

MCS - Mock 3 - Piping

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Please find the tutor comments in red text + in the comments column.

SECTION 1

Brief Note.

A, New Genmaicha green tea variant.

Business model is all about defining, creating and delivering value to those that the value is to be provided for. with reference to Piping business model.

Create Value.

This is all about knowing what the consumers want and create value base on their need. Piping does this by educating the customers that by providing high quality products with quality packages, they are been identified by their brand which provide value to them.

In terms of the new genmaicha green tea, the customers are not carried along, this need brand of tea that goes against piping business model is created for profit making. the principles on which piping operates is been ignored.

Define Value.

This is about identifying the value that is needed and to whom. Piping does this by getting feedback from the consumers on what they want and this is implemented in the creation of quality product, quality packages and their brand.

Going with the new genmaicha green tea, this is going against our value which is to the apply the consumers feedback to any product. Also we pride ourselves in the production of good quality product and quality packages. using cheap packaging and providing lower quality tea is against Piping business model.

Deliver value.

This is all about provide value that the customer wants. in terms of piping, this is delivering to them the high quality product that they expect from us and the quality packaging will pride our selves in delivering. the delivering of high quality goods is a justification of our charging premium price.

With the new genmaicha green tea, the price of the tea will be sold at a lower price at the expenses of the quality in order for it to be affordable. Also using cheaper packaging alternative. This also go against Piping business model and vision which is to deliver high quality goods to his customers.

Capturing Residual value.

This is about creating value for them selves and others which is shared between us, the stakeholders and the shareholders. piping does this by buying high quality raw materials and products an value to its manufacturing process to justify selling at a higher price. It also support growers through paying realistic prices, It controls cost through operating efficiency manufacturing process.

In the terms of the new gemaicha green tea, they do not even have the machine that will be use to produce this new variant of tea, also due to capacity constraint and technical complexities, we may not be able to capture residual value if we go ahead to invest in this new brand of green tea.

In conclusion, the answer for the above requirement falls slightly below the pass standard due to:

- 1) incorrect explanations of the Piping's business model and
- 2) lack of "evaluation" – the analytical part.

Refer the suggested answer to get a clear picture the range of points that you can discuss in terms of "evaluate".

B, Implication of Insourcing and Outsourcing the Newgreen Tea.

Insourcing.

Insourcing is when we decide to keep the production of the green tea in house. however doing this has both merit and demerits.

Comment [TCS1]: Ideally, you should restate this as mentioned in the pre-seen.

Comment [TCS2]: Unclear what you meant by "customers are not carried along"

Comment [TCS3]: According to the pre-seen this relates to "Create Value"

Comment [TCS4]: Correct!

Comment [TCS5]: Not accurate. Study the explanations given in the pre-seen in preparation of the exam as you have to state it as it is.

Comment [TCS6]: While this point is correct, it does not relate to the "delivering value" aspect of Piping's business model.

Comment [TCS7]: This is correct!

Comment [TCS8]: Do not refer to the company you work for as "they"

The merit of keeping production in house is that the same 700 staffs employed to manage and monitor the manufacturing and production process will be used, we will not need to pay for additional manpower to do the work.

Comment [TCS9]: This is questionable since we have to increase the production capacity, isn't it?

Also We may not need to source for new raw materials, for some items can be taken from the existing materials to produce the green tea, with the expectation of adding the new ingredients.

The demerit of keeping the production in house are .

The staffs have been trained to produced high quality product and packages, since the new tea is of lower quality and packages, we may need to train additional staffs on how to lower their standard to do this.

Comment [TCS10]: Correct!

We have been told that there is capacity constraint, this means we may need to find a new factory to produce this need tea which will add to the cost of production. Also new machine is required meaning we will need an up front cost to purchase machinery if we decide to keep it in house.

Comment [TCS11]: Good points!

The market of low quality product is new to us, we are not sure how our customers will reach and accept this product since we are compromising on our known premium standard to provide this.

Comment [TCS12]: This will be applicable regardless of whether we insource or outsource, right?

Outsourcing.

Outsourcing is when the production and manufacturing of a product is contracted to a third party to undertake on our behalf. However this has its merit and de merit.

merit of outsourcing green tea.

The new green tea brand will be handled by professional and expertise that are trained to provide this brand and who might have done similar brand.

Comment [TCS13]: Good!

Also they will be doing the selling and marketing for us, since they are external agencies (Maryland), all the risk and reward of the tea production and aftersales services will be done by them not us.

Comment [TCS14]: No, they will not. Scenario does not say so.

By outsourcing the tea, the issue of going against our business model will not be noticeable since the production and sales of the tea is handled by a third party -Maryland.

We will not need to purchase the new machinery or look for new factory to produce the new green tea, thereby saving on the initial investment needed.

Comment [TCS15]: Correct!

Demerit of doing this is that we will loss on the expert skills, knowledge and experience of producing this new green tea, which will have been a plus to us if this was done in house.

The cost of outsourcing is expensive, we will have to pay them a fees for providing the service. It will also free us from paying depreciation cost for the machinery and rental cost for the new factory if it was done in house.

Comment [TCS16]: This is a merit right? It should have been included under "merits".

All documentation to the production of the new tea will be kept by Maryland instead of it been with us. this means they will have to be handling all production and sales, a continious cost we will need to factor into our expenditure.

In conclusion, I will recommend we outsource the production of the new green tea to Maryland because this will save us the costs of purchase of the new machinery, looking for a new factory and also training staffs on the production and manufacturing process.

Finance Manager.

The answer for the above requirement does carry some good points. However, there seems to be a misunderstanding about outsourcing in that you have assumed that sales and marketing would also be outsourced, which is wrong.

The points on merits and demerits could have been more structured to improve clarity.

SECTION 2

Brief Note.

A, Good will calculation and its presentation in the financial statement.

Good will is an intangible asset and it arises when we sell a company to another company, in this case we are acquiring/ buying GHK to produce and sell Genmaicha green tea. the sales should be done at fair value (market value) .

Good will is the portion of then purchase price that is higher than the sum of the net fair value of the purchased asset.

In the sales of asset, if the value of goodwill remains the same or increase this will be treated as an impairment of good will as per IAS 36 Intangible asset and will be recorded in the statement of profit and loss account .

The good will amount will be recorded under intangible asset in the statement of financial position.

Also since the good will purchase is not in the same currency as Piping, (N\$) will need to convert the currency as per foreign exchange currency in IAS 21. The impairment of good will calculation will be recorded at the average rate in the statement of profit and loss, while the amount going to the statement of financial position will be recoded at the closing rate.

We will need to prepare both group accounts and subsidiary accounts as per IFRS 10 Consolidated accounts, due to GHK retaining 10% of the shares.

However the goodwill accounting treatment will be recorded in the consolidated accounts.

Unfortunately, you have missed the second part of the requirement in this task. Refer the screenshot from the mock paper below.

Please prepare a briefing document for me which includes:

- Firstly, explain how goodwill will be calculated if Piping acquires GHK **and** how the acquisition would be presented in the financial statements.

(sub task (a) = 60%)

Pay close attention to the word "and"

B, Financial and non Financial factors in acquisition.

Before an acquisition is made, we will need to consider various factors. this will be both financial and non financial.

Financial factors to consider are:

We will need to carry out a due diligence on GHK, to find out their reputation, their relationship with customers and suppliers, with the communities to establish what we are getting in to. Also is there any problems to be inherited.

Do will have the initial investment to purchase the good will, also are we willing to add GHK as our subsidiary, since they are retaining 10% of the shares, this need to be agreed by the share holders. having them with us will lead to dilution of our shares.

How are we sourcing for the fund to acquire DHK, are we going for debt or equity finance, it will be cheaper for us to go for debt finance since it will be cheaper and it carries a low risk.

If GHK are a company well known in the market, the purchase of them will be a bonus for us, for there will be less marketing and advertising to do.

Comment [TCS17]: "Goodwill" is a single word ☺

Comment [TCS18]: While this explanation is correct, it is better if you explain the meaning of goodwill and how it is calculated in a similar way to how it has been explained in the first para of the suggested answer for this requirement.

Comment [TCS19]: It is not relevant in the context of the scenario. You are only expected to talk about goodwill arising on acquisition.

Comment [TCS20]: Consolidated statement of financial position

Comment [TCS21]: You have correctly identified the need to apply IAS 21. Great work ☺

Comment [TCS22]: This is correct. But these are non-financial factors right?

Comment [TCS23]: Wrong wording. It must be "... funds to purchase a 90% stake?"

Also in the acquisition of a company, we will be taken over their staffs and directors (90%) we will need to consider their terms of employment to see if there is any clause to be dealt with. For those who are asset to the company, we will need to offer them a reward incentive such as if they stay with us for a number of years to train our staffs and give us time to learn the trade fully, we will offer them x amount.

We will save on staff training cost since we already have the acquired staffs with the expertise, experience and skills to do the Job. Also we will not need to buy new premises and machinery since we are acquiring an existing one.

The current DHK Factory, has it been purchased out right by DHK or are they under a lease agreement, if so what are the terms of the lease, can the lease clause be broken or do will need to continue with the existing agreement despite the fact that they are coming under a new management.

The discussion of financial factors should be mainly based on the statement of financial position of GHK provided in the attachment. The numbers in the attachment were given for a reason, and you are expected to draw from it and construct your points.

Non financial factors to consider are.

We pride our selves in our brand and production of quality products, this is done through the use of quality machineries, we need to check the quality of machineries GHK has, for if they are old or not up to standard compare to ours, this will mean we will need to invest in the purchase of new equipment which will be a huge capital cost on our part, it is essential will factor this into the acquisition cost if agreed.

Also is there any pending court case, any bad publicity from social media or the press, all this also need to be checked. How are they with co operate social responsibly, we are a listed company, it is essential we acquire a company this has similar reputation to us.

How are the raw materials needed for the production of the new green tea sourced, are they easily available, if yes where, are the suppliers known. Will there be an issue of forex when sourcing for them or in case of changes in legislations, can will find local suppliers to minimise cost of foreign exchange, this will need to be taken into consideration as well.

Finance Manager.

Comment [TCS24]: Not sure why you mentioned 90%? If it's going to be a subsidiary, then we will have control over the entire company.

Comment [TCS25]: This is not an immediate concern when deciding whether to acquire a company or not, right?

Comment [TCS26]: You are contradicting your own point in the preceding paragraph where you have mentioned that we need to train the staff.

Comment [TCS27]: Good!

SECTION 3

Brief Note.

A, Determine Retail price for the new green tea.

Retain price can be determine by using the cost plus mark up price model

This makes us of the total cost of goods plus adding a fixed percentage (mark up) to arrive at the total cost of the product that we will be selling to consumers/customers.

This is a good way to increase the profit margin using mark up.

We can also use cost plus marginal cost model.

This makes use of adding the cost of labour, overhead cost, material cost and then add the mark up. This will factor in all the cost of raw materials into the cost of production. However overhead cost cannot be traced back to the cost of production.

This is particularly useful when we want to use price differentiation whereby we will be having different pricing for different locations, depending on the types of customers in each locations.

Piping can determine the retain price to use by going with the cost plus marginal cost model that makes use of price differentiation. this will be useful to piping since they will be selling the tea at different countries. The product cost of the tea will then be determine by the types of customers in each location, how develop the countries are and how popular the sales of tea is in the location.

As you said, you seem to have not understood the requirement correctly but props for coming up with a response. Hope you were able to refer to the suggested answer and get an understanding of the requirement.

B, Choose of retain pricing strategy.

We will be going with the price differentiation strategy. This is because all the production cost of each raw materials will be capture in the unit cost.

SECTION 4

Report

A Legal Issues-Accounting treatments.

IAS 37 provisions for contingent liabilities and contingent assets is define as a present obligation because of past event, legal or constructive.

IAS 37 is only recognised when there is an announcement. In the case of Genmaicha tea, the tea packaging labelled wrongly and dispatched to the consumer is an announcement to the public. Also, since any official complain has being made to the consumer affairs authority, this is now a present obligation and an announcement has been made. A lawsuit is in avoidable.

Going to court will damage our reputation, even if we choose to settle out of court, we still need to make provisions for contingent liabilities in the statement of financial position.

We will need to recognise contingent liabilities in accordance with IAS 37.

An initial cost may need to be paid, pending further negotiation of the final amount, if this is the case, the initial payment will be recoded in the expenditure side of the statement of profit and loss account. Any final payment agreed, the initial payment made will be deducted and the final balance will be recorded in the liabilities side of the statement of financial position.

Also, some compensation payments may need to be made to retail business, this will need to be accounted for under contingent liabilities.

You have got some basic points right, which is great. However, the answer needs to be more technically accurate. Please refer the suggested answer to get a clear picture.

B, Leadership.

Leadership is when we work together as a team with the skills and experience of both the organisation and that of each team members to achieve the company's organisational objectives. It is all about delegating, monitoring and follow up on tasks assigned to each team members.

In the case of Piping, leadership involves working as part of a team whereby staffs are delegated task in various department such as raw materials, work in progress, finished goods, inspections and quality control checks and sales team.

The issue of the use of pure green tea package instead of Genmaicha green tea, is an inspection and quality control checks error.

Your answer for the above requirement on leadership is very general and it does not relate to the specific requirement "How we can use effective leadership from Piping's end to deal with the current situation..."

So, the above points will not score any marks unfortunately.

Remember you must always address the specific task requirement.

B1, the current situation can be addressed in the following ways.

Piping should make a press release/public announcement in the newspaper/ television apologising for the error made and promising to recall all wrong product sent and even pay compensations to retailers where applicable.

Comment [TCS28]: It is not necessary to define or explain basic concepts such as leadership.

Comment [TCS29]: This was not really a requirement of the task

The sales team will go ahead and recall all the products already sent out, stop the warehouse department from dispatching any more goods to retailers.

The after sales team will need to work on refunds that need to be made to retailers, since we deal with business to business (B2B), then the retailers will need to handle their own individual customers side of the refunds. Where compensations need to be paid, this will need to be negotiated by our legal team, once an amount is agreed, payment will be dispatched to those liable for compensation.

Package recalled will be send back to production department, where the package will be stripped off and replace with the correct packages, The leader/supervisor will allocate more staffs to the production department to help with the stripping of wrong package and re packaging with the correct package. This will be a highly prioritised task.

B2, how to prevent re occurrence in the future.

Once the goods are being packaged, extra staffs will be delegated to the finished goods and quality control department to check and ensure all packages are inspected before they are sent off to the warehouse.

Also, final inspection should be carried out once they are packaged by the inspection team to ensure all labelling are correctly done.

If this requires extra workforce resources to carry this task out, fund will be allocated to the inspection team. All these extra measures will prevent any future re occurrence.

C, Impact on WACC of piping.

This will have an impact on the WACC of piping. Because we are a listed company, the announcement of the scandal may result to a temporary fall in the earnings per shares of piping.

Investors will be beginning to panic; the board of directors will need to have a meeting with the shareholders/ investors to assure them that the situation is under control and that we are dealing with it.

Also, depending on the quantity of the packages affected, we will need extra fund/ resources to produce new set of packages to correct the initial error, this will be funded from debt.

The temporary situation will also have an impact on our gearing ratios.

Finance Manager.

Comment [TCS30]: The issue is with the label, right? – Misprint! So the solution is to make sure the contents in the label are checked and approved before printing.

It is not necessary for the staff to check the label in each and every package.

Comment [TCS31]: Incorrect. It will be a fall in the "share price".

Comment [TCS32]: These points do not relate to the requirement "Impact on WACC of piping" and hence will not score any marks unfortunately.

Comment [TCS33]: Not really and not necessary to talk about this anyways since it does not relate to the requirement.

Please find below the mark breakdown.

Section 1	Allocated - 37.5	Task A (18.5)	Task B (19)		
	Gained	7	12		19
Section 2	Allocated - 37.5	Task A (22)	Task B (15.5)		
	Gained	7	8		15
Section 3	Allocated - 37.5	Task A (11)	Task B (11)	Task C (15.5)	
	Gained	3			3
Section 4	Allocated - 37.5	Task A (15.5)	Task B (11)	Task C (11)	
	Gained	8	3	0	11
			Total (out of 150)		51
Pass Mark: 80/150					