Embracing change. Shaping futures.

Performance Management

Read the mind of a PM marker

Think Ahead

Contents

Introduction

I am a member of the team who will mark Performance Management. This article is designed to give you, the candidate, an insight into my mind, so that you can better understand what a marker will be looking for when it comes to marking your Performance Management script.

Insight into a marker's thinking – appreciating what we are trained to look for, what we award marks for, the reasons why marks may not be awarded – will help you fulfil your potential and gain the necessary marks to pass.

It will help you appreciate the points that will attract marks so that you can better assess your answers when practicing questions.

> **Fulfil your potential and gain the necessary marks to pass.**

This article uses two candidates' answers to a question selected from the September 2017 exam.

To support your reading of this article, you should refer to the September/December 2017 – Sample Questions. **Click the link here**.

You may also find it interesting to refer to the published answers for the September/December 2017 sample questions, noting the differences and comparing the length and style to the candidates' answers seen in this article. It's important to remember that you don't need to replicate the published answer to achieve a pass. **Click the link here**.

Question 32

This question is drawn from the performance measurement area of the syllabus. Question scenarios may be set in the context of a private sector organisation, divisional performance or not-for-profit organisations and the public sector.

This question concerned divisional performance of a manufacturing company including appraising an investment. A similar question was examined also in June 2018.

A pass mark cannot be earned from calculations alone.

(a) (i) Calculate the return on investment (ROI) for each of the two divisions of Sports Co. **(6 marks)**

(ii) Discuss the performance of the two divisions for the year, including the main reasons why their ROI results differ from each other. Explain the impact the difference in ROI could have on the behaviour of the manager of the worst performing division. **(6 marks)**

(b) (i) Calculate the residual income (RI) for each of the two divisions of Sports Co and briefly comment on the results of this performance measure. **(4 marks)**

(ii) Explain the advantages and disadvantages of using residual income (RI) to measure divisional performance. **(4 marks)**

20 marks

Observations on the requirements

The elements of each of the calculations in (a)(i) and (b)(i) are very straightforward and are therefore worth just 1 mark for both the divisions.

A quick glance at the requirements might suggest that 10 marks are available for calculations – 6 for (a)(i) and 4 for (b)(i). But careful reading of (b)(i) shows that there must be 1 mark for 'briefly comment on the results on this performance measure'. Therefore, a pass mark cannot be earned from calculations alone.

Part (a)(ii) requires **discussion** of the performance of the two divisions, **including** the main reasons why they differ **AND explaining** the impact the difference could have on the behaviour of the manager of the worst performing division. It is very important to identify all elements of requirements. The examiner reported that candidates who ignored the 'and explain' element spent too long looking at irrelevant or unnecessary comparisons.

Part (b)(ii) requires an **explanation** of advantages and disadvantages. Textbook knowledge must be applied to the given scenario. For example, 'RI reduces dysfunctional decision making' does not explain the advantage. However, 'RI reduces dysfunctional decision making because it uses the company's cost of capital, so positive RI projects for the company would also be accepted by the division' would clearly be rewarded with a mark.

Textbook knowledge must be applied to the given scenario.

Notes on candidate one's answer to Q32

Follow this link to see candidate one's answer to Q32

[View it here]

Note 1

One mark was available for starting with net profit and one for the calculation of average assets. One mark was given for the calculation of ROI, even though the candidate ignored the necessary adjustments to calculate controllable profit. This 'method mark' shows the application of the 'own figure rule'.

Note 2

The first mark has been awarded for making use of the target ROI as this was a key point in the scenario. A further mark has been given for attempting to explain why the ratios of the two vary. Even though the explanation is confused (ROI of Division C should be expected to be higher than for Division E), the candidate has shown that they understand that not investing in new assets will lead to a higher ROI.

Note that the 'own figure rule' may apply to narrative answers as well as calculations. The candidate failed to earn 3 marks in part (a)(i) by ignoring the adjustments necessary to calculate controllable profit. Full credit must therefore be given for valid points based on the incorrect ratios calculated, as if they had been correct.

Note 3

No credit is given for either of the comments on head office costs and depreciation. These are not valid points because they should have been adjusted for. The 'own figure rule' cannot apply to statements that are technically wrong. One mark has been given for using another key point in the scenario (the $2m investment) to explain the lower ROI.

> ## The 'own figure rule' may apply to narrative answers as well as calculations.

Note 4

As Division C is the worst performing according to the candidate's calculation, credit will again be given for valid points. The first point has been given a mark because the candidate has suggested a reason why the manager may be demotivated. A further mark is given for a valid impact on behaviour.

Note 5

As noted in the observations on requirements, there were three elements to this part. The candidate has been rewarded for a balanced answer which sought to provide reasons using information in the scenario. This answer clearly illustrates that it is vital to attempt the discursive requirements even if your calculations may be incorrect. Also note that poor grammar is not penalised; as long as it is reasonable to expect a marker to understand the candidate's meaning.

> ## It is vital to attempt the discursive requirements.

Note 6

All 3 marks for the calculation are awarded even though the profit is incorrect. The candidate already lost the marks for not adjusting profit in part (a)(i), so the own figure rule applies.

Note 7

One mark has been given for 'comment'. Even though it was not well explained or clear, credit has been given for linking positive amounts to both divisions having performed well and referencing the cost of capital as low.

Note 8

One mark is given for the second advantage. The other 'textbook' comments do not explain any advantage or disadvantage of using RI to measure divisional performance. (The first advantage is not exclusive to RI, that something is 'difficult to understand' is not a valid reason for not using it and the last point is not a problem of the measure, but of its application.)

The mark for candidate one for Q32 is 13/20.

> **TOTAL:**
>
> ## 13/20

Notes on candidate two's answer to Q32

Follow this link to see candidate two's answer to Q32

[View it here]

Note 1

Comparing this with candidate one's script, candidate two earns only the mark for starting with net profit and the method mark for the calculation of ROI.

Given that there were 6 marks available for this part, the candidate should have realised that there must have been more to the calculations than these simple ratios. That they were given opening and closing divisional controllable net assets should have prompted the need to calculate the average controllable net assets. This is turn should have prompted the need to calculate controllable profit, in order calculate a meaningful ratio.

> ### Candidates should label all parts of their answer.

Note 2

The candidate has not indicated the split between parts (i) and (ii). As a point of exam technique, candidates should label all parts of their answer. Not only should this help you ensure that you have answered all parts, but it will help a marker ensure that all parts are marked. If there is no indication that a part has been attempted, it will appear that it has not. Here, a mark is given for making use of the target ROI, as this was a key point in the scenario.

Again this was for 6 marks so one sentence is inadequate. There were other key points in the scenario:

- Divisional managers make decisions about investments – did either make investment? Yes, Division E made $2m investment. How does investment affect ROI? It increases net assets so reduces ROI.

- Divisional manager receive a bonus for achieving the target – will they get a bonus?

- Are there any other obvious differences that could affect their relative performance (as shown by ROI)? Yes – depreciation method.

Note 3

The mark allocation indicates that candidates should have spent 21 minutes on this part. Giving just a quarter of this time, say 5-6 minutes, to reading the scenario carefully for key points of information would have been time well spent.

> ### Reading the scenario carefully for key points of information would have been time well spent.

Note 4

All 3 marks are awarded for the calculation (see Note 6 for candidate one).

Note 5

One mark is given for this qualitative comment (indicated by 'healthy').

Note 6

That RI is 'best suited' is not an advantage. Goal congruence in decision making is an advantage and the candidate has conveyed its meaning. So this has been awarded a mark even though the candidate has not spelt out how this is achieved.

Note 7

The candidate did not allocate their time strictly and so ran out of time. Note that the candidate would have saved a little time if they had used a column layout for their calculations.

The mark for candidate two for Q32 is 8/20.

TOTAL:

8/20

Marks

September/December 2017 exam marked answers

Question 32 candidate one

(a)(i) Return on investment

	Division C	Division E
Profit	1,455	3,950
Average assets	11,000	27,000
ROI	13.2%	14.6%

1

1

1

← *Note 1*

TOTAL – Part (a)(i):

3/6

(a)(ii) Performance measurement

<u>Division C</u>
The target ROI for each division is 18%. During the year Division C ROI is 13.2% – less than the target means division didn't performed well.

1

If we discuss why ROI of both divisions differs from each other. As we could see division C is not buying any new NCA for the division. They may reduce their depreciation expense and would have increased their ROI for the period.

1

← *Note 2*

<u>Division E</u>
Division E's ROI is also less than the targeted ROI of 18%. First reason is the extra head office cost of $700,000 which it recharges to division E. And as we can see the division E has invested $2m in new plant and machinery in the beginning of the year so it would have charged full year's depreciation to these results. This could be the reason of lower ROI.

1

← *Note 3*

On the other hand 30% of dep cost of $460,000 related to assets controlled but not owned by Head Office may resulted in low ROI.

<u>Impact on the behaviour of worst performing division</u>
As we can clearly see Division C is performing worst.

1

The manager may be demotivated by the allocation of high fixed costs.
He might think that is it not a suitable measure. He may encourage more slacks.
He might stop investing funds in new non-current assets in order to increase his performance.

1

← *Note 4*

← *Note 5*

TOTAL – Part (a)(ii):

5/6

Relevant notes

(b) Residual income (RIs)

(i)

	Division C	Division E
Profit	1,455	3,950
Less	(11,000 x 12%)	(27,000 x 12%)
	135 positive	710 positive

Performance measurement
Division C:
Results are positive. Means division have performed well just because low 12% cost have reduced from profit.

Division E:
Also performed well. Results are positive. Because division E has invested high amount on new investment that's why its results are better than division C.

TOTAL – Part (b)(i):
4/4

(ii)

Advantages of using RI:

1 – it shows clear results and cuts those costs which are out of manager's control.

2 – it reduces profit for a notional interest charge on capital which gives better picture of the performance measures.

Disadvantages:

1 – it's a little complicated and difficult to understand

2 – it could demotivate managers if cost of capital not charged correctly

TOTAL – Part (b)(ii):
1/4

TOTAL – Q32:
13/20

Notes

Relevant notes

Question 32 candidate two

(a)(i) ROI

<u>For division C</u> $'000 common
Net profit $1,455
Closing net assets $9,000
1,455/9,000 = 16.16%

2 ← *Note 1*

<u>For division E</u>
Net profit $3,950
Closing net assets $30,000
3,950/$30,000 = 13.1%

Comparing both the divisions the division C is performing better than division E but both divisions fail to achieve the ROI target of 18%.

1 ← *Note 2*

**TOTAL – Part (a):
3/12** ← *Note 3*

(b)(i) RI – cost of capital = 12%

<u>For division C</u> $'000 common
Net profit $1,455
Closing net assets $9,000 x 12% = $1,080

	1,455
	(1,080)
RI =	$375

<u>For division E</u>

Closing net assets	$30,000
Cost of capital	12%
	3,600
	3,950
	(3,600)
RI =	$350

3 ← *Note 4*

Both divisions are having a healthy RI of $375,000 for division C and $350,000 for division E.

1 ← *Note 5*

**TOTAL – Part (b)(i):
4/4**

(ii) Advantages of RI

1 – Compared to ROI, RI is best suited for investment centre.
2 – By using RI for performance measure divisions make decisions in 'goal congruence' with the whole organisation.
Disadvantage
1 – There can

1 ← *Note 6*

**TOTAL – Part (b)(ii):
1/4** ← *Note 7*

**TOTAL – Q32:
8/20**

Notes

Relevant notes

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