ACCA INTERIM ASSESSMENT

Advanced Performance Management

2012

Paper P5

Time allowed

Reading time: **15 minutes**

Writing time: **3 hours**

This paper is divided into two sections

Section A BOTH questions are compulsory and MUST be answered

Section B TWO questions ONLY to be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

Kaplan Publishing/Kaplan Financial

KAPLAN PUBLISHING

SECTION A

BOTH QUESTIONS ARE COMPULSORY AND MUST BE ANSWERED

QUESTION 1 – ICS

Assume that 'now' is May 20X8.

ICS was established ten years ago. The company began by providing computer software programs to local businesses. This is an industry which is dynamic. Rapid technological development constantly causes fast changes within the industry.

The demand for ICS's services grew. After two years of operation ICS had almost doubled its turnover and had taken on more staff. In addition to software programming, ICS then diversified into providing emergency computer data retrieval services. This necessitated obtaining some specialist equipment and hiring specifically trained staff. Rapid growth in turnover continued for the first four or five years, but has reduced in recent years.

ICS is managed by a board of directors, and the company is financed by equity (mostly held by private investors) and debt. The current gearing ratio is in the proportion of 60% equity to 40% debt. The shareholders are becoming concerned about ICS's recent poor performance.

Financial results

The financial results for the last five years of trading are shown below.

Year ended 31 December	*20X3*	*20X4*	*20X5*	*20X6*	*20X7*
	$000	$000	$000	$000	$000
Sales	6,300	6,400	6,600	6,500	6,300
Variable costs	4,621	4,732	4,881	4,891	4,778
Fixed costs	1,481	1,489	1,730	1,750	1,900
Capital employed	2,400	2,500	2,500	2,600	2,600

Turnover provided in percentage terms each year to different types of customer sector:

	20X3	*20X4*	*20X5*	*20X6*	*20X7*
% retail	70	65	65	55	50
% industrial	23	26	26	30	33
% other	7	9	9	15	17

Comparative figures for each of the three sectors served by ICS for the years 20X3 and 20X4 are as follows:

20X3	*Retail*	*Industrial*	*Other*	*Total*
	$000	$000	$000	$000
Contribution	1,323	290	66	1,679
Profit before interest charges and tax	221	0	(23)	198
20X4	*Retail*	*Industrial*	*Other*	*Total*
	$000	$000	$000	$000
Contribution	1,249	333	86	1,668
Profit before interest charges and tax	209	0	(30)	179

Management information systems

ICS has never made any provision for management information. They use a local accountancy firm, Y & Partners, which produces only the statutory information and returns. It was A, an accountant from Y & Partners, who provided the financial and turnover percentage information given above.

While it is not possible to be fully accurate, A estimates that the variable costs and fixed costs as a proportion of turnover for each type of service provided were:

	Variable costs: % of turnover	*Fixed costs: % of turnover*
Years	*20X3 to 20X7*	*20X3 and 20X4*
Retail	70	25
Industrial	80	20
Other	85	20

A calculates the fixed costs in each of these sectors over the last three years to have been as follows:

Year ended 31 December	*20X5*	*20X6*	*20X7*
	$000	$000	$000
Retail	1,070	890	790
Industrial	470	590	800
Other	190	270	310

For some years, A has tried to explain to ICS the necessity to be provided with regular management information, in particular management accounting information. However, ICS has always rejected this advice, saying that it would be too expensive and that the board of ICS should not 'waste its time on detail'.

'In any case', the Managing Director says, 'I know the business we are in. I am able to see what work we should be taking on. I know the way to be successful and profitable is to expand the services we provide. This worked before several years ago and will work again.'

A has expressed concern over ICS's cash flow.

Note: Net present value calculations are **not** required in answering this question.

Required:

(a) Discuss how setting corporate objectives can help and/or obstruct ICS in satisfying the demands made by its shareholders. (7 marks)

(b) Discuss the relevance of the provision of management information to a company such as ICS when the business environment is always changing so fast. (6 marks)

(c) Provide an analysis of the turnover and costs for the years 20X5 to 20X7 over the three sectors which ICS services. Comment on the results of your analysis and advise what management accounting information should be provided for ICS. Your advice should identify the priorities which should be addressed, given the current financial circumstances of ICS. (17 marks)

(Total: 30 marks)

QUESTION 2 – CINQUE DIVISION

Cinque Division produces three types of wooden container which it sells to external customers and transfers to other divisions within its own group of companies.

Relevant budget information for the period ended 31 December 2010 on which the unit costs per container are based is as follows:

Container type:	*Uno*	*Due*	*Tre*
Total production/sales (units)	50,000	25,000	75,000
Direct material per container (square metres)	1.2	0.8	2.4

Material cost per square metre is $30.

Overhead costs for the division are:

	$000
Production conversion cost	6,000
Administration cost	1,800
Selling/marketing cost	1,000
Distribution cost	1,400

The current policy in Cinque division is to compile unit cost per container on the basis of production cost plus distribution cost. Administration and selling/marketing costs are considered general divisional costs which are not product specific.

The budgeted unit costs per container are calculated as the sum of:

- direct material cost
- production conversion cost absorbed on the basis of an overall percentage on direct material cost
- distribution cost as an overall average cost per container unit.

Product pricing is based on the achievement of an overall return on capital employed of 15% (ignore taxation). A single mark-up percentage applicable to all container types is applied to product specific unit cost in order to achieve this ROCE level. The resulting selling prices form the basis of selling and marketing strategy. Capital employed is taken as $16,800,000.

Required:

(a) Prepare calculations which show the detailed unit cost and selling price calculations for each container type. (8 marks)

(b) Activity based unit costs are prepared for the period ended 31 December 2010. These differ from the original unit costs in a number of cost areas. The relevant amended elements of product specific unit costs are:

	Uno	*Due*	*Tre*
	$	$	$
Production conversion cost	42.81	30.69	41.23
Distribution cost	2.40	8.00	14.40
Selling/marketing cost (see note 1)	1.20	6.00	1.20

Note 1: 30% of the budgeted selling and marketing cost has been identified as product specific. This has been charged to container types after taking into account relevant activities. The balance of selling and marketing cost is still considered a divisional cost.

(i) Prepare a summary which compares original and activity based information per container for cost, profit and selling price for each type of container, where selling prices remain as calculated in (a) above. (5 marks)

(ii) A substantial proportion of sales of Uno are transfers to other divisions within the group. This business is obtained in competition with potential external suppliers. In addition, Cinque division is experiencing problems in retaining the level of market which it has budgeted for Tre.

Using this additional information together with the original versus activity based unit cost/profit/price analysis, suggest possible action by management for EACH of the three types of container in order to improve divisional and group profitability. (6 marks)

(c) Cinque division has a proposed strategy to redesign container Uno. There is some controversy as to the effect of the redesign on the number of cuts required per unit, which is seen as a key cost driver in the production process and also on the quantity of direct material which will be required per product unit. Probabilities have been estimated for the level at which these key variables will occur. Number of cuts and quantity of material are independent of each other. The estimates are as follows:

Direct material per unit (sq.m)	*Probability*
1.6	0.3
1.2	0.4
0.8	0.3

Number of cuts per unit	*Probability*
40	0.3
35	0.2
25	0.5

(i) Prepare a summary which shows the range of possible activity based unit cost outcomes for Uno showing the combined probability of each outcome, using the Appendix on the following page as appropriate. (6 marks)

(ii) Comment on the likely impact of management's attitude to risk on their decision whether or not to implement the redesign strategy for Uno on financial grounds. You should include the calculation of, and comment on, the expected value of the product specific cost for Uno in your answer. (5 marks)

(Total: 30 marks)

Appendix

Two Way data table to monitor the effect on the activity based product unit cost for product Uno of a proposed redesign. This may affect the direct material per unit – range 1.6 to 0.8 square metres and the number of cuts required – range 25 to 50:

		Number of cuts				
		25	**30**	**35**	**40**	**50**
Material required (sq. m)	**1.6**	94.31	95.38	96.30	97.10	98.42
	1.4	87.00	88.08	89.00	89.80	91.12
	1.2	79.62	80.69	81.61	82.41	83.73
	1.0	72.14	73.21	74.13	74.93	76.25
	0.8	64.56	65.63	66.55	67.35	68.67

(Total Section A: 60 marks)

SECTION B

TWO QUESTIONS ONLY TO BE ANSWERED

QUESTION 3 – SPC

The directors of the newly set up Snack Pot Company (SPC) have won a contract with a group of Universities to sell the various flavours of snack pots within the student canteens and vending machines.

The following information is available:

1 SPC produce healthier snack pots than those already available, with lower sugar, salt and most importantly fat levels.

2 SPC have estimated that they will achieve a 7% share of the 100m snack pots sold per annum.

3 The average selling price of the snack pot sold in canteen and vending machine is $0.90. The university wishes to make a mark-up of 25% on all snack pots sold.

4 The cost of ingredients is estimated at $0.25 for all snack pots made.

5 Packaging and labelling costs $0.12 per snack pot.

6 Fixed overheads have been estimated $1,250,000 per annum. This includes the wages and salaries of staff. All employees are new to the food production industry and are subject to fixed term contracts.

7 Distribution costs are expected to be 6% of SPC's sales revenue

8 SPC hope to achieve a target sales margin of 15%.

9 The Universities want assurance that inventory levels will be monitored and maintained.

10 The directors of SPC hope to further develop the range of flavours of snack pots and are open to suggestions from the Universities.

Required:

(a) Using the above information calculate whether SPC will achieve its target sales margin of 15%. (5 marks)

(b) Explain five critical success factors to the performance of SPC if they are to achieve success in the marketplace. (10 marks)

(c) Explain the importance of an electronic extranet link between SPC and the inventory control systems within the electronic vending machines and canteens at the Universities. (5 marks)

(Total: 20 marks)

QUESTION 4 – SPEEDY EAT

Speedy Eat is the world's largest and best-known food service retailing group with more than 30,000 'fast-food' outlets in over 120 countries. Currently half of its restaurants are in the USA, where it first began 50 years ago, but up to 1,000 new restaurants are opened every year worldwide. Restaurants are wholly owned by the group (it has previously considered, but rejected, the idea of a franchising of operations and collaborative partnerships).

As market leader in a fiercely competitive industry, Speedy Eat has strategic strengths of instant global brand recognition, experienced management, site development expertise and advanced technological systems. Speedy Eat's basic approach works as well in Kandy or Kuala Lumpur as it does in Kansas: although the products are broadly similar, menus are modified to reflect local tastes. Analysts agree that it continues to be profitable because it is both efficient and innovative.

The group's vision is to be 'the world's favourite' through service, cleanliness and value, and it is following three main strategies:

1 To achieve profitable growth by building on key strengths.

2 To 'delight' every customer in every restaurant.

3 To be a good employer in each community in which it has a restaurant. (Despite this, some critics claim staff are mainly unskilled and lowly paid.)

Speedy Eat's future plans are to maximise global opportunities and continue to expand markets. Speedy Eat has long recognised that the external environment can be very uncertain and consequently does not move into new locations or countries without first undertaking a full investigation.

You are part of a strategy steering team responsible for investigating the key factors concerning Speedy Eat's entry for the first time into the restaurant industry in the Republic of Borderland.

Required:

(a) Justify the use of a PEST framework to assist your team's environmental analysis for the Republic of Borderland. (8 marks)

(b) Discuss the main issues arising from applying this framework. (12 marks)

(Total: 20 marks)

QUESTION 5 – GAP ANALYSIS

Most organisations recognise that continuing as at present, sometimes referred to as the 'do nothing' option, is rarely advisable as it is likely to lead to a performance shortfall against objectives. Even new policies may not guarantee meeting organisational objectives.

The planning technique 'gap analysis' is a means by which an organisation can assess whether proposed policies are likely to achieve their objectives or the degree to which they might fall short.

Required:

(a) **Typically, an organisation might construct and then respond to a gap analysis as part of an overall (rational) approach to strategic planning and management such as the model described by Johnson and Scholes. Explain the role of gap analysis in the strategic planning model, evaluate the usefulness of the 'gap analysis' technique as part of such a system and explain the main criticisms of this rational approach. (10 marks)**

(b) **Some people feel that gap analysis has declined in popularity, particularly within the private sector. Discuss why this should be the case and, using examples, explain how gap analysis could be particularly helpful to public sector organisations. (10 marks)**

(Total: 20 marks)

(Total Section B: 40 marks)