

Chapter 3

ALPACA HOTEL GROUP – SUMMARY AND KEY TOPICS

1 INTRODUCTION

It is absolutely crucial that you completely familiarise yourself with the pre-seen information prior to attempting the Case Study exam. Merely reading through the materials is unlikely to be sufficient and it is also important that you consider which aspects of the three technical subjects may be useful and relevant for the Case Study.

The exercises in the following three chapters will help you to gain a thorough understanding of the Case Study scenario and ensure you are fully prepared to attempt the Practice Tasks later in this Workbook.

Solutions to these exercises are provided but are not exhaustive. It is important that you attempt exercises yourself and makes notes of your answers before reviewing the solutions.

2 OVERVIEW OF PRE-SEEN

Originally formed in 1930 by the opening of the first hotel in the country of Maylandia by the Scrivens family, the business grew both by organic means via the construction of hotels and by acquisition until it was quoted on the Maylandia stock exchange in 2000 when the original family sold their interest.

Alpaca has developed and is focussed on maintaining a well-known brand by delivering a quality differentiated service in the in the luxury end of the market, having a 10% share of the luxury hotel rooms available in Maylandia. The Alpaca Group has some 50 hotels with 9000 rooms in three divisions focussing on the Central, Southern and Northern areas of Maylandia. Each of these divisions has different clientele. This creates a need for each of the hotels to be responsive to different client preferences, tastes and requirements. To facilitate this “local knowledge” the Alpaca group is structured on a divisional basis with hotel managers reporting in to each divisional team on a monthly basis. The three divisions may help to compensate each other if one experiences problems e.g. if there is a poor ski season in the north, this may be compensated to some extent by a good summer in the resort hotels.

The Alpaca Group has clearly stated its mission and objectives in the statement to investors and continues its desire to grow. The business however is not specific about how these objectives may be achieved. This growth will not come without business risks. Whilst the revenue sources are

largely out of the business's control (driven by consumer preferences), they should aim to ensure that costs are maintained at an appropriate level and profitability by distribution channel should be carefully monitored. There is no clear evidence that Alpaca has a formal risk management process in place to ensure that all risks pertinent to the success of the business objectives are monitored and mitigated.

Alpaca has continued its success resulting in an industry wide reputation, strong brand, a clear business model and a reputation for quality and luxury. In the last year however revenue and profitability have both fallen, which may mean there is a need for Alpaca to be more mindful of market trends e.g. the update of hotel rooms to reflect changes in customer preferences. Analysing market trends may also result in the need for more detailed information and data analysis to consider changes to the existing business model by e.g. measuring the success of the business against the achievement of core values by introducing non-financial performance measures and/or measuring performance via benchmarking. If this is done well enough, e.g. identifying best practice and implementing change before competitors do, the business may be able to gain a significant competitive advantage. This will be important to take advantage of future opportunities such as the "Year of Culture" in Maylandia.

All opportunities for Alpaca will be fuelled by external pressures requiring the need for greater awareness of competition, changes in consumer taste, improvements in technology, social and economic pressures affecting disposable income and consideration of the associated risks. This makes for a complex trading environment.

Detailed information on how each aspect of service provision and related costs are progressing to facilitate decisions concerning Alpaca's future strategy will be critical. To define value by meeting the developing needs of guests in the business and leisure sectors new service development will be key to match with emerging trends if quality and reputation are to be maintained.

These challenges will generate risks to the future success within the industry and require immediate planning, innovation and action to mitigate those risks. Investment will be required to ensure that the quality Alpaca offers is maintained, revenue growth is reinstated, and costs controlled to ensure that both a growth in profitability is achieved again and reputation maintained. For example, the objective to have a new hotel every three years, either by acquisition or construction, will require considerable financial commitment, and quite a lead time before revenues may be generated, particularly if the hotel is constructed.

The internal activities of Alpaca will need to be carefully analysed to establish how these costs are incurred and how they can be better managed in the future. Failure to do so will challenge the future profitability and success of Alpaca in a highly complex business ecosystem.

3 KEY TOPICS BY CORE ACTIVITY

Core Activity A: Evaluate opportunities to add value

Providing an acceptable return on investment to shareholders

This must be measured and steps taken to improve if Alpaca continues to fall behind on performance. The development of suitable financial and non-financial performance measures will be key to success.

Value creation

The selection and implementation of suitable business models that will create value for stakeholders, given the recent fall in revenue and profitability will be critical

Capital expansion

One of Alpaca's goals is to acquire at least one new hotel every three years, so capital acquisitions and investment appraisals are very relevant. The business also constructs its own hotels, also needing investment appraisals to determine viability. The company will need a robust investment appraisal process in place.

Pricing

Pricing is largely controlled by a software algorithm. Faults or errors in relation to the software could lead to inappropriate pricing. Alpaca should take care that its prices reflect the value embedded in its offering. Too many 'bargain' prices could erode the brand.

Business Model

Consumer preferences are largely out of the control of Alpaca, but will affect the business model that they adopt. Alpaca must keep up with market trends, to reduce costs and improve profitability. A review of their current approach to trading, sourcing of data and use of information to reflect necessary change in the new digital environment is highly likely.

Core Activity B: Implement senior management decisions

Project management

If Alpaca decides to develop any new products or take advantage of new technology, this is likely to result in a new project. The application of appropriate project management tools and techniques to effectively manage projects will be key to success as will the identification of the key project personnel.

Risk management in capital projects

The management of risks in any future capital projects will be important throughout and will support the choice and implementation issues of future strategic direction. Alpaca have acquired to grow their business in the past but all new projects or acquisitions will need to be financially assessed. It would be wise to review and be able to explain and apply all investment appraisal techniques.

Sources of finance

Any future investment will require finance. The selection of suitable sources of finance and understanding the characteristics of the different types of such funding will be critical to success.

Team development

It seems clear that the team at Alpaca will need to work closely together with significant emphasis on supporting the objective of guest satisfaction. It will be the successful operation of these teams that is critical to future success.

Core Activity C: Manage performance and costs to aid value creation

KPIs

A significant aspect of the new syllabus E2/P2 papers is the focus on setting KPIs for different parts of the business. For Alpaca designing new means of non-financial performance measurement or balanced scorecards will be important to measure success in an ever changing business ecosystem. In addition it will be important to consider where the necessary information would come from for such an exercise.

Responsibility centres profitability

Each hotel acts as an individual profit centre, meaning that appropriate targets for profitability (ones that are controllable by hotel managers) should be set and measured to drive performance. The balanced scorecard will be relevant here, in particular the non-financial perspectives. The achievement of objectives in these areas will drive financial performance.

Benchmarking

Alpaca operates 50 hotels, which are likely to be performing at different levels. Benchmarking could be used to ensure that improvements are made to low performers.

Control of costs

Profit margins appear to be deteriorating and below budget. In addition to careful price monitoring, costs need to be kept under tight control to reverse this trend.

Leadership and Governance

Not mentioned explicitly within the pre-seen; however, this does not mean that both leadership and governance cannot feature in the real exam. Make sure you revise key aspects such as separating CEO and chairman, NEDs and their roles and different leadership styles – particularly as Alpaca's performance has declined.

Core Activity D: Measure performance

Risk management

The identification, analysis and management of risks will be important throughout and will support the choice and implementation issues of future strategic direction. Ethical issues e.g. social media; environmental issues along with the usual business issues, including quality are prominent.

Assessment of financial position

The Alpaca Group have recently experience a fall in revenue and profitability. It will be important to be able to explain the significance of key ratios and apply them to Alpaca to determine appropriate corrective action.

Accounting treatments

Important aspects to consider could be:

Accounting for provisions and related issues

Given the nature of the hotel industry and the inspection regime within which it operates, it is possible that fines and penalties could be imposed by regulators. Compensation may also be payable to hotel users who suffered a less than satisfactory experience during a recent stay at an Alpaca hotel.

Training

The nature and quality of training of hotel staff is often a very important issue. Accounting for training costs, and the benefits such training may bring could be a relevant issue to Alpaca.

Classification of expenditure

Alpaca operates luxury hotels. Therefore, the upkeep of the properties will be important to ensure that the expectations of hotel guests are met or exceeded. This is likely to include considerable expenditure on repairs and maintenance and enhancements to hotels.

Core Activity E: Manage internal and external stakeholders**Additions to the group**

It may be important, given the stated objectives of Alpaca to consider possible acquisition of another entity to extend market share and perhaps benefit from economies of scale.

Decision making and conflict

Given the context of the pre-seen, it is likely that they will be difficult decisions to be made which will inevitably lead to difference of opinion within the management team. It would be wise to revise the key aspects of communication, negotiation and conflict management.

Notes:

Chapter 4

CORE ACTIVITY A: EVALUATE OPPORTUNITIES TO ADD VALUE.

SYLLABUS WEIGHTING

- 15 -25%

ASSESSMENT OUTCOMES

- I can select appropriate capital investment appraisal techniques and apply them in order to support capital investment decisions, including product/ service development, digital transformation projects and acquisitions.
- I can identify and use relevant digital data sources to assist in capital investment decisions.
- I can explain which pricing strategies are appropriate.
- I can select and implement suitable business models that will create value for stakeholders, including business models in the context of digital ecosystems.
- I can analyse the impact of disruptive and digital operating business models in the context of digital ecosystems.
- I can explain the relevance of weighted average cost of capital.

FAMILIARISATION EXERCISES

EXERCISE 1 - DIGITAL DATA SOURCES

QUESTION:

“The creation of value is a common theme in the description of the purpose of business models”.

Alpaca creates value through the creation of a calming and attractive environment at each of its hotels.

What are the five key elements that must connect and align to create value sometimes referred to as the operating model of the firm?

EXERCISE 2 - DIGITAL ENTERPRISES

QUESTION:

Give examples of approaches that a business may need to adopt to encompass change in the digital world.

EXAM-STYLE PRACTICE TASKS

PRACTICE TASK A1 – CAPITAL INVESTMENT

Trigger and task

To: Financial Manager

From: Liz Petrov - Senior Financial Manager

Date: Today

Subject: Investment appraisal types and processes

Hi,

Subsequent to a recent board review, I've been asked to ensure that we have adequate documentation regarding the processes that we undertake and the techniques that we use for decision-making.

In particular, we need to include some information in relation to our capital investment process. As you know, we mostly use net present value techniques to evaluate capital projects, but we need to provide documentation as to all the techniques available and their usefulness to us. I'd like you to provide two sets of notes for me.

First, could you put together some notes on the stages of the capital investment process that we should follow for large capital projects, with examples of how each stage relates to Alpaca?

Second, please include brief summaries of the four main types of investment appraisal and their usefulness to Alpaca.

Regards,

Liz

Prepare the work that the Senior Financial Manager has requested.

(Time: 45 minutes)

Chapter 5

CORE ACTIVITY B: IMPLEMENT SENIOR MANAGEMENT DECISIONS.

SYLLABUS WEIGHTING

- 15-25%

ASSESSMENT OUTCOMES

- I can apply appropriate project management tools and techniques to effectively manage projects at the appropriate stage in the project life cycle.
- I can identify the key project personnel, explain their responsibilities and set appropriate performance measures.
- I can select and apply suitable tools and techniques for managing risk and uncertainty in capital projects.
- I can select suitable financing sources and explain the characteristics of the different types of funding.
- I can recognise the characteristics of high performing teams.

FAMILIARISATION TASKS

EXERCISE 1 – PROJECT MANAGEMENT

QUESTION:

Alpaca are considering a new project. What are the key elements to be included in a project initiation document (PID)?

EXERCISE 2 – STRESS TESTING

QUESTION:

What is meant by stress testing in relation to capital investment projects?

EXAM-STYLE PRACTICE TASKS

PRACTICE TASK B1 – PROJECT MANAGEMENT

Trigger and Task

To: Financial Manager
From: Senior Financial Manager
Date: Today
Subject: Customer reviews and new projects

I have just attended a meeting with the institutional shareholders who are concerned that even in the light of significant competitive threat from changes in technology which we have recently discussed; Alpaca seem to be lagging behind in new projects to achieve our stated strategic objective of increasing room capacity and guest satisfaction.

The key change that has brought this discussion to a head is the recent information received from Visitadvisor, particularly in the context of quality of service and cleanliness.

Sam Singh is currently reviewing procedures across the Alpaca Group, particularly in the light of this disturbing information, and the options we need to generate to reverse these trends and remain a dominant player in the industry. Sam is also concerned however that time and money should not be wasted on unrealistic projects which may arise from any knee jerk reaction to this information. We have to bear in mind that often such reviews are subject to manipulation.

In this context he is considering the introduction of a more formal project acceptance process. This will include the creation of a feasibility report which will then be produced for all future projects and he has asked for our help to prepare a discussion document for the next board meeting.

I think that this is a great idea and would like to support this new initiative.

Please can you prepare a briefing note for discussion at that meeting to cover the following:

- How should we assess the feasibility of a project?
- Outline the likely contents of any future formal feasibility study report.

Prepare the work that the Senior Financial Manager has requested (Time: 45 minutes)

PRACTICE TASK B2 – FINANCIAL REPORTING

Trigger and task

This morning you received the following email from Finley Rae (CEO):

<p>To: You From: Finley Rae (CEO) Subject: A request for help!</p>
<p>Hi</p> <p>In preparation for a directors' board meeting next week I wonder if you could prepare some briefing notes that can be distributed ahead of that meeting?</p> <p>Understandably, not all of the attendees have a detailed knowledge of financial reporting as they focus upon their functional area of expertise and experience. However, along with other members of the Board of Directors, I believe that some awareness of financial reporting issues will inform their understanding of matters to be discussed at that meeting. Normally I talk to Zoe Diaz (FGD) about this sort of thing, but Zoe is tied up with auditors today and suggested that I contact you for help.</p> <p>Could you prepare some notes that I could circulate to the attendees at the meeting next week that explains:</p> <ul style="list-style-type: none">• The difference between equity and debt capital, and• How equity and debt capital may be raised, and <p>Please use information from the extracts of financial statements which I understand Zoe circulated to all members of the accounting and finance team last week (the pre-seen case) to help explain things.</p> <p>Thanks Finley</p>

Task

Respond to Finley Rae's email

(Time:45 Minutes)

PRACTICE TASK B3 – RISK AND UNCERTAINTY IN CAPITAL PROJECTS**Trigger and Task**

Your line manager, Liz Petrov, has sent the following email to you

To: Financial Manager

Date: today

Subject: Risk and uncertainty

The board has been considering a project to open up a basic hotel to test the market and see whether the operation of basic hotels is a viable long-term strategy for us. The market is very competitive and so opening one hotel would allow us to determine its potential to Alpaca.

If we go ahead, the hotel would operate under a different brand name, although we haven't yet decided whether the name would be related to Alpaca (such as Alpaca Essentials) or not.

When we are a little further on in the negotiations we will produce a full investment appraisal for the project, but for now I'd like you to think about the risk side of things.

I'd like you to cover how we would deal with risk and uncertainty in relation to the investment appraisal for the project. Could you provide some explanations of the techniques of sensitivity analysis, expected values and simulation and how they could help us make a more robust decision regarding the project's viability?

I'd like you to consider also the more specific business risks involved in the project and how they may affect the investment appraisal process. Please provide examples of three specific risks we ought to consider and how we might mitigate them.

Regards,

Liz Petrov

Prepare the work that your line manager has requested.

(Time: 45 minutes)

Chapter 6

CORE ACTIVITY C: MANAGE PERFORMANCE AND COSTS TO AID VALUE CREATION.

SYLLABUS WEIGHTING

- 15-25%

ASSESSMENT OUTCOMES

- I can advise on the measurement, analysis and reporting on the performance of responsibility centres.
- I can analyse the processes needed to ensure employee engagement, empowerment and alignment to enhance individual and team performance.
- I can compare leadership styles and identify the most appropriate style to use.
- I can use appropriate cost management and cost transformation techniques to manage costs and improve profitability.
- I can identify and apply appropriate quality management techniques to enhance value.
- I can identify and apply value management techniques to enhance value. I can apply the techniques that quantify and present risk to stakeholders.

FAMILIARISATION TASKS

EXERCISE 1 – RESPONSIBILITY CENTRES

QUESTION:

“The divisions are investment centres for reporting purposes and each hotel is viewed as a profit centre.”

Discuss the difference between investment centres and profit centres and what this means for the ability of hotel managers to make decisions.

EXERCISE 2 – QUALITY MANAGEMENT

QUESTION:

List the four costs of quality and give examples of each in relation to the hotel’s cleaning service

EXERCISE 3 – STAKEHOLDER VALUE

QUESTION:

The identification of stakeholders is necessary to gain an understanding of the sources of risks and disruption when taking business decisions.

What approach may a business need to adopt when applying the concept of value to stakeholder analysis in the digital world?

EXAM-STYLE PRACTICE TASKS

PRACTICE TASK C1 – BALANCED SCORECARD

Trigger and Task

Your line manager has emailed you:

To: Financial Manager

Date: Today

Subject: Balanced scorecard

Hi,

I'd like to consider introducing some more performance measures across the business. We focus very much on the financials and on quality control, but I'm sure there are areas where we are falling behind because they are not currently measured, particularly in our individual hotels.

I'd like to take this to the board. Can you provide me with some briefing notes that I can use?

Please make sure that the notes cover an overview of the balanced scorecard and its perspectives, how it links to our mission and objectives and why non-financial measures are just as important as financial ones.

Please also include a discussion of appropriate measures for each of the non-financial perspectives that could help us evaluate and improve performance in the hotels.

Regards,

Liz

Prepare the work requested.

(Time: 45 minutes)

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PRACTICE TASK C2 – LEADERSHIP

Trigger and task

You receive the following email:

From: Zoe Diaz
To: Financial Manager
Date: Today
Subject: Hotel technology

Analysts are predicting that the hotel and hospitality industry will become increasingly reliant on technology.

For example, a recent article suggests that it is expected that the hospitality industry will see a new breed of hotel guests who will seek unique experiences personalised to meet their exact needs. The article suggests that in 2020, these “digital native” guests will want the ability to customise almost every aspect of their stay. In order to respond to the rising popularity of personalisation, hotels will need to implement more advanced reservation systems that empower guests to personalise their stay to their taste.

The Board are naturally concerned with these predictions and are currently engaging in very honest and open discussions about our leadership style in the digital age. In order for Alpaca to survive digital disruption within our industry, the executive leadership team will need to demonstrate key abilities. As I understand it, some of those abilities focus on internal processes, while others are driven by the external business environment.

There has been a lot of research in this area and I will be scheduling an agenda item at the next scheduled board meeting to discuss these issues.

To assist me in this context please could you prepare a briefing note which covers the following:

- What leadership styles might the board need to adopt in the digital age?
- Identify how these leadership styles apply to the Alpaca Group.

Zoe

Prepare the work requested.

(Time: 45 minutes)

Chapter 7

CORE ACTIVITY D: MEASURE PERFORMANCE.

SYLLABUS WEIGHTING

- 15-25%

ASSESSMENT OUTCOMES

- I can select and apply suitable tools and techniques for managing risk and uncertainty associated with performance related issues.
- I can select and apply suitable tools and techniques for managing risk and uncertainty in business models.
- I can use the financial statements to assess and report on financial performance and position, interpreting and reporting on a wide range of ratios.
- I can support managers by recommending actions to improve financial performance and position and assessing how suggestions impact on the wider organisational ecosystem.
- I can select appropriate accounting treatments and explain their implications for users of the financial statements.

FAMILIARISATION TASKS

EXERCISE 1 – RISKS OF APAS IT SYSTEM

QUESTION:

Identify some of the upside and downside risks involved in the use of Alpaca’s APAS software package.

EXERCISE 2 – ACCOUNTING FOR IMPAIRMENT OF HOTELS

QUESTION:

Some of Alpaca’s hotels in Alpaca’s ‘Northern Slopes’ (North) have recently suffered from poor customer reviews, particularly on social media. The principal reason for this appears to be disruption to the guest experience whilst refurbishments were taking place, and also due to adverse comments regarding the nature and quality of the refurbishments made.

One consequence of the poor reviews has been a significant fall in the number of advance bookings made for the following year. Normally, North can expect a number of guests to return the following year, and to book early to guarantee their choice of the dates and room allocation. The problems have also come to the attention of the press and have depressed the number of enquiries regarding bookings that would normally be expected.

Alpaca now needs to consider the potential impact this may have on the financial statements.

Explain how impairment of the hotels in the North would be determined and accounted for.

EXERCISE 3 – ACCOUNTING FOR REVALUATION OF PPE

QUESTION:

Alpaca revalued non-current assets during the year ended 31 December 2019 (almost certainly its some or all of its property portfolio, although this is not explicitly stated within the pre-seen information).

Explain the accounting treatment relating to revaluation of property, plant and equipment, along with how any fall in value should be accounted for.

EXERCISE 4 – ACCOUNTING FOR ADVERTISING AND MARKETING COSTS**QUESTION:**

Alpaca is considering incurring considerable costs to market and promote its City Central hotels to the business community in advance of the Maylandian Year of Culture in 2021.

All marketing and promotion costs would be incurred during 2020. The costs would include production of printed brochures by a specialist printer which referred to the year of culture and which would be distributed throughout business organisations in Maylandia and neighbouring countries to promote the City Central hotels to business users. The brochures would be available in late 2020 and would be used in late 2020 and throughout 2021. In addition, it is anticipated that advertisements placed in newspapers, radio and television would be published or broadcast throughout winter 2020 and spring 2021.

Explain the accounting requirements relating to the accounting treatment of the costs incurred if the marketing and promotion activity was undertaken.

EXAM-STYLE PRACTICE TASKS

PRACTICE TASK D1 – FINANCIAL PERFORMANCE

UPDATE

The Board of Directors, which includes non-executive directors (NEDs) will meet at the end of next week to evaluate Alpaca's financial performance and position in what has been a challenging time.

TRIGGER

This morning you received the following email from Finley Rae:

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

Hi

I wonder if I could ask you for some assistance.

I'm rather pushed for time and wonder if I could ask you to prepare an analysis of the financial performance and position of Alpaca? I would normally do this myself, but I have a number of other things which I'm trying to progress at the moment.

To keep it straightforward for me, please calculate appropriate ratios for Alpaca, and make any comments that will help the NEDs with their understanding of the financial information available.

I realise this is quite a significant exercise for you, but it would be appreciated if you could complete the work by Tuesday of next week, prior to the board meeting.

Thanks

Finley

TASK

Respond to Finley's email

Time: (45 Minutes)

UPDATE

REFERENCE MATERIAL**ANALYSIS OF PERFORMANCE AND POSITION****Alpaca - Ratio analysis**

Financial Statements (page 20-22)

		2019		2018
Revenue growth	(499-504) / 504	-1.0%		
Gross profit growth	(197-202) / 202	-2.5%		
Operating profit growth	(56-78) / 78	-28.2%		
Pre-tax profit growth	(41-62) / 62	-33.9%		
Post-tax profit growth	(34-54) / 54	-37.0%		
Gross profit margin	197 / 499	39.5%	202 / 504	40.1%
Operating profit margin	56 / 499	11.2%	78 / 504	15.5%
Pre-tax margin	41 / 499	8.2%	62 / 504	12.3%
Post-tax margin	34 / 499	6.8%	54 / 504	10.7%
Effective tax rate	7 / 41	17.0%	8 / 62	12.9%
Effective interest rate	15 / (395+103)	3.0%	16 / (398+99)	3.2%
Non-current asset utilisation	499 / 1,985	0.25 times	504 / 2,067	0.24 times
Return on capital employed	56 / (1,527+395)	2.9%	78 / (1,507+398)	4.1%
Return on equity	34 / 1,527	2.2%	54 / 1,507	3.6%
Current ratio	238 / 221	1.08 : 1	139 / 213	0.65 : 1
Quick ratio	(238-3) / 221	1.06 : 1	(139-2) / 213	0.64 : 1
Inventory days	(3/302) × 365	3.62 days	(2/302) × 365	2.42 days
Receivables days	(47/499) × 365	34.37 days	(39/504) × 365	28.24 days
Payables days	(110/302) × 365	133.00 days	(104/302) × 365	125.70 days
Working capital cycle	4+34-133	-95 days	2+28-126	-96 days
Gearing (D / (D+E))	395 / (1,527+395)	20.55%	398 / (1,507+398)	20.90%
Interest cover	56 / 15	3.7 times	78 / 16	4.9 times

Dividend cover – parent shareholders	34 / 17	2.0 times
Dividend cover – NCI shareholders		N/A
Dividend as % of profit – parent shareholders	17 / 34	50.0%
Dividend as % of profit – NCI shareholders		N/A

Consolidated SOCIE (not provided in case study scenario)

	Parent shareholders	NCI shareholders
	M\$m	M\$m
Retained earnings b/f	501	
Profit after tax for year	34	
Dividends	(17)	
Retained earnings c/f	<u>518</u>	<u></u>

Note: You will not be expected to perform detailed calculations in the real exam.

NB – it is appreciated that the volume of information in this task is over and above that which would be expected in the real exam. The task is included for analysis purposes to ensure that the assessment outcome ***“I can use the financial statements to assess and report on financial performance and position, interpreting and reporting on a wide range of ratios”*** is covered

PRACTICE TASK D2 – FINANCIAL REPORTING**UPDATE**

The Board of Directors, has recently taken a heightened interest in health and safety issues, following the release of its annual report on hotel hygiene standards in Maylandia. Lyn Hao (Marketing Director) is taking the lead on this issue on behalf of the Board of Directors.

TRIGGER

This morning you received the following email from Lyn Hao:

To: You (Financial Manager)
From: Lyn Hao (Marketing Director)
Subject: Information request – fines and penalties

Hi

As you are probably aware, Alpaca is subject to inspection and review by a number of regulators, not least the Maylandian Health and Safety Administration (MHSA). Given the extensive nature of this regulation and inspection regime, it is important that Alpaca has robust systems and procedures in place to minimise the risk of breaches of regulation.

I am aware that, on the whole, Alpaca has a good record of complying with relevant laws and regulations and that Alpaca treats these issue with appropriate seriousness, but there is always a risk that things may go wrong at some point and I would like to understand the financial reporting implications of such an event occurring.

As a related issue, it may be that some breaches of law or regulation may be regarded as more severe or significant than others, such as an outbreak of severe food poisoning in one of the Southern Resort hotels, compared with, say, one partially-lit (rather than fully lit) hotel corridor.

Could you:

- (a) explain the accounting requirements relating to when fines and penalties should be recognised in the financial statements? This should include reference to any additional costs incurred, such as 'deep cleaning' of the kitchen area following a food poisoning incident, before it is permitted to open again.
- (b) explain whether the two illustrative breaches noted above would be treated any differently in terms of the accounting requirements?
- (c) explain the financial reporting implications of breaches of health and safety regulations if, for example, it was established that the cause of the food poisoning was the supply of contaminated fish by a regular supplier.

Please respond before the end of the week

Prepare the work requested. (Time 45 minutes)

Chapter 8

CORE ACTIVITY E: MANAGE INTERNAL AND EXTERNAL STAKEHOLDERS.

SYLLABUS WEIGHTING

- 15-25%

ASSESSMENT OUTCOMES

- I can explain the financial reporting implications of additions to the group.
- I can explain the behavioural and transfer pricing issues associated with internal trading.
- I can explain the implications of Integrated Reporting for the reporting entity and its stakeholders.
- I can advise on the communication process. I can advise on the negotiation process.
- I can advise on conflict management

FAMILIARISATION TASKS

EXERCISE 1 – INTEGRATED REPORTING

Question:

Explain the purpose and objectives of preparing an integrated report.

EXAM-STYLE PRACTICE TASKS

PRACTICE TASK E1 – TRANSFER PRICING

Trigger and Task

Your line manager is on holiday. You have received an email from Zoe Diaz, the finance director.

To: Financial Manager

Date: Today

Subject: Transfer pricing

It has recently come to our attention that we have significant wastage levels of food in the restaurants attached to our hotels. We are implementing measures to try and reduce this wastage.

One such measure is to allow the transfer of surplus food, where it is within its expiry date and can be transferred safely without compromising food handling regulations, to other hotels that can make use of it.

Our initial thought was that the transfer should happen at zero value, but some hotel managers have insisted that a price be attached to it so that they don't lose out from supplying food to other hotels.

Could you provide me with some notes on transfer pricing, that cover:

The objectives of transfer pricing and how they fit this situation

The bases for setting transfer prices and a recommendation for an appropriate transfer price basis for the food.

Regards,

Zoe

Prepare the work that Zoe has requested.

(Time 45 minutes)

PRACTICE TASK E2 – FINANCIAL REPORTING

UPDATE

It is currently a busy time for the Board of Directors of Alpaca as it considers the implications of acquiring a new subsidiary.

TRIGGER

This morning you received the following email from Finley Rae (CEO):

To: You (Financial Manager)

From: Finley Rae (CEO)

Subject: Potential acquisition of a new subsidiary

Hi

In preparation for a directors' board meeting next week I wonder if you could prepare some briefing notes covering the following issues?

When making an acquisition, the Board of Directors of Alpaca has always acquired all of the issued share capital of the subsidiary acquired. I understand that it is possible to gain control of a subsidiary by acquiring the majority, rather than all, of the issued share capital. Consideration is now being given to acquiring a majority shareholding in a new subsidiary. This could be either a subsidiary in Maylandia, or in another country. If Alpaca did acquire a foreign subsidiary, then I expect that there will be some foreign currency issues to deal with when preparing the consolidated financial statements.

Please prepare some notes that I can circulate to the attendees at the meeting next week that explains:

- a) How non-controlling interest in a newly-acquired subsidiary can be measured upon initial recognition, and how this affects the calculation and accounting treatment of goodwill?
- b) How, if Alpaca did acquire a foreign subsidiary, are the financial statements of the foreign subsidiary included within Alpaca's consolidated financial statements? Note: I understand some principles of preparing consolidated accounts such as elimination of intra-group transactions, balances and unrealised profits etc. I'd like you to focus on the foreign currency issues only.

Thanks
Finley

TASK

Respond to Finley Rae's email.

Time: (45 Minutes)

PRACTICE TASK E3 – STAFFING ISSUES

Trigger and task

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

The trade union is less than happy at the news that we are pursuing the introduction of new technology in our hotels and in particular the flexibility of roles that this new technology will engender.

The union is concerned about the effect on its members in terms of future job security and current roles. I have been reliably informed that they will be meeting to consider taking industrial action imminently.

I am really concerned because some of our business customers have already expressed concern about whether we will be able to meet their needs if any threatened strike goes ahead.

Part of the problem is that the union believes that communication with our staff has been poor in the development of new processes and services. These basic concerns are correct in my opinion. We carried out a quick review and we remain very traditional in our approach to business and our communication is no exception in this context.

We need to be sure that, given the remote locations of some of our hotels and our increased use of technology between the hotel divisions, we really take advantage of all types of communication available to be sure that all relevant staff and stakeholders are kept well informed.

I need you to draft some briefing notes for an emergency meeting called by the CEO to cover the following matters:

Firstly, please provide some advice regarding the different approaches to digital communication our managers could take in this situation to deal with staff concerns.

Secondly, please outline a strategy for our negotiations with the trade union over the threatened strike action and future issues that may arise.

Senior Financial Manager