



EXPRESS Notes

ACCA Paper F5

Performance Management

For exams in 2012



theexpgroup.com

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START About Express Notes

We are very pleased that you have downloaded a copy of our Express notes for this paper. We expect that you are keen to get on with the job in hand, so we will keep the introduction brief.

First, we would like to draw your attention to the terms and conditions of usage. It's a condition of printing these notes that you agree to the terms and conditions of usage. These are available to view at www.theexpgroup.com. Essentially we want to help people get through their exams. If you are a student for the ACCA exams and you are using these notes for yourself only, you will have no problems complying with our fair use policy.

You will however need to get our written permission in advance if you want to use these notes as part of a training programme that you are delivering.

WARNING! These notes are not designed to cover everything in the syllabus!

They are designed to help you assimilate and understand the most important areas for the exam as quickly as possible. If you study from these notes only, you will not have covered everything that is in the ACCA syllabus and study guide for this paper.

Components of an effective study system

On ExP classroom courses, we provide people with the following learning materials:

- The Express notes for that paper
- The ExP recommended course notes / essential text or the ExPeditte classroom course notes where we have published our own course notes for that paper
- The ExP recommended exam kit for that paper.
- In addition, we will recommend a study text / complete text from one of the ACCA official publishers, but we do not necessarily give this as part of a classroom course, as we think that it can sometimes slow people down and reduce the time that they are able to spend practising past questions.

ExP classroom course students will also have access to various online support materials, including:

- The unique ExP & Me e-portal, which amongst other things allows "view again" of the classroom course that was actually attended.
- ExPand, our online learning tool and questions and answers database

Everybody in the World has free access to ACCA's own database of past exam questions, answers, syllabus, study guide and examiner's commentaries on past sittings. This can be an invaluable resource. You can find links to the most useful pages of the ACCA database that are relevant to your study on ExPand at www.theexpgroup.com.

How to get the most from these Express notes

For people on a classroom course, this is how we recommend that you use the suite of learning materials that we provide. This depends where you are in terms of your exam preparation for each paper.

Your stage in study for each paper	These Express notes	EXP recommended course notes, or EXPedite notes	EXP recommended exam kit	ACCA online past exams
Prior to study, e.g. deciding which optional papers to take	Skim through the Express notes to get a feel for what's in the syllabus, the "size" of the paper and how much it appeals to you.	Don't use yet	Don't use yet	Have a quick look at the two most recent real ACCA exam papers to get a feel for examiner's style.
At the start of the learning phase	Work through each chapter of the Express notes in detail before you then work through your course notes. Don't try to feel that you have to understand everything – just get an idea for what you are about to study. Don't make any annotations on the Express notes at this stage.	Work through in detail. Review each chapter after class at least once. Make sure that you understand each area reasonably well, but also make sure that you can recall key definitions, concepts, approaches to exam questions, mnemonics, etc.	Nobody passes an exam by what they have studied – we pass exams by being efficient in being able to prove what we know. In other words, you need to have effectively input the knowledge and be effective in the output of what you know. Exam practice is key to this. Try to do at least one past exam question on the learning phase for each major chapter.	Don't use at this stage.

Your stage in study for each paper	These Express notes	ExP recommended course notes, or ExPeditate notes	ExP recommended exam kit	ACCA online past exams
Practice phase	Work through the Express notes again, this time annotating to explain bits that you think are easy and be brave enough to cross out the bits that you are confident you'll remember without reviewing them.	Avoid reading through your notes again. Try to focus on doing past exam questions first and then go back to your course notes/ Express notes if there's something in an answer that you don't understand.	This is your most important tool at this stage. You should aim to have worked through and understood at least two or three questions on each major area of the syllabus. You pass real exams by passing mock exams. Don't be tempted to fall into "passive" revision at this stage (e.g. reading notes or listening to CDs). Passive revision tends to be a waste of time.	Download the two most recent real exam questions and answers. Read through the technical articles written by the examiner. Read through the two most recent examiner's reports in detail. Read through some other older ones. Try to see if there are any recurring criticisms he or she makes. You must avoid these!
The night before the real exam	Read through the Express notes in full. Highlight the bits that you think are important but you think you are most likely to forget.	Unless there are specific bits that you feel you must revise, avoid looking at your course notes. Give up on any areas that you still don't understand. It's too late now.	Don't touch it!	Do a final review of the two most recent examiner's reports for the paper you will be taking tomorrow.
At the door of the exam room before you go in.	Read quickly through the full set of Express notes, focusing on areas you've highlighted, key workings, approaches to exam questions, etc.	Avoid looking at them in detail, especially if the notes are very big. It will scare you.	Leave at home.	Leave at home.

Our Express notes fit into our portfolio of materials as follows:

Express Notes

Provide a base understanding of the most important areas of the syllabus only.



Expedite Notes

Provide a comprehensive coverage of the syllabus and accompany our face to face professional exam courses



Expert Notes

Provide detailed coverage of particular technical areas and are used on our Professional Development and Executive Programmes.

To maximise your chances of success in the exam we recommend you visit www.theexpgroup.com where you will be able to access additional free resources to help you in your studies.



START
About The EXP Group

Born with a desire to be the leading supplier of business training services, the ExP Group delivers courses through either one of its permanent centres or onsite at a variety of locations around the world. Our clients range from multinational household corporate names, through local companies to individuals furthering themselves through studying for one of the various professional exams or professional development courses.

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Our expert team has worked with many different audiences around the world ranging from graduate recruits through to senior board level positions.

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A conventional way of apportioning the cost would be on the basis of employees:

$$\begin{aligned} \text{Workshop A: } & (200/500) \times 500,000 = 200,000 \\ \text{Workshop B: } & (300/500) \times 500,000 = \frac{300,000}{500,000} \end{aligned}$$

An ABC approach might look at the number of visits to the clinic by the employees of A and B.

$$\begin{aligned} \text{Workshop A: } & 150 \text{ visits p.a.} \\ \text{Workshop B: } & 70 \text{ visits p.a.} \end{aligned}$$

In this case, the apportionment could be:

$$\begin{aligned} \text{Workshop A: } & (150/220) \times 500,000 = 340,909 \\ \text{Workshop B: } & (70/220) \times 500,000 = \frac{159,091}{500,000} \end{aligned}$$

The different levels of usage may reflect different degrees of occupational hazard present in the two workshops.

ABC advantages: provides a more precise way to determine costs per unit of output, especially since not all overhead costs are driven by production volumes.

Budgetary planning, pricing decisions and managing performance are all facilitated by ABC.

ABC disadvantages: it can be complex and costly to implement. It is not a "plug-in-and-go" system! It is therefore imperative that management carefully weigh the costs against the (expected) benefits from ABC before deciding to implement it.



KEY KNOWLEDGE
Target costing

This is a market-oriented approach to costing which starts by identifying the likely price that a product can fetch in the market, deducts the profit that the product is expected to earn, and arrives at the maximum (target) cost of manufacturing the product.

Such a method usually requires successive iterations in order to close a "cost gap", i.e. where the costs are above the targeted level. Product re-design, alternative materials and production processes are examined in order to achieve the desired level of costs.



KEY KNOWLEDGE

Life-cycle costing

A product normally “lives” beyond one accounting period and the costs connected to its development/design, launch and maintenance fall unevenly across time periods. This method takes a comprehensive view of the costs relating to the product throughout its life-cycle.



KEY KNOWLEDGE

Back-flush Accounting

This is a simplified costing method which can be used in conditions of short operational cycles and low inventories. Companies working on a Just-In-Time (JIT) basis may practise it, as it avoids the detailed tracking of costs during production; instead, it records costs when goods are completed. These costs are then “back-flushed” through the system based on standard costs.



KEY KNOWLEDGE

Throughput accounting

This method is also consistent with a JIT environment and focuses on the bottlenecks in a production process; by eliminating these bottlenecks, it raises the amount of output that can flow through the process (assuming there is demand for the output – the idea is not to produce for inventory!).

The throughput accounting approach itself considers all costs (including direct labour) as fixed and treats only direct materials as being variable in the short term.



EXAMPLE

A company seeking to determine whether to continue to transport its products by truck or to switch to the railroad discovers that insurance costs are identical in both choices; in that case, insurance costs are not relevant to the decision.

If, however, there is a difference in the two insurance costs, then one can speak of the difference between the two choices as being "incremental"; this difference (referred to in some places as the "differential") is relevant to the decision under consideration.

Future

Relevant costs refer to the future, i.e. they can be influenced prospectively by choice. It follows that:

Sunk costs are not relevant: They have already taken place and cannot be reversed.

Committed costs, if they cannot be avoided, are likewise not relevant, even if the timing of their occurrence is in the future. Their "unavoidability" has already been established in the past (making them effectively the equivalent of sunk costs).

In keeping with the above logic, relevant costs therefore involve cash, are incremental and relate to the future.

Relevant costs need to be identified with care, as they may include opportunity costs.



EXAMPLE

A company considers building a storage facility on the site of a parking lot. If the parking lot had been generating parking fees which will now be lost, then this foregone revenue is an opportunity cost.



KEY KNOWLEDGE

Break-even Analysis

Cost-Volume-Profit (CVP) Analysis

The breakeven formula

Total Costs = Fixed Costs + Unit Variable Cost x Number of Units

Total Revenue = Sales Price x Number of Units

If

TC = Total Costs,

FC = Fixed Costs,

V = Unit Variable Cost,

X = Number of Units,

TR = Total Revenue,

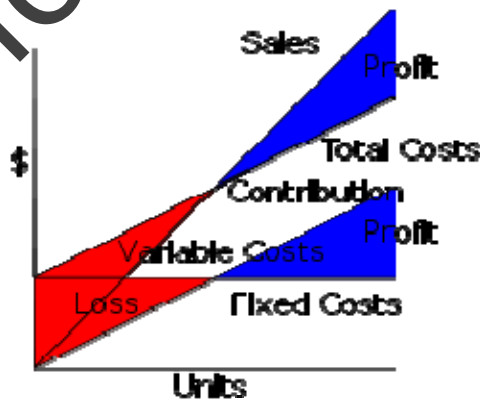
SP = Selling Price,

C = SP – V = Unit Contribution and

CM% = C/SP = Contribution Margin,

Then the *break-even point* (the output level at which TR=TC) is:

- In units sold: $X = FC/C$
- In dollar sales: $TR = FC/CM\%$



- Safety Margin = Budgeted Sales – Break-even point (units/dollars)
- C is an important indicator, as it shows the contribution of each unit sold towards covering fixed costs. Therefore, in the short run, the firm may prefer to produce/sell below break-even in order to recover some of its fixed costs.

Relevant costs, incremental analysis and linear programming

- Relevant costs are costs expected to vary with the action taken
 - Past (sunk) costs are irrelevant
 - Fixed costs are irrelevant if there is idle capacity
 - Variable (marginal) costs are relevant
 - Opportunity costs (foregone benefits) are relevant
- Incremental analysis uses relevant costs in order to quantify the short-term effects of business decisions taken.

Applying incremental analysis in business decision-making

- Accept or reject a special order
 - Accept if selling price exceeds variable production cost and there is spare capacity
- Make (in-sourcing) or buy (out-sourcing)
 - Outsource least efficient activities if full capacity reached
- Capital budgeting
 - Invest if marginal cost of investing is below marginal cost of not investing (marginal benefit foregone)
- Disinvestment
 - Divest if (marginal revenue generated + cost of resulting idle capacity + severance payments + restoration costs) fall below marginal cost of production + salvage value of assets

Determining optimal mix of products where there are limiting factors

It addresses the problem of maximizing or minimizing a linear function subject to linear constraints. The constraints may be equalities or inequalities.



START Pricing decisions

The pricing of a product or service is crucially influenced by several factors:

Internal: How much does it **cost** us to produce it?

External: How much is a **customer** willing to pay for it?

The latter is further influenced by how much the **competition** is charging for the same (or similar) product or service.



KEY KNOWLEDGE

The price elasticity of demand (PED)

This measures the sensitivity of (customer) demand to a change in prices. There is usually an inverse relationship: when price goes up, demand goes down (and vice versa).

$$\text{PED} = \frac{\% \text{ change in demand}}{\% \text{ change in price}}$$



EXAMPLE

A cinema increases its ticket prices from \$4 to \$6; as a result, the number of cinema goers drops from 2,000 to 1,500.

$$\text{The PED} = \frac{(500/2000)}{(2/4)} = \frac{25\%}{50\%} = 0.5 \text{ (Note: Ignore + or - signs; take the absolute value)}$$

In the above example, demand is considered inelastic, because the $\text{PED} < 1$. When $\text{PED} > 1$, then demand is considered elastic.



KEY KNOWLEDGE

Demand Equation

Whereas the PED is expressed in percentages, the demand equation (or function) is portrayed as a downward sloping straight line which shows price and demand combinations in their full values. The equation is expressed as

$$P = a - bQ$$

Where:

P = price – corresponding to the dependent variable (y-axis) on a graph;

Q = (Quantity) demanded – corresponding to the independent variable (x-axis);

a = the maximum price (where Q = 0) -- corresponding to the y-intercept; and

b = the slope of the (negatively-sloping) line (change in P / change in Q)



EXAMPLE

On an average Saturday night, a cinema (capacity: 225) attracts 150 visitors at a price of \$5. If the price of the ticket is decreased by \$0.50 then 25 more people will come.

In order to fill up the cinema, the ticket price would have to be set at:

$$5 = a - (0.50/25) \times 150; \text{ therefore, } a = 8, \text{ and}$$

$$P = 8 - 0.02Q$$

$$\text{At } Q = 225, P = \$3.50$$



KEY KNOWLEDGE Total Cost Function

An equation can also be formulated to express the relationship between total costs and variable costs:

$$Y = aX + b$$

Where:

Y = Total costs;

X = Output – corresponding to the independent variable;

a = fixed cost – corresponding to the Y-intercept;

b = the variable cost per unit -- corresponding to the slope of the total cost line



EXAMPLE

The variable cost per unit of a bottling process is 10 cents per unit. Fixed costs amount to \$5,000. At an output level of 20,000 units, what is the total cost?

$$Y = \$5,000 + (\$0.10) \times 20,000$$

$$= \$7,000$$

When working with bulk discounts and other sales volumes, it is important to make sure that fixed costs remain unchanged over the output range covered. If they increase (as a result of expanding the production capacity, for example) then the new (higher) level of fixed costs need to be included in the calculation of total costs.



KEY KNOWLEDGE Pricing Strategies

There are a variety of pricing strategies with which one should be familiar:

Cost plus: A mark-up is added to a given cost base (which can be variable or full production cost).

Skimming: Enter the market at a high price to catch customers willing and able to pay the price.

Penetration pricing: Go in at a very low price to win market share.

Premium pricing: Maintain a high price due to the nature of the product.

Target pricing: This method "backs into" the price by calculating the required profit and the possible production costs first.

Promotional Pricing: These are in support of campaigns to raise customer awareness of a product.

Perceived value pricing: Plays on perception of value and what the market is willing to pay.

Value Pricing: Increasing the value content of the product so as to defend market share (in times of difficult economic conditions or competition).

Product-line pricing: Sell a “core” product cheaply and price high related products.

Volume-discounting pricing: The bigger the order, the lower the price per unit.

Discriminatory pricing: Pricing the same product at different levels in different markets (geographical) or market segments (customers).

Psychological Pricing: Plays on the emotion of the consumer.

Product Bundle Pricing: Combining products into one pack and pricing it overall.

Complementary product pricing: This refers to products that are used in conjunction with other products (e.g. printers and cartridges, razor grips and blades, staplers and staples, automobiles and spare parts). Typically, the approach to pricing may be low for the main product and more expensive for the “re-fills”.

Relevant cost pricing: Basing the price on a keen (accurate) understanding of the real costs of the product or service.

Make-Buy

A make-buy decision requires the determination of all relevant costs.



EXAMPLE

An automotive components producer can supply itself externally with car heaters for \$210 per unit. In considering whether to make these internally, the company calculates that an equivalent unit can be made in 2 labour hours using \$100 worth of materials.

Labour is currently at full capacity producing carburettors which generate contribution of \$100. A carburettor takes 2.5 hours to produce. Labour costs \$10 per hour. The carburettor also absorbs fixed overhead costs at the rate of \$20 per labour hour.

The relevant costs are (\$):

Materials:	100
Contribution lost (carburettors):	80
Labour (added-back):	<u>20</u>
	200

It is cheaper to produce internally.

Shut Down decisions