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# Answers

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**1 (a) REPORT**

**To:** Daniel Hoffman, CEO, The Big Cinema Group

**From:** External Consultant

**Subject:** Corporate governance arrangements

**Date:** 30<sup>th</sup> November 2021

**Introduction**

To enable TBCG's proposed development plans, the CFO has identified a possible IPO in Heland as a way to secure the required investment. This would involve a change in the corporate governance arrangements at TBCG, and this report will compare the current family based structure of governance with the practices required of a listed company.

**Comparison of governance arrangements – Family v Listed**

There are a number of differences between the governance arrangements for a privately-owned family business like TBCG and a public company which TBCG would become after its shares are listed on the HSE.

**Agency Relationship**

In general, governance arrangements are much more formal for public companies than for family businesses. This is because of the need to be accountable to external shareholders who have no direct involvement in the business. In a family business that is privately owned, shareholders are likely to be members of the extended family, as with the Hoffman family in TBCG, and there is usually less need for formal accountability because there is less of an "agency" issue.

An agency relationship occurs when the "principal", the shareholders, delegate responsibility for managing the company to an "agent", the directors, as there is a clear separation between ownership and control. In TBCG this does not occur, as the shareholders (the Hoffman family) and the directors are the same people, but as a listed company the shareholders would include individuals and institutions who are remote from the business and therefore wish to ensure that their investment is being managed appropriately by a suitable board of directors.

**Greater transparency and scrutiny**

As a listed company TBCG would be required to report publicly on a regular basis regarding its performance, its plans and strategy and any current issues and possible developments. This would therefore increase the level of scrutiny from shareholders, potential investors and journalists and the wider public. TBCG has not experienced this in the past, as the Hoffman family have been able to make private decisions on how the company operates without the need to consult or see approval from any other parties. This may well be difficult for the current directors to work in such an environment.

**Chair/CEO role**

A listing would also require the membership of the TBCG board to change. The dual CEO/Chair role currently occupied by Daniel, and previously occupied by Leon, would

probably not be acceptable to external shareholders, who would prefer to see the appointment of a new independent Chair, with Daniel possibly remaining as CEO.

### **Non-executive directors**

As Heland follows a principles based approach to governance they would most probably require a unitary board structure, which is a single board comprising of both executive and non-executive directors. TBCG's current board comprises three executive directors and four other members of the Hoffman family. It could be argued that the four other members are classed as non-executive directors by the Heland corporate governance code, but they would not be classed as independent if they are significant shareholders in TBCG and also due to their close family relationships with the executive members on the board. They may be classed as shareholder representatives only, with their primary role to protect the interests of the Hoffman family.

Although the executive director roles may remain in place initially, the new shareholders, following a listing, would prefer the appointment of independent NED's, so the current members of the Hoffman family occupying these roles would need to be replaced in a phased and manageable process. NED's would also need to be a majority on the board so that would mean the appointment of at least 4 new NED's, including the Chair, and the NED's would be expected to provide more challenge to the executive directors and greater input to strategic planning, which has been missing from the current members of the board.

### **Stakeholders**

It is generally the case that public companies are more highly regulated and have many more stakeholders to manage than family businesses. The higher public visibility that these businesses have makes them more concerned with maintaining public confidence in their governance and to seek to reassure their shareholders. This may be especially so in Heland as the HSE is globally recognised for its strict listing requirements and TBCG would therefore be expected to behave in a similar way to other HSE listed companies.

### **Board committees**

The more formal governance structures that apply to listed companies also includes the requirement to establish a committee structure, which TBCG does not currently operate, which would, as a minimum, require an audit committee, remuneration committee and a nominations committee. This may also increase the requirement for additional NED's to ensure that committees are resourced appropriately.

### **Relations with shareholders**

As a listing will include many new potential shareholders for TBCG, the board will need to ensure that there is greater transparency with and accountability to the shareholders. Such measures will include additional reporting requirements, and regular meetings and communication with shareholders, which would not be applicable to family firms. Shareholders will demand an investor relations department, and information on a number of issues throughout the year, including briefings on final year and interim results and explanations whenever performance or behaviour is below expectation.

**Short-term v Long-term performance**

Similarly the board will be under pressure to produce profits against targets each year, which may be against TBCG's previous long-term approach, as advocated by its founder, Jacob Hoffman. If, for example, the long-term approach may have meant taking less profit in one year to leave liquidity or cash in place for a future period, this may become more difficult for a listed company, which can sometimes be under pressure to achieve short-term financial targets such as a dividend payments.

**Conclusion**

A key reason for consideration of the IPO in Heland is to access the external capital available on the HSE. The funding decision is, however, outside the scope of this report, and instead the report has focused on comparing the differences in governance arrangements between the current Hoffman family-based structure, and a possible listing status, that brings about significant change to not only how the board operates but would also have a significant influence on TBCG's future way of operating.

**Marking scheme**

*Comparison of governance in family businesses and listed companies – up to 1 mark for each generic point with up to 1 further mark for each point if it is applied to TBCG. Up to 1 mark for advising of appropriate changes required to TBCG's governance.*

*Maximum of 10 marks in total*

**Professional skills may be additionally rewarded as in the following rubric:**

| <b>How well has the candidate demonstrated professional skills as follows:</b>  | <b>Not at all</b>   | <b>Not so well</b>  | <b>Quite well</b>   | <b>Very well</b>  |
|---|---|---|---|---|
| <p>Evaluation skills in comparing two different approaches to corporate governance and their application to TBCG.</p> | <p>The candidate has demonstrated poor or no evaluation skills.</p> <p>The candidate has failed to provide a suitable comparison between the two different arrangements, with no application to TBCG.</p> | <p>The candidate has demonstrated limited evaluation skills.</p> <p>The candidate has provided some comparison between the two different arrangements but with limited application to TBCG.</p> | <p>The candidate has demonstrated good evaluation skills.</p> <p>The candidate has provided a good comparison of the different governance arrangements and attempted to apply this to TBCG.</p> | <p>The candidate has demonstrated excellent evaluation skills.</p> <p>The candidate has provided an excellent comparison of the different governance arrangements and clearly demonstrates an understanding of how they may impact on TBCG.</p> |
|   | <b>0</b>  | <b>1</b>  | <b>2</b>  | <b>3</b>  |

**(b) BRIEFING NOTE - CONFIDENTIAL**

**To:** Daniel Hoffman

**From:** External Consultant

**Subject:** Non-executive directors (NED's) at TBCG

**The value of NED's to TBCG**

NED's can be a valuable resource for all companies, regardless of whether they are private or public listed companies. I have identified a number of points to demonstrate how it may now be beneficial for you to consider the recruitment of independent NED's to the board of TBCG.

**Independence**

TBCG's board of directors have traditionally come from the Hoffman family, and there has always therefore been a family interest in any decisions made for TBCG. There has been no independent perspective that can assess situations objectively, and consider what would be the best decision for the company and its future. NED's can provide this more balanced perspective to possibly counter the family influence. This could result in a much more robust decision-making process for TBCG.

**Strategic perspective**

NED's should be more strategic in their thinking and will help the executive directors of TBCG to consider the future strategy for the organisation, which may well be different from their current international expansion plans. Given that NED's have often been executive directors in other companies and have often experienced previous NED appointments, they can ensure that TBCG have a robust strategic management process in place.

**Skills and experience**

I know that you have previously expressed a view that you feel that external NED's do not fully understand the cinema business, but you and the rest of your executive team do, and therefore TBCG should be recruiting for additional board skills to complement and support this business knowledge.

By recruiting for external NED's TBCG can access people with significant levels of skills and experience, for example, experience of directing a company from private to public ownership (currently a proposal for TBCG), skills in expansion to overseas markets (in line with TBCG's current growth plans) and experience of strategic change (TBCG's desire to become more decentralised). This level of skills and experience within the board can assist TBCG to make the right decisions and avoid costly mistakes.

**Scrutinising performance**

NED's are required to hold executive directors to account for the decisions taken and the company's performance. They will provide a challenge to the executive team, which is something that the current NEDs do not appear willing or able to do. However, this should be in the company's best interest, and in particular the shareholders best interests, which is still the wider Hoffman family.

**Reputation**

The recruitment of highly regarded NED's can enhance the reputation of the organisation to key stakeholders, which, for TBCG, will include its employees, the film distributors and banks. This could also enhance the reputation of TBCG within Heland and the wider geographic region, where it currently wishes to expand. If TBCG were to list the business in Heland, an effective and balanced board could also be attractive to potential investors.

**Compliance**

The recruitment of an appropriate number of independent NED's will probably ensure that TBCG is compliant with any future rules and regulations, if it was to go public and become a listed company. This may happen in Heland, but the recruitment now would enable TBCG to embed a new way of governance prior to progressing to a listed company.

***Marking scheme***

*How NED's could be valuable for TBCG – up to 1 mark for each appropriate point with up to a further 1 mark for application to TBCG – up to a maximum of 8 marks in total.*

*Maximum of 8 marks in total*

**Professional skills may be additionally rewarded as in the following rubric:**

| <b>How well has the candidate demonstrated professional skills as follows:</b>   | <b>Not at all</b>   | <b>Quite well</b>  | <b>Very well</b>  |
|--|---|--|---|
| Communication skills in constructing a persuasive argument for the recruitment of independent NED's to the TBCG board. | <p>The candidate has demonstrated poor or no communication skills.</p> <p>The candidate has failed to provide a compelling argument in support of recruiting NEDs. The candidate's answer contains no application to TBCG</p> | <p>The candidate has demonstrated good communication skills.</p> <p>The candidate has made a range of persuasive points supporting the recruitment of NEDs, some of which contain good application to TBCG</p> | <p>The candidate has demonstrated excellent communication skills.</p> <p>The candidate has made a range of persuasive points, including evidence of counter-argument in relation to Daniel's current point of view. Points are applied to TBCG.</p> |
|  | <b>0</b>  | <b>1</b>   | <b>2</b>  |



**(c) REPORT**

**To:** Board of Directors, The Big Cinema Group

**From:** External Consultant

**Subject:** Decentralisation for Heland cinemas

**Date:** 30<sup>th</sup> November 2021

**Introduction**

Following on from the discussions at the last board meeting, the board requested that a report be prepared on the benefits and risks of a decentralised management structure for Heland cinemas and advice on how to manage the change to such a structure for three different groups of cinema managers.

**Benefits and risks of the proposed decentralisation structure in Heland**

**Benefits**

- This could allow the senior management team at TBCG to focus on their development plans. Assurance that the existing Heland business is being managed by the CM's will provide senior management with greater level of confidence to push on with their plans.
- This may result in head office efficiencies and savings as more decisions would be taken at a local cinema manager level, and therefore free-up resources at a head office level.
- The existing Heland cinema network is firmly established, and the brand is seen as the market leader, so changing to a decentralised structure could be seen as a progressive, and low risk, option to extend the business in Heland.
- This could act as a pilot for TBCG to establish how such a structure can work in practice, which could then be applied and replicated to all future countries when TBCG expand.
- This could provide a cultural shift in TBCG, as the Hoffman family have dominated the organisation for many years, and a move to a decentralised structure will shift some of that control to a much wider employee base, which could work well for TBCG, especially as they plan to expand to other countries.
- Giving local cinemas, and their managers, greater decision making could be very motivating for staff, as they are the people who should know their local markets, and therefore best placed to make the right decisions. Similarly having incentive plans in place will be motivating for all staff, especially if their contributions are recognised, when they achieve in excess of the TBCG targets.
- If CM's, over time, will be able to take responsibility for the decisions currently made by head office, this could result in cost savings for TBCG, with the significant reduction of head office departments and infrastructure.

## **Risks**

- As members of the board have already highlighted, the existing centralised structure has worked well for many years, so changing this will increase the risk to TBCG that could have a negative impact on the operational and financial performance of the Heland cinema network.
- The current cinema managers were not recruited to have profit responsibility for their cinema business, as the role has previously focused on purely the day-to-day operational management responsibilities. Therefore managers may not have the skills, experience and knowledge to work in a different structure.
- Many existing managers, as evidenced through the social media platform, are fearful and uncertain of the proposed change, and this may result in resistance from some managers and ultimately the departure from TBCG to work for competitors.
- TBCG may need to increase costs in the short term as they look to train all cinema managers, and their staff, across their 65 sites in Heland, and there may also be additional recruitment costs incurred to appoint new managers in to certain sites.
- This will be a shift in the culture of TBCG from the board of directors, as previously TBCG have effectively been controlled by the Hoffman family, given their 100% board membership, and for this decentralised structure the Hoffman family will need to relinquish some of this control to cinema managers, and will they be able to do this.
- Currently there appears to be three different groups of cinema managers, so this will be difficult for TBCG directors to manage such a diverse group through this significant change process.
- If TBCG targets under a new decentralised structure are unrealistic then this will be very demotivating for cinema managers, so the level of targets needs to be realistic and achievable.
- As one of the manager groups has already identified, there may be employment law issues to consider for TBCG, as they could be significantly changing the terms and conditions of cinema managers, which may result in legal and / or tribunal issues in future.

## **Managing change with TBCG cinema managers**

From views shared on social media platforms, TBCG is aware of potentially three groups of cinema managers who have formed different opinions and views on the proposed change to a more decentralised structure across Heland.

According to the Johnson, Scholes & Whittington (JSW) model, which identified five leadership styles that can be used in managing strategic change, we can identify a suitable style for each CM group as follows.

### **The “positive” group**

This group appears eager to establish a new way of working, as they feel that it will expand their skills and help them to develop their careers.

The most appropriate option with this group would be *collaboration or participation*.

TBCG should work with them and involve them in creating the plans for decentralisation, may be establishing a project group, as they can help plan the best way to implement such a system and resolve issues along the way. This group will most probably be supporters and advocates of the project when speaking with staff and other cinema managers, so directors will similarly need to be very supportive of this group.

### **The “fearful” group**

This group are concerned that they do not have the right experience and are therefore fearful for the future of their jobs. There may also be a lack of confidence in their ability to perform in a different role in the future.

The most appropriate option would be *education and communication*.

This group need reassurance and confirmation that they will not lose their jobs and instead that they will be given sufficient support to develop and change to the new way of operating. This should include communication of the reasons for the change, so that this group understand why it is happening, and that TBCG is not trying to make managers redundant, but instead it is trying to improve the organisation and help it to develop further in future.

Communication could take many forms, including face to face meetings (particularly with senior directors), recorded presentations (due to geographic restrictions) and written documents fully explaining the rationale of the move to decentralisation.

### **The “resistant” group**

This group appear to be the most vocal and believe that the change is not legal, as they think it will involve a change to employment conditions (which may well be true) and they are actively encouraging other managers to oppose any potential change.

The most appropriate option here may cover many possible stages of the JSW model. There may be lack of understanding on what would be involved and certainly in relation to changes in the manager’s employment contract, so *education* may be a suitable approach initially to clearly communicate the changes and what would be involved, and this may well address the concerns of some members of this group.

However, if this group is opposed to any potential change, then *direction* and, ultimately, *coercion* may be suitable, as TBCG cannot continue to wait for the support of this group once the change process has started. TBCG directors would need to use their authority as senior staff to ultimately tell managers that they will be required to perform in their new role, and if they fail to do so, then disciplinary proceedings may be initiated, which could result in the loss of their jobs.

### **Conclusion**

The report has identified several benefits and risks of moving to a decentralised management structure in Heland, which should provide a more informed assessment for the board to consider when making its decision.

The second part of the report provides further insight on how best to manage the strategic change to a decentralised structure, as an understanding that managers may have potentially diverse reactions to change is important, so that appropriate plans can then be made to address groups using alternative styles and methods.

***Marking scheme***

*Benefits and risks of the proposed decentralised management structure – 1 mark each for any relevant benefit or risk which is applied to TBCG - to a maximum of 8 marks.*

*Points must be applied to TBCG to be awarded marks.*

*Identification of appropriate management styles to the three TBCG cinema manager groups – the JSW model would be appropriate but marks can and should be awarded for relevant points however the candidate has structured their answer - up to 3 marks for relevant choice and discussion for each of the three groups – to a maximum of 8 marks in total.*

*Maximum of 14 marks in total*

**Professional skills may be additionally rewarded as in the following rubric:**

| <b>How well has the candidate demonstrated professional skills as follows:</b>  | <b>Not at all</b>   | <b>Not so well</b>   | <b>Quite well</b>   | <b>Very well</b>  |
|---|---|--|---|---|
| <p>Commercial acumen skills in showing insight and perception in explaining suitable leadership styles when TBCG is managing change with diverse groups of cinema managers.</p> | <p>The candidate has demonstrated poor or no commercial acumen skills.</p> <p>The candidate has failed to show insight and perception in identifying the needs of each manager group and in explaining how best to manage the change process.</p> | <p>The candidate has demonstrated good commercial acumen skills.</p> <p>The candidate has shown some insight and perception in identifying the needs of each manager group but has failed to adequately explain how best to manage the change process.</p> | <p>The candidate has demonstrated good commercial acumen skills.</p> <p>The candidate has shown insight and perception in identifying the needs of each manager group and made a good attempt to explain how best to manage the change process.</p> | <p>The candidate has demonstrated excellent commercial acumen skills.</p> <p>The candidate has shown excellent insight and perception in identifying the needs of each manager group and has clearly explained how best to manage the change process.</p> |
|   | <b>0</b>  | <b>1</b>   | <b>2</b>  | <b>3</b>  |

(d) **EMAIL - CONFIDENTIAL**

**To:** Daniel Hoffman; Susan Hoffman  
**From:** External Consultant  
**Subject:** Zark rental fees  
**Date:** 30<sup>th</sup> November 2021

Hi Daniel and Susan,

Following your recent email exchange regarding the outstanding Zark rental fees I have highlighted below the possible implications to TBCG if these fees are omitted from the draft financial statements.

**Potential rental fees due to Zark Films**

The management accountant had provided Susan with the following information and I have therefore used this to estimate the outstanding fees to Zark.

| <b>Film</b>  | <b>Total Customer Admissions</b> |
|--------------|----------------------------------|
| Zark film 1  | 198,647                          |
| Zark film 2  | 211,423                          |
| Zark film 3  | 311,398                          |
| Zark film 4  | 114,659                          |
| Zark film 5  | 364,683                          |
| <b>Total</b> | <b>1,200,810</b>                 |

- Total TBCG admissions to Zark films for the latest financial year = 1,200,810
- Estimated box office revenue generated by TBCG from Zark films = 1,200,810 x \$8.76 (average admission price based on \$57.6m total revenue, 70% of which is box office revenue (\$40.3m) and 4.6m customer admissions) = \$10,519,095
- Rental fees to Zark = \$10,519,095 x 45% = **\$4,733,593**

**The implications to TBCG if no fees are recognised**

Although Zark Films have not made a claim or sent an invoice for their rental fees in the latest financial year, TBCG still has an obligation to pay these fees and therefore TBCG should still record this liability in their financial statements. In addition, the estimated outstanding fees are \$4.7m, which is a material amount in the financial statements of TBCG, and represents 8% of revenue in the last financial year.

**Incorrect financial statements**

The purpose of financial statements is to provide useful information to allow users to assess financial position, performance and management stewardship. If the Zark rental fees are omitted from the TBCG financial statements then this would not be an accurate reflection of the company's performance over the latest financial year. Profits would be overstated by approximately \$4.7m as this expense would not be included in the statement of financial performance.

**Auditor reaction**

The missing fee may or may not be identified by the external auditors when completing their audit. Given the size of the fees one would hope that the omission would at least be picked up during an analytical review by the auditors, but also given TBCG's history with Zark, and the significant amount of Zark films that are viewed by TBCG's customers (over 25% in the latest financial year), the audit process should highlight the missing expense.

The auditors would be required to question the directors as to why this fee had not been accrued when preparing the financial statements. This would not look good for the TBCG finance team, and in particular Susan in her role as CFO.

**Impact on future performance**

At some point Zark will probably claim their fees for the last financial year (and possibly even Zark's acquirer if the acquisition proceeds as per the recent rumours) and if they are omitted in the latest financial statements then the fee will still need to be recognised at a future date, which may well distort performance in the following year.

**Stakeholder reaction**

Although TBCG is a private company and is not subject to public scrutiny in relation to its financial performance, if the news of this omission did reach other stakeholders (i.e. employees, the government, banks), then they may well be very surprised by the actions of the directors in either missing or omitting such a large transaction. Indeed the current finance team at TBCG may question the integrity of the directors if they were told to ignore the fees for this year, and this message could then be shared with other employees, especially in head office.

**Zark reaction**

Zark will not be happy that these fees have not yet been paid and that TBCG may have purposefully tried to avoid payment. This could damage existing and future relationships with Zark, and access to future film releases. This may also influence other film distributors when negotiating with TBCG in future.

I hope that I have provided you with some further feedback on the issues surrounding the Zark rental fees, and that this may persuade you to reconsider the decision to ignore for the current financial year.

If you have any further questions then please do let me know.

Regards  
External Consultant

**Marking scheme**

*Calculation of outstanding rental fees – 2 marks for correct calculation (\$4,733,593).*

*Implications if rental fees are omitted from financial statements – up to 2 mark for each relevant point and explanation – up to a maximum of 8 marks.*

*Maximum of 8 marks in total*

**Professional skills may be additionally rewarded as in the following rubric:**

| <b>How well has the candidate demonstrated professional skills as follows:</b>                          | <b>Not at all</b>  | <b>Quite well</b>   | <b>Very well</b>  |
|---|--|---|---|
| Scepticism skills in challenging Daniel's decision to ignore the outstanding rental fees to Zark films. | The candidate has demonstrated poor or no scepticism skills.<br><br>The candidate has failed to sufficiently challenge the decision to ignore the rental fees. | The candidate has demonstrated good scepticism skills.<br><br>The candidate has shown some evidence of challenging the decision and the reasons why it may not be acceptable. | The candidate has demonstrated excellent scepticism skills.<br><br>The candidate has challenged the decision and provided clear reasons why it may not be acceptable. |
|   | <b>0</b>   | <b>1</b>  | <b>2</b>  |



2 (a) EMAIL – CONFIDENTIAL

**To:** Anthony Fallon  
**From:** External Consultant  
**Subject:** Possible KPI's for Bradley Bikes  
**Date:** 30<sup>th</sup> November 2021  
Hi Anthony,

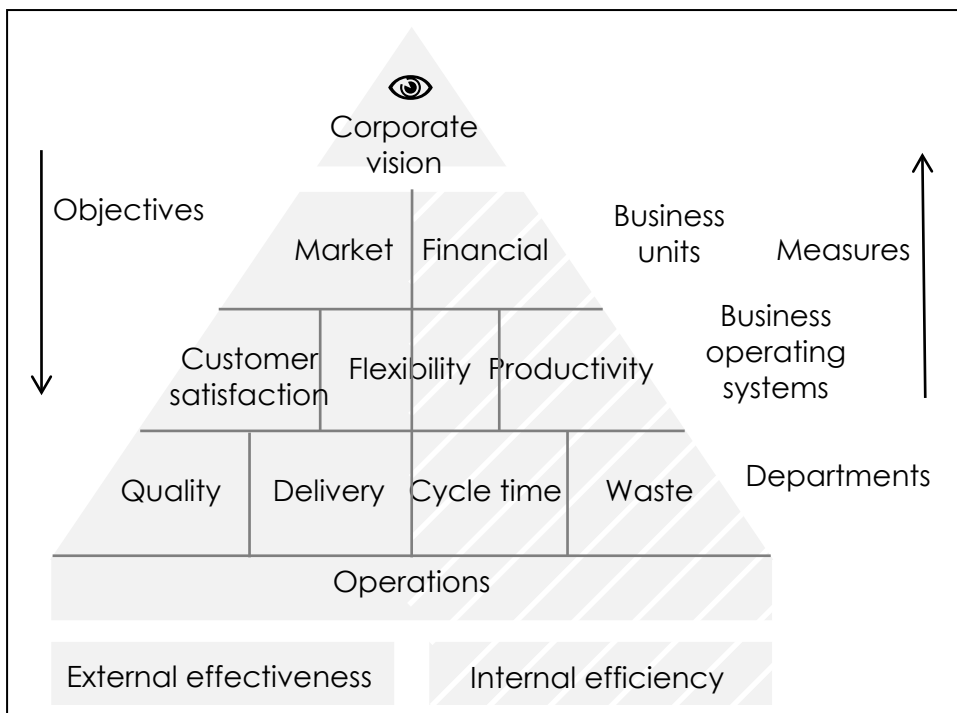
You have expressed a view that BB has traditionally only focused on its financial performance and does not currently have any appropriate KPI's to track BB's progress against its mission and vision, I have proposed below a number of indicators that I feel will align with the company's operations and strategic goals.

To help provide structure to this task, I have used the performance pyramid framework, which I have briefly explained below.

**Performance Pyramid**

The pyramid developed because it was recognised that it is often difficult to identify measures at the operational level that are consistent with and support the overall strategy of the organisation. An organisation operates at different levels, and will therefore need to focus on different activities, but it is important that these activities are not in isolation, and instead are aligned from top to bottom, hence the pyramid effect.

The diagram below shows the vision (and mission) at the top of the organisation with strategic objectives cascading down the organisation to business units, systems, departments and day-to-day operations. Measures, or KPI's, must then be established at each of these levels and reported up to ensure that the whole organisation is working towards the same goals.



Using the core levels in the pyramid framework I have highlighted possible measures for BB and the reasons why.

**Marketing performance:** % brand recognition

BB's vision is to establish itself as the number one brand globally for foldable bikes, and therefore a possible measure could relate to brand awareness, by undertaking market research in different countries to establish whether the public are aware of the BB name/brand when connected with foldable bicycles.

**Financial performance:** % market share / % market growth

This will provide BB with an indication of their current position within the foldable bike market and also a way to track progress over time. The vision is clear as to their aspirations (to be the number one global brand for foldable bikes), so this KPI will clearly assess BB's progress towards this.

**Customer satisfaction:** % satisfied with their purchase / % of repeat customers

BB prides itself on looking after customers so measures need to be clear as to whether BB is succeeding in this, or not. The proposed measures track not only the level of satisfaction with the purchase process and initial product, but also whether customers remain loyal and continue to buy further bikes from BB in future. This is a lead indicator to support BB's vision to be the number one global brand.

**Flexibility:** Average number of customisation options per bike

This is a measure of BB's innovation, which appears important to BB given its reputation for design excellence. Although BB is not producing many completely new products, it continues to invest in the development of its bikes, and the number of options selected and purchased by customers will indicate whether customers actually like the changes made, and are willing to pay for the additional features.

**Productivity:** % rework

Given BB's manufacturing base for both bikes, it is important to assess the level of efficiency in its production processes. This measure will indicate whether the production is subject to any potential issues by assessing the level of rework required, which could either be as a percentage or in monetary terms.

**Quality:** Number of product recalls / Number of customer complaints / Number of returns under warranty / Quality control

This measure will support BB's reputation for quality, by assessing external failure costs, through the need for product recalls if it is found that a particular production batch has some design weaknesses that need to be checked, or when a customer, for whatever reason, is not happy with the product they have purchased.

**Delivery:** % of deliveries made on time / Orders lost

In addition to the product itself, BB needs to ensure that customers receive the product in a timely manner and certainly within the stated times. It may well be reliant on third parties for the distribution of bikes from its facility to the customer, but it is still BB's responsibility and this could affect the customer experience. It may also result in lost orders as customers cancel their order as they have waited too long to receive their bike.

**Cycle time:** Time taken to build a completed product

An understanding of the time taken to produce a finished product is important for a manufacturing company, and this may improve significantly if BB moves to a JIT production for the FE-bike.

**Waste:** % waste

BB should monitor the level of waste from the production process, which is not only a financial issue, but could also damage the environmental goals for BB, depending on the type and level of waste produced.

There are other measures that may also be suitable for BB, for example:

The number of bikes sold in cities and towns – this will help BB to understand whether they are helping to change how people travel in line with their mission statement. Growth in this measure would appear to support BB's mission.

The average length of service for employees - which provides an indication of loyalty and satisfaction within the BB workforce.

I trust that the measures identified above have provided you with some ideas for KPI's suitable for reporting within BB, but if you need to discuss further please do let me know.

Regards  
External Consultant

***Marking scheme***

*Explanation of the performance pyramid - up to a maximum of 2 marks. (Candidates are not required to produce a diagram as part of their answer)*

*Suggested KPI's – 1 mark for a relevant KPI for BB and a further mark for a reasoned explanation as to why the KPI would be suitable – up to a maximum 12 marks.*

*Maximum of 12 marks in total*

**Professional skills may be additionally rewarded as in the following rubric:**

| <b>How well has the candidate demonstrated professional skills as follows:</b>  | <b>Not at all</b>   | <b>Not so well</b>   | <b>Quite well</b>  | <b>Very well</b>   |
|---|---|--|--|--|
| <p>Commercial acumen skills in demonstrating awareness of suitable KPI's that can measure progress against BB's strategy.</p> | <p>The candidate has demonstrated poor or no commercial acumen skills.</p> <p>The candidate has failed to demonstrate a suitable awareness of a suitable range of KPI's with little or no explanation of how they could be appropriate against BB's strategy.</p> | <p>The candidate has demonstrated limited commercial acumen skills.</p> <p>The candidate has demonstrated an awareness of a number of potentially suitable KPI's but has not provided sufficient explanation on why they may be appropriate against BB's strategy.</p> | <p>The candidate has demonstrated good commercial acumen skills.</p> <p>The candidate has demonstrated an awareness of suitable KPI's and has provided some reasoning as to why they may be appropriate to measure progress against BB's strategy.</p> | <p>The candidate has demonstrated excellent commercial acumen skills.</p> <p>The candidate has demonstrated an awareness of excellent KPI's with clear explanations as to why they may be appropriate against BB's strategy.</p> |
|   | <b>0</b>  | <b>1</b>   | <b>2</b>   | <b>3</b>   |

**(b) REPORT**

**To:** Board of Directors, Bradley Bikes

**From:** External consultant

**Subject:** Adopting Just-in-time (JIT) for FE bike production

**Date:** 30<sup>th</sup> November 2021

**Introduction**

BB are considering the adoption of a just-in-time (JIT) system for the manufacture of its new FE bike type and this report will assess the benefits and risks of using this approach.

**What is Just-in-time?**

Just-in-time (JIT) is a demand-pull system of ordering from suppliers, which aims to reduce inventory levels to zero. It can be broken into two parts: purchasing and production. Each part has a similar goal, which is to produce the components for the next stage of the production process only when they are needed (i.e. demand-pull).

**Benefits of JIT for BB**

- A JIT system will ensure that BB has lower working capital requirements, due to the zero inventory approach, which should help minimise working capital requirements as part of this new investment.
- The FE-bike has been designed to be highly customised, which can be designed and chosen through BB's new e-commerce website. JIT production supports this flexibility in meeting customer's individual needs.
- The new FE-bike will probably continue to be developed and enhanced in future, in a similar way to the F-bike, and JIT will allow for much faster response times when product specification changes are required.
- A JIT environment will create a certain culture within the workforce that will focus on flexibility, efficiency and cost improvements which should reap benefits to BB in future.
- Introducing a new facility based on JIT production will support BB's innovative reputation for design and engineering excellence.
- The new FE-bike facility may act as a pilot for BB, which could then be adapted for the F-bike production in future.
- The JIT way of operating will ensure that BB is closer to its suppliers, and will possibly involve dealing with fewer, but higher quality and more reliable suppliers – a partnership arrangement rather than a traditional supplier relationship. This could have wider benefits for the F-bike production.

### **Risks of JIT to BB**

- A significant investment will be required in order to make the facility JIT compliant. This investment will need to be repaid through future sales of the FE-bike, and there is a risk that this does not occur and there is limited return on this investment.
- JIT is dependent on accurate forecasts of demand and this will require a new way of working, and if forecasts are incorrect it could result in delays to production. Gillgate is a potentially significant market for the FE-bike, but demand has not yet been established for the BB version of the foldable electric bike.
- BB will need to find reliable, quality suppliers, and they may not be available, or local enough to BB's new Wesland facility. They may also produce materials that are not suitable for JIT production, in terms of quality, and may fail to deliver on time, which again may cause significant production delays.
- BB will be reliant on the right technology infrastructure and the integration between the website, the facility and BB's suppliers – if this did not work or encountered problems, then the whole production schedule may need to be halted.
- BB management and staff have not previously worked in a JIT environment as the F-bike is still a labour intensive production method. Will existing staff adopt or be resistant, and if so will BB need to recruit externally and are those staff currently available in Wesland.

### **Conclusion**

The option of establishing a JIT environment for the production of the new FE-bike will bring many benefits to BB, not only in relation to the FE-bike but also the knowledge and experience gained for potential future adoption for the production of the F-bike.

However, there are also risks involved with such a system, and BB must be aware of these risks in order to mitigate, wherever possible, if the decision is made to proceed.

### **Marking scheme**

*1 mark for brief explanation of just-in-time (JIT), in the context of BB.*

*1 mark for each benefit of JIT applied to BB – up to a maximum of 6 marks.*

1 mark for each risk of JIT applied to BB – up to a maximum of 6 marks.

Maximum of 10 marks in total

**Professional skills may be additionally rewarded as in the following rubric:**

| <b>How well has the candidate demonstrated professional skills as follows:</b>                                  | <b>Not at all</b>  | <b>Not so well</b>  | <b>Quite well</b>  | <b>Very well</b>   |
|---|--|---|--|--|
| Evaluation skills in assessing whether a JIT system would be an appropriate option for BB's FE-bike production. | <p>The candidate has demonstrated poor or no evaluation skills.</p> <p>The candidate has failed to identify and assess relevant benefits and risks when assessing JIT for BB's FE-bike production.</p> | <p>The candidate has demonstrated limited evaluation skills.</p> <p>The candidate has identified some benefits and risks of JIT but these have not been sufficiently explained in the context of BB's FE-bike production.</p> | <p>The candidate has demonstrated good evaluation skills.</p> <p>The candidate has identified a number of benefits and risks of JIT and has made a good attempt at relating them to BB's FE-bike production.</p> | <p>The candidate has demonstrated excellent evaluation skills.</p> <p>The candidate has clearly explained the benefits and risks of JIT and how they apply to BB's FE-bike production.</p> |
|   | <b>0</b>   | <b>1</b>  | <b>2</b>   | <b>3</b>   |

**(c) BRIEFING NOTE – CONFIDENTIAL**

**To:** Anthony Fallon  
**From:** External Consultant  
**Subject:** Warranty provision

BB provide a warranty provision for customers who have purchased the F-bike that covers the repair and replacement of any defects and parts that occur for up to two years following the purchase date.

**Accounting issues to consider**

As per IAS 37 Provisions, Contingent Liabilities and Contingent Assets a warranty provision should be recognised when there is a present legal or constructive obligation to transfer economic resources resulting from past events, the transfer is probable and a reliable estimate of the obligation can be made.

For BB there is an obligation to repair and replace, if required, and given that BB sell in excess of 23,000 bikes per year it is probable that a number of customers, albeit small, will make a claim on their warranty. It is difficult, however, to estimate how many customers may claim on the warranty and the scope, or cost, of any claims made. BB should keep records of warranty claims made each year, in terms of both the numbers and the costs incurred, and this can then inform future calculations for a provision.

John has stated that he cannot access any reliable information for estimating purposes and sought your advice based on your greater experience.

**Ethical issues to consider**

BB has previously recognised a warranty provision for each of the last 4 years equivalent to 2% of revenue. So the argument that a reliable estimate of the obligation cannot be made is questionable and possibly unethical. The absence of a provision for 2021 implies that the opening provision will be credited to profit or loss, which would result in an increase in profit for 2021. This issue may therefore look like an attempt to avoid recognising a provision because of the negative impact it would have on the financial statements, and as Managing Director of BB it is your responsibility to ensure that the financial statements represent a true and fair view of BB's operation during the period. By omitting the provision from the accounts, you are not fulfilling this responsibility. I am aware that you are also subject to a remuneration bonus based on the profit performance of BB, but this should not distract you when reviewing and approving BB's financial statements for the year.

Similarly, John, as a newly qualified accountant, should ensure that the draft financial statements are accurate to the best of his knowledge, before they are reviewed by BB's external auditors. It would be prudent for John to continue to calculate the provision based on previous years, in the absence of any more reliable information.

A calculation of 2% of revenue for 2021 would produce a provision of  $\$35.1\text{m} \times 2\% = \$702,000$ . This would also mean that BB would not achieve its profit target of  $\$7.5\text{m}$  for 2021, as the adjusted profit for the year would be  $\$7\text{m}$ .

This is a significant amount and if John has any concerns regarding the calculation of a



provision he should discuss this with the external auditors.

**Recommendation**

You should not be distracted by any personal remuneration plans, and I would suggest that you meet with John to reassure him on the need to make a provision, and support the 2% calculation, if applicable.

As you have already stated to John, the finance team should record all matters relating to warranty claims during the year, which will then inform the following years' provision. The \$702k for 2021 may well be excessive, but given the current data, this would appear to be the most prudent estimate.

**Marking scheme**

*1 mark for each relevant point in relation to the accounting and ethical issues regarding the warranty provision – up to a maximum of 7 marks.*

*Up to 2 marks for a recommendation on actions for Anthony to consider.*

*Maximum of 8 marks in total*

**Professional skills may be additionally rewarded as in the following rubric:**

| <b>How well has the candidate demonstrated professional skills as follows:</b>                    | <b>Not at all</b>   | <b>Quite well</b>  | <b>Very well</b>  |
|---|---|--|---|
| Scepticism skills in challenging the views of Anthony and providing an appropriate recommendation | <p>The candidate has demonstrated poor or no scepticism skills.</p> <p>The candidate has provided little or no challenge to Anthony's views in relation to the warranty provision and has failed to identify appropriate actions.</p> | <p>The candidate has demonstrated good scepticism skills.</p> <p>The candidate has provided some challenge to Anthony's views and discussed possible actions for Anthony and John.</p> | <p>The candidate has demonstrated excellent scepticism skills.</p> <p>The candidate has challenged Anthony's views and provide clear and decisive actions for Anthony and John.</p> |
|   | <b>0</b>  | <b>1</b>   | <b>2</b>  |

**(d) BRIEFING PAPER**

**To:** Anthony Fallon

**From:** External Consultant

**Subject:** Lisdam Store Performance Report

**Assessment of existing performance report**

The current report shows the calculation of gross profit and net profit from the store and shows how this has changed over the past three years along with a forecast for 2022. There is also a breakdown of the performance in the last two quarters of 2021. The report breaks revenue and costs into different categories to allow for further detail if required.

The report does not present its information clearly. The style of presentation could be confusing to a non-accountant as it shows a large table of numbers with few clear highlights, and it is difficult to assess which numbers are absolute figures and which are calculations. There are also no percentage figures (i.e. gross or net margin) and the numbers are given to the last \$ where it may be sufficient to work in thousands of dollars when assessing annually in this way.

The figures for 2019 and 2020 may not be particularly relevant as the Lisdam store was only opened in 2019 and therefore you would expect that performance in the early years may well be different to the current period.

There is also no budget information for 2021 (or indeed 2022, unless “forecast” is the budget or simply the latest forecast), to assess actual performance against budget, and therefore no variance either in absolute or percentage terms.

It is unclear as to the value of the quarterly figures, and their positioning on the right side of the report.

**Improvements to the content and presentation**

- Increased focus on the presentation, with greater use of underlining, making certain figures bold for emphasis and inserting line spaces between certain sections of the report (i.e. revenue / gross profit / expenses / net profit).
- Greater use of percentage figures – to represent margins (gross and net) and changes between reporting periods (i.e. % increase / decrease). For the quarterly figures for 2021 percentages could be shown compared to the overall 2021 figures, for example it appears that Q3 and Q4 trading in 2021 contributes a significant percentage of the total 2021 figures.
- Use summarised figures only, so total revenue, gross profit, net profit, rather than the detailed breakdown. This may especially be useful when comparing across the 3 year period. The detailed figures could be provided in an additional report if required.

- Inclusion of a budget and a corresponding variance analysis comparing actual to budget performance and showing the difference as a percentage.
- Inclusion of monthly information – recent monthly performance may provide a more current picture on performance, especially when there has been a change in performance levels.
- Benchmark information – as BB operate 8 city stores, it would be useful to see a comparison with the best city store or the average performance across all stores.
- The information in this report is purely based on revenue and expenses, and additional KPI information may be beneficial, for example, number of bikes sold, the average price per bike, number of bike hire days, average value of repairs, customer satisfaction, number of complaints, average cost per staff member.

### **Does the existing report assist BB in its decision for the Lisdam store?**

The report provides a historic view of performance at the Lisdam store since it opened in 2019, which is good for BB to view when assessing the decision to expand or not. The report shows that the Lisdam store has been loss making throughout this time, albeit the loss has been reducing each year, so it suggests that performance has been improving for each year of its operation. This is to be expected when a new business is starting in a new location, as their reputation will be developed over the first few years of trading.

The report demonstrates that revenue has been increasing each year and in the last two quarters of 2021 there has been a significant increase in both revenue and profitability. It would be better if the report could clearly identify the percentage change between years to highlight the significance of the performance change. Information on margins would also help highlight whether the Lisdam store is managing to increase its profitability margins.

The report contains the absolute performance data for the history of the Lisdam store, which is required when making a decision to expand its retail space, but the report fails to provide sufficient analysis of this data to provide more meaningful information to BB for its decision. Further analysis would be required before a decision can be made.

### ***Marking scheme***

*Assessment of BB performance report – 1 mark for each relevant point - to a maximum of 4 marks.*

*Improvements to BB performance report – 1 mark for each relevant point - to a maximum of 4 marks.*

*Comments on whether existing report would be suitable for decision to expand retail space - up to 2 marks for a well-reasoned suggestion.*

**Professional skills may be additionally rewarded as in the following rubric:**

| <b>How well has the candidate demonstrated professional skills as follows:</b>  | <b>Not at all</b>   | <b>Quite well</b>  | <b>Very well</b>   |
|---|---|--|--|
| Analysis skills in reflecting on Anthony's opinion that the performance report is not easy to understand and does not present a clear view on the Lisdam store's current performance to date. | <p>The candidate has demonstrated poor or no analysis skills.</p> <p>The candidate has failed to provide a reasonable assessment of the performance report.</p> | <p>The candidate has demonstrated good analysis skills.</p> <p>The candidate has provided a good assessment of the performance report and identified some possible improvements.</p> | <p>The candidate has demonstrated excellent analysis skills.</p> <p>The candidate has provided an excellent assessment of the performance report and identified clear ideas on how the report can be improved.</p> |
|   | <b>0</b>  | <b>1</b>   | <b>2</b>   |