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ACCA – Paper P5 Advanced Performance Management September and December 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

September and December
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 Rockborough council has been heavily criticised in recent years over its use of incremental budgeting and so has decided to experiment with zero-based budgeting (ZBB). Accordingly the new Chief Finance Officer (CFO) put in to place the following process:
- (1) The areas to be budgeted for using ZBB were decided upon and those responsible informed. All these people were sent on a two-day course that attempted to explain how ZBB worked.
 - (2) Decision packages were requested with reasonable deadlines for each area and the road maintenance and building decision package is reproduced below.
 - (3) Once received, the decision packages were to be reviewed and challenged before a second and final draft was agreed.
 - (4) The decision packages were to be ranked using a weighting and ranking system and the budget was then to be allocated. The weighted and ranking system is explained below.

Weighted and ranking

In order to decide on the ranking of each decision package they were to be scored out of 10 in each of 6 areas based on the PESTEL model. Each area was to be scored by an independent manager within the council.

The weightings were not disclosed to the producers of the decision packages but are shown here:

- Political 30%
- Economic 30%
- Social 5%
- Technological 5%
- Environmental 15%
- Legal 15%

Each score given is multiplied by the % above to give a total score and this is then used to determine the budget allocation.

For example a ZBB budgeting package has already been submitted (not road building and maintenance) and the scoring was as follows:

	Score	Weighting	Total score
Political	6	30%	1.80
Economic	5	30%	1.50
Social	8	5%	0.40
Technological	6	5%	0.30
Environmental	2	15%	0.30
Legal	4	15%	0.60
Total score			4.90

The budget allocation for this was set at \$73.5m and further allocations to other projects were to be pro-rata to this +/-10%.

Road Building and Maintenance Decision Package

This decision package is in support of a request for \$120m of funding to support the building of new roads and the repair and maintenance of the existing roads in the Rockborough area.

Political

It is well known that the current national government is supportive of improvements to the transport infrastructure in the country. It has recently funded a new high-speed rail link to connect our major cities and so it is suggested that improving our road network would meet national government approval.

Local government elections are looming (3 months away) and poor roadways are often seen to fill complaint boxes of local councillors. If money is allocated to improve our roads the existing councillors are more likely to gain re-election.

Car taxes (raised by central government) far exceed the amount actually spent on the roads. The national car lobby is extremely vociferous on this issue. It is felt we have a moral obligation to increase spending in this area.

Economic

Delays created by poor roads and road works “cost” the local economy over \$40m each year in terms of late meetings, cancelled appointments and so on. It is felt that the true cost of these proposals is therefore much less that is being requested.

The budget (requested at \$120m) is specified on a least cost basis having consulted 5 different contractors.

The money will go to firms that are locally represented in our city hence improving employment in the area.

Social

Car ownership is ever increasing and so our road network must keep pace. It is expected that car ownership will increase by 30% over the next 10 years.

Public transport may suit a small number of people (commuters for example) but for many the car is their main and preferred mode of transport. Most people's journeys cannot be easily carried out without a car and the council should accept that. It is not for the council to dictate individual transport choices and we should build and maintain the roads, as the people want us to.

Technological

Car technology has improved dramatically over recent years and this has resulted in fewer accidents (in particular fatal ones) and much better fuel consumption. It is proposed therefore that the historic arguments about traffic accidents and global warming are less serious as a result.

Environmental

As mentioned above with better fuel economy the environmental arguments surrounding global warming and the use of fossil fuels are weakened and so our roads must facilitate the increased use of cars.

Legal

The council has a legal obligation to maintain the roads. Indeed failure to do so has in the past resulted in many legal claims against us by car drivers that have damaged their cars in potholes. Extra spending on pothole repairs could actually save the \$30m we pay in out of court and in court settlements.

Further points

The weather has been unusually cold in recent winters and this has destroyed the roads in our area. Money must be spent on repairing damaged roads.

Required:

You are a management accountant for the council. Write a report to the council:

- (a) Evaluate the use of the PESTEL model for the purpose of a decision package in ZBB. (10 marks)
- (b) Assess the arguments made in the decision package produced for road buildings and maintenance. You should consider strengths and weaknesses discussing each in turn. (20 marks)
- (c) Produce 10 follow up questions that the council officials can put to the budget holder for road building and maintenance when the decision package is challenged. (5 marks)
- (d) Evaluate the use of the weighted and ranking system explained in the text above explaining the benefits and risks of such an approach. (11 marks)

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

(Total: 50 marks)

SECTION B

TWO QUESTIONS FROM THE THREE GIVEN MUST BE ATTEMPTED

- 2 HCI is a company that offers the design, installation and maintenance of private telephone networks, intranets and extranets for large corporate clients. A recent contract, for example, was for a multi-national media organisation to provide a network to support in excess of 5,000 staff.

Since its foundation three years ago, HCI has been very successful. In 2013 and 2014 the company achieved a Return on Capital Employed (ROCE) of 50% and 48% respectively. HCI already has an enviable reputation in the industry for excellence in technological innovation and outstanding customer service. These key success factors have allowed HCI to be able to charge a premium price for its services.

HCI's founder and CEO, Jane, previously worked in a research institute and her expertise has been fundamental to HCI's continual innovation. In addition, HCI allocates 25% of the previous year's revenue for capital investment in technological innovation each year.

HCI currently employs 60 people, several of whom are Jane's former colleagues. These employees in particular have contributed to the culture of research excellence and technological innovation.

HCI has no formal written statement of strategy. However, Jane, who owns 100% of the share capital, wants the company to continue growing within its current market/business segment, and to provide a rewarding lifestyle for herself and secure well-paid jobs for HCI's employees.

HCI's control system

HCI relies on a traditional system of budgetary control:

Monthly management accounts are prepared in which actual expenditure is compared to budgeted expenditure.

Budgets are prepared using actual levels of expenditure for the previous budget year together with an adjustment for inflation.

HCI does not have any system of targets or controls based on non-financial factors.

HCI also reports its overall Return on Capital Employed (ROCE) each month as Jane considers this to be the best control measure available for her to use.

HCI's actual total sales figure is compared against budget but there is no sectional analysis. The last forecast was for sales in 2015 of \$18 million.

When Jane started HCI, she knew the details of every customer and contract and their levels of profitability. However, as HCI has expanded she can no longer do this.

Beyond budgeting

Jane's ambitions stretch to all areas of the business and after a recent board meeting, where the issue was discussed at length, she is seriously considering the adoption of a beyond budgeting approach. She is hopeful that such a radical move would enable the business to react to its environment and that it would assist in its continued growth.

Required:

- (a) Evaluate HCI's current control system. (10 marks)
- (b) Advise HCI how non-financial performance measures could assist in the evaluation of HCI's two key success factors. (5 marks)
- (c) Discuss the suitability of beyond budgeting for HCI. Explain the potential reasons why Jane is considering the move to beyond budgeting and any reservations that she may have. (10 marks)

(Total: 25 marks)

- 3** Ochilpark is an engineering manufacturing company specialising in the production of mobile machinery for the construction industry. The company has identified and defined a market in which it wishes to operate. This will provide a new focus for an existing product range. Ochilpark has identified a number of key competitors and intends to focus on close co-operation with its customers in providing products to meet their specific design and quality requirements. Efforts will be made to improve the effectiveness of all aspects of the cycle, from product design to after-sales service to customers. This will require inputs from a number of departments in the achievement of the specific goals of the new proposal. Efforts will be made to improve productivity in conjunction with increased flexibility of methods.

An analysis of financial and non-financial data relating to the new proposal is shown in Schedule 1 below.

Schedule 1

	New proposal – estimated statistics		
	2016	2017	2018
Total market size (\$m)	120	125	130
Ochilpark sales (\$m)	15	18	20
Ochilpark total costs (\$m)	14.1	12.72	12.55
Ochilpark sundry statistics:			
Production achieving design quality standards (%)	95%	97%	98%
Returns from customers as unsuitable (% of deliveries)	3.0%	1.5%	0.5%
Cost of after-sales service (\$m)	1.5	1.25	1.0
Sales meeting planned delivery dates (%)	90%	95%	99%
Average cycle time (customer enquiry to delivery) (weeks)	6	5.5	5
Components scrapped in production (%)	7.5%	5.0%	2.5%
Idle machine capacity (%)	10%	6%	2%

Some additional cost information has also been provided in Schedule 2 below.

Schedule 2	2016	2017	2018
Target costs			
– variable (as % of sales)	40%	40%	40%
– fixed (total)	\$2m	\$2m	\$2.5
Internal failure costs (% of total target cost)	20%	10%	5%
External failure costs (% of total target cost)	25%	12%	5%
Appraisal costs	\$0.5m	\$0.5m	\$0.5
Prevention costs	\$2.0m	\$1.0m	\$0.5m

The company is considering the implementation of a new performance measurement system in an attempt to make a clear link between performance and strategy and to be flexible and adapt to an ever changing business environment. The directors are considering implementing the performance pyramid, a modelling tool that can be used in the design of a new performance measurement system or the re-design of an existing performance measurement system.

Required:

- (a) Prepare a table (\$m) of the total costs for the new proposal for each of the years 2016, 2017 and 2018, detailing target costs, internal and external failure costs, appraisal costs and prevention costs. (4 marks)
- (b) Explain the meaning of each of the cost classifications in (a) and comment on their trend and inter-relationship. You should provide examples of each classification. (8 marks)
- (c) Prepare an analysis (both discursive and quantitative) of the new proposal for the period 2016 to 2018. The analysis should use the information provided in the question, together with the data in Schedule 1. The analysis should contain the following:
 - (i) Discussion of the external effectiveness of the proposal in the context of ways in which (1) *Quality* and (2) *Delivery* are expected to affect customer satisfaction and hence the marketing of the product. (4 marks)
 - (ii) Discussion of the internal efficiency of the proposal in the context of ways in which the management of (1) *Cycle time* and (2) *Waste* are expected to affect productivity and hence the financial aspects of the proposal. (4 marks)
- (d) Discuss the potential benefits to Ochilpark of implementing the performance pyramid. (5 marks)

(Total: 25 marks)

- 4 Bonos sell high-end sound equipment both to the discerning public and to conference venues, they also sell substantial numbers of systems to cinemas around the world.

The Finance Director (FD) has been concerned for some time about the long-term prospects of the business but the aggressive Managing Director (MD) has largely ignored his comments at board meetings. The FD decided to commission a consultant to carry out an Argenti based exercise, a summary of the results of which are shown below.

The Argenti scoring system is a matter of judgement but where the defect score exceeds 10 and the mistakes score exceeds 15 then Argenti would argue that the business has survival risks. This is also true if the overall score exceeds 25.

Defect	Score
Dominant MD, unwilling to listen to the views of others	4
Poor bank relations, Bonos has exceeded its overdraft limits regularly but has no long term debt	4
Poor internal controls over the pricing of deals. The salesmen are free to negotiate on price with wide tolerances. As a result some loss making deals are in place. See Mega Cinema deal below	4
Poor internal controls exist over cash collection	1
Has an exclusivity contract with a supplier to supply all systems	3
Poor systems are in place over in house delivery van maintenance resulting in regular breakdown and hence late delivery	1
TOTAL	17

Mistakes	Score
Bad debt incurred of \$50,000	2
Late delivery of major system to cinema chain resulting in damaged brand and penalties	2
Mega Cinema deal very poor. After all directly attributable costs a loss is made per installation. An exit clause exists on early termination of the contract of \$40,000. The salesman that negotiated the deal recently left Bonos and joined Mega Cinema on a seemingly generous salary level	8
Exceeded overdraft limits causing disagreements with the bank	4
Exclusive supplier has been late in delivery regularly in the last 6 months	3
TOTAL	19

Symptoms	Score
Debtor days up by 50 days to 135 days	2
Gross profit % down by 8 percentage points to 32%	4
Revenue growth very high due to Mega Cinema deal – over trading?	3
TOTAL	9

Your advice is being sought on what Bonos could do to rectify the situation it finds itself in and improve its survival prospects and performance.

Required:

- (a) Briefly evaluate the use of Argenti's model by Bonos. (8 marks)
- (b) Suggest an action plan to deal with Bonos most serious issues (all issues will score but greater marks are available for correctly focussing on those that are most serious). (17 marks)

(Total: 25 marks)