
Answers

Section C

31 (a) (i) Flexed budget for Cowly restaurant

	Original budget	Flexed budget	Actual	Variance
Number of customers	1,500	1,800	1,800	
	\$	\$	\$	\$
Revenue	75,000	90,000	87,300	2,700 A
Food and drink costs	(22,500)	(27,000)	(26,100)	900 F
Staff costs	(31,500)	(37,800)	(38,250)	450 A
Heat, light and power	(7,500)	(9,000)	(8,100)	900 F
Rent, rates and other overheads	(12,000)	(12,000)	(12,600)	600 A
Profit	<u>1,500</u>	<u>4,200</u>	<u>2,250</u>	<u>1,950 A</u>

Notes:

Revenue: $\$75,000/1,500 = \50 per customer: $\$50 \times 1,800 = \$90,000$
 Food and drink: $\$22,500/1,500 = \15 per customer: $\$15 \times 1,800 = \$27,000$
 Staff costs: $\$31,500/1,500 = \21 per customer: $\$21 \times 1,800 = \$37,800$
 Heat, light and power: $\$7,500/1,500 = \5 per customer: $\$5 \times 1,800 = \$9,000$

- (ii) The most significant weakness in the current performance report is that the original budget is not flexed to adjust for the actual numbers of customers served.

The existing report shows that the Cowly restaurant has overspent on all its costs which could be a concern given the importance of cost control in Yumi Co. However, the main reason for the revenue variance and the costs variances is the fact that the number of customers the restaurant served was 20% higher than budgeted (1,800 v 1,500).

If the budget is flexed for the actual number of customers, this allows a more meaningful assessment of the restaurant's performance to be made.

Once the flexed budget is prepared, it can be seen that revenues were actually lower than would have been expected, given the number of customers served with average spend per head being \$48.50 instead of \$50. Food and drink costs were also less than budget. Taken together with the reduction in average customer spending, this might suggest that some of the items on the menu had been changed since the budget was originally set.

Another weakness in Yumi Co's budgetary control report is the fact that staff costs and heat, light and power costs are assumed to be purely variable costs – dependent on the number of customers. However, although the restaurant may recruit some temporary staff in busy periods, it is likely that at least some of the staff will be permanent, meaning that it would be more appropriate to treat staff costs as semi-variable rather than variable.

Similarly, it seems likely that there will be a significant fixed element within heat, light and power costs, so treating these as wholly variable costs does not seem appropriate.

- (b) Under an incremental budgeting approach, the current year's budget and results are taken as the starting point for preparing the next year's budget. The budget is then adjusted for any expected changes, such as the impact of inflation on costs and prices, and sales growth or decline.

The main advantage of the incremental approach is that it is a relatively straightforward way of preparing a budget, appropriate for organisations which are operating in relatively stable environments. The locations of Yumi Co's restaurants, away from significant competition, suggest that the operating environment is relatively stable, meaning incremental budgeting is appropriate.

Similarly, the fact that Yumi Co appears to have a relatively well-established brand and customer base suggests that using an incremental approach to budgeting future revenues appears reasonable, even if it is difficult to identify some changes which need to be adjusted for in the next year's budget. However, one of the major disadvantages of incremental budgeting is that it does not provide any incentive to make operations more efficient or economical. If the current year figures include slack or inefficiencies, then using them as the start-point for the next year's figures means that inefficiency is automatically perpetuated into the next year.

Such an approach seems somewhat inconsistent with the focus on cost control within Yumi Co. If the company is worried about its relatively low margins, then an approach to budgeting which challenges costs more critically (such as zero-based budgeting or activity-based budgeting) might be more suitable for helping to drive down costs. For example, the highest cost is staff wages which could be analysed and Yumi Co could investigate making changes to its staffing model to reduce costs and/or improve efficiency.

As mentioned in part (a), whether labour costs and heat, light and power vary proportionately with the number of customers appears debatable. If Yumi Co's incremental budgets ignore the relationship between activities and costs, then ultimately

the budgets will provide Yumi Co's management with little relevant information for managing costs. This could become an increasingly important issue if competition in Yumi Co's markets intensifies.

- (c) The current budget process is a centralised, top-down process, meaning that the managers from Yumi Co's restaurants do not have any opportunity to influence the budgets for their restaurants.

By contrast, in a participative approach, the managers of each restaurant would be able to influence the figures for their restaurant, rather than having budget targets simply imposed on them.

Involving the managers in the budgeting process should help to make the budgets more effective and realistic. The local managers should have a greater understanding of the environmental factors and operational constraints which will influence the performance of their restaurants. For example, the manager of the Cowly restaurant will have a better understanding of their customers and market conditions and thus provide a greater insight into the potential impact of the new restaurant than a member of the finance team at Yumi Co's head office would have. Similarly, managers are more likely to be committed to achieving a budget if they have been involved in creating it – not least because their involvement in the preparing the budget should help to ensure that they feel the budget figures are realistic.

However, involving the restaurant managers in the budgeting process is likely to make it more time-consuming. For example, instead of running their restaurants, managers will have to spend time in meetings with head office staff planning and preparing their budgets. In this respect, it may be more appropriate for Yumi Co to maintain the current, top-down process for restaurants which are operating in a stable environment (and where the insights from local managers will add little value), but introduce a more participative approach for restaurants like Cowly which are facing a period of change.

Another potential disadvantage of participative budgeting is that managers may try to influence the budgets so that their targets can be achieved easily. By doing this, a restaurant's performance, compared to budget, will appear to improve, but this would actually be an illusion. One of the main issues Yumi Co could face in this respect is that, given the range of different locations of its restaurants, it will be difficult for head office staff to know whether individual managers are setting targets which are easy or challenging. If the restaurants were all similar, or in similar locations, it would be easier to compare the figures suggested by individual managers to assess how challenging, or not, they are.

Similarly, managers are more likely to highlight issues which will lead to a reduction in their budget targets, rather than ones which increase their targets. For example, the manager at Cowly has highlighted that the new competitor will make it more difficult for them to achieve budget. However, the manager does not appear to have made a corresponding acknowledgement that the increased numbers of visitors to Cowly could support an increased revenue target. There is a danger that the managers' participation in the budgets could lead to the targets becoming less challenging, which in turn could affect Yumi Co's competitiveness and profitability.

32 (a) (1) To provide education which promotes intellectual initiative and produces confident and ambitious graduates who have reached the highest academic standards to prepare them for success in life and the workplace

There are various performance indicators which can be looked at to ascertain whether RU is meeting this strategic aim. First, question 1 of the survey shows that 83% of students think that the course is intellectually stimulating and the quality of teaching is high. This has gone down by three percentage points since 20X5, which is not good.

In the NOS survey, the percentage of graduates agreeing that the course has developed them as a person has increased from 80% in 20X5 to 82% in 20X6. This would indicate that RU is indeed developing confident and ambitious graduates.

However, the number of graduates achieving first class degrees in 20X6 has fallen vastly from 28% to 20%. Given that the entry requirements were only relaxed in 20X6, this should not have had any impact on results. This infers that the quality of teaching may have declined and the ratio of students to academic staff has increased from 35:1 to 40:1. It appears that, although many new students were recruited in 20X6, there were not enough new academic staff recruited to deal with the influx of students. This is shown by the fact that student numbers increased by 13% but academic staff costs only increased by 6%.

As there was presumably a pay rise in the year too, it is clear that a proportionate amount of new staff were not recruited. This failing is also reflected by the fall in the answer to question 2 from 86% to 82%, with students being less satisfied in 20X6 with the advice and support they have received. Also, the staff retention rate has gone down in 20X6, meaning that staff are less familiar with RU and therefore more likely to provide a fragmented service.

However, in 20X5 74% of employers were happy with the graduates they recruited, in 20X6 this dropped to 72%. In addition, in 20X5 only 65% of students have managed to obtain graduate jobs within a year compared to previous years. Given that RU has relaxed the entry requirements for students in 20X6, this may mean that its 20X6 recruits are not as well qualified as its 20X5. This could mean that in the future the number of graduates obtaining graduate jobs within a year and the satisfaction percentages of employers could fall further. This decision has meant that there has been a 23% increase in fee income, but it compromises RU's ability to meet its first strategic aim.

(2) To provide an organised, efficient learning environment with access to cutting edge technology and facilities

As regards premises, the money spent on maintaining these has decreased by 10% in 20X6, despite the increased student numbers. In the NOS survey, the percentage of students satisfied with these facilities has gone down nine percentage points from 92% to 83%. This suggests that this particular strategic aim has been neglected. Students seem far less satisfied with the way that the courses are run and administered now, with a fall of nine percentage points in

answers to question 4. Administration staff costs have only increased by 5% despite a 13% increase in student numbers and, presumably, a pay rise during the year. It can be inferred that staff are under increasing pressure and unable to cope with the increased numbers. This is again reflected by the fall in the staff retention rate from 90% in 20X5 to 75% in 20X6.

(3) To be a leader in sustainable business practices which protect the environment and support local people

As with the above strategic aim, this one also seems to have been a little forgotten in 20X6. In 20X5, RU won an environmental award for its campuses. It also took part in a food sharing initiative which helped the local community. It has now got rid of its recycling bins and ceased to be involved in the food share project. RU's spending on sustainability and community assistance has actually halved in 20X6. This decline in activity is partly attributable to staff shortages. All in all, this is not very good as RU is now failing to meet one of its main strategic aims.

(4) To provide attractive, innovative conference and event facilities, attracting clients both nationally and internationally

Conference and event income has gone up by 13% in 20X6, which is a good increase for RU. It has managed to control its costs relating to these events well too, since these have only increased by 4%. RU has also won an award for its conference facility and attracted a number of new clients. RU therefore appears to be focusing well on this strategic aim.

(5) To be recognised both nationally and internationally for the scope and relevance of their research

Income from research at RU has actually gone down by 13% this year, as have the associated costs. Whilst a local university has won an award for their contribution to research, RU has not been successful in this regard. The suggestion is that this aim has not been focused on in 20X6.

Overall satisfaction

In addition to the above, it should be considered that the overall satisfaction percentage for students has decreased from 83% to 81%. This could have serious implications for RU as it is the main performance indicator used both internally and externally to assess how RU is performing. As well as meaning that RU may well now attract fewer students, it will also have an impact on the fees which can be charged to students in future years. The university needs to consider how it can improve the service it is providing in order to improve overall satisfaction.

Calculations

	2016 \$m	2015 \$m	%age increase/(decrease)
Income			
Tuition fees	148	135.6	9%
Research grants	3.5	4.5	(22%)
Conferences and other events	18	16	13%
Total income	<u>169.5</u>	<u>156.1</u>	9%
Expenditure			
Academic staff costs	80.8	76.2	6%
Administration staff costs	50.4	48	5%
Premises, facilities and technology costs	7.6	8.4	(10%)
Event and conference costs	8.3	8	4%
Research grants	3.1	4	(23%)
Sustainability and community assistance	1.2	2.4	(50%)
Total expenditure	<u>151.4</u>	<u>147</u>	3%
Surplus	18.1	9.1	99%
Student numbers	27,000	24,000	13%

Section C

Maximum marks Marks awarded

31 (a) (i)	Flexed budget:	
	Revenue	0.5
	Food and drink	0.5
	Staff	0.5
	Heat, light and power	0.5
	Rent and rates	0.5
	Profit	0.5
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		3
	(ii) Weaknesses	4
(b)	Discussion	6
(c)	Definition of participative budgeting	1
	Advantages and disadvantages	6
		<hr/>
		7
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		20
32 (a)	Calculations	4
	Strategic aims discussion	16
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		20
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PM Examiner's commentary on September/December 2019 sample questions

Q31 Yumi Co

This question covers various aspects of budgeting, requiring a fairly broad knowledge of this syllabus area. This is typical of many PM questions – the syllabus is large, and an important revision strategy is to cover the whole syllabus, rather than being an expert in some areas, and hoping that those areas come up.

Requirement (a) (i) shows the importance of basic knowledge – flexed budgets are covered in the MA syllabus at the Applied Knowledge level, and are expected to be something which a well prepared PM candidate should manage easily. It was pleasing to see that this was generally the case – this part of the question was performed well, with many scoring the full three marks.

(a) (ii) was less well answered, primarily due to poor exam technique. 'Traditional' questions, following the creation of a flexed budget, would ask candidates to assess the business' performance in the period and this is easily done by comparing the newly-flexed budget to actual results. The requirement, however, does not ask for this and a little extra time spent analysing the requirement can avoid this particular pitfall.

Looking at this requirement in detail, it starts '**With reference to your answer in part (a) (i)**' – this is important to note, but this doesn't tell us what is needed done, so it is necessary to read on. '**explain the main weaknesses**' – verbs are crucial in requirements and explain is regularly used, and means something needs to be made clear – in this case weaknesses but weaknesses of what? '**in the current monthly budget statements issued to the restaurants as a basis for managing performance.**' That's everything – so why are the budget statements very useful for assessing the performance of the restaurants? The requirement says to use the answer from (a) (i), but there may also be clues in the written scenario.

Reading the model answer will help identify some of the points that could've been made. However, if coming up with any points is difficult, it would be helpful to think about what is important when assessing performance. Rule number one – it should be controllable. The scenario says that Head Office costs are apportioned, which should set alarm bells ringing straight away. Another big clue here is that the budget has had to be flexed – this is done because it's not fair to compare (say) material costs at budgeted activity to material costs at actual activity as if more meals have been sold than expected, then of course material costs would be higher! Other points can be made but the most important thing here is to address the requirement. There were no marks awarded for assessing the performance of the business.

Part (b) asks for a discussion on whether incremental budgeting is suitable for Yumi Co. This is a good example of applying knowledge to the scenario. Discussions should, where possible, involve both sides of the argument, so the requirement is looking for reasons why incremental budgeting is/isn't appropriate. Again, a good knowledge of the theory is essential here –



knowing the advantages and disadvantages of incremental budgeting will make the marks easy to pick up. The following are usually considered:

Advantages

- Quicker than other methods (and therefore cheaper)
- Easily understood by managers
- Suitable for businesses in a stable environment

Disadvantages

- Errors from prior periods can be carried forwards
- Managers may spend unnecessarily in order to receive the same budget next year

It is vital to have this knowledge (for this and other areas of the syllabus), however, simply memorising and writing them out will rarely score high marks. Writing the above simply does not address the requirement – it needs to be applied to Yumi Co. However, the scenario can be used to expand the above points into a discussion.

- Quicker and cheaper than other methods – this is suitable for Yumi Co as they have a focus on cost control.
- Easily understood by managers – although the budgets are currently prepared centrally, it would help Yumi Co if the restaurant managers understood the process.
- Suitable for a stable environment – this is applicable to Yumi Co as the scenario says that results are consistent. A couple of recent changes are mentioned, but incremental budgeting would allow Yumi Co to allow for them.
- Errors/inefficiencies from prior periods can be carried forwards – this disadvantage would be a worry for Yumi Co, as margins are tight, so it would want to avoid this.
- Managers may spend unnecessarily – also something which Yumi Co would want to avoid due to the need to reduce costs. The final two points may be enough to suggest that moving away from incremental budgeting may be the answer.

The model answer makes the above points, obviously phrased differently, but the aim here isn't to reproduce the model answer, it's to show that the points made can all be obtained by having the right tools – knowledge of the theory, followed by application to the scenario.

Requirement (c) is similar to (b) – again the key skill is to apply knowledge to this scenario. Writing out the advantages and disadvantages of participative budgeting will not pass this question – it must be made applicable to Yumi Co. To take one example, an advantage of participative budgeting is that the lower level managers have better knowledge of the processes. This can be applied to Yumi Co by saying that 'local restaurant managers will understand the local market better, allowing for local events, tastes or changes, such as new



competition.’ This extra detail shows an understanding of how the question applies to the scenario.

Q32 Robinholt

In contrast to the other question, this question had one requirement for the full 20 marks. This can often be daunting to candidates, however, do not panic! Questions of this type can almost always be divided up into smaller chunks, making things much more manageable. Use of headings, which are often given in the requirement, allow answers to be structured appropriately.

Looking at the requirement for this question in more detail:

‘Using Robinholt’s five strategic aims, assess its performance for 20X6.’

The answer **must** identify the strategic aims, and use each one as a heading. Although there may be some crossover between aims, what essentially the phrasing of the requirement has done is break itself down into five shorter questions, of four marks each. Thinking of it in this way makes it seem easier than trying to attempt 20 marks in one go.

It is essential to read the scenario first. This is always an important part of answering any question, but especially in a performance assessment scenario. Time is tight – so it is important to actively read the scenario to determine the information required. To assess performance, there needs to be something to compare it to – be this prior periods, industry averages, targets/budgets, etc. It is also important to know what decisions have been made during the period – these decisions will have affected performance, and can be used to explain the numbers.

The five strategic aims also need to be identified as the answer will be structured around these. This is where the word processing software in the CBE is incredibly useful as the aims can be put in as headings straightaway and none of them will be missed. Reading the scenario identifies the aims immediately.

Financial information is also given, as well as results of student surveys and some other non-financial information. The skill now is to identify which pieces of information are relevant to each aim. Don’t be overawed by the amount of information – a very strong answer would discuss (and calculate where necessary) two performance measures per strategic aim – if it seems that there isn’t a lot to say on one aim, see if there’s more that can be said on another.

Using the scenario information is absolutely vital here – even things which seem relatively minor. For example, the first paragraph says that Robinholt has increased student numbers (a calculation mark can be achieved by working this out to be 12.5%) by lowering entry requirements. Is this in line with aim 1 – “...graduates who have achieved the highest academic standards...” – maybe not. That decision to lower entry requirements could have



had further impacts, i.e. what are the results like? The number of students attaining a first class degree has fallen by 8 percentage points – so clearly not meeting aim 1. Similarly, the number of employers happy with their graduates has also fallen.

Taking this approach of looking at the scenario information to determine what is relevant to the aims and the impact of the various decisions taken by Robinholt was the ideal way to approach this question.

