

# PERFORMANCE

RELEVANT TO ACCA QUALIFICATION PAPER F5

**One of the key areas of the Paper F5 syllabus is that of performance measurement and control. It is perhaps more integral to the whole area of performance management than any other topic examined under the syllabus. How disappointing then, that these questions are often among the poorest answered on the paper.**

It would not be possible, in a single article, to cover every type of performance measurement question that could be examined. This article will therefore focus on a classic performance measurement question, which involves a combination of financial and non-financial analysis. I will take you through the performance measurement question that appeared in the December 2009 paper, step by step, showing you how I would expect such a question to be answered.

The question read as follows:

Thatcher International Park (TIP) is a theme park and has for many years been a successful business, which has traded profitably. About three years ago the directors decided to capitalise on their success and reduced the expenditure made on new thrill rides, reduced routine maintenance where possible (deciding instead to repair equipment when it broke down) and made a commitment to regularly increase admission prices. Once an admission price is paid customers can use any of the facilities and rides for free. These steps increased profits considerably, enabling good dividends to be paid to the owners and bonuses to the directors. The last two years of financial results are shown opposite. TIP operates in a country where the average rate of inflation is around 1% per annum.

TABLE 1: TIP'S FINANCIAL RESULTS 2008 AND 2009

	2008	2009
	\$	\$
Sales	5,250,000	5,320,000
Less expenses:		
Wages	2,500,000	2,200,000
Maintenance – routine	80,000	70,000
Repairs	260,000	320,000
Directors salaries	150,000	160,000
Directors bonuses	15,000	18,000
Other costs (including depreciation)	<u>1,200,000</u>	<u>1,180,000</u>
<u>Net profit</u>	<u>1,045,000</u>	<u>1,372,000</u>
Book value of assets at start of year	13,000,000	12,000,000
Dividend paid	500,000	650,000
Number of visitors	150,000	140,000

ONE OF THE KEY AREAS OF THE PAPER F5 SYLLABUS IS THAT OF PERFORMANCE MEASUREMENT AND CONTROL. IT IS PERHAPS MORE INTEGRAL TO THE WHOLE AREA OF PERFORMANCE MANAGEMENT THAN ANY OTHER TOPIC EXAMINED UNDER THE SYLLABUS.

# MEASUREMENT

## Required:

**(a) Assess the financial performance of TIP using the information given above. (14 marks)**

During the early part of 2008 TIP employed a newly qualified management accountant. He quickly became concerned about the potential performance of TIP and to investigate his concerns he started to gather data to measure some non-financial measures of success. The data he has gathered is shown in **Table 2** opposite.

## Required:

**(b) Assess the quality of the service that TIP provides to its customers using Table 1 and any other relevant data and indicate the risks it is likely to face if it continues with its current policies.**

**(6 marks)**  
(20 marks)

### BREAKING DOWN THE QUESTION

It is clear from the way that the requirements are split that Part (a) is asking about financial performance and Part (b) is asking about non-financial performance. Broadly speaking, you should, therefore, keep the majority of your comments about non-financial aspects to Part (b). Having said this, there will sometimes be times when it will be relevant to mention the non-financial effect of something when discussing the financial effect and you should do this, being sure not to deviate too far away from what the requirement is asking you to do.

TABLE 2: TIP'S NON-FINANCIAL MEASURES OF SUCCESS

	2008	2009
Hours lost due to breakdown of rides (Note 1)	9,000 hours	32,000 hours
Average waiting time per ride	20 minutes	30 minutes

Note 1: TIP has 50 rides of different types. It is open 360 days of the year for 10 hours each day.

(a) Assess the financial performance of TIP using the information given above

Before any kind of comment can be made about financial performance, it is important to perform some preliminary calculations in order to ascertain what the relative movements have been from 2008 to 2009. Be sure that you read your year headings correctly and don't get the 2008 figures mixed up with the 2009 ones. It seems like an obvious point but candidates do make this mistake fairly regularly. This would render the whole of your answer wrong; not a good start. While financial statements are usually shown with the most recent year on the left-hand side and the older year on the right-hand side, management accounts usually show the years the other way round. The fact is, you can't presume anything and you just have to read the question carefully.

The next point to consider is what kind of analysis needs to be prepared. You should note that it will rarely be appropriate to look at numbers in absolute rather than relative terms. What does it matter, for example, if repairs are \$320,000 in 2009? This means nothing unless we have something to compare them to, whether this is prior year figures, as in this case, or budgeted figures or industry averages, as could be the case in another question. In this type of question, it makes most sense to look at the percentage increase or decrease in each of our figures from 2008 to 2009. This has been done in the section headed 'Workings' below.

You will see that I haven't performed a calculation for 'other costs'. This is because the movement in it from year to year is so small that it is not worth mentioning. Also, we do not really know what costs are in here, other than depreciation, so we can't really make many comments. Our movement in sales, on the other hand, is also relatively small but has been mentioned.

IT IS IMPORTANT THAT YOUR ANSWER DOES NOT BECOME 'A SEA OF WORDS', IE JUST PAGES OF WRITING WITH NO HEADINGS AND NO STRUCTURE. IF YOU HAVE NOT BEEN GIVEN GUIDANCE AS TO HOW TO LAY OUT YOUR ANSWER BY THE EXAMINER, YOU MUST DECIDE WHAT AN APPROPRIATE FORMAT WOULD BE.

The reason for this is that, first, sales in a key figure and can't be ignored and secondly, we know enough about other things going on in the business (eg reduction in the number of visitors) in order to be able to draw valid conclusions about sales. I have set out my workings as I would like to see them in your exam scripts, namely, all labelled up with a working reference. While, in the real world, such analysis would be expected to appear after any commentary as a kind of appendix, since you are not being asked for a report here it doesn't really matter whether you show them at the beginning or end of your answer.

#### Workings:

(W1) Sales growth is  
 $\$5,320,000/\$5,250,000 = 1.3\%$   
 (W2) Average admission prices were:  
 2008:  $\$5,250,000/150,000 = \$35$   
 per person  
 2009:  $\$5,320,000/140,000 = \$38$   
 per person  
 An increase of  $\$38/\$35 = 8.57\%$   
 (W3) Directors pay up by  
 $\$160,000/\$150,000 = 6.7\%$   
 (W4) Directors bonuses levels up  
 from  $\$15,000/\$150,000$  or 10%  
 to  $\$18,000/\$160,000$  or 12.5%  
 of turnover. This is an increase of 20%  
 (W5) Wages are down by  $(\$2,500,000 -$   
 $\$2,200,000)/\$2,500,000$  or 12%  
 (W6) Routine maintenance down by  
 $(\$80,000 - \$70,000)/\$80,000 = 12.5\%$   
 (W7) Repairs up by  $(\$320,000 -$   
 $260,000)/\$260,000 = 23\%$   
 (W7) Loss of customers is  $(150,000 -$   
 $140,000)/150,000 = 6.7\%$   
 (W9) Profits up by  
 $\$1,372,000/\$1,045,000 = 31.3\%$   
 (W8) Return on assets:  
 2008:  $\$1,045,000/\$13,000,000 = 8.03\%$   
 2009:  $\$1,372,000/\$12,000,000 = 11.4\%$

Using the calculations you have prepared and setting out your answer

It may surprise you, as indeed it surprised me, to find that a number of candidates got no further on this question than performing the calculations above. These calculations, whilst essential to answering the question, would only ever be worth a relatively small number of the marks and are merely a starting point. 'Assessing the financial performance' means discussing it and commenting on in what respects it is poor or maybe strong.

It is important that your answer does not become 'a sea of words', ie just pages of writing with no headings and no structure. If you have not been given guidance as to how to lay out your answer by the examiner, you must decide what an appropriate format would be. In this case, your headings could be taken from your workings, eg 'sales', 'directors' pay and bonuses' etc. You should then start your discussion of each point by first referring to the calculation that you have performed in the relevant working. It is critical that, having referred to the percentage movement in the figure under discussion from year to year, you don't just leave it like that. For example, a poor answer on sales would be this:

#### Sales

*These have increased by 1.3% in the year.*

A poor, but slightly less poor answer might read:

**Sales**

*These have increased by 1.3% (W1) in the year. This is good.*

The second answer is slightly better than the first because it references the percentage increase to the workings and also makes a comment about the increase. However, what does 'good' mean? How can we say whether a 1.3% increase in sales is good or bad if we don't refer to inflation rates (if provided in the question, as in this case), admission prices and visitor numbers? Whenever you are making a comment, ask yourself: 'Why do I care? Why is it important?'. This will help you to follow your thoughts through. A good answer for sales would read as follows:

**Sales**

*Sales have increased by 1.3% (W1) in 2009, as compared to 2008. Since inflation was 1%, the increase is barely above the inflation rate. This means that, in real terms, sales have hardly increased at all. From the financial information provided, we can see that the number of visitors in 2009 has fallen from 150,000 to 140,000. This means that the average admission price in 2009 was \$38 per person, compared to \$35 per person in 2008, an increase of 8.57% (W2). While it is good that the company has been able to secure an increase in admission price, it is not good that this has potentially been partly responsible for a fall in visitor numbers.*

You can see that the good answer starts with the percentage increase in sales from the workings and adds to it other information from the question or from the workings that is relevant to the figure being discussed (in this case, inflation and admission prices). Only then is it possible to make comments that have any kind of validity.

To further emphasise the importance of looking at the overall picture rather than one figure in isolation, let's look at 'maintenance and repairs'. Routine maintenance costs have fallen by 12.5%. On the face of things, this looks good. However, we cannot comment on maintenance costs without considering how repair costs have been affected. These have increased by 23%. We also need to go further here and comment on the actual amounts involved (or look at the total costs for maintenance and repairs and comment on the total percentage increase). While maintenance costs have decreased by a mere \$10,000, repairs have increased by \$60,000. This tells us nearly everything we need to know about what has happened. It is clear that, because routine maintenance has not been carried out, machines are breaking down and repairs are, therefore, required.

This assessment is further supported by the non-financial information, which tells us that the hours due to breakdown of rides has increased from 9,000 hours in 2008 to 32,000 hours in 2009. Although it would be inappropriate to talk about the effect of this on quality of service and risks in Part (a), since we would then be stepping into the requirement of Part (b), it should be mentioned in passing.

So, a poor answer to this part of the question would be this.

**Routine maintenance costs**

*These have fallen by 12.5%, which is a good reduction.*

**Repair costs**

*These have increased by 23%, which is substantial.*

A good answer, on the other hand, would read something like this:

**Routine maintenance and repair costs**

*In 2009, routine maintenance costs fell by 12.5% (W6), a fall of \$10,000. At the same time, however, repair costs increased 23% (W7), a \$60,000 increase. By looking at these two figures together, and the fact that hours due to lost breakdown of rides increased from 9,000 hours in 2008 to a huge 32,000 hours in 2009, one can only conclude that the lack of routine maintenance was a poor decision and is costing the business dearly in terms of increased repair costs and problems with the rides. The decision to reduce maintenance by the company needs to be reviewed urgently.*

By this point, it is hopefully clear that there is little point in simply doing a few calculations and making meaningless comments. In questions on performance measurement, you need to look at each figure as part of an overall set of data, bringing other data in where relevant. A figure in isolation, such as sales, tells us little about what has really happened during the year. It is only by bringing other information in that any true assessment on financial performance can be made.

This principal can equally be applied to any assessment of non-financial performance, as considered below.

Part (b) Assess the *quality* of the service that TIP provides to its customers using Table 1 and any other relevant data and indicate the *risks* it is likely to face if it continues with its current policies.

Once again, it is important that you adopt some kind of structure for your answer, rather than just producing a 'sea of words'. By using the structure of headings, you make yourself focus on what the requirement is actually asking you to do. This should stop you from 'rambling', ie talking about things that are not being asked of you and not relevant. Whenever I used to answer exam questions, I would refer back to the requirement many times while writing, constantly asking myself: 'Am I answering the question?'

Time spent thinking rather than writing is time well spent.

In this particular question, the examiner has basically told you what headings to use by using italics for the words '*quality*' and '*risks*'. The fact that you are being asked about qualitative aspects of the situation means that you are obviously being asked about non-financial performance. Most of the information that is relevant to this discussion has already been given to you in the question (number of visitors, hours due to breakdown of rides and average waiting time). It is also possible (although not essential) to work out lost capacity in 2008 and 2009, ie percentage of hours lost out of total hours available in order to make a year on year comparison. This would be done as follows:

Capacity of rides in hours is 360 days x 50 rides x 10 hours per day = 180,000  
 2008 lost capacity is 9,000/180,000 = 0.05 or 5%  
 2009 lost capacity is 32,000/180,000 = 0.177 or 17.8%

When discussing quality, it is important to ask yourself the question: 'In a business like this, what affects my enjoyment of the service?'. The answer will be – how many rides are available to ride on and how long I have to queue each time. The reliability of the rides and average queuing time are therefore appropriate subheadings. You could also mention that the rides need to be safe as well, or you could leave this to your discussion on risks.

Then, when discussing 'risks' in the second part of your answer to Part (b), you need to think about what the potential outcomes of the current policies are. In order to answer this, you first need to have a clear idea about the policies that have been adopted. These are mentioned in the preamble of the question and include reduced expenditure on new rides, a move from routine maintenance to reactive repairs and an increase in prices. Where you are giving a number of points in an answer, like here, it is useful to bullet point them. This not only makes your answer easier to mark, but it makes you aware of how much you are saying.

Regarding this last point – how much you should say in performance measurement questions – you should be largely guided by the marks available. Part (b) is only worth five marks so it warrants substantially less time being spent on it than Part (a). Often in these types of questions, there is far more you could say than the time that is available. This is particularly the case in Part (a) here. The key is to get good coverage. It is pointless, for example, to spend half of your time discussing sales in Part (a), meaning that you don't get enough time to cover all the other key figures. Your answers must always be balanced.

#### SUMMARY

- ▣ Present calculations in a referenced list
- ▣ Don't consider any one piece of information or number in isolation
- ▣ Use headings wherever possible and avoid writing 'a sea of words'
- ▣ When you are writing a statement, eg 'sales have increased by 1.3%' always ask yourself the question 'why do I care?'. This will help you make a meaningful point and take a thought through to its logical conclusion.
- ▣ Read all the requirements and make sure that you don't start talking about, eg requirement (b) in requirement (a), as you will then find that you have nothing to say when you get to requirement (b).
- ▣ Use the marks available as a guide as to how much to write. There are no set marking rules such as 'one mark per valid point'. Marks vary from question to question.