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ACCA – Paper P5 Advanced Performance Management June 2015 Final Assessment

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- 1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

<ul style="list-style-type: none">• Time management	<ul style="list-style-type: none">• Handwriting	<ul style="list-style-type: none">• Presentation and layout	<ul style="list-style-type: none">• Use of English
<ul style="list-style-type: none">• Points clearly and concisely made	<ul style="list-style-type: none">• Relevance of answers to question	<ul style="list-style-type: none">• Coverage and depth of answer	<ul style="list-style-type: none">• Accuracy of calculations
<ul style="list-style-type: none">• Calculations cross-referenced to workings	<ul style="list-style-type: none">• All parts of the requirement attempted	<ul style="list-style-type: none">• Length of answers equates to marks available	<ul style="list-style-type: none">• Read the question carefully

- 2 For each question, please provide suitable constructive comments

Question Number	General Comments	Exam Technique Comments

ACCA FINAL ASSESSMENT

Advanced Performance Management

June 2015

Time allowed

Reading and planning: **15 minutes**

Writing: **3 hours**

This paper is divided into two sections

Section A This ONE question is compulsory and MUST be attempted

Section B TWO questions ONLY to be attempted

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

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Paper P5

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SECTION A

THIS ONE QUESTION IS COMPULSORY AND MUST BE ATTEMPTED

- 1 The Harding Law Partnership (HLP) provides legal services to commercial clients in the country of Strifeland. The partnership commenced trading on 1 June 20X1. Each of the advisors employed by HLP is a specialist in the provision of legal services in respect of ONLY one of the following categories of work; property, commercial or litigation.

Appendices 1.1 and 1.2 below show statistics (both budget and actual) for the twelve month period ended 31 May 20X7 for HLP and also for a competitor, Merlin Advisory Services (MAS).

Additional information relating to HLP for the year ended 31 May 20X7 is as follows:

- (1) Fees charged per consultation (including subcontracted consultations):

<i>Type of work</i>	<i>Fee per consultation(\$)</i>
Property	75
Commercial	150
Litigation	250

- (2) HLP offered an 'Advisory Protection Scheme' under which member clients paid a fixed annual fee which entitled them to priority service and a number of consultations without further charge during the year.

The number of non-chargeable consultations and fees payable under the Advisory Protection Scheme were as follows:

<i>Type of work</i>	<i>Number of consultations without further charge</i>	<i>Annual fee (\$) per client</i>
Property	20	1,500
Commercial	40	6,000

Note: The scheme did not apply to litigation work and you may assume that no client for property and commercial affairs required more than the number of consultations allowed without further charge to which each client is entitled under the 'Advisory Protection Scheme'.

- (3) Each advisor was paid a salary of \$50,000 per annum.
- (4) HLP used the services of subcontractors when its own staff were unable to undertake commercial or litigation work due to a lack of expertise. Payments to subcontractors were as follows:

<i>Type of work</i>	<i>Payment (\$) per consultation</i>
Commercial	450
Litigation	500

- (5) Actual other operating expenses (excluding salaries of advisors and subcontract costs as per notes (3) and (4) above) amounted to \$2,850,000, including an amount of \$250,000 paid in respect of professional indemnity insurance premiums.

Budgeted other operating expenses (excluding salaries of advisors and subcontract costs as per notes (3) and (4) above) were \$3,250,000, including an amount of \$250,000 in respect of professional indemnity insurance premiums.

Information for competitor MAS for the year ended 31 May 20X7 is as follows:

- (1) Fees charged per consultation (including subcontracted consultations):

<i>Type of work</i>	<i>Fee per consultation (\$)</i>
Property	60
Commercial	150
Litigation	200

- (2) Cost information:

	\$000
Salaries	1,560
Professional indemnity insurance costs	100
Other operating costs	2,032

- (3) MAS operated a similar 'Advisory Protection Scheme' to that of HLP. The annual fees charged were \$1,200 and \$5,000 in respect of property and commercial work agreements respectively.
- (4) MAS also used the services of subcontract advisors for specialist work at a cost of \$350 per consultation.

Required:

Write a report to the partners of the Harding Law Partnership that addresses the following issues:

- (a) Using the information contained in Appendix 1.1, prepare budgeted and actual income statements for HLP and also an income statement on an actual basis for MAS for the year ended 31 May 20X7. (13 marks)
- (b) Using the information contained in Appendix 1.1, discuss the financial performance of HLP and MAS, incorporating details of the following in your discussion:
- (i) Overall client fees (total and per consultation).
 - (ii) Advisory protection scheme consultation 'utilisation levels' for both property and commercial clients.
 - (iii) Cost/expense levels. (10 marks)
- (c) Using the information contained in Appendix 1.2, compare the performance of HLP and MAS incorporating relevant percentage and ratio statistics under the following headings:
- (i) competitiveness (5 marks)
 - (ii) service quality, and (7 marks)
 - (iii) flexibility. (3 marks)
- (d) The managing partner of HLP stated at a recent partners' meeting that 'every advisor should aim to ensure that 95% of all hours he/she works are billed to clients. This will ensure that we remain both profitable and competitive'.

Discuss the statement of the managing partner, drawing attention to any concerns that you may have regarding the statement and making reference to consultant utilisation levels. (8 marks)

Question 1 includes professional marks for the format, style and structure of the discussion of your answer. (4 marks)

(Total 50 marks)

Appendix 1.1: Statistics for the year ended 31 May 20X7

	<i>HLP</i>		<i>MAS</i>
	<i>Budget</i>	<i>Actual</i>	<i>Actual</i>
Number of advisors employed throughout the year:			
Property	12	12	10
Commercial	10	10	10
Litigation	4	6	6
Number of chargeable consultations (by work category), undertaken by own advisors:			
Property	17,080	20,200	12,500
Commercial	12,000	13,200	10,200
Litigation	1,920	2,400	2,125
Number of chargeable consultations undertaken by subcontractors:			
Commercial	–	320	20
Litigation	–	600	20
‘Advisory Protection Scheme’ consultation uptake (property)	9,000	9,900	9,000
‘Advisory Protection Scheme’ consultation uptake (commercial)	4,000	7,200	6,000
Number of non-chargeable remedial consultations (all in respect of commercial work)	–	180	135
	<hr/>	<hr/>	<hr/>
Total consultations undertaken	44,000	54,000	40,000
	<hr/>	<hr/>	<hr/>
Number of Advisory Protection Scheme clients			
– Property	600	600	900
Number of Advisory Protection Scheme clients			
– Commercial	200	200	300

Appendix 1.2: Other statistics for the year ended 31 May 20X7

	<i>HLP</i>		<i>MAS</i>
	<i>Budget</i>	<i>Actual</i>	<i>Actual</i>
Number of enquiries received from potential new clients	22,000	25,000	28,000
Number of new client consultations	11,000	10,000	18,200
Number of on-time consultations	44,000	51,000	39,600
Number of times consultations were re-scheduled	–	1,620	200
Number of successful consultations (property and commercial)	44,000	45,900	38,000
Number of client complaints received	–	670	135
Number of successful claims for negligent advice	–	3	–

SECTION B

TWO QUESTIONS FROM THE THREE GIVEN MUST BE ATTEMPTED

2 Introduction

PK is jointly owned by two United Kingdom based conglomerates which manufacture mainly electrical products. In its own right, PK is regarded as a world leader in the installation and maintenance of railway transport signalling systems. The company is based in Europe, where most of its manufacturing units are located, but it has established other plants and marketing facilities in the USA, Latin America, Asia and Australia.

Activities of the company

The company specialises in the supply of railway signalling and control systems and employs over 15,000 staff worldwide. In addition to these systems PK also supplies advanced electronic equipment for safety signalling applications, which can be added to systems that have already been installed. Passenger information systems are also manufactured and supplied by the company, which uses advanced technology to provide full displays on railway platforms and stations.

Over the last decade PK has experienced increasing competition within its European and North American markets.

Recent international activities

In addition to carrying out major signalling work for the Channel Tunnel rail link between the United Kingdom and mainland Europe, PK has recently equipped a high-speed rail line in Asia with electronic equipment. Within Europe, the company succeeded in winning the tender to build, equip, operate and maintain a rail link between a major Scandinavian city and its airport.

Research and development

The Chief Executive of PK has stated that the market-oriented approach of the company requires that it should maintain and develop its position as leader in 'state of the art' technology. This is facilitated by a large established Research and Development unit, which aims to improve product reliability and develop advanced computer software solutions in its business activities, all at lower cost, without compromising quality.

The reduction of life cycle costs and environmental damage, whilst at the same time pursuing technical developments, have been stated by the Chief Executive as key objectives of the company.

Financial position of PK

The latest Report and Accounting Statements declared that the financial year just ended produced results which were 'disappointing'. The Chief Executive indicated that the company had experienced difficult trading conditions and encountered strengthening international competition. Whilst turnover increased, operating profit after tax and overall orders were lower than the previous year. At the year-end, the number of orders in the order book was 8% below the level achieved at the previous year-end.

A bridged comparative accounting information for last two financial years is as follows:

	20X1	20X0
	£000	£000
Value of orders	3,750	4,600
Turnover	4,400	3,900
Operating profit after taxation	310	320
Shareholders' equity	935	850

PK had achieved on average a 20% growth in turnover and a 10% increase in operating profit after taxation over the preceding five-year period until 20X1. The Chairman of one of the parent holding companies has expressed his concern regarding PK's results in 20X1. In response, the Chief Executive of PK has outlined his company's strategy of international acquisition and joint ventures as a means of returning to sustained growth and profitability.

Proposed acquisition

A number of acquisitions and joint venture arrangements outside Europe are planned. In particular, the acquisition of a small South African electronics component manufacturer (RA) is being actively pursued. If acquired, RA will provide the basis for PK to increase its range of products in what is considered to be an expanding market with high growth potential.

The acquisition would enable advantage to be taken of the opportunities for development in South Africa. In addition, RA would provide a base for further market penetration of other African countries. RA is unquoted and owned by a diverse group of shareholders, with family interests in the company controlling 40% of the voting shares.

PK considers that RA is under-capitalised. It is currently achieving a 2% return on turnover after interest and tax despite working at full capacity. RA employs 2,000 people, who possess mixed abilities and skills. Mostly, however, the employees are unskilled or at best very poorly trained. As much as 25% of RA's products are returned by customers because of faults, and this proportion has steadily increased over recent years.

The directors of PK are mindful that the South African currency (the Rand) is continuing to depreciate in value compared with the English currency (Pound Sterling). The Rand has continually fallen in value compared with the pound over a long period and currently stands at an exchange rate of 7.6 Rand to £1, whereas a year ago the exchange rate was 6 Rand to £1.

Required:

- (a) Explain the difficulties with which the parent companies may be confronted in assessing PK's performance. (7 marks)
- (b) Recommend and justify what financial and non-financial measures may be applied to assess the performance of PK. (8 marks)
- (c) Discuss the strategic objectives and market opportunities available to PK which will be created by its acquisition of RA. (10 marks)

(Total: 25 marks)

- 3** Welcome Events (WE) is a large team building and events company, serving companies throughout the UK. It organises a range of activities for clients of all sizes, from small owner-managed firms through to multinationals. It has four divisions; three activity divisions specialising in different aspects of the business: outdoor challenge, indoor creations and evening extravaganzas, and one, welcome catering, which provides on-site meals (from luxury cold buffets to sit down dinners) for all the others.

Welcome Catering (WC), is a recent addition to the company portfolio. Previously catering was bought in on an ad hoc basis from a range of preferred suppliers, but WE believe that the quality of food and service will be significantly better using their own caterers. WC also has a small separate sub-division which supplies catering services to outside firms. It was set up to honour contracts still running when WC was bought by WE and it is in the process of being wound down. However, it has come to the attention of head office that the manager of Outdoor Challenge (OC) has booked outside caterers for a number of events in the next quarter, at an agreed price of \$18 per meal.

WE appraises the managers of each division quarterly and the results have just been compiled for the last period (quarter 3). They are appraised on the basis of net profit earned and paid a bonus at the end of each period equal to 1½% of the amount earned over budget. In order to appraise the performance of WC and to ensure that the activity divisions do not treat the provision of in-house catering as cost free, WE has introduced a transfer pricing policy. For simplicity, the transfer price for each meal they provide is the same as the price WC has been charging to outside clients – the full actual cost of each meal plus a 20% mark-up.

The activity divisions charge clients for standard events on the basis of Person Event Days or PEDs; a PED is the cost of one person attending one event for one day and includes one meal on average. The recommended price is set based on standard full absorption cost plus the transfer price, which is worked out on the basis of pre-set budgets, with a mark-up of 25% then applied.

Financial data for Outdoor Challenge and WE are given below:

Welcome Catering

The standard cost of a meal has been budgeted at \$10 and it was anticipated they would provide 44,000 meals during the quarter. Fixed costs were budgeted at \$176,000 for the period. By the end of the quarter, WC had provided 45,000 meals at an average variable cost of \$14.20 per meal, with fixed costs of \$187,000 incurred.

Outdoor Challenge

The standard variable cost for a PED is \$50 and fixed costs were budgeted at \$210,000. The target sales level for the quarter was 14,000 PEDs. In fact OC sold 14,500 PEDs at an average price of \$104 each with average variable costs of \$48 per unit (owing in part to an unexpected purchase discount). Fixed costs came in on budget.

OC division have recently been asked to bid for a new events contract by a large national firm. The initial contract is a for a trial period – to provide 480 PEDs over the next three months. The contract is expected to lead to significant business in the future, provided the initial phase goes well, and the management of WE are keen for OC to secure the deal.

The client has indicated that a price in the region of \$65 per PED would have a good chance of winning. OC and WC would both have sufficient capacity in quarter 4 to accommodate the contract.

Required:

- (a) Calculate the net profit to be reported by OC and WC divisions based on the past three months' performance. (3 marks)
- (b) Calculate the bonus to be earned by the manager of each division. (5 marks)
- (c) Comment on your calculations in (a) and (b) and on OCs decision to book outside caterers. (6 marks)
- (d) At what price per PED should the parent (WE) be happy to secure the new contract, assuming that the variable cost of meals is likely to remain at \$14.2 for the foreseeable future? Will OC be prepared to bid at that price? (5 marks)
- (e) What alternative transfer pricing policies could WE adopt and why? (6 marks)

(Total: 25 marks)

- 4 Best-Trak is a railway company in the European country of Xandia and was formed 15 years ago when the former state monopoly, Xandia Rail, was broken up and privatised. The current system is that Best-Trak maintains the rail infrastructure including railway lines, signalling and stations and the Xandia Government invites tenders from a range of private rail operators to run the trains on a number of regional rail networks.

Regulation

Best-Trak is the only company currently given the role of maintaining the rail infrastructure and, historically at least, there has been no tendering of contracts or competition. To compensate for the lack of competition, the Xandia Government set up an industry regulator, Railwatch, to ensure value for money for rail users and taxpayers. Railwatch's approach involves a comprehensive monitoring programme of Best-Trak's stewardship of the national rail network, including a range of performance indicators and scrutiny of its business plan, annual return and regulatory accounts.

Rail operators

Contracts for the regional rail operators are usually awarded for a five year period based on a range of criteria linked to predicted customer numbers and revenues, cost efficiency and commitments to further investment in rolling stock. Once awarded, the industry regulator, Railwatch, again monitors a range of performance indicators and will fine operators who fall short of targets. This is a controversial area and many rail operators blame the activities of Best-Trak for adverse variances. For example, operators are assessed on train punctuality but sometimes delays are due to signalling problems, an area under the responsibility of Best-Trak. Establishing the causes of variances is subject to much debate.

Best-Trak – performance management

Previous performance indicators for Best-Trak focused on cost efficiency and keeping within spending targets. However, Best-Trak has come under much criticism after a report blamed it for two recent train accidents and for train delays. A government minister was recently quoted as stating that they need to see evidence of improvements by Best-Trak the following areas, or they might consider putting Best-Trak's licence out to tender:

- (1) Outputs (e.g. operational performance and asset condition established in periodic reviews) are being delivered.
- (2) Inefficiencies and problems identified in the recent report are being addressed.
- (3) The longer term sustainability of the network is not being compromised.

After significant public pressure, Railwatch has thus decided to review the range of indicators it uses to monitor Best-Trak's performance. The new indicators will cover:

- (a) safety
- (b) operational performance
- (c) asset performance and condition
- (d) finance
- (e) efficiency
- (f) customer satisfaction; and
- (g) environmental impact.

At a recent meeting of the Best-Trak Board it was agreed that the key priorities were safety and reducing delays that could be attributed to Best-Trak. Furthermore the Finance Director suggested that Best-Trak should make use of Environmental Management Accounting (EMA) to improve its environmental credibility.

Required:

- (a) **Assess the impact of governmental regulation and policies on the performance measurement techniques used and performance levels achieved by former state monopoly companies such as Best-Trak. (5 marks)**
 - (b) **For each of the two critical success factors (CSFs) given in the question, identify THREE performance indicators (PI) that could support measurement of their achievement and discuss their usefulness to Best-Trak. (12 marks)**
 - (c) **Discuss the importance of environmental credentials to Best-Trak and suggest how EMA could help Best-Trak to improve its environmental credibility. (8 marks)**
- (Total: 25 marks)**