

Examiner's report

P5 Advanced Performance Management December 2015



Introduction

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

In this report, our 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. We have added comments about potential improvements to examination approach which could be made, after the commentary on each question.

We will begin with general comments about the approach and then provide a commentary on the questions in the examination paper.

General Comments

The examination paper comprised two sections, A and B. Section A consisted of one compulsory question for 50 marks in total. Section B consisted of three optional questions for 25 marks each from which candidates were required to answer two questions.

The majority of candidates attempted their allocation of three questions and there was little evidence of poor time management in terms of completing the paper. Amongst the section B questions, question 3 was probably marginally favoured in the number of candidates attempting it. Question 2 was the least favoured in the number of attempts seen.

The examining team continues to be concerned by the quality of answers that has been observed which is consistent with that of the last ten diets of P5. The advice in past examiner's reports and approach articles does not seem to have been taken up by many candidates. We would strongly advise that candidates use these materials to ensure that they have the right overall attitude to P5, which is intended to lie at a post-graduate level.

Principally, this means paying specific attention to the question requirement: at P5, questions demand that scenarios are "evaluated" and "assessed" rather than described. The difference is fundamental and crucial as an analysis involves a study of applicability rather than a description. Similarly, candidates are often required to 'advise'. For example, a candidate who answers a question focused on how an organisation can improve its performance management system by using the balanced scorecard by simply describing the perspectives of the model is demonstrating knowledge of a technique but is not answering the question. Advice involves explaining how this particular model is applicable to the *specific* scenario and the benefits it can provide to the company. Also, providing a history of how and when such a model was developed, although interesting, adds little benefit when providing advice. Such an approach is straightforward to adopt when considering past papers and should be the basis for any revision strategy. Knowledge of any technique – be it balanced scorecard, or just-in-time – is essentially taken for granted at this level. The essence of P5 is the application of this knowledge to a practical scenario and it is the demonstration of these skills which will make for a successful response at P5.

Candidates who come to this examination expecting to repeat memorised material will probably score only between 20% and 30%. Many candidates have clearly been taught that they should define in their answer any 'jargon' terms in the question requirement. However, they are wrong to assume that this alone will provide them with a passing answer at P5.

A lack of basic knowledge was demonstrated by many candidates at this diet;

- 1) in question 1(iii) several candidates clearly did not demonstrate the basic characteristics of kaizen costing, thus making it impossible to answer how implementing such a process would impact on performance management.
- 2) In question 3(b) many candidates when unable to produce basic calculations on the capacity of the service provided by the organisation.

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. As in previous diets, it was very clear to the marking team that those candidates that had grasped the need for this went on to pass the paper.

This issue leads directly to the well-worn advice to candidates to 'answer the question asked'. There are several examples in the discussion below where candidates answered a slightly different requirement from the one asked or simply ignored a part of the requirement (and thus the marks on offer). There was also a continuing disregard for the suggestions contained within the scenario. Candidates should remember that the scenario is intended to mimic real life, in so far as is possible in the examination context.

Question One

This 50-mark question was based around a multinational manufacturing business. Firstly, candidates were required to evaluate the accuracy of an EVATM calculation and the assumptions made within the calculation, advising on the results. They were then asked to explain the weaknesses of the current key performance indicators (KPIs) relating to the organisation's critical success factors (CSFs) and suggest justified alternative KPIs. They were then asked to explain three improvement projects that were being implemented and how these projects would help meet the CSFs and the impact each would have on the existing KPIs. Finally, they were asked to assess the impact of a proposed, new information system on the three improvement projects.

Part (i) required an evaluation of the *accuracy* of an EVA calculation that had been provided. EVA is an important metric and as such it is fundamental for a P5 candidate to be able to identify errors in a calculation and correct them. This part of the question was generally well attempted, although several candidates failed to optimise their marks. Therefore a discussion of some of the weaknesses is needed:

- Many candidates spent time discussing the advantages and disadvantages of using EVA, such as 'closely related to cash flow' and 'is difficult to calculate in practice', but this was not asked for in the requirement. Candidates should ensure that they focus on the specifics of the requirement, and although a brief explanation of a model/technique may add some value, it is unlikely to warrant several paragraphs, and in some cases pages, when it was not asked for.
- Several candidates failed to recognise the correct treatment of depreciation on leases or that the opening capital employed figure should be used and not the closing figure.
- Some candidates failed to notice that that WACC had not been too adjusted for the tax relief and therefore did not make an adjustment. However, it should be noted that the majority of candidates that did notice this went on to correctly calculate a revised WACC figure.
- Most worryingly was that fact that several students incorrectly interpreted a Debt: Equity ratio of 100% as meaning that the company was financed entirely by debt and there was no equity. This is a fundamental error and one the marking team was surprised to see at this level.
- The responses from several candidates were too superficial, with some providing revised calculations with no explanation of the changes. This type of question, which requires an evaluation of whether or not something is accurate, demands candidates to state more than it is right or wrong. Candidates must be able to state what is inaccurate, explain what the correct treatment should be, AND explain why this is the case.

Part (ii) asked for a brief explanation of the weaknesses of the current KPIs and provide justified alternative KPIs for the critical success factors. This question was generally attempted well with many candidates scoring maximum marks. It is important when setting KPIs to understand the impact it may have on performance and also to consider whether or not it is suitable in relation to the CSF. The only major failing on this part of the question was regarding the recommendations of alternative KPIs. Several candidates seemed to misunderstand what a KPI is and make bland statements like the company should 'focus on training' or 'ensure that customers receive quality products' as opposed to suggesting measurable metrics.

Part (iii) asked for an explanation of how each of three improvement projects would help meet the CSFs and the impact they would each have on the KPIs. The responses from candidates were mixed on this part of the question, ranging from summary explanations of the improvement projects (just-in-time, kaizen costs and examining costs of quality) to comprehensive discussion that each would have on the CSFs and KPIs. With any new project, care should be taken to ensure that they will assist in helping an organisation achieve its objectives, and as such whether or not they will be beneficial to the CSFs. In addition, changes to current processes may also lead to a change in appropriate KPIs. For example, is a KPI focused on the number of units produced per hour applicable within a just-in-time manufacturing environment where the focus is on quality and based on a demand-pull framework?

The responses from many candidates were limited by the fact that detailed knowledge of kaizen costing and costs of quality were lacking. Again, this emphasises the need for candidates to ensure that they have a sound grasp of basic management accounting knowledge.

Part (iv) asked for an assessment of the impact of a new information system on the three improvement projects. Many candidates re-iterated the features of the new system that were detailed in the question but provided little in the way of developing this into an assessment of how it would impact on the improvement projects. Candidates need to be aware of the fact that to assess the impact of a new information system on a project, a good answer will identify what are the information requirements of each project and whether or not the new system will meet these requirements. For example, the implementation of initiatives such as just-in-time manufacturing is heavily reliant on an appropriate information system allowing for co-ordination of deliveries and manufacturing schedules in order to meet customer demands.

As has become common, those candidates who had practised writing professional answers prior to the examination performed admirably in the presentation area (4 marks). The markers were looking for suitable report headings, an introduction, a logical structure, signposted by the good use of subheadings in the answer, and a clear, concise style. A conclusion was not required for the 4 marks but if a suitable and substantive one was offered then it was given additional credit. It may be worth noting that introductions of the form 'I have addressed the issues relating to performance management of the organisation' are inadequate. A more substantive description of the contents of the report is required.

Section B

Question Two

This 25-mark question covered the issues of international transfer pricing within a manufacturing company. This question proved to be the least popular with candidates.

Part (a) asked for advice on international transfer prices. On the whole this was well attempted, with candidates stating the factors to consider and then explaining why. It is important to understand that when providing advice an explanation or justification will be required. The need to consider government regulations, including taxation rates and import duties, as well as exchange rates are key factors with regards to setting international transfer prices. Candidates who failed to score well here generally did not focus on the fact that the question specifically referred to '*international*' transfer pricing, and as a result only discussed the goals of transfer pricing such as 'goal congruence' and 'divisional autonomy'.

Part (b) required candidates to evaluate the change in profit after tax if a change in the transfer price did not take place. Few candidates attempted this in a meaningful way and a number failed to identify that calculations were required to effectively evaluate the change. The question was done badly for several reasons;

- Candidates often failed to realise that a change in profit calculation was required for both divisions.
- Some candidates did not seem to understand that a transfer price represents revenue for one division

and a cost for the other. Therefore a change in the transfer price will change the revenue and cost respectively for each division and thus will impact on each divisions' profits.

Part (c) asked for an assessment of how the current and the proposed transfer pricing systems would affect performance management. Those candidates that scored well on this part of the question tended to structure their answers in a way that identified the aim of transfer pricing with regards performance management, for example, each division having a degree of autonomy and being appraised based on profit, and then discussing how the two transfer pricing systems would affect this. Few candidates seemed to appreciate the problems of transferring at actual cost and how transferring at standard cost would stop inefficiencies being passed on.

Overall, international transfer pricing, unlike domestic transfer pricing, can impact on profitability for the group due to taxation and exchange rates, and as such is an important topic for candidates to understand and evaluate.

Question Three

This 25-mark question was based on the application and usefulness of the balanced scorecard within a service organisation, and consideration of the problems in assessing and interpreting performance measures. Candidates were also asked to evaluate the capacity levels of the service and assess whether overcrowding was prevalent.

Part (a) required advice on how the balanced scorecard could improve performance management systems. The majority of candidates clearly knew the structure of the theory, although some merely listed the four perspectives as opposed to explaining what they were. Candidates should be aware that few marks are awarded at this level for providing superficial lists. The emphasis of the question was how the balanced scorecard can improve the system. Therefore it is essential that candidates recognise that they need to identify specific aspects of the model and how they would benefit the system. Simply listing potential metrics scored few marks unless the candidate could clearly demonstrate the benefit. For example, explaining that the company could use EVA as a measure under the financial perspective provides little evidence that a candidate understands how using the balance scorecard is beneficial. However, to score well, a candidate could explain that the approach aims to ensure the long-term success of the company and using EVA would be an improvement on using, say, ROCE.

Part (b) required candidates to evaluate claims that the services were overcrowded. The calculations for this part of the question were generally performed well. Credit was given to various approaches to show whether or not overcrowding was evident given the data presented. It is therefore worthwhile mentioning that candidates do not have to follow prescribed methods to demonstrate a point as long as there is a logical approach and the answer is well explained. However, few candidates attempted to discuss the claim of overcrowding in any detail other than to say whether or not capacity was exceeded. Candidates should be aware that the scenarios on P5 are written to reflect real world examples and as such, in this scenario, discussing practical considerations would be beneficial.

Part (c) required candidates to assess the problems that may be encountered when selecting and interpreting performance measures when applying the balanced scorecard. This part of the question was well attempted by many candidates. This is a clear example of where understanding the advantages and disadvantages of a model, and then demonstrating how they relate to the given scenario, will allow candidates to score well. One of the main shortcomings in many responses to this question was a failure to specifically answer the question, which focused on selecting and interpreting, for example, there can be conflicting metrics. Several candidates simply discussed the difficulties in adopting a balanced scorecard approach, such as commitment from management, and a general discussion of target setting, such as measure fixation. Again, re-iterating earlier comments, candidates should ensure that they specifically answer the question that has been set.

Question Four

This 25-mark question was based on an organisation that stages live events. The question was split into two parts, with the first part considering how a Porter's 5 Forces assessment can be used and the second part asking

candidates to evaluate how the introduction of a new IT system and newly proposed organisational strategies would change the role of a management accountant and the benefit it would have on the business.

Part (a) required candidates to provide advice on how a Porter's 5 Forces assessment could be used to manage the high forces (given in the question), assessing the difficulties in defining and measuring the forces, and also to provide a justified performance measure to assess the strength of each of those forces. Marks were available for a general discussion of Porter's 5 Forces and many candidates clearly demonstrated an understanding of the model and its application. However, some candidates failed to specifically answer the requirement and instead simply explained the possible reasoning for the analysis of the forces that had already been carried out or simply tried to offer advice on how the company could be more profitable. The marking team would like to strongly recommend that candidates should attempt to structure their answers in line with the specific requirements in the questions. Candidates who structured their answer along the lines of 'managing the force', 'difficulties in defining the force', 'difficulties in measuring the force', and 'recommending a performance measure for each force' scored well on this part.

Part (b) required an evaluation of how a new IT system could change the role of the management accountants and assess how it would impact the business. This question was reasonably attempted. It is important for candidates to understand that to evaluate a change they should firstly identify what the current position is and then evaluate the impact the new IT system will have. Several candidates used Burns and Scapens to structure their answer. Although no specific model was required here this was a sensible approach in answering the question. However, many responses highlighted little in the way of an evaluation of the change and tended to simply repeat the features of the new IT system that were detailed in the question.

Conclusion

In conclusion, the main messages for future candidates, similar to those given in the past, are:

- Answer the question requirement
- Understand the main theoretical models and how to apply them.
- When considering a technique or model, consider some of the issues, areas that may be affected by its implementation and development. This is an area that is always relevant to performance management.
- Practice application of your knowledge in scenario contexts – revising using past papers and answering the questions - is a good way of getting into the mind set to help you achieve a pass in P5.