

Examiner's report

Performance Management (PM)

December 2018



The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for future candidates.

General comments

The Performance Management (PM) exam is offered in both computer-based (CBE) and paper formats. The structure is the same in both formats but our model of delivery for the CBE exam means that candidates do not all receive the same set of questions. In this report, the examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for future candidates.

- Section A objective test questions – we focus on two specific questions that caused difficulty in this sitting of the exam
- Section B objective test case questions – here we look at the key challenge areas for this section in the exam
- Section C constructed response questions - here we provide commentary around some of the main themes that have affected candidates' performance in this section of the exam, identifying common knowledge gaps and offering guidance on where exam technique could be improved, including in the use of the CBE functionality in answering these questions.

Section A

Here we take a look at **TWO** Section A questions which proved to be particularly difficult for candidates.

Example 1

Binny Co has annual sales of \$960,000 and a current ratio of 3.2:1. All of its sales are for cash and are priced at a mark-up on cost of 50%. The average cash balance is \$40,000 and the inventory turnover period is 90 days.

Assuming 360 days in a year, what is Binny Co's quick ratio (acid test ratio)?

- A 0.64
- B 0.53
- C 0.80
- D 1.56

What does this test?

- ✓ The calculation of financial performance indicators (FPI) for liquidity.

What is the correct answer?

- ✓ The correct answer is **A**
- The quick ratio = (current assets – inventory)/current liabilities. To be able to calculate this ratio, the value of inventory, current assets and current liabilities need to be established.
- To determine the value of inventory, the cost of sales value and the inventory turnover period need to be used. First the cost of sales has to be calculated based on the mark-up on cost of 50%. The cost of sales will be $100/150 \times \$960,000 = \$640,000$. On that basis, the inventory value can be calculated using the inventory turnover period as $90 \text{ days}/360 \text{ days} \times \$640,000 = \$160,000$.
- The current ratio = current assets/current liabilities. In Binny Co, the current ratio is 3.2:1 and the only current assets are inventory and cash balances as all sales are on cash basis.
- From the above information, the current liabilities can be calculated.
 - Current assets = $\$160,000$ (inventory) + $\$40,000$ (cash balance) = $\$200,000$
 - Rearranging the formula for current ratio, the current liabilities = $\$200,000/3.2 = \$62,500$
- Now we have the inventory value, current assets and current liabilities, the quick ratio can be calculated = $(\$200,000 - \$160,000)/\$62,500 = 0.64$. Alternatively the quick ratio could have been calculated by taking the cash balance only of $\$40,000$ and dividing by the current liabilities.
- Choosing option **B**, 0.53, would have been arrived at if the inventory value had been calculated based on the sales value of $\$960,000$. Inventory would be $90 \text{ days}/360 \text{ days} \times \$960,000 = \$240,000$. This value would then have been used in the current ratio formula as the current assets value (forgetting to add the cash balance) to arrive at the current liabilities figure $\$240,000/3.2 = \$75,000$. The cash balance would then be used with the current liabilities figure to calculate the quick ratio $\$40,000/\$75,000 = 0.53$.
- Choosing option **C**, 0.80 would be arrived at if the cost of sales is worked out based on a margin rather than a mark-up. Cost of sales = $50/100 \times \$960,000 = \$480,000$ and inventory = $90 \text{ days}/360 \text{ days} \times \$480,000 = \$120,000$. Current liabilities will be $(\$120,000 + \$40,000)/3.2 = \$50,000$ and the quick ratio will be $\$40,000/\$50,000 = 0.80$.
- Choosing option **D**, 1.56 would be arrived at if all the value of inventory, current assets and current liabilities were all calculated correctly and the inverse of the correct formula was used i.e. $\text{current liabilities}/(\text{current assets} - \text{inventory}) = \$62,500/\$40,000 = 1.56$.

Example 2

The following costs relate to management accounting information for Kite Co for April 20X8:

Cost	\$
Employee time spent filling in purchase requisitions	600
Use of barcodes and scanners to record inventory	200
Storage of sales information no longer needed	400
Time taken by staff to input data into production system	900

What were the total direct data capture costs for Kite Co for April 20X8?

- A \$200
- B \$800
- C \$1,700
- D \$2,100

What does this test?

- ✓ The identification of direct data capture costs of management accounting information.

What is the correct answer?

- ✓ The correct answer is **A**
- In this question, candidates must be able to identify the different types of costs associated with management accounting information and how it is collected.
- Only the cost of the use of bar coding and scanners is a direct data capture cost therefore = \$200.

Section B

Section B tests candidates' knowledge on a number of topics in more detail than section A, with three case questions containing five two-mark objective test questions. The range of topics covered in the December 2018 examination was:

- Cost volume profit analysis
- Activity based costing
- Life-cycle costing
- Variances
- Decision making under risk and uncertainty

A few key points that came out of section B were:

- Read the case scenario and requirements very carefully. This goes for the whole exam, but any objective test question is 'all or nothing' – if you misread the requirement or miss a vital piece of information from the scenario and get the answer incorrect you score zero for that question. Close reading is also important for identifying the instructions in the question on how to round your answers.
- Cover the whole syllabus. The list above should highlight this – PM has a large syllabus which can seem daunting, but it is essential to have a broad knowledge. If, for example, a section B OT case covering variances comes up and you haven't covered this in your studies, the 10 marks available are left to chance.
- Be able to apply your knowledge of theories/techniques to the scenario given, as in the case questions these areas will often be examined in the context of the case. It is important that you are able to apply the logic of a concept or theory to a problem and so you need to understand the method and why you are doing the calculations and not just focus on how to do the calculations.

Section C

Candidates were presented with questions drawn mainly from the areas of:

- Pricing
- Transfer pricing
- Performance measurement in a private sector context, a public sector context and a divisional structure context
- Rolling budgets
- Flexed budgets
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These will be discussed in turn. Although the specifics of individual questions will not be discussed, common areas candidates either performed well on or struggled with will be highlighted. Advice will be provided to improve exam performance.

Pricing

Pricing questions often test the candidates' understanding of pricing within the context of profit maximisation, from section B of the syllabus. They may involve determining the profit-maximising price, as in the published question from September/December 2017, TR Co, although candidates should be mindful that both the algebraic approach and the tabular approach are examinable.

When candidates are asked to set out their answer in a particular format as was the case in December 2018, it is really important that they do so. Many easy marks could be lost on a question because certain required columns of numbers are missing. Also, candidates do not seem to understand how to calculate marginal cost or marginal revenue, which is fundamental knowledge for anyone training to become an accountant. For example, to calculate the marginal revenue of selling five units at \$55 each instead of four units at \$60 each, one must take $(5 \times \$55)$ less $(4 \times \$60)$, which would be \$35. Marginal revenue for this would **not** be \$55 less \$60 i.e. \$(5), this is just the difference in price. Errors of this nature are common.

Similar to TR Co, many questions on pricing will require some discussion of different pricing strategies. Whilst it is apparent that most candidates have a basic grasp of key strategies, like market skimming or penetration pricing, they appear to be unfamiliar with other strategies. Also, even when discussing key strategies, candidates often fail to apply them to the context in the question when discussing whether or not they are suitable.

Transfer pricing

Transfer pricing is not a very popular topic with candidates. A recent question on this area was the Portable Garage Company (PG Co) which was published in March/June 2018. As is often the case in these questions, PG Co included some simple marks for preparing profit statements for each of the divisions and the company. The best approach here is always to put the narrative on the left-hand side of the page and then have one column for each of the divisions and another for the company itself. External and internal sales revenue should be split out and any internal

purchase costs should also be split out. The internal sales revenue/purchase costs do not need to be shown in the company column as these occur as a result of the two divisions transferring goods between them and do not impact the overall consolidated company results. PG Co also asked candidates to calculate a minimum transfer price; this is often a requirement in a question of this nature. When a division has spare capacity, the opportunity cost of that spare capacity is zero; therefore the minimum transfer price will always simply be the marginal cost per unit. In addition, candidates should be able to explain the impact of a transfer pricing policy on the behaviour and decision-making of divisional management and be able to assess whether decisions about the transfer of goods or services are goal congruent and beneficial for the company as a whole.

However, regardless of how many times transfer pricing is examined; it is still an area where understanding seems to be generally lacking.

Performance measurement

This area of the syllabus, section D, requires candidates to be able to analyse a business's performance from a variety of perspectives (including financial and non-financial factors) and explain the performance over a given timeframe or against budget or in comparison to a competitor. Often candidates have to give careful consideration to what the organisation has set out to achieve, as detailed in the scenario. Performance measurement questions can be examined in a variety of settings. For example, questions might centre on a large manufacturing company, a smaller service sector company or a public sector organisation. An example of a traditional performance measurement question is Jungle Co, from the September 2016 exam. However, questions may sometimes focus more on working capital management and liquidity. In December 2018, the more traditional performance measurement question was generally well-answered, with many candidates scoring all of the calculation marks and coming up with sensible reasons for the numbers they had calculated. The biggest omission, however, was not looking in any depth at the two key performance indicators given in the scenario, which would have given candidates a lot more to expand on.

Questions set within a public sector context are not always so well-answered. There are often some straight-forward marks for definitions, which candidates score well on and candidates also generally manage to earn many of the calculation marks. However, as far as the discussion goes, there is very little consideration of cause and effect, which leads to some poor marks. It is never enough to say that one department, for example, is better than another without examining why this might be the case.

Finally, questions set within a divisional context often produce some pleasing answers. An example of one such question is Sports Co published in September/December 2017. In questions of this nature, calculations often involve calculating 'controllable profits' and 'controllable assets' figures. Common errors in this diet included deducting depreciation on the Head Office assets from the **Head Office assets** figure rather than adding it back to the division's profit figure; or deducting depreciation on the **division's** net assets from the division's profit figure a second time rather than adding back depreciation on the Head Office assets. This demonstrates a lack of understanding, which is also apparent from any accompanying discussion as to why such adjustments are necessary.

Rolling budgets

Rolling budgets sit within section C of the syllabus and are represented by, for example, Static Co from the published December 2016's exam.

In Static Co, part (a) asked candidates to prepare the company's rolling budget for the next four quarters. The question made it clear that the assumptions of the original budget were accurate but incorrect prices had been used in the first place. This meant that, before the rolling budget could be prepared, the actual gross profit margin (GPM) from the quarter that had just ended needed to be calculated (38%). This percentage then needed to be applied when calculating the cost of sales and gross profit figures for the rolling budget. Many candidates simply calculated the GPM from the original budget (40%) and ignored the actual quarter 1 figures. This meant that their cost of sales and gross profit figures were therefore incorrect in their rolling budget. Similar mistakes were made in December 2018's rolling budget question.

A common error in these questions is to start the rolling budget with the actual quarter 1 figures which are given in the question and then only produce three further quarters. This shows a lack of understanding of how rolling budgets work and it was disappointing to see this same mistake being made again in December 2018.

Static Co asked for a discussion of the problems which had occurred at the company as a result of the previous budgeting process and improvements which might now be seen as a result of using realistic rolling budgets. It also asked candidates to discuss problems which might be encountered when implementing a new budgeting system. It should be expected that some element of discussion along these lines will be required in questions covering this area and it is important not to simply copy out parts of the scenario without adding any value to them. This was the case in December 2018 where the question asked for the benefits of introducing rolling budgets for the company in the scenario and also the implications of changing the budgeting approach. Many candidates do not fully explain their points, for example, simply saying a benefit of rolling budgets is that they are forward-looking is not saying why that is useful for the company in the question. It is this expansion that adds value to an answer.

Flexed budgets

Questions on this area from section C of the syllabus require some core knowledge from MA on how to prepare flexed budgets. The most important thing when preparing a flexed budget is that the original quantity used in the original budget is revised, in the flexed column, to the actual quantity. Without this revision, the flexed budget would be meaningless and yet the biggest problem when this area is examined is that the majority of candidates do not revise the quantity in this way. This makes it very difficult to earn any marks. Similarly, when budgeted figures are compared to actual figures, it is critical that the same time period is under consideration. If a budget is given for one year, for example, but actual figures only exist for three months, then when flexing the budget, it is essential that the original budget figures are multiplied by 3/12 to show the time apportionment, assuming that costs and revenues accrue evenly throughout the year. In addition to both of these important revisions for timescale and actual quantities, a flexed budget should then revise any costs which were used in the original budget which were outdated.

It is apparent that this is an area in which candidates struggle and need to develop their skills in order to reach the standard required by the ACCA professional qualification.

Exam technique

As always, exam technique is an important aspect of success in any exam. Throughout this report the importance of reading and interpreting requirements very carefully has been reiterated many times; failure to do this is often the cause of poor scores. The tendency for some candidates is to answer the question that they want to get rather than answering the question which they have been given.

Candidates should ensure that they have read all the requirements and noted the mark allocation for each requirement; this is especially important in CBE as the requirements might be split over several screens. Each requirement should be properly broken down so that it can be established what is being asked. A recommended approach to this would be that at the start of an answer, candidates should do a small plan in which they have broken down a requirement and asked themselves how many things they are being asked to do, making sure that they consider all aspects of the requirement.

It is easier to be more focussed when answering a question using word processing skills and spreadsheets, as the mere fact that what has been written or calculated can be seen more clearly, which helps candidates to avoid the temptation to discuss things which are irrelevant. Also, if candidates realise that they have missed a point out from an earlier part of a question, it is easier to go back and insert it in the correct place. This would have been particularly useful in the performance measurement question that required candidates to answer the question using the headings taken from the scenario.

Finally, please remember to use the spreadsheet functionality available. Totals should be calculated by inserting formulae rather than typing in the number. This was still an issue in the December 2018 exam, even though CBE exams are well-established.

Guidance and Learning Support resources to help you succeed in your exam

Preparing for the PM exam may appear daunting but there are many support resources available to help candidates. There are technical articles available on the topics discussed in this report and all the past exams referred to (and many more) are available on ACCA's website. Candidates should refer to these regularly when studying for their exams. These resources are provided to help candidates develop confidence in their knowledge and understanding of PM.

<http://www.accaglobal.com/uk/en/student/exam-support-resources/fundamentals-exams-study-resources/f5.html>