.</p>
<p>Synthesis</p>	<p>As synthesis is a combined (integrated) view or perspective which is achieved by knitting together various strands of an argument, analysis, discussion and narrative.</p> <p>This thinking skill must be mastered at this level as it is frequently required to provide the upshot to senior management who require</p>	<p>When you don’t <i>synthesise</i> because you have not done enough practice (lack of application ability); instead, you display a lower level skill such as giving a lot of separate details.</p>

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	<p>the essence, not the detail, of an analysis of a situation. Synthesis should consist of a solution, the problem and the reason in a clear and concise form.</p> <p>For example, you are frequently required to appraise performance, options for resource acquisition and strategic direction.</p>	
<p>Evaluations An evaluation can be positive or negative but an “appreciation” is a positive form of evaluation. Assess is also an evaluation.</p>	<p>Generally, an evaluation is a process of determining the value of a phenomenon and it entails answering questions: e.g. did the strategy work effectively? In other words, did it deliver the expected outcomes? If it did then we conclude that the strategy was worthwhile.</p> <p>Therefore, an evaluation follows a synthesis of all the relevant elements. Judgement is exercised because the situations may be complex e.g. one may never be certain to what extent the strategy delivered the observed outcomes. It may have been a coincidence; it may be that there were environmental factors at work that played a decisive part.</p> <p>That is why critical thinking is essential in carrying out an evaluation asking: “what-if”, “to what extent”, etc.</p> <p>An evaluation always has a conclusion that is focused on an objective: it indicates whether an objective has been achieved or would be achieved by the means identified and adopted. Sometimes the conclusion may be that it is not practical to draw a conclusion.</p>	<p>When you don’t <u>evaluate</u> <u>because</u> you have not done enough practice (lack of application ability); instead, you display a lower level skill such as giving a lot of separate details without an insightful overall opinion.</p>
<p>Comment</p>	<p>A comment can express an opinion; it need not be evaluative but it mostly is. Read the context. E.g. comment on the KPI means say whether they are suitable or not with reasons that are germane to the CSFs and the strategy and environment to which they relate.</p>	<p>When you state without analysing and commenting.</p>

For a more extensive analysis and explanations of how and why students fail refer to [Common mistakes in P5](#)

Key nonfinancial performance measures

Traditional financial measures of past performance should be replaced with more flexible dynamic measures that reflect the drivers of future financial performance. This requires a combination of financial and nonfinancial performance measures that are linked to the external environment.

As future growth and market share reflects customer satisfaction the **fundamentals required** to deliver ongoing customer satisfaction levels that match or exceed the competition must be measured and evaluated as part of strategic performance management.

Measures of efficiency

Efficiency is the rate (usually measured in units per labour hour) at which the entity converts inputs to outputs (expressed as a price that represents a value proposition to the customer). Logically, where there is demand efficiency is a key factor in satisfying that demand and capturing the market. Thus it is essential that critical efficiency indicators are measured and monitored. They include:

- Time to market new products (effectiveness and efficiency of the **innovation cycle**: from identifying a need for new products to making goods available in stores)
- Manufacturing lead times (efficiency of the manufacturing process: time since decision to manufacture to finished products being available)
- Material usage efficiency variances
- Labour efficiency variances
- Quality design costs (linkages between design and production)
- Other quality prevention costs
- Quality failure costs (internal and external)

Measures of innovation

The customer seeks increasing value for money (flow and pull as in lean thinking model or Porter's Diamond customer expectations or demand conditions) that can only be fulfilled through continuous innovation. Successful companies must innovate continuously to stay competitive for customers. Concepts such as Lean thinking, Six Sigma, Business process re-engineering, TQM, models such as Prism, Pyramid, BSC, Building blocks all address this fundamental requirement as a priority in strategic management. Therefore, the organisation must build innovative capacity and measure

- Number of new products launched
- Efficiency e.g. reduced cycle time in routine production as an indicator of process innovation
- Number of patents
-

Measures of Learning and growth

Growth requires learning from past experience, trends in the environment and from competitors to renew and extend strategic capacity. Therefore measures of learning capacity are critical to strategic management for future growth. Examples:

- Employee development potential indicated by intellectual capacity for learning and training
- Staff retention strategies
- Strategies for preserving learning and growth e.g. organisational memory (intranet, employee retention, updating procedures)
- Training programmes
- Recruitment of employees with suitable abilities and attributes that can add value through individual and team contributions

- Customer opinion surveys and suggestions for improvement of quality of service.

Measures of customer satisfaction

Trace performance that builds relationships with customers to secure customer loyalty – customer relationship management (CRM). These include

- Convenient response time
- In-time delivery of goods/services (Pyramid/Building blocks)
- Flexibility to accommodate customer demands such as multi-channel, late delivery, etc. e.g. Debenhams, Amazon
- Product/service reliability
- Customer's purchasing plans – customer plans to buy more of our products in future
- Key account ranking
- Partnerships with customers
- Customer satisfaction surveys e.g. asking customers whether they would recommend the organization to others

Lean thinking & management techniques

Lean thinking drives all the cost and quality management techniques. It is aimed at providing continuously improving value as perceived by the customer.

Lean thinking thus underpins:

THE VALUE CHAIN & VALUE NETWORKS

Porter's value chain framework

PLANNING

Activity-based budgeting

Kaizen budgeting

Zero-based budgeting

COST MANAGEMENT ACCOUNTING

Activity-based costing

Kaizen costing

Lean accounting

TQM

JIT

MIS

INNOVATION

Read the study text chapter on C_1 of the syllabus to get more detailed discussion of Lean thinking and associated management techniques.

Measurement

Measurement refers to numerical information that quantifies input, output, and performance dimensions of processes, products, services, and the overall organisation (outcomes). Performance measures might be simple (derived from one measurement) or composite.

Performance

Performance refers to output results and their outcomes obtained from processes, products, and services that permit evaluation and comparison relative to goals, standards, past results, and other organisations. Performance can be expressed in **non-financial** and **financial terms**.

Suitability

Suitability refers to the fit between the chosen means and the ends to be achieved and it is a **core theme** in performance management. For example:

- i) in the case of **strategy** it is the extent to which the strategy addresses the key issues relating to the strategic position of the entity;
- ii) in the case of **performance measurement** it is the extent to which the **performance measure** reflects the **critical success factors**; so if the entity is a **cost leader** a key performance measure is the **unit cost of production** because the entity is pursuing a **strategy of cost minimisation** **seeking to drive** out competitors that cannot match its **cost structure**. So the measure **indirectly** measures production levels as part of the ratio as well as sales levels, being the driver of production. Look for ultimate measures of the success of a strategy; see if other critical factors are implicit as indirect measures. This is the strategy to adopt as CEOs tend to limit the reportable measures in order to reduce information overload by thoughtless accountants.

Have a look at the [Examiner's report for March 2017](#) questions 3 and 4 to assess how important suitability is to performance management.

In **evaluating suitability** it is essential to keep in mind that this is not a simple and straight forward process. Your evaluation should reflect the complexity of strategic management and the need to prioritise measures on the dashboard to keep within constraints imposed by the question. The measure must match the strategic option as explained above. At the same time it should also

- i) Reflect changes (threats and opportunities) in the environment e.g. Porters five forces (always read the scenario with these in mind). E.g. can cost leadership be sustained in the face of threat of substitutes, convergence, and bargaining power of suppliers to raise input cost?

- ii) **Reflect weaknesses**: the effect of an organisation's weaknesses must be monitored to assess the likelihood that it may suffer as a result. For example, in June 2015 q1i: the SWOT analysis reveals a **weakness in IT capability** which in the face of changes in marketing channels could be a **potential threat** as competitors might gain a **competitive advantage** over MS if this weak IT capability meant it could not exploit the rapidly changing marketing channels available on social media. Therefore, to protect its brand, a suitable measure must address MS's management of the effects of changes in marketing channels by monitoring users who actively read and respond to its messages looking for assurance that they have loyal followers despite their IT weakness.
- iii) Reflect that the business is complex and requires different measures for different divisions; cost leadership may be pursued for one division but differentiation may be pursued for another, so a different contrasting measure may be required. Be very alert through critical reading of the case study.
- iv) Stakeholder expectations and influence: for more rapid growth and shareholder wealth maximisation. EVA is not supreme; compare the merits of EVA relative to others. Which measures address which stakeholders?
- v) Cultural influences: potential for culture clash especially where diversification is a strategic option. Measures that are most aligned with the prevailing culture.
- vi) Reflect business changes: insourcing to outsourcing (and vice versa);

Vague

What is **vague** is what does not respond to and integrate specific scenario issues.

For example, the **budgeting system** will help improve control within the media and publishing operation (*general business context but only indicates type not circumstances*). This statement is **vague** because it does not refer to a specific context (*what issues, events and conditions are paramount and why?*) and so is hard for the management (your audience in the P5 exam) to appreciate it – it is of limited use to them.

How can you improve this statement?

Think about the needs of management and the specific business circumstances they face – read the scenario purposefully searching for the relevant issues and their implications (requirements, impacts, etc.). To “**discuss**” means to translate issues into propositions (claims) which you must then prove by means of “**arguments**” and “**explanations**”.

LEVEL 1: This shows knowledge of the tools and their uses but only does so in a limited general textbook way. What it lacks LEVEL 2 gives.

By requiring managers to forecast income and expenditure the budgeting system can help managers plan ahead and anticipate short-term and long-term problems and opportunities. This can enable the management to overcome threats while maximising opportunities. For example, the cash budget can be used to highlight cash shortfalls early in the year (or lifecycle, production cycle, etc.). Such early warning gives management ample opportunity to arrange overdrafts and other short-term finance at least cost to close the anticipated cash flow gap. In terms of exploiting opportunities forecasting can reveal

seasonal patterns giving management plenty of time to exploit those opportunities through proactive management of capacity and flexible pricing strategies catering for customers in the off season.

LEVEL 2: This takes the system for granted but uses skill and insight in how the various tools work by showing how they can be integrated.

Having produced the budget on an incremental basis, managers have demonstrated clear motivation and commitment to deliver their targets within budget limits allowing flexibility for opportunities that may emerge. For the first half year an analysis of actual spend in relation to the flexed budget evidences that all the key drivers of sales, purchases and production are on target as no significant variances have been reported. The balanced scorecard registers consistent metrics depicting steady growth compatible with a steady increase in customer satisfaction. This trend underscores the positive metrics in the learning and growth perspective where significant staff training in design, production, sales and finance have had a dramatic uplift in staff morale as evidenced by the staff satisfaction surveys. Overall this has had a beneficial effect on our TQM measures of process and product output where the incidence of wastage and defective products has seen a significant drop much to the satisfaction of the TQM team who have previously struggled to demonstrate measurable impacts on the production process. In terms of Kaizen costing it is evident that dovetailing the budgeting systems with the costing system has demonstrable benefits within the lean management strategy. This has been enhanced by the ERP system which has facilitated two critical aspects: i) setting cost reduction targets at the beginning of the planning period; ii) monitoring cost savings; iii) setting target costs for products; and iv) setting new targets for cost improvement. The particular construction of the ERP systems is the integration of the budgeting and the costing systems such that information can be shared between them promptly for planning and monitoring.

However, management has recently carried out **functional benchmarking** of the entity's **operations** against its nearest competitor and found that the entity's costs are considerably higher than those of its competitor and the average in the industry. The entity's cost structure has not changed for over five years; the incremental budgeting system has always been in use. Management is thinking about investigating alternative budgeting systems to enable it to better understand and control its costs. As strategic management accountant you have been asked to advise on alternative budgeting systems and to set out the criteria by which the systems can be compared and appraised so that a decision can be made about the best system to adopt for the entity's current and future needs.

LEVEL 3

An **evaluation** of the current **incremental budgeting** system is required. This entails identifying specific weaknesses in relation to the firm's **strategic objectives** and making claims about a better budgeting system such as **activity based budgeting** that might bring about the required benefits (specify the benefits).

The **criteria of evaluation** are:

1. It must be simple to operate
2. Cheap
3. Suitable - fit the strategic and operational requirements.
4. Improve on the current system

The need to **control costs** suggests ABB. This is an obvious choice given that the incremental budgeting system does not currently afford the entity the means to

1. Scrutinise its costs because it assumes the starting cost level and adds a bit on top every year without justifying the base cost level.
2. Classify its costs into discretionary and essential (necessary for production and support)
3. Isolate overheads – these are simply loaded onto products and priced out making the entity uncompetitive.

The next step is to outline how **ABB** can improve **cost management**.

Illustrate this by means of simple calculations in a competitive scenario where cost management is critical: the **entity is a price taker**. It has no scope to protect its margins as in an oligopoly or monopoly. Examples of such an industry: food retail, mobile phone technology, etc.

It is important to emphasize that **budgeting** would need to be flexible.

Value based management

Value-based management is managing performance for value that contributes to increasing shareholder wealth driven by the net return from value-based activities measured as the present value of future cash flow from income. **Value-based activities** create value for customers and provide revenue for the organisation. Creating value requires capabilities, processes, strategies and contributions from stakeholders e.g. investors, volunteers, lenders, etc. These elements drive value (cash flow) through the organisation. Managing for value in essence means managing the cash flow effects of these elements: forecasting, planning, assessing and managing risk, measuring performance, evaluation of performance for control, rewarding performance, managing growth. Etc.

Value is created by transforming resources into goods and services at a price the customer can accept. The transformation can be by technology (e.g. automation in advanced manufacturing systems) or by people in labour intensive industries.

The following **measurement** and **management** techniques are integral to VBM.

EVA

Economic value added is a performance measurement technique that measures return on capital employed in creating value for customers by deducting the cost of capital from the net operating profit after tax. The net operating profit after tax is obtained by deducting the operating cost from the revenue generated from delivering value to customers (operating income as opposed to income investment income from investing activities).

It is essential to note the following points about EVA:

- i) EVA is cash based and as such adjusts statutory accounting profit by excluding non-cash items such as amortisation of noncurrent assets

- ii) EVA excludes R&D from its costs charged against operating profit if it does not contribute value to the current period. Thus R&D associated with goods yet to be launched are added back to operating profit if they have previously been charged.
- iii) A key EVA principle is that returns on capital employed are only recognized after charging the cost of invested capital. Hence the finance cost (or interest charge) is excluded – operating profit before interest is the base figure to which eligible adjustments are added.
- iv) As a result of not charging interest the legitimate tax saving is not recognised in EVA calculations. Any tax shield is included with the actual tax paid to obtain the total tax chargeable against operating profit to obtain NOPAT.
- v) EVA only recognises actual tax paid in the year as it is concerned with economic value added in the year. The statutory tax charge is subject to accounting adjustments such as unrelated to economic value added.

Exam articles

[Part 1 – detailed calculations and adjustments with annotations](#)

[Part 2 – interpretations, applications and comparisons with ROI, RI and ROCE](#)

PLANNING

Performance prism

Balanced score card

Zero-based budgets

COSTING

Kaizen costing

ABC

Lifecycle costing

Target costing

PRODUCTION & INVENTORY MANAGEMENT

JIT

1

QUALITY

TQM

SYSTEM

ERP

CRM: integrating people and technology e.g. through performance metrics to enable effective customer relationships for recruitment, retention and satisfaction of long-term customers.

CULTURE

Enabling and rewarding high achievement through suitable staff management, appraisal and development techniques

Learning and growth: training to develop required competences; positive learning attitude to mistakes;

Performance culture extended across the value network: to partners, suppliers, etc. once fully internally embedded.

WORD STRENGTH & HIERARCHY

Critical	Essential; of the greatest importance to the way things might happen. CSFs: KPIs can drive performance if combined with strategic alignment of employee, management and shareholder interests through a culture that rewards employees and management fairly based on performance as in share-based payment
Essential	The conditions or factors that the organisation <u>cannot do without</u> . E.g. strategic execution requires it (the condition or factor) because it is a generic critical success factor : time, innovation, quality, cost, management, systems, information and strategic resources or capabilities. The case study explicit states the condition; or it may indicate it. For example, if the mission is to be number 1 in the industry then that indicates that the organization must innovate – that means it must make new products. This must not be confused with quality or with brand awareness.
Crucial	Extremely important or necessary. Strategic capabilities; customer services quality. E.g. CRM system is crucial for an online retailer such as Amazon that relies on high customer ratings and loyalty for ongoing dominance . The CRM system enables Amazon to collect data about customers so that they market and respond fast to customer complaints.
Necessary	Needed in order to achieve a particular result – the objective.
Required	Necessary according to the rules or for a particular purpose as the question verbs require a particular answer approach, content, structure, style, format, etc.
Important	Necessary or of great value; ERP system is important to a Secondary School but essential to Dell – a global operation.
Significant	Important or noticeable