SECTION A

QUESTION 1

The following exhibits provide information relevant to the question

EXHIBIT 1: Company information – the background, organisation structure and current position of the company: Calavie Manufacturing (Calavie).

Calavie Manufacturing (Calavie) is a listed, multinational manufacturer of household refrigerators. It is made up of three divisions: Doilet, Essan and Fada.

- Doilet makes basic refrigerators which are sold across all of its geographical markets.
- Essan makes high-quality, premium-priced refrigerators for sale in the wealthier markets in which it operates.
- Fada makes a variety of hardware and software systems which link refrigerators and other household goods to a home management system which, for example, in the case of the refrigerators, will automatically scan the contents of the refrigerator and reorder food from web-based suppliers as required.

The business has concentrated on growth over the last five years but its weak share price performance has led to complaints from its investors, who feel that their wealth is not being maximised. The board believes that they need to take an overview of the whole business, beginning with its performance measurement methods. They have engaged a consultant to perform a Boston Consulting Group (BCG) analysis of the position of the three divisions and from this, they want to look in more detail at the performance measurement and management issues within each division.

EXHIBIT 2: Divisional performance measurement – details of the overall, strategic performance indicators for assessing the performance of Calavie's divisions and the work required by the CEO on this area.

Calavie uses return on investment (ROI) as a strategic performance indicator to assess the three divisions. There has been debate at the board level as to whether this is an appropriate divisional performance indicator. The bonuses of the management of each division are assessed against this indicator. As the year's performance report is being prepared, the chief executive officer (CEO) has suggested that you evaluate the performance of the three divisions using both ROI and a suggested replacement, residual income (RI). As part of this work, she wants you to include an analysis of the different ways these measures could be calculated, taking into consideration the effect of head office costs and the effect of the research and development and brand marketing costs. She needs the calculations you provide to be clear and justified. She also wants you to evaluate the appropriateness of ROI and RI for divisional performance measurement. At this stage, she does not want any other indicators to be considered. She has supplied you with data in Appendix 1 to do this.

EXHIBIT 3: BCG analysis – instructions from the CEO regarding how she wants a BCG (Boston Consulting Group) analysis prepared by a consultant to be applied to Calavie's divisions.

The consultant's BCG analysis is given in Appendix 2. The CEO wants you to assess how this can be used to assist in performance management generally and then, using your knowledge of performance measurement to apply it to each division in turn, recommending, with justification, up to two suitable, financial key performance indicators (KPIs) for each division.

EXHIBIT 4: Management information – explanation of the current information systems used by the divisions and the advice requested by the CEO for the board on a good approach to management information.

The existing information systems at Calavie have been developed within each division and the divisions separately supply reports to head office for use by the company's executive.

Each division operates on a functional basis with its own manufacturing, sales and marketing and administration departments. As a result, the board feels that they lack a clear understanding of what is driving the performance of each division. The CEO wants to redesign existing information systems to bring the divisions and the board into a closer connection. However, as this project has not yet begun, she feels that the board needs a broad understanding of a good approach to management accounting information. Therefore, first, she wants an explanation of the general aims of management accounting information at the different levels of the organisation and then second, the board needs your advice on how applying the qualities of good information can improve the communication from Calavie's divisions to the company's executive.

EXHIBIT 5: Appendix 1 – financial performance data for the divisions for year ended 30 June 20X5.

Calavie Manufacturing

Divisional performance (Year ended 30 June 20X5)

	Doilet	Essan	Fada
	$m	$m	$m
Revenue	484	223	32
Variable costs	248	81	10
Divisional overheads	94	41	5
Research and development	0	1	8
Brand-building marketing	5	12	0
Apportioned head office costs	36	14	2
Total operating costs	383	149	25
Operating profit	**101**	**74**	**7**
Restructuring costs	0	11	0
Profit before tax	**101**	**63**	**7**
Capital employed	615	261	31

Notes:

1. The notional cost of capital used is 11% per annum
2. The current cost of debt is 6%
3. Essan moved its main office to a prestigious new building incurring res
4. The average return on investment for the industry is believed to be 15
5. The research and development and brand-building marketing costs are made by the divisions for the long-term benefit of Calavie

EXHIBIT 6: Appendix 2 – the consultant's BCG analysis.

Key features of the divisions:

Doilet makes basic refrigerators for use across all of its geographical markets. The management aims to be a cost leader in its markets which are not growing significantly.

Essan makes high-quality, premium-priced refrigerators for sale in the wealthier markets in which it operates. The divisional management has successfully created a market-leading brand which is seeing high growth in both sales and profits as its markets are becoming wealthier still. However, the competition and requirement to spend heavily on brand-building makes this a riskier business sector.

Fada was set up to create a system to link refrigerators to a home management system. This project was initially successful and as a result, it was realised that there were other opportunities to link household items into the internet. Fada has pursued a number of such development projects to launch a number of new products. However, there have been technical difficulties and varying levels of sales of these new products. As a result, Fada is only one of many similar sized companies within this market segment and it has seen weak financial results, while requiring considerable investment to support its development.

BCG categorisation:

Doilet can be reasonably treated as a cash cow as it is one of the two largest businesses by market share in a low growth market.

Essan is the star of Calavie as it is the market leader in a rapidly growing market.

Fada is a problem child as it is in a high-growth market but does not have a large market share.

REQUIREMENTS

It is now 1 September 20X5.

Write a report to the board of Calavie to respond to the CEO's instructions for work on the following areas:
(i) divisional performance measurement

(16 marks)

(ii) the BCG analysis

(18 marks)

(iii) management information at Calavie

(12 marks)

Professional marks will be awarded for the format, style and structure of the discussion of your answer.

(4 marks)

SECTION B

QUESTION 2

The following exhibits provide information relevant to the question

EXHIBIT 1: Company information – the background, industry and operating conditions of the company: Vaa.

Vaa is a manufacturer of electronic consumer goods. It is made up of two divisions, R division and S division, and a head office which provides the overall management of Vaa. Both the divisions and head office are based in Essland, where they manufacture all goods and where there is currently an economic recession. The corporation tax rate in Essland is 25%.

A large proportion of the electronic goods manufactured by R division use a key component which R division transfers in from S division. There are several companies throughout the world who manufacture a component which fulfils the same function as the component produced by S division. The component produced by S division, however, has much lower energy consumption than those of its competitors.

Both R and S divisions are profit centres. Both have the autonomy to be able to negotiate the price at which the key component is transferred between the two divisions and to be able to choose whether to purchase or sell the key component externally.

EXHIBIT 2: Transfer pricing – details relating to the problems of setting transfer prices between the R and S divisions.

Despite R and S divisions having similar revenue and capital employed, R division has only broken even in recent years, whereas S division has made substantial profits. R division managers have complained that this is due to the high transfer price for the key components which are transferred from S division.

Head office is concerned about the amount of time divisional managers spend arguing about a suitable transfer price, when their efforts would be better focused on other important areas of the business, such as finding ways to utilise spare capacity.

There is also concern from the head office that the divisions negotiate in a self-interested way, so that head office often has to intervene and impose a transfer price which maximises the performance of Vaa as a whole. Head office is considering setting up a formal transfer pricing policy.

R division managers have proposed that the components be transferred at the market price in future, because they believe that R division should have a share of the cost savings which S division would make compared to if S division sold externally, such as administration costs and bad debts.

Head office understands the potential benefits of this approach but not the disadvantages.

EXHIBIT 3: International acquisition – information about the possible acquisition of a subsidiary in Teeland and the factors to be considered when determining international transfer prices.

Vaa is considering acquiring a subsidiary in the country of Teeland, which would be known as T division and would also be managed as a profit centre. Teeland is one of the largest producers of electronic consumer goods in the world and uses a different currency to Essland. The Teeland government is concerned about the level of competition to local manufacturers from imported goods and is considering introducing a range of protectionist measures, for example, the introduction of import tariffs, to deal with this. The corporation tax rate in Teeland is 16%.

Vaa plans to use the key component manufactured by S division in T division's products and has asked for advice on the factors which it should consider when setting international transfer prices, assuming the acquisition goes ahead.

REQUIREMENTS

(a) Advise Vaa on the criteria for designing a formal transfer pricing policy for its two divisions in Essland.

(9 marks)

(b) Explain the disadvantages for Vaa of using market-based transfer prices.

(8 marks)

(c) Advise Vaa on the factors it should consider when setting international transfer prices in relation to the potential acquisition in Teeland.

(8 marks)

QUESTION 3

The following exhibits provide information relevant to the question

EXHIBIT 1: Company information – the background, mission statement and structure of the company: Breac.

Breac is a sports clothing goods company which operates globally. It purchases sports clothing goods which have already been partly manufactured, completes the manufacture of the goods and then sells these goods through its global retail outlets.

Breac's mission is to be the best sports clothing goods company in the world.

Breac has 25,000 employees and a turnover of $8 billion approximately. Each country of operation is classed as an individual strategic business unit (SBU).

EXHIBIT 2: Manufacturing agreement – details of a manufacturing agreement struck between Breac and another company: Gowan.

Breac has agreed with Gowan, a large global manufacturing company, that Gowan will manufacture the major part of all sports clothing goods for Breac. Breac will then complete the manufacture of these clothing goods. This completion work includes Breac adding its own brand name, specialist climate cool material and synthetic waterproof fabrics. Breac will then despatch the clothing goods to its retail outlets.

Breac's manufacturing departments have highlighted that the clothing goods received from Gowan are often neither up to the required standard nor delivered on time. Problems have also been identified in both the retail outlets and by the end-user which have been attributed to the poor quality of material supplied by Gowan. Specific quality problems have included stitching disintegrating, poor quality of material and clothing goods being incorrectly sized.

Breac and Gowan each have their own individual information systems. Breac's is an advanced computerised system whereas Gowan's is more basic and parts of it are manual. The two companies' systems are unable to communicate with each other.

Breac's staff at various levels in the organisation have suggested that a formal service level agreement (SLA) with Gowan is required if the agreement is to continue.

EXHIBIT 3: Value-based management – information about the possible introduction of value-based management (VBM) at Breac.

Breac's chief executive officer (CEO) was recently at a presentation on value-based management (VBM) where the main presenter indicated that it was a management methodology best suited to a large-scale manufacturing company such as Breac. VBM was further explained as a methodology which takes the idea of creating value through the return of future cash flows and embeds this in an organisation's culture. It should align all a company's processes with the key drivers of value.

An example of Breac's strategic performance report is provided in Appendix 1. This strategic performance report is produced by each SBU for the Management Board of Breac on a monthly basis. The format and structure of this strategic performance report has not changed in three years.

The CEO now wishes to investigate the possibility of using VBM in all of Breac's SBUs and he has asked you, as an external consultant in this area, for your views on this. He has indicated to you that he specifically requires you to consider the effect of the introduction of VBM on the measures in the example strategic performance report.

EXHIBT 4: Appendix 1 – an example of Breac's strategic performance report.

EXAMPLE OF BREAC'S PERFORMANCE REPORT

Financial
Sales revenue
Gross profit margin
Operating profit margin

Manufacturing
Percentage of goods returned (from either end user or the retail outlet)
Percentage of goods produced and delivered on-time to the retail outlets
Number of stock-outs per month per retail outlet (Note 1)

Marketing
Marketing spend
Marketing contribution to revenue (Note 2)

Notes:
1. A stock-out is when the retail outlet does not have inventory of a particular product.
2. The percentage of overall SBU revenue that can be traced back to the marketing team's efforts.

REQUIREMENTS

It is now 1 September 20X5.

(a) Assess the problems which may be faced by Breac when developing a service level agreement (SLA) with Gowan.

(10 marks)

(b) Evaluate how the introduction of VBM would affect the current measures in the strategic performance report prepared by the SBUs and recommend, with justification, as to whether VBM should be introduced at Breac.

(15 marks)