Mini Mock – Suggested Answers

Operational Case Study – November 2023 / February 2024

Section 1

<u>Disposal of equipment</u>

Impact on our financial statements

Out of all the equipment we are selling, some of the assets may not be sold by the year end. These must be treated according to IFRS 5 – Noncurrent assets held for sale and discontinued operations.

To be reclassified as an asset held for sale, an asset needs to be available for immediate sale in its present condition and its sale must be highly probable.

A sale is highly probable when; management are committed to sell the asset, there is an active program to find a buyer, the asset is marketed at a reasonable price, the sale is expected to take place within 12 months, and it is unlikely that the plan to sell the asset will change.

If the above conditions are satisfied, such assets should be valued at the lower of carrying value and fair value less costs to sell. We should not depreciate the assets any longer and it should be shown under current assets instead of non-current assets.

If we are disposing all the assets by the year end, we will depreciate the equipment up until the date of disposal and calculate a profit on disposal of C$ 600,000 less C$ 140,000 (which is the carrying value at the date of disposal).

The asset will be derecognized in the statement of financial position and the profit on disposal amounting to C$ 460,000 will be recognized in the statement of profit or loss. In addition, the statement of cash flow will show the C$ 600,000 as proceeds from the sale of property, plant and equipment.

Impact on our tax charge

The sale of equipment will give rise to a capital gain which will be chargeable to tax at the corporate tax rate of 25%.

The amount of the capital gain will be the proceeds of sale amounting to C$ 600,000 less the original cost of the equipment of C$ 350,000 less the tax depreciation available for the period from the date of purchase, until the date of sale of 31st December 2023.

The tax depreciation will be calculated at the tax depreciation percentage of 25% per year on reducing balance basis which is relevant to the period multiplied by C$ 350,000.

KPI measures: Packaging material suppliers

Number of late deliveries: We deal with multiple suppliers which manufacture packaging material which are specific to Personal Best. It could be that most of these suppliers are based in different parts of the country. Therefore, it is inevitable that there will be a period between ordering and receiving packaging material (lead time).

Therefore, it is important for our production planning to ensure that we don't end up holding excessive inventory levels and that our suppliers keep to their lead times. Therefore, a useful performance measure would be to keep track of the number of late deliveries (as measured against expected lead time) for each supplier.

Percentage of returns due to poor quality: The quality of our packaging material is central to the quality of products we sell. We should therefore make sure that quality of all packaging material received is as expected and return any that fail this inspection. Regular tracking of the percentage of returns against total deliveries by suppliers will allow us to assess which suppliers are failing in terms of delivering high quality, PB branded packaging material.

Number of supplier queries taking more than two days to resolve: One of the issues with packaging material suppliers was that it was extremely difficult for our procurement employees to reach them to communicate delays in orders or any other procurement related inefficiency.

Therefore, another performance measure for all our suppliers could be linked to how quickly and efficiently they deal with queries. We need to have suppliers which we can work collaboratively with, especially since we procure packaging material which are customized to include PB's logos & design.

The CGMA Cost Transformation Model

Engendering a cost-conscious culture

To be successful, any business needs to be conscious about all types of costs and how these behave. Hence, Personal Best needs to be clear about how it intends to use its economic resources, both at present and the future.

Thus, we need to plan acquisitions of raw material, packaging and accessories, and their respective inventory cycles. Further we need to plan staffing levels to optimally utilize our economic resources.

This type of cost consciousness needs to be inculcated into the culture of the organization, thus enabling our managers take decisions to make optimal use of economic resources while maintaining our reputation for quality. Further, such a culture will drive our employees to achieve utmost levels of cost efficiencies as well.

Managing the risk inherent in driving cost-competitiveness

A successful business needs to consider the risks associated with cost reduction. For instance, Personal Best can reduce inventory cycles to drive costs down. However, such a move could expose the company towards a multitude of risks linked with stock-outs, thus affecting the brand reputation in a negative manner.

Hence, we need to achieve a balance between quality and costs. Personal Best needs to ensure that any cost management measures which are introduced do not lead to a deterioration of customer experience.

Understanding cost drivers, cost accounting systems and processes

It is of utmost importance that an organization understands how costs are generated in the organization. For Personal Best, this means understanding drivers of costs within the organization. After identifying cost drivers, Personal Best can focus to achieve cost efficiencies which leads to cost savings.

Personal Best could use activity-based costing to identify cost drivers and plan for cost efficiencies. This leads to a better understanding of key cost drivers, and the company can then focus on reducing these cost drivers. In addition, accurate costing leads to better profitability.

Connecting products and profitability

This part of the model is involved with making sure that the services offered by Personal Best contributes positively to profit. To achieve this, costing initiatives need to be carried out accurately, which helps us understand unprofitable sections that can either be removed from the company's portfolio or the costs associated with the product can be managed appropriately.

In Personal Best, we offer a plethora of pre-and post-workout snacks. We need to ensure that each of these products are making a positive contribution to profit. One method of achieving this is to adopt a more accurate and detailed costing system such as activity-based costing.

Generating maximum value through new products

When introducing new products, a company needs to ensure that it identifies the exact needs of customers and how much customers are willing to pay for products or services offered. Further, we must meet our profitability targets when introducing a new product as well.

To commence this exercise, we must identify the type of products offered by Personal Best at present and compare it with needs of customers to identify a gap. If a gap exists, then we can come up with action to close the gap, thereby gaining maximum value through our product offerings.

Incorporating sustainability to optimize profits

A company needs to embrace environmental concerns to contribute positively towards sustainability. This will bring positive brand recognition as well as increased profitability through reduced costs (via reduction of waste for instance).

Incorporating sustainability should be of utmost importance to Personal Best. The organization will need to have an increased emphasis on energy efficient machines and improving manufacturing efficiency. In fact, Personal Best believes in sustainability, given that it strives to be Carbon Neutral within four years, whilst engaging in ethical sourcing practices.

Additionally, we should consider publicizing the environmental costs of our production processes so that customers can evaluate our footprint in manufacturing. Doing so would bring positive reputational effects which will help fulfill customer needs, and at the same time safeguard the environment.

Section 2

<u>Sales variance report for the Protein Bar Range</u>

Sales price variance

The sales price variance is calculated as actual selling price less the budgeted selling price multiplied by the actual sales volume. In our case, the sales price is adverse for products Peanut and Almond. This is because we offered a 20% discount per Peanut bar to mitigate reputational damage. Further, to boost sales volumes, a 10% discount was offered on Almond Bars, thereby bringing down the actual sales price to approximately C$ 19.

However, the sales price variance is favourable for Cashew Bars, due to Personal Best charging an additional price of C$ 2 per bar, given the inclusion of organic cashews.

Sales mix profit variance

The sales mix profit variance is calculated as the difference between actual sales at the budgeted mix and actual sales, multiplied by the standard profit per unit. To analyze each sales mix variance, we need to identify the products with the highest and lowest profitability.

If a higher proportion of profitable products were sold (for instance, Peanut Bars), then the sales mix profit variance will be favorable. If a higher proportion of less profitable bars were sold (Cashew Bars), then the variance will be adverse.

In our case, we have exceeded sales budgets for Almond and Cashew Bars, which has contributed towards a favorable sales mix variance. Further, it is probable that we were able to sell a higher amount of Almond and Cashew Bars, given the success of the marketing campaign carried out for Almond Bars backed by a discount of 10% (which contributed towards an increased demand for Almond bars), and due to the excellent review Cashew Bars received on a leading fitness magazine.

Note that we sold a lesser number of Peanut Bars compared to budgeted sales, and the mix variance for the product category is adverse. This is so even after offering a discount and running a marketing campaign.

Further, we have exceeded the budgets for both Almond and Cashew Bars, the least profitable of our products, while selling an extremely low amount of our most profitable product (Peanut Bars). Thus, the overall sales mix profit variance is adverse.

Sales quantity profit variance

This variance is calculated as the difference between the actual sales volume at budgeted mix and the budgeted sales volume, multiplied by the standard profit per unit. The total sales quantity variance is adverse since we only sold 709,700 units of Protein Bars overall, which is lesser by 450,300 units (1,160,000 – 709,700 units) compared to our budgeted sales units.

When analyzing each product, we can see that the sales quantity profit variance is adverse across all product ranges. This is normal, since we have sold a lesser number of units in total, compared to the budget. Although we have exceeded sales budgeted in two product categories (Almond and Cashew Bars), the significant drop in sales of Peanut Bars (due to the quality issue) has an overriding effect on sales quantity, thereby making the overall variance adverse.

Planning and operational variances

Standards are normally based on the anticipated environment. If the environment is significantly different from the expected environment, actual performance should be compared with a standard that takes account of these changed conditions. This would provide a more meaningful measure of managerial performance. This is particularly important if performance is linked to pay and rewards.

It could be argued for example, that the impact of the discounting on the Peanut and Almond ranges should be shown separately as a planning variance. The standard selling price should have been based on the average discounted price and not the normal selling price.

Similarly, the quality issue in our Peanut range (due to purchasing expired ingredients) could not have been anticipated when the budget was set. It would not be appropriate however to separate the price variance in isolation, since a reduction or increase in price would be expected to have an impact on the sales volume and mix. Therefore, splitting the price variance into planning and operational variances would also involve splitting the mix and quantity variances.

Further, it is not too clear as to who has control of pricing of products, especially since discounts were offered on Peanut and Almond ranges, while the price of the Cashew range was increased. If the pricing decisions were not within the control of the Sales Heads, then the price variance should be shown separately as a planning variance.

Conversely, if the discounts were determined by the Sales Heads, the variances should be depicted separately as operational variances.

Planning variances may not be controllable; however, they do provide some useful information for managers on the accuracy of their planning and could help to improve the accuracy of future plans. It may be that the sales volumes and mix used in the budget were inaccurate and therefore at least some of the variance should be treated as a planning variance as it is outside the control of the operational managers.

On the other hand, operational variances are controllable and so they provide a better measure of the operating efficiency. If we are trying to assess the performance of Sales Heads, it would be better to separate out the planning variances from the operational variances. Failure to separate the variance may result in demotivation of the heads if they are being held responsible for variance that they cannot control.

Managing redundancies in an ethical manner

The automation to be adopted within packaging operations will result in a surplus of workers. To address the gap between labor supply and demand, we can explore the following options.

Internal transfers

Although the individuals in question are currently engaged with packaging operations, they may have skills and capabilities that might be applied within another division related to production.

This would be a cost-effective option that would also result in boosting motivation of the affected employees. However, this option can only be used if other divisions within the production department has adequate work to assign to newly transferred employees. Further, the employees who are being transferred will have to agree to this.

Job placements

If internal transfers are not possible, we may be able to assist them in seeking work in other companies. We might provide them with career counseling, CV writing advice, and job interview preparation, as well as arrange for the services of outplacement specialists (Headhunters).

Voluntary retirement scheme (VRS)

We should explain the situation to the employees and ask some of the employees to accept voluntary retirement. Because of the retirement benefits we must provide; this would be an extremely expensive option. However, it will ensure that the redundancy process goes as smoothly as possible.

Paid time off work

We could offer these employees one or two months of paid leave, thereby providing them adequate time to look for other jobs and attend job interviews, without having to worry about missing work. This will also help to lessen employee resistance towards the redundancy process.

Redundancy

This should be the last option to be considered by Personal Best. We have the legal authority to lay off employees because the changes in packaging operations will inevitably result in job losses.

However, since this is an unfavorable outcome for employees, we must offer compensation to guarantee that employee interests are respected while sticking to any established and agreed-upon procedure.

I hope that this information would satisfy your need. Please contact me if you need any further explanations.

Finance Officer