Mock Examination : ACCA Paper P5
Advanced Performance Management

Session : December 2012

Prepared by : Mr Ian Lim

Your Lecturer

☐ Mr Ian Lim

Your Mailing Address : ______________________________________
____________________________________

Your Contact Number : ______________________________________

I wish to have my script marked by my lecturer and

☐ collect the marked script at the SAA-GE Reception Counter
☐ have the marked script returned to me by mail

(Please submit your script latest by 12th November 2012 for marking)
Section A – BOTH questions are compulsory and MUST be attempted

QUESTION 1

The Superior Software House (SSH) commenced trading on 1 December 2002 in the country of Bonlandia. SSH develops bespoke software packages on behalf of clients. When requested to do so, SSH also provides training to clients’ staff in the use of these software packages. On 1 December 2006, the directors of SSH established a similar semi-autonomous operation in Karendia. All software packages are produced in Bonlandia and transferred to Karendia at cost plus attributable overheads i.e. there is no mark-up on the software packages transferred from Bonlandia to Karendia.

Karendia is a country in which the structure of industry has changed during recent years. There has been a major shift from traditional manufacturing businesses to service orientated businesses which place a far greater emphasis upon the use of business software.

The operational managers in both Bonlandia and Karendia have no control over company policies in respect of acquisitions and financing.

The operational manager of Bonlandia receives a bonus of 40% of his basic salary for meeting all client delivery deadlines in respect of Karendia. At a recent meeting he instructed his staff to ‘install client software by the due date and we’ll worry about fixing any software problems after it’s been installed. After all, we always fix software problems eventually’. He also stated that ‘it is of vital importance that we grow our revenues in Karendia as quickly as possible.

Our clients in Karendia might complain but they have spent a lot of money on our software products and will not be able to go to any of our competitors once we have installed our software as all their businesses would suffer huge disruption’.

Financial data (all stated on an actual basis) in respect of the two divisions for the two years ended 30 November 2007 and 2008 are shown on the next page:

<table>
<thead>
<tr>
<th>Summary Income Statements:</th>
<th>Bonlandia</th>
<th>Karendia</th>
<th>Combined</th>
<th>Bonlandia</th>
<th>Karendia</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>14,600</td>
<td>2,800</td>
<td>17,400</td>
<td>14,000</td>
<td>2,000</td>
<td>16,000</td>
</tr>
<tr>
<td>Salaries</td>
<td>4,340</td>
<td>1,248</td>
<td>5,588</td>
<td>4,000</td>
<td>1,200</td>
<td>5,200</td>
</tr>
<tr>
<td>Software &amp; consumables</td>
<td>2,040</td>
<td>486</td>
<td>2,526</td>
<td>2,000</td>
<td>450</td>
<td>2,450</td>
</tr>
<tr>
<td>Other operating costs</td>
<td>2,880</td>
<td>654</td>
<td>3,534</td>
<td>2,800</td>
<td>600</td>
<td>3,400</td>
</tr>
<tr>
<td>Marketing</td>
<td>2,392</td>
<td>600</td>
<td>2,992</td>
<td>2,100</td>
<td>400</td>
<td>2,500</td>
</tr>
<tr>
<td>Interest (Group)</td>
<td>2,392</td>
<td>600</td>
<td>2,992</td>
<td>2,100</td>
<td>400</td>
<td>2,500</td>
</tr>
<tr>
<td>Depreciation and amortisation</td>
<td>400</td>
<td>160</td>
<td>560</td>
<td>400</td>
<td>100</td>
<td>500</td>
</tr>
<tr>
<td>Total costs</td>
<td>12,052</td>
<td>3,148</td>
<td>16,050</td>
<td>11,300</td>
<td>2,750</td>
<td>14,950</td>
</tr>
<tr>
<td>Profit/(loss) for the period</td>
<td>2,548</td>
<td>(348)</td>
<td>1,350</td>
<td>2,700</td>
<td>(750)</td>
<td>1,050</td>
</tr>
</tbody>
</table>
Statements of financial position:

<table>
<thead>
<tr>
<th></th>
<th>Bonlandia</th>
<th>Karendia</th>
<th>Combined</th>
<th>Bonlandia</th>
<th>Karendia</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$000</td>
<td>$000</td>
<td>$000</td>
<td>$000</td>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current assets</td>
<td>9,000</td>
<td>1,600</td>
<td>10,600</td>
<td>8,000</td>
<td>1,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Current assets</td>
<td>4,550</td>
<td>1,000</td>
<td>5,550</td>
<td>5,000</td>
<td>800</td>
<td>5,800</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>13,550</td>
<td>2,600</td>
<td>16,150</td>
<td>13,000</td>
<td>1,800</td>
<td>14,800</td>
</tr>
<tr>
<td><strong>Equity and liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital and reserves</td>
<td>9,150</td>
<td></td>
<td>7,800</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term borrowings (Group)</td>
<td>4,000</td>
<td></td>
<td>4,500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>2,400</td>
<td>600</td>
<td>3,000</td>
<td>2,000</td>
<td>500</td>
<td>2,500</td>
</tr>
<tr>
<td><strong>Total equity and liabilities</strong></td>
<td>16,150</td>
<td></td>
<td>14,800</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Required:**

Write a report to the finance director to:

(a) **Assess the financial performance of SSH and its operations in Bonlandia and Karendia during the years ended 30 November 2007 and 2008.**

Note: you should highlight additional information that would be required in order to provide a more comprehensive assessment of the financial performance of each operation. (14 marks)

(b) **Discuss the statements of the operational manager of Bonlandia and assess their implications for SSH.** (4 marks)

(c) (i) **Briefly explain the main features of Economic Value Added (EVA®) as it would be used to assess the performance of divisions.** (2 marks)

(ii) **Briefly explain how the use of EVA® to assess divisional performance might affect the behaviour of divisional senior executives.** (4 marks)

(d) **Assess the likely criteria which would need to be satisfied for software to be regarded as ‘quality software’.** (4 marks)

(e) **Suggest a set of SIX performance measures which the directors of SSH could use in order to assess the quality of service provided to its clients.** (3 marks)

Professional marks will be awarded in Question 1 for appropriateness of style and structure of the answer. (4 marks)

(35 marks)
QUESTION 2

D is currently a large business which sells cars. D was established almost 30 years ago when the founder started buying and selling used cars. The company has expanded steadily since then. It now owns 32 vehicle dealerships that are spread across the country.

All of the dealerships now sell new cars. Each dealership has a franchise from a specific motor manufacturer. The dealerships do not compete with one another. Those which sell luxury models are well distanced from one another, as are those which sell more basic models. D has at least one dealership for each of the major manufacturers.

All of the dealerships accept customers’ old cars as trade-ins against the cost of their new car. Trade-in cars are resold at the dealerships if they are less than four years old and are in good condition. If they do not meet these criteria then they are sold through a third party’s car auction. It is company policy that each trade-in is serviced and repaired by the dealership that accepted the car from the customer.

D’s inventory of second hand cars is organised in order to maximise selling prices. Cars are often moved across the country in order to ensure that each dealership has a balanced inventory on offer. High quality luxury cars are sold through the dealerships that specialise in luxury models. Other cars are sorted according to manufacturer. Second hand cars tend to attract higher selling prices if they are sold through a dealership that sells new cars of the same make.

The founder of the business remains in place as D’s Chief Executive. He has always been closely involved in the day to day supervision of the business but he has now decided to change things. He is thinking about setting up a divisional structure, with four regional divisions for dealerships in the North, South, East and West of the country. Each division will be managed by its own divisional manager and there will be a small executive team based at D’s head office to take charge of the business as a whole. The founder’s intention is that the divisional managers will be left free to manage without interference from the centre, but performance will be observed and monitored closely.

**Required:**

(a) The founder has decided that each of the divisional managers will be evaluated using a balanced scorecard system.

**Recommend**, with reasons, TWO measures that should appear under each perspective:

- Financial
- Customer
- Learning and growth
- Internal business processes

(b)

(i) **Evaluate** the potential for dysfunctional behaviour arising from the transfer of trade-ins between dealerships and divisions.

(ii) **Explain** how the problems identified in (i) might be overcome.

*(Total 25 marks)*
QUESTION 3

G manufactures a range of valves that are used in the manufacture of car braking systems. G sells its components to several major car manufacturers. It is difficult to manufacture a perfectly serviceable valve every time because the manufacturing process is complicated and involves several steps. After each step has been completed the company runs a series of quality checks and valves that fail are discarded before they go on to the next stage or are accepted into inventory. The rejection rates vary from step to step, but can be as high as 5% in some stages of the production process. Overall, G budgets for a 20% rejection rate when estimating the size of production runs.

There are substantial costs associated with quality checks and rejections. Approximately 20% of staff time is devoted to quality control. The rejected components have no scrap value and so G has to pay to dispose of them in an environmentally acceptable manner.

Staff morale appears to have a role in the determination of quality. Failure rates are higher on Friday afternoons and Monday mornings when employees are distracted by looking forward to the weekend or demotivated by the start of the working week. Also major televised sporting events broadcast late at night can lead to deterioration in the quality of the following day’s output because staff have stayed up to watch the event.

The failure rate depends largely upon the care with which the manufacturing machinery has been set up and calibrated before a batch of parts is processed, although that is not the only factor. For example, a defective part may have passed through earlier quality checks unnoticed and could cause a failure at a later stage.

G’s board is keen to enjoy the benefits associated with total quality management (TQM), but has not committed itself to a full implementation of TQM. As an initial step the board asked production supervisors to come into work an hour early once a week for a quality circle meeting. The board had intended to devote more time and effort to TQM if this initial step had proved successful, but the directors have been disappointed by the initial feedback, which can be summarised as follows:

- The supervisors have proposed that the working week be reorganised so that staff can leave early on a Friday afternoon and have longer breaks on a Monday. This proposal is supported by a revised schedule that would make up for this time by having staff work longer hours in the middle of the week. G’s board has rejected this proposal because there would be some additional administrative costs associated with the proposed new working arrangements.

- The supervisors wish to reallocate some of the present quality control staff to production so that more staff time would be available to permit production processes to be properly set up. The supervisors believe that production staff have to work at close to 100% of their capacity and that such effort is not consistent with producing high quality work. Reducing the pressure would lead to a dramatic reduction in failed parts and so the company would need fewer quality inspectors. G’s board has rejected this proposal because it believes that staff should be encouraged to work harder and not to slow down. Also, the board would expect any reduction in the quality control staff to offer the opportunity to reduce staffing and save costs.
Required:

(a) Advise G’s board on the shortcomings of the approach that it has taken to TQM.  

(8 marks)

(b) Recommend, stating reasons, the actions that G’s board should have taken in order to successfully introduce TQM within G. 

(7 marks)

(b) Advise G’s board on the risks associated with reducing the number of quality control staff in the factory. 

(10 marks)

(Total 20 marks)
QUESTION 4

(a) JYT manufactures and sells a range of products. It is not dominant in the market in which it operates and, as a result, it has to accept the market price for each of its products. The company is keen to ensure that it continues to compete and earn satisfactory profit at each stage throughout a product’s life cycle.

Required:

Explain how JYT could use Target Costing AND Kaizen Costing to improve its future performance.

Your answer should include an explanation of the differences between Target Costing and Kaizen Costing.

(10 marks)

(b) MLC, which was established in 1998, manufactures a range of garden sheds and summerhouses using timber purchased from a number of suppliers.

The recently appointed managing director has expressed increasing concern about the falling sales volumes, rising costs and hence declining profits over the last two years.

Required:

Discuss how business process re-engineering could help to improve the profits of MLC.

(10 marks)

(Total 20 marks)
QUESTION 5

EEE is an established chemical company extracting flavours and oils from plant materials and supplying them to the flavours and fragrances industries. The shareholders include institutional investors (20%), employees and pensioners of the company (20%) and the descendants of the family (30%) who founded the business approximately 100 years ago. The remainder of the shares are in public ownership. The company is reasonably successful but, recently, there has been pressure on margins and its future is not guaranteed.

The majority of the Board of Directors are members of the founding family who have always taken an active part in the management of the business.

When the company was originally started, the surrounding area was mainly used as agricultural land but, over time, a residential area has developed around the factory. Although many of the workers in the factory live locally, some of the housing is quite expensive and has attracted affluent residents from the local city.

The chemical engineers at EEE have recently developed, and patented, a new process which would allow EEE to extract onion oil and garlic oil at far better yields than those obtained by existing processes. The market for these oils is very profitable and presents a significant opportunity for EEE to gain a real competitive advantage in its industry.

Unfortunately, as with all extraction processes, there will be some leakage and, although perfectly safe and compliant with all safety legislation, the smell of the oils will offend some of the more affluent residents who have complained to local government officers.

There is very little other industry in the area and EEE is a large contributor to the local economy. One of the trade union representatives working in EEE is also an elected council member serving in the local government.

Required:

As management accountant you have been asked to:

(a) Advise the Board of Directors of the advantages to EEE of conducting a stakeholder analysis in the context of the proposed investment decision; 

(b) Analyse the principal stakeholders in EEE in the context of the proposed investment in the new process; 

(c) Recommend an acceptable course of action to the Board of Directors in the light of the stakeholder analysis conducted in (b).

(Total 20 marks)