

ACCA MOCK B

Advanced Performance Management

December 2017

Time allowed

3 hours 15 minutes

The paper is divided into two sections

Section A: This 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 GT Autos is a car dealership business. It sells new and second-hand vehicles and provides car repairs and servicing. A finance department produces the monthly management accounts, the annual financial accounts and provides general administration that supports the business. The finance staff put together the budgets based on analysis of past actual results and a little input from the other departments so as to reflect the current trends.

The accountant is suggesting that the business would benefit from moving away from the fixed salaries it pays at the moment towards a more variable reward structure. The general manager is a little sceptical stating that the moment that rewards become variable staff will attempt to manipulate the measures/results for personal gain. Accordingly he wants a thorough analysis of any proposals so that all potential behavioural consequences and manipulations are understood.

Car Sales

The sales people sell new and second-hand vehicles. There is a recommended retail price for new cars, which the manufacturers want dealers to achieve where possible but some discounting is accepted up to a 15% limit. Extras can be fitted at the factory on manufacture of the car or can be added by the dealer if the chosen car has passed the point in the production line where that particular extra is fitted. The customer has no way of knowing where in the production line a car might be at any point in time. Customers perceive factory fitted extras are more reliable but the dealership makes more margin by fitting the extras themselves. Having the extras factory fitted is a much smoother process, however, enabling cars to be turned around and sent to the customer far quicker.

(Turnaround = received from manufacturer and delivered to customer)

There is a little more flexibility in relation to the price of second hand cars depending on mileage, condition and extras on the car. However, in recent years customers are getting better at knowing the true value of a car. Websites list thousands of cars and so comparison is easy. The sales people have the option to build in servicing of a second hand car if they wish so that the price the customer pays includes servicing for a fixed period. Sales people have flexibility in the price that they charge for servicing in order to secure the deal.

Repairs and servicing

GT Autos carry out simple mechanical repairs and servicing for vehicles they have sold and for other vehicles. They do not do insurance work for accidents.

Repairs can be carried out using original equipment manufacturer (OEM) parts or by using cheaper alternatives. OEM parts are specified for the repair and servicing of the new cars that they sell in order to keep warranties intact. The non-OEM parts are considerably cheaper to buy for GT Autos.

Servicing is carried out to a strict schedule specified by the manufacturer, however where the technician discovers something wrong with the car other work can be carried out with the owner's permission.

The accountant has suggested that the following rewards schemes be separately considered.

Sales people

- A fixed payment per car based on the volume of new and second-hand cars sold in a month. A minimum of 5 cars is expected each month and no reward is to be made on 4 cars sold or less. Also a fixed payment in total will be made to any salesman that sells over 20 cars in a given month.
- Alternatively, a fixed % reward based on the sales value of the cars sold. This would apply to any car sold but would exclude the value of any servicing.

Service and repair technicians

- A fixed payment per car based on throughput (volume serviced or repaired) each day. If a car is scheduled for return to a customer and then is not ready in time a deduction from the reward is made of 50% of that reward. If the lateness is due to late delivery of parts ordered on time this deduction is not made.
- Alternatively, a % of the margin made on each job undertaken. Margin is the invoiced amount less the cost of parts only. Losses are ignored.

Finance staff

Finance staff will be rewarded with a % of profit for the whole business over budget on a monthly basis.

Activity based management

The business is considering a range of actions that could be taken to manage and improve performance. The finance director is strongly in favour of the introduction of an activity-based approach. However, although the general manager does understand that the introduction of activity-based costing could result in more accurate costs, he has little understanding of the wider meaning and implications of introducing an activity-based management approach.

Required:

Prepare a report for the general manager:

- (a) Which discusses in detail both the potential behavioural consequences and the potential manipulation of actual results that could occur in order to secure better rewards for each of the following:
- (i) Sales people (10 marks)
 - (ii) Service and repair technicians (10 marks)
 - (iii) Finance staff (10 marks)
- (b) Which explains how GT Autos can motivate its managers to achieve its performance targets with reference to Vroom's expectancy theory. (5 marks)
- (c) Which explains what is meant by an activity-based management approach and evaluates the implications for GT Autos of such an approach. (11 marks)

You are to write as an external performance management consultant.

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 only to be attempted

- 2 PAK manufactures packaging solutions for the food and healthcare industry. A traditional company, it has built a reputation for revolutionary and robust styles of packaging.

The company is split into two divisions. The North and South Divisions of PAK produce roughly the same kind of output of packaging material and it is therefore considered appropriate by head office (HO) to compare their performance.

For the accounting period just ended the finance department within HO has produced the following summarised information:

	<i>North Division</i>	<i>South Division</i>
	\$000	\$000
Sales:		
External customers	2,000	150
Other division	60	1,800
	2,060	1,950
Variable costs:		
Production	370.8	234
Selling and distribution	160	78
	530.8	312
Contribution	1,529.2	1,638
Fixed costs:		
Production (includes depreciation on plant)	300	720
Selling and distribution	200	110
Administration	240	160
HO costs apportioned	150	280
	890	1,270
Divisional operating profit	639.2	368
Divisional capital employed	3,196	4,600
ROI	20%	8%

Concern has been expressed at the poor ROI achieved by the South Division, especially in light of the major investment in plant and equipment undertaken there, and also compared to the return achieved by the North Division with very much older operating assets. PAK's cost of capital is 10%.

The company's information system is highly decentralised with separate systems operating in each division and at head office. In order to remain competitive, the newly appointed Head of Strategy has deemed it necessary to develop the IT system to include

- a unified corporate database
- network technology and
- an enterprise resource planning system.

Required:

- (a) Demonstrate how the ROI for each division has been calculated and suggested an improved approach, explaining your reasoning. As far as the figures permit, restate the divisional ROIs based on your suggested improvement. (3 marks)
- (b) Calculate each division's residual income (RI) and briefly comment on the divisional performance as revealed by this measure. (3 marks)
- (c) For each division, determine, and briefly justify, some additional appropriate financial indicators of performance. Using these financial indicators, your answers to (a) and (b) and any other relevant information from the question, analyse the financial performance of the two divisions. (10 marks)
- (Note: A maximum of 4 marks are available for the additional appropriate financial indicators of performance).
- (d) Evaluate the improvements suggested to PAK's information systems. (9 marks)

(Total: 25 marks)

- 3** RestEasy is a small family run hotel chain based in Yorkshire, a major region in England and Western Europe. The hotel has been in existence for 20 years and built up a core of loyal customers seeking mid quality range accommodation.

In recent years trade has started to slacken off and so the family decided to analyse why this might be. Their main findings were:

- The introduction of new local competitors has taken trade from RestEasy. These competitors have been what might be described as cost-leaders offering relatively cheap but clean accommodation with joint venture partners providing a coffee shop and food on the premises. Although technically cost-leaders, the standards are viewed to be quite good with new beds, clean linen, a choice of pillows to suit customer needs and celebrity based marketing.
- RestEasy themselves received some criticism for failing to invest in the accommodation and the view was that the hotel chain did not provide a good value proposition.
- The legacy KPI system used had not been changed for many years and needed upgrading. A consultant offered to help design a new system and the old and new proposal are shown.

RestEasy responded to these findings by deciding to upgrade the rooms which all now include en-suite facilities, free WIFI, music dock and a better grade TV. The hotel management now need advice about the KPI system, as they are not convinced that this needs changing. They feel that with the upgrades that they have made and the marketing of those then the loyal customers will return and that will inevitably reflect in better results.

Old KPI system

The hotel has used net profit %, occupancy rates and a small number of cost control measures for many years. These cost control measures include: maximum total wage spend increases and repairs must not to exceed 2% of turnover in any one year.

New proposal

The consultant has suggested the adoption of a quality focus and using a balanced scorecard approach has suggested the following KPIs be adopted instead:

- 1 Overall customer experience score, based on a scale of 1-5 with the information gathered by the use of a very brief questionnaire to be left in each room each day.
- 2 The on-line processing system is to be monitored by measuring the proportion of on-line bookings compared to total bookings.
- 3 Staff turnover rate will measure the learning aspect.

Required:

- (a) **Explain why the existing system of KPIs might be contributing towards the financial decline of RestEasy. (8 marks)**
- (b) **Evaluate the use of the Balanced Scorecard approach to this quality-based problem (you are not expected to suggest alternative approaches). (5 marks)**
- (c) **Evaluate the suggested KPIs AND suggest three others with justifications. (12 marks)**

(Total: 25 marks)

- 4 The RJ Business Consulting Group (RJ) offers its clients a wide range of consultancy services, including risk analysis, financial modelling, strategic analysis and IS/IT advice. Its competitive strategy of differentiation relies on employing high calibre staff and the use of sophisticated, proprietary software packages.

Information technology (IT) division

The IT division of RJ provides consulting services to external clients as well as to other divisions within the group. Consultants always work in teams of two on every consulting day. Each consulting day is charged to external clients at \$1,500 which represents cost plus 150% profit mark up. The total cost per consulting day has been estimated as being 80% variable and 20% fixed.

The director of the Human Resources (HR) Division of RJ has requested the services of two teams of consultants from the IT division on five days per week for a period of 48 weeks, and has suggested that she meets with the director of the IT division in order to negotiate a transfer price. The director of the IT division has responded by stating that he is aware of the limitations of using negotiated transfer prices and intends to charge the HR division \$1,500 per consulting day.

The IT division always uses 'state of the art' video-conferencing equipment on all internal consultations which would reduce the variable costs by \$100 per consulting day. Note: this equipment can only be used when providing internal consultations.

New management information system (MIS) at RJ

The current recession has seen the consulting industry experience a downturn in demand and increasingly competitive tender processes. As a result, RJ is considering implementing a new MIS to enable managers to make timely and effective decisions for planning, directing and controlling activities. One of the directors previously worked for an organisation which used a lean MIS to increase efficiency and improve quality and is keen for this alternative option to be explored further.

Required:

- (a) Calculate and discuss the transfer prices per consulting day at which the IT division should provide consulting services to the HR division in order to ensure that the profit of the RJ Business Consulting Group is maximised in each of the following situations:
- (i) Every pair of consultants in the IT division is 100% utilised during the required 48-week period in providing consulting services to external clients, i.e. there is no spare capacity.
 - (ii) There is one team of consultants who, being free from other commitments, would be available to undertake the provision of services to the HR division during the required 48-week period. All other teams of consultants would be 100% utilised in providing consulting services to external clients.
 - (iii) A major client has offered to pay the IT division \$528,000 for the services of two teams of consultants during the required 48-week period. (12 marks)
- (b) Explain THREE limitations that the director of the IT division may feel that negotiated transfer prices have for the IT division and for RJ overall. (6 marks)
- (c) Explain what is meant by 'lean' and the necessary requirements to ensure a lean MIS in RJ. (7 marks)

(Total: 25 marks)

(Total for Section B: 50 marks)