Examiner’s report

P5 Advanced Performance Management
December 2012

Introduction
Firstly, I would like to offer my congratulations to all of those candidates who achieved a pass at this diet and my commiserations to those who did not.

In this report, my aim is to indicate areas of good and poor performance with the specific additional purpose of helping future candidates assess what is required of them.

The examination paper comprised two sections, A and B. Section A consisted of two compulsory questions for 60 marks in total. Section B consisted of three optional questions for 20 marks each from which candidates were required to answer two questions.

General Comments
I would offer similar broad comments to past reports, as these remain relevant to this paper. Most examinations require a balance of memory work and evaluation/analysis. As one goes through the levels this balance changes, from pure memory to more analysis. Good candidates distinguish themselves by being aware that if they come to this examination expecting to repeat memorised material, they will probably score only between 20% and 30%.

The basis of this examination is analysis and application. The candidate will need a foundation in the techniques of the syllabus but should focus more on evaluation of these techniques and consideration of their usefulness *to the given scenario*. This is not difficult to revise as it is a mindset that can easily be encouraged by considering attempting past papers as an integral part of the revision process. Candidates need to be aware that performance management is an area which, at an advanced level, is dependent upon situation and environment. A good, professional-level answer will go beyond the mere repetition of how a technique works and focus on relating it to the entity’s specific environment. It was very clear to the marking team at this diet that, typically, those candidates that had grasped the need for this went on to pass the paper with ease.

The vast majority of candidates attempted their allocation of four questions, and there was little evidence of time pressure though much of poor time management. This was evident where about half of a candidate’s script was taken up with the answer to question 1, which was worth only 34% of the marks. Time problems were exacerbated by a failure to read the question requirement and produce an answer that was relevant to the question asked. Future candidates should use the mark allocation as a guide to how much to write on particular topic and practice past paper questions under timed conditions in order to become familiar with this discipline.

The overall quality of the numerical working and the commentary on the results remains an area of concern. As noted in many previous reports and disappointingly, there has not been significant improvement over the diets in this aspect of candidates’ performance. For example in Q1, where a commentary on numerical data was requested, there were numerous examples of scripts that limited themselves to basically putting into sentences the numbers calculated, e.g. ‘North’s net income has fallen while East and Wests’ have risen.’ This is inadequate on its own and gained no credit as a comment.

In advising those who will review this paper in the future, I must give some well-worn suggestions. Firstly, some candidates are not spending sufficient time on reading the question and understanding its requirements. There is an article on this point which has appeared on the ACCA website but the lessons still do not appear to have been learned. For example, markers frequently commented on answers to Q4 (a) which, instead of explaining why liquidity and gearing were important along side profitability, offered a review of the performance of the company in the scenario, leaving the reader to draw conclusions.

Secondly, there was evidence that the syllabus is being only partially studied. I am afraid that I can offer no words of encouragement to those who insist on playing this risky game with the examinations. There was evidence on Q2 on budgeting methods, Q3 (b) on the impact of the regulatory environment on performance management, Q4 (b) on qualitative failure prediction models and Q5 (a) on Burns and Scapens report that these areas had been only superficially covered by candidates in their studies. However, there was good performance on the detailed calculation of EVA required in Q3 (a), which had been the subject of an article in July 2011.

Thirdly, I would make a general criticism of the candidates' comments made on the issue of manipulation of performance measures. This is being used in a generic fashion without thought given to the implications of such criticism. Candidates need to be aware that all measures are to a greater or lesser extent subject to this problem and to demonstrate that gradation in their answer. They must support such comments with evidence from the scenario otherwise they are in danger of accusing their clients/colleagues/superiors of fraud without justification! Greater subtlety of understanding and communication is expected of a professional solution at the final level of the ACCA qualification.

Finally, in the style of presentation of answers, candidates should avoid the *unexplained* use of jargon. It is possibly due to the candidates' lack of confidence in applying their knowledge that there is a tendency to simply put down lists of jargon phrases and hope for marks. As in previous diets, better presented answers, which demonstrate neat layout, logical structure and a readable style, offer an easier opportunity for markers to understand and so credit the points being made – this is something that will always remain an important point for candidates preparing for P5.

Specific Comments

Question One

This 34-mark question was based on an advertising agency, Lincoln & Lincoln Advertising (LLA), and tested candidates' ability to analyse basic management accounting data to assess the performance of the business' three regional offices then to consider and improve the performance measures used at these offices and finally, to evaluate and improve the current remuneration policy at LLA. There were four professional marks available for format, style, structure and clarity of discussion in the required report. Generally, this question was reasonably answered although many easy marks were omitted in parts (i) and (ii) by candidates not addressing their advice to the individual circumstances of the three offices and instead only offering generic comments for the whole company. The scenario gave much detail on the three offices and it should have been obvious that they each faced their own challenges which required a tailored response – indeed, the CEO in the scenario specifically advises candidates to avoid 'a one-size fits all policy'.

Part (i) for 10 marks required candidates to assess the recent performance of the three regional offices of LLA by interpreting the data already prepared. For a standard P5 question topic, the general performance on this part was poor. Most candidates understood that there were differences between the offices but failed to bring them out in their answers. The marks in this question were for analysis of the data not its repetition. Therefore, those candidates who explained the implications of the data or succeeded in connecting trends in one indicator with another scored well (e.g. falling revenue plus fixed costs leads to larger falls in profit). The best answers offered a general overview of the three offices performance and then took each office in turn to bring out the commercial issues present there e.g. West's rapid growth but dangerous increase in receivables. Future candidates should consider the reader in writing their responses. In this situation, the board would have found an answer divided into sections by office much more helpful than split into sections based on the standard headings of an accountant's ratio analysis.

Part (ii) for 10 marks required an evaluation of the choice of net income as the performance measure for the regional offices and suggestions of other measures and why they are appropriate for each office. As in part (i), candidates scored well if they appreciated the need to address the regional offices' specific requirements. Many candidates offered a reasonable set of generic suggestions for the company as a whole but missed out on the regional differences.

The first part of the requirement sought an evaluation of the existing performance measure (net income) and a recognition of two key facts – this measure contained uncontrollable costs and it was too general to cover the issues across the company. Other criticisms of the measure were credited as well, however, these were the main areas.

The second part required justified recommendations of alternative metrics. Most candidates realised that non-financial indicators would be useful and those that made suggestions appropriate to LLA scored well. Those that offered lists of metrics that could apply to any company scored significantly less well. There were many answers that provided lengthy (possibly rote-learned) proposals of ROCE, EVA™ and RI although these were of limited use in this scenario, as they did not address the issues in the different offices nor did they address the fact that LLA would be likely to have a large intangible asset base. The better solutions made sure that their comments on these alternatives were consistent with their criticism of the existing measure.

Part (iii) for 10 marks required an evaluation of LLA's remuneration policy suggesting improvements. This part was typically well done. Most candidates addressed their comments to the five different grades of staff given in the scenario. However, as in Q2 (a), many candidates assumed that all of the existing policies must be wrong and so only made negative comments – future candidates need to be aware that evaluate means to give a balanced assessment (including both the positive and negative aspects of an issue). On the suggested improvements, most candidates provided practical suggestions addressing the weaknesses previously discussed. For example, the best candidates suggested that the account management staff should have part of their remuneration based on measures of client satisfaction such as retention. However, many candidates seem to be under the misapprehension that share schemes solve all remuneration policy issues. These schemes can address alignment of interests of staff with shareholders but do not *necessarily* address the shortsighted nature of many bonus schemes.

Future candidates should study the question and model solution for parts (i) and (ii) as these give good examples of addressing the particulars of a scenario.

Question Two

This 26-mark question covered the core topic of budgeting methods requiring an evaluation of and improvements to the current budget method at the four divisions of Drinks Group (DG), a drinks manufacturer. This question was usually done reasonably overall with answers to parts (a) and (b) being better than (c) and (d).

Part (a) for 8 marks required candidates to evaluate the current (incremental) budgeting method at each division. This part was generally well done with candidates scoring well by identifying the circumstances at each division and then evaluating if these made incremental budgeting appropriate. A few candidates seemed to assume that as the method was being questioned it must be flawed for all divisions and then sought reasons to justify this view. This is a poor approach to any question as it pre-judges the outcome without consideration of the evidence in the scenario. Incremental budgeting would be a strong candidate at the stable H and S divisions. Also, some candidates spent excessive time suggesting and justifying alternative budgeting methods when this was not asked for and indeed, represented the bulk of the work in the remaining parts of the question.

Part (b) for 8 marks required a recalculation of the budget for Fizzy division (F) using rolling budgeting and an assessment the use of rolling budgeting at this division. This part involved a simple application of the method and then comment on its appropriateness for F. Candidates generally performed well in this part although many did not bother to prepare the new quarter's figures (Q1 of the next year) which keep the budget rolling forward and as a result missed out on some easy marks.

Part (c) for 4 marks required a justified recommendation of the budgeting method at the Marketing division (M). This part was generally poorly done with candidates unable to identify the relevant circumstances at M that would suggest possible budgeting methods. Amongst these circumstances were the project-based nature of marketing activity and the desire of the other divisions to control marketing spending.

Part (d) for 6 marks required an analysis and recommendation of the appropriate level of participation in budgeting at Drinks Group (DG). Answers to this part were mixed. Most candidates identified the current level of participation although a significant number just assumed that the current process was all top-down ignoring the fact that divisional managers have input into the growth estimates (which are the important ones) in the existing incremental budget. The best candidates realised that having suggested different budget methods for the four divisions, they should address their comments about level of participation to each division dependent on its budget method.

Future candidates should be aware that budgeting is a core topic and candidates will be expected to know the relative merits of the different methods and how to apply them in a scenario.

Question Three

This 20-mark question was based on Stillwater Services (SS), which provided water and sewage services to the public and businesses of a region of the imaginary country of Teeland. The question tested the areas of EVA™ and impact of regulatory control on performance management.

Part (a) for 13 marks required an evaluation of the performance of SS using EVA™. The calculation of this metric was discussed in a recent article and had clearly been well prepared in advance by many candidates who scored most of those marks available. The calculations of NOPAT could be done by starting from PAT or Operating Profit and both approaches gained credit. The weakest area of the calculations was of the adjustments to capital employed. Most candidates realised the need to comment on the numbers and gave a summary sentence. However, many did not appreciate that there were 3 marks available for comments and so did not provide any broader comment on the key assumptions in the method or its limitations. This could be seen as a failure to appreciate the need to 'evaluate' rather than simply 'calculate', which would be an approach more appropriate to a lower level paper such as F5.

Part (b) for 7 marks required an assessment of whether SS meets its given, regulatory ROCE target and comments on the impact of such a constraint on performance management at SS. This part was generally poorly done with many candidates not realising that the ROCE target was an upper limit on the company. The better candidates commented on the circumstances that could lead to generating a higher ROCE than allowed, the impact of the fines that would result and the management approach that should be taken as a result. Few candidates spotted that this constraint on the regulated side of the business would mean that the unregulated part of the business would be the engine of growth for SS while the regulated side could act as a cash cow supplying capital. The impact on business performance of the regulatory environment is mentioned in the syllabus and study guide at B2 and future candidates would be advised that specific mention of an issue implies that question scenarios can be based around that area.

Question Four

This 20-mark question was based on the nursing home company Coal Creek Nursing Homes (CCNH) and tested candidates' knowledge of importance of liquidity and gearing metrics and the use of qualitative models for prediction of corporate failure.

Part (a) for 11 marks required a discussion of why indicators of liquidity and gearing need to be considered in conjunction with profitability at CCNH. Scores on this part were mixed with only the better candidates addressing the question requirement. Most candidates scored the incidental marks available for illustrative calculations from CCNH – although it was disappointing to see how many could not accurately calculate simple ratios. However, having done this work they allowed it to lead them into believing that the question asked for a general assessment of the financial situation of CCNH when in answering the question, this should be used as an illustration of why indicators of liquidity and gearing are needed alongside those of profitability. It was also notable that although many candidates successfully dealt with issues around financial gearing, only a few candidates addressed the operational gearing at the business. There appeared to be lack of identification of the cost structures (variable/fixed) within CCNH that ought to be a basic point in the financial assessment of a business by a management accountant.

Part (b) for 9 marks required an explanation of one qualitative model for predicting corporate failure and comments on CCNH's position applying this model. Few candidates demonstrated a clear understanding of the issues in using a qualitative model and in particular, in the Argenti model only a minority could explain defects, mistakes made and symptoms of failure. Many could quote the headings but few could explain what they referred to – the wiser candidates tried to cover this by illustrating each heading with an example from CCNH. However, given the above comments, it was pleasing to see that many candidates scored reasonably well by identifying the specific issues at CCNH.

Future candidates would be advised to learn the basic lesson in part (a) which is to answer the question asked. They should also note the importance of grasping the cost structures of a business in a P5 scenario.

Question Five

This 20-mark question was based on Herman Swan & Co (HS), which makes fashionable clothes and leather goods and tested candidates' knowledge of the Burns and Scapens report on the future role of management accountants and performance issues surrounding brand loyalty and awareness. Although this was the least popular of the section B questions, those candidates that tackled this question clearly grasped the nature of the business and typically did well in their scenario-related comments and illustrations.

Part (a) for 12 marks required a description of the changes in the role of the management accountant based on Burns and Scapens work, explaining what is driving these changes and justify why they are appropriate to HS. Most candidates had a broad grasp of the issues being dealt with by Burns and Scapens and did well trying to weave these in to the specific circumstances at HS. However, few candidates could remember the detail of the report and so their analysis often missed out on one of the three factors mentioned (technology, management structure and competition).

Part (b) for 8 marks required a discussion of the impact of brand loyalty and awareness on the business both from the customer and the internal business process perspectives and an evaluation of suitable measures for brand loyalty and awareness, illustrated by the information in the scenario. Most candidates were able to discuss brand loyalty from the customer perspective and suggest suitable measures, fewer were able to clearly distinguish the internal process perspective although they had realised that quality was a key part of the product offering. The better candidates distinguished themselves by differentiating between loyalty and awareness with awareness preceding loyalty and being about beginning to attract new customers while loyalty was about retention of existing customers.

Future candidates would be advised that application of performance measurement concepts to specific scenarios will remain a core part of P5. So, it should be a part of revision to practice taking the measures mentioned in the syllabus and study guide and seeing how they apply to different businesses.