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# Answers

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1 (a) Operating performance

Bus occupancy is the critical operating statistic in assessing the operating performance of GBC and TTC since it is the number of fare-paying passengers which drives the revenue generation of each organisation. Indeed, passenger fares constitute the only source of income of each of the respective organisations.

Actual and budgeted levels of total bus occupancy (fare-paying and non fare-paying passengers) achieved/to be achieved were as follows:

Year	GBC			TTC		
	2006	2007(actual)	2007(budget)	2006	2007(actual)	2007(budget)
% occupancy	(working 2)					
Route						
Eastern	65	60	60	60	80	75
Southern	80	75	60	60	80	75
Western	32.5	30	60	–	–	–
Hopper	65	60	60	60	80	75

However, GBC provides free transport for passengers on its Eastern, Western and Hopper routes and the % occupancy of fare-paying passengers only is as follows:

Year	2006	2007
% occupancy	% occupancy	% occupancy
Route		
Eastern	55	50
Southern	80	75
Western	25	22.5
Hopper	55	50

Hence it can be seen that GBC's bus actual occupancy has fallen from the levels achieved during the previous year. On the other hand, TTC has achieved average increases of 20% with regard to all three routes it operated and also exceeded a more demanding budget of 75% average bus occupancy with regard to each route.

It is quite conceivable that TTC has gained business at the expense of GBC by virtue of the fact that it provides a higher quality of service for which customers are willing to pay the average 20% premium charged by TTC. The fact that TTC operates fewer vehicles than GBC together with its higher depreciation charge in respect of vehicles suggests that the fleet of buses operated by TTC is newer than that of GBC.

It is interesting to note that, on average each GBC bus was in operation for 320 days whereas each TTC bus was in operation for 340 days. This might well be indicative of the fact that the fleet of buses operated by GBC is much older than that of TTC, a fact seemingly supported by the much higher repairs and maintenance costs incurred by GBC.

Financial performance

	2006 GBC Actual	2007 GBC Actual	2007 GBC Budget	2006 TTC Actual	2007 TTC Actual	2007 TTC Budget
Turnover(\$)	5,670,400	5,222,400	5,683,200	4,308,480	5,744,640	5,385,600
Net profit (\$)	1,513,800	816,720	1,453,200	870,100	2,199,840	1,823,600
Assets (nbv) (\$)	700,000	630,000	630,000	2,500,000	2,250,000	2,250,000
Profit/Assets (%)	216.3	129.64	230.7	34.8	97.8	81.0
Profit/Sales (%)	26.7	15.64	25.6	20.2	38.3	33.9

GBC had a much poorer year in 2007 than it had anticipated. It made a profit of \$816,720 which is a reduction of \$697,080 (46%) from that of the previous year. During the previous year GBC had made a profit of \$1,513,800. GBC had budgeted for a fall in profit of \$60,600 (\$1,513,800 – \$1,453,200) but such a large deviation from plan would certainly alarm its stakeholders. By contrast, TTC has had an excellent year in 2007 achieving a net profit amounting to \$2,199,840 which is more than 2.5 times the level of profit achieved in 2006 (\$870,100). TTC also exceeded its budgeted profit by \$376,240 (20.6%).

Revenues from fares within GBC during 2007 have fallen by \$448,000 (7.9%) from the previous year, whereas revenue from fares within TTC during 2007 have increased by \$1,436,160 (33.33%) over the previous year's level.

Variable costs per mile are 10 cents per bus mile higher in GBC than they are in TTC. The fact that GBC has opted to use environmentally friendly fuel in its vehicles is evidence of its concern for society. The use of environmentally friendly fuel caused increases in average variable costs amounting to \$126,080 (1,260,800 x (\$2.10 – \$2)) during 2007.

Fixed costs during 2006 within GBC were above budget with salaries, repairs and maintenance, and other operating expenses exceeding budgeted levels by \$25,000, \$40,000 and \$13,000 respectively and were \$50,000, \$60,000 and \$13,000 above the levels incurred during 2006. By contrast, TTC salaries were as per budget whilst repairs and maintenance and

other operating expenses were \$2,000 and \$20,000 below budgeted levels. Salaries increased by \$10,000 whilst other operating costs by \$20,000 over the previous year's levels. Repairs and maintenance costs remained at \$40,000, the same level as incurred during 2006.

**Workings:**

**(1) Calculation of figures marked with an asterisk(\*):**

	Buses per route	Journeys per route	Days in operation	Fare-paying passengers	Fare per passenger (\$)	\$
GBC Eastern revenue (2006)	6	2	320	44	10	= 1,689,600
GBC Southern revenue (2007)	6	2	320	60	10	= 2,304,000
TTC Southern revenue (2007)	4	2	340	64	12	= 2,088,960
TTC Hopper budgeted revenue (2007)	2	1	340	60	36	= 1,468,800

	Buses per route	Days	Kilometres	Journeys	Cost (\$)	
GBC Eastern variable costs (2007)	6	320	100	2	2.1	= 806,400
TTC Southern variable costs (2007)	4	340	120	2	2	= 652,800

**(2) GBC – Level of total occupancy:**

Route	No. of fare-paying passengers	No. of non fare-paying passengers	Total	Occupancy %
Eastern	44	8	52	65
Southern	64	0	64	80
Western	20	6	26	32.5
Hopper	44	8	52	65

**(b) The relative performance of GBC and TTC is difficult to assess due to the following:**

- (i) They would appear to have differing objectives. GBC provides free transport for senior citizens and charges lower fares than TTC. GBC also uses environmentally friendly fuel. Each of these factors inhibits a direct comparison of the two organisations.
- (ii) The organisations are funded differently. It is evident that TTC uses loan finance to fund operations which gives rise to interest charges which are not incurred by GBC. On the other hand GBC is funded by the government.
- (iii) TTC has higher fixed asset values which precipitate much higher depreciation charges.
- (iv) There is also a lack of non-financial performance indicators such as the number of on-time arrivals, number of accidents, complaints re passenger dissatisfaction, staff turnover, adherence to relevant legislation, convenience of pick-up/drop-off points etc.

The following items of additional information would assist in assessing the financial and operating performance of the two companies:

- (1) The number of staff employed by each organisation would assist in the assessment of the financial and operating performance. Ratios such as revenue generated per employee and operating costs per employee might provide useful comparators of financial and operating efficiency.
- (2) Safety and accident records of each organisation would give an indication of the reliability and safety afforded to passengers by each organisation. Passenger safety is of paramount importance to all passenger transport businesses.
- (3) Records of late/cancelled buses together with the number of complaints received from the passengers would provide an indication of the efficiency of the service provided by each organisation.
- (4) The accessibility of the services, location of pick-up/drop-off points would provide an indication of the flexibility of service delivery provided by each organisation.
- (5) The comfort, cleanliness and age of the respective bus fleets would provide a further indication of the level of service quality provided by each organisation.
- (6) The fuel emission levels of the buses operated by each organisation would provide an indication of the extent of their 'social responsibility'.

- Notes: (i) Only three items of additional information were required.  
(ii) Alternative relevant discussion and examples would be acceptable.

**(c) It would appear that in operating a bus service to the Western region of Geeland that GBC is fulfilling a social objective since a contribution loss amounting to \$38,400 (\$230,400 – \$268,800) was made as a consequence of operating the route to the Western region during 2007. As an organisation which is partially funded by the government it is highly probable that GBC has objectives which differ from those of TTC which is a profit-seeking organisation.**

The value of a social service such as the provision of public transport can be quantified, albeit, in non-financial times. It is possible to apply quantitative measures to the bus service itself, the most obvious ones being the number of passengers carried and the number of passenger miles travelled.

The cost of the provision of alternative transport to the Western region might also enable a value to be placed on the current service by GBC.

It might be possible to estimate quantitatively some of the social benefits resulting from the provision of the transport facility to and from the Western region. For example, GBC could undertake a survey of the population of the Western region in order to help estimate the extent to which rural depopulation would otherwise have occurred had the transport facility not been made.

The application of the technique of cost-benefit analysis makes it possible to estimate money values for non-monetary benefits. Social benefits can therefore be expressed in financial terms. It is highly probable that the fact that the Western region is served by GBC will increase the attractiveness of living in a rural area, which may in turn precipitate an increase in property values in the Western region and the financial benefit could be expressed in terms of the aggregate increase in property values in the region as a whole.

**2 (a) (i)**

	\$m		
	Year 1	Year 2	Year 3
	\$m	\$m	\$m
Net cash inflow	12.5	18.5	27.0
Less: Depreciation	15.0	15.0	15.0
Profit/(loss)	(2.5)	3.5	12.0
Less: cost of capital (at 10% of wdv)	(4.5)	(3.0)	(1.5)
RI	(7.0)	0.5	10.5

A positive NPV of \$1.937m indicates that the performance is acceptable over the three-year life of the proposal.

The RI shows a negative value of \$7m in year 1. This is likely to lead to its rejection by the management of Alpha Division because they participate in a bonus scheme that is based on short-term performance evaluation.

The short-term focus on performance evaluation might lead to the rejection of investment opportunities such as the one under consideration which would be detrimental to the Delta Group. Management of the Delta Group should give immediate consideration to changing the focus of the bonus scheme.

**(ii)** Measures of divisional profitability may be viewed as evaluating managerial performance and/or economic performance of the division. Management are likely to take the view that any contribution value used as a measure of their performance should only contain revenue or cost elements over which they have control. If each of the measures 1 to 3 shown in the question are considered the following analysis may be made:

**1. Variable short run contribution margin:**

This measure may be viewed as unacceptable to divisional management where it contains inter-divisional transfers. In this case this should not be a problem since the use of adjusted market price is in effect equivalent to external selling price after the deduction of cost elements (e.g. special packaging) that are not appropriate to inter-divisional transfers.

**2. Controllable profit:**

This measure will be calculated by deducting controllable fixed costs from the variable short-run contribution. These costs may include labour costs and/or equipment rental costs that are fixed in the short term but are subject to some influence by divisional management. For example, divisional management action may enable efficiency gains to be achieved in order to reduce the level of fixed labour or equipment rental costs that are incurred. In addition, it will be relevant to determine whether divisional management is free to source such items as they wish or if there is some direction for them to use, for example, a Delta Group Service Division for equipment rental requirements.

The inclusion of depreciation of fixed assets as a charge in evaluating controllable contribution may be debated depending on the extent to which divisional management has control over investment decisions.

**3. Divisional profit:**

Depending on the extent to which investment decisions relating to Alpha Division are ultimately authorised at Delta Group level, depreciation may be viewed as a non-controllable cost, chargeable in arriving at the divisional profit and hence as part of divisional economic performance measurement.

Other non-controllable costs attributed to the division may be a share of Group finance and legal staff costs for services provided to the division. Such costs are non-controllable by divisional management and may be viewed as avoidable only if the division was closed.

The divisional profit figure is useful in evaluating the economic performance of the division in that it represents the contribution made by Alpha Division towards the overall profitability of the Delta Group.

- (b) (i) In order to compute EVA, adjustments must be made to the conventional after tax profit measures of \$67m and \$82m shown in the summary income statements. Since we know that financial accounting depreciation is equal to economic depreciation then no adjustment is required to take into account the fact that economic depreciation differs from financial accounting depreciation. In calculating EVA the calculation of adjusted profit represents an attempt to approximate cash flow after taking into account a charge in respect of economic depreciation. Hence non-cash expenses are added back to the profit reported in the income statement. Net interest is also added back to the reported profit because the returns required by the providers of funds are reflected in the cost of capital adjustment. It is the net interest i.e. interest after tax that is added back to reported profit because interest will already have been allowed as an expense in the computation of the taxation liability.

In computing EVA, the calculation of capital employed should be based on adjustments which seek to approximate economic value at the commencement of each period. Due to the lack of sufficient information the book value of shareholders' funds plus long-term capital loans at the end of 2005 is used as a basis for the determination of economic capital employed at the commencement of 2006.

Goodwill is a measure of the price paid for a business in excess of the current cost of the net separable assets of the business. Payments in respect of goodwill may be viewed as adding value to the company. Therefore any amounts in respect of goodwill amortisation appearing in the income statement are added back to reported profit since they represent part of the intangible asset value of the business.

By the same token, the cumulative write off of \$45 million is added back to capital employed in order to show a more realistic value of the capital base realistic value of the capital employed. This is because goodwill represents an element of the total value of a business. The value placed on goodwill should be regularly reviewed and any diminution in its value should be recognised immediately in the income statement.

The calculation of EVA in respect of the two years under consideration is as follows:

	2006	2007
<b>Adjusted profit:</b>	<b>\$m</b>	<b>\$m</b>
Profit after tax	67	82
Amortisation of goodwill	5	5
Other non-cash expenses	12	12
Interest expense	4.2	4.2
Adjusted profit	<u>88.2</u>	<u>103.2</u>
<b>Adjusted capital employed:</b>	<b>\$m</b>	<b>\$m</b>
Year beginning	279	340
Non-capitalised leases	16	16
Goodwill	45	50
Adjusted capital employed	<u>340</u>	<u>406</u>

The weighted average cost of capital should be based on the target capital structure of 50% Debt: 50% Equity.

The calculations are as follows:

$$\text{WACC 2006: } (16\% \times 50\%) + (10\% \times 0.7 \times 50\%) = 11.5\%$$

$$\text{WACC 2007: } (18\% \times 50\%) + (10\% \times 0.7 \times 50\%) = 12.5\%$$

Therefore EVA in respect of both years can be calculated as follows:

$$\text{EVA 2006} = 88.2 - (340 \times 11.5\%) = \$49.1 \text{ million}$$

$$\text{EVA 2007} = 103.2 - (406 \times 12.5\%) = \$52.45 \text{ million}$$

The EVA measures indicate that the Gamma Group has added significant value during each year under consideration and thereby achieved a satisfactory level of performance.

- (ii) Disadvantages of an EVA approach to the measurement of financial performance include:

- (i) The calculation of EVA may be complicated due to the number of adjustments required.
- (ii) It is difficult to use EVA for inter-firm and inter-divisional comparisons because it is not a ratio measure.
- (iii) Economic depreciation is difficult to estimate and conflicts with generally accepted accounting principles.

Note: Other relevant discussion would be acceptable.

**3 (a) Forecast Income Statement of HSC for the year ending 31 December 2008:**

	<b>\$000</b>
Revenue	45,000
Materials	17,500
Packaging	3,750
Distribution	3,600
Fixed costs	5,401
	<hr/>
Total costs	30,251
Profit	14,749
Profit/sales (%)	32.78%
Target rate of return (%)	32.00%
Target return (\$000)	14,400
	<b>\$</b>
Materials can increase by the excess profit over budget	349,000
Material costs could increase to	17,849,000
Therefore increase =	1.994%

Based on the information provided an expected return on sales amounting to 32.78% of revenue would be made in which case the statement made by the finance director was correct.

The finance director was correct to be concerned with an increase in the cost of all ingredients as the return % is very sensitive to an increase in the price of ingredients purchased by HEG, as material costs cannot rise in price by more than \$349,000 which represents an average increase amounting to 1.994%.

**(b) Critical success factors are as follows:**

**Product quality**

The fact that the production staff have no previous experience in a food production environment is likely to prove problematic. It is vital that a comprehensive training programme is put in place at the earliest opportunity. HSC need to reach and maintain the highest level of product quality as soon as possible.

**Supply quality**

The quality of delivery into SFG supermarkets assumes critical significance. Time literally will be of the essence since 90% of all sandwiches are sold in SFG's supermarkets before 2 pm each day. Hence supply chain management must be extremely robust as there is very little scope for error.

**Technical quality**

Compliance with existing regulations regarding food production including all relevant factory health and safety requirements is vital in order to establish and maintain the reputation of HSC as a supplier of quality products. The ability to store products at the correct temperature is critical because sandwiches are produced for human consumption and in extreme circumstance could cause fatalities.

**External credibility**

Accreditation by relevant trade associations/regulators will be essential if nationwide acceptance of HSC as a major producer of sandwiches is to be established.

**New product development**

Whilst HSC have developed a range of healthy eating sandwiches it must be recognised that consumer tastes change and that in the face of competition there will always be a need for a continuous focus on new product development.

**Margin**

Whilst HSC need to recognise all other critical success factors they should always be mindful that the need to obtain the desired levels of gross and net margin remain of the utmost importance.

- Notes: (i) Only five critical success factors were required.  
(ii) Alternative relevant discussion and examples would be acceptable.

**(c) The introduction of ERPS has the potential to have a significant impact on the work of management accountants. The use of ERPS causes a substantial reduction in the gathering and processing of routine information by management accountants. Instead of relying on management accountants to provide them with information, managers are able to access the system to obtain the information they require directly via a suitable electronic access medium.**

ERPS integrate separate business functions in one system for the entire organisation and therefore co-ordination is usually undertaken centrally by information management specialists who have a dual responsibility for the implementation and operation of the system.

ERPS perform routine tasks that not so long ago were seen as an essential part of the daily routines of management accountants, for example perpetual inventory valuation. Therefore if the value of the role of management accountants is not to be diminished then it is of necessity that management accountants should seek to expand their roles within their organisations.

The management accountant will also control and audit the ERPS data input and analysis. Hence the implementation of ERPS provides the management accountant with an opportunity to change the emphasis of their role from information gathering and processing to that of the role of advisers and internal consultants to their organisations. This new role will require management accountants to be involved in interpreting the information generated from the ERPS and to provide business support for all levels of management within an organisation.

4 (a)

**Order Number 377**  
**Summary total cost statement**

	\$'000	\$'000
Unit-based costs:		
Direct material cost (\$180 x 5,000)	900	
Direct labour cost (\$150 x 5,000)	750	
Power cost (\$120 x 5,000)	600	2,250
Batch-related costs:		
Design work (\$30,000 x 5)	150	
Machine set up (\$34,000 x 5)	170	
Production scheduling (\$60,000 x 5)	300	
Selling – batch expediting – (\$60,000 x 5)	300	
Admin. – invoicing & accounting (\$24,000 x 5)	120	
Distribution (\$12,000 x 5)	60	1,100
Product sustaining costs:		
Engineering design & support (per order)	350	
Production line maintenance (per order)	1,100	
Marketing (per order)	200	1,650
Total cost excluding business/facility sustaining costs		5,000
Business/Facility sustaining costs:		
Relating to production, administration, selling & distribution based on overall business/facility time used. 30% x \$5,000,000		1,500
Total cost of order		6,500

Note: number of batches = 5,000units/1,000 = 5 batches

- (b) A cost driver is the factor that determines the level of resource required for an activity. This may be illustrated by considering costs for each of the four levels in Order Number 377.

**Unit based costs:**

Direct material costs are driven by the quantity, range, quality and price of materials required per product unit according to the specification for the order.

Direct labour costs are driven by the number of hours required per product unit and the rate per hour that has been agreed for each labour grade.

**Batch related costs:**

The number of machine set-ups per batch is the cost driver for machines used.

The number of design hours per batch is the cost driver for design work.

**Product sustaining costs:**

The number of marketing visits to a client per order is the cost driver for marketing cost chargeable to the order.

The number of hours of production line maintenance per order is the cost driver for production line cost.

**Business sustaining costs:**

These costs are absorbed at a rate of 30% of total cost excluding business sustaining costs. This is an arbitrary rate which indicates the difficulty in identifying a suitable cost driver/drivers for the range of residual costs in this category. Wherever possible efforts should be made to identify aspects of this residual cost that can be added to the unit, batch or product related analysis.

The cost drivers are useful in that they provide a basis for an accurate allocation of the cost of resources consumed by an order. In addition, investigation of the cause(s) of a cost driver occurring at its present level allows action to be considered that will lead to a reduction in the cost per unit of cost driver.

Examples of causes that might be identified are:

Material price may be higher than necessary due to inefficient sourcing of materials. This may be overcome through efforts to review sourcing policy and possibly provide additional training to staff responsible for the sourcing of materials.

The number of machine set-ups per batch may be due to lack of planning of batch sizes. It may be possible for batch sizes in this order to be increased to 1,250 units which would reduce the number of batches required to fulfil the order from five to four. This should reduce overall costs.

The amount of production line maintenance (and hence cost) required per order may be reduced by examining causes such as level of skill of maintenance carried out – by GMB's own staff or out-sourced provision. Action would involve re-training of own staff or recruitment of new staff or changing of out-source providers.

*(alternative relevant examples and discussion would be acceptable for all aspects of part (b))*

- (c) The benefits of an activity-based system as the basis for product cost/profit estimation may not be straightforward. A number of problems may be identified.

The selection of relevant activities and cost drivers may be complicated where there are many activities and cost drivers in complex business situations.

There may be difficulty in the collection of data to enable accurate cost driver rates to be calculated. This is also likely to require an extensive data collection and analysis system.

The problem of 'cost driver denominator level' may also prove difficult. This is similar to the problem in a traditional volume related system. This is linked to the problem of fixed/variable cost analysis. For example the cost per batch may be fixed. Its impact may be reduced, however, where the batch size can be increased without a proportionate increase in cost.

The achievement of the required level of management skill and commitment to change may also detract from the implementation of the new system. Management may feel that the activity based approach contains too many assumptions and estimates about activities and cost drivers. There may be doubt as to the degree of increased accuracy which it provides.

*(alternative relevant examples and discussion would be acceptable)*

- 5 (a) In order to assess the attractiveness of the option to enter the market for spirally-wound paper tubes, the directors of BPC could make use of Michael Porter's 'five forces model'.

In applying this model to the given scenario one might conclude that the relatively low cost of the machine together with the fact that an unskilled person would only require one day's training in order to be able to operate a machine, constitute relatively low costs of entry to the market. Therefore one might reasonably conclude that the threat of new entrants might be high. This is especially the case where the market is highly fragmented.

The fact that products are usually purchased in very large quantities by customers together with the fact that there is little real difference between the products of alternative suppliers suggests that customer (buyer) power might well be very high. The fact that the paper tubes on average only comprise between 1% and 2% of the total cost of the purchaser's finished product also suggests that buyer power may well be very high.

The threat from suppliers could be high due to the fact that the specially formulated paper from which the tubes are made is sometimes in short supply. Hence suppliers might increase their prices with consequential diminution in gross margin of the firms in the marketplace.

The threat from competitive rivals will be strong as the four major players in the market are of similar size and that the market is a slow growing market. The market leader currently has 26% of the market and the three nearest competitors hold approximately 18% of the market.

The fact that Plastic Tubes Co (PTC) produces a narrow range of plastic tubes constitutes a threat from a substitute product. This threat will increase if the product range of PTC is extended and the price of plastic tubes is reduced.

The fact that a foreign-based multinational company is considering entering this market represents a significant threat from a potential new entrant as it would appear that the multinational company might well be able to derive economies of scale from large scale automated machinery and has manufacturing flexibility.

Low capital barriers to entry might appeal to BPC but they would also appeal to other potential entrants. The low growth market, the ease of entry, the existence of established competitors, a credible threat of backward vertical integration by suppliers, the imminent entry by a multi-national, a struggling established competitor and the difficulty of differentiating an industrial commodity should call into question the potential of BPC to achieve any sort of competitive advantage. If BPC can achieve the position of lowest cost producer within the industry then entry into the market might be a good move. In order to assess whether this is possible BPC must consider any potential synergies that would exist between its cardboard business and that of the tubes operation.

From the information available, the option to enter the market for cardboard tubes appears to be unattractive. The directors of BPC should seek alternative performance improvement strategies.

- (b) It would appear that JOL's market share has declined from 30% to  $(80 - 26)/3 = 18\%$  during the last three years. A 12% fall in market share is probably very significant with a knock-on effect on profits and resultant cash flows. Obviously such a declining trend needs to be arrested immediately and this will require a detailed investigation to be undertaken by the directors of JOL. Consequently loss of market share can be seen to be an indicator of potential corporate failure. Other indicators of corporate failure are as follows:



Six performance indicators that an organisation might fail are as follows:

**Poor cash flow**

Poor cash flow might render an organisation unable to pay its debts as and when they fall due for payment. This might mean, for example, that providers of finance might be able to invoke the terms of a loan covenant and commence legal action against an organisation which might eventually lead to its winding-up.

**Lack of new production/service introduction**

Innovation can often be seen to be the difference between 'life and death' as new products and services provide continuity of income streams in an ever-changing business environment. A lack of new product/service introduction may arise from a shortage of funds available for re-investment. This can lead to organisations attempting to compete with their competitors with an out of date range of products and services, the consequences of which will invariably turn out to be disastrous.

**General economic conditions**

Falling demand and increasing interest rates can precipitate the demise of organisations. Highly geared organisations will suffer as demand falls and the weight of the interest burden increases. Organisations can find themselves in a vicious circle as increasing amounts of interest payable are paid from diminishing gross margins leading to falling profits/increasing losses and negative cash flows. This leads to the need for further loan finance and even higher interest burden, further diminution in margins and so on.

**Lack of financial controls**

The absence of sound financial controls has proven costly to many organisations. In extreme circumstances it can lead to outright fraud (e.g. Enron and WorldCom).

**Internal rivalry**

The extent of internal rivalry that exists within an organisation can prove to be of critical significance to an organisation as managerial effort is effectively channeled into increasing the amount of internal conflict that exists to the detriment of the organisation as a whole. Unfortunately the adverse consequences of internal rivalry remain latent until it is too late to redress them.

**Loss of key personnel**

In certain types of organisation the loss of key personnel can 'spell the beginning of the end' for an organisation. This is particularly the case when individuals possess knowledge which can be exploited by direct competitors, e.g. sales contacts, product specifications, product recipes, etc.

**Professional Level – Options Module, Paper P5  
Advanced Performance Management**

**December 2007 Marking Scheme**

		<i>Marks</i>	<i>Marks</i>		
<b>1</b>	<b>(a)</b> Operating performance – calculations – comments Financial performance – calculations – comments Professional marks	3			
		6			
		11			
		6			
		<u>4</u>	Maximum 23		
	<b>(b)</b> Comments (on merit): Problems Items of information				
		3 x 1	3		
		3 x 1	<u>3</u>	6	
	<b>(c)</b> Comments (on merit): Reasons Value				
			4		
			<u>4</u>	Maximum 6	
		<u>35</u>			
<b>2</b>	<b>(a) (i)</b> Calculation of RI Comments (on merit)	3			
		<u>3</u>	6		
	<b>(ii)</b> For each of measures 1 to 3 including reference to managerial/economic performance and to illustrative items given in the question	3 x 3		Maximum 8	
	<b>(b) (i)</b> Adjusted profit after tax Adjusted capital employed WACC EVA Comment		3		
			3		
			1		
			1		
			<u>1</u>	Maximum 8	
	<b>(ii)</b> Disadvantages of EVA	3 x 1		<u>3</u>	
		<u>25</u>			
<b>3</b>	<b>(a)</b> Profit Profit/Sales % Materials – price sensitivity	6 x 0.5	3		
			1		
			<u>2</u>	Maximum 5	
	<b>(b)</b> Critical success factors	5 x 2	10	10	
	<b>(c)</b> Comments (on merit) Nature of work Changing role				
			3		
			<u>3</u>	Maximum 5	
			<u>20</u>		
	<b>4</b>	<b>(a)</b> Unit level costs Batch related costs Product sustaining costs Business sustaining costs		1	
				2	
				1	
				<u>1</u>	5
<b>(b)</b> Identification and appropriateness of cost driver of levels 1 to 4 expenses Causes of the cost drivers 1–3 Possible benefits					
			6		
			3		
			<u>3</u>	Maximum 10	
<b>(c)</b> Comments (on merit)					
			<u>5</u>	<u>5</u>	
			<u>20</u>		

		<i>Marks</i>	<i>Marks</i>
<b>5 (a)</b>	Comments (on merit): Each of the five forces Conclusion	5 x 2 10 <u>1</u>	Maximum 10
<b>(b)</b>	Comments (on merit) Fall in market share significant (with percentage 18%) Indicators	6 x 1.5 1 1 <u>9</u>	Maximum <u>10</u> <u>20</u>