



Paper P2

PERFORMANCE MANAGEMENT

Acorn Chapters

- 1 Relevant costing
- 2 Learning curve theory
- 3 Pricing
- 4 Budgeting
- 5 Break-even analysis (CVP analysis)
- 6 Activity based costing
- 7 Modern manufacturing techniques
- 8 Limiting factors
- 9 Transfer pricing

Syllabus overview

While Paper P2 continues the analytic theme of Paper P1 Performance Operations (for example in terms of identifying relevant costs), its main focus is on the application of information in the management processes of decision-making and control, so as to optimise performance. The first two sections deal respectively with the key contributors to operational performance – revenue (decisions of what to produce, at what price) and costs (how to manage them to maximise profitability). The role of control in monitoring and improving performance then comes to the fore in the final two sections, dealing with principles and practices in the use of responsibility centres and budgeting.

Syllabus structure

The syllabus comprises the following topics and study weightings:

A	Pricing and Product Decisions	30%
B	Cost Planning and Analysis for Competitive Advantage	30%
C	Budgeting and management Control	20%
D	Control and Performance Measurement of Responsibility Centres	20%

Assessment strategy

There will be a written examination paper of three hours, plus 20 minutes of pre-examination question paper reading time. During the 20 minutes you can: read the question paper and annotate or highlight the question paper. However you will not be allowed to: open the answer book; write in the answer book; add any loose sheets/supplements to your answer book; or use calculators. Failure to comply with these rules will be considered as a serious breach of the exam regulations.

The examination paper will have the following sections.

Section A	50 marks	Five compulsory medium answer questions, each worth ten marks. Short scenarios may be given, to which some or all questions relate.
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Section B	50 marks	One or two compulsory questions. Short scenarios may be given, to which questions relate.
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A - PRICING AND PRODUCT DECISIONS – 30%

1. Discuss concepts of cost and revenue relevant to pricing and product decisions.

a) discuss the principles of decision-making including the identification of relevant flows and their use alongside non-quantifiable factors in making rounded judgements;

b) discuss the possible conflicts between cost accounting for profit reporting and valuation and information required for decision-making;

c) discuss the particular issues that arise in pricing decisions and the conflict between 'marginal cost' principles and the need for full recovery of all costs incurred.

- Relevant cash flows and their use in short-term decisions, typically concerning acceptance/rejection of contracts, pricing and cost/benefit comparisons.
- The importance of strategic, intangible and non-financial judgements in decision-making.
- Relevant costs and revenues in decision-making and their relation to accounting concepts.
- Marginal and full cost recovery as bases for pricing decisions in the short and long-term.

2. Analyse short-term pricing and product decisions.

(a) explain the usefulness of dividing costs into variable and fixed components in the context of short-term decision making;

(b) interpret variable/fixed cost analysis in multiple product contexts to break-even analysis and product mix decision making, including circumstances where there are multiple constraints and linear programming methods are needed to identify 'optimal' solutions;

(c) discuss the meaning of 'optimal' solutions and how linear programming methods can be employed for profit maximising, revenue maximising and satisfying objectives;

(d) analyse the impact of uncertainty and risk on decision models based on CVP analysis.

- Simple product mix analysis in situations where there are limitations on product/service demand and one other production constraint.
- Multi-product break-even analysis, including break-even and profit/volume charts, contribution/sales ratio, margin of safety etc.
- Linear programming for more complex situations involving multiple constraints. Solution by graphical methods of two variable problems, together with understanding of the mechanics of simplex solution, shadow prices etc. (Note: questions requiring the full application of the simplex algorithm will not be set although candidates should be able to formulate an initial tableau, interpret a final simplex tableau and apply the information it contained in a final tableau).
- Sensitivity analysis of CVP-based decision models.

3. Discuss pricing strategies and their consequences.

a) apply an approach to pricing based on profit maximisation in imperfect markets;



(b) discuss the financial consequences of alternative pricing strategies;

(c) explain why joint costs must be allocated to final products for financial reporting purposes, but why this is unhelpful when decisions concerning process and product viability have to be taken.

- Pricing decisions for profit maximising in imperfect markets. (Note: tabular methods of solution are acceptable).
- Pricing strategies and the financial consequences of market skimming, premium pricing, penetration pricing, loss leaders, product bundling/optional extras and product differentiation to appeal to different market segments.
- The allocation of joint costs and decisions concerning process and product viability based on relevant costs and revenues.

B. COST PLANNING AND ANALYSIS FOR COMPETITIVE ADVANTAGE (30%)

1. Evaluate techniques for analyzing and managing costs for competitive advantage

(a) compare and contrast value analysis and functional cost analysis;

(b) evaluate the impacts of just-in-time production, the theory of constraints and total quality management on efficiency, inventory and cost;

(c) explain the concepts of continuous improvement and Kaizen costing that are central to total quality management;

(d) prepare cost of quality reports;

(e) apply learning curves to estimate time and cost for new products and services;

(f) apply the techniques of activity-based management in identifying cost drivers/activities;

(g) explain how process re-engineering can be used to eliminate non-value adding activities and reduce activity costs;

(h) explain how target costs can be derived from target prices and the relationship between target costs and standard costs;

(i) discuss the concept of life cycle costing and how life cycle costs interact with marketing strategies at each stage of the life cycle.

(j) discuss the concept of the value chain and the management of contribution/profit generated throughout the chain;

(k) discuss gain sharing arrangements whereby contractors and customers benefit if contract targets for cost, delivery etc. are beaten;

(l) analyse direct customer profitability and extend this analysis to distribution channel profitability through the application of activity-based costing ideas;

(m) apply Pareto analysis as a convenient technique for identifying key elements of data and in presenting the results of other analyses, such as activity-based profitability calculations.

- Value analysis and quality function deployment.



- The benefits of just-in-time production, total quality management and theory of constraints and the implications of these methods for decision-making in the 'new manufacturing environment'.
- Kaizen costing, continuous improvement and cost of quality reporting.
- Learning curves and their use in predicting product/service costs, including derivation of the learning rate and the learning index.
- Activity-based management in the analysis of overhead and its use in improving the efficiency of repetitive overhead activities.
- Target costing.
- Life cycle costing and implications for marketing strategies.
- The value chain and supply chain management, including the trend to outsource manufacturing operations to transition and developing economies.
- Gain sharing arrangements in situations where, because of the size of the project, a limited number of contractors or security issues (e.g. in defence work), normal competitive pressures do not apply.
- The use of direct and activity-based cost methods in tracing costs to 'cost objects', such as customers or distribution channels, and the comparison of such costs with appropriate revenues to establish 'tiered' contribution levels, as in the activity-based cost hierarchy.
- Pareto analysis.

C. BUDGETING AND MANAGEMENT CONTROL (20%)

1. Explain the principles that underlie the use of budgets in control.

(a) explain the concepts of feedback and feed-forward control and their application in the use of budgets for planning and control;

(b) explain the concept of responsibility accounting and its importance in the construction of functional budgets that support the overall master budget;

(c) identify controllable and uncontrollable costs in the context of responsibility accounting and why uncontrollable costs may or may not be allocated to responsibility centres.

- Control system concepts.
- The use of budgets in planning: 'rolling budgets' for adaptive planning.
- Responsibility accounting and the use of budgets for control: controllable costs and; treatment of uncontrollable costs; the conceptual link between standard costing and budget flexing.

2. Evaluate performance using budgets, recognising alternative approaches and sensitivity to variable factors.

(a) evaluate projected performance using ratio analysis;

(b) evaluate the consequences of "what if" scenarios and their impact on the master budget;

(c) evaluate performance using fixed and flexible budget reports.

- Assessing the financial consequences of projected performance through key metrics including profitability, liquidity and asset turnover ratios.
- What-if analysis based on alternate projections of volumes, prices and cost structures and the use of spreadsheets in facilitating these analyses.
- The evaluation of out-turn performance using variances based on 'fixed' and 'flexed' budgets.



3. Discuss the broader managerial issues arising from the use of budgets in control.

- a) discuss the impact of budgetary control systems and setting of standard costs on human behaviour;
- (b) discuss the role of non-financial performance indicators;
- (c) compare and contrast traditional approaches to budgeting with recommendations based on the 'balanced scorecard';
- (d) discuss the criticisms of budgeting, particularly from the advocates of 'beyond budgeting' techniques.
- Behavioural issues in budgeting: participation in budgeting and its possible beneficial consequences for ownership and motivation; participation in budgeting and its possible adverse consequences for 'budget padding' and manipulation; setting budget targets for motivation; implications of setting standard costs etc.
 - Non-financial performance indicators.
 - Criticisms of budgeting and the recommendations of the advocates of the balanced scorecard and 'beyond budgeting'.

D. CONTROL AND PERFORMANCE MEASUREMENT OF RESPONSIBILITY CENTRES (20%)

1. Discuss the use of responsibility centres in devising organization structure and in management control.

- (a) discuss the use of cost, revenue, profit and investment centres in devising organisation structure and in management control.
- Organisation structure and its implications for responsibility accounting.

2. Discuss information suitable for management decision-making in responsibility centres.

- (a) discuss cost information in appropriate formats for cost centre managers, taking due account of controllable/uncontrollable costs and the importance of budget flexing;
- (b) discuss revenue and cost information in appropriate formats for profit and investment centre managers, taking due account of cost variability, attributable costs, controllable costs and identification of appropriate measures of profit centre 'contribution';
- (c) discuss alternative measures of performance for responsibility centres.
- Presentation of financial information representing performance and recognising issues of controllable/uncontrollable costs, variable/fixed costs and tracing revenues and costs to particular cost objects.
 - Return on investment and its deficiencies; the emergence of residual income and economic value added to address these.

3. Discuss the broader managerial issues arising from the division of the organisation into responsibility centres.

- (a) discuss the likely behavioural consequences of the use of performance metrics in managing cost, profit and investment centres;



(b) discuss the typical consequences of a divisional structure for performance measurement as divisions compete or trade with each other;

(c) discuss the likely consequences of different approaches to transfer pricing for divisional decision making, divisional and group profitability, the motivation of divisional management and the autonomy of individual divisions;

(d) discuss in principle the potential tax and currency management consequences of internal transfer pricing policy.

- The behavioural consequences of performance management and control.
- The theory of transfer pricing, including perfect, imperfect and no market for the intermediate good.
- Use of negotiated, market, cost-plus and variable cost based transfer prices. 'Dual' transfer prices and lump sum payments as means of addressing some of the issues that arise.
- The interaction of transfer pricing and tax liabilities in international operations and implications for currency management and possible distortion of internal company operations in order to comply with Tax Authority directives.