

Examiner's report

F5 Performance Management

September 2015



General Comments

There were two sections to the examination paper and all questions were compulsory. Section A consisted of 20 multiple choice questions (two marks each) which covered a broad range of syllabus topics. Section B had three shorter questions (worth 10 marks each) and two longer questions (worth 15 marks each). These questions covered all of the main syllabus areas.

On the whole, candidates scored better in Section A than Section B. The calculation aspects of Section B were also encouraging, showing that the technical side of the subject can be overcome with preparation and practice. However, many candidates did not apply the information given in the scenario to their answers in the written sections, and tried to rely on knowledge alone. Application of knowledge to the scenario is a vital skill, and will be tested throughout the ACCA syllabus.

Specific Comments

Section A

It was very pleasing to see that once again almost all candidates attempted all of the questions. Candidates preparing for the next examination of F5 are advised to work through the pilot paper, past exam papers and sample questions discussed here and to carefully review how each of the correct answers were derived. Section A questions aim to provide a broad coverage of the syllabus, and future candidates should aim to revise all areas of the F5 syllabus, rather than attempting to question spot. The following two questions are reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific questions selected.

Sample Questions for Discussion

Example 1

B Co. operates a production process which generates a contribution of \$4 per hour. Wages are paid at \$7 per hour and labour is fully utilised. During busy periods workers are offered the chance to work overtime, which is paid at \$10 per hour. However, workers are currently refusing to work overtime because of an industrial dispute.

B Co has just received an additional order which must be fulfilled immediately which will require 10 hours of labour to fulfil.

What is the total relevant cost of labour for the additional order?

- A \$11
- B \$40
- C \$100
- D \$110

This question tested candidates' knowledge of relevant costing principles, specifically labour costs and was not answered well by candidates. When finding the relevant cost of labour, the first question we should ask is 'do we have spare capacity?' If we do (and our labour is paid a guaranteed minimum number of hours), then we can undertake the job at no extra cost, therefore the relevant cost is zero (remember that relevant costs look at the change in cash flows as a result of a decision).



However, in this question, there is no spare capacity. If this is the case, we have to look at the options available, and pick the cheapest. If we pay overtime, or hire extra staff, any extra costs are relevant as the extra costs are directly linked to the job. The other option is to divert production from another product, which is an option here.

The general rule for this situation is that the relevant cost is the contribution lost plus the labour cost, but it's worth looking into why, as this is a common mistake in relevant costing questions. What we have to look at is 'what are the changes in cashflows as a result of this decision'. If we look purely at labour costs, there is no change – we are simply telling our workforce to stop working on one product, and come and work on the job in question, so no change in cashflows. We do, however, lose the benefit from the product we divert from. We lose the revenue, because we can no longer sell the product, but we save the variable costs as we no longer make it. Fixed costs will be unchanged, so the benefit lost is the contribution. Finally though, we've just said that we'll save the variable costs of producing the other product, but we won't actually save the labour costs - which is why we need to add them back. It can be a difficult concept to understand, but remember, if we're diverting production, the relevant cost is contribution lost plus the labour cost.

In the context of our question, we can either divert production or pay overtime. Based on the above, the cost of diverting production is the contribution lost of \$4/hr plus the labour cost of \$7/hr, ie \$11/hr. The overtime cost is \$10/hr, so ordinarily we would choose this as it is cheaper, however due to the industrial action no overtime is available. This leaves us with only one option – pay \$11/hr. The question asks for the total cost of the 10 hours required, so $\$11/\text{hr} \times 10\text{hours} = \110 , answer D.

Answer A was the correct hourly relevant cost, but not the total cost. Answer B recognised the contribution lost of \$4/hr, but didn't add back the labour cost. Answer C was the cost of the overtime, which couldn't be selected due to the industrial dispute.

Relevant costs are a regularly examined topic in F5 and future candidates should be aware of relevant costing principles, as well as common relevant costs such as materials, labour and overheads.

Example 2

B Co produces quarterly rolling budgets and had forecast the costs of material purchases for the next four quarters (quarters 1, 2, 3 and 4). Purchases for quarter 1 were budgeted to be \$220,000 and it was anticipated that the cost of materials would rise at a rate of 2% per quarter.

At the end of quarter 1:

- Actual material purchases were recorded at \$210,000. This was due to a change of material supplier during the quarter.
- A revised estimate for the increase in material purchase costs was made. The rise was now predicted to be only 1% per quarter.
- The budget was updated.

What estimate for total annual material purchases should be recorded in the updated budget?

- A \$896,754
- B \$852,684
- C \$861,211
- D \$1,071,211

This question tested the area of budgeting, specifically rolling budgets, and was not well answered by the majority of candidates. The main point here is that budgets are updated to include all information – at the end of quarter 1 we have more information than when we set the budget at the start of quarter 1. Our original budget incorporating the 2% increase as originally forecast would look as follows:



	Q1	Q2	Q3	Q4	Tot
Material	220,000	224,400	228,888	233,466	906,754

The new information is that actual quarter one material purchases were \$210,000 and the increase would only be 1% per quarter. With this new information we would roll our budget on a quarter, starting with Q2. The most important number here is the Q2 forecast – this would now be based on a 1% increase on the Q1 actual figure, as this is the most up to date information we have. Therefore the Q2 figure is $\$210,000 \times 101\% = \$212,100$. The remaining quarters' forecast figures follow from this – increasing by 1% per quarter, giving the following:

	Q2	Q3	Q4	Q1	Tot
Material	212,100	214,221	216,363	218,527	861,211

Therefore the answer is **C**. Answer A simply takes the original budget and revises the Q1 figure to \$210,000 – reducing the total by \$10,000. Answer B is obtained by adding Q2-Q4 revised budget, but including the Q1 actual figure, which does not 'roll' the budget on a quarter. Answer D includes the correct figures, but incorrectly adds in the Q1 figures, which would no longer form part of the budget.

Budgeting is a key area of the F5 syllabus, and future candidates should be aware of all the different methods available to a business.

Section B

Question One

The first question was a ten mark question covering target costing. Part (a) required knowledge of the steps involved in target costing. This was well answered by most candidates – showing a good appreciation of the basics of the subject.

Part (b) required candidates to apply this knowledge to the scenario given, and discuss the benefits and difficulties faced in implementing target costing within a service provider. Results on this question were mixed – it was pleasing to see that many candidates were aware of how service providers differ from manufacturers. However, a common error in this question was to explain the characteristics of service providers but not apply it to target costing as required, making it very difficult to award marks. Writing "Services are variable in nature," is true, but doesn't address the requirement regarding the difficulties of target costing. "Services are variable in nature, therefore the amount of resources used for each customer will be different, making pricing and costing more difficult," would address the requirement. Better answers used the facts given in the scenario to give their points more weight and would score more highly as a result.

Exam technique is important on questions like this too – the requirement asked for benefits and difficulties – two separate things. Candidates should try to break up their written answers with headings wherever possible; both to give the answer structure and to ensure that the whole requirement is met. Some candidates failed to achieve full marks as they only addressed half of the requirement – this could be avoided by reading the requirements carefully during the 15 minute reading time.

Question Two



Part (a) required candidates to use the minimax regret approach to advise a business on its supply levels. A significant proportion of candidates were able to score full marks on this question as they knew the method required – as is often the case in questions of this nature, if the steps are known, full marks can be obtained.

Unfortunately, if candidates are not familiar with the steps, then it is very difficult to score any marks. This shows the importance of preparation, and using the resources available. Past papers are available, to allow candidates to practise the techniques needed. While minimax regret hasn't been examined in detail on a long question, it was discussed in detail in the Examiner's report from the June 2015 sitting – showing its importance. The F5 syllabus is very broad, and there is a lot to learn – however, question spotting is a tactic which can prove damaging – it is much better to spend the time going through the syllabus and trying to cover everything, rather than being an expert on only some topics such as ABC or linear programming.

Part (b) required an explanation of an 'expected value' and discussion of its merits in this situation. This was another area where candidates struggled – a common approach was to write out the formula. This does not address the requirement, as it does not explain that it is a long-run weighted average return. Strong answers recognised that expected values are used by risk neutral investors for repeated decisions.

Question Three

Question 3 required candidates to assess the performance of a company. The scenario gave performance measures for three categories, along with scores for the company's competitors.

Part (a) asked candidates to calculate a weighted average overall score for each company, based on the three measures already given. Part (b) followed on from this, requiring candidates to discuss whether statement made by the company's managing director regarding their performance was true. Again, good exam technique was invaluable here – the statement made two key points – stronger answers took each point in turn and assessed its validity. A significant minority of candidates misinterpreted the requirement, and discussed the performance of the company, and how it might improve. Careful analysis of the requirements (during the reading and planning time) would have avoided this.

Part (c) tested candidates' knowledge of the terms Efficiency and Effectiveness in a Value For Money (VFM) framework and their application in this scenario. A pleasing number of candidates scored very well on this part of the question, applying the knowledge to the information in the scenario. Application marks were scored when candidates selected appropriate measures for the company.

Question Four

The first of the longer questions covered Multi-Product CVP (Cost-Volume-Profit) analysis for a business selling three products. It was encouraging to see that many candidates were well prepared for these questions.

Part (a) required the calculation of the weighted average contribution to sales ratio, and was well answered by most, and full marks were regularly scored. However, there were still many candidates who simply took the mean of the individual contribution to sales ratios. These must be weighted according to the revenues expected from each product. By far the simplest method for calculating this figure is to take the total contribution and divide by total revenue. Another common mistake is to add up the individual contribution/unit and divide by the sum of the individual selling prices. This does not give the correct weighting, which is why we have to multiply by volume first.

Part (b) tested candidates' ability to calculate the margin of safety. This requirement was well answered.

Part (c) asked candidates to produce a multi-product Breakeven chart. This was the first time that such a chart had been asked for, and as a consequence marks were low. Many answers gave a Profit Volume chart, which

was asked for last time this topic was examined in detail. It's possible that this could have been due to not reading the requirement carefully enough – picking out the key words “multi-product” and “chart”, and rushing to do the graph.

Part (d) was a simple test of the candidates' understanding of how the breakeven point would change if the products were sold in a different order. Most candidates recognised that the breakeven point would reduce, but did not pick up the “explain” mark – that the fixed costs would be covered quicker by the higher C/S ratio.

Question Five

Question 5 tested variances – specifically planning and operational sales variances. The scenario gave candidates a draft operating statement showing the sales volume and sales price variance, as calculated by a trainee accountant (which contains errors). There is also information regarding the market conditions and decisions made by the sales director.

Part (a) firstly asked candidates to redraft the operating statement, correcting any errors. It was good to see that most did address the “redraft” element of the requirement – essentially copying down what was in the scenario, and checking the numbers. The other requirement in part (a) was to show the sales variances at a level of detail which would be sufficient to assess the performance of the company and the sales director. Well prepared candidates realised that this meant that some of the variances would be down to uncontrollable “planning” errors, and the original budget should be revised accordingly. The operating statement could then show the variances due to uncontrollable factors, and those down to internal decisions, i.e. planning and operational variances.

Many candidates attempted to calculate cost variances in answering this question. While no marks could be lost, valuable time is wasted. Part (b) then asked candidates to assess the performance of the business and sales director. The difficulty here was identifying the cause and effect relationships between the various variances and the information in the scenario. Basic marks will be awarded for saying what a variance means, but more marks can be given if a candidate explains WHY it happened. For example, “The sales price planning variance was adverse, meaning that the market price was lower than expected,” will get some credit, but “The sales price planning variance was adverse, meaning that the market price was lower than expected. This was due to the government's tax cut, which was out of the control of the sales manager,” will gain more marks. The difference here can be clearly seen with the second response containing a justification and so candidates should practise supporting their points with information from the scenarios given.

Conclusion

Performance in the technical areas of this examination was strong. Candidates should review past papers to identify the skills required in applying their knowledge, as this is a common weakness. Analysing the requirement carefully and using the information provided in the scenario are also areas many candidates should look to improve. Whilst the size of the F5 syllabus may be daunting, good exam technique is just as important as learning the management accounting methods and techniques.