ANSWERS

EXERCISE 1 – VALUE CREATION

Answer:

Partners – these include suppliers, employees, contractors and other partners (high priority stakeholders) who provide access to resources, markets and technologies.

Resources – firms use their relationships with their suppliers to source and secure the right resources to make products or services that satisfy their customers.

Processes – firms need to design, develop and deploy processes that provide the infrastructure to convert resources (inputs) into goods and services (outputs).

Activities – firms and their partners engage in activities that use the processes to convert resources into goods and services.

Outputs – firm's outputs are in the form of products, services and experience, which aim to meet the customer value proposition

EXERCISE 2 - DIGITAL ENTERPRISES

Answer:

Research at the World Economic Forum suggests firms will need to adopt one of five approaches (or a combination of five) approaches:

- **Build** new business models by creating and developing new products and services when the opportunity is related to the firm's core business

- **Buy** another company, engaging early with a digital disruptor will be important to outperform the competition and minimise the investment needed

- **Partner** with a digital disruptor to learn more about emergent opportunities with a longer term view toward extending the partnership or acquisitions in the future

- **Invest** in "start-ups" enabling an established player to connect with new skills and capabilities

- **Incubate/accelerate** representing a closer relationship to the investing company which provides resources, capabilities and infrastructure to the "start-up".

PRACTICE TASK A1 – CAPITAL INVESTMENT

To: Liz Petrov

From: Financial Manager

Date: Today

Subject: Investment appraisal types and processes

Capital investment process

A robust capital investment process is made up of three phases, the creation phase, the decision phase and the implementation phase.

Creation phase.

In this phase, the company determines which of the available projects it is initially investigating will be a good fit with company strategy.

The first stage of this phase is to determine the objectives of the investment. These should tie into the objectives of the organisation. For listed companies such as Alpaca, the main objective is normally that of shareholder wealth maximisation.

The second stage of this phase is to search for appropriate investment opportunities. This will involve looking for projects that tie into the objectives. For Alpaca, our business model is all about creating value and our objectives are to increase occupancy rates, deliver high guest satisfaction and to acquire at least one new hotel every three years.

The objective of acquiring hotels is very obviously linked to the capital investment appraisal process, but capital investment may also be needed to help achieve the other objectives. For instance, we may wish to upgrade our kitchens so that our ability to produce high quality food quickly is improved, leading to higher guest satisfaction, or we may need to refurbish the rooms with better en-suite facilities to keep up with modern trends and increase occupancy levels.

This stage will also involve rejecting potential projects because they don't fit into the company's objectives. For instance, there may be many hotels available to purchase, but if we do not feel that we would be able to operate them at a level consistent with our aim of operating as a luxury hotel provider then we would reject the opportunity.

The third stage is to identify the states of nature. This means that the company should try to gather as much data as possible about issues that could affect the company and the projects over their life and beyond. It will involve trying to predict the direction of the economy in Maylandia and possibly in other countries if we decide to operate there or if supplies are sourced there. This would include predictions for interest rates, tax rates and inflation rates, all of which will affect the investment appraisals. It will review and evaluate trends within the hotel industry, which may affect the scale of the investment, and trends in prices, for major cost areas and for revenues.

Decision phase.

This phase involves listing possible outcomes, measuring payoffs and selecting investment projects to go ahead with. It is the investment appraisal part of the process.

There are different methods of investment appraisal, which will be discussed later. The company may choose to use only one method or to evaluate the results of more than one method for a particular project.

The company should also look at non-financial factors surrounding the project as the appraisal tools usually only focus on financial results. This could include such things as whether we would be able to source enough staff at the correct skill levels in the area in which we are planning to operate a new hotel, or whether there are different building regulations in the area of the country we are planning to construct a new hotel.

Implementation phase.

The first stage of the implementation phase is to get approval and sign-off from senior management for the chosen projects. This is the stage at which the large capital investment is committed, so should be treated with due consideration. A capital expenditure committee may be established whose purpose is to review and critique the proposals before sign-off, with the objectives of the company always in mind. The committee should be made up of people from key stakeholders within the business.

Once the project is implemented, this should not be the end of the process. It's important that businesses review the investments that they have taken on to see if they did indeed make the right decision and whether the project provided the returns that it indicated it would. Having a review in place can identify where poor decisions have been made in the past and enable the company to revise its procedures to try and avoid making them again and to improve the decision-making process in the future. For instance, it may be that a hotel doesn't receive the customer numbers that were anticipated as part of the investment appraisal process, because a competitor hotel opened up at the same time. For future decisions, we would ensure to undertake a more robust competitor analysis.

The review should ideally be undertaken by someone who was not involved in the initial decision-making process, so that their views are objective.

Introduction of a review process may not mean that we are able to ensure that project problems never occur again, but it should be considered in order to give us a robust approach to project decision making in future.

Types of investment appraisal

Net present value (NPV)

NPV calculations are theoretically the best tool to use for appraising capital, long-term investments. They take account the time value of money, allowing for the reduced value of cash over time, which is particularly important for projects that last longer than a year. They also use

estimates of future cash flows rather than profits, so should be undistorted by subjective accounting issues and more relevant to real value for the business.

The NPV itself correlates directly to the increase in business value and therefore shareholder wealth for taking on a project, so should enable us to make decisions that help us to achieve our main goal as a quoted company of maximising shareholder wealth.

They are relatively complex calculations, but that does not diminish their use as decision-making tools.

Payback

The payback method of investment appraisal simply measures how long a large initial cash investment amount will take to be returned to the business. It can be calculated using the predicted cash flows or using the discounted versions of them to take the time value of money into account.

It isn't a particularly sophisticated method of investment appraisal, but can be useful if the company does need its investment cash returned quickly, perhaps due to liquidity issues or to be invested in even better projects. It is also relatively easy for non-financial managers to understand.

Accounting rate of return

This method measures the return on capital invested in a project over its life. It has the advantage of being easy to explain to non-financial managers, but as it is based upon profits rather than cash flows, can potentially be distorted / manipulated.

It is, however, commonly used and well understood by investors.

Internal rate of return

This technique is related to the NPV method and can be defined as the discount rate that gives a zero NPV. It is effectively a measure of return inherent to the particular cash flows and their timings. It can be compared to the expected rate of return that our investors want (aka our cost of capital) to see if a project provides a sufficient return to satisfy those investors.

It is useful when our investors are focussed on earning a particular percentage return and so want to see project evaluations on that basis, but it offers no real advantage in comparison to the NPV method.

Financial Manager

Notes:

Notes:

Notes:

ANSWERS

EXERCISE 1 – PROJECT MANAGEMENT

Answer:

There is no set format required for a PID but it would generally contain the following sections:

Purpose statement – explains why the project is being undertaken.

Scope statement – outlines the major activities of the project. This section is important in helping to prevent 'scope creep', whereby additional activities are added making achievement of the cost and time objectives totally impossible.

Deliverables – tangible elements of the project, such as reports, assets and other outputs.

Cost and time estimates – expectations in terms of the project budget. Likely to be revised as the project progresses, but are necessary to give a starting point for planning.

Objectives – a clear statement of the mission, critical success factors and key milestones of the project.

Stakeholders – a list of the major stakeholders in the project and their interest in the project.

Chain of command – a statement (and diagram) of the project organisation structure.

EXERCISE 2 – STRESS TESTING

Answer:

Stress testing relates to analysing a business's position to consider how well it could cope in difficult conditions. It is used to assess the vulnerability of a position against hypothetical events (for instance a significant loss of data or a downturn in the market).

In relation to an appraisal of a capital investment project, stress testing could be done using simulation. For example, to test the effect of a significant market downturn, simulations could be run with much lower sales volumes than anticipated to determine the effect on the project returns.

The determination of the real options available for the project would also be useful here. For example, if a significant negative event happens during the project life, would the company have the option to abandon the project and avoid incurring potential future losses.

PRACTICE TASK B1 – PROJECT MANAGEMENT (linked to core activity B1)

Briefing note:

To: Senior Financial Manager
From: Financial Manager
Date: Today
Subject: Project feasibility

Feasibility of a project is assessed in four main ways; operationally, technically, ecologically and economically.

A feasibility study is not a full-blown study; it gathers just sufficient information to enable management to make informed judgements on whether to proceed.

Technical feasibility relates to the adequacy of the existing technical resources, from the viewpoints of equipment, technical expertise and existing processes, to cope with the proposed new service, or the ease with which those resources can be upgraded. Essentially is the existing technology suitable?
This may be an issue for Alpaca given its traditional approach.

For any project to be technically feasible, the staff involved in the development must have the expertise, and be capable of being trained to meet any new requirements. This could be an issue for Alpaca given the heavy reliance on staff to run hotels, the absence of new projects, the lack of direct responsibility for research and development on the board and the potential availability constraints of suitably qualified staff.

Economic feasibility is the second aspect to be considered. Consideration is required here of the various costs that will be incurred in the development and support of the new system, and the monetary benefits that this will bring to Alpaca. From an investment perspective we have cash available and access to further funding should this be necessary, but we will need to be careful that the project addresses the key concerns of stakeholders, particularly given the recent fall in revenue and profitability. Essentially is it worth it?

It is important to note that depending on the final product design, it is possible that some long-term benefits may be forthcoming, but they are intangible, and unlikely to justify the costs of systems development. Alpaca will need to be aware of these, for example repeat business or cross selling opportunities with other revenue streams such as weddings and conferences but they are unlikely to be included in the decision making process.

Ecological/environmental feasibility is primarily driven by understanding the customers' needs and expectations. This will clearly need careful consideration as they may prefer services that are less harmful to the environment. Any misunderstanding in this context can have an effect on brand and reputation. It will be important to gain the opinion of the users if possible, over and above those generated from the webpage review site.

Finally, operational feasibility must be reviewed. This is dependent upon a review of the human resources required for the project and supporting any new service, upgrade or development. Similarly to the technical feasibility constraints, Alpaca need to be mindful of the availability of suitably qualified personnel and current workload issues. Close discussion with key board members is important here to determine any operational constraints at the earliest opportunity.

The lack of a specific HR function may present a problem in this context. It is similarly critical that any new project fits with the overall strategy and goals of Alpaca.

The feasibility report should contain the following:

• Introduction

• Terms of reference - these explain how the new service was selected for the study, and provides details about the scope of the study

• Existing products – a description is given of the current services provided and how the changes to process, functionality etc. will improve the offering

• Service requirements - the requirements for a new service are specified. These are derived from the existing service, and (for new requirements) from our management at Head Office and divisional level plus feedback from existing customers and users. In this context, it may be best to construct our customer survey, bearing in mind the potential manipulation of data sourced from webpage reviews.

• Proposed service improvement - an outline of the preferred new service specification is provided, that will meet the stated requirements. This should include, for example, functionality, highlight the differences between old and new services, and identify new materials required, software changes, production process improvements and additional staff requirements.

• Development plan - a suggested project plan, and how it will be implemented

• Costs and benefits - a detailed analysis should be given of the costs that will be incurred in developing, manufacturing and marketing the new service; and the monetary value (should this be able to be determined) of the benefits that the new product will provide

• Alternatives considered - a description should be given of the various service alternatives that have been considered, together with explanations of why they have been rejected in favour of the recommended approach

- Conclusions and recommendations
- Supporting appendices – to include detailed calculations etc.

Financial Manager

PRACTICE TASK B2 – FINANCIAL REPORTING (linked to core activity B4)

To: Finley Rae (CEO)
From: You
Subject: Re: A request for help!

Hi Finley,

Thanks for your email. Here's the information you requested.

As a fundamental point, the classification of funds raised to provide the long-term finance for the business is very important. Whether a particular source of funding is classified as debt or equity will affect its classification in the statement of financial position and key financial accounting ratios such as the gearing ratio. It will also affect the calculations for the cost of equity, the cost of debt and the overall weighted average cost of capital.

The difference between equity and debt capital
IAS 32 *Financial statements: Presentation* (IAS 32) requires that financial instruments are classified as either assets, liabilities or equity.

If an entity has raised finance, it will be classified as either a liability or as equity. The critical distinction between liability and equity is whether or not the financial instrument contains any obligations to transfer economic benefits. If there is such an obligation (e.g. to pay an annual return to the provider of finance and/or to redeem or repay the amount raised, the financial instrument should be classified as a liability.

A financial instrument used to raise finance should only be classified as equity if there are no obligations within the terms of the instrument i.e. it is an interest in the residual assets of the business after all liabilities have been settled and there is no obligation to pay an annual return to the providers of capital.

Note that some instruments, such as convertible debt or redeemable shares are hybrid or compound instruments which contain elements of both liability and equity. Such instruments should be split at the time finance is raised between their separate elements and each accounted for as such.

IFRS 9 *Financial instruments* (IFRS 9) deals with accounting for financial instruments following their initial classification. Many loan liabilities will be accounted for at amortised cost, using the effective or implicit rate of interest from the terms of the agreement. Equity instruments used to raise finance will be reflected in share capital and share premium account balances in the statement of financial position and will not subject to re-measurement in the financial statements following their issue.

Raising finance
Should Alpaca decide to make a significant investment, such as constructing a new hotel or acquiring a new subsidiary, it may have a requirement to raise additional finance.

Alpaca currently has long-term debt finance at 31 December 2019 of M$395m and a gearing ratio of 20.5%. If additional loan finance was raised, this may increase gearing to a level where current and potential investors may perceive financial risk has been increased to an unacceptable level.

Raising equity finance

As a listed entity, Alpaca could offer it's a new issue of equity shares to the public. This could be expensive in terms of compliance with corporate governance and other regulatory requirements. The current owners of Alpaca would also need to think carefully about the extent to which they would be happy to dilute their current interest in Alpaca in order to raise finance.

An alternative to an issue of shares to the market at full price could be a rights issue to current shareholders. A rights issue would have the advantage of enabling the current shareholders to maintain their proportionate voting interest in the entity, and would avoid any dilution of ownership. It would also be cheaper in comparison to a full market issue. A rights issue may have a greater chance of success as it involves existing shareholders rather than trying to persuade new investors to provide the required finance. However, as a rights issue is typically priced at a discount to the market price it may not raise as much finance in comparison to an issue of shares at market value.

Alpaca may be able to approach specific institutional or venture capital organisations if its need for finance matches the investment portfolio objectives of those institutions.

The success or otherwise of such a share issue will be dependent upon the expectations potential investors in terms of of future dividends and capital growth in the value of shares.

An issue of equity shares, whether by rights issue or an issue at full market price, would have the advantage of reducing the gearing ratio from its present level of 20.5%.

Raising debt finance

Alpaca could borrow funds from its bank or other organisations that specialise in lending to entities operating in the hotel industry.

As an entity quoted on the stock exchange, Alpaca could issue bonds via the stock market. This would have the benefit of being able to raise finance from many different investors, both private investors and institutions. Note, however, that the gearing ratio is already 20.5% and potential investors may be reluctant to invest in a more highly geared entity.

As a hotel company, Alpaca owns a substantial property portfolio, with property, plant and equipment representing approximately 90% of total assets, of which the overwhelming majority will be hotel properties. Normally, property would be the assets that potential lenders would regard as the most suitable as security to support any loans advanced.

That said, some lenders may be willing to advance funds against the level of hotel reservations

(along with historical indications of trends in bookings) if it can be demonstrated that it provides a reliable revenue and cash stream to Alpaca. If Alpaca did raise debt finance, it may need to comply with loan covenants, perhaps including specified profitability and/or liquidity measures. This could hamper the freedom of the board of directors to determine and implement future strategy.

Compound instruments

A further option would be to issue a compound or hybrid financial instrument, such as a convertible bond. This would enable Alpaca to raise finance at a lower cost compared to simple debt finance as investors will value the ability to pay a choice of how they would like their initial investment to be redeemed – either in cash, or by an issue of shares. Since convertible bonds will be recorded partly as debt and partly as equity, they would also have a less adverse effect on the gearing ratio compared to regular bonds.

Investors may consider convertible bonds to be a less risky way of investing in Alpaca and may be attracted by the potential of becoming an equity shareholder in the future with the ability to receive future dividends.

If you need any further information, please contact me.

Financial Manager

PRACTICE TASK B3 – RISK AND UNCERTAINTY IN CAPITAL PROJECTS (linked to core activity B3)

To: Liz Petrov

From: Financial manager

Date: Today

Subject: Risk and uncertainty

Sensitivity analysis

Sensitivity analysis is a method of determining the sensitivity of a project's returns in relation to a particular variable.

For instance, the initial investment appraisal may determine that the project has an acceptable NPV and should be undertaken. However, the project may be more sensitive to changes in some of its variables than others. Also, it may be that some of the variables included in the analysis are more subject to uncertainty than others as they may be more difficult to forecast – sales volumes, for instance, in a market in which we are not familiar.

Performing a sensitivity analysis on each of the variables will provide additional information to help us make a better analysis of the project.

By calculating the sensitivity of a variable and determining by how much it would need to change to alter our decision about the project, we can then use professional judgement to decide whether such a change is likely. The lower the sensitivity the more critical the variable is to our decision. The higher the potential volatility of the variable, the lower the tolerance the project will have for changes in its value.

For the project, as it is a venture into a new type of market, one that we do not have direct experience of, we may find that our estimates are more subject to uncertainty than usual. This may be particularly relevant for sales volumes in the unfamiliar market and for the costs of providing a lower quality of service than we are used to. Therefore, a sensitivity analysis would be particularly relevant for these variables.

Expected values

Expected values, or the weighted average result, can be used where probabilities are available for variables within the project. These probabilities are used to weight the potential values of the variables to produce an average result. The project evaluation is then performed using these average values. For instance, we may predict different occupancy levels with different probabilities of them occurring. Weighting the figures to produce an average occupancy level would allow us to produce an investment appraisal at this level for evaluation.

Alternatively, it may be predicted that the variables are dependent on the environment the project sits within. For example, the figures would be dependent on trends for budget hotel demand, which may themselves be dependent on forecasts of the level of the economy. If different economic growth levels can be predicted with an associated probability, an appraisal can

be done for each economic situation and the results of each appraisal then put into an expected value calculation to determine an overall average result.

The method does rely heavily on the determination of probabilities, which can be subject to much uncertainty themselves, inherent when predicting future values.

It is also limited in use for a one-off project such as this where an average result is not relevant, although would be more useful if we were to plan a whole chain of basic hotels in the future.

Simulation

This method involves producing an investment appraisal for several different scenarios. It is an enhancement of sensitivity analysis, allowing for changes to multiple variables at the same time.

The result is a frequency distribution of potential results for the project, which allows analysis of the most likely results as well as the best case and worst-case scenarios and the overall spread between them (the risk).

The results can allow management to gain a deeper understanding of the potential success of the project and should therefore be able to make a more informed judgement of whether or not to go ahead with it. This technique could be particularly useful when entering a new market, such as for this project.

Specific business risks in relation to the project

The project value will be highly dependent on the market demand for budget hotel offerings, a market that we are currently unfamiliar with. We should mitigate the risk of forecasting market levels inaccurately by getting access to as much information about the market as is possible. We could analyse past trends and look at industry forecasts. We may want to engage a specialist market analyst to provide us with appropriate information.

There is a risk that offering basic hotels will damage our brand reputation as a luxury hotel provider. There is potentially a risk that if we use the Alpaca name on the budget brand that it causes confusion, with people possibly booking to stay there without realising that they will not be getting a luxury experience. Customers may inaccurately conclude that we are lowering standards across our entire business. We would lose business as a result.

To mitigate this we should ensure that there is a clear distinction between our luxury business and the new basic hotel. We should consider not using the Alpaca name, although its use could attract customers to the new venture.

There is a risk that the project will not hit early targets for occupancy and revenues if the market doesn’t welcome the new addition. As the market is so competitive, it is very possible that our prices will have to be so low that we do not end up covering our costs.

To mitigate this, we should allow for potential early termination of the project in our planning. This may mean, for instance, setting up the project by leasing a hotel with a possibility of an early termination of the lease, or of purchasing a hotel that could be sold on to another hotel chain.

Financial Manager

ANSWERS

EXERCISE 1 – RESPONSIBILTY CENTRES

Answer:

In both types of centre, managers are able to make decisions regarding revenues and costs. For example, as profit centres, hotel managers may make decisions on pricing to affect revenues and on supplier choices to affect costs.

Only in an investment centre do managers have the authority to make decisions related to capital investment. This means that capital investment decisions can only be made at divisional level.

Hotel managers will be unable, for instance, to make decisions in relation to such projects as major refurbishments, upgrade of leisure facilities, extension of the building, etc.

EXERCISE 2 – QUALITY MANAGEMENT

Answer:

Prevention costs

e.g. cost of producing a schedule of cleaning for each day so that every room that needs to be cleaned is on the list and can be ticked off once cleaned.

Appraisal costs

e.g. cost of employing a supervisor who checks a number of the rooms after cleaning to ensure that the standard of cleaning is at the right level

Internal failure costs

Cost of having to re-clean a room if the standard is not correct or if it has not been cleaned at all – identified before a customer has taken occupancy.

External failure costs

Cost of dealing with dissatisfied customers who have been allowed to check into a room that has not been cleaned properly, including the loss of reputation that a poor review on social media or review sites might lead to.

EXERCISE 3 – STAKEHOLDER VALUE

Answer:

In the digital world, it is vital that organisations decide who they are creating value for, with whom and why they are so doing.

To do this a firm may apply a four step process:

Identify the stakeholders for and with whom they seek to create value. For example customers, suppliers, shareholders etc.

Prioritise and rank the stakeholders. (NB for most firms, the customer is given the highest priority).

Establish and identify the needs of the high priority stakeholders.

Formulate value propositions that meet the needs of the high priority stakeholders.

Each stakeholder will then be ranked according to their following attributes:

- **Power** – ability to impose their will
- **Legitimacy** – according to the norms and values of the firm and society
- **Urgency** – the need for immediate action in the light of a stakeholder claim.

PRACTICE TASK C1 – BALANCED SCORECARD (linked to core activity C1)

To: Liz Petrov

From: Financial manager

Date: Today

Subject: Balanced scorecard

Overview

The Balanced Scorecard is a performance measurement system focused on four perspectives; financial, customer, internal business processes and learning and growth.

Within the financial perspectives are the traditional financial performance indicators that relate to profit targets, liquidity, return on capital, etc.

Traditional performance measures focus on financial results, which are important to our shareholders but which have already occurred, so don't necessarily give us the best view of how performance will fare going forward.

The idea behind the scorecard is that the non-financial measures of the other perspectives all drive performance in the future. For instance, we may be very profitable now, but unless we keep our customers happy, maintain and improve efficiency levels and ensure that we are always innovating, our business may not be sustainable over the long-term. Hence, there is a need for non-financial performance indicators to help us understand our potential for future success.

The remaining three perspectives help businesses to focus on the non-financial aspects and give them as much weight as the financial ones. Bear in mind that achievement of the non-financial goals should help improve performance towards achieving long-term financial goals too.

The customer perspective focuses on how customers view the business and can include such measures as whether they are happy with the service they have received, from booking through to check out. It should also enable us to see whether customers genuinely rate us as the luxury brand we aim to be. Achievement of goals in this perspective will help to drive future financial success through returning customers and positive word of mouth and Visitadvisor reviews.

The internal business processes perspective focuses on efficiency and productivity measures and achievement of goals here should help us to keep costs down, leading to achievement of our financial goals, whilst also contributing to achievement of customer satisfaction measures.

The learning and growth perspective should contain measures that aim to ensure we are staying ahead of the market in terms of innovation and growing in the direction we want, including measures such as the number of new hotel locations in the pipeline and whether training targets are being achieved. Inadequate training could lead to poor customer experiences and would be detrimental to our brand.

The starting point to implement a scorecard is the mission or strategy. Our mission is 'to provide authentic hospitality by making a difference to our guests and the environment in which we live'.

This doesn't translate very well to direct objectives for individual areas of the business such as our hotels, so we would need to break it down into specific objectives.

One such objective is to increase occupancy rates. Measures of customer satisfaction and, in particular, why they may not return to one of our hotels, would help us to improve customer retention and hence occupancy rates. Measures of efficiency when it comes to room cleaning could help us to improve and offer earlier check-in and later checkout times to increase our attractiveness to customers.

Hotel measures

Customer perspective. Improvements in customer satisfaction are key aspects of this perspective for the hotels.

Measuring customer satisfaction through the use of post-stay surveys, Visitadvisor reviews or comment cards available to occupants would allow us to track satisfaction levels. Determination of how they are changing could lead us to spot areas where we are lagging behind. Comparison of our own hotels against each other could enable us to spot high and low performers and use benchmarking techniques to improve the performance of those with lowest satisfaction.

Internal business processes perspective. To measure efficiency within our hotels, we could determine standards against which we could track performance. For instance, the standard time taken to check in or out a guest, the standard time from meal order to delivery in our restaurants, the standard time to clean different sizes of room. Again, in tracking performance in this way, we can not only determine whether targets are being met but use the numbers to benchmark hotels against each other with a view to sharing best practise and improving the performance of all. Set against this would be the need to ensure that our quality levels are maintained during any cost cutting or efficiency improvement projects.

Wastage levels, for instance in our restaurants, should also be monitored and improved if necessary to save costs.

Learning and Growth perspective. We could determine an appropriate level of training for the various roles of staff in our hotels and then monitor to determine whether the appropriate training has been received and applied by employees during their working routines.

As one of our objectives is to acquire at least one new hotel every three years we should not only track the actual number of new hotel openings, but the number of hotel acquisitions / constructions that are in progress so that we are looking forward and not just backwards in relation to achieving this objective.

Financial Manager

PRACTICE TASK C2 – LEADERSHIP (linked to core activity C3)

To: Finance director
From: Financial Manager
Date: Today
Subject: Leadership in the digital age

Briefing Paper

In order for Alpaca to adapt to and survive digital disruption, research suggests that the Board of Directors will need to demonstrate a number of key abilities, for example:

Inspirational leadership – digitisation is an exercise in change management, but on a bigger, quicker and more prevalent scale than any organisation will typically be used to. Research suggests that the Board will need to energise the workforce and inspire confidence that digitisation is the right way forwards and is being implemented in the right way. This may be a significant challenge for Alpaca given its 90 year history and strong focus on tradition and branding.

Competitive edge – the Board will need to motivate other personnel within Alpaca to see digital transformation has the right strategy; they will also have to persuade personnel to potentially change their mind-set. This will be an interesting challenge as there remains a significant market for the more traditional luxury associated with the Alpaca brand. They may encounter resistance in this context particularly from the more senior, established staff.

Establishing a strategic direction – Alpaca has clear statements on this aspect, via our mission and objectives. A digital strategy may require it to be done in a different way. For example, the planning horizon may need to be shortened, or greater flexibility introduced – perhaps a move away from the traditional approach of construction (organic) and acquisition of hotels to a more emergent approach, which would enable Alpaca to adapt quickly to change as time passes. Research suggests that the digital age will bring many changes to strategic relationships such as partnerships or joint ventures.

Influence external stakeholders – for example, providers of finance. Raising capital will be necessary, but showing how that capital may be applied and the value that will result might be more problematic. Will investing in smart room technology deliver increased shareholder wealth? If so, how much will be result and what will be the timescale for delivery of that increased wealth? There will be greater uncertainty over outcomes, and the Board will need to be persuasive, articulate and compelling in any revision of the business model and value proposition.

Collaboration – Alpaca will need to see itself as part of a much wider ecosystem if it is to deliver the value. This will require careful thought on understanding the ecosystem, for example local suppliers of food and materials. Although procurement for most items is managed by the operations team at divisional level, with suppliers delivering goods directly to the hotels that require replenishment, there may still be an element of dealing with local suppliers. What are the restrictions on these dealings, who to collaborate with and how each part of the ecosystem will contribute toward delivering value for the Alpaca shareholders.

Business judgement – what sort of business model will the organisation need to put in place? It is probable that an altogether different model to what has worked in the past will be required. Alpaca have done well with their existing model but given the ever changing environment and intense competitive rivalry in the industry it is inevitable that our business model will be constantly under review

Execution – having determined what technologies can help to drive the Alpaca forwards, thought must then be given to how these can be used most effectively by the people within the business. People and technology need to work in harmony to produce the desired outcomes. This will involve the Board considering how to communicate and implement change. The current divisional structure may need to be reviewed to ensure it is still appropriate given these changes

Building talent – it will be critical to identify the skills that staff will need to demonstrate and to manage training/recruitment to ensure that the business has those skills. New roles are likely to be required, including at the most senior level – for example, perhaps a new board position of Director of Technology may be required to be sure that this highly sensitive and strategically important area is constantly under review.

Financial Manager

ANSWERS

EXERCISE 1 – RISKS OF APAS IT SYSTEM

Answer:

Upside risks

Rooms should always be offered at an attractive price, leading to higher occupancy rates

As long as the built-in algorithms are robust, there is less scope for human error and inconsistency in relation to room pricing.

Downside risks

If the system goes down, there may not be appropriate staff numbers available with the correct level of knowledge and skill to take over the room pricing. Rooms may end up left unsold or sold at much cheaper prices than is appropriate.

If the algorithm is incorrectly programmed, rooms may not be offered at the highest reasonable rates, leading to a loss of revenue for Alpaca.

The system may be hacked, allowing hackers to secure rooms at very low prices or even for free.

EXERCISE 2 – ACCOUNTING FOR IMPAIRMENT OF HOTELS

Answer:

IAS 36 Impairment of assets (IAS 36) defines impairment of an asset when its recoverable amount is less that its carrying amount in the financial statements. Recoverable amount is the greater of either:

(a) value-in-use – i.e. the value generated if the asset was o continue to be used in the business, or

(b) fair value less costs to sell – i.e. the net proceeds that would be raised from disposal of the asset.

IAS 36 requires that an impairment review is performed when there is an indication of impairment, one such indicator would be a fall in utilisation of an asset, such that its revenue earning ability has been adversely affected.

An impairment review should be performed on a cash-generating unit, which is a collection of assets that generates independent income streams. Each North hotel could be considered as an individual cash generating unit, or they may be considered as one collective cash generating unit for the purposes of conducting the impairment review(s).

If, following the impairment review(s) impairment is identified, the hotel(s) affected need to be written down to their recoverable amount, with the write-off usually treated as an expense in the statement of profit or loss.

The exception to this general principle is if the hotels now considered to be impaired have previously been subject to an upward revaluation in an earlier year. If this is the case, any impairment calculated would first be offset against the revaluation reserve relating to that property. If there was impairment in excess of the available revaluation surplus, this must the written off as an expense in the statement of profit or loss.

Following any impairment write-off, the annual depreciation charge should be re-estimated based upon the new recoverable amount.

EXERCISE 3 – ACCOUNTING FOR REVALUATION OF PPE

Answer:

IAS 36 Impairment of assets (IAS 36) defines impairment of an asset when its recoverable amount is less that its carrying amount in the financial statements. Recoverable amount is the greater of either:

(a) value-in-use – i.e. the value generated if the asset was o continue to be used in the business, or

(b) fair value less costs to sell – i.e. the net proceeds that would be raised from disposal of the asset.

IAS 36 requires that an impairment review is performed when there is an indication of impairment, one such indicator would be a fall in utilisation of an asset, such that its revenue earning ability has been adversely affected.

An impairment review should be performed on a cash-generating unit, which is a collection of assets that generates independent income streams. Each North hotel could be considered as an individual cash generating unit, or they may be considered as one collective cash generating unit for the purposes of conducting the impairment review(s).

If, following the impairment review(s) impairment is identified, the hotel(s) affected need to be written down to their recoverable amount, with the write-off usually treated as an expense in the statement of profit or loss.

The exception to this general principle is if the hotels now considered to be impaired have previously been subject to an upward revaluation in an earlier year. If this is the case, any impairment calculated would first be offset against the revaluation reserve relating to that property. If there was impairment in excess of the available revaluation surplus, this must the written off as an expense in the statement of profit or loss.

Following any impairment write-off, the annual depreciation charge should be re-estimated based upon the new recoverable amount.

EXERCISE 4 – ACCOUNTING FOR ADVERTISING AND MARKETING COSTS

Answer:

In principle, marketing and promotion costs should be written off as an expense as they are incurred, unless there is an IFRS Standard or accounting principle that requires a different treatment.

In terms of the costs of producing the brochures, Alpaca would consume the benefits of that cost as soon as the brochures are received from the specialist printer. Even if the brochures were to be distributed over a period of time (including into 2021) the cost should be written off as it is incurred. It cannot be regarded as probable that the costs incurred to produce the brochures will lead to the inflow of future economic benefits. There will be minimal realisable value in a brochure, (unless for pulping as waste paper) particularly if the brochure is customised to refer to the year of culture.

It is also worth considering the accounting requirements of IAS 38 Intangible assets (IAS 38). IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It may be argued that incurring advertising and marketing costs to produce brochures and media adverts creates an intangible asset as such costs are expected to bring future economic benefits to Alpaca from increased bookings, not only during 2021, but perhaps over an extended number of years, It could further be argued that the potential benefits could last a number of years as a result of increased awareness of the business community of Alpaca City Centre Hotels, not just for the period of the year of culture but beyond that.

In terms of the costs incurred to place newspaper, radio and television adverts, the same principle will apply. However, with media adverts, Alpaca will consume the benefits of the costs incurred when the adverts are published or broadcast. Therefore, if some of the media adverts are to be published and broadcast during 2021, a proportion of the total costs incurred in producing and publishing/broadcasting those adverts can be carried forward into 2021 as prepayments using the matching principle.

Other than the limited exception above, IAS 38 specifically forbids recognition of advertising and promotional costs as intangible assets.

PRACTICE TASK D1 – FINANCIAL REPORTING (linked to core activity D3)

To: Finley Rae (CEO)
From: You (Financial Manager)
Subject: Re: Information request

Hi Finley,

Here is the information you requested.

ANALYSIS OF PERFORMANCE AND POSITION

Alpaca - Analysis

All references to 2019 / 2018 are referring to the years ending 31 December 2019 / 31 December 2018 respectively.

Note that calculations for average inventory days, average receivables' collection period and average payables' credit period have been performed but they may be of limited value, given the nature of Alpaca's business. This is considered further within the analysis, which follows.

Financial performance

All of Alpaca's profitability measures deteriorated from 2018 to 2019. There was a 1% fall in revenue, with a significant decline in operating profit, which was down by over 28% from 2018.

The gross profit margin fell from 40.1% in 2018 to 39.5% in the following year, with operating profit margin down to 11.2% from 15.5% over the same time period. It would appear that, despite the drop in revenue, Alpaca found it difficult to reduce costs to any significant extent to maintain the same level of profitability.

There was a very small increase in non-current asset utilisation from 0.24 times up to 0.25 times in 2019. This is probably a reflection of a fall in revenue along with a small decrease in the carrying amount of property, plant and equipment. Over the same time period, return on capital employed (ROCE) was 4.1% in 2018 and fell to 2.9% in 2019. The fall in ROCE is a consequence of a fall in operating profit, compounded by a small increase in capital employed.

There is no specific information within the pre-seen case of any significant changes made by Alpaca during the year, or that specific significant factors external to the company had an effect upon its financial performance and position. There are comments relating to the general competitive environment of the hotel industry, but no Alpaca-specific comments.

Financial position

Both the current and acid test ratio improved from 2018 to 2019. In the case of the current ratio, the movement was from 0.65: 1 to 1.08: 1 and for the acid test ratio, it improved from 0.64: 1 to 1.06: 1. However, the improvement in both ratios must be treated with caution as, for both years, there was a bank overdraft which considerably reduced the net cash and equivalent

balances available to Alpaca. For 2018, there was a net overdraft of $M1m, and a net cash balance of $M 85m, a net improvement of $M86m.

Given the nature of Alpaca's activities, it is recognised that most bookings made by individuals will be by debit or credit card, resulting in cash received by Alpaca with reasonable reliability. Corporate bookings and bookings made via agents or third party external websites are likely to take a longer credit period. Bargaining power of the hotel group may enable Alpaca to negotiate favourable credit terms and discounts on standard prices charged by suppliers.

The average trade receivables' collection period increased from 28 days in 2018 to 34 days in 2019. It is unclear whether this was a deliberate policy of extending credit periods to increase room utilisation and revenue, or whether it was due to poor credit control, or even a combination of both factors.

Similarly, the average credit period taken from suppliers increased from 126 days to 133 days over the same period. This could be due to Alpaca negotiating extended credit terms with suppliers, or perhaps due to the deliberate delay of making payments to retain cash in the business. It may even be a reflection of liquidity problems with Alpaca having insufficient cash resources to pay liabilities as they fall due. It should be noted that, in using cost of sales, there is likely to be some distortion in the calculation of the payables payment period if, for example cost of sales includes expenses such as depreciation charges on property, plant and equipment and other establishment-related expenses.

The gearing ratio fell slightly to 20.6% in 2019 from 20.9% in the previous year. The level of long-term loans was virtually constant throughout 2018 and 2019, meaning that the fall in the gearing ratio was due to a small increase in equity, specifically retained earnings and revaluation surplus. The effective interest rate fell from 3.2% to 3.0% over the two years under consideration. Note that this calculation includes the overdraft at each reporting date as it appears to be part of the permanent financing of the group. Interest cover fell during the same period from 4.9 times to 3.7 times. Note that finance charges will include interest on long-term loans, along with overdraft interest.

Alpaca paid a dividend to its shareholders in 2019, which amounted to 50% of the profit after tax for the year. As a listed entity, there may be an expectation on the part of institutional shareholders in particular that they will receive an annual dividend. Dividend cover of 2.0 indicates that Alpaca may have trouble paying the same level of dividend if profit for the year was to fall by a relatively small amount. Similarly, based upon the current circumstances, Alpaca is likely to have difficulty increasing the dividend paid to shareholders.

Statement of cash flows

Net cash from operating activities of $M76m which exceeded profit before tax by M$35m, and is the primary source of finance to meet investing and financing activities. Reference has already been made to increased holdings of inventory and receivables, substantially offset by an increase in payables. Significant operating cash outflows for interest paid and taxation totalled $M32m,

representing 42% of net cash flow from operating activities.
Disposal of property plant and equipment generated $M86m but incurred a loss of $M29m/
Given that only $M56m was invested to acquire new property, plant and equipment, it may be questioned whether Alpaca is maintaining its operational capacity, particularly given its objective to increase capacity, partly by organic growth and partly by acquisition. As a related issue, continued disposal of property, plant and equipment cannot be regarded as an operational source of generating cash inflows for the business.
A very small loan repayment of $M3m was made during the year. Alpaca will need to consider how it may best repay its overdraft and also repay its loan liabilities. Alpaca may need to consider renegotiating its loan facility as redemption date approaches, or find alternative finance, such as an issue of equity shares.

If you need any further information, please contact me.

Financial Manager

PRACTICE TASK D2 – FINANCIAL REPORTING (linked to core activity D5)

To: Lyn Hao (Marketing Director)

From: You (Financial Manager)

Subject: Re: Information request – fines and penalties

Date: Today

Hi Lyn,

(a) Accounting for fines and penalties

The principal source of accounting requirements relating to accounting for fines and penalties is IAS 37 Provisions, contingent liabilities and contingent assets (IAS 37). IAS 37 specifies the three criteria required for recognition of a provision in the financial statements as follows:

(a) there must be a legal or constructive obligation arising as a result of a past event

(b) it is probable that there will be an outflow of economic benefits

(c) the provision is capable of reliable measurement

In terms of practical application of these requirements it may be that, for example, an investigation by Alpaca has established the cause of the problem in advance of any investigation by the MHSA.

If the cause of the problem was a breach of food hygiene regulations by kitchen staff at the hotel, this would be regarded as creating an obligation as a result of a past event.

If Alpaca or its employees were responsible for creating that obligation, it would be regarded as probable (more likely than not) that there will be an outflow of economic benefits to settle that obligation. The outflow of economic benefits will almost certainly be payment of a fine or other penalty, including compensation to hotel residents who suffered food poisoning.

A reliable measurement of such outflows can normally be made, perhaps by reference to the relevant legislation or regulation which may include a scale of penalties or fines that can be imposed, or flowing discussion with legal advisors or insurers who may have a better understanding of the financial consequences of such an event.

Note that it is not necessary for Alpaca to wait until there has been an investigation by the MHSA, or for its report to be issued or for any penalty to be formally imposed. It is sufficient that Alpaca regards the imposition of a penalty to be probable.

Any penalty or compensation required to be paid would be classified as an expense in the statement of profit or loss, and as a current liability until settlement is made.

The accounting treatment of any additional costs incurred, such as ‘deep cleaning’ of the kitchen would be assessed using IAS 37 on the same basis. Although it will be desirable to have the kitchen cleaned and operational again as soon as possible, the fundamental issue to consider is

whether that cost would be incurred in response to satisfying an unavoidable obligation. For example, Alpaca may decide to close the hotel permanently and this would avoid the need to incur the 'deep cleaning' cost. If a cost can be legitimately avoided, it cannot be regarded as satisfying an obligation. Therefore, such costs would be accounted for as they were incurred.

(b) Treatment of the two illustrative breaches

In essence, the principles used to determine the accounting treatment of the two items should be the same, applying the principles of IAS 37.

One possible distinction between the two illustrative examples is the potential impact of the two issues. The issue of poor lighting may be regarded as a relatively minor breach by HMSA, with perhaps just a written warning and receipt of an assurance that it has been rectified and will not be repeated. The cost of rectification is also likely to be relatively small.

The issue of food poisoning, in addition to giving rise to fines or other penalties, may also cause reputational damage to the business. If the hotel affected was part of a business acquired at some date in the past, it may be necessary to consider conducting an impairment review of that part of the business, with the potential outcome that a cash generating unit (i.e. business unit) including goodwill may need to be written down to its recoverable amount in the consolidated financial statements.

In more extreme circumstances, it may be that the ability of Alpaca to continue as a going concern could be threatened. If this was the case, Alpaca would need to consider whether it was appropriate to continue to produce its annual financial statements on the basis that it was expected to continue to operate as a going concern for the foreseeable future. If this basis of accounts preparation was no longer appropriate, the financial statements would need to be prepared on a 'break-up' basis using realisable values for all assets and liabilities.

(c) Supply of contaminated fish

If the food poisoning has been caused by the supply of contaminated fish, Alpaca would continue to have liability for serving it to hotel residents, and would be subject to the same penalties and sanctions are discussed previously. However, an additional issue is the possibility that Alpaca may be able to make a counterclaim against the fish supplier for all costs and losses incurred relating to the breach of MHSA regulations.

The ability to make a claim against the fish supplier would be regarded as a contingent asset in accordance with IAS 37. A contingent asset is a possible asset that may arise from a past event, the past even being the supply of contaminated fish, and the possible asset being the receipt of compensation from the fish supplier which may be, for example, subject to negotiation or settlement by court case.

Alpaca must assess the probability of success of the contingent asset being received. If it was regarded as remote or only possible, there should be no recognition in the financial statements, and nor should there be any disclosure of the contingent asset.

If the contingent asset is regarded as probable, then there should be disclosure only of the contingent asset in the financial statements. If the contingent asset is regarded as virtually certain, it should be recognised in the financial statements. This may occur, for example, when a court case judgement has been made, or a settlement agreed with the fish supplier regarding the payment of an agreed sum.

Note that, when a contingent asset is recognised in the financial statements, it should not be offset against provisions recognised relating to the same issue unless there is an established or legal right of set-off.

Financial Manager

ANSWERS

EXERCISE 1 – INTEGRATED REPORTING

Answer:

The purpose of an integrated report is to explain to providers of financial capital how the entity creates value over time. An integrated report is also likely to be useful to stakeholders other than the providers of equity and loan capital.

The four key objectives of an integrated report are:

1 – to improve the quality of information available to providers of financial capital.

2 – to provide a more cohesive and efficient approach to corporate reporting that communicates a full range of factors that affect the ability to create value.

3 - to enhance accountability and stewardship of those responsible for the management and direction of the entity.

4 - to support integrated thinking, decision-making and actions that focus upon value creation.

PRACTICE TASK E1 – TRANSFER PRICING (linked to core activity E2)

To: Zoe Diaz

From: Financial Manager

Date: Today

Subject: Transfer pricing

Transfer pricing objectives

The overall aim of transfer pricing is that prices are set so that the managers involved do not end up making poor decisions in relation to the transfers.

Goal congruence

Each hotel runs as a profit centre and is measured on its ability to earn profit. A hotel that is sending food to other hotels will want to earn a profit on it and so ideally would want to set a high transfer rice, perhaps including a profit element but at least covering its costs. A hotel receiving food will not want to pay more than from their regular suppliers, otherwise it will be encouraged to use its regular suppliers rather than the internal supply and this may cost the company extra due to the food going to waste. The system should be set so that the business as a whole benefits, with no extra cost incurred due to the pricing system.

Performance measurement

As mentioned above, the prices set will feed into the profits of each hotel involved. The profits should be a reflection of managerial performance and should not be distorted by inappropriate transfer prices. This is particularly important if staff bonuses and pay rewards are based on hotel performance figures.

Maintaining autonomy for hotel managers.

Hotel managers make decisions that affect the profitability of their hotels. If a transfer price is set centrally, the managers may feel that their decision-making ability is being removed and this can lead to a lack of motivation and effort. Overall company performance will then suffer.

Recording the movement of goods and services

Simply put, a transfer pricing system also enables the business to track the movement of the transferred food, ensuring accurate record keeping.

A fair allocation of profits

Inappropriate transfer prices may lead to hotel managers feeling that they are being treated unfairly. For instance, a manager who is motivated to keep costs down for the business as a whole may decide to make use of as much transferred food as possible, to reduce company wastage. If the transfer price is set at a higher level than they would pay to their local suppliers, they will not feel that it is at a fair level and that their hotel profits are being compromised from their efforts to improve overall profits.

Bases of setting and recommendation

There are three main bases for setting a transfer price – market-based, cost-based and negotiated prices

Market-based

This wold involve transferring the food at market prices, i.e. the prices that would be charged by an external market – the suppliers of the food.

It may be that adjustments would be needed to the price. External delivery costs would be saved and the overall price could be reduced by this value. However, internal delivery costs would be incurred and the hotel supplying the food would wish to cover these costs and may add them onto the price.

Cost-based

This would end up being very similar to the market-based price, as the cost to the hotel transferring the food would be the price that had been charged from the initial supplier, along with any extra delivery costs incurred for the transfer.

It is possible that some costs would be saved if the transfer occurred, for example the costs of disposing of wasted food. These costs could be deducted from the transfer price and the transferring hotel would not lose out, while the receiving hotel would benefit.

Negotiated prices

This would involve individual negotiation between hotel managers. It could lead to inconsistent prices being charged and would potentially use up management time that could be better used elsewhere. The price would be likely to end up at a similar level to the market- or cost-based levels.

The price charged depends on whether there is an intermediate market for the item being transferred. In this case, there is for the receiving hotel, which could purchase the food from the transferring hotel or from their usual supplier.

From the overall company point of view, it would be cheaper to have the food transferred and save on wastage and disposal costs than for the food to go to waste and additional food purchased from the external supplier.

There is no external market for the supplying hotel, so they will not be concerned about missing profit by selling to the sister hotel, just about recovering their costs.

Therefore, it is recommended that a cost-based system is used, with any cost savings, such as those of food disposal, passed onto the receiving hotel.

In this way, the supplying hotel will be able to recover the costs of any food not used and the receiving hotel may make some savings compared to its external supplier on food it receives from the other hotel.

Both hotel managers will be happy with the situation and goal congruent decisions should be made.

Financial Manager

PRACTICE TASK E2 – FINANCIAL REPORTING (linked to core activity E1)

To: Finley Rae (CEO)
From: You (Financial Manager)
Subject: Re: Potential acquisition of a new subsidiary

Hi Finley,

Thanks for your email. Here's the information you requested.

Non-controlling interest in a newly-acquired subsidiary

FRS 3 Business combinations (IFRS 3) permits the NCI in a newly acquired subsidiary can be measured in either of the following two ways:

a) using the 'proportionate share of net assets' method. As the name suggests, this method measures the NCI based on its entitlement to the share of the fair value of net assets of the subsidiary at the date of acquisition.

   In terms of the impact upon initial recognition of goodwill, the consequence is that goodwill is based upon only the controlling entity's interest in the subsidiary. If there is a subsequent impairment of goodwill, any impairment will be borne by the parent only.

b) using the fair value or 'full goodwill' method. This method measures the NCI based upon its share of the fair value of net assets at the date of acquisition plus a share of the goodwill associated with the subsidiary at that date. This will result in an increased valuation for NCI (and goodwill) at initial recognition in the consolidated financial statements in comparison with the alternative method.

   If there is a subsequent impairment of goodwill, the resultant profit or loss charge will also be greater under the full; goodwill method. However, the write-off will be shared between the controlling entity and the NCI based upon their relative shareholding in the subsidiary. Note that, following write-off of impaired goodwill, it is not permitted to reverse or reinstate a previous goodwill impairment write-off.

The NCI balance at the reporting date will be classified as part of equity in the consolidated statement of financial position. This is because it is one element contributing to the financing of the group as a whole. It should not be classified as a liability.

One further practical point is the NCI valuation method can selected on an 'acquisition-by-acquisition' basis. Therefore it is possible that, within a corporate group, the NCI of some subsidiaries at acquisition were measured using the 'proportionate share of net assets' basis, whilst others were measured using the full goodwill method.

Foreign subsidiary – consolidation issues

IAS 21 The effects of changes in foreign exchanges rates (IAS 21) specifies the principles of translating the results of a foreign operation for inclusion in a set of consolidated financial

statements. IS 21 requires that the assets and liabilities of a foreign subsidiary are translated at the closing rate, and that all items of income and expense are translated at the average rate of exchange for inclusion in the consolidated financial statements.

IAS 21 regards goodwill arising on acquisition of a foreign subsidiary as an asset of the subsidiary, and therefore goodwill should be calculated in the functional currency (i.e. local currency) of the subsidiary, and then be subject to annual retranslation at the closing rate at each reporting date for inclusion in the consolidated financial statements. Therefore, even without considering whether there is impairment of goodwill in any given year, the M$ value of goodwill in the financial statements will change annually, depending upon the movement in the exchange rate from one reporting date to the next between the Maylandian dollar and the local (functional) currency used by the foreign subsidiary.

For the purposes of this explanatory email, I will base my comments on the assumption that goodwill will be calculated based upon the valuing non-controlling interest at full fair value, rather than on a proportion of net asset basis.

The consequence of this is that there will be an annual gain or loss on retranslation of goodwill. This annual gain or loss is an unrealised gain or loss and is therefore classified as an item of other comprehensive income in the statement of profit or loss and other comprehensive income, which is then attributed between the controlling group and the non-controlling interest based upon their respective shareholdings in the subsidiary. Similarly, there will be an annual gain or loss on retranslation of net assets, and this will be accounted for in the same way as the retranslation gain or loss arising on goodwill.

In the consolidated statement of financial position, the annual gain or loss on retranslation of net assets and goodwill is allocated between the controlling group and non-controlling interest based upon their respective shareholdings. The non-controlling interest share is added to (or deducted from) the net balance attributed to the non-controlling interest shareholders. The group share is accumulated as a non-distributable component of equity. It should not be regarded as part of retained earnings.

If you need any further information or clarification, please contact me.

Financial Manager

PRACTICE TASK E3 – STAFFING ISSUES (linked to core activity E4;E5)

From: Financial Manager
To: Senior Financial Manager
Subject: Staffing issues

Our workforce will need to become flexible with the emergence and application of new technology. As a result, the need for team-based, collaborative and digitally connected work environments will become even more critical to the efficiency of Alpaca and its future growth plans.

It is suggested therefore that Alpaca consider the use of digital communication. We could implement any or all of the following but it is recommended that we carry out a cost benefit analysis prior to any commitment to implement new processes.

Intranet

Mainly used for effective internal communication and collaboration between colleagues, with the intention of developing a more educated, skilled and engaged workforce.

The intranet can be accessed by any authorised users within a business organisation, but with the development of "bring-your-own-device" (BYOD), for example smart phones and working from home, an intranet solution will result in a more flexible workforce and ensure all employees are informed and working towards common business objectives and goals.

The benefit of the intranet is the ability to easily share company news and build an information-rich environment. For example, news feeds can be personalised for each staff member based upon their team, department and/or location to ensure that the most relevant news is provided to meet their needs. However, it will be necessary to ensure data security by allocating access permissions via password or specifically designed security measures to ensure sensitive or confidential information is protected.

Intranets can be further developed by facilitating communication among staff working in different locations (so given future plans ideal for the Alpaca Group), or in a particular location or area of specialty facilitating interaction with the content and offering feedback in real-time. This would be ideal to ensure that internal union representatives are aware of, and can comment on or contribute to, future business plans.

Chat and private messaging

Collaborative spaces which provide private/group messaging and "chat functions" are often viewed as one of the best business communication tools to keep teams working together – they are an effective form of communication for busy employees and managers.

For example, in the case of Alpaca, the instant messaging facility makes updates on projects and general team discussion much easier. In the current situation of increased flexibility of working for staff members and the new technology initiative, this should work well given our employees are spread across different geographical locations. Similarly they enable files to be shared and conversations can be accessed if needed for the benefit of efficient project management.

Discussion forums

A discussion forum can bring together management and employees and allows for an open discussion on any topic (usually set up and monitored/moderated). It can also help with knowledge dissemination and bring the workforce together.

Forums are also effective in archiving organisational knowledge to be used by anyone as a reference. Employee morale can also be boosted by participating in regular discussion forums which will also facilitate knowledge sharing. This will enable information to be discovered by people who need it, when they need it.

Internal blogs

Employees can share ideas and experiences quickly in an informal fashion. Some of the benefits that this communication tool provides include creating a searchable and permanent database of knowledge and expertise and promoting open discussion and collaboration among the workforce. This would be ideal in the context of any future plans to develop new technology in the hotels. In addition it connects employees across departments and locations and keeps the staff up-to-date on important information and company updates, for example staffing schedules and our new technology trials.

Data visualisation

Data refers to when data is displayed in customisable, interactive 3D formats that allows users to manipulate and drill down into detail as required. Central to data visualisation is understanding and ease of use, placing the ability to find data in the hands of the end user, through intuitive, user friendly interfaces. For example, creating a dashboard to display the key performance indicators of a business in a live format, thus allowing immediate understanding of current performance and potentially prompting action to correct or amend performance accordingly. In the case of new technology, this will be a key tool to enable understanding of the need for such changes and therefore benefit acceptance.

Negotiation strategy with unions

The first issue that we need to address is communication. The nature of our working environment is that hotel staff are spread over a considerable distance and cannot be easily brought together for a meeting. We have to make sure that we keep the staff well informed of management's position throughout the negotiations; otherwise the union representatives may force a strike that could have been avoided.

A successful negotiation will align our interests with those of the union members. Given the technology changes that have occurred in the hospitality industry, we cannot agree to maintain the status quo in terms of the numbers of staff and the skills required of them. One possible compromise would be to provide all personnel with training that will equip them to pursue other opportunities, both within Alpaca and other employers. For example, Alpaca could ensure that distance learning opportunities offered to staff are directly relevant to a wide range of career opportunities, both with Alpaca and in seeking other jobs.

The courses could emphasise transferrable skills, such as communication and organisational skills for reception staff and other skills associated with the hospitality industry such as health and safety training. For example, these skills could be of particular benefit to companies such as AirBnB given the recent growth in on-line sales.

Alpaca may also be able to restructure its remuneration award schemes so that the remaining union members do not suffer an overall loss in their reward. For example, the fact that there will be potentially fewer staff overall means that if the payments to individuals were enhanced to maintain previous levels the cost to Alpaca would be acceptable because it would still offer a significant overall saving.

Potential issues in negotiation

The first step will be to adequately define the need for technological change and increased flexibility in the workforce. It sounds as if changes in technology will make it possible to employ union members with differing qualifications and experiences and in some cases a reduction in overall staffing levels. There is nothing that necessarily forces us to do so, although there may be an opportunity to reduce recruitment and salary costs. This could be of benefit to Alpaca given the recent financial results but it would need to be carefully managed to protect our brand and reputation

If there are potential savings to be made then we should reconsider our job descriptions and person specifications. Even if staff need fewer qualifications, there will still be desirable traits that we can identify and retain in order to ensure the safe and efficient operation of our hotels.

The divisions, in their HR capacity, will have to be briefed on the new and reduced requirements. Staff will have to be trained to ensure that shortlists for future recruitment reflect the revised needs, without risking employing candidates who would be unsuitable. To do so would challenge our key strategic objectives of delivering high guest satisfaction.

Care will have to be taken in presenting these changes to existing staff. We will have to take precautions not to alienate long-serving members of staff, particularly those skilled members of staff, who may feel that their qualifications are being marginalised and belittled. They may also be concerned that their jobs are at risk if Alpaca believes that it would be cost-effective to make them redundant and replace them with less qualified individuals at a later stage.

Financial Manager