

ACCA FINAL ASSESSMENT

Advanced Performance Management

June 2012

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

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Paper P5

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SECTION A

BOTH QUESTIONS ARE COMPULSORY AND MUST BE ANSWERED

1 THE GROVE

Assume that the date is 1 December 20X3.

The Grove is a privately owned Company. It operates 14 luxury day spas and boutique hotels throughout the country. Each of the buildings is in a sensitively converted space such as a Georgian townhouse or a converted brewery. The company promises an experience that ‘is out of this world and will melt your cares away’. The Grove is open for 365 days in the year.

The Day Spas

The day spas are open to adults only. There are three types of spa guest:

- Type 1 = non members – these spa guests are not staying at the hotel. They use the spa facilities irregularly or only once.
- Type 2 = members – these spa guests are not staying at the hotel but have been awarded membership of the day spa due to their regular use of the spa facilities.
- Type 3 = hotel guests – these spa guests are those guests staying at the hotel who also wish to use the spa facilities.

Each day spent by a guest at the spa is called a ‘Guest Day’. During the year ending 30 November 20X3 a total of 204,400 guests visited The Grove but this number is expected to increase by 10% in the forthcoming year.

40% of the guests were type 1, 20% type 2 and the remaining 40% type 3 guests. Management expect the guest mix to remain the same in the forthcoming year.

Guests can either purchase a ‘One-day Guest Pass’ (this allows them to use all facilities for one day and to enjoy two treatments) or a ‘Two-day Guest Pass’ (this allows them to use all facilities for two days and to enjoy four treatments). During the year ending 30 November 20X3, 70% of guests purchased a One-day Guest pass and the remaining 30% purchased a Two-Day Guest Pass. Management expect this mix to remain the same in the forthcoming year.

The prices were as follows:

	<i>One-Day Guest Pass</i>	<i>Two-Day Guest Pass</i>
Type 1 guest	\$220	\$352
Type 2 guest	\$190	\$304
Type 3 guest	\$150	\$240

All operating costs incurred during the year ending 30 November 20X3 are expected to inflate by 5%. This has led to a decision by management to increase the selling prices of its guest passes by 5% with effect from 1 December 20X3.

Operating costs for the y/e 30/11/X3 were as follows:

	\$	<i>Variable costs (%)</i>	<i>Fixed cost (%)</i>
Salary costs	15,432,333	100	–
Cleaning	4,576,742	25	75
Catering	5,774,394	80	20
Other operating costs	8,744,952	40	60

Variable costs vary according to the number of guest days.

Hotels

There are 200 rooms in total and the charge per room for the year ending 30 November 20X3 was \$200 per night. Average occupancy for the year was 60% and this is expected to remain the same for the year ending 30 November 20X4.

Total operating costs for the year ending 30 November 20X3 were \$6,061,464. Operating costs and room prices will increase by 4% in the forthcoming year.

Required:

- (a) Prepare a statement showing the budgeted net profit or loss for the year to 30 November 20X4. (7 marks)

- (b) The management accountant of the Grove has prepared the two-way data table shown in Appendix 1. Discuss how the directors could use such a table. (4 marks)

- (c) (i) Another organisation has announced its intention to open a number of day spas and hotels. The management of the Grove are uncertain of the impact that this will have on the number of visitors to its spas and hotels during the y/e 30/11/X4. Current estimates of the number of guests to the spa facilities and the average % occupancy of the hotels are:

Day Spas		Hotels	
Guest Days	Probability	Occupancy %	Probability
Increase by 20%	0.20	75%	0.10
Increase by 10%	0.60	60%	0.60
Decrease by 5%	0.20	45%	0.30

Using Appendix 1 on the next page, prepare a summary which shows the range of possible net profit or loss outcomes, and the combined probability of each outcome. The table should also show the expected value of net profit or loss for the year. (6 marks)

- (ii) Comment briefly on the use of expected values by management. (2 marks)
- (d) Discuss FOUR performance measurement criteria that management could utilise in order to assess the quality of service provided by the hotels. Indicate what would be measured and state the mechanisms which would enable measurement of the chosen criteria. (4 marks)
- (e) Name and comment on the actions that could be taken by management in the short-term, in an attempt to ensure that the profitability of the Grove is not affected by the opening of day spas and hotels by another organisation. (4 marks)
- (f) Explain the term 'strategic management accounting' and discuss the benefits that might accrue to the Grove as a result of its introduction by management. (8 marks)

(Total: 35 marks)

Two-way data table monitoring net profit in the year 30 November 20X4 for a range of spa facility guest levels and hotel occupancy

		% change in guest days (using 20X3 as base)										
		-15%	-10%	-5%	No change	+5%	+10%	+15%	+20%	+25%	+30%	
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	
	75	4,803,730	7,453,312	10,102,894	12,752,476	15,402,058	18,051,640	20,701,222	23,350,804	26,000,386	28,649,968	
	70	4,044,530	6,694,112	9,343,694	11,993,276	14,642,858	17,292,440	19,942,022	22,591,604	25,241,186	27,890,768	
Hotel	65	3,285,330	5,934,912	8,584,494	11,234,076	13,883,658	16,533,240	19,182,822	21,832,404	24,481,986	27,131,568	
occupancy	60	2,526,130	5,175,712	7,825,294	10,474,876	13,124,458	15,774,040	18,423,622	21,073,204	23,722,786	26,372,368	
%	55	1,766,930	4,416,512	7,066,094	9,715,676	12,365,258	15,014,840	17,664,422	20,314,004	22,963,586	25,613,168	
	50	1,007,730	3,657,312	6,306,894	8,956,476	11,606,058	14,255,640	16,905,222	19,554,804	22,204,386	24,853,968	
	45	248,530	2,898,112	5,547,694	8,197,276	10,846,858	13,496,440	16,146,022	18,795,604	21,445,186	24,094,768	
	40	-510,670	2,138,912	4,788,494	7,438,076	10,087,658	12,737,240	15,386,822	18,036,404	20,685,986	23,335,568	

2 ELEGANT HOTELS

Elegant Hotels is a chain of twenty hotels across the country. Each hotel is wholly owned by the company. Four years ago the chain was bought by a group of investors who installed a new management team.

The new management team introduced a new reward scheme for the hotel managers in an attempt to motivate managers to improve the revenue and profitability of the chain. The salary package devised for each manager comprised:

- A relatively low fixed salary
- A bonus payment based on high room occupancy rate. The occupancy rate is the percentage of usable hotel beds filled every night. Managers who achieved more than 90% occupancy rate receive a significant bonus. This target is aimed at keeping the hotel full.
- A smaller bonus payment based on the net profit margin achieved by the hotel. This is aimed at improving the profitability of the hotel.

However, despite these incentives the overall performance of the company is still declining. Managers are generally achieving a high occupancy rate but are largely failing to deliver higher net margins. It is also clear that some managers have achieved a high occupancy rate by declaring that some bedrooms were unfit for use or were being used as seminar rooms.

Also, the pursuit of high occupancy and high net profit appears to be affecting the perceived image of the hotel chain. Once regarded as a mid-market hotel chain, the chain now seems to be perceived as a budget buy. A large percentage of bookings are received through the Internet broker lastsecondhotels.com and their view of the chain is given below, together with some visitor quotes from their web site.

Comments

'Great last minute bargain ... very easy to get rooms at half the advertised rate'

'Full of school children on a trip ... will not be using this chain again' 'No Internet connections in the rooms or public areas, very disappointing'

'The bath was cracked and the windows were dirty. Cheap, but badly in need of a clean'

'Receptionists were very off-hand and unable to help. Did not seem to know much about the area surrounding the hotel'

'The staff were surly and uncommunicative. Much worse than last time we visited it. It used to be such a lovely hotel' 'Cheap, but don't eat there. The price for breakfast was extortionate' 'Cheap and cheerful but don't pay the full rate! Always lots of cheap beds available'

'Food was expensive and dull. The serving staff were uncommunicative, the cutlery was dirty and damaged. Staff were more interested in talking to each other than to the customers'

'Restaurant food was very expensive and of poor quality. The two nights I stayed there I was the only customer in the restaurant'

Lastsecondhotels.com says: 'Value for money hotels with rooms always available. Perfect for those last minute breaks'

Required:

- (a) Analyse the unanticipated consequences of the management reward scheme at Elegant Hotels. (15 marks)**
- (b) Evaluate the potential benefits of using the DMAIC methodology at Elegant Hotels. (10 marks)**

(Total: 25 marks)

(Total Section A: 60 marks)

SECTION B**TWO QUESTIONS ONLY TO BE ANSWERED****3 SPIRO**

- (a) Spiro Division is part of a vertically-integrated group of divisions all located in one country. All divisions sell externally, and also transfer goods to other divisions within the group. Spiro Division's performance is measured using profit before tax as a performance measure.

Required

- (i) **Prepare an outline statement which shows the costs and revenue elements which should be included in the calculation of divisional profit before tax. (5 marks)**
- (ii) **The degree of autonomy which is allowed to divisions may affect the absolute value of profit reported.**

Discuss this statement in relation to Spiro Division. (8 marks)

- (b) Division A makes a component, Y, which it currently transfers to division B. The following information is available:

- Division A can sell Y externally for \$25
- Division A's variable cost of producing Y is \$18
- Division A has no spare capacity
- Division B can purchase component Y externally for \$22.

Required:

Discuss the pricing basis on which divisions should offer to transfer goods in order that corporate profit-maximising decisions can take place. (7 marks)

(Total: 20 marks)

4 FINANCIAL SCANDALS

Over the past few years, there have been a number of high profile financial scandals surrounding the reporting of company performance, and the associated role of accountants. As a consequence, organisations have been urged to consider future practice carefully. Some feel that an over-emphasis by a company on market expectations and profitability may be detrimental to its long term well-being. Such thinking has implications for the objectives of a company and the range of performance measures used both externally and internally.

Required:

- (a) **Discuss the functions that organisational objectives should fulfil strategically and the main disadvantages of using only profit-related performance measures. (10 marks)**
- (b) **The balanced scorecard approach has been described as relating an assessment of performance to choice of strategy through four categories of measurement. It is used by many organisations in monitoring performance. Evaluate the use of the balanced scorecard in meeting stakeholder needs and determining objectives. (10 marks)**

(Total: 20 marks)

5 OCHILPARK PLC

Ochilpark plc has identified and defined a market in which it wishes to operate. This will provide a ‘millennium’ focus for an existing product range. Ochilpark plc 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 ‘millennium’ product range. 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 ‘millennium’ proposal is shown in Schedule 2.1 below.

Schedule 2.1

	‘Millennium’ proposal – estimated statistics		
	20X0	20X1	20X2
Total market size (\$m)	120	125	130
Ochilpark plc sales (\$m)	15	18	20
Ochilpark plc total costs (\$m)	14.1	12.72	12.55
Ochilpark plc 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%

Required:

- (a) (i) Prepare a table (\$m) of the total costs for the ‘millennium’ proposal for each of years 20X0, 20X1 and 20X2 (as shown in Schedule 2.1), detailing target costs, internal and external failure costs, appraisal costs and prevention costs. The following information should be used in the preparation of the analysis:

	20X0	20X1	20X2
Target costs			
– variable (as % of sales)	40%	40%	40%
– fixed (total)	\$2m	\$2m	\$2.5m
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	\$0.5m
Prevention costs	\$2.0m	\$1.0m	\$0.5m

(4 marks)

- (ii) Explain the meaning of each of the cost classifications in (i) above and comment on their trend and inter-relationship. You should provide examples of each classification. (8 marks)
- (b) Prepare an analysis (both discursive and quantitative) of the 'millennium' proposal for the period 20X0 to 20X2. The analysis should use the information provided in the question, together with the data in Schedule 2.1. 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)

(Total: 20 marks)

(Total Section B: 40 marks)