

Examiner's report

P5 Advanced Performance Management

June 2013



Introduction

Firstly, we would like to offer our congratulations to all of those candidates who achieved a pass at this diet and our commiserations to those who did not.

In this report, our aim is to indicate areas of good and poor performance with the specific additional purpose of helping future candidates assess what is required of them. We have added comments about potential improvements to examination approach that could be made after the commentary on each specific question.

We will begin with general comments about the approach and then provide a commentary on the specific questions in the examination paper.

General Comments

Firstly, the examining team are concerned by a general downward trend in the quality of answers that has been observed over the last 4 diets of P5. The advice in past examiner's reports and approach articles does not seem to have been taken up by many candidates. We would strongly advise that candidates use these materials to ensure that they have the right overall attitude to P5, which is intended to lie at a post-graduate level.

As a result, we would offer similar broad comments to past reports. Most examinations require a balance of memory work and evaluation/analysis. As one goes through the levels (say from F2 to F5 to P5) this balance changes, from pure memory to more analysis. Good candidates distinguish themselves by being aware that if they come to this examination expecting to repeat memorised material, they will probably score only between 20% and 30%.

The basis of this examination is analysis and application which then leads to evaluation. The candidate will need a foundation in the techniques of the syllabus but should focus more on evaluation of these techniques and consideration of their usefulness *to the given scenario*. This is not difficult to revise as it is a mindset that can easily be encouraged by attempting past papers as an integral part of the revision process. Candidates need to be aware that performance management is an area which, at an advanced level, is dependent upon situation and environment. A good, professional-level answer will go beyond the mere repetition of how a technique works and focus on relating it to the entity's specific environment. As in previous diets, it was very clear to the marking team that those candidates that had grasped the need for this went on to pass the paper. Those that did not wasted time by writing lengthy, non-specific descriptions of methods scoring insufficient marks to pass that question (examples of this fault from this diet were in question 2a on activity-based costing and question 4a on transfer pricing).

The examination paper comprised two sections, A and B. Section A consisted of one compulsory question for 50 marks in total. Section B consisted of three optional questions for 25 marks each from which candidates were required to answer two questions. Thus, there was a new format to the examination with a single 50-mark question in section A at this diet. This was discussed in the examiner's article on approach to P5 and illustrated by a pilot paper released on the ACCA website. There seems to be some evidence to support the view that some candidates were surprised by the change in format and so, were not preparing thoroughly for the examination. Future candidates should make full use of the free content provided by ACCA, especially in a paper (such as P5) whose syllabus contains an indicator for the need to remain up to date with current issues and therefore, the need to check the content of articles, such as those on the ACCA website.

The vast majority of candidates attempted their allocation of three questions, and there was little evidence of time pressure though some of poor time management. This was evident where about two-thirds of a candidate's script was taken up with the answer to question 1, which was worth only 50% of the marks. Future candidates



should use the mark allocation as a guide to how much to write on particular topic and practice past paper questions under timed conditions in order to become familiar with this discipline.

It was notable that most candidates avoided those questions in section B that involved detailed working with quantitative techniques picked up at earlier papers (e.g. question 2 on activity-based costing and question 4 on transfer pricing). Most candidates selected question 3 as one of their section B questions. One plausible reason for this is that many candidates were familiar with the model in question 3 from having recently sat the P3 examination. However, the avoidance of questions 2 and 4 and the generally poor performance from those that attempted these questions combined with the history of poor performance in quantification of answers in previous diets continues to concern the examining team. P5 is a paper about making and supporting **quantitative** decision-making at a strategic level within an organisation.

This problem may be exacerbated by the continuing desire of candidates to revise topics selectively rather than studying the whole of the syllabus. As in previous diets, we can offer no comfort to those candidates. It should be further noted that the syllabus for P5 includes the knowledge that should be brought forward from previous levels. Those candidates who have exemptions from the supporting papers must ensure that they have revised the relevant areas from their previous studies – we consider this as a possible reason for the many inaccurate efforts to perform the relatively simple cost and profit calculations in questions 2 and 4.

We are happy to report that, after beating the drum of ‘read the requirement’ for many diets, candidates at this diet performed better. For example, in question 1 (ii), there were many fewer examples of evaluating the performance of the company and many more of evaluating the performance report of the company, which was what was required by the question. However, there are still a minority who persist in such errors despite our best efforts in past examiner’s reports and articles to illustrate these faults. (See examiner’s article – ‘Reading the question requirements at paper P5’)

Specific Comments

Question One

This 50-mark question was based on a hotel chain, Kolmog. The question began by testing candidates’ ability to explain the characteristics of a service (hotel) business compared to a manufacturing one then requested an evaluation of the current performance reporting at Kolmog. This should have given candidates time to absorb the idea of the industry sector and company specific information that the question provided. The question then requested an evaluation of a proposed balanced scorecard at Kolmog along with a description of the difficulties in implementing and using this performance management system. Finally, the candidates were asked to explain the purpose of setting challenging targets and to evaluate aspects of the hotel managers’ performance reward system using the building block model.

In part (i) for 5 marks, most candidates scored reasonably well in explaining the characteristics of a service business. The better candidates used examples that directly related to Kolmog or at least to a hotel business. Weaker candidates listed rote-learned jargon terms such as simultaneity, heterogeneity, intangibility and perishability with a simple general definition. Such answers scored poorly as they did not address Kolmog specifically or even compare service to manufacturing businesses.

Part (ii) of the question, worth 8 marks, required an evaluation of current performance reporting at Kolmog. Generally, this part was done reasonably well but most candidates still fail to apply a logical approach to such a question by firstly, considering what such reports aim to achieve and so relate the report to the achievement of the mission of the company being examined. There also were too many answers that ended up by listing many areas of information that *could* be added to the report with little thought to the danger of over-loading the board (as the current report did in a different way). Future candidates may be able to avoid such a problem by

reminding themselves of whom the report addresses (the board) and what their information needs are (strategic level).

Part (iii) for 12 marks requested an evaluation of a proposed balanced scorecard (BSC) with suggestions for improvement. The proposed BSC represented a simplified version of what candidates will see in the real world – a tailored BSC where the standard four perspectives were indirectly being covered. It was pleasing to see most candidates handle this aspect of the question well. However, as in part (ii), candidates would have scored more efficiently had they attended to the mission of the company and how the scorecard would aid its achievement.

In part (iv) for 7 marks, candidates often drifted away from the question requirement for the *difficulties* (not improvements required) in implementing and using the BSC at Kolmog. The examining team were surprised at the poor answers to this question part as they considered that it would be a common practice in revision of a method in P5 to consider its advantages, disadvantages and the likely difficulties encountered in using it. Those candidates that illustrated each of their difficulties with an example for Kolmog scored well.

Part (v) considered issues around the reward system at Kolmog. It was worth 14 marks for an explanation of the purpose of setting challenging targets and then an evaluation of standards and rewards at the company. Most candidates demonstrated good understanding of the use of ‘stretch’ targets and the reward system implications at Kolmog. However, there was weaker understanding of the ‘standards’ element from Fitzgerald and Moon’s building block model. It was pleasing to see that most candidates knew at least some of the key criteria for judging standards and rewards (ownership, achievability, fairness/equity; clarity, motivation, controllability) but the illustration of these points with relevant comments for Kolmog was weaker.

As has become common, those candidates who had practised writing professional answers prior to the examination performed admirably in the presentation area (4 marks). The markers were looking for suitable report headings, an introduction, a logical structure, signposted by the good use of subheadings in the answer, and a clear, concise style. Candidates should note that quantity is no substitute for quality in their answers. Long rambling answers often hide valuable advice in the fog of waffle.

Future candidates would be advised to use the mission and aims of the company in question in assessing their current and future plans for performance reporting and management.

Section B

Question Two

This 25-mark question covered the impact of different choices of overhead allocation systems (absorption and ABC) on costs of two product types and performance management at Navier Aerials, a satellite dish manufacturer and installer.

This question was generally poorly done with weak efforts at handling the quantification of the two costing systems compounded by lack of knowledge about quality issues and as a result, little evidence to be able to evaluate and advise Navier.

Part (a) for 13 marks asked for an evaluation of two methods of allocating overheads (absorption and ABC) at Navier. This required the candidate to use the partially completed calculations in the question to work out cost per dish for each product type and then to consider the implications of the results. Many candidates seemed perplexed that the calculations were not more difficult and yet commonly failed to do them accurately. As has been stated in previous examiner’s reports, at the P5 level, candidates will often be presented with much data already prepared (by a junior accountant) and then be required to complete or assess/interpret the work done. Candidates seemed ill prepared for this task both in general and specifically on the costing methods in the scenario although this type of task has been tested before (Question 2 in December 2010).

Candidates should note that the scenario presented the kind of situation that they will often come across in real life where the finance director had (roughly) estimated the impact of different product types. They were required to do the work more accurately and then comment on the results. One question posed here was: is the effort in generating more accurate overhead allocation worth the effort?

Future candidates should be wary of simply *assuming* that the newer, more complex method is the best solution in practice.

Part (b) for 12 marks then moved from the performance measurement aspect of the scenario into the performance management implications. This requirement requested how the information on each activity in the department under scrutiny can be used and improved upon in assisting cost reduction and quality management. It required a consideration of the information each of the activities listed in the question and how these impact on the two areas of cost reduction and quality management.

There were some excellent answers which took a process-focussed approach to cost reduction using, for example, management information systems. However, most candidates displayed a weak grasp of quality cost issues and also, a failure to prioritise their work towards the major cost areas of 'handling enquiries and preparing quotes' and 'complaints handling'.

Future candidates would be advised to revise approaches from earlier levels assumed at P5 and practice questions on the evaluation of their use compared to each other.

Question Three

This 25-mark question was based on Stokeness Engineering, which was in the development phase prior to manufacturing hydrogen fuel cell power units for sale to bus and truck manufacturers. Candidates were asked to use Porter's five forces model on Stokeness to assess the impact of the external business environment on the performance management and give a justified recommendation of one new performance measure for each of the five force areas. They were then asked to consider a detailed performance measurement issue in defining the market in measuring a market share which Stokeness already uses as a performance measure and finally, to assess and discuss the risk appetite of the main shareholders at Stokeness.

The question was, by far, the most popular question in section B. It was, generally, reasonably done due to good performance in part (a) though marks were often dragged down by very few being scored for parts (b) and (c).

Part (a) for 16 marks was generally well done with good use made of the information in the scenario to give useful performance management advice to Stokeness. However, many candidates chose to only partially read the second part of the requirement which asked for 'a *justified* recommendation of *one new* performance measure for each of the five force areas'. Instead, they produced only a list of performance measures for each area, often including market share – failing, in three ways, to answer the question.

Part (b) for 4 marks tested a common area of uncertainty in an important, strategic performance measure. This part was poorly done and often, the only point raised was that the market was new and involved new technology so defining it would be difficult. Again, many candidates chose instead to answer the question 'how do you measure market share?' and so missed the point. There were a few excellent efforts which realised that the definition of market (and so its size) depended on whether you were talking about hydrogen fuel cells, alternative energy power technologies more generally or any sort of power unit including existing petrol/diesel engines.

Part (c) for 5 marks looked at risk appetites and their effect on performance measurement. Most candidates were able to justify a view on the risk appetite of the VCs although many wasted time with a rote-learned list of all the possibilities which in a 5-mark question was wasting time. However, few candidates could provide valuable



comment on the impact on performance measurement and many chose to talk more generally about the impact on performance management at Stokeness when a focus on the choice of metrics was required.

Future candidates would be advised to read the requirement carefully and answer the question asked.

Question Four

This 25-mark question was based on transfer pricing issues at Landual Lamps, a lighting manufacturer. The question required an assessment of the current system and then the consideration of two changes: one to the transfer pricing policy and one to the divisional structure of the company.

This question was generally poorly done with weak (often no) efforts at handling the quantification issues – recalculating the current transfer price, calculating the impact of the two proposed changes on the various entities in the scenario. Again, this meant that candidates often had very little to say in evaluating or giving advice in the commentary parts of their answers. Also, candidates did not focus their answers on the stated area of competitive advantage for Landual in making the housing components. This ought to have been a priority.

Part (a) for 10 marks required an evaluation of the current system of transfer pricing at Landual – the requirement emphasised the need for calculations. There were a number of faults in the existing system which needed to be pointed out with the impact that correcting these would have on the divisions in the company.

In part (b) 6 marks were available for advice for the finance director on the impact of changing the transfer pricing policy for housing components to using variable costs. A useful answer here would provide firstly, what this change would do to profit in the two divisions and for the company as a whole and then, from this, consider the likely reactions of the key stakeholders (the three sets of management). Unfortunately, if the (simple) quantification work was not done then very few candidates could see that this change lead to lower profits in the division that was the key competitive advantage of the company (the difficult process of design and manufacture of the housing components).

Finally, in part (c) an evaluation of the impact of the change in proposed divisional structure on the profits for the various entities was required for 9 marks. The question provided an illustration of the impact of changing the emphasis of a division from profit centre to cost centre as well as increasing the number of divisions. Again as in part (b), the calculations were straightforward but where they were done at all, they were often done poorly. A common basic mistake was imputing a revenue stream to the new housing division when it was stated that it was to become a cost centre. As a result, much ink was spilled discussing the impact that the reduction in profit for the housing area would have on the morale of its management, rather than focussing on the change to a cost control emphasis that this change would affect.

Future candidates would be advised to consider, during their revision, the impacts that strategic changes such as designation of cost, profit and investment centres would have on the performance management of divisions or departments within a company.